GLADSTONE CAPITAL CORP
Form N-2
May 16, 2007

As filed with the Securities and Exchange Commission on May 16, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

1933 Act File No. 333-

Form N-2

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

PRE-EFFECTIVE AMENDMENT NO.

POST-EFFECTIVE AMENDMENT NO.

GLADSTONE CAPITAL CORPORATION

(Exact name of registrant as specified in charter)

1521 WESTBRANCH DRIVE, SUITE 200

MCLEAN, VA 22102

(Address of principal executive offices)

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

DAVID GLADSTONE

CHAIRMAN AND CHIEF EXECUTIVE OFFICER

GLADSTONE CAPITAL CORPORATION

1521 WESTBRANCH DRIVE, SUITE 200

MCLEAN, VIRGINIA 22102

(Name and address of agent for service)

COPIES TO:

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Approximate date of proposed public offering: From time to time after the effective date of this registration statement.

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

CALCULATION OF REGISTRATION FEE UNDER THE SECURITIES ACT OF 1933

Title of Securities Being Registered	Proposed Maximum Aggregate Offering Price	**Amount of Registration Fee**
Common Stock, $0.001 par value per share, and Debt Securities	$ 300,000,000	$ 9,210
Total	$ 300,000,000	$ 9,210

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until this Registration Statement shall become effective on such date as the Commission, acting pursuant to Section 8(a), may determine.

SUBJECT TO COMPLETION, DATED MAY 16, 2007

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

PROSPECTUS

$300,000,000

COMMON STOCK
DEBT SECURITIES

We may offer, from time to time, up to $300 million aggregate initial offering price of our common stock, $0.001 par value per share, or debt securities, which we refer to in this prospectus collectively as our Securities, in one or more offerings. The Securities may be offered at prices and on terms to be set forth in one or more supplements to this prospectus. In the case of our common stock, the offering price per share, less any underwriting commissions or discounts, will not be less than the net asset value per share of our common stock at the time we make the offering. You should read this prospectus and the applicable prospectus supplement carefully before you invest in our Securities.

Our Securities may be offered directly to one or more purchasers, including existing stockholders in a rights offering, through agents designated from time to time by us, or to or through underwriters or dealers. The prospectus supplement relating to the offering will identify any agents or underwriters involved in the sale of our Securities, and will disclose any applicable purchase price, fee, commission or discount arrangement between us and our agents or underwriters or among our underwriters or the basis upon which such amount may be calculated. See Plan of Distribution. We may not sell any of our Securities through agents, underwriters or dealers without delivery of a prospectus supplement describing the method and terms of the offering of such Securities. Our common stock is traded on The Nasdaq Global Select Market under the symbol GLAD. As of May 11, 2007, the last reported sales price for our common stock was $23.48.

This prospectus contains information you should know before investing, including information about risks. Please read it before you invest and keep it for future reference. This prospectus may not be used to consummate sales of securities unless accompanied by a prospectus supplement.

An investment in our Securities involves certain risks, including, among other things, risks relating to investments in securities of small, private and developing businesses. We describe some of these risks in the section entitled Risk Factors, which begins on page 9. Shares of closed-end investment companies frequently trade at a discount to their net asset value and this may increase the risk of loss of purchasers of our Securities. You should carefully consider these risks together with all of the other information contained in this prospectus and any prospectus supplement before making a decision to purchase our Securities.

The Securities being offered have not been approved or disapproved by the Securities and Exchange Commission or any state securities commission nor has the Securities and Exchange Commission or any state securities commission passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

, 2007

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We have not authorized any dealer, salesman or other person to give any information or to make any representation other than those contained or incorporated by reference in this prospectus or any accompanying supplement to this prospectus. You must not rely upon any information or representation not contained or incorporated by reference in this prospectus or the accompanying prospectus supplement as if we had authorized it. This prospectus and any prospectus supplement do not constitute an offer to sell or a solicitation of any offer to buy any security other than the registered securities to which they relate, nor do they constitute an offer to sell or a solicitation of an offer to buy any securities in any jurisdiction to any person to whom it is unlawful to make such an offer or solicitation in such jurisdiction. The information contained in this prospectus and any prospectus supplement is accurate as of the dates on their respective covers only. Our business, financial condition, results of operations and prospects may have changed since such dates.

PROSPECTUS SUMMARY

The following summary contains basic information about this offering. It likely does not contain all the information that is important to an investor. For a more complete understanding of this offering, we encourage you to read this entire document and the documents to which we have referred. Except where the context suggests otherwise, the terms we, us, our, the Company and Gladstone Capital refer to Gladstone Capital Corporation; Adviser refers to Gladstone Management Corporation; Administrator refers to Gladstone Administration, LLC; Gladstone Commercial refers to Gladstone Commercial Corporation, Gladstone Investment refers to Gladstone Investment Corporation; and Gladstone Companies refers to our Adviser and its affiliated companies.

GLADSTONE CAPITAL CORPORATION

General

We were incorporated under the General Corporation Laws of the State of Maryland on May 30, 2001. Our investment objectives are to achieve a high level of current income by investing in debt securities, consisting primarily of senior notes, second lien notes, and senior subordinated notes of established private businesses that are backed by leveraged buyout funds, venture capital funds or others, with a particular emphasis on second lien and senior subordinated notes. In addition, we may acquire existing loans, which meet this profile, from leveraged buyout funds, venture capital funds and others. 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 extend 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, which we refer to in this prospectus as the 1940 Act.

We seek to invest in small and medium-sized businesses that meet certain criteria, including some or all of the following: (1) the potential for growth in cash flow, (2) adequate assets for loan collateral, (3) experienced management teams with a significant ownership interest in the borrower, (4) profitable operations based on the borrower s cash flow, (5) reasonable capitalization of the borrower (usually by buyout funds or venture capital funds) and (6) 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 by the borrower or by exercise of our right to require the borrower to buy back its warrants. We lend to borrowers that need funds to, among other things, effect a change of control, restructure their balance sheets, or finance growth, including acquisitions. Our loans typically range from $5 million to $15 million, although this investment size may vary proportionately as the size of our capital base changes, generally mature in no more than seven years and accrue interest at fixed or variable rates.

Our Investment Adviser and Administrator

Our Adviser, is our affiliate and investment adviser and is led by a management team which has extensive experience in our lines of business. All of our directors and executive officers serve as either directors or executive officers, or both, of Gladstone Commercial, a publicly traded real estate investment trust; Gladstone Investment, a publicly traded business development company; our Adviser; and our Administrator. Our Adviser also has a wholly-owned subsidiary, our Administrator, which employs our chief financial officer, chief compliance officer, controller, treasurer and their respective staffs.

Our Adviser and our Administrator also provide investment advisory and administrative services to our affiliates Gladstone Commercial, Gladstone Investment and Gladstone Land Corporation, an agricultural real estate company owned by Mr. Gladstone. In the future, our Adviser may provide investment advisory and administrative services to other funds, both public and private, of which it is the sponsor.

We have been externally managed by our Adviser pursuant to an investment advisory and management agreement since October 1, 2004. Our Adviser was organized as a corporation under the laws of the State of Delaware on July 2, 2002, and is a registered investment adviser under the Investment Advisers Act of 1940, as amended. Our Adviser is headquartered in McLean, Virginia, a suburb of Washington D.C., and also has offices in New York, New Jersey, Pennsylvania, Illinois, Texas, Kentucky and Washington.

Our Investment Objectives and Our Strategy

We seek 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 backed by leveraged buyout funds, venture capital funds or others. 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. There can be no assurance that we will realize our investment objectives. We seek to invest primarily in three categories of debt of private companies:

- S*enior Subordinated Notes.* We seek to invest a portion of our assets in senior subordinated notes. Holders of senior subordinated notes are subordinated to the rights of holders of senior debt in their right to receive principal and interest payments or, in the case of last out tranches of senior debt, liquidation proceeds from the borrower. As a result, senior subordinated notes are riskier than senior notes. Although such loans are sometimes secured by significant collateral, the lender is largely dependent on the borrower s cash flow for repayment. Additionally, lenders may receive warrants to acquire shares of stock in borrowers or other yield enhancements in connection with these loans. Senior subordinated notes include second lien loans and syndicated second lien loans.

- *Senior Notes.* We seek to invest a portion of our assets in senior notes of borrowers. Using its assets and cash flow as collateral, the borrower typically uses senior notes to cover a substantial portion of the funding needed to operate. Senior lenders are exposed to the least risk of all providers of debt because they command a senior position with respect to scheduled interest and principal payments. However, unlike senior subordinated and junior subordinated lenders, these senior lenders typically do not receive any stock, warrants to purchase stock of the borrowers or other yield enhancements. As such, they generally do not participate in the equity appreciation of the value of the business. Senior notes may include revolving lines of credit, senior term loans, senior syndicated loans and senior last-out tranche loans.

- *Junior Subordinated Notes.* We also seek to invest a small portion of our assets in junior subordinated notes. Holders of junior subordinated notes are subordinated to the rights of the holders of senior debt and senior subordinated debt in their rights to receive principal and interest payments from the borrower. The risk profile of junior subordinated notes is high, which permits the junior subordinated lender to obtain higher interest rates and more equity and equity-like compensation.

THE OFFERING

We may offer, from time to time, up to $300,000,000 of our Securities, on terms to be determined at the time of the offering. Our Securities may be offered at prices and on terms to be disclosed in one or more prospectus supplements. In the case of the offering of our common stock, the offering price per share less any underwriting commissions or discounts will not be less than the net asset value per share of our common stock at the time of the offering.

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

Set forth below is additional information regarding the offering of our Securities:

The Nasdaq Global Select Market Symbol	GLAD
Use of Proceeds	Unless otherwise specified in a prospectus supplement, we intend to use the net proceeds from the sale of our Securities for general corporate purposes. We expect the proceeds to be used first to pay down existing short-term debt, then to make investments in small and medium sized businesses in accordance with our investment objectives, and any remaining proceeds to be used for other general corporate purposes. See Use of Proceeds.
Dividends and Distributions	We have paid monthly dividends to the holders of our common stock and generally intend to continue to do so. The amount of the monthly dividends is determined by our Board of Directors on a quarterly basis and is based on our estimate of our annual investment company taxable income and net short-term taxable capital gains. See Price Range of Common Stock and Distributions. Certain additional amounts may be deemed as distributed to stockholders for income tax purposes. Other types of securities will likely pay distributions in accordance with their terms.
Taxation	We intend to continue to elect to be treated for federal income tax purposes as a regulated investment company, which we refer to as a RIC. Accordingly, we generally will pay no corporate-level federal income taxes on any ordinary income or capital gains that we distribute to our stockholders. To maintain our RIC status, we must meet specified source-of-income and asset diversification requirements and distribute annually at least 90% of our taxable ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, out of assets legally available for distribution. See Price Range of Common Stock and Distributions.
Trading at a Discount	Shares of closed-end investment companies frequently trade at a discount to their net asset value. The possibility that our shares may trade at a discount to our net asset value is separate and distinct from the risk that our net asset value per share may decline. We cannot predict whether our shares will trade above, at or below net asset value.

Certain Anti-Takeover Provisions	Our Board of Directors is divided into three classes of directors serving staggered three-year terms. This structure is intended to provide us with a greater likelihood of continuity of management, which may be necessary for us to realize the full value of our investments. A staggered board of directors also may serve to deter hostile takeovers or proxy contests, as may certain provisions of Maryland law and other measures we have adopted. See Certain Provisions of Maryland Law and of Our Articles of Incorporation and Bylaws.
Dividend Reinvestment Plan	We have a dividend reinvestment plan for our stockholders. This is an opt in dividend reinvestment plan, meaning that stockholders may elect to have their cash dividends automatically reinvested in additional shares of our common stock. Stockholders who do not so elect will receive their dividends in cash. Stockholders who receive distributions in the form of stock will be subject to the same federal, state and local tax consequences as stockholders who elect to receive their distributions in cash. See Dividend Reinvestment Plan.
Management Arrangements	Gladstone Management Corporation serves as our investment adviser, and Gladstone Administration, LLC serves serve as our administrator. We have entered into a license agreement with our Adviser, pursuant to which our Adviser has agreed to grant us a non-exclusive license to use the name Gladstone and the Diamond G logo. For a description of our Adviser, our Administrator, the Gladstone Companies and our contractual arrangements with these companies, see Management Certain Transactions Advisory and Administration Agreements, and Management Certain Transactions License Agreement.

Fees and Expenses

The following table is intended to assist you in understanding the costs and expenses that an investor in this offering will bear directly or indirectly. We caution you that some of the percentages indicated in the table below are estimates and may vary. Except where the context suggests otherwise, whenever this prospectus contains a reference to fees or expenses paid by us or Gladstone Capital, or that we will pay fees or expenses, stockholders will indirectly bear such fees or expenses as investors in Gladstone Capital. The following percentages were calculated based on net assets as of March 31, 2007.

	Current	
Stockholder Transaction Expenses		
Sales load (as a percentage of offering price)		%
Dividend reinvestment plan expenses(1)	None	
Estimated annual expenses (as a percentage of net assets attributable to common stock)		
Management fees(2)	3.44	%
Incentive fees payable under investment advisory and management agreement (20% of realized capital gains and 20% of pre-incentive fee net investment income)(3)	2.74	%
Interest Payments on Borrowed Funds(4)	4.44	%
Other expenses	1.26	%
Total annual expenses (estimated)(2)(5)	11.88	%

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(1) The expenses of the reinvestment plan are included in stock record expenses, a component of Other expenses. We do not have a cash purchase plan. The participants in the dividend reinvestment plan will bear a pro rata share of brokerage commissions incurred with respect to open market purchases, if any. See Dividend Reinvestment Plan for information on the dividend reinvestment plan.

(2) Our annual base management fee is 2.0% (0.5% quarterly) of our average gross assets, which is defined as total assets of Gladstone Capital, including investments made with proceeds of borrowings, less any uninvested cash or cash equivalents pledged to creditors. See Management Advisory and Administration Agreements and footnote 3 below.

(3) The incentive fee consists of two parts: an income-based fee and a capital gains-based fee. The income-based fee will be payable quarterly in arrears, and will equal 20% of the excess, if any, of our pre-incentive fee net investment income that exceeds a 1.75% quarterly (7.0% annualized) hurdle rate, subject to a catch-up provision measured as of the end of each calendar quarter. The catch-up provision requires us to pay 100% of our pre-incentive fee net investment income with respect to that portion of such income, if any, that exceeds the hurdle rate but is less than 125% of the quarterly hurdle rate (or 2.1875%) in any calendar quarter (8.75% annualized). The catch-up provision is meant to provide our Adviser with 20% of our pre-incentive fee net investment income as if a hurdle rate did not apply when our pre-incentive fee net investment income exceeds 125% of the quarterly hurdle rate in any calendar quarter (8.75% annualized). The income-based incentive fee will be computed and paid on income that may include interest that is accrued but not yet received in cash. Our pre-incentive fee net investment income used to calculate this part of the income incentive fee is also included in the amount of our gross assets used to calculate the 2% base management fee (see footnote 2 above). The quarter ended December 31, 2006 was the first quarter under our new advisory agreement and, as a result, was the first quarter in which the incentive fee was earned. For purposes of this computation, the aggregate gross amount of the December 31, 2006 and March 31, 2007 fees, exclusive of any credits, was annualized to determine the percentage the fee represents of net assets. After giving effect to credits against the incentive fee, the annualized incentive fee was 0.17% of net assets as of March 31, 2007. There can be no assurance that our Adviser will give any credits against the incentive fee in the future. The capital gains-based portion of the fee did not have an effect on the incentive fee for purposes of this calculation since we have not realized overall net capital gains to date.

Examples of how the incentive fee would be calculated (exclusive of any credits) are as follows:

- Assuming pre-incentive fee net investment income of 0.55%, there would be no income-based incentive fee because such income would not exceed the hurdle rate of 1.75%.

- Assuming pre-incentive fee net investment income of 2.00%, the income-based incentive fee would be as follows:

= 100% × (2.00% - 1.75%)

= 0.25%

- Assuming pre-incentive fee net investment income of 2.30%, the income-based incentive fee would be as follows:

= (100% × (catch-up : 2.1875% - 1.75%)) + (20%× (2.30% - 2.1875%))

= (100% × 0.4375%) + (20% × 0.1125%)

= 0.4375% + 0.0225%

= 0.46%

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- Assuming net realized capital gains of 6% and realized capital losses and unrealized capital depreciation of 1%, the capital gains-based incentive fee would be as follows:

$= 20\% \times (6\% - 1\%)$

$= 20\% \times 5\%$

$= 1\%$

For a more detailed discussion of the calculation of the two-part incentive fee, see Management Advisory and Administration Agreements.

(4) We have entered into a revolving credit facility, under which our borrowing capacity is $170 million, effective February 9, 2007. We have drawn down on this credit facility and we expect to borrow additional funds in the future up to an amount so that our asset coverage, as defined in the 1940 Act, is at least 200% after each issuance of our senior securities. Assuming that we borrowed $170 million at an interest rate of 6.38%, interest payments on borrowed funds would have been 6.41% of our net assets as of March 31, 2007.

(5) Includes our overhead expenses, including payments under the administration agreement based on our projected allocable portion of overhead and other expenses incurred by our Administrator in performing its obligations under the administration agreement. See Management Certain Transactions Advisory and Administration Agreements.

Example

The following example demonstrates the projected dollar amount of total cumulative expenses that would be incurred over various periods with respect to a hypothetical investment in our Securities. In calculating the following expense amounts, we have assumed we would have no leverage and that our annual operating expenses would remain at the levels set forth in the table above. In the event that Securities to which this prospectus relates are sold to or through underwriters, a corresponding prospectus supplement will restate this example to reflect the applicable sales load.

	1 Year	3 Years	5 Years	10 Years
You would pay the following expenses on a $1,000 investment, assuming a 5% annual return	$ 89	$ 257	$ 412	$ 745

While the example assumes, as required by the Securities and Exchange Commission, which we refer to as the SEC, a 5% annual return, our performance will vary and may result in a return greater or less than 5%. Additionally, we have assumed that the entire amount of such 5% annual return would constitute ordinary income as we have not historically realized positive capital gains (computed net of all realized capital losses and unrealized capital depreciation) on our investments, nor do we expect to realize positive capital gains in the foreseeable future. Because the assumed 5% annual return is significantly below the hurdle rate of 7% (annualized) that we must achieve under the investment advisory and management agreement to trigger the payment of an income-based incentive fee, we have assumed, for purposes of the above example, that no income-based incentive fee would be payable if we realized a 5% annual return on our investments. Additionally, because we have not historically realized positive capital gains (computed net of all realized capital losses and unrealized capital depreciation) on our investments, we have assumed that we will not trigger the payment of any capital gains-based incentive fee in any of the indicated time periods. If we achieve sufficient returns on our investments, including through the realization of capital gains, to trigger an incentive fee of a material amount, our expenses, and returns to our investors after such expenses, would be higher than reflected in the example. In addition, while the example assumes reinvestment of all dividends and distributions at net asset value, participants in our dividend reinvestment plan will receive a number of shares of our common stock, determined by dividing the total dollar amount of the dividend payable to a participant by the market price per share of our common stock at the close of trading on the valuation date for the dividend. See Dividend Reinvestment Plan for additional information regarding our dividend reinvestment plan.

This example and the expenses in the table above should not be considered a representation of our future expenses, and actual expenses (including the cost of debt and incentive fees, if any, and other expenses) may be greater or less than those shown. As noted in the Fees and Expenses table above, we estimate that annual incentive fees payable under the investment advisory and management agreement will be 2.74% of net assets attributable to common stock.

CONSOLIDATED SUMMARY FINANCIAL DATA
(in thousands, except per share data)

The following table summarizes our consolidated financial data. The summary financial data as of and for the years ended September 30, 2006, 2005 and 2004 is derived from our audited consolidated financial statements included in this prospectus. The summary financial data as of and for the years ended September 30, 2003 and 2002 is derived from our audited consolidated financial statements that are not included in this prospectus. The summary financial data as of and for the six months ended March 31, 2007 and 2006 is derived from our unaudited consolidated financial statements included in this prospectus. You should read this data together with our consolidated financial statements and notes thereto presented elsewhere in this prospectus and the information under Consolidated Selected Financial Data and Management s Discussion and Analysis of Financial Condition and Results of Operations for more information.

	Year Ended September 30, 2006	Year Ended September 30, 2005	Year Ended September 30, 2004	Year Ended September 30, 2003	Year Ended September 30, 2002	Six Months Ended March 31, 2007 (unaudited)	Six Months Ended March 31, 2006 (unaudited)
Total Investment Income	$ 26,899,846	$ 23,949,759	$ 20,395,968	$ 15,154,874	$ 10,455,703	$ 16,877,496	$ 13,031,019
Total Net Expenses	$ 7,549,266	$ 6,663,614	$ 7,103,193	$ 3,858,953	$ 2,839,102	$ 5,990,213	$ 3,384,789
Net Investment Income	$ 19,350,580	$ 17,286,145	$ 13,292,775	$ 11,295,921	$ 7,616,601	$ 10,887,283	$ 9,646,230
Net Increase in Net Assets Resulting from Operations	$ 24,430,235	$ 15,490,682	$ 10,570,290	$ 11,073,581	$ 7,616,601	$ 8,248,454	$ 13,823,730
Per Share Data:							
Net Increase in Net Assets Resulting from Operations:							
Basic	$ 2.15	$ 1.37	$ 1.05	$ 1.10	$ 0.76	$ 0.67	$ 1.22
Diluted	$ 2.10	$ 1.33	$ 1.02	$ 1.09	$ 0.75	$ 0.67	$ 1.20
Cash Distributions Declared per Share	$ 1.635	$ 1.515	$ 1.365	$ 1.10	$ 0.81	$ 0.84	$ 0.81
Statement of Assets and Liabilities Data:							
Total Assets	$ 225,783,215	$ 205,793,094	$ 215,333,727	$ 214,566,663	$ 172,922,039	$ 291,015,954	$ 217,725,319
Net Assets	$ 172,570,487	$ 151,610,683	$ 152,226,655	$ 130,802,382	$ 130,663,273	$ 169,323,895	$ 156,461,511
Other Data:							
Number of Portfolio Companies at Period End	32	28	16	11	7	51	28
Principal Amount of Loan Originations	$ 135,954,879	$ 143,794,006	$ 86,267,500	$ 47,011,278	$ 97,705,054	$ 127,641,175	$ 65,159,566
Principal Amount of Loan Repayments	$ 124,009,929	$ 88,019,136	$ 47,158,995	$ 18,005,827	$ 18,387,191	$ 62,230,246	$ 63,517,133
Total Return(1)	5.21 %	5.93 %	24.40 %	21.74 %	9.60 %	11.50 %	(0.75)%
Weighted Average Yield on Investments(2):							
With PIK Interest(3)	12.74 %	12.36 %	13.78 %	13.86 %	14.79 %	n/a	12.56 %
Without PIK Interest(3)	12.74 %	12.23 %	13.44 %	13.14 %	13.82 %	12.58 %	12.56 %

(1) For the fiscal years ended September 30, 2006, 2005 and 2004, the total return equals the increase of the ending market value over the beginning market value plus monthly dividends divided by the monthly beginning market value. For the fiscal years ended September 30, 2003 and 2002, total return equals the increase of the ending market value over the beginning market value, plus distributions, dividend by the beginning market value.

(2) Weighted average yield on investments equals interest income on investments divided by the average investment balance throughout the year.

(3) Refer to Note 2 of the Notes to Consolidated Financial Statements for an explanation of PIK, or Paid-in-Kind, interest.

ADDITIONAL INFORMATION

We have filed with the SEC a registration statement on Form N-2 under the Securities Act of 1933, as amended, which we refer to as the Securities Act, with respect to the Securities offered by this prospectus. This prospectus, which is a part of the registration statement, does not contain all of the information set forth in the registration statement or exhibits and schedules thereto. For further information with respect to our business and our Securities, reference is made to the registration statement, including the amendments, exhibits and schedules thereto, contained in the registration statement.

We also file reports, proxy statements and other information with the SEC under the Securities Exchange Act of 1934, as amended, which we refer to as the Exchange Act. Such reports, proxy statements and other information, as well as the registration statement and the amendments, exhibits and schedules thereto, can be inspected at the public reference facilities maintained by the SEC at 100 F Street, N.E., Washington, D.C. 20549. Information about the operation of the public reference facilities may be obtained by calling the SEC at 1-202-551-8090. The SEC maintains a web site that contains reports, proxy statements and other information regarding registrants, including us, that file such information electronically with the SEC. The address of the SEC s web site is http://www.sec.gov. Copies of such material may also be obtained from the Public Reference Section of the SEC at 100 F Street, N.E., Washington, D.C. 20549, at prescribed rates. Our common stock is listed on The Nasdaq Global Select Market and our corporate website is located at http://www.gladstonecapital.com. The information contained on, or accessible through, our website is not a part of this prospectus.

We make available free of charge on our website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC.

We also furnish to our stockholders annual reports, which include annual financial information that has been examined and reported on, with an opinion expressed, by our independent registered public accounting firm. See Experts.

RISK FACTORS

You should carefully consider the risks described below and all other information provided and incorporated by reference in this prospectus (or any prospectus supplement) before making a decision to purchase our Securities. The risks and uncertainties described below are not the only ones facing us. Additional risks and uncertainties not presently known to us, or not presently deemed material by us, may also impair our operations and performance.

If any of the following risks actually occur, our business, financial condition or results of operations could be materially adversely affected. If that happens, the trading price of our Securities could decline, and you may lose all or part of your investment.

We are dependent upon our key management personnel and the key management personnel of our Adviser, particularly David Gladstone, George Stelljes III and Terry Lee Brubaker, and on the continued operations of our Adviser, for our future success.

We have no employees. Our chief executive officer, chief operating officer, chief investment officer and chief financial officer, and the employees of our Adviser, do not spend all of their time managing our activities and our investment portfolio. We are particularly dependent upon David Gladstone, George Stelljes III and Terry Lee Brubaker in this regard. Our executive officers and the employees of our Adviser allocate some, and in some cases a material portion, of their time to businesses and activities that are not related to our business. We have no separate facilities and are completely reliant on our Adviser, which has significant discretion as to the implementation and execution of our business strategies and risk management practices. We are subject to the risk of discontinuation of our Adviser s operations or termination of the investment advisory agreement and the risk that, upon such event, no suitable replacement will be found. We believe that our success depends to a significant extent upon our Adviser and that discontinuation of its operations could have a material adverse effect on our ability to achieve our investment objectives.

We may be obligated to pay our Adviser incentive compensation even if we incur a loss.

On December 2, 2005, our stockholders approved a proposal to enter into an amended and restated investment advisory agreement with our Advisor, which we refer to as the Amended Advisory Agreement. On October 1, 2006, the Amended Advisory Agreement became effective. The Amended Advisory Agreement entitles our Adviser to incentive compensation for each fiscal quarter in an amount equal to a percentage of the excess of our investment income for that quarter (before deducting incentive compensation, net operating losses and certain other items) above a threshold return for that quarter. Our pre-incentive fee net investment income for incentive compensation purposes excludes realized and unrealized capital losses that we may incur in the fiscal quarter, even if such capital losses result in a net loss on our statement of operations for that quarter. Thus, we may be required to pay our Adviser incentive compensation for a fiscal quarter even if there is a decline in the value of our portfolio or we incur a net loss for that quarter. For additional information on incentive compensation under the Amended Advisory Agreement with our Adviser, see Business Investment Advisory and Administration Agreements Management services and fees under the amended and restated investment advisory agreement.

Our Adviser s failure to identify and invest in securities that meet our investment criteria or perform its responsibilities under the Amended Advisory Agreement may adversely affect our ability for future growth.

Our ability to achieve our investment objectives will depend on our ability to grow, which in turn will depend on our Adviser s ability to identify and invest in securities that meet our investment criteria. Accomplishing this result on a cost-effective basis will be largely a function of our Adviser s structuring of the investment process, its ability to provide competent and efficient services to us, and our access to financing on acceptable terms. The senior management team of our Adviser has substantial responsibilities under the Amended Advisory Agreement. In order to grow, our Adviser will need to hire, train supervise and manage new employees successfully. Any failure to manage our future growth effectively could have a material adverse effect on our business, financial condition and results of operations.

We operate in a highly competitive market for investment opportunities.

A large number of entities compete with us and make the types of investments that we seek to make in small and medium-sized privately owned businesses. We compete with a large number of private equity funds, leveraged buyout funds and venture capital funds, investment banks and other equity and non-equity based investment funds, and other sources of financing, including traditional financial services companies such as commercial banks. Many of our competitors are substantially larger and have considerably greater financial, technical and marketing resources than we do. For example, some competitors may have a lower cost of funds and access to funding sources that are not available to us. In addition, certain of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more relationships and build their market shares. Furthermore, many of our potential competitors are not subject to the regulatory restrictions that the 1940 Act imposes on us as a business development company. We cannot assure you that the competitive pressures we face will not have a material adverse effect on our business, financial condition and results of operations. Also, as a result of this competition, we may not be able to take advantage of attractive investment opportunities from time to time and there can be no assurance that we will be able to identify and make investments that satisfy our investment objectives or that we will be able to fully invest our available capital.

Our business model is dependent upon developing and sustaining strong referral relationships with leveraged buyout funds and venture capital funds.

We are dependent upon informal relationships with leveraged buyout funds, venture capital funds, and traditional lending institutions to provide us with deal flow. If we fail to maintain our relationship with such funds or institutions, or if we fail to establish strong referral relationships with other funds, we will not be able to grow our portfolio of loans and fully execute our business plan.

Our loans to small and medium-sized borrowers are extremely risky and you could lose all or a part of your investment.

Loans to small and medium-sized borrowers are subject to a number of significant risks including the following:

- **Small and medium-sized businesses may have limited financial resources and may not be able to repay the loans we make to them.** Our strategy includes providing financing to borrowers that typically is not readily available to them. While we believe that this provides an attractive opportunity for us to generate profits, this may make it difficult for the borrowers to repay their loans to us upon maturity. A borrower s ability to repay its loan may be adversely affected by numerous factors, including the failure to meet its business plan, a downturn in its industry or negative economic conditions. Deterioration in a borrower s financial condition and prospects usually will be accompanied by deterioration in the value of any collateral and a reduction in the likelihood of us realizing on any guarantees we may have obtained from the borrower s management. Although we will sometimes seek to be the senior, secured lender to a borrower, in most of our loans we expect to be subordinated to a senior lender, and our interest in any collateral would, accordingly, likely be subordinate to another lender s security interest.

- **Small and medium-sized businesses typically have narrower product lines and smaller market shares than large businesses.** Because our target borrowers are smaller businesses, they will tend to be more vulnerable to competitors actions and market conditions, as well as general economic downturns. In addition, our portfolio companies may face intense competition, including competition from companies with greater financial resources, more extensive development, manufacturing, marketing and other capabilities and a larger number of qualified managerial and technical personnel.

- **There is generally little or no publicly available information about these businesses.** Because we seek to make loans to privately owned businesses, there is generally little or no publicly available operating and financial information about our potential borrowers. As a result, we rely on our officers, our Adviser and its employees and consultants to perform due diligence investigations of these borrowers, their operations and their prospects. We may not learn all of the material information we need to know regarding these businesses through our investigations.

- **Small and medium-sized businesses generally have less predictable operating results.** We expect that our borrowers may have significant variations in their operating results, may from time to time be parties to litigation, may be engaged in rapidly changing businesses with products subject to a substantial risk of obsolescence, may require substantial additional capital to support their operations, to finance expansion or to maintain their competitive position, may otherwise have a weak financial position or may be adversely affected by changes in the business cycle. Our portfolio companies may not meet net income, cash flow and other coverage tests typically imposed by their senior lenders. A borrower s failure to satisfy financial or operating covenants imposed by senior lenders could lead to defaults and, potentially, foreclosure on its senior credit facility, which could additionally trigger cross-defaults in other agreements. If this were to occur, it is possible that the borrower s ability to repay our loan would be jeopardized.

- **Small and medium-sized businesses are more likely to be dependent on one or two persons.** Typically, the success of a small or medium-sized business also depends on the management talents and efforts of one or two persons or a small group of persons. The death, disability or resignation of one or more of these persons could have a material adverse impact on our borrower and, in turn, on us.

- S**mall and medium-sized businesses are likely to have greater exposure to economic downturns than larger businesses.** We expect that our borrowers will have fewer resources than larger businesses and an economic downturn is more likely to have a material adverse effect on them. If one of our borrowers is adversely impacted by an economic downturn, its ability to repay our loan would be diminished.

- **Small and medium-sized businesses may have limited operating histories.** While we intend to target stable companies with proven track records, we may make loans to new companies that meet our other investment criteria. Borrowers with limited operating histories will be exposed to all of the operating risks that new businesses face and may be particularly susceptible to, among other risks, market downturns, competitive pressures and the departure of key executive officers.

We may not realize gains from our equity investments and other yield enhancements.

When we make a subordinated loan, we may receive warrants to purchase stock issued by the borrower or other yield enhancements, such as success fees (conditional interest). Our goal is to ultimately dispose of these equity interests and realize gains upon our disposition of such interests. We expect that, over time, the gains we realize on these warrants and other yield enhancements will offset any losses we experience on loan defaults. However, any warrants we receive may not appreciate in value and, in fact, may decline in value and any other yield enhancements, such as success fees, may not be realized. Accordingly, we may not be able to realize gains from our equity interests or other yield enhancements and any gains we do recognize may not be sufficient to offset losses we experience on our loan portfolio. Because the loans we make and equity securities we receive when we make loans are not publicly traded, there will be uncertainty regarding the value of our privately held securities that could adversely affect our determination of our net asset value.

A large percentage of our portfolio investments are, and will continue to be, in the form of securities that are not publicly traded. The fair value of securities and other investments that are not publicly traded may not be readily determinable. Our Board of Directors has established a valuation policy and consistently applied valuation procedures used to determine the fair value of these securities quarterly. These procedures for the determination of value of many of our debt securities rely on the opinions of value submitted to us by Standard & Poor s Securities Evaluations, Inc., which we refer to as SPSE. SPSE will only evaluate the debt portion of our investments for which we specifically request evaluation, and SPSE may decline to make requested evaluations for any reason in its sole discretion. However, to date, SPSE has accepted each of our requests for evaluation.

Our procedures also include provisions whereby our Adviser will establish the fair value of any equity securities we may hold where SPSE is unable to provide evaluations. The types of factors that may be considered in determining the fair value of our debt and equity investments include some or all of the following: the nature and realizable value of any 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, comparison to publicly traded companies, discounted cash flow, and other relevant factors. Because such valuations, particularly valuations of private securities and private companies, are inherently uncertain, may fluctuate over short periods of time, and may be based on estimates, our determinations of fair value may differ materially from the values that might have resulted from a readily available market for these securities.

In the future, we anticipate that a small portion of our assets may consist of equity securities that are valued based on internal assessment, using our own valuation methods approved by our Board of Directors, without the input of SPSE or any other third-party evaluator. We believe that our equity valuation methods reflect those regularly used as standards by other professionals in our industry who value equity securities. However, determination of fair value for securities that are not publicly traded, whether or not we use the recommendations of an independent third party evaluator, necessarily involves the exercise of subjective judgment. Our net asset value could be adversely affected if our determinations regarding the fair value of our investments were materially higher than the values that we ultimately realize upon the disposal of such securities.

The lack of liquidity of our privately held investments may adversely affect our business.

Most of our investments presently consist of, and will continue to consist of, loans and warrants acquired in private transactions directly from borrowers or from the originators of loans to such borrowers. Substantially all of the investments we presently hold are, and the investments we expect to acquire in the future will be, subject to restrictions on resale, including, in some instances, legal restrictions, or will otherwise be less liquid than publicly traded securities. The illiquidity of our investments may make it difficult for us to quickly obtain cash equal to the value at which we record our investments if the need arises. This could cause us to miss important business opportunities. In addition, if we are required to quickly liquidate all or a portion of our portfolio, we may realize significantly less than the value at which we have previously recorded our investments. In addition, we may face other restrictions on our ability to liquidate an investment in a portfolio company to the extent that we, our Adviser, or our respective officers, employees or affiliates have material non-public information regarding such portfolio company.

Due to the uncertainty inherent in valuing these securities, our determinations of fair value may differ materially from the values that would exist if a ready market for these securities existed. Our net asset value could be materially affected if our determinations regarding the fair value of our investments are materially different from the values that we ultimately realize on our disposal of such securities.

Our business plan is dependent upon external financing which may expose us to risks associated with leverage.

Our business requires a substantial amount of cash to operate and grow. We may acquire such additional capital from the following sources:

- **Senior Securities.** We intend to issue debt securities, other evidences of indebtedness (including borrowings under our line of credit) and possibly preferred stock, up to the maximum amount permitted by the 1940 Act. The 1940 Act currently permits us, as a business development company, to issue debt securities and preferred stock, to which we refer collectively as senior securities, in amounts such that our asset coverage, as defined in the 1940 Act, is at least 200% after each issuance of senior securities. As a result of issuing senior securities, we will be exposed to the risks associated with leverage. Although borrowing money for investments increases the potential for gain, it also increases the risk of a loss. A decrease in the value of our investments will have a greater impact on the value of our common stock to the extent that we have borrowed money to make investments. There is a possibility that the costs of borrowing could exceed the income we receive on the investments we make with such borrowed funds. In addition, our ability to pay dividends or incur additional indebtedness would be restricted if asset coverage is not at least twice our indebtedness. If the value of our assets declines, we might be unable to satisfy that test. If this happens, we may be required to liquidate a portion of our loan portfolio and repay a portion of our indebtedness at a time when a sale may be disadvantageous. Furthermore, any amounts that we use to service our indebtedness will not be available for distributions to our stockholders.

- **Common Stock.** Because we are constrained in our ability to issue debt for the reasons given above, we are dependent on the issuance of equity as a financing source. If we raise additional funds by issuing more common stock or debt securities convertible into or exchangeable for our common stock, the percentage ownership of our stockholders at the time of the issuance would decrease and they may experience dilution. In addition, any convertible or exchangeable securities that we issue in the future may have rights, preferences and privileges more favorable than those of our common stock.

- **Securitization.** In addition to issuing securities to raise capital as described above, we anticipate that in the future we will securitize our loans to generate cash for funding new investments. An inability to successfully securitize our loan portfolio could limit our ability to grow our business, fully execute our business strategy and impact our profitability. Moreover, successful securitization of our loan portfolio might expose us to losses as the loans in which we do not plan to sell interests will be those that are riskier and more apt to generate losses.

A change in interest rates may adversely affect our profitability and our hedging strategy may expose us to additional risks.

We anticipate using a combination of equity and long-term and short-term borrowings to finance our lending activities. As a result, a portion of our income will depend upon the difference between the rate at which we borrow funds and the rate at which we loan these funds. Certain of our borrowings may be at fixed rates and others at variable rates. Ultimately, we expect approximately 20% of the loans in our portfolio to be at fixed rates and approximately 80% to be at variable rates determined on the basis of a benchmark prime rate. As of March 31, 2007, our portfolio had approximately 56% of the total of the loan cost value at variable rates with a floor, approximately 2% of the total loan cost value at variable rates with a floor and ceiling, 40% at variable rates without a floor or ceiling and approximately 1% of the total loan portfolio cost basis at a fixed rate. Pursuant to our initial line of credit, we agreed to enter into hedging transactions such as interest rate cap agreements, futures, options and forward contracts. To date, we hold only one interest rate cap agreement. In the event that we securitize a portion of our loan portfolio in the future, we believe that we will likely be required to enter into similar arrangements with respect to the securitized loans. While hedging activities may insulate us against adverse fluctuations in interest rates, they may also limit our ability to participate in the benefits of lower interest rates with respect to the hedged portfolio. Adverse developments resulting from changes in interest rates or hedging transactions could have a material adverse effect on our business, financial condition and results of operations.

Our credit facility imposes certain limitations on us.

We will have a continuing need for capital to finance our loans. In order to maintain RIC status, we will be required to distribute to our stockholders at least 90% of our ordinary income and short-term capital gains on an annual basis. Accordingly, such earnings will not be available to fund additional loans. Therefore, we are party to a credit agreement arranged by Deutsche Bank AG as the structuring agent. The agreement provides us with a revolving credit line facility of $170 million. In the future, borrowings outstanding on the credit line facility may be repaid with the proceeds we may receive from securitizing some or all of the loans in our portfolio for long-term funding. The line of credit facility will permit us to fund additional loans and investments as long as we are within the conditions set out in the credit agreement.

As a result of the line of credit facility, we are subject to certain limitations on the type of loan investments we make, including restrictions on geographic concentrations, sector concentrations, loan size, payment frequency and status, and average life. Our failure to satisfy these limitations could result in foreclosure by our lenders which would have a material adverse effect on our business, financial condition and results of operations.

Our investments are typically long term and will require several years to realize liquidation events.

Since we generally intend to make five to seven year term loans and hold our loans and related warrants or other yield enhancements until the loans mature, you should not expect realization events, if any, to occur over the near term. In addition, we expect that any warrants or other yield enhancements that we receive when we make loans may require several years to appreciate in value and we cannot give any assurance that such appreciation will occur.

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

In addition to risks associated with delays in investing our capital, we are also subject to the risk that investments that we make in our portfolio companies may be repaid prior to maturity. We will first use any proceeds from prepayments to repay any borrowings outstanding on our line of credit. In the event that funds remain after repayment of our outstanding borrowings, then we will generally reinvest these proceeds in government securities, pending their future investment in new debt securities. These government securities will typically have substantially lower yields than the debt securities being prepaid and we could experience significant delays in reinvesting these amounts. As a result, our results of operations could be materially adversely affected if one or more of our portfolio companies elects to prepay amounts owed to us. Additionally, prepayments could negatively impact our return on equity, which could result in a decline in the market price of our common stock.

We will be subject to corporate level tax if we are unable to satisfy Internal Revenue Code requirements for RIC qualification.

To maintain our qualification as a RIC, we must meet income source, asset diversification and annual distribution requirements. The annual distribution requirement is satisfied if we distribute at least 90% of our ordinary income and short-term capital gains to our stockholders on an annual basis. Because we use leverage, we are subject to certain asset coverage ratio requirements under the 1940 Act and could, under certain circumstances, be restricted from making distributions necessary to qualify as a RIC. Warrants we receive with respect to debt investments will create original issue discount, which we must recognize as ordinary income, increasing the amounts we are required to distribute to maintain RIC status. Because such warrants will not produce distributable cash for us at the same time as we are required to make distributions in respect of the related original issue discount, we will need to use cash from other sources to satisfy such distribution requirements. The asset diversification requirements must be met at the end of each calendar quarter. If we fail to meet these tests, we may need to quickly dispose of certain investments to prevent the loss of RIC status. Since most of our investments will be illiquid, such dispositions, if even possible, may not be made at prices advantageous to us and, in fact, may result in substantial losses. If we fail to qualify as a RIC for any reason and become fully subject to corporate income tax, the resulting corporate taxes could substantially reduce our net assets, the amount of income available for distribution, and the actual amount distributed. Such a failure would have a material adverse effect on us and our shares. For additional information regarding asset coverage ratio and RIC requirements, see Business Leverage and Material U.S. Federal Income Tax Considerations.

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 and our Administrator 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. In addition, all of our directors and executive officers serve as either directors or executive officers, or both, of Gladstone Commercial and Gladstone Investment and our Adviser and Administrator also provide investment advisory and administrative services to these affiliates as well as Gladstone Land. In the future, our Adviser and our Administrator may provide investment advisory and administrative services, as applicable, to other funds, both public and private, of which it is the sponsor. 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 targeted. 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 to ensure the fair and equitable treatment of all the funds it manages. 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 the Gladstone 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 March 31, 2007, 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.

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 shareholders 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 or our Administrator has interests that differ from those of our stockholders, giving rise to a conflict.

Our Adviser is not obligated to provide a waiver of the incentive fee, which could negatively impact our earnings and our ability to maintain our current level of, or increase, distributions to our stockholders.

On October 1, 2006, we implemented the Amended Advisory Agreement with our Adviser. In addition to providing for a base management fee based on our total assets, this agreement contemplates a quarterly incentive fee based on our pre-incentive fee net investment income and an annual incentive fee based on our capital gains, if any. Our Adviser has the ability to issue a full or partial waiver of the incentive fee for current and future periods, however our Adviser is not required to issue this waiver. If our Adviser does not issue this waiver in future quarters, it could negatively impact our earnings and may compromise our ability to maintain our current level of, or increase, distributions to our stockholders, which could have a material adverse impact on our stock price.

Changes in laws or regulations governing our operations, or changes in the interpretation thereof, and any failure by us to comply with laws or regulations governing our operations may adversely affect our business.

We and our portfolio companies are subject to regulation by laws at the local, state and federal levels. These laws and regulations, as well as their interpretation, may be changed from time to time. Accordingly, any change in these laws or regulations, or their interpretation, or any failure by us or our portfolio companies to comply with these laws or regulations may adversely affect our business. For additional information regarding the regulations to which we are subject, see Regulation as a Business Development Company and Material U.S. Federal Income Tax Considerations.

We may experience fluctuation in our quarterly results.

We could experience fluctuations in our quarterly operating results due to a number of factors including, among others, the interest rates payable on our debt securities, variations in and the timing of the recognition of realized and unrealized gains or losses, the level of our expenses, the degree to which we encounter competition in our markets and general economic conditions. As a result of these factors, results for any period should not be relied upon as being indicative of performance in future periods.

There is a risk that you may not receive dividends or that our dividends may not grow over time.

Our current intention is to distribute at least 90% of our ordinary income and short-term capital gains to our stockholders on a quarterly basis. We expect to retain net realized long-term capital gains to supplement our equity capital and support the growth of our portfolio, although our Board of Directors may determine in certain cases to distribute these gains. We cannot assure you that we will achieve investment results or maintain a tax status that will allow or require any specified level of cash distributions or year-to-year increases in cash distributions. Provisions of our articles of incorporation and bylaws could deter takeover attempts and adversely impact the price of our shares.

Our articles of incorporation and bylaws and the Maryland General Corporation Law contain provisions that may have the effect of discouraging, delaying or making more difficult a change in control and preventing the removal of incumbent directors. The existence of these provisions may negatively impact the price of our shares and may discourage third-party bids. These provisions may reduce any premiums paid to you for our shares. Furthermore, we are subject to Section 3-602 of the Maryland General Corporation Law which governs business combinations with interested stockholders and could delay or prevent a change in control. In addition, our Board of Directors is elected in staggered terms which makes it more difficult for a hostile bidder to acquire control of us.

The market price of our shares may fluctuate significantly.

The market price and marketability of our shares may from time to time be significantly affected by numerous factors, including many over which we have no control and that may not be directly related to us. These factors include the following:

- price and volume fluctuations in the stock market from time to time, which are often unrelated to the operating performance of particular companies;
- significant volatility in the market price and trading volume of shares of RICs, business development companies or other companies in our sector, which is not necessarily related to the operating performance of these companies;
- changes in regulatory policies or tax guidelines, particularly with respect to RICs or business development companies;
- loss of business development company status;
- loss of RIC status;
- changes in our earnings or variations in our operating results;
- changes in the value of our portfolio of investments;
- any shortfall in our revenue or net income or any increase in losses from levels expected by securities analysts;
- departure of key personnel;
- operating performance of companies comparable to us;
- short-selling pressure with respect to our shares or business development companies generally;
- general economic trends and other external factors; and
- loss of a major funding source.

Fluctuations in the trading prices of our shares may adversely affect the liquidity of the trading market for our shares and, if we seek to raise capital through future equity financings, our ability to raise such equity capital.

Shares of closed-end investment companies frequently trade at a discount from net asset value.

Shares of closed-end investment companies frequently trade at a discount from net asset value. This characteristic of shares of closed-end investment companies is separate and distinct from the risk that our net asset value per share will decline. Although shares of our common stock have historically traded at a premium to net asset value, there can be no guarantee that they will continue to do so.

We could face losses and potential liability if intrusion, viruses or similar disruptions to our technology jeopardize our confidential information or that of users of our technology.

Although we have implemented, and will continue to implement, security measures, our technology platform is and will continue to be vulnerable to intrusion, computer viruses or similar disruptive problems caused by transmission from unauthorized users. The misappropriation of proprietary information could expose us to a risk of loss or litigation.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

All statements contained or incorporated by reference in this prospectus or any accompanying prospectus summary, other than historical facts, may constitute forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. These statements may relate to, among other things, future events or our future performance or financial condition. In some cases, you can identify forward-looking statements by terminology such as may, might, believe, will, provided, anticipate, future, could, growth, plan, should, would, if, seek, possible, potential, likely or the negative of such terms or comparable terminology. These forward-looking stat involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others: (1) adverse changes in interest rates; (2) our failure or inability to establish or maintain referral arrangements with leveraged buyout funds and venture capital funds to generate loan opportunities; (3) the loss of one or more of our executive officers, in particular David Gladstone, Terry Lee Brubaker, or George Stelljes III; (4) our inability to extend, refinance, or maintain our credit facilities on terms reasonably acceptable to us, if at all, in future equity capital resources; (5) our inability to successfully securitize our loan portfolio on terms reasonably acceptable to us, if at all; (6) the decision of our competitors to aggressively seek to make senior and subordinated loans to small and medium-sized businesses on terms more favorable than we intend to provide; and (7) those factors described in the Risk Factors section of this prospectus. We caution readers not to place undue reliance on any such forward-looking statements, which are made pursuant to the Private Securities Litigation Reform Act of 1995 and, as such, speak only as of the date made. 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 prospectus.

USE OF PROCEEDS

Unless otherwise specified in any prospectus supplement accompanying this prospectus, we intend to use the net proceeds from the sale of the Securities for general corporate purposes. We expect the proceeds to be used first to pay down existing short-term debt, then to make investments in small and medium sized businesses in accordance with our investment objectives, and any remaining proceeds to be used for other general corporate purposes. We anticipate that substantially all of the net proceeds of any offering of Securities will be utilized in the manner described above within three months of the completion of such offering. Pending such utilization, we intend to invest the net proceeds of any offering of Securities primarily in cash, cash equivalents, U.S. government securities, and other high-quality debt investments that mature in one year or less from the date of investment, consistent with the requirements for continued qualification as a RIC for federal income tax purposes.

PRICE RANGE OF COMMON STOCK AND DISTRIBUTIONS

We have distributed and currently intend to distribute in the form of cash dividends, a minimum of 90% of our ordinary income and short-term capital gains, if any, on a quarterly basis to our stockholders in the form of monthly dividends. We intend to retain long-term capital gains and treat them as deemed distributions for tax purposes. We report the estimated tax characteristics of each dividend when declared while the actual tax characteristics of dividends are reported annually to each stockholder on Form 1099 DIV. There is no assurance that we will achieve investment results or maintain a tax status that will permit any specified level of cash distributions or year-to-year increases in cash distributions. At the option of a holder of record of common stock, all cash distributions can be reinvested automatically under our Dividend Reinvestment Plan in additional whole and fractional shares. A stockholder whose shares are held in the name of a broker or other nominee should contact the broker or nominee regarding participation in our Dividend Reinvestment Plan on the stockholder s behalf. See Risk Factors We will be subject to corporate level tax if we are unable to satisfy Internal Revenue Code requirements for RIC qualification; Dividend Reinvestment Plan; and Material U.S. Federal Income Tax Considerations.

Our common stock is quoted on The Nasdaq Global Select Market under the symbol GLAD. Our common stock has historically traded at prices above its net asset value. There can be no assurance, however, that any premium to net asset value will be maintained. As of May 11, 2007, we had 81 stockholders of record. The following table sets forth the range of high and low sales prices of our common stock as reported on The Nasdaq Global Select Market (for periods prior to July 1, 2006, The Nasdaq National Market) and the dividends declared by us for the last two completed fiscal years and the current fiscal year through May 11, 2007.

	Net Asset Value Per Share(1)	Closing Price High	Closing Price Low	Premium of High to Net Asset Value(2)	Premium of Low to Net Asset Value(2)	Dividends Declared
FY 2005						
First Quarter	$ 13.58	$ 25.35	$ 22.61	$ 11.77	$ 9.03	$ 0.360
Second Quarter	$ 13.64	$ 24.80	$ 20.94	$ 11.16	$ 7.30	$ 0.360
Third Quarter	$ 13.61	$ 23.96	$ 21.18	$ 10.35	$ 7.57	$ 0.390
Fourth Quarter	$ 13.41	$ 26.00	$ 22.55	$ 12.59	$ 9.14	$ 0.405
FY 2006						
First Quarter	$ 13.74	$ 23.68	$ 20.36	$ 9.94	$ 6.62	$ 0.405
Second Quarter	$ 13.84	$ 22.42	$ 19.96	$ 8.58	$ 6.12	$ 0.405
Third Quarter	$ 13.95	$ 23.50	$ 20.79	$ 9.55	$ 6.84	$ 0.405
Fourth Quarter	$ 14.02	$ 23.08	$ 21.10	$ 9.06	$ 7.08	$ 0.420
FY 2007						
First Quarter	$ 13.88	$ 25.21	$ 21.96	$ 11.33	$ 8.08	$ 0.420
Second Quarter	$ 13.82	$ 24.24	$ 21.24	$ 10.42	$ 7.42	$ 0.420
Third Quarter (through May 11, 2007)	*	$ 24.60	$ 23.16	*	*	$ 0.420

(1) Net asset value per share is determined as of the last day in the relevant quarter and therefore may not reflect the net asset value per share on the date of the high and low sale price. The net asset values shown are based on outstanding shares at the end of each period.

(2) The premiums set forth in these columns represent the high or low, as applicable, closing price per share for the relevant quarter minus the net asset value per share as of the end of such quarter, and therefore may not reflect the premium to net asset value per share on the date of the high and low closing prices.

* Not available.

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CONSOLIDATED SELECTED FINANCIAL DATA
(in thousands, except per share data)

The following consolidated selected financial data as of and for the years ended September 30, 2006, 2005 and 2004 is derived from our audited consolidated financial statements included in this prospectus. The consolidated selected financial data as of and for the years ended September 30, 2003 and 2002 is derived from our audited consolidated financial statements that are not included in this prospectus. The consolidated selected financial data as of and for the six months ended March 31, 2007 and 2006 is derived from our unaudited consolidated financial statements included in this prospectus. You should read this data together with our consolidated financial statements and notes thereto presented elsewhere in this prospectus and the information under Management s Discussion and Analysis of Financial Condition and Results of Operations for more information.

	Year Ended September 30, 2006	Year Ended September 30, 2005	Year Ended September 30, 2004	Year Ended September 30, 2003	Year Ended September 30, 2002	Six Months Ended March 31, 2007 (unaudited)	Six Months Ended March 31, 2006 (unaudited)
Total Investment Income	$ 26,899,846	$ 23,949,759	$ 20,395,968	$ 15,154,874	$ 10,455,703	$ 16,877,496	$ 13,031,019
Total Net Expenses	$ 7,549,266	$ 6,663,614	$ 7,103,193	$ 3,858,953	$ 2,839,102	$ 5,990,213	$ 3,384,789
Net Investment Income	$ 19,350,580	$ 17,286,145	$ 13,292,775	$ 11,295,921	$ 7,616,601	$ 10,887,283	$ 9,646,230
Net Increase in Net Assets Resulting from Operations	$ 24,430,235	$ 15,490,682	$ 10,570,290	$ 11,073,581	$ 7,616,601	$ 8,248,454	$ 13,823,730
Per Share Data:							
Net Increase in Net Assets Resulting from Operations:							
Basic	$ 2.15	$ 1.37	$ 1.05	$ 1.10	$ 0.76	$ 0.67	$ 1.22
Diluted	$ 2.10	$ 1.33	$ 1.02	$ 1.09	$ 0.75	$ 0.67	$ 1.20
Cash Distributions Declared per Share	$ 1.635	$ 1.515	$ 1.365	$ 1.10	$ 0.81	$ 0.84	$ 0.81
Statement of Assets and Liabilities Data:							
Total Assets	$ 225,783,215	$ 205,793,094	$ 215,333,727	$ 214,566,663	$ 172,922,039	$ 291,015,954	$ 217,725,319
Net Assets	$ 172,570,487	$ 151,610,683	$ 152,226,655	$ 130,802,382	$ 130,663,273	$ 169,323,895	$ 156,461,511
Other Data:							
Number of Portfolio Companies at Period End	32	28	16	11	7	51	28
Principal Amount of Loan Originations	$ 135,954,879	$ 143,794,006	$ 86,267,500	$ 47,011,278	$ 97,705,054	$ 127,641,175	$ 65,159,566
Principal Amount of Loan Repayments	$ 124,009,929	$ 88,019,136	$ 47,158,995	$ 18,005,827	$ 18,387,191	$ 62,230,246	$ 63,517,133
Total Return(1)	5.21 %	5.93 %	24.40 %	21.74 %	9.60 %	11.50 %	(0.75)%
Weighted Average Yield on Investments(2):							
With PIK Interest(3)	12.74 %	12.36 %	13.78 %	13.86 %	14.79 %	n/a	12.56 %
Without PIK Interest(3)	12.74 %	12.23 %	13.44 %	13.14 %	13.82 %	12.58 %	12.56 %

(1) For the fiscal years ended September 30, 2006, 2005 and 2004, the total return equals the increase of the ending market value over the beginning market value plus monthly dividends divided by the monthly beginning market value. For the fiscal years ended September 30, 2003 and 2002, total return equals the increase of the ending market value over the beginning market value, plus distributions, dividend by the beginning market value.

(2) Weighted average yield on investments equals interest income on investments divided by the average investment balance throughout the year.

(3) Refer to Note 2 of the Notes to Consolidated Financial Statements for an explanation of PIK, or Paid-in-Kind, interest.

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

We were incorporated under the General Corporation Laws of the State of Maryland on May 30, 2001. Our investment objectives are to achieve a high level of current income by investing in debt securities, consisting primarily of senior notes, second lien notes, and senior subordinated notes of established private businesses that are backed by leveraged buyout funds, venture capital funds or others, with a particular emphasis on second lien and senior subordinated notes. In addition, we may acquire existing loans, which meet this profile, from leveraged buyout funds, venture capital funds and others. 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 extend 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 1940 Act.

We seek to invest in small and medium-sized businesses that meet certain criteria, including some or all of the following: (1) the potential for growth in cash flow, (2) adequate assets for loan collateral, (3) experienced management teams with a significant ownership interest in the borrower, (4) profitable operations based on the borrower s cash flow, (5) reasonable capitalization of the borrower (usually by buyout funds or venture capital funds) and (6) 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 by the borrower or by exercise of our right to require the borrower to buy back its warrants. We lend to borrowers that need funds to, among other things, effect a change of control, restructure their balance sheets, or finance growth, including acquisitions.

Our loans typically range from $5 million to $15 million, although this investment size may vary proportionately as the size of our capital base changes, generally mature in no more than seven years and accrue interest at fixed or variable rates. Some of our loans may contain a provision that calls for some portion of the interest payments to be deferred and added to the principal balance so that the interest is paid, together with the principal, at maturity. This form of deferred interest is often called paid in kind or PIK interest, and, when earned, we record PIK interest as interest income and add the PIK interest to the principal balance of the loans. We seek to avoid PIK interest with all potential investments under review. We currently do not hold any investments with PIK and, therefore, there was no PIK accrued on our balance sheet as of March 31, 2007.

Because the majority of our portfolio loans consist of term debt of private companies who typically cannot or will not expend the resources to have their debt securities rated by a credit rating agency, we expect that most of the debt securities we acquire will be unrated. We cannot accurately predict what ratings these loans might receive if they were in fact rated, and thus cannot determine whether or not they could be considered investment grade quality.

To the extent possible, our loans generally are collateralized by a security interest in the borrower s assets. Interest payments are generally made monthly or quarterly (except to the extent of any PIK interest) with amortization of principal generally being deferred for several years. The principal amount of the loans and any accrued but unpaid interest generally become due at maturity at five to seven years. When we receive a warrant to purchase stock in a borrower in connection with a loan, the warrant will typically have an exercise price equal to the fair value of the portfolio company s common stock at the time of the loan and entitle us to purchase a modest percentage of the borrower s stock.

Original issue discount, or OID, arises when we extend a loan and receive an equity interest in the borrower at the same time. To the extent that the price paid for the equity is not at market value, we must allocate part of the price paid for the loan to the value of the equity. Then the amount allocated to the equity, the OID, must be amortized over the life of the loan. As with PIK interest, the amortization of OID also produces income that must be recognized for purposes of satisfying the distribution requirements for a RIC under Subchapter M of the Internal Revenue Code, which we refer to as the Code, whereas the cash is received, if at all, when the equity instrument is sold. We seek to avoid OID and to date do not hold any investments with OID.

In addition, 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. In addition, our Adviser provides other services to our portfolio companies, for which it receives fees, in connection with our investments. The fees for these services are generally paid to our Adviser in part at the time a prospective portfolio company signs a non-binding term sheet with us (as further described in the following paragraph), with the remainder paid at the closing of the investment. These fees are generally non-recurring, however in some instances they may have a recurring component which is also paid to our Adviser. Any fees received for other services, with the exception of recurring monitoring and review fees, by our Adviser are currently credited against the base management fee payable to our Adviser pursuant to the terms of the Amended Advisory Agreement, which has the effect of reducing our expenses to the extent of any such credits. The specific other services our Adviser provides vary by portfolio company, but generally include a broad array of services to the portfolio companies such as investment banking services, arranging bank financing, arranging equity financing, structuring financing from multiple lenders and investors, reviewing existing credit facilities, restructuring existing loans, raising equity and debt capital, turnaround management, merger and acquisition services and recruiting new management personnel. To date our Adviser has not charged for managerial assistance services, 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.

Prior to making an investment, we ordinarily enter into a non-binding term sheet with the potential borrower. These non-binding term sheets are generally subject to a number of conditions, including, but not limited to, the satisfactory completion of our due diligence investigations of the potential borrower s business, reaching agreement on the legal documentation for the loan, and the receipt of all necessary consents. Upon execution of the non-binding term sheet, the potential borrower generally pays our Adviser a non-refundable fee for its services rendered through the date of the non-binding term sheet. These fees are received by our Adviser and are offset against the base management fee payable to our Adviser, which has the effect of reducing our expenses to the extent of any such fees received by our Adviser.

In the event that we expend significant effort in considering and negotiating a potential investment that ultimately is not consummated, we generally will seek reimbursement from the proposed borrower for our reasonable expenses incurred in connection with the transaction, including legal fees. Any amounts collected for expenses incurred by our Adviser in connection with unconsummated investments will be reimbursed to our Adviser. Amounts collected for these expenses incurred by us will be reimbursed to us and will be recognized in the period in which such reimbursement is received, however, there can be no guarantee that we will be successful in collecting any such reimbursements.

During the six months ended March 31, 2007, we extended, directly or through participations, approximately $127.6 million of new loans to a total of 32 companies. Also, during the six months ended March 31, 2007, one borrower repaid its loans ahead of contractual maturity, one borrower refinanced its investment and we sold or were repaid in full on 11 syndicated loans of approximately $56.9 million, and we received scheduled contractual principal repayments of approximately $5.1 million, for total principal repayments of approximately $62.0 million. During the fiscal year ended September 30, 2006, we extended, directly or through participations, approximately $136 million of new loans to a total of 22 companies. Also, during the fiscal year ended September 30, 2006, 7 borrowers repaid their loans ahead of contractual maturity and we sold or repaid in full on 9 syndicated loans, and sold 3 loan investments at a loss for an aggregate return of capital of approximately $20 million and we received scheduled contractual principal repayments of approximately $20 million, for total principal repayments of approximately $124 million. Since our initial public offering in August 2001, we have made 190 different loans to, or investments in, 100 companies for a total of approximately $622.2 million, before giving effect to principal repayments on investments and divestitures.

We are continuously working toward the consummation of more loan originations and syndicated investments in an effort to grow our loan portfolio. These prospective loans are subject to, among other things, the satisfactory completion of our due diligence investigation of each borrower, acceptance of terms and structure and attainment of necessary consents. With respect to each prospective loan, we will only agree to provide the loan if, among other things, the results of our due diligence investigations are satisfactory, the terms and conditions of the loan are acceptable and all necessary consents are received. Our management has initiated its due diligence investigations of the potential borrowers, however we cannot assure you that we will not discover facts in the course of completing our due diligence that would render a particular investment imprudent or that any of these loans will actually be made.

Our Investment Adviser and Administrator

Our Adviser is led by a management team which has extensive experience in our lines of business. Our Adviser is controlled by David Gladstone, our chairman and chief executive officer. Mr. Gladstone is also the chairman and chief executive officer of our Adviser. Terry Lee Brubaker, our vice chairman, chief operating officer, secretary and director, is a member of the board of directors of our Adviser and its vice chairman and chief operating officer. George Stelljes III, our president, chief investment officer and director, is a member of the board of directors of our Adviser and its president and chief investment officer. Harry Brill, our chief financial officer, is also the chief financial officer of our Adviser. Our Adviser s wholly-owned subsidiary, our Administrator, employs our chief financial officer, chief compliance officer, controller, treasurer and their respective staffs.

Our Adviser and Administrator also provide investment advisory and administrative services to our affiliates, Gladstone Commercial, a publicly traded real estate investment trust; Gladstone Investment, a publicly traded business development company; and Gladstone Land Corporation, an agricultural real estate company owned by Mr. Gladstone. All of our directors and executive officers serve as either directors or executive officers, or both, of Gladstone Commercial and Gladstone Investment. In the future, our Adviser may provide investment advisory and administrative services to other funds, both public and private, of which it is the sponsor.

We have been externally managed by our Adviser pursuant to an investment advisory and management agreement since October 1, 2004. Our Adviser was organized as a corporation under the laws of the State of Delaware on July 2, 2002, and is a registered investment adviser under the Investment Advisers Act of 1940, as amended. Our Adviser is headquartered in McLean, Virginia, a suburb of Washington D.C., and also has offices in New York, New Jersey, Pennsylvania, Illinois, Texas, Kentucky and Washington.

Investment Advisory and Management Agreements

On December 2, 2005, our stockholders approved a proposal to enter into an amended and restated investment advisory agreement, which we refer to as the Amended Advisory Agreement, with our Adviser and an administration agreement which we refer to as the Administration Agreement, with our Administrator, both of which became effective on October 1, 2006. The Amended Advisory Agreement replaced the original advisory agreement which terminated on September 30, 2006 and we refer to as the Initial Advisory Agreement. We continue to pay our direct expenses including, but not limited to, directors fees, legal and accounting fees, and stockholder related expenses under the Amended Advisory Agreement.

Pursuant to the Initial Advisory Agreement, we paid our Adviser an annual advisory fee of 1.25% of our total assets (as reduced by cash and cash equivalents pledged to creditors), payable in quarterly computed increments of 0.3125%, and an annual administrative fee of 0.75% of our total assets (as reduced by cash and cash equivalents pledged to creditors), payable in quarterly computed increments of 0.1875%, for a total annual base management fee of 2%. This fee was then directly reduced by the amount of loan servicing fees paid to our Adviser and any other fees received by our Adviser from our borrowers and potential borrowers.

Under the Amended Advisory Agreement, we pay our Adviser an annual base management fee of 2% of our average gross assets, which is defined as total assets less cash and cash equivalents pledged to creditors calculated as of the end of the two most recently completed fiscal quarters and also consists of a two-part incentive fee.

The first part of the incentive fee is an income-based incentive fee which rewards our Adviser if our quarterly net investment income (before giving effect to any incentive fee) exceeds 1.75% of our net assets (the hurdle rate). We will pay our Adviser an income incentive fee with respect to our pre-incentive fee net investment income in each calendar quarter as follows:

- no incentive fee in any calendar quarter in which our pre-incentive fee net investment income does not exceed the hurdle rate (7% annualized);

- 100% of our pre-incentive fee net investment income with respect to that portion of such pre-incentive fee net investment income, if any, that exceeds the hurdle rate but is less than 2.1875% in any calendar quarter (8.75% annualized); and

- 20% of the amount of our pre-incentive fee net investment income, if any, that exceeds 2.1875% in any calendar quarter (8.75% annualized).

Quarterly Incentive Fee Based on Net Investment Income

Pre-incentive fee net investment income
(expressed as a percentage of the value of net assets)

Percentage of pre-incentive fee net investment income
allocated to income-related portion of incentive fee

The second part of the incentive fee is a capital gains incentive fee that will be determined and payable in arrears as of the end of each fiscal year (or upon termination of the Amended Advisory Agreement, as of the termination date), commencing on October 1, 2006, and will equal 20% of our realized capital gains as of the end of the fiscal year. In determining the capital gains incentive fee payable to our Adviser, we will calculate the cumulative aggregate realized capital gains and cumulative aggregate realized capital losses since our inception, and the aggregate unrealized capital depreciation as of the date of the calculation, as applicable, with respect to each of the investments in our portfolio. A discussion regarding the basis for our Board of Directors approval of the Amended Advisory Agreement is available in our Annual Report on Form 10-K for the fiscal year ended September 30, 2006.

Our Adviser s board of directors agreed to voluntarily waive 1.5% of the annual 2.0% base management fee to 0.5% for senior syndicated loans for each of the three months ended December 31, 2006 and March 31, 2007.

In addition to the base management and incentive fees under the Amended Advisory Agreement, certain fees received by our Adviser from our portfolio companies were credited against the investment advisory fee under the Initial Advisory Agreement, and will continue to be paid to our Adviser and credited under the Amended Advisory Agreement. Our Adviser services our loan portfolio pursuant to a loan servicing agreement with Gladstone Business Loan, LLC, which we refer to as Business Loan, in return for a 1.5% annual fee, based on the monthly aggregate outstanding loan balance of the loans pledged under our credit facility. Effective in April 2006, our Adviser s board of directors voted to reduce the portion of the annual fee to 0.5% for senior syndicated loans. This fee directly reduces the amount of the fees payable under both the Initial and Amended Advisory Agreements. For the three months ended March 31, 2007 and 2006, we incurred $760,623 and $734,644, respectively, and for the six months ended March 31, 2007 and 2006 we incurred $1,479,775 and $1,450,059, respectively, in loan servicing fees.

For the three months ended March 31, 2007, the gross base management fee, based on the Amended Advisory Agreement, before reductions for loan servicing and other fees was $1,211,108, as compared to $1,087,023 for the three months ended March 31, 2006. After being reduced by loan servicing fees of $760,623 and other fees received by our Adviser of $775,000, our net base management fee was a credit of $324,516 for the three months ended March 31, 2007, as compared to reductions for loan servicing fees of $734,644 and other fees received by our Adviser of $673,000, our net base management fee was a credit of $320,621 for the three months ended March 31, 2006. For the six months ended March 31, 2007, the gross base management fee, based on the Amended Advisory Agreement, before reductions for loan servicing fees and other fees was $2,328,692. After being reduced by loan servicing fees of $1,479,775 and other fees received by our Adviser of $1,086,000, our net base management fee for the six months ended March 31, 2007 was a credit of $237,084. For the six months ended March 31, 2006, the gross base management fee, before reductions for loan servicing fees and other fees was $2,071,139. After being reduced by loan servicing fees of $1,450,059 and other fees received by our Adviser of $1,223,000, our net base management fee for the six months ended March 31, 2006 was a credit of $601,920. At March 31, 2007, $217,631 of unpaid loan servicing fees and $324,516 of base management fee due to us was recorded net in fees due from Adviser in the accompanying consolidated statement of assets and liabilities.

For the three and six months ended March 31, 2007, we recorded a gross incentive fee of $1,158,995 and $2,307,478, respectively, which was offset by a waiver voluntarily issued by our Adviser s board of directors of $1,088,378 and $1,657,372, respectively, which resulted in a net incentive fee due to our Adviser of $70,617 and $650,106, respectively, of which $70,617 is unpaid and is netted and recorded in fees due from Adviser on our consolidated statements of assets and liabilities. There was no incentive fee recorded for the three and six months ended March 31, 2006 as the Amended Advisory Agreement was not in effect.

Administration Agreement

Under the Administration Agreement, we pay separately for administrative services. The Administration Agreement provides for payments equal to our allocable portion of our Administrator s overhead expenses in performing its obligations under the Administration Agreement including, but not limited to, rent for employees of our Administrator, and our allocable portion of the salaries and benefits expenses of our chief financial officer, controller, chief compliance officer, treasurer and their respective staffs. Our allocable portion of expenses is derived by multiplying our Administrator s total allocable expenses by the percentage of our average total assets (the total assets at the beginning and end of each quarter) in comparison to the average total assets of all companies managed by our Adviser under similar agreements.

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States, which we refer to as GAAP, 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. Our accounting policies are more fully described in the Notes to Consolidated Financial Statements contained elsewhere in the registration statement of which this prospectus is a part. We have identified our investment valuation process as our most critical accounting policy.

Investment Valuation

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

General Valuation Policy: Using procedures established by our Board of Directors, we value our investment portfolio each quarter. We carry our investments at fair value, as determined in good faith by or under the direction of our Board of Directors. Securities that are publicly traded, if any, are valued at the closing price of the exchange or securities market on which they are listed on the valuation date. Securities that are not traded on a public exchange or securities market, but for which a limited market exists and that have been rated by a nationally recognized statistical rating organizations, or NRSRO, (such as certain participations in syndicated loans) are valued at the indicative bid price offered by the syndication agent on the valuation date.

Debt and equity securities that are not publicly traded, for which a limited market does not exist, or for which a limited market exists but that have not been rated by a NRSRO (or for which we have various degrees of trading restrictions) are valued at fair value as determined in good faith by or under the direction of our Board of Directors. In making the good faith determination of the value of these securities, we start with the cost basis of the security, which includes the amortized OID and PIK interest, if any. We then apply the methods set out below in Valuation Methods. Members of our Adviser s portfolio management team prepare the valuations of our investments in portfolio companies using the most recent portfolio company financial statements and forecasts. These individuals also consult with portfolio company senior management and ownership to obtain further updates on the portfolio company s performance, including information such as industry trends, new product development, and other operational issues. 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.

At March 31, 2007, we engaged Standard & Poor s Securities Evaluations, Inc., or SPSE, to submit opinions of value for most of our loan securities. We request that SPSE also evaluate and assign values to success fees (conditional interest included in some loan securities) when we determine that the probability of receiving a success fee on a given loan is above 6-8%, a threshold of significance. Upon completing our collection of data with respect to the investments (including the information described under Credit Information, the risk ratings of the loans described under Loan Grading and Risk Rating and the factors described under Valuation Methods), this valuation data is forwarded along 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.

SPSE opinions of value 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 the Board 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 whether to accept the recommended valuation of our investment portfolio. Our Adviser and our management recommended, and the Board of Directors elected to accept, the opinions of value delivered by SPSE on the loans in our portfolio as denoted on the schedule of investments as of March 31, 2007, September 30, 2006 and September 30, 2005, included in our 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. Because SPSE does not provide values for equity securities, our Adviser determines the fair value of these investments using valuation policies approved by our Board of Directors.

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. If we held a controlled or affiliate investment, we and our Adviser would participate in periodic board meetings of such portfolio companies and also require them to provide annual audited and monthly unaudited financial statements. Using these statements and board discussions, our Adviser would calculate and evaluate the credit statistics.

Loan Grading and Risk Rating: As part of our valuation procedures we risk rate all of our investments in debt securities. For syndicated loans that have been rated by a 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.

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 a 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 a 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 a 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 a NRSRO, however, no assurance can be given that a 10 on our scale is equal to a BBB on a 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%
1	Caa3	CC	PD is 65% and the EL is 16.7% to 20%
0	N/a	D	PD is 85% or there is a Payment Default: and the EL is greater than 20%

(a) The default rates set here are for a ten year term debt security. If the company s 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. Currently, none of our investments are on non-accrual. At March 31, 2007, no payments were past due on any of our debt securities. Additionally, we do not risk rate our equity securities.

The following table lists the risk ratings for all non-syndicated loans in our portfolio at March 31, 2007, September 30, 2006 and September 30, 2005, representing approximately 64%, 73% and 62%, respectively, of all loans in our portfolio:

Rating	Mar. 31, 2007	Sept. 30, 2006	Sept. 30, 2005
Average	**7.1**	7.2	7.6
Weighted Average	**7.0**	7.2	7.6
Highest	**10.0**	9.0	9.0
Lowest	**5.0**	6.0	6.0

The following table lists the risk ratings for syndicated loans in our portfolio that are not currently rated by an NRSRO at March 31, 2007, September 30, 2006 and September 30, 2005, representing approximately 14%, 17% and 32%, respectively, of all loans in our portfolio:

Rating	Mar. 31, 2007	Sept. 30, 2006	Sept. 30, 2005
Average	**6.2**	6.1	6.2
Weighted Average	**6.1**	6.3	6.3
Highest	**9.0**	8.0	7.0
Lowest	**4.0**	4.0	5.0

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 a NRSRO. The following table lists the risk ratings for all syndicated loans in our portfolio that are currently rated by an NRSRO at March 31, 2007, September 30, 2006 and September 30, 2005, representing approximately 22%, 10% and 6%, respectively, of all loans in our portfolio:

Rating	Mar. 31, 2007	Sept. 30, 2006	Sept. 30, 2005
Average	**B-/B3**	CCC+/Caa1	CCC+/Caa1
Weighted Average	**CCC+/Caa1**	CCC+/Caa1	CCC/Caa2
Highest	**BB-/Ba2**	B-/B3	CCC+/B3
Lowest	**CCC/Caa3**	CCC/Caa1	CCC+/Caa2

Valuation Methods: We determine the value of publicly-traded debt securities based on the closing price for the security on the exchange or securities market on which it is listed on the valuation date. We value debt securities that are not publicly traded, but for which a limited market for the security exists, such as participations in syndicated loans, at the indicative bid price offered by the syndication agent on the valuation date. At March 31, 2007, none of the debt securities in our portfolio were publicly traded and there was a limited market for 31 debt securities in our portfolio. At September 30, 2006, none of the debt securities in our portfolio were publicly traded and there was a limited market for 9 debt securities in our portfolio. At September 30, 2005, none of the debt securities in our portfolio were publicly traded and there was a limited market for 12 debt securities in our portfolio.

For debt securities that are not publicly traded, for which there is no market, or for which there is a market but have not been rated by a NRSRO, we begin with the risk rating designation of the security as described above. Using this risk rating designation, we seek to determine the value of the security as if we currently intended to sell the security and consider some or all of the following factors:

- the cost basis and the type of the security;
- the nature and realizable value of the collateral;
- the portfolio company s ability to make payments and discounted cash flow;

- reports from portfolio company senior management and board meetings;
- reported values of similar securities of the portfolio company or comparable companies; and
- changes in the economy affecting the portfolio company.

We value convertible debt, equity, success fees or other equity-like securities for which there is a market based on the market prices for such securities, even if that market is not robust. At March 31, 2007, September 30, 2006 and September 30, 2005, there was no market for any of the equity securities we owned. To value equity securities for which no market exists, we use the same information we would use for a debt security valuation described above, except risk-rating, as well as standard valuation techniques used by major valuation firms to value the equity securities of private companies. These valuation techniques consist of discounted cash flow of the expected sale price in the future, valuation of the securities based on recent sales in comparable transactions, and a review of similar companies that are publicly traded and the market multiple of their equity securities. At March 31, 2007, September 30, 2006 and September 30, 2005, we had $146,124, $37,000 and $37,000, respectively, invested, at cost, in equity securities compared to our debt portfolio with a cost basis of $281,379,326, $216,165,986 and $205,338,554, respectively.

At March 31, 2007, we had total unrealized depreciation of $3,037,674, which was mainly comprised of unrealized deprecation of $1,250,000 on our senior subordinated term debt investment in Visual Edge Technology, Inc., unrealized depreciation of $733,000, on the aggregate of our investments in LocalTel, Inc. and unrealized depreciation of $482,488 on our senior subordinated term debt investment in Consolidated Bedding, Inc. Unrealized appreciation of $1,754,910 was primarily composed of unrealized appreciation of $789,061 on our warrants in Finn Corporation, a $180,800 success fee value on our senior term debt investment in Allied Extruders, Inc. and a $94,219 success fee value on our senior term debt investment in SCPH Holdings, Inc. In the aggregate, we recorded net unrealized depreciation of $1,282,764 on our total investment portfolio as of March 31, 2007.

At September 30, 2006, we had total unrealized appreciation of $2,015,198, which was mainly comprised of unrealized appreciation of $672,431 on our warrants of Finn Corporation, unrealized appreciation of $607,625 on our senior term debt in Mistras Holding Corporation and unrealized appreciation of $148,287 on our senior subordinated term debt investment in Xspedius Communications, LLC. This unrealized appreciation was offset by unrealized depreciation of $575,434, most notably composed of unrealized depreciation of $131,367 on our senior subordinated term debt investment in Consolidated Bedding, Inc. and unrealized depreciation of $115,750 on our senior term debt in LocalTel Inc. In the aggregate, we recorded net unrealized appreciation of $1,439,764 on our total investment portfolio as of September 30, 2006.

At September 30, 2005, we had total unrealized depreciation of $6,231,296, which was mainly composed of unrealized depreciation in our senior subordinated term debt investment in Finn Corporation (excluding the warrants) of $3,150,000, our senior subordinated term debt investment in Xspedius Communications of $1,493,182, and our senior term debt in ARI Holdings, Inc. of $1,053,939 (which was subsequently sold at the September 30, 2005 reflected fair value), partially offset by unrealized appreciation, most notably on, the value of our warrants of Finn Corporation, which had an unrealized appreciation of $645,114 and our senior term debt investment in Woven Electronics Corporation, which had unrealized appreciation of $431,436. This aforementioned unrealized appreciation plus unrealized appreciation of $625,955 on certain other investments, primarily in our originated loan investments and certain syndicate participations, most notably Infor Global Solutions Ltd., which had unrealized appreciation of $248,750, which resulted in overall net unrealized depreciation of $4,528,791 as of September 30, 2005.

Tax Status

Federal Income Taxes

We currently qualify and 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 are required to distribute to stockholders at least 90% of investment company taxable income, as defined by the Code. We have a policy to pay out as a dividend 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 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 is recorded on the accrual basis to the extent that such amounts are expected to be collected. We will stop accruing interest on investments and write off any previously accrued and uncollected interest when it is determined that interest is no longer collectible. Conditional interest or a success fee is recorded when earned upon full repayment of a loan investment.

Paid in Kind Interest

In the future, we may hold loans in our portfolio which contain a PIK interest provision. 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 dividends, even though we have not yet collected the cash.

RESULTS OF OPERATIONS

Comparison of the Six Months Ended March 31, 2007 to the Six Months Ended March 31, 2006

Investment Income

Investment income for the six months ended March 31, 2007 was $16,877,496, as compared to $13,031,019 for the six months ended March 31, 2006. Interest income from our investment portfolio increased from March 31, 2006 due to the increase in new loans of $127,641,175, offset by principal repayments and investment sales of approximately $62,230,246.

Interest income from our investments in debt securities of private companies was $16,153,059 for the six months ended March 31, 2007 as compared with $12,722,371 for the six months ended March 31, 2006, which included approximately $63,000 of PIK interest. This increase consisted of net new investments of approximately $65.4 million for the six months ended March 31, 2007, as compared to net new investments of approximately $1.6 million for the six months ended March 31, 2006. As a result of a refinancing by Badanco Acquisition Corp. and a full repayment by Mistras Holdings Corp., we recorded success fees of approximately $1,733,000 during the six months ended March 31, 2007.

The annualized weighted average yield on our portfolio for the six months ended March 31, 2007 was 12.6%; there was no PIK interest accrued during the six months ended March 31, 2007. The annualized weighted average yield on our portfolio for the six months ended March 31, 2006 was 12.6% (with and without giving effect to PIK interest).

Interest income from invested cash and cash equivalents for the six months ended March 31, 2007 was $68,914, as compared to $13,536 for the six months ended March 31, 2006 due to an increase in cash held in the custodial account which is interest bearing.

For the six months ended March 31, 2007 and March 31, 2006, we recorded $271,122 and $214,126, respectively, in interest income from loans to our employees in connection with the exercise of employee stock options. The increase is the result of additional loans issued in connection with employee stock option exercises during the fourth quarter of the previous fiscal year.

For the six months ended March 31, 2007, we recorded $384,401 of prepayment fees and other income, as compared to $80,986 for the six months ended March 31, 2006. The income for both periods consisted of prepayment penalty fees received upon the full repayment of certain loan investments ahead of contractual maturity and prepayment fees received upon the early unscheduled principal repayments which, in both instances, were based on a percentage of the outstanding principal amount of the loan at the date of prepayment.

Operating Expenses

Operating expenses, prior to credits from our Adviser, for the six months ended March 31, 2007 were $8,733,585, as compared to $4,557,552 for the six months ended March 31, 2006. Operating expenses for the six months ended March 31, 2007 reflected a significant increase in interest expense and management fees, prior to credits, as well as the addition of the incentive and administration fees, prior to credits, under the Amended Advisory and Administration Agreements.

Loan servicing fees of $1,479,775 were incurred for the six months ended March 31, 2007, as compared to $1,450,059 for the six months ended March 31, 2006. These fees were incurred in connection with a loan servicing agreement between Business Loan and our Adviser, which is based on the size of the portfolio. These fees were reduced against the amount of the base management fee due to our Adviser.

For the six months ended March 31, 2007, we incurred a gross base management fee of $848,916, less credits for fees received by our Adviser of $1,086,000, for a net base management fee credit of $237,084, as compared to the six months ended March 31, 2006, in which we incurred a gross base management fee of $621,080, less credits for fees received by our Adviser of $1,223,000, for a net base management credit of $601,920. The base management fee is computed quarterly as described under Investment Advisory and Management Agreement. The fees increased in the current period due to the growth of the investment portfolio as compared to the same period of the prior year and fewer credits for fees received by our Adviser which reduce the base management fee.

Effective October 1, 2006, the income based incentive fee became effective and as such we recorded a gross incentive fee of $2,307,478, which was reduced by a voluntary waiver issued by our Adviser s board of directors of $1,657,372, which resulted in a net incentive fee of $650,106, which is recorded in fees due to Adviser on our consolidated statements of assets and liabilities. There was no incentive fee recorded for the six months ended March 31, 2006, as the Amended Advisory Agreement was not in effect.

Effective October 1, 2006, the Administration Agreement became effective in which we provide payments equal to our allocable portion of our Administrator s overhead expenses in performing its obligations under the Administration Agreement including, but not limited to, rent for employees of our Administrator, and our allocable portion of the salaries and benefits expenses of our chief financial officer, chief compliance officer and controller and their respective staffs. We incurred an administration fee of $294,851 for the six months ended March 31, 2007. There was no administration fee recorded during the six months ended March 31, 2006, as the Administration Agreement was not in effect.

Professional fees, consisting primarily of legal and audit fees, for the six months ended March 31, 2007 were $220,001, as compared to $233,353 for the six months ended March 31, 2006. The slight decrease is due to the reimbursement of certain legal fees at the time of investment funding.

Amortization of deferred financing costs, in connection with our line of credit, was $126,500 for the six months ended March 31, 2007 and $58,536 for the six months ended March 31, 2006. The increase is due to the amortization of additional fees incurred with our line of credit which were not in place during the prior year period.

Interest expense for the six months ended March 31, 2007 was $2,931,276, as compared to $1,600,244 for the six months ended March 31, 2006. This increase is primarily a result of increased borrowings under our line of credit during the six months ended March 31, 2007, which borrowings were partially used to finance our increased investments, borrowings remaining outstanding for longer periods of time and an increase in the interest rates on our borrowings.

Stockholder related costs for the six months ended March 31, 2007 were $151,016, as compared to $244,799 for the six months ended March 31, 2006. Stockholder related costs include such recurring items as transfer agent fees, NASDAQ listing fees, SEC filing fees and annual report printing fees. These fees decreased during the six months ended March 31, 2007 since there was no special proxy solicitation filed as there was during the six months ended March 31, 2006.

Directors fees for the six months ended March 31, 2007 were $111,220, as compared to $54,212 for the six months ended March 31, 2006 due to the increase in annual stipend fees and their related monthly amortization.

Insurance expense for the six months ended March 31, 2007 was $125,092, as compared to $101,367 for the six months ended March 31, 2006. The increase is primarily the result of an increase in the amortization of our directors and officers insurance policy premiums.

There was no stock option compensation expense recorded for the six months ended March 31, 2007 as there was no longer a stock option plan in effect. Stock option compensation expense for the six months ended March 31, 2006 was $77,322 and was the result of the adoption of the SFAS No. 123 (revised 2004) *Share-based Payment*.

Other expenses were $137,460 for the six months ended March 31, 2007, as compared to $116,580 for the six months ended March 31, 2006. The expenses primarily represent direct expenses such as travel related specifically to our portfolio companies, loan evaluation services for our portfolio companies, press releases and backup servicer expenses.

Income Tax Expense

During the six months ended March 31, 2006, we recorded approximately $50,000 in connection with penalties incurred on misclassified revenue on its fiscal year 2004 corporate tax return.

Net Realized Gain (Loss) on Sale of Investments

During the six months ended March 31, 2007, we sold or were repaid in full on eleven syndicate loan investments for a net gain of $86,519, as compared to an aggregate net loss of $803,095, which was composed of $1,180,595 loss from the sale of two investments and a gain of $377,500 from the sale of a syndicate investment during the six months ended March 31, 2006.

Realized Gain on Settlement of Derivative

During the six months ended March 31, 2007, we received interest rate cap agreement payments of $22,793 as a result of the one month LIBOR, the Prime Rate or the Federal Funds Rate, exceeding 5%.

There was no realization during the six months ended March 31, 2006 as the one month LIBOR was below 5%.

Net Unrealized (Depreciation) Appreciation on Derivative

During the six months ended March 31, 2007, we recorded net unrealized depreciation of $25,613 due to a decrease in the fair market value of our interest rate cap agreement, as compared to unrealized appreciation of $23,766 during the six months ended March 31, 2006.

Net Unrealized (Depreciation) Appreciation on Investments

For the six months ended March 31, 2007, we recorded net unrealized depreciation on investments of $2,722,528, as compared to net unrealized appreciation of $4,956,829, for the six months ended March 31, 2006. The unrealized depreciation is mainly attributable to the depreciated fair value on certain investments.

Net Increase in Net Assets from Operations

Overall, we realized a net increase in net assets resulting from operations of $8,248,454 for the six months ended March 31, 2007. Based on a weighted-average of 12,272,012 basic and diluted shares outstanding, our net increase in net assets from operations per weighted-average common share for the six months ended March 31, 2007 was $0.67, basic and diluted.

For the six months ended March 31, 2006, we realized a net increase in net assets resulting from operations of $13,823,730. Based on a weighted-average of 11,307,510 (basic) and 11,555,479 (diluted) shares outstanding, our net increase in net assets from operations per weighted-average common share for the six months ended March 31, 2006 was $1.22 (basic) and $1.20 (diluted).

Comparison of the Fiscal Years Ended September 30, 2006 and September 30, 2005

Investment Income

Investment income for the fiscal year ended September 30, 2006 was approximately $26.9 million as compared to approximately $23.9 million for the fiscal year ended September 30, 2005. This increase is primarily a result of a rise in interest income from an increase of approximately $136.0 million of new investments from the prior year and the collection of approximately $1.3 million of exit fees upon the full repayment of two portfolio company investments.

Interest income from our investments in debt securities of private companies was approximately $25.6 million, including $63,000 of PIK interest, for the fiscal year ended September 30, 2006 as compared to $22.4 million for the fiscal year ended September 30, 2005, including $394,000 of PIK interest. This increase was primarily the result of approximately $136.0 million of new investments for the fiscal year ended September 30, 2006 and the collection of approximately $1.3 million of exit fees upon the full repayment of two portfolio company investments. The decrease in PIK income for the fiscal year ended September 30, 2006 was the result of the early repayment in full of one loan containing a PIK provision.

The weighted average yield on our portfolio for the fiscal year ended September 30, 2006 was 12.74% (with and without giving effect to PIK interest). The weighted average yield on our portfolio for the fiscal year ended September 30, 2005 was 12.23% (without giving effect to PIK interest) and 12.36% (after giving effect to PIK interest). The yields were computed based on the cost value of the investment portfolios.

Interest income from invested cash and cash equivalents for the fiscal year ended September 30, 2006 was approximately $38,000, as compared to approximately $33,000 for the fiscal year ended September 30, 2005. This increase was primarily caused by an increase in cash balances during the year resulting from sales and principal repayments of portfolio investments of approximately $124 million for the fiscal year ended September 30, 2006.

Prepayment fees and other income was approximately $0.8 million for the fiscal year ended September 30, 2006 and $1.1 million for the fiscal year ended September 30, 2005. For the fiscal year ended September 30, 2006, this consisted of approximately $0.8 million of prepayment penalty fees. For the fiscal year ended September 30, 2005, this consisted of approximately $1.0 million of prepayment penalty fees and approximately $24,000 of waiver fees for certain loan covenants.

Operating Expenses

Operating expenses for the fiscal year ended September 30, 2006 were approximately $9.5 million, as compared to approximately $7.5 million for the fiscal year ended September 30, 2005. This increase was mainly a result of an increase in loan servicing fees, interest expense, stockholder related costs and other expenses, offset by reductions in professional fees and amortization of deferred financing fees.

Loan servicing fees of approximately $2.9 million were incurred for the fiscal year ended September 30, 2006 as compared to approximately $2.5 million for the fiscal year ended September 30, 2006. These fees were incurred in connection with a loan servicing agreement between Business Loan and our Adviser, which is based on the size of the aggregate outstanding loan portfolio. These fees were directly credited against the amount of the management fee due to our Adviser.

Effective October 1, 2004, we entered into an advisory agreement with our Adviser whereby our Adviser serves as our external adviser. As compensation for the services of our Adviser, we pay our Adviser an annual advisory fee of 1.25% of total assets (as reduced by cash and cash equivalents pledged to creditors), payable in quarterly computed increments of 0.3125%, and an annual administrative fee of 0.75% of total assets (as reduced by cash and cash equivalents pledged to creditors), payable in quarterly computed increments of 0.1875%, for a total fee of 2% of total assets (as reduced by cash and cash equivalents pledged to creditors). Effective in April 2006, our Adviser s board of directors voluntarily waived the advisory fee on a temporary basis by reducing the 1.25% annual fee to 0.5% per annum applicable only to the senior syndicated loans in which we already have a second lien position. We continue to pay direct expenses including, but not limited to, directors fees, legal and accounting fees, stockholder related expenses, and directors and officers insurance. Under the advisory agreement, our Adviser provides the managerial assistance and other services to our portfolio companies and likewise our Adviser directly receives any fees for such services. Any such fees are credited directly against the 2% management fee payable to our Adviser. The 2% management fee is also directly reduced by the amount of the monthly loan servicing fees we pay to our Adviser. Overall, the management fee due to our Adviser cannot exceed 2% of total assets (as reduced by cash and cash equivalents pledged to creditors) during any given fiscal year. On October 1, 2006, we entered into the Amended Advisory Agreement with our Adviser and the Administration Agreement with our Administrator.

The following table sets forth the quarterly computations of the management fee for the fiscal years ended September 30, 2006 and September 30, 2005, based on the quarterly increment of 0.50% (0.3125% quarterly advisory fee plus 0.1875% quarterly administrative fee) and the reduced fee for senior syndicated loans of 0.125% per quarter:

	September 30, 2006	June 30, 2006	March 31, 2006	December 31, 2005
Fee:				
Total assets at	$ 223,979,932 (a)	$ 207,265,095	$ 217,404,695	$ 211,823,244
Less: Senior syndicated loans subject to reduced fee	(11,011,616)(b)	(3,018,897)(b)		
Less: Borrowings under line of credit at				(15,000,000)(c)
Total assets subject to quarterly fee of 0.50% as of	212,968,316	204,246,198	217,404,695	196,823,244
Quarterly fee rate	0.50 %	0.50 %	0.50 %	0.50 %
Management fee before senior syndicated loan advisory fee	1,064,841	1,021,231	1,087,023	984,116
Total senior syndicated loan advisory fee at quarterly rate 0.125%	13,765 (d)	3,774 (d)		
Gross management fee before loan servicing fee credit	1,078,606	1,025,005	1,087,023	984,116
Less: loan servicing fee from Business Loan	763,851	693,965	734,644	715,415
Management fee before credit	314,755	331,040	352,379	268,701
Direct Credit to Management Fee:				
Fee revenue recorded by our Adviser	289,000	539,000	673,000	550,000
Net management fee for the three months ended(e)	$ 25,755	$ (207,960)	$ (320,621)	$ (281,299)

	September 30, 2005	June 30, 2005	March 31, 2005	December 31, 2004
Fee:				
Total assets	$ 205,793,094	$ 209,320,463	$ 213,753,998	$ 194,085,591
Less: Borrowings under line of credit			(18,644,179)(f)	(22,435,000)(f)
Total assets subject to quarterly fee of 0.50% as of	205,793,094	209,320,463	195,109,819	171,650,591
Quarterly fee rate	0.50 %	0.50 %	0.50 %	0.50 %
Gross management fee before loan servicing fee credit	1,028,965	1,046,602	975,549	858,254
Less: loan servicing fee from Business Loan	745,263	687,971	585,542	530,952
Management fee before credit	283,702	358,631	390,007	327,302
Direct Credit to Management Fee:				
Fee revenue recorded by our Adviser	100,000	240,600	450,000	286,500
Net management fee for the three months ended	$ 183,702	$ 118,031	$ (59,993)	$ 40,802

(a) Excludes amounts due from employees in connection with tax withholdings related to the exercise of non-qualified stock options during the third and fourth quarters of fiscal 2006. (Refer to Note 5 of the Notes to Consolidated Financial Statements)

(b) In April 2006, our Adviser s board of directors waived on a temporary basis the annual advisory fee from 1.25% to 0.5% (0.125% quarterly) for those senior syndicated loans in which we also hold a syndicated second lien position.

(c) This amount represents borrowings under one of our lines of credit that were held in cash and cash equivalents as of December 31, 2005. The $15.0 million was to be used to fund a new loan investment, however, the investment did not fund until January 2006. Solely for the purposes of calculating the amount of the management fee due to our Adviser, we treat any such amounts as cash and cash equivalents pledged to creditors under the terms of our advisory agreement with our Adviser. As a result, such amounts are deducted from our total assets for purposes of computing the asset base upon which the management fee is determined.

(d) This amount represents the reduced quarterly advisory fee applicable only to the senior syndicated loans.

(e) If the amount presented is in parentheses it denotes the amount is due back to us from our Adviser; if the amount is positive, it indicates that we owe our Adviser the stated amount.

(f) This amount represents borrowings under one of our lines of credit that were held in cash and cash equivalents as of March 31, 2005 and December 31, 2004, for the purpose of satisfying our asset diversification requirements under the Code. Solely for the purposes of calculating the amount of the management fee due to our Adviser, we treat any such amounts as cash and cash equivalents pledged to creditors under the terms of our advisory agreement with our Adviser. As a result, such amounts are deducted from our total assets for purposes of computing the asset base upon which the management fee is determined.

Professional fees, consisting primarily of legal and audit fees, for the fiscal year ended September 30, 2006 were approximately $548,000, as compared to approximately $725,000 for the fiscal year ended September 30, 2005. The decrease is due primarily to a decrease in non-reimbursable legal fees and extra audit fees in the prior year in connection with internal control procedures.

Amortization of deferred financing costs, in connection with our lines of credit, were approximately $140,000 for the fiscal year ended September 30, 2006 and approximately $386,000 for the fiscal year ended September 30, 2005. The decrease is due to the completion of the amortization cycle related to certain deferred financing costs.

Interest expense for the fiscal year ended September 30, 2006 was approximately $3.2 million as compared to approximately $1.8 million for the fiscal year ended September 30, 2005. This increase is primarily a result of increased borrowings under our lines of credit during the fiscal year ended September 30, 2006, which borrowings were used, in part, to finance our increased investments, borrowings remaining outstanding for longer periods of time and an increase in the interest rates on our borrowings.

Stockholder related costs for the fiscal year ended September 30, 2006 were approximately $304,000, as compared to approximately $220,000 for the fiscal year ended September 30, 2005. Stockholder related costs include such recurring items as transfer agent fees, securities listing fees, and electronic filing fees. The increase is due mainly to the printing and mailing of the special proxy statement in connection with the special meeting of stockholders, the printing and mailing of the annual report to stockholders and the annual proxy to stockholders, and the fees associated with the Schedule TO filed in connection with the offer to amend the terms of the options outstanding under the 2001 Plan.

Directors fees for the fiscal year ended September 30, 2006 were approximately $116,000, as compared to approximately $102,000 for the fiscal year ended September 30, 2005. This is the result of the addition of a new director in December 2005.

Insurance expense for the fiscal year ended September 30, 2006 was approximately $207,000, as compared to approximately $178,000 for the fiscal year ended September 30, 2005. The increase is primarily the result of an increase of our directors and officers insurance premiums.

Stock option compensation expense for the fiscal year ended September 30, 2006 was approximately $285,000. This is the result of the adoption of SFAS No. 123(R) Share-based Payment. SFAS No. 123(R) replaces SFAS No. 123, Accounting for Stock-Based Compensation and supersedes Accounting Principles Board, or APB, Opinion No. 25, Accounting for Stock Issued to Employees, which we refer to as APB No. 25. SFAS No. 123(R) is effective for awards that are granted, modified, or settled in cash for annual periods beginning after June 15, 2005. We adopted SFAS No. 123(R) on October 1, 2005 using the modified prospective approach. Under the modified prospective approach, stock-based compensation expense will be recorded for the unvested portion of previously issued awards that remain outstanding at October 1, 2005 using the same estimate of the grant date fair value and the same attribution method used to determine the pro forma disclosure under SFAS No. 123. SFAS No. 123(R) also requires that all share-based payments to employees after October 1, 2005, including employee stock options, be recognized in the financial statements as stock-based compensation expense based on the fair value on the date of grant. There was no stock option compensation expense recorded for the fiscal year ended September 30, 2005. As a result of the amendment of the 2001 Plan, all unvested stock options became vested as of April 11, 2006 and therefore, all residual stock compensation expense related to options vesting subsequent to September 30, 2006 was recorded in the current fiscal year. As of September 30, 2006, there were no options outstanding.

Other expenses were approximately $485,000 for the fiscal year ended September 30, 2006, as compared to approximately $236,000 for the fiscal year ended September 30, 2005. Of this $485,000, approximately $300,000 relates to employer taxes, interest and penalties arising from withholding taxes on stock option exercises that were not remitted to the respective taxing authorities during the third and fourth quarters of fiscal 2006. The remaining $185,000 of other expenses primarily represent direct expenses such as travel related specifically to our portfolio companies, loan evaluation services for our portfolio companies, press releases and backup servicer expenses.

Income Tax Expense

During the fiscal year ended September 30, 2006, we recorded approximately $102,000 in tax expense in connection with interest penalties incurred on misclassified revenue on its fiscal year 2004 corporate tax return.

Gladstone Capital Advisers, Inc., our wholly-owned subsidiary, is subject to federal and state income taxation on the income it has recorded such as managerial assistance and other fees. During the fiscal year ended September 30, 2005, Gladstone Capital Advisers incurred aggregate federal and state income taxes of $209,278 resulting from taxable income it received during the 2004 fiscal year. Following the externalization of our management effective October 1, 2004, substantially all revenues previously received by Gladstone Capital Advisers are now received by our Adviser. As a result, we do not anticipate incurring significant tax expense as a result of the activities of Gladstone Capital Advisers in the future.

Realized (Loss) Gain on Sale of Investments

During the fiscal year ended September 30, 2006, we sold our investments in ARI Holdings, Inc. and Marcal Paper Mills, Inc. for an aggregate loss of approximately $1.18 million and were repaid on several syndicated loans which contained unamortized premiums resulting in realized gains of approximately

$149,000 for a total net realized loss of approximately $904,000. During the fiscal year ended September 30, 2005, we sold our $975,000 syndicated participation in Burt s Bees, Inc. for a gain of $9,750 and we sold our $2.0 million syndicated participation in Marietta Corp. for a gain of $20,000.

Realized Gain on Settlement of Derivative

During the fiscal year ended September 30, 2006, we received our first interest rate cap agreement payments totaling approximately $15,000 as a result of the one month LIBOR exceeding 5%. There was no realization during the fiscal year ended September 30, 2005 as the one month LIBOR was below 5%.

Net Unrealized Depreciation on Derivative

As a result of the increase in fair market value of our interest rate cap agreement, we recorded a nominal net unrealized appreciation derivative for the fiscal year ended September 30, 2006, as compared to net unrealized depreciation of approximately $39,000 for the fiscal year ended September 30, 2005.

Net Unrealized Appreciation (Depreciation) on Investments

For the fiscal year ended September 30, 2006, we recorded net unrealized appreciation on investments of approximately $6.0 million as compared to net unrealized depreciation of approximately $1.8 million for the fiscal year ended September 30, 2005. The unrealized appreciation is mainly attributable to the early repayment or sale of loans that were underperforming as of September 30, 2005, most notably Finn Corporation and ARI Holdings, Inc., as well as the unrealized appreciation on the Finn Corporation warrant currently still in our portfolio.

Net Increase in Net Assets from Operations

Overall, we realized a net increase in net assets resulting from operations of approximately $24.4 million for the fiscal year ended September 30, 2006. Based on a weighted average of 11,381,378 (basic) and 11,615,922 (diluted) shares outstanding, our net increase in net assets from operations per weighted average common share for the fiscal year ended September 30, 2006 was $2.15 (basic) and $2.10 (diluted).

For the fiscal year ended September 30, 2005, we realized a net increase in net assets resulting from operations of approximately $15.5 million. Based on a weighted average of 11,292,466 (basic) and 11,609,146 (diluted) shares outstanding, our net increase in net assets from operations per weighted average common share for the fiscal year ended September 30, 2005 was $1.37 (basic) and $1.33 (diluted).

Comparison of the Fiscal Years Ended September 30, 2005 and September 30, 2004

Investment Income

Investment income for the fiscal year ended September 30, 2005 was approximately $23.9 million as compared to approximately $20.4 million for the fiscal year ended September 30, 2004. This increase was primarily a result of a rise in interest income from an increase of approximately $143.8 million of new investments from the prior year and the collection of approximately $1.2 million of exit fees upon the full repayment of a portfolio company investment.

Interest income from our investments in debt securities of private companies was approximately $22.4 million, including $394,000 of PIK interest, for the fiscal year ended September 30, 2005 as compared to $18.2 million for the fiscal year ended September 30, 2004, including $553,000 of PIK interest. This increase was primarily the result of approximately $143.8 million of new investments for the fiscal year ended September 30, 2005 and the collection of $1.2 million of exit fees upon the full repayment of a portfolio company investment. The decrease in PIK income for the fiscal year ended September 30, 2005 was the result of scheduled principal repayments for one loan containing a PIK provision and an early repayment for another loan containing a PIK provision.

The weighted average yield on our portfolio for the fiscal year ended September 30, 2005 was 12.23% (without giving effect to PIK interest) and 12.36% (after giving effect to PIK interest). The weighted average yield on our portfolio for the fiscal year ended September 30, 2004 was 13.44% (without giving effect to PIK interest) and 13.78% (after giving effect to PIK interest). The yields were computed based on the cost value of the investment portfolios.

Interest income from invested cash and cash equivalents for the fiscal year ended September 30, 2005 was approximately $33,000, as compared to approximately $84,000 for the fiscal year ended September 30, 2004. This decrease was primarily caused by a decrease in cash balances as a result of $143.8 million of new investments and generally maintaining less cash on hand and using borrowed funds to fund new investments.

No fee income was recorded for the fiscal year ended September 30, 2005, as compared to approximately $1.1 million for the fiscal year ended September 30, 2004. This decrease was the result of the externalization of our management, effective October 1, 2004, through the engagement of our affiliate, our Adviser, to serve as our external adviser. Our Adviser receives all fees in connection with our investments and prospective investments, which fees are offset against the advisory fee payable to our Adviser. Fee income for the fiscal year ended September 30, 2004 consisted primarily of investment banking and annual review fees received in connection with investments we closed during the 2004 fiscal year. During the fiscal year ended September 30, 2004, the fee income was mainly attributable to the closing of the Gammill, Inc., Woven Electronics Corp., Benetech, Inc,. Mistras Holdings Corp. ($1.0 million investment), A and G, Inc. and Allied Extruders, Inc. investments, in the approximate aggregate amount of $52.8 million.

Prepayment fees and other income was approximately $1.1 million for the fiscal year ended September 30, 2005 and $573,000 for the fiscal year ended September 30, 2004. For the fiscal year ended September 30, 2005, this consisted of approximately $1.0 million of early principal payment penalty fees and approximately $24,000 of waiver fees for certain loan covenants. For the fiscal year ended September 30, 2004, this amount was comprised of $545,000 of early principal payment penalty fees, $17,000 of waiver fees for certain loan covenants, and $11,000 in up-front fees for a proposed investment.

Operating Expenses

Operating expenses for the fiscal year ended September 30, 2005 were approximately $7.5 million, as compared to approximately $7.1 million for the fiscal year ended September 30, 2004. This increase was mainly a result of an increase in interest expense, stockholder related costs and professional fees. Additionally, operating expenses for the fiscal year ended September 30, 2005 reflected a significant reduction in direct operating expenses, as a result of the externalization of our management effective October 1, 2004, offset by an increase in loan servicing fees and management fees incurred as a result of this externalization.

Loan servicing fees of approximately $2.5 million were incurred for the fiscal year ended September 30, 2005. These fees were incurred in connection with a loan servicing agreement between Business Loan and our Adviser, which became effective July 12, 2004. These fees were directly credited against the amount of the management fee due to our Adviser. During the fiscal year ended September 30, 2004, loan servicing fees of approximately $502,000 were incurred from the period July 12, 2004, the date that our Adviser began to service our loan portfolio, since prior to that the loan portfolio was serviced under a similar agreement with Gladstone Capital Advisers, Inc., our wholly-owned subsidiary, and the fees Business Loan paid to Gladstone Capital Advisers, Inc. were eliminated upon consolidation of our financial results.

Effective October 1, 2004, we entered into an advisory agreement with our Adviser whereby our Adviser served as our external adviser. As compensation for the services of our Adviser, we paid our Adviser an annual advisory fee of 1.25% of total assets (as reduced by cash and cash equivalents pledged to creditors), payable in quarterly computed increments of 0.3125%, and an annual administrative fee of 0.75% of total assets (as reduced by cash and cash equivalents pledged to creditors), payable in quarterly computed increments of 0.1875%, for a total fee of 2% of total assets (as reduced by cash and cash equivalents pledged to creditors). We continued to pay direct expenses including, but not limited to, directors fees, legal and accounting fees, stockholder related expenses, and directors and officers insurance. Under the advisory agreement, our Adviser provided the managerial assistance and other services to our portfolio companies that we previously provided through our wholly-owned subsidiary Gladstone Capital Advisers, and likewise our Adviser directly received any fees for such services. Any such fees were credited directly against the 2% management fee payable to our Adviser. The 2% management fee was also directly reduced by the amount of the monthly loan servicing fees we paid to our Adviser. Overall, the management fee due to our Adviser cannot exceed 2% of total assets (as reduced by cash and cash equivalents pledged to creditors) during any given fiscal year. Because we were internally managed at all times prior to October 1, 2004, no management fee was recorded for the three months ended September 30, 2004, June 30, 2004, March 31, 2004 or December 31, 2003.

The following table sets forth the quarterly computations of the management fee for the fiscal year ended September 30, 2005, based on the quarterly increment of 0.50% (0.3125% quarterly advisory fee plus 0.1875% quarterly administrative fee):

	September 30, 2005	June 30, 2005	March 31, 2005	December 31, 2004
Fee:				
Total assets	$ 205,793,094	$ 209,320,463	$ 213,753,998	$ 194,085,591
Less: Borrowings under line of credit(a)			(18,644,179)	(22,435,000)
Total assets subject to quarterly fee	205,793,094	209,320,463	195,109,819	171,650,591
Quarterly fee rate	0.50 %	0.50 %	0.50 %	0.50 %
Gross management fee before loan servicing fee credit	1,028,965	1,046,602	975,549	858,254
Less: loan servicing fee from Business Loan	745,263	687,971	585,542	530,952
Management fee before credit	283,702	358,631	390,007	327,302
Direct Credit to Management Fee:				
Fee revenue recorded by our Adviser	100,000	240,600	450,000	286,500
Net management fee for the three months ended	$ 183,702	$ 118,031	$ (59,993)	$ 40,802

(a) This amount represents borrowings under one of our lines of credit that were held in cash and cash equivalents as of March 31, 2005 and December 31, 2004, for each respective quarter, for the purpose of satisfying our asset diversification requirements under the Code. There were no borrowings outstanding for this purpose at September 30, 2005 or at June 30, 2005. Solely for the purposes of calculating the amount of the management fee due to our Adviser, we treat any such amounts as cash and cash equivalents pledged to creditors under the terms of our advisory agreement with our Adviser. As a result, such amounts are deducted from our total assets for purposes of computing the asset base upon which the management fee is determined.

Professional fees, consisting primarily of legal and audit fees, for the fiscal year ended September 30, 2005 were approximately $725,000, as compared to approximately $580,000 for the fiscal year ended

September 30, 2004. The increase is due primarily to an increase in non-reimbursable legal fees and audit costs incurred in connection with internal control procedures.

Amortization of deferred financing costs, in connection with our lines of credit, were approximately $386,000 for the fiscal year ended September 30, 2005 and approximately $1.4 million for the fiscal year ended September 30, 2004. The decrease is due to the expensing of approximately $1.2 million of capitalized fees during the fiscal year ended September 30, 2004 which related to the assignment of the warehouse line of credit from a former lender, CIBC World Markets, Inc., to Deutsche Bank AG in September 2004.

Interest expense for the fiscal year ended September 30, 2005 was approximately $1,775,000 as compared to approximately $742,000 for the fiscal year ended September 30, 2004. This increase is a result of increased borrowings under our lines of credit during the fiscal year ended September 30, 2005, which borrowings were used, in part, to finance our increased investments, and to a lesser extent, an increase in the interest rate.

Stockholder related costs for the fiscal year ended September 30, 2005 were approximately $220,000, as compared to approximately $140,000 for the fiscal year ended September 30, 2004. Stockholder related costs include such recurring items as transfer agent fees, securities fees, electronic filing fees and printing and mailing of annual reports and proxy statements to stockholders.

Directors fees for the fiscal year ended September 30, 2005 were approximately $102,000, as compared to approximately $112,000 for the fiscal year ended September 30, 2004. This is the result of fewer board meetings held during the fiscal year ended September 30, 2005 as compared to the fiscal year ended September 30, 2004.

Insurance expense for the fiscal year ended September 30, 2005 was approximately $178,000, as compared to approximately $258,000 for the fiscal year ended September 30, 2004. The decrease is primarily the result of the externalization of our management. Effective October 1, 2004, our Adviser pays general insurance expenses directly and such insurance coverage is included in the services we receive in consideration for the 2% management fee we pay to our Adviser. Insurance expense incurred during the fiscal year ended September 30, 2005 represents the amortization of our directors and officers insurance premiums, which are expenses for which we continue to be responsible following the externalization of our management.

Effective October 1, 2004, all of our employees became employees of our Adviser and therefore no salaries or benefit expenses were incurred by us for the fiscal year ended September 30, 2005, as compared to approximately $2.6 million for the fiscal year ended September 30, 2004. We reimburse our Adviser for its employee services as part of the annual advisory and administrative fees payable under the advisory agreement.

Effective October 1, 2004, our Adviser began to pay rent directly, and therefore for the fiscal year ended September 30, 2005 no rent expense was incurred by us as compared to approximately $139,000 of rent expense for the fiscal year ended September 30, 2004. General overhead expenses, such as rent, are also included as part of the management fee to our Adviser.

Other expenses were approximately $236,000 for the fiscal year ended September 30, 2005, as compared to approximately $702,000 for the fiscal year ended September 30, 2004. This decrease is primarily a result of our Adviser handling general overhead type expenses. The expenses for the fiscal year ended September 30, 2005 primarily represent direct expenses such as travel related specifically to our portfolio companies, loan evaluation services for our portfolio companies, press releases and backup servicer expenses.

Income Tax Expense

Gladstone Capital Advisers, Inc., our wholly-owned subsidiary, is subject to federal and state income taxation on the income it has recorded such as managerial assistance and other fees. During the fiscal year ended September 30, 2005, Gladstone Capital Advisers incurred aggregate federal and state income taxes of approximately $209,000 resulting from taxable income it received during the 2004 fiscal year. Following the externalization of our management effective October 1, 2004, substantially all revenues previously received by Gladstone Capital Advisers are now received by our Adviser. As a result, we do not anticipate incurring significant tax expense as a result of the activities of Gladstone Capital Advisers in the future.

Realized Gain on Sale of Investments

During the fiscal year ended September 30, 2005, we sold our $975,000 syndicated participation in Burt s Bees, Inc. for a gain of $9,750 and we sold our $2.0 million syndicated participation in Marietta Corp. for a gain of $20,000, as compared to the fiscal year ended September 30, 2004 in which we bought and sold our $1.0 million investment in Metokote Corporation for a gain of $12,500.

Net Unrealized Depreciation on Derivative

As a result of the decline in fair market value of our interest rate cap agreement, we recorded net unrealized depreciation on derivative of approximately $39,000 for the fiscal year ended September 30, 2005, as compared to net unrealized depreciation of approximately $214,000 for the five months the investment was held during the fiscal year ended September 30, 2004.

Net Unrealized Appreciation (Depreciation) on Investments

For the fiscal year ended September 30, 2005, we recorded net unrealized depreciation on investments of approximately $1.8 million as compared to net unrealized depreciation of approximately $2.5 million for the fiscal year ended September 30, 2004. The increase in unrealized depreciation was mainly attributable to the decrease in the value of the Finn Corporation senior subordinated term debt of approximately $3.2 million, a decline of approximately $1.5 million in the fair value of Xspedius Communications, LLC and a decline in the value of ARI Holdings, Inc. of approximately $1.1 million, partially offset by appreciation of approximately $645,000 in the value of the Finn warrants, and the fair value of the success fee on Woven Electronics Corporation of approximately $348,000 as well as unrealized appreciation on certain of our syndicated loan participations.

Net Increase in Net Assets from Operations

Overall, we realized a net increase in net assets resulting from operations of approximately $15.5 million for the fiscal year ended September 30, 2005. Based on a weighted average of 11,292,466 (basic) and 11,609,146 (diluted) shares outstanding, our net increase in net assets from operations per weighted average common share for the fiscal year ended September 30, 2005 was $1.37 (basic) and $1.33 (diluted).

For the fiscal year ended September 30, 2004, we realized a net increase in net assets resulting from operations of approximately $10.6 million. Based on a weighted average of 10,101,341 (basic) and 10,344,388 (diluted) shares outstanding, our net increase in net assets resulting from operations per weighted average common share for the fiscal year ended September 30, 2004 was $1.05 (basic) and $1.02 (diluted).

LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2007, we had investments in debt securities of, or loans to, 51 private companies, totaling approximately $281.5 million (cost basis) of total assets.

During the six months ended March 31, 2007 and March 31, 2006, the following investment activity occurred:

Quarter Ended	New Investments	Principal Repayments	Net Gain/(Loss) on Disposal
March 31, 2007	$ 75,330,167	$ 38,263,017	$ 84,205
December 31, 2006	52,311,008	23,967,229	2,314
	$ 127,641,175	$ 62,230,246	$ 86,519
March 31, 2006	$ 38,471,109	$ 24,815,067	$ 377,500
December 31, 2005	26,688,457	38,702,066	(1,180,595)
	$ 65,159,566	$ 63,517,133	$ (803,095)

During the years ended September 30, 2006, 2005 and 2004, the following investment activity occurred:

Year Ended	New Investments	Principal Repayments	Net Gain/(Loss) on Disposal
September 30, 2006	$ 135,954,879	$ 124,009,929	$ (903,945)
September 30, 2005	$ 143,794,006	$ 88,019,136	$ 29,750
September 30, 2004	$ 86,267,500	$ 47,158,995	$ 12,500

The following table summarizes the contractual principal amortization and maturity of our investment portfolio by fiscal year:

Fiscal Year Ended September 30,	Amount
2007	$ 3,467,481
2008	10,569,881
2009	18,976,253
2010	30,422,730
2011	80,548,730
Thereafter	137,540,375
	$ 281,525,450

Net cash used in operating activities for the six months ended March 31, 2007, consisting primarily of the items described in Results of Operations and the investment activity described above, was approximately $56.5 million as compared to net cash provided by operating activities of approximately $1.6 million for the six months ended March 31, 2006. Net cash provided by investing activities consisted of $300,941 and $23,094 for the six months ended March 31, 2007 and March 31, 2006, respectively, and consisted of the principal repayment of employee loans. Net cash provided by financing activities for the six months ended March 31, 2007 was approximately $58.5 million and mainly consisted of borrowings on our line of credit of approximately $146.9 million, offset by repayments on line of credit borrowings of approximately $76.6 million, and approximately $10.3 million for the payment of dividends. Net cash used in financing activities was approximately $1.8 million for the six months ended March 31, 2006 and consisted primarily of net cash provided from borrowings on our line of credit, net of repayments, of approximately $7.3 million, offset by the payment of dividends of approximately $9.2 million.

During the six months ended March 31, 2007, cash and cash equivalents increased from approximately $732,000 to approximately $3.0 million.

Subsequent to March 31, 2007, we sold either outright or to our affiliate Gladstone Investment approximately $16.9 million of syndicated loan participations via an independent broker and were repaid in full on one loan origination investment of approximately $5.6 million and received a success fee of approximately $195,000. Sales to Gladstone Investment were made in reliance on Rule 17a-7 of the 1940 Act. The proceeds from the sales were used to reduce our borrowings on our line of credit. We also funded approximately $39.4 million of loan originations, increased our positions in certain syndicate investments by approximately $4.4 million and funded approximately $1.0 million of lines of credit already held in our portfolio, for total aggregate funding of approximately $44.8 million. As of May 11, 2007, our outstanding balance on our line of credit was approximately $90.2 million.

Net cash provided by operating activities for the fiscal year ended September 30, 2006, consisting primarily of the items described in Results of Operations and the investment activity described above, was approximately $7.2 million as compared to net cash used in operating activities of approximately $61.5 million for the fiscal year ended September 30, 2005. Net cash provided by investing activities was approximately $0.2 million for the fiscal year ended September 30, 2006 and consisted of the repayment of employee loans. Net cash used in financing activities for the fiscal year ended September 30, 2006 was approximately $7.2 million and consisted of approximately $149.8 million of repayments on the lines of credit, and approximately $18.6 million for the payment of dividends. These outflows were partially offset by approximately $146.7 million of cash received from borrowings on the lines of credit and the exercise of stock options for approximately $14.7 million.

During the fiscal year ended September 30, 2006, cash and cash equivalents increased from approximately $504,000 at the beginning of the year to approximately $732,000 at the end of the year. This increase was largely the result of cash generated from operations offset by investment purchases and repayments of our revolving credit facility.

Net cash used in operating activities for the fiscal year ended September 30, 2005, consisting primarily of the items described in Results of Operations and the investment activity described above, was approximately $61.5 million as compared to net cash used operating activities of approximately $82.7 million for the fiscal year ended September 30, 2004. In addition, net cash used in operating activities for the year ended September 30, 2005 included the repayment of the repurchase agreement (as described below) of approximately $21.3 million. Net cash provided by investing activities was approximately $0.8 million for the fiscal year ended September 30, 2005 and was comprised of employee loan principal repayments. Net cash used in financing activities for the fiscal year ended September 30, 2005 was approximately $4.8 million and consisted mainly of approximately $142.7 million of repayments on the lines of credit, approximately $17.1 million for the payment of dividends, $105,000 paid to renew a line of credit and approximately $111,000 of costs incurred subsequent to the shelf offering in September 2004. These outflows were partially offset by approximately $155.0 million of cash received from borrowings on the lines of credit and the exercise of stock options for approximately $270,000.

During the fiscal year ended September 30, 2005, cash and cash equivalents decreased from approximately $66.0 million at the beginning of the year to approximately $504,000 at the end of the year. This decrease was largely the result of the purchase of new investments, the repayment of the repurchase agreement in October 2004 (as described below) and also the payment of dividends throughout the fiscal year ended September 30, 2005.

Net cash used in operating activities for the fiscal year ended September 30, 2004, consisting primarily of the items described in Results of Operations and the investment activity described above, was approximately $82.7 million. At September 30, 2004, the net cash used was due largely in part to $57.1 million used in connection with the purchase of the repurchase agreement and the repayments of the repurchase agreement, and new investments of approximately $86.3 million, partially offset by principal repayments of $47.2 million. Net cash provided by investing activities for the fiscal year ended

September 30, 2004 was approximately $0.2 million and consisted of principal repayments on employee loans. Net cash provided by financing activities was approximately $47.3 million for the fiscal year ended September 30, 2004 and consisted primarily of proceeds from a public shelf offering of common stock which yielded net proceeds of approximately $24.4 million, the borrowings, net of repayments, on the lines of credit for net proceeds of approximately $40.7 million, partially offset by the payment of dividends of approximately $17.1 million.

During the fiscal year ended September 30, 2004, cash and cash equivalents decreased from approximately $101.1 million at the beginning of the year to approximately $66.0 million at the end of the year. This decrease was largely the result of the purchase of new investments and the repurchase agreement described below.

On September 29, 2004, we entered into a repurchase agreement, which we refer to as the FBW Repurchase Agreement, with Ferris Baker Watts, Incorporated for $44,984,950. On September 30, 2004, this amount was reduced to $21,345,997 with the application of the net proceeds from a public offering of our common stock. This remaining balance was settled on October 1, 2004. The FBW Repurchase Agreement was recorded at cost and was fully collateralized by a United States Treasury Bill with a fair value of $50,000,000, a carrying value of $49,984,950 that matured on October 7, 2004 and earned interest of $2,133. The interest rate on the FBW Repurchase Agreement was 4.25% for a cost of $7,831. In the future, we may use a similar form of repurchase agreement as an investment option or in order to satisfy certain asset diversification requirements and maintain our status as a RIC under Subchapter M of the Code.

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. In accordance with these requirements, we declared and paid monthly cash dividends of $0.14 per common share for July, August, September, October, November and December 2006 and January, February and March 2007 and $0.135 per common share for January, February, March, April, May and June 2006, and October, November and December 2005. In April 2007, our Board of Directors declared a monthly cash dividend of $0.14 per common share for each of April, May and June 2007.

We anticipate continuing to borrow funds and, from time to time issuing additional equity securities, to obtain additional capital to make further investments. On May 2, 2007, we completed a public offering of 2,000,000 shares of our common stock, at a price of $24.25 per share, under a shelf registration statement and pursuant to the terms set forth in a prospectus dated April 16, 2007, as supplemented by a final prospectus dated April 27, 2007. Net proceeds of the offering, after underwriting discounts and offering expenses were approximately $45,625,000 and were used to repay outstanding borrowings under our line of credit.

We have filed a registration statement with the SEC, of which this prospectus is a part, that once declared effective by the SEC, would permit us to issue, through one or more transactions, up to an aggregate of $300 million in securities, consisting of common stock and/or debt securities. We may not issue any securities under this registration statement until the SEC has declared the registration statement effective, and we currently have no immediate plans to issue any securities under the registration statement.

Revolving Credit Facility

Through our wholly-owned subsidiary, Business Loan, we have a $170 million revolving credit facility, which we refer to as the DB Facility, with Deutsche Bank AG, as administrative agent, which is scheduled to mature on May 25, 2007. Pursuant to the DB Facility, Business Loan has pledged the loans it holds to secure future advances by certain institutional lenders. Interest rates charged on the advances under the

DB Facility will be based on LIBOR, depending on market conditions, and will adjust periodically. As of May 11, 2007, our outstanding principal balance under the DB Facility was approximately $90.2 million at an interest rate of approximately 6.3%. Available borrowings are subject to various constraints imposed by Deutsche Bank AG, based on the aggregate loan balance pledged by Business Loan, which varies as loans are added and repaid, regardless of whether such repayments are early prepayment or are made as contractually required. At May 11, 2007, the remaining borrowing capacity available under the DB Facility was approximately $79.8 million.

The DB Facility, which is available for general corporate purposes, contains covenants that, among other things, 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 DB Facility also restricts some of the terms and provisions (including interest rates, terms to maturity and payments schedules) and limits the borrower and industry concentrations of loans that are eligible to secure advances. As of March 31, 2007, Business Loan was in compliance with all of the DB Facility covenants. We currently intend to securitize all of the loans held by Business Loan and to use the proceeds from the securitization to pay down any amounts then outstanding under the revolving credit facility. However, there can be no assurance that we will be able to successfully securitize any of these loans on terms acceptable to us, if at all.

The administrative agent also requires that any interest or principal payments on pledged loans be remitted directly by the borrower into a lockbox account with the Bank of New York as custodian. Deutsche Bank AG is also the trustee of the account and once a month remits the collected funds to us. For the six months ended March 31, 2007, the amount due from custodian increased by approximately $1.2 million.

Our Adviser services the loans pledged under the DB Facility. As a condition to this servicing arrangement, we executed a performance guaranty pursuant to which we guaranteed that our Adviser would comply fully with all of its obligations under the facility. The performance guaranty requires us to maintain a minimum net worth of $100 million plus 75% of any new equity or subordinated debt issued. The performance guaranty also requires us to maintain asset coverage with respect to senior securities representing indebtedness of at least 200%, in accordance with Section 18 of the 1940 Act. As of March 31, 2007, we were in compliance with our covenants under the performance guaranty.

Contractual Obligations and Off-Balance Sheet Arrangements

As of March 31, 2007, we were party to signed and non-binding term sheets for two loan originations for $14.0 million. We expect to fund these potential investments as follows:

		Payment Due by Period			
Contractual Obligations	**Total**	**Less than 1 Year**	**1-3 Years**	**3-5 Years**	**More than 5 Years**
Investments	$ 14,000,000	$ 14,000,000			
Total	$ 14,000,000	$ 14,000,000	$	$	$

As of the date of this prospectus, one of the investment purchase obligations summarized above in an aggregate amount of $7.0 million has been funded. See Note 11 Contractual Obligations in our unaudited Consolidated Financial Statements for further information.

All prospective investments are subject to, among other things, the satisfactory completion of our due diligence investigation of each borrower, acceptance of terms and structure and receipt of necessary consents. With respect to each prospective loan, we will only agree to provide the loan if, among other things, the results of our due diligence investigations are satisfactory, the terms and conditions of the loan are acceptable and all necessary consents are received. We have initiated our due diligence investigations of the potential borrowers, however, there can be no guarantee that facts will not be discovered in the course of completing the due diligence that would render a particular investment imprudent or that any of these investments will actually be made.

We did not have any significant off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K, as of March 31, 2007.

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, 2007, our portfolio had approximately 56% of the total loan portfolio cost basis at variable rates with a floor, approximately 2% of the total loan portfolio cost basis at a variable rate with a floor and ceiling, 40% of the total loan portfolio cost basis at variable rates without a floor or ceiling and approximately 1% of the total loan portfolio cost basis at a fixed rate.

We have a $170 million revolving credit facility, based on variable rates, with Deutsche Bank AG, which matures May 25, 2007.

In February 2004, we entered into an interest rate cap agreement in order to fulfill an obligation under our line of credit to enter into certain hedging transactions in connection with our borrowings under the line of credit. We purchased this interest rate cap agreement with a notional amount of $35 million (which is amortized quarterly) for a one-time, up-front payment of $304,000. The interest rate cap agreement entitles us to receive payments, if any, equal to the amount by which interest payments on the current notional amount at one month LIBOR exceed the payments on the current notional amount at 5%. The cap expires in February 2009. This interest rate cap agreement effectively caps our interest payments on our line of credit borrowing, up to the notional amount of the interest rate cap, at five percent. This mitigates our exposure to increases in interest rates on our borrowings on our lines of credit, which are at variable rates. At March 31, 2007, the cap agreement had a fair market value of $24,671 and a current notional amount of $10.9 million. At March 31, 2007, the one month LIBOR rate was approximately 5.32%.

To illustrate the potential impact of changes in interest rates on our net increase in net assets resulting from operations, we have performed the following analysis, which assumes that our balance sheet remains constant and no further actions beyond the interest rate cap agreement are taken to alter our existing interest rate sensitivity. Under this analysis, a hypothetical increase in the one month LIBOR by 1% would increase our net increase in net assets resulting from operations by approximately $1.5 million or 8.2%, over the next twelve months, compared to the net increase in net assets resulting from operations for the twelve months ended March 31, 2007. A hypothetical decrease in the one month LIBOR by 1% would decrease net increase in net assets resulting from operations by approximately $1.5 million, or 8.2%, over the next twelve months, compared to the net increase in net assets resulting from operations for the twelve months ended March 31, 2007. Although management believes that this analysis is indicative of our existing interest rate sensitivity, it does not adjust for potential changes in credit quality, size and composition of our loan portfolio on the balance sheet and other business developments that could affect net increase in net assets resulting from operations. Accordingly, no assurances can be given that actual results would not differ materially from the results under this hypothetical analysis.

In the event that we securitize a portion of our loan portfolio, we believe that we will likely be required to enter into further hedging arrangements in the future with respect to securitized loans. While hedging activities may mitigate our exposure to adverse fluctuations in interest rates, certain hedging transactions that we may enter into in the future, such as interest rate swap agreements, may also limit our ability to participate in the benefits of lower interest rates with respect to our portfolio of investments.

We may also experience risk associated with investing in securities of companies with foreign operations. We currently do not anticipate investing in debt or equity of foreign companies, however, some potential portfolio companies may have operations located outside the United States. These risks include, but are not limited to, fluctuations in foreign currency exchange rates, imposition of foreign taxes, changes in exportation regulations and political and social instability.

On October 1, 2006, we implemented an amended and restated investment advisory and management agreement with our Adviser. In addition to providing for a base management fee based on our total assets, this agreement contemplates a quarterly incentive fee based on our pre-incentive fee net investment income and an annual incentive fee based on our capital gains, if any. Our Adviser has the ability to issue a full or partial waiver of the incentive fee for current and future periods, however our Adviser is not required to issue this waiver. If our Adviser does not issue this waiver in future quarters, it could negatively impact our earnings and may compromise our ability to maintain our current level of, or increase, distributions to our stockholders, which could have a material adverse impact on our stock price.

BUSINESS

Overview

We were incorporated under the General Corporation Laws of the State of Maryland on May 30, 2001. Our investment objectives are to achieve a high level of current income by investing in debt securities, consisting primarily of senior notes, second lien notes, and senior subordinated notes of established private businesses that are backed by leveraged buyout funds, venture capital funds or others, with a particular emphasis on second lien and senior subordinated notes. In addition, we may acquire existing loans, which meet this profile, from leveraged buyout funds, venture capital funds and others. 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 extend 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 1940 Act.

Our Investment Strategy

We seek to invest in small and medium-sized businesses that meet certain criteria, including some or all of the following: (1) the potential for growth in cash flow, (2) adequate assets for loan collateral, (3) experienced management teams with a significant ownership interest in the borrower, (4) profitable operations based on the borrower s cash flow, (5) reasonable capitalization of the borrower (usually by buyout funds or venture capital funds) and (6) 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 by the borrower or by exercise of our right to require the borrower to buy back its warrants. We lend to borrowers that need funds to, among other things, effect a change of control, restructure their balance sheets, or finance growth, including acquisitions.

We believe that our business strategy will enable us 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 backed by leveraged buyout funds, venture capital funds or others. In addition, from time to time we might acquire existing loans that meet this profile from leveraged buyout funds, venture capital funds and others. 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 might receive when we make loans. Our loans typically range from $5 million to $15 million, although this investment size may vary proportionately as the size of our capital base changes. Our loans generally mature in no more than seven years and accrue interest at fixed or variable rates.

Our Investment Adviser and Administrator

Our Adviser is our investment adviser and is led by a management team which has extensive experience in our lines of business. All of our directors and executive officers serve as either directors or executive officers, or both, of Gladstone Commercial, a publicly traded real estate investment trust; Gladstone Investment, a publicly traded business development company; our Adviser; and our Administrator. Our Adviser also has a wholly-owned subsidiary, our Administrator, which employs our chief financial officer, chief compliance officer, controller, treasurer and their respective staffs.

Our Adviser and our Administrator also provide investment advisory and administrative services to our affiliates Gladstone Commercial, Gladstone Investment and Gladstone Land Corporation, an agricultural real estate company owned by Mr. Gladstone. In the future, our Adviser may provide investment advisory and administrative services to other funds, both public and private, of which it is the sponsor.

We have been externally managed by our Adviser pursuant to an investment advisory and management agreement since October 1, 2004. Our Adviser was organized as a corporation under the laws of the State of Delaware on July 2, 2002, and is a registered investment adviser under the Investment Advisers Act of 1940, as amended. Our Adviser is headquartered in McLean, Virginia, a suburb of Washington D.C., and also has offices in New York, New Jersey, Pennsylvania, Illinois, Texas, Kentucky and Washington.

Corporate Information

Our executive offices are located at 1521 Westbranch Drive, Suite 200, McLean, Virginia 22102 and our telephone number is (703) 287-5800. Our corporate website is located at www.gladstonecapital.com. Our website and the information contained therein or connected thereto shall not be deemed to be incorporated into this prospectus or the registration statement of which it forms a part.

Investment Process

Overview of Loan Origination and Approval Process

To originate loans, our Adviser s lending professionals use an extensive referral network comprised of venture capitalists, leveraged buyout funds, investment bankers, attorneys, accountants, commercial bankers and business brokers. Our Adviser s lending professionals review informational packages from these and other sources in search of potential financing opportunities. If a potential opportunity matches our investment objectives, the lending professionals will seek an initial screening of the opportunity from our Adviser s investment committee, which is composed of Messrs. Gladstone, Brubaker and Stelljes. If the applicant passes this initial screening, the lending professionals will conduct a due diligence investigation of the applicant. Upon completion of the due diligence investigation, the lending professionals create a detailed borrower profile summarizing the prospective borrower s historical financial statements, industry and management team and analyzing its conformity to our general investment criteria. The lending professionals then present this profile to the investment committee, which must unanimously approve each loan.

Prospective Portfolio Company Characteristics

We have identified certain characteristics that we believe are important to profitably lend to small and medium-sized businesses. The criteria listed below provide general guideposts for our lending and investment decisions, although not all of these criteria may be followed in each instance.

- *Growth.* In addition to generating sufficient cash flow to service its debt, a potential borrower generally will be required to establish its ability to grow its cash flow. Anticipated growth will be a key factor in determining the value ascribed to any equity position we acquire in connection with our loans.

- *Significant sponsor.* We seek businesses in which leveraged buyout funds or venture capital funds have invested. We believe that a business in which a substantial equity sponsor has made a meaningful investment is more likely to be a good borrowing candidate.

- *Liquidation value of assets.* Although we do not generally intend to operate as an asset-based lender, liquidation value of the assets collateralizing our loans is an important factor in each credit decision. Emphasis is placed both on tangible assets (e.g., inventory, plant, property and equipment) and intangible assets (e.g., accounts receivable, customer lists, networks, databases and recurring revenue streams).

- *Experienced management team.* We generally require that each borrower have a management team that is experienced and properly incentivized through a significant ownership interest in the borrower. We generally will require that a borrower have, at a minimum, a strong chief executive officer and chief financial officer who have demonstrated the ability to accomplish the borrower s objectives and implement its business plan.

- *Profitable or near-profitable operations.* We focus on borrowers that are profitable or near-profitable at the operating level. We do not typically lend to, or invest in, start-up or other early stage companies, nor do we typically lend to, or invest in, businesses that are experiencing significant operating problems.

- *Exit strategy.* Prior to making a loan for which we receive a warrant to purchase stock of the borrower or other yield enhancement, we analyze the potential for the borrower to experience a liquidity event that will allow us to realize value for our equity position. Liquidity events include, among other things, an initial public offering, a private sale of our financial interest, a merger or acquisition of the borrower or a purchase of our equity position by the borrower or one of its stockholders.

Extensive Due Diligence

Our Adviser conducts what we believe are extensive due diligence investigations of our prospective portfolio companies and investment opportunities. Our due diligence investigation may begin with a review of publicly available information, and will generally include some or all of the following:

- a review of the potential borrower s historical and projected financial information;

- interviews with management, employees, customers and vendors of the applicant;

- background checks; and

- research on the applicant s products, services or particular industry.

We also rely on the long-term relationships that our Adviser s professionals have with venture capitalists, leveraged buyout funds, investment bankers, commercial bankers and business brokers, and on the extensive direct experiences of our executive officers and managing directors in providing debt and equity capital to small and medium-sized private businesses. Prior to closing on our investments, additional due diligence may be conducted on our behalf by attorneys, accountants or other outside advisers as appropriate.

Investment Structure

We typically invest in senior, senior subordinated and junior subordinated loans. Our loans typically range from $5 million to $15 million, although the size of our investments may vary as our capital base changes. Our loans generally mature within seven years and accrue interest at a fixed or variable rate that exceeds the prime rate. In the past, some of our loans have had a provision that calls for some portion of the interest payments to be deferred and added to the principal balance so that the interest is paid, together with the principal, at maturity. This form of deferred interest is often called paid in kind, or PIK, interest, and, when earned, we record PIK income as interest income and add the PIK interest to the principal balance of the loans. At present, none of our loans contain a PIK provision.

To the extent possible, our loans generally are collateralized by a security interest in the borrower s assets. In senior and subordinated loans, we do not usually have the first claim on these assets. Interest payments on loans we make will generally be made monthly or quarterly (except to the extent of any PIK interest) with amortization of principal generally being deferred for several years. The principal amount of the loans and any accrued but unpaid interest will generally become due at maturity at five to seven years. We seek to make loans that are accompanied by warrants to purchase stock in the borrowers or other yield enhancement features, such as success fees. Any warrants that we receive will typically have an exercise price equal to the fair value of the portfolio company s common stock at the time of the loan and entitle us to purchase a modest percentage of the borrower s stock. Success fees are conditional interest that is paid if the borrower is successful. The success fee is calculated as additional interest on the loan and is paid upon the occurrence of certain triggering events, such as the sale of the borrower. If the event or events do not occur, no success fee will be paid.

From time to time, a portfolio company may request additional financing, providing us with additional lending opportunities. We will consider such requests for additional financing under the criteria we have established for initial investments and we anticipate that any debt securities we acquire in a follow-on financing will have characteristics comparable to those issued in the original financing. In some situations, our failure, inability or decision not to make a follow-on investment may be detrimental to the operations or survival of a portfolio company, and thus may jeopardize our investment in that borrower.

As noted above, we expect to receive yield enhancements in connection with many of our loans, which may include warrants to purchase stock. If a financing is successful, not only will our debt securities have been repaid with interest, but we will be in a position to realize a gain on the accompanying equity interests or other yield enhancements. The opportunity to realize such gain may occur if the borrower is sold to new owners or if it makes a public offering of its stock. In most cases, we will not have the right to require that a borrower undergo an initial public offering by registering securities under the Securities Act, but we generally will have the right to sell our equity interests in any subsequent public offering by the borrower. Even when we have the right to participate in a borrower s public offering, the underwriters might insist, particularly if we own a large amount of equity securities, that we retain all or a substantial portion of our shares for a specified period of time. Moreover, we may decide not to sell an equity position even when we have the right and the opportunity to do so. Thus, although we expect to dispose of an equity interest after a certain time, situations may arise in which we hold equity securities for a longer period.

Temporary Investments

Pending investment in the debt of private companies, we invest our otherwise uninvested cash primarily in cash, cash items, government securities or high-quality debt securities maturing in one year or less from the time of investment, to which we refer collectively as temporary investments, so that 70% of our assets are qualifying assets for purposes of the business development company provisions of the 1940 Act. For information regarding regulations to which we are subject and the definition of qualifying assets, see Regulation as a Business Development Company.

Hedging Strategies

Although it has not yet happened, nor do we expect this to happen in the near future, when one of our portfolio companies goes public, we may undertake hedging strategies with regard to any equity interests that we may have in that company. We may mitigate risks associated with the volatility of publicly traded securities by, for instance, selling securities short or writing or buying call or put options. Hedging against a decline in the value of such investments in public companies would not eliminate fluctuations in the values of such investments or prevent losses if the values of such investments decline, but would establish other investments designed to gain from those same developments. Therefore, by engaging in hedging transactions, we can moderate the decline in the value of our hedged investments in public companies. However, such hedging transactions would also limit our opportunity to gain from an increase in the value of our investment in the public company. Pursuant to our initial line of credit, we agreed to enter into hedging transactions, such as interest rate cap agreements. To date, we hold only one interest rate cap agreement. In the event that we securitize a portion of our loan portfolio in the future, we believe that we will likely be required to enter into similar arrangements with respect to the securitized loans. Hedging strategies do pose risks to us and our stockholders, however we believe that such activities, because they will be limited to only a portion of our portfolio, are manageable.

Section 12(a)(3) of the 1940 Act prohibits us from effecting a short sale of any security in contravention of such rules and regulations or orders as the SEC may prescribe as necessary or appropriate in the public interest or for the protection of investors . . . However, to date, the SEC has not promulgated regulations under this statute. It is possible that such regulations could be promulgated in the future in a way that would require us to change any hedging strategies that we may adopt. We will only engage in hedging activities in compliance with applicable law and regulations.

Extensive Loan Referral Network

Our executive officers and our Adviser s managing directors have an extensive referral network of venture capitalists, leveraged buyout funds, investment bankers, attorneys, commercial bankers and business and financial brokers. We believe that this established network, consisting of relationships established over many years by Messrs. Gladstone, Stelljes, and Brubaker and our Adviser s managing directors will generate opportunities to identify and make senior and subordinated loans to selected businesses that satisfy our investment criteria. We intend to continue to pursue additional informal relationships with other leveraged buyout funds and venture capital funds that we believe may lead to the origination of loans.

Flexible Transaction Structuring

We believe our management team s broad expertise and its ability to draw upon many years of combined experience enables our Adviser to identify, assess, and structure investments successfully across all levels of a company s capital structure and manage potential risk and return at all stages of the economic cycle. We are not subject to many of the regulatory limitations that govern traditional lending institutions such as banks. As a result, we expect to be flexible in selecting and structuring investments, adjusting investment criteria and transaction structures, and, in some cases, the types of securities in which we invest. We believe that this approach should enable our Adviser to identify attractive investment opportunities that will continue to generate current income and capital gain potential throughout the economic cycle, including during turbulent periods in the capital markets. One example of our flexibility is our ability to exchange our publicly-traded stock for the stock of an acquisition target in a tax-free reorganization under the Code. After completing an acquisition in such an exchange, we can restructure the capital of the small company to include senior and subordinated debt.

Leverage

For the purpose of making investments other than temporary investments and to take advantage of favorable interest rates, we intend to issue senior debt securities (including borrowings under our current lines of credit) up to the maximum amount permitted by the 1940 Act. The 1940 Act currently permits us to issue senior debt securities and preferred stock, to which we refer collectively as senior securities, in amounts such that our asset coverage, as defined in the 1940 Act, is at least 200% after each issuance of senior securities. We may also incur such indebtedness to repurchase our common stock. As a result of issuing senior securities, we are exposed to the risks of leverage. Although borrowing money for investments increases the potential for gain, it also increases the risk of a loss. A decrease in the value of our investments will have a greater impact on the value of our common stock to the extent that we have borrowed money to make investments. There is a possibility that the costs of borrowing could exceed the income we receive on the investments we make with such borrowed funds. In addition, our ability to pay dividends or incur additional indebtedness would be restricted if asset coverage is less than twice our indebtedness. If the value of our assets declines, we might be unable to satisfy that test. If this happens, we may be required to liquidate a portion of our loan portfolio and repay a portion of our indebtedness at a time when a sale may be disadvantageous. Furthermore, any amounts that we use to service our indebtedness will not be available for distributions to our stockholders. Our Board of Directors is authorized to provide for the issuance of preferred stock with such preferences, powers, rights and privileges as it deems appropriate, provided that such an issuance adheres to the requirements of the 1940 Act. See Regulation as a Business Development Company Asset Coverage for a discussion of our leveraging constraints.

Securitization

We have a wholly-owned subsidiary, Business Loan, which acquires and holds loans that we anticipate will be securitized in the future. Business Loan entered into a credit agreement with a group of institutional lenders that provides for a $170 million revolving credit facility. We use these proceeds to make additional loans and increase the size of our loan portfolio. We currently intend to securitize all or a portion of the loans held by Business Loan and, if we are able to securitize these loans, we will use the proceeds from the securitization to pay down any amounts outstanding under the revolving credit facility. On February 9, 2007, we increased our revolving credit facility by $20 million to $170 million.

Ongoing Relationships with and Monitoring of Portfolio Companies

Monitoring

Our Adviser s investment professionals monitor the financial trends of each portfolio company on an ongoing basis to determine if each is meeting its respective business plans and to assess the appropriate course of action for each company. We monitor this information regarding the status and performance of each portfolio company, and use it to evaluate the overall performance of our portfolio.

Our Adviser employs various methods of evaluating and monitoring the performance of our investments, which include some or all of the following:

- Assessment of success in the portfolio company s overall adherence to its business plan and compliance with covenants;
- Attendance at and participation in meetings of the portfolio company s board of directors;
- Periodic contact, including formal update interviews with portfolio company management, and, if appropriate, the financial or strategic sponsor;
- Comparison with other companies in the portfolio company s industry; and
- Review of monthly and quarterly financial statements and financial projections for portfolio companies.

Managerial Assistance and Services

The 1940 Act requires that a business development company make available managerial assistance to its portfolio companies by providing significant guidance and counsel concerning the management, operations, or business objectives and policies of the respective portfolio company. We provide these and other services to our portfolio companies through our Adviser. Currently, neither we nor our Adviser charges a fee for managerial assistance. Our Adviser receives fees for other services it provides to 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 closing of the investment. The services our Adviser provides to 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 loans, raising equity and debt capital, turnaround management, merger and acquisition services and recruiting new management personnel. When our Adviser receives fees for these services, all of those fees are credited to the base management fees we pay to our Adviser. 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 fees. While our Adviser receives all fees in connection with our investments, such fees received by our Adviser, with the exception of monitoring and review fees, are entirely credited to us as a reduction of the advisory fee payable under the advisory agreement between us.

Prior to making an investment, we ordinarily enter into a non-binding term sheet with the potential borrower. Upon execution of the non-binding term sheet, the potential borrower generally pays our Adviser a non-refundable fee for its services rendered through the date of the non-binding term sheet. These fees are received by our Adviser and are offset against the base management fee payable to our Adviser, which has the effect of reducing our expenses to the extent of any such fees received by our Adviser.

Valuation Process

The following is a general description of the steps we take each quarter to determine the value of our investment portfolio. All of our portfolio investments are recorded at fair value as determined in good faith by our Adviser and our management using procedures established by, and under the direction of our Board of Directors. As a result, there is uncertainty as to the value of our portfolio investments, and our estimates of fair value may differ significantly from the values that could obtained if a ready market for the securities existed. Investments for which market quotations are readily available are recorded in our financial statements at such market quotations. With respect to any investments for which market quotations are not readily available, we follow the following valuation process each quarter:

- Our quarterly valuation process begins with each portfolio company or investment being initially assessed by our Adviser s investment professionals responsible for the investment, using valuation policies and procedures previously established by our Board of Directors.

- For all debt securities other than those that we value using the latest bid and ask price, we will seek an independent opinion of value of such debt securities from SPSE.

- Preliminary valuation conclusions are then discussed with our management, and documented, along with any SPSE opinions of value, for review by our Board of Directors.

- Our Board of Directors reviews this documentation and discusses the input of our Adviser, management, and the opinions of value of SPSE to arrive at a determination for the aggregate fair value of our portfolio of investments.

Our valuation policies, procedures and processes are more fully described under Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies Investment Valuation.

Investment Advisory and Administration Agreements

Since October 1, 2004, we have been externally managed pursuant to a contractual investment advisory arrangement with our Adviser, under which our Adviser has directly employed all of our personnel and paid its payroll, benefits, and general expenses directly. Our initial investment advisory agreement with our Adviser, which we refer to as the Initial Advisory Agreement, was in place from October 1, 2004 through September 30, 2006. On October 1, 2006, we entered into an amended and restated investment advisory agreement with our Adviser, which we refer to as the Amended Advisory Agreement, and an administration agreement with our Administrator, which we refer to as the Administration Agreement. Our Board of Directors proposed the Amended Advisory Agreement to stockholders in order to provide what it considers to be more appropriate incentives to reward fund management, and our stockholders approved each of these agreements on December 2, 2005. The management services and fees in effect under the Initial and Amended Advisory Agreements are described below. In addition to the fees described below, certain fees received by our Adviser from our portfolio companies were credited against the investment advisory fee under the Initial Advisory Agreement, and will continue to be paid to our Adviser and credited under the Amended Advisory Agreement. In addition, we continue to pay our direct expenses including, but not limited to, directors fees, legal and accounting fees, and stockholder related expenses under the Amended Advisory Agreement.

Management services and fees in effect through September 30, 2006

Pursuant to the Initial Advisory Agreement, we paid our Adviser an annual advisory fee of 1.25% of our total assets (as reduced by cash and cash equivalents pledged to creditors), payable in quarterly increments of 0.3125%, and an annual administrative fee of 0.75% of our total assets (as reduced by cash and cash equivalents pledged to creditors), payable in quarterly increments of 0.1875%. Our Adviser s board of directors agreed to waive, for the quarters ending June 30, 2006 and September 30, 2006, the annual advisory fee of 1.25% to 0.5% for those senior syndicated loans in which we had existing syndicated second lien participations.

Management services and fees under the amended and restated investment advisory agreement and administrative fees under the administrative agreement

Effective October 1, 2006, we now pay our Adviser an annual base management fee of 2% of our average gross assets, which is defined as total assets less cash and cash equivalents pledged to creditors calculated as of the end of the two most recently completed fiscal quarters, in addition to a two-part incentive fee. The first part of the incentive fee is an income-based incentive fee which rewards our Adviser if our quarterly net investment income (before giving effect to any incentive fee) exceeds 1.75% of our net assets (the hurdle rate). We will pay our Adviser an income incentive fee with respect to our pre-incentive fee net investment income in each calendar quarter as follows:

- no incentive fee in any calendar quarter in which our pre-incentive fee net investment income does not exceed the hurdle rate (7% annualized);

- 100% of our pre-incentive fee net investment income with respect to that portion of such pre-incentive fee net investment income, if any, that exceeds the hurdle rate but is less than 2.1875% in any calendar quarter (8.75% annualized); and

- 20% of the amount of our pre-incentive fee net investment income, if any, that exceeds 2.1875% in any calendar quarter (8.75% annualized).

Quarterly Incentive Fee Based on Net Investment Income

Pre-incentive fee net investment income
(expressed as a percentage of the value of net assets)

Percentage of pre-incentive fee net investment income
allocated to income-related portion of incentive fee

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The second part of the incentive fee is a capital gains incentive fee that will be determined and payable in arrears as of the end of each fiscal year (or upon termination of the Amended Advisory Agreement, as of the termination date), commencing on October 1, 2006, and will equal 20% of our realized capital gains as of the end of the fiscal year. In determining the capital gains incentive fee payable to our Adviser, we will calculate the cumulative aggregate realized capital gains and cumulative aggregate realized capital losses since our inception, and the aggregate unrealized capital depreciation as of the date of the calculation, as applicable, with respect to each of the investments in our portfolio.

Our Adviser s board of directors agreed to waive, for the fiscal quarters ending December 31, 2006 and March 31, 2007, the annual 2.0% base management fee to 0.5% for senior syndicated loan participations.

Under the Amended Advisory Agreement, we will pay separately for administrative services under the Administration Agreement. The Administration Agreement provides for payments equal to our allocable portion of our Administrator s overhead expenses in performing its obligations under the Administration Agreement, including but not limited to rent, and our allocable portion of the salaries and benefits expenses of our chief financial officer, chief compliance officer and controller and their respective staffs.

The same individuals who managed our portfolio continue to manage our portfolio under the Amended Advisory Agreement and, although the administrative services are now provided separately pursuant to the Administration Agreement, we do not expect that our stockholders will notice any change or diminution in services because of this organizational separation.

Regulations promulgated by the SEC prohibit business development companies from implementing an incentive advisory fee while having in place a stock option plan or any outstanding stock options. In connection with the approval of the Amended Advisory Agreement, and pursuant to an offer approved by our Board of Directors on April 11, 2006, we extended an offer to the then-current stock option holders to amend the terms of all outstanding stock options under our Amended and Restated 2001 Equity Incentive Plan, which we refer to as the 2001 Plan, to accelerate the contractual expiration date of these options to September 30, 2006. The offer was filed with the SEC on April 12, 2006, was conducted in accordance with the federal tender offer rules and regulations, and was conditioned upon the acceptance by 100% of the current stock option holders. Our Board of Directors also accelerated in full the vesting of all outstanding options other than options held by the non-employee directors effective April 11, 2006, resulting in accelerated vesting of 34,500 outstanding options. On May 31, 2006, 100% of the current stock option holders accepted the tender offer, and on September 30, 2006, all outstanding stock options and the 2001 Plan were terminated. Upon the effectiveness of the Amended Advisory Agreement and Administration Agreement on October 1, 2006, the Initial Advisory Agreement terminated.

License Agreement

We have entered into a license agreement with our Adviser, pursuant to which our Adviser has granted us a non-exclusive license to use the name Gladstone and the Diamond G trademark. This license agreement requires us to pay our Adviser a royalty fee of $1 per quarter. The amount of the fee is negotiable on an annual basis by our compensation committee and approved by a majority of our independent directors. The license arrangement will terminate in the event that our Adviser is no longer our adviser.

Code of Ethics

We and our Adviser have each adopted a Code of Ethics and Business Conduct applicable to our officers, directors and all employees of our Adviser and our Administrator that comply with the guidelines set forth in Item 406 of Regulation S-K of the Securities Act. As required by the 1940 Act, this code establishes procedures for personal investments, restricts certain transactions by our personnel and requires the reporting of certain transactions and holdings by our personnel. A copy of this code is available for review, free of charge, at our website at www.gladstonecapital.com. We intend to provide disclosure of any amendments to or waivers of the provisions of this code by posting information regarding any such amendment or waiver to our website within four days of its effectiveness.

Compliance Policies and Procedures

We and our Adviser have adopted and implemented written policies and procedures reasonably designed to prevent violation of the federal securities laws, and our Board of Directors is required to review these compliance policies and procedures annually to assess their adequacy and the effectiveness of their implementation.

Competition

A large number of entities compete with us and make the types of investments that we seek to make in small and medium-sized privately-owned businesses. Such competitors include private equity funds, leveraged buyout funds, venture capital funds, investment banks and other equity and non-equity based investment funds, and other financing sources, including traditional financial services companies such as commercial banks. Many of our competitors are substantially larger than we are and have considerably greater funding sources that are not available to us. In addition, certain of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments, establish more relationships and build their market shares. Furthermore, many of these competitors are not subject to the regulatory restrictions that the 1940 Act imposes on us as a business development company. There is no assurance that the competitive pressures we face will not have a material adverse effect on our business, financial condition and results of operations. In addition, because of this competition, we may not be able to take advantage of attractive investment opportunities from time to time and there can be no assurance that we will be able to identify and make investments that satisfy our investment objectives or that we will be able to meet our investment goals. Recently we have seen an increase in our competition such that terms and rates for proposed loans have been reduced. However, we believe that our extensive loan referral network and flexible transaction structuring enable us to compete effectively for opportunities in the current market environment.

Staffing

We do not currently have any employees and do not expect to have any employees in the foreseeable future. Currently, services necessary for our business are provided by individuals who are employees of our Adviser and our Administrator pursuant to the terms of the Amended Advisory Agreement and the Administration Agreement, respectively. Each of our executive officers is an employee or officer, or both, of our Adviser and our Administrator. No employee of our Adviser or our Administrator will dedicate all of his or her time to us. However, we expect that 20-25 full time employees of our Adviser or our Administrator will spend substantial time on our matters during the remainder of calendar year 2007. We anticipate that the number of employees of our Adviser who devote time to our matters will increase as we acquire more investments. Effective October 1, 2006, with our entrance into the Amended Advisory and Administration Agreements, as approved by our stockholders on December 2, 2005, accounting and compliance services are provided by the same individuals who currently provide these services to us, however these individuals now provide these services to us through our Administrator pursuant to the Administration Agreement. All other services will continue to be performed by the same individuals under the Amended Advisory Agreement.

As of April 30, 2007, our Adviser and our Administrator had 52 full-time employees. A breakdown of these full-time employees is summarized by functional area in the table below:

Number of Individuals	Functional Area
6	Executive Management
36	Investment Management, Portfolio Management, and Due Diligence
10	Administration, Accounting, Compliance and Human Resources

Properties

We do not own any real estate or other physical properties materially important to our operation. Our Adviser is the current leaseholder of all properties in which we operate. We occupy these premises pursuant to our investment advisory and management agreement with our Adviser. Our headquarters are located at our Adviser s headquarters in McLean, Virginia, a suburb of Washington D.C., and we also have operations at our Adviser s seven other offices in New York, New Jersey, Pennsylvania, Illinois, Texas, Kentucky and Washington.

Legal Proceedings

We are not currently subject to any material legal proceedings, nor, to our knowledge, is any material legal proceeding threatened against us.

PORTFOLIO COMPANIES

The following table sets forth certain information as of March 31, 2007, regarding each portfolio company in which we had a debt or equity security as of such date. All such investments have been made in accordance with our investment policies and procedures described in this prospectus.

Company (1)	Industry	Investment(2)	Cost	Fair Value
ActivStyle Acquisition Co.	Service-medical products	Line of Credit(5)(9)	$ 450,000	$ 448,875
ActivStyle, Inc.	distribution	(9.6%, Due 7/2009)		
3100 Pacific Street North		Senior Term Debt(5)	3,040,000	3,040,000
Minneapolis, MN 55411				
		(9.6%, Due 7/2011)		
		Senior Term Debt(3)(5)	2,500,000	2,500,000
		(11.9%, Due 7/2011)		
Advanced Homecare	Service-home health nursing	Senior Subordinated Term Debt(5)(6)	6,300,000	6,300,000
Management, Inc.	services	(11.8%, Due 12/2013)		
7502 Greenville Ave., Suite				
100 Dallas, TX 75231				
Allied Extruders, LLC	Manufacturing-polyethylene	Senior Real Estate Term Debt	1,000,000	1,000,000
P&O Packaging Acquisition LLC	film	(9.8%, Due 3/2011)		
36-08 Review Avenue Long		Senior Term Debt (3)(5)(19)	8,000,000	8,170,800
Island City, NY 11101		(11.3%, Due 3/2011)		
Anitox Acquisition Company	Manufacturing-preservatives	Senior Real Estate Term Debt	3,415,828	3,360,000
Anitox Holding, Inc.	for animal feed	(8.8%, Due 1/2012)		
Anitox Corporation		Senior Term Debt(5)	2,750,000	2,750,000
1055 Progress Circle		(9.6%, Due 1/2012)		
Lawrenceville, GA 30043		Senior Term Debt(3)(5)	2,750,000	2,750,000
		(11.8%, Due 1/2012)		
Badanco Acquisition Corp.	Service-luggage design and	Senior Subordinated Term Debt(5)	9,750,000	9,762,188
994 Riverview Drive	distribution	(12.1%, Due 7/2012)		
Totowa, NJ 07512				
Benetech, Inc.	Service & Manufacuring-dust	Senior Term Debt(5)	1,787,500	1,816,547
1851 Albright Rd.	management systems for the	(10.3%, Due 5/2009)		
Montgomery, IL 60538	coal and electric utility	Senior Term Debt(3)(5)	2,965,625	3,028,645
	industries	(13.3%, Due 5/2009)		
Bresnan Communications, LLC	Service-telecommunications	Senior Term Debt(6)	1,001,958	1,000,000
One Manhattanville Rd.		(7.1%, Due 9/2013)		
Purchase, NY 10577-2596		Senior Subordinated Term Debt(6)	1,510,780	1,530,000
		(9.9%, Due 3/2014)		
CHG Companies, Inc.	Service-healthcare staffing	Letter of Credit(5)(6)	400,000	404,500
CHG Medical Staffing, Inc.		(7.9%, Due 12/2012)		
CHG Healthcare East, Services, Inc.		Senior Term Debt(5)(6)	1,596,000	1,613,955
4021 South 700 Suite 300		(7.9%, Due 12/2012)		
Salt Lake City, UT 84107		Senior Subordinated Term Debt(5)(6)	500,000	507,500
		(11.3%, Due 12/2012)		
Clinton Holdings, LLC	Distribution-aluminum sheets	Senior Subordinated Term Debt(5)	15,500,000	15,538,750
Clinton Aluminum Acquisition, LLC	and stainless steel	(12.6%, Due 1/2013)		
Metal Transportation, LLC		Common Stock Warrants(7)	109,124	109,124
Clinton Distribution Center, LLC				
Clinton Aluminum				
6270 Van Buren Road				
Clinton, OH 44216				
Consolidated Bedding, Inc.	Manufacturing-mattresses	Senior Subordinated Term Debt(5)	2,340,538	1,858,050
500 S. Falkenburg Road		(14.4%, Due 3/2009)		
Tampa, FL 33619				

Country Road Communications LLC Country Road Management, Inc. 1500 Mt. Kemble Avenue, Suite 203 Morristown, NJ 07960	Service-telecommunications	Senior Subordinated Term Debt (5)(6) (13.2%, Due 7/2013)	5,964,420	6,030,000
Critical Healthcare Solutions, Inc. Two Tower Building One Fayette Street Suite 150 Conshohocken, PA 19428	Service-home therapy and respiratory therapy	Senior Term Debt(8) (8.6%, Due 1/2012)	1,987,500	1,986,258
Dealer Computer Services, Inc. (d/b/a Reynolds & Reynolds) The Reynolds and Reynolds Company One Reynolds Way Dayton, OH 45430	Manufacturing & Service Systems for automotive retailers	Senior Term Debt(8) (7.4%, Due 10/2012)	947,240	954,936
Defiance Acquisition Corporation 1090 Perry Street Defiance, OH 43512	Manufacturing-trucking parts	Senior Term Debt(3)(5) (13.3%, Due 4/2010)	6,325,000	6,317,094
Doe & Ingalls Management LLC Doe & Ingalls of North Carolina Operating LLC Doe & Ingalls of Florida Operating LLC Doe & Ingalls of Virginia Operating LLC Doe & Ingalls of Maryland Operating LLC 1301 Person Street Durham, NC 27703	Distributor-specialty chemicals	Senior Term Debt(5) (9.8%, Due 11/2010)	4,300,000	4,310,750
		Senior Term Debt(3)(5) (13.3%, Due 11/2010)	4,477,500	4,483,097
Emdeon Business Services, Inc. 26 Century Blvd. Nashville, TN 37214	Service-healthcare technology solutions	Senior Term Debt(6) (7.6%, Due 11/2013)	2,479,803	2,486,483
		Senior Subordinated Term Debt(6) (10.4%, Due 5/2014)	2,013,952	2,030,000
Employment Solutions Management, Inc. Employbridge 1040 Crown Pointe Parkway Suite 1040 Atlanta, GA 30338	Service-specialty staffing	Senior Term Debt(8) (8.3%, Due 10/2012)	2,992,989	2,996,241
		Senior Subordinated Term Debt(8) (12.3%, Due 10/2013)	3,000,495	3,000,000
Express Courier International, Inc. P.O. Box 290279 Nashville, TN 37229-0279	Service-ground delivery and logistics	Line of Credit(10) (9.6%, Due 6/2009)	200,000	200,000
		Senior Term Debt(5) (9.6%, Due 6/2011)	4,465,000	4,470,581
		Senior Term Debt(3)(5) (11.8%, Due 6/2011)	3,950,000	3,954,938
Finn Corporation 9281 Lesaint Drive Fairfield, OH 45014	Manufacturing-landscape equipment	Common Stock Warrants	37,000	826,061
FR X Ohmstede Holdings, LLC FR X Ohmstede Acquisitions Co. Ohmstede Ltd. 895 North Main Street P.O. Box 2431 Beaumont, TX 77701	Service & Manufacuring-heat exchangers	Senior Term Debt(6) (7.9%, Due 8/2013)	2,739,130	2,749,402
		Senior Subordinated Term Debt(6) (12.4%, Due 8/2014)	3,011,583	3,052,500

Generac Acquisition Corp. Hwy. 59 & Hillside Road P.O. Box 8 Waukesha, WI 53187	Manufacturing-standby power products	Senior Term Debt(8) (7.9%, Due 11/2013)	2,356,200	2,375,344
Global Materials Technologies, Inc. 1540 E. Dundee Road Palatine, IL 60067	Manufacturing-steel wool products and metal fibers	Senior Term Debt(3)(5) (14.3%, Due 11/2009)	5,200,000	5,018,000
GTM Holdings, Inc. Gold Toe Investment Corp.	Manufacturing-socks	Senior Term Debt(6)	498,750	501,244