GLADSTONE CAPITAL CORP
Form 10-Q
February 01, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTER ENDED DECEMBER 31, 2009

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

COMMISSION FILE NUMBER: 814-00237

GLADSTONE CAPITAL CORPORATION

(Exact name of registrant as specified in its charter)

MARYLAND	**54-2040781**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1521 WESTBRANCH DRIVE, SUITE 200

MCLEAN, VIRGINIA 22102

(Address of principal executive office)

(703) 287-5800

(Registrant s telephone number, including area code)

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

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

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

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

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. The number of shares of the issuer s Common Stock, $0.001 par value, outstanding as of February 1, 2010 was 21,087,574.

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GLADSTONE CAPITAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES

(DOLLAR AMOUNTS IN THOUSANDS, EXCEPT PER SHARE DATA)

(UNAUDITED)

	December 31, 2009	September 30, 2009
ASSETS		
Non-Control/Non-Affiliate investments (Cost 12/31/09: $293,830; 9/30/09: $312,043)	$ 272,380	$ 286,997
Control investments (Cost 12/31/09: $53,634; 9/30/09: $52,350)	34,258	33,972
Total investments at fair value (Cost 12/31/09: $347,464; 9/30/09: $364,393)	306,638	320,969
Cash	6,374	5,276
Interest receivable investments in debt securities	3,159	3,048
Interest receivable employees (Refer to Note 4)	113	85
Due from custodian	9,770	3,059
Due from Adviser (Refer to Note 4)		69
Deferred financing fees	640	1,230
Prepaid assets	381	341
Receivable from portfolio companies, less allowance for uncollectible receivables of $32 and $0 at December 31, 2009 and September 30, 2009, respectively	611	1,528
Other assets	828	305
TOTAL ASSETS	$ 328,514	$ 335,910
LIABILITIES		
Accounts payable	$	$ 67
Interest payable	339	378
Fee due to Administrator (Refer to Note 4)	178	216
Due to Adviser (Refer to Note 4)	1,285	834
Borrowings under line of credit at fair value (Cost 12/31/09: $73,400; 9/30/09: $83,000)	73,531	83,350
Accrued expenses and deferred liabilities	1,688	1,800
Funds held in escrow	44	189
TOTAL LIABILITIES	77,065	86,834
NET ASSETS	$ 251,449	$ 249,076
ANALYSIS OF NET ASSETS		
Common stock, $0.001 par value, 50,000,000 shares authorized and 21,087,574 shares issued and outstanding at December 31, 2009 and September 30, 2009	$ 21	$ 21
Capital in excess of par value	328,164	328,203
Notes receivable employees (Refer to Note 4)	(8,504)	(9,019)
Net unrealized depreciation on investments	(40,826)	(43,425)
Net unrealized appreciation on borrowings under line of credit	(131)	(350)
Accumulated Net Realized Losses	(27,275)	(26,354)
TOTAL NET ASSETS	$ 251,449	$ 249,076
NET ASSETS PER SHARE	$ 11.92	$ 11.81

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

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GLADSTONE CAPITAL CORPORATION

CONDENSED CONSOLIDATED SCHEDULE OF INVESTMENTS

AS OF DECEMBER 31, 2009

(DOLLAR AMOUNTS IN THOUSANDS)

(UNAUDITED)

Company (1)	Industry	Investment (2)	Cost	Fair Value
NON-CONTROL/NON-AFFILIATE INVESTMENTS				
Non-syndicated Loans:				
Access Television Network, Inc.	Service-cable airtime (infomercials)	Senior Term Debt (14.5%, Due 12/2009) (5) (11)	$ 963	$ 770
ACE Expediters, Inc	Service-over-the-ground logistics	Senior Term Debt (13.5%, Due 9/2014) (5) (12)	5,157	5,015
		Common Stock Warrants (8)	200	447
ActivStyle Acquisition Co.	Service-medical products distribution	Senior Term Debt (13.0%, Due 4/2014) (3) (9)	4,000	4,021
Allison Publications, LLC	Service-publisher of consumer oriented magazines	Senior Term Debt (10.0%, Due 9/2012) (5)	9,554	8,848
		Senior Term Debt (13.0%, Due 12/2010) (5)	260	254
Anitox Acquisition Company	Manufacturing-preservatives for animal feed	Line of Credit, $3,000 available (4.5%, Due 1/2011) (5)	1,500	1,498
		Senior Term Debt (8.5%, Due 1/2012) (5)	2,877	2,855
		Senior Term Debt (10.5%, Due 1/2012) (3) (5)	3,688	3,623
BAS Broadcasting	Service-radio station operator	Senior Term Debt (11.5%, Due 7/2013) (5)	7,435	6,691
CCS, LLC	Service-cable TV franchise owner	Senior Term Debt (non-accrual, Due 8/2008) (5) (10) (11)	631	319
Chinese Yellow Pages Company	Service-publisher of Chinese language directories	Line of Credit, $700 available (7.3%, Due 9/2010) (5)	450	429
		Senior Term Debt (7.3%, Due 9/2010) (5)	486	462
CMI Acquisition, LLC	Service-recycling	Senior Subordinated Term Debt (10.3%, Due 11/2012) (5)	6,236	5,987
	Distributor-specialty chemicals		2,100	2,074

Doe & Ingalls Management LLC		Senior Term Debt (6.8%, Due 11/2010) (5) Senior Term Debt (7.8%, Due 11/2010) (3) (5)	4,354	4,299
Finn Corporation	Manufacturing-landscape equipment	Common Stock Warrants (8)	37	1,005
GFRC Holdings LLC	Manufacturing-glass-fiber reinforced concrete	Line of Credit, $2,000 available (4.5%, Due 12/2010)		
		Senior Term Debt (9.0%, Due 12/2012) (5)	6,599	6,508
		Senior Subordinated Term Debt (11.5%, Due 12/2012) (3) (5)	6,666	6,507
Global Materials Technologies, Inc.	Manufacturing-steel wool products and metal fibers	Senior Term Debt (13.0%, Due 6/2010) (3) (5)	4,360	3,270
Heartland Communications Group	Service-radio station operator	Senior Term Debt (10.0%, Due 5/2011) (5)	4,563	2,499
Interfilm Holdings, Inc.	Service-slitter and distributor of plastic films	Senior Term Debt (12.3%, Due 10/2012) (5)	4,937	4,752
International Junior Golf Training Acquisition Company	Service-golf training	Line of Credit, $1,500 available (9.0%, Due 5/2010) (5)	700	693
		Senior Term Debt (8.5%, Due 5/2012) (5)	1,987	1,938
		Senior Term Debt (10.5%, Due 5/2012) (3) (5)	2,500	2,406
KMBQ Corporation	Service-AM/FM radio broadcaster	Line of Credit, $200 available (11.0%, Due 3/2010) (5)	153	38
		Senior Term Debt (11.0%, Due 3/2010) (5)	1,783	445
Legend Communications of Wyoming LLC	Service-operator of radio stations	Line of Credit, $500 available (12.0%, Due 6/2011) (5)	497	423
		Senior Term Debt (12.0%, Due 6/2013) (5)	9,373	7,967
Newhall Holdings, Inc.	Service-distributor of personal care products and supplements	Line of Credit, $3,000 available (11.3%, Due 5/2010) (5)	1,000	930
		Senior Term Debt (5) (11.3%, Due 5/2012) (5)	3,870	3,599
		Senior Term Debt (14.3%, Due 5/2012) (3) (5)	4,410	4,057
Northern Contours, Inc.	Manufacturing-veneer and laminate components	Senior Subordinated Term Debt (10.0%, Due 5/2010) (5)	6,475	5,439

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Company (1)	Industry	Investment (2)	Cost	Fair Value
Northstar Broadband, LLC	Service-cable TV franchise owner	Senior Term Debt (0.7%, Due 12/2012) (5)	$ 156	$ 128
Pinnacle Treatment Centers, Inc.	Service-Addiction treatment centers	Senior Term Debt (10.5%, Due 12/2011) (5)	2,550	2,509
		Senior Term Debt (10.5%, Due 12/2011) (3) (5)	7,500	7,237
Precision Acquisition Group Holdings, Inc.	Manufacturing-consumable components for the aluminum industry	Equipment Note (8.5%, Due 10/2011) (5)	1,000	973
		Senior Term Debt (8.5%, Due 10/2010) (5)	4,125	4,012
		Senior Term Debt (11.5%, Due 10/2010) (3) (5)	4,053	3,941
PROFITSystems Acquisition Co.	Service-design and develop ERP software	Line of Credit, $350 available (4.5%, Due 7/2010)		
		Senior Term Debt (8.5%, Due 7/2011) (5)	1,450	1,339
		Senior Term Debt (10.5%, Due 7/2011) (3) (5)	2,900	2,650
RCS Management Holding Co.	Service-healthcare supplies	Senior Term Debt (8.5%, Due 1/2011) (3) (5)	2,312	2,289
		Senior Term Debt (10.5%, Due 1/2011) (4) (5)	3,060	3,014
Reliable Biopharmaceutical Holdings, Inc.	Manufacturing-pharmaceutical and biochemical intermediates	Line of Credit, $5,000 available (9.0%, Due 10/2010) (5)	700	695
		Mortgage Note (9.5%, Due 10/2014) (5)	7,315	7,279
		Senior Term Debt (9.0%, Due 10/2012) (5)	1,418	1,407
		Senior Term Debt (11.0%, Due 10/2012) (3) (5)	11,783	11,577
		Senior Subordinated Term Debt (12.0%, Due 10/2013) (5)	6,000	5,790
		Common Stock Warrants (8)	209	
Saunders & Associates	Manufacturing-equipment provider for frequency control devices	Senior Term Debt (9.8%, Due 5/2013) (5)	10,780	10,686
SCI Cable, Inc.	Service-cable, internet, voice provider	Senior Term Debt (non-accrual, Due 10/2008) (5) (10) (11)	2,945	442
Sunburst Media - Louisiana, LLC	Service-radio station operator	Senior Term Debt (10.5%, Due 6/2011) (5)	6,406	5,913
Sunshine Media Holdings	Service-publisher regional B2B trade magazines	Senior Term Debt (11.0%, Due 5/2012) (5)	16,948	16,143
		Senior Term Debt (13.5%, Due 5/2012) (3) (5)	10,700	10,085

Thibaut Acquisition Co.	Service-design and disbribute wall covering	Line of Credit, $1,000 available (9.0%, Due 1/2011) (5)	1,000	944
		Senior Term Debt (8.5%, Due 1/2011) (5)	1,488	1,404
		Senior Term Debt (12.0%, Due 1/2011) (3) (5)	3,000	2,786
VantaCore	Service-acquisition of aggregate quarries	Senior Subordinated Term Debt (12.0%, Due 8/2013) (5)	13,658	13,590
Viapack, Inc.	Manufacturing-polyethylene film	Senior Real Estate Term Debt (10.0%, Due 3/2011) (5)	725	711
		Senior Term Debt (13.0%, Due 3/2011) (3) (5)	4,058	3,977
Visual Edge Technology, Inc.	Service-office equipment distribution	Line of credit, $3,000 available (10.8%, Due 9/2011) (5)	2,915	2,302
		Senior Subordinated Term Debt (15.5%, Due 8/2011) (5)	5,000	3,950
Westlake Hardware, Inc.	Retail-hardware and variety	Senior Subordinated Term Debt (9.0%, Due 1/2011) (5)	15,000	14,588
		Senior Subordinated Term Debt (10.3%, Due 1/2011) (5)	10,000	9,625
Winchester Electronics	Manufacturing-high bandwidth connectors and cables	Senior Term Debt (5.3%, Due 5/2013) (5)	1,250	1,241
		Senior Term Debt (5.7%, Due 5/2013) (5)	1,690	1,648
		Senior Subordinated Term Debt (14.0%, Due 6/2013) (5)	9,925	9,528
Subtotal - Non-syndicated loans			283,820	264,471

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Company (1)	Industry	Investment (2)	Cost	Fair Value
Syndicated Loans:				
GTM Holdings, Inc.	Manufacturing-socks	Senior Subordinated Term Debt (11.8%, Due 4/2014) (13)	$ 500	$ 337
Puerto Rico Cable Acquisition Company, Inc.	Service-telecommunications	Senior Subordinated Term Debt (7.8%, Due 1/2012) (6)	7,170	5,998
WP Evenflo Group Holdings Inc.	Manufacturing-infant and juvenile products	Senior Term Debt (8.0%, Due 2/2013) (6)	1,896	1,574
		Senior Preferred Equity (8)	333	
		Junior Preferred Equity (8)	111	
		Common Stock (8)		
Subtotal - Syndicated loans			10,010	7,909
Total Non-Control/Non-Affiliate Investments			**$ 293,830**	**$ 272,380**
CONTROL INVESTMENTS				
BERTL, Inc.	Service-web-based evaluator of digital imaging products	Line of Credit, $842 available (non-accrual, Due 10/2010) (7)(10)(13)	$ 930	$
		Common Stock (7) (8)	423	
Clinton Holdings, LLC	Distribution-aluminum sheets and stainless steel	Senior Subordinated Term Debt (12.0%, Due 1/2013) (5)	17,140	13,712
		Common Stock Warrants (7) (8)	109	
Defiance Integrated Technologies, Inc.	Manufacturing-trucking parts	Senior Term Debt (11.0%, Due 4/2013) (3) (5)	7,354	7,355
		Common Stock (7) (8)	1	
		Guaranty ($250)		
Lindmark Acquisition, LLC	Service-advertising	Senior Subordinated Term Debt (11.3%, Due 10/2012) (7)	12,000	10,500
		Senior Subordinated Term Debt (13.0%, Due Upon Demand) (7)	1,553	1,058
		Common Stock (7) (8)	1	
LYP Holdings Corp.	Service-yellow pages publishing	Line of credit, $1,850 available (10.0%, Due 12/2010) (7)	1,248	1,248
		Senior Term Debt (12.5%, Due 2/2012) (7)	325	222
		Line of Credit, $3,000 available (non-accrual, Due 6/2010) (7) (10)	1,170	
		Senior Term Debt (non-accrual, Due 6/2011) (7) (10)	2,688	
		Senior Term Debt (non-accrual, Due 6/2011) (3) (7) (10)	2,750	
		Common Stock Warrants (7) (8)		
			169	163

U.S. Healthcare Communications, Inc.	Service-magazine publisher/operator	Line of credit, $400 available (non-accrual, Due 12/2010) (7) (10)				
		Line of credit, $450 available (non-accrual, Due 12/2010) (7) (10)		450		
		Common Stock (7) (8)		2,470		
Western Directories, Inc.	Service-directory publisher	Line of credit, $1,280 available (non-accrual, Due 12/2009) (7) (10)		1,268		
		Preferred Stock (7) (8)		1,584		
		Common Stock (7) (8)		1		
Total Control Investments			**$**	**53,634**	**$**	**34,258**
Total Investments			**$**	**347,464**	**$**	**306,638**

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(1) Certain of the listed securities are issued by affiliate(s) of the indicated portfolio company.
(2) Percentage represents interest rates in effect at December 31, 2009 and due date represents the contractual maturity date.
(3) Last Out Tranche of senior debt, meaning if the portfolio company is liquidated, the holder of the Last Out Tranche is paid after the senior debt.
(4) Last Out Tranche of senior debt, meaning if the portfolio company is liquidated, the holder of the Last Out Tranche is paid after the senior debt, however, the debt is also junior to another Last Out Tranche.
(5) Fair value was based on opinions of value submitted by Standard & Poor s Securities Evaluations, Inc.
(6) Security valued based on the indicative bid price on or near December 31, 2009, offered by the respective syndication agent s trading desk or secondary desk.
(7) Fair value was based on the total enterprise value of the portfolio company using a liquidity waterfall approach. The Company also considered discounted cash flow methodologies.
(8) Security is non-income producing.
(9) ActivStyle s fair value was based on the full repayment subsequent to December 31, 2009 and includes a success fee with a fair value of $21 (see Note 10).
(10) BERTL, CCS, SCI Cable, U.S. Healthcare, Western Directories and a portion of LYP Holdings are currently past due on interest payments and are on non-accrual.
(11) Access TV s loan matured in December 2009, CCS loan matured in August 2008 and SCI Cable s loan matured in October 2008. The Company is actively working to recover amounts due under these loans, however, there is no assurance that there will be any recovery of amounts past due.
(12) ACE Expediters interest and BERTL s interest include paid in kind (PIK) interest. Please refer to Note 2 Summary of Significant Accounting Policies.
(13) Security valued based on the transaction sale price subsequent to December 31, 2009 (see Note 10).

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

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GLADSTONE CAPITAL CORPORATION

CONSOLIDATED SCHEDULE OF INVESTMENTS

AS OF SEPTEMBER 30, 2009

(DOLLAR AMOUNTS IN THOUSANDS)

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

Doe & Ingalls Management LLC		Senior Term Debt (6.8%, Due 11/2010) (5)		
		Senior Term Debt (7.8%, Due 11/2010) (3) (5)	4,365	4,267
Finn Corporation	Manufacturing-landscape equipment	Common Stock Warrants (8)	37	1,223
GFRC Holdings LLC	Manufacturing-glass-fiber reinforced concrete	Line of Credit, $2,000 available (4.5%, Due 12/2010)		
		Senior Term Debt (9.0%, Due 12/2012) (5)	6,599	6,450
		Senior Subordinated Term Debt (11.5%, Due 12/2012) (3) (5)	6,665	6,432
Global Materials Technologies, Inc.	Manufacturing-steel wool products and metal fibers	Senior Term Debt (13.0%, Due 6/2010) (3) (5)	4,410	3,528
Heartland Communications Group	Service-radio station operator	Senior Term Debt (10.0%, Due 5/2011) (5)	4,567	2,726
Interfilm Holdings, Inc.	Service-slitter and distributor of plastic films	Senior Term Debt (12.3%, Due 10/2012) (5)	4,950	4,715
International Junior Golf Training Acquisition Company	Service-golf training	Line of Credit, $1,500 available (9.0%, Due 5/2010) (5)	700	690
		Senior Term Debt (8.5%, Due 5/2012) (5)	2,120	2,036
		Senior Term Debt (10.5%, Due 5/2012) (3) (5)	2,500	2,366
KMBQ Corporation	Service-AM/FM radio broadcaster	Line of Credit, $200 available (11.0%, Due 3/2010) (5)	153	69
		Senior Term Debt (11.0%, Due 3/2010) (5)	1,785	801
Legend Communications of Wyoming LLC	Service-operator of radio stations	Line of Credit, $500 available (12.0%, Due 6/2011) (5)	497	450
		Senior Term Debt (12.0%, Due 6/2013) (5)	9,373	8,482
Newhall Holdings, Inc.	Service-distributor of personal care products and supplements	Line of Credit, $3,000 available (11.3%, Due 5/2010) (5)	1,000	945
		Senior Term Debt (5) (11.3%, Due 5/2012) (5)	3,870	3,657
		Senior Term Debt (14.3%, Due 5/2012) (3) (5)	4,410	4,112

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Company (1)	Industry	Investment (2)	Cost	Fair Value
Northern Contours, Inc.	Manufacturing-veneer and laminate components	Senior Subordinated Term Debt (10.0%, Due 5/2010) (5)	$ 6,562	$ 5,414
Pinnacle Treatment Centers, Inc.	Service-Addiction treatment centers	Line of Credit, $500 available (4.5%, Due 12/2009)		
		Senior Term Debt (10.5%, Due 12/2011) (5)	2,750	2,633
		Senior Term Debt (10.5%, Due 12/2011) (3) (5)	7,500	7,059
Precision Acquisition Group Holdings, Inc.	Manufacturing-consumable components for the aluminum industry	Equipment Note (8.5%, Due 10/2011) (5)	1,000	988
		Senior Term Debt (8.5%, Due 10/2010) (5)	4,250	4,192
		Senior Term Debt (11.5%, Due 10/2010) (3) (5)	4,074	4,023
PROFITSystems Acquisition Co.	Service-design and develop ERP software	Line of Credit, $350 available (4.5%, Due 7/2010)		
		Senior Term Debt (8.5%, Due 7/2011) (5)	1,600	1,468
		Senior Term Debt (10.5%, Due 7/2011) (3) (5)	2,900	2,632
RCS Management Holding Co.	Service-healthcare supplies	Senior Term Debt (8.5%, Due 1/2011) (3) (5)	2,437	2,383
		Senior Term Debt (10.5%, Due 1/2011) (4) (5)	3,060	2,949
Reliable Biopharmaceutical Holdings, Inc.	Manufacturing-pharmaceutical and biochemical intermediates	Line of Credit, $5,000 available (9.0%, Due 10/2010) (5)	800	788
		Mortgage Note (9.5%, Due 10/2014) (5)	7,335	7,261
		Senior Term Debt (9.0%, Due 10/2012) (5)	1,530	1,507
		Senior Term Debt (11.0%, Due 10/2012) (3) (5)	11,813	11,518
		Senior Subordinated Term Debt (12.0%, Due 10/2013) (5)	6,000	5,640
		Common Stock Warrants (8)	209	282
Saunders & Associates	Manufacturing-equipment provider for frequency control devices	Senior Term Debt (9.8%, Due 5/2013) (5)	10,780	10,618
SCI Cable, Inc.	Service-cable, internet, voice provider	Senior Term Debt (9.3%, Due 10/2008) (5) (12)	2,881	576
Sunburst Media - Louisiana, LLC	Service-radio station operator	Senior Term Debt (10.5%, Due 6/2011) (5)	6,411	5,817
Sunshine Media Holdings	Service-publisher regional B2B trade magazines	Senior Term Debt (11.0%, Due 5/2012) (5)	16,948	15,973
			10,700	9,978

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

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Company (1)	Industry	Investment (2)	Cost	Fair Value
Syndicated Loans:				
GTM Holdings, Inc.	Manufacturing-socks	Senior Subordinated Term Debt (11.8%, Due 4/2014) (6)	$ 500	$ 220
Kinetek Acquisition Corp.	Manufacturing-custom engineered motors & controls	Senior Term Debt (3.6%, Due 11/2013) (7)	1,438	925
Puerto Rico Cable Acquisition Company, Inc.	Service-telecommunications	Senior Subordinated Term Debt (7.8%, Due 1/2012) (6)	7,174	5,713
Wesco Holdings, Inc.	Service-aerospace parts and distribution	Senior Subordinated Term Debt (6.0%, Due 3/2014) (7)	2,264	1,856
WP Evenflo Group Holdings Inc.	Manufacturing-infant and juvenile products	Senior Term Debt (8.0%, Due 2/2013) (6)	1,901	1,235
		Senior Preferred Equity (8)	333	
		Junior Preferred Equity (8)	111	
		Common Stock (8)		
Subtotal - Syndicated loans			13,721	9,949
Total Non-Control/Non-Affiliate Investments			**$ 312,043**	**$ 286,997**
CONTROL INVESTMENTS				
BERTL, Inc.	Service-web-based evaluator of digital imaging products	Line of Credit, $842 available (non-accrual, Due 10/2009) (10)(13)(15)	$ 930	$
		Common Stock (8) (15)	424	
Clinton Holdings, LLC	Distribution-aluminum sheets and stainless steel	Senior Subordinated Term Debt (12.0%, Due 1/2013) (5) (14)	15,500	12,013
		Escrow Funding Note (12.0%, Due 1/2013) (5) (14)	640	496
		Common Stock Warrants (8) (15)	109	
Defiance Integrated Technologies, Inc.	Manufacturing-trucking parts	Senior Term Debt (11.0%, Due 4/2010) (3) (11)	6,005	6,005
		Senior Term Debt (11.0%, Due 4/2010) (3) (11)	1,178	1,178
		Common Stock (8) (15)	1	816
		Guaranty ($250)		
Lindmark Acquisition, LLC	Service-advertising	Senior Subordinated Term Debt (11.3%, Due 10/2012) (15) (16)	12,000	10,410
		Senior Subordinated Term Debt (13.0%, Due Upon Demand) (15) (16)	1,553	1,049
		Common Stock (8) (15)	1	
LYP Holdings Corp.	Service-yellow pages publishing	Line of credit, $1,250 available (10.0%, Due 7/2010) (15)	1,168	1,168

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

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

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

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GLADSTONE CAPITAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(DOLLAR AMOUNTS IN THOUSANDS, EXCEPT PER SHARE DATA)

(UNAUDITED)

	Three Months Ended December 31, 2009	Three Months Ended December 31, 2008
INVESTMENT INCOME		
Interest income Non-Control/Non-Affiliate investments	$ 8,984	$ 11,661
Interest income Control investments	693	20
Interest income Cash		10
Interest income Notes receivable from employees (Refer to Note 4)	113	117
Prepayment fees and other income	14	
Total investment income	9,804	11,808
EXPENSES		
Interest expense	1,535	2,461
Loan servicing fee (Refer to Note 4)	929	1,623
Base management fee (Refer to Note 4)	721	434
Incentive fee (Refer to Note 4)	375	1,176
Administration fee (Refer to Note 4)	178	227
Professional fees	912	313
Amortization of deferred financing fees	494	719
Stockholder related costs	78	89
Directors fees	48	48
Insurance expense	68	57
Other expenses	67	66
Expenses before credit from Adviser	5,405	7,213
Credit to base management and incentive fees from Adviser (Refer to Note 4)	(29)	(1,286)
Total expenses net of credit to base management and incentive fees	5,376	5,927
NET INVESTMENT INCOME	4,428	5,881
REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS AND BORROWINGS UNDER LINE OF CREDIT:		
Net realized loss on investments	(920)	(1,731)
Net unrealized appreciation (depreciation) on investments	2,599	(13,253)
Net unrealized depreciation on borrowings under line of credit	219	
Net gain (loss) on investments and borrowings under line of credit	1,898	(14,984)
NET INCREASE (DECREASE) IN NET ASSETS RESULTING FROM OPERATIONS	$ 6,326	$ (9,103)
NET INCREASE (DECREASE) IN NET ASSETS RESULTING FROM OPERATIONS PER COMMON SHARE:		
Basic and Diluted	$ 0.30	$ (0.43)
WEIGHTED AVERAGE SHARES OF COMMON STOCK OUTSTANDING:		
Basic and Diluted	21,087,574	21,087,574

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

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GLADSTONE CAPITAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS

(DOLLAR AMOUNTS IN THOUSANDS)

(UNAUDITED)

	Three Months Ended December 31, 2009	2008
Operations:		
Net investment income	$ 4,428	$ 5,881
Net realized loss on investments	(920)	(1,731)
Net unrealized appreciation (depreciation) on investments	2,599	(13,253)
Net unrealized depreciation on borrowings under line of credit	219	
Net increase (decrease) in net assets from operations	6,326	(9,103)
Capital transactions:		
Shelf offering costs	(39)	(3)
Distributions to stockholders	(4,428)	(8,856)
Repayment of principal on employee notes		4
Reclassification of principal on employee note	514	
Net (decrease) in net assets from capital transactions	(3,953)	(8,855)
Total increase (decrease) in net assets	2,373	(17,958)
Net assets at beginning of year	249,076	271,748
Net assets at end of period	$ 251,449	$ 253,790

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

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GLADSTONE CAPITAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(DOLLAR AMOUNTS IN THOUSANDS)

(UNAUDITED)

	Three Months ended December 31, 2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Net increase (decrease) in net assets resulting from operations	$ 6,326	$ (9,103)
Adjustments to reconcile net increase (decrease) in net assets resulting from operations to net cash provided by operating activities:		
Purchase of investments	(2,171)	(8,702)
Principal repayments on investments	15,404	14,927
Proceeds from sale of investments	2,782	2,212
Net amortization of premiums and discounts	45	(49)
Increase in investment balance due to paid in kind interest	(51)	(17)
Net realized loss on investments	920	1,731
Amortization of deferred financing fees	494	719
Change in net unrealized (depreciation) appreciation on investments	(2,599)	13,253
Change in net unrealized appreciation on borrowings under line of credit	(219)	
(Increase) decrease in interest receivable	(139)	902
Increase in funds due from custodian	(6,711)	(2,760)
Increase in prepaid assets	(40)	(15)
Decrease in due from affiliate	69	
Decrease (increase) in receivables from portfolio companies	885	(272)
Decrease in other assets	24	69
Decrease in accounts payable	(67)	
Decrease in interest payable	(39)	(103)
Decrease in accrued expenses and deferred liabilities	(112)	(181)
Increase in fees due to affiliate (Refer to Note 4)	451	268
Decrease in administration fee due to Gladstone Administration (Refer to Note 4)	(38)	(20)
Decrease in funds held in escrow	(145)	(158)
Net cash provided by operating activities	15,069	12,701
CASH FLOWS FROM FINANCING ACTIVITIES:		
Shelf offering costs	(39)	(3)
Borrowings from the line of credit	2,900	22,500
Repayments on the line of credit	(12,500)	(27,060)
Distributions paid	(4,428)	(8,856)
Receipt of principal on notes receivable employees (Refer to Note 4)		4
Deferred financing rebate (fees)	96	(23)
Net cash used in financing activities	(13,971)	(13,438)
NET INCREASE (DECREASE) IN CASH	1,098	(737)
CASH, BEGINNING OF PERIOD	5,276	6,493
CASH, END OF PERIOD	$ 6,374	$ 5,756
NON-CASH FINANCING ACTIVITIES		
Reclassification of principal on employee note (Refer to Note 4)	$ 514	$

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

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GLADSTONE CAPITAL CORPORATION

FINANCIAL HIGHLIGHTS

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

(UNAUDITED)

	Three months ended December 31, 2009	2008
Per Share Data (1)		
Net asset value at beginning of period	$ 11.81	$ 12.89
Income from investment operations:		
Net investment income (2)	0.21	0.28
Net realized loss on investments (2)	(0.04)	(0.08)
Net unrealized appreciation (depreciation) on investments (2)	0.12	(0.63)
Net unrealized depreciation on borrowings under line of credit (2)	0.01	
Total from investment operations	0.30	(0.43)
Distributions to stockholders (3)	(0.21)	(0.42)
Reclassification of principal on employee note (3)	0.02	
Net asset value at end of period	$ 11.92	$ 12.04
Per share market value at beginning of period	$ 8.93	$ 15.24
Per share market value at end of period	$ 7.69	$ 8.09
Total return (4)(5)	(11.58)%	(44.09)%
Shares outstanding at end of period	21,087,574	21,087,574
Statement of Assets and Liabilities Data:		
Net assets at end of period	$ 251,449	$ 253,790
Average net assets (6)	$ 248,874	$ 262,001
Senior Securities Data:		
Borrowings under line of credit	$ 73,531	$ 146,470
Asset coverage ratio (7)(8)	442%	273%
Asset coverage per unit (8)	$ 4,420	$ 2,733
Ratios/Supplemental Data:		
Ratio of expenses to average net assets-annualized (9)	8.69%	11.01%
Ratio of net expenses to average net assets-annualized (10)	8.64%	9.05%
Ratio of net investment income to average net assets-annualized	7.12%	8.98%

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

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

(3) Distributions are determined based on taxable income calculated in accordance with income tax regulations which may differ from amounts determined under accounting principles generally accepted in the United States of America.

(4) Total return equals the change in the ending market value of the Company s common stock from the beginning of the period taking into account distributions reinvested in accordance with the terms of the Company s dividend reinvestment plan. Total return does not take into account distributions that may be characterized as a return of capital. For further information on the estimated character of the Company s distributions please refer to Note 8.

(5) Amounts were not annualized.

(6) Average net assets are computed using the average of the balance of net assets at the end of each month of the reporting period.

(7) As a business development company, the Company is generally required to maintain a ratio of at least 200% of total assets, less all liabilities and indebtedness not represented by senior securities, to total borrowings.

(8) Asset coverage ratio is the ratio of the carrying value of the Company s total consolidated assets, less all liabilities and indebtedness not represented by senior securities, to the aggregate amount of senior securities representing indebtedness. Asset coverage per unit is the asset coverage ratio expressed in terms of dollar amounts per $1 thousand of indebtedness.

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

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

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

GLADSTONE CAPITAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2009

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

(UNAUDITED)

NOTE 1. ORGANIZATION

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

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

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

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

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

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

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Unaudited Interim Financial Statements

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

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

Investment Valuation Policy

The Company carries its investments at market value to the extent that market quotations are readily available and reliable, and otherwise at fair value, as determined in good faith by its Board of Directors. In determining the fair value of the Company s investments, the Adviser has established an investment valuation policy (the Policy). The Policy is approved by the Company s

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Board of Directors and each quarter the Board of Directors reviews whether the Adviser has applied the Policy consistently and votes whether or not to accept the recommended valuation of the Company s investment portfolio.

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

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

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

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

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

As of December 31, 2009, the Company assessed trading activity in its syndicated loan assets and determined that there continued to be market liquidity and a functioning secondary market for these assets. Thus, firm bid prices or indicative bids were used to fair value the Company s remaining syndicated loans as of December 31, 2009. However, for the syndicated loan sale completed after December 31, 2009, the Company used the sales price to value such syndicated loan.

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

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

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

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

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

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

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

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

Interest Income Recognition

Interest income, adjusted for amortization of premiums and acquisition costs and for the accretion of discounts, is recorded on the accrual basis to the extent that such amounts are expected to be collected. Generally, when a loan becomes 90 days or more past due or if the Company s qualitative assessment indicates that the debtor is unable to service its debt or other obligations, the Company will place the loan on non-accrual status and cease recognizing interest income on that loan until the borrower has demonstrated the ability

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and intent to pay contractual amounts due. However, the Company remains contractually entitled to this interest. At December 31, 2009, two Non-Control/Non-Affiliate investments and four Control investments were on non-accrual with an aggregate cost basis of approximately $13,001, or 3.7% of the cost basis of all loans in the Company s portfolio. At September 30, 2009, one Non-Control/Non-Affiliate investment and four Control investments were on non-accrual with an aggregate cost basis of approximately $10,022, or 2.8% of the cost basis of all loans in the Company s portfolio. Conditional interest, or a success fee, is recorded when earned or upon full repayment of a loan investment.

Paid in Kind Interest

The Company has two loans in its portfolio which contain PIK provisions. The PIK interest, computed at the contractual rate specified in each loan agreement, is added to the principal balance of the loan and recorded as income. To maintain the Company s status as a RIC, this non-cash source of income must be paid out to stockholders in the form of distributions, even though the Company has not yet collected the cash. For the three months ended December 31, 2009 and 2008, the Company recorded PIK income of $51 and $17, respectively.

Recent Accounting Pronouncements

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

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

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

In January 2010, FASB issued ASU No. 2010-06, Fair Value Measurements and Disclosures, that requires reporting entities to make new disclosures about recurring or nonrecurring fair-value measurements including significant transfers into and out of Level 1 and Level 2 fair-value measurements and information on purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair-value measurements. The FASB also clarified existing fair-value measurement disclosure guidance about the level of disaggregation, inputs, and valuation techniques. The new and revised disclosures are required to be implemented in fiscal years beginning after December 15, 2009 and December 15, 2010. The Company is currently evaluating the impact of adopting this standard on its financial position and results of operations.

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NOTE 3. INVESTMENTS

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

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

At December 31, 2009, all of the Company s assets were valued using Level 3 inputs.

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

	As of December 31, 2009			
	Level 1	**Level 2**	**Level 3**	**Total Fair Value Reported in Condensed Consolidated Statements of Assets and Liabilities**
Senior Term Debt	$	$	$ 198,577	$ 198,577
Senior Subordinated Term Debt			106,609	106,609
Preferred Equity Securities				
Common Equity Securities			1,452	1,452
Total investments at fair value	$	$	$ 306,638	$ 306,638

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

Total investments at fair value	$		$		$	320,969	$	320,969

Changes in Level 3 Fair Value Measurements

The following table provides a roll-forward in the changes in fair value during the three-month period from September 30, 2009 to December 31, 2009, and for the three-month period from September 30, 2008 to December 31, 2008, for all investments for which the Company determines fair value using unobservable (Level 3) factors. When a determination is made to classify a financial instrument within Level 3 of the valuation hierarchy, the determination is based upon the significance of the unobservable factors to the overall fair value measurement. However, Level 3 financial instruments typically include, in addition to the unobservable or Level 3 components, observable components (that is, components that are actively quoted and can be validated by external sources). Accordingly, the losses in the table below include changes in fair value due in part to observable factors that are part of the valuation methodology.

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Fair value measurements using unobservable data inputs (Level 3)

	Non-Control/ Non-Affiliate Investments	Control Investments	Total
Three months ended December 31, 2009:			
Fair value at September 30, 2009	$ 286,997	$ 33,972	$ 320,969
Realized losses (a)	(920)		(920)
Reversal of prior period depreciation on realization (b)	1,406		1,406
Unrealized appreciation (depreciation) (b)	2,193	(1,000)	1,193
New investments, repayments, and settlements, net (c)	(17,296)	1,286	(16,010)
Transfers in (out) of Level 3			
Fair value as of December 31, 2009	$ 272,380	$ 34,258	$ 306,638
Three months ended December 31, 2008:			
Fair value at September 30, 2008	$ 407,153	$ 780	$ 407,933
Realized losses (a)	(1,731)		(1,731)
Reversal of prior period depreciation on realization (b)	1,185		1,185
Unrealized depreciation (b)	(13,626)	(812)	(14,438)
New investments, repayments and settlements, net (c)	(8,969)	598	(8,371)
Transfers in (out) of Level 3			
Fair value as of December 31, 2008	$ 384,012	$ 566	$ 384,578

	Senior Term Debt	Senior Subordinated Term Debt	Preferred Equity Securities	Common Equity Securities	Total
Three months ended December 31, 2009:					
Fair value at September 30, 2009	$ 212,290	$ 105,794	$	$ 2,885	$ 320,969
Realized losses (a)	(513)	(407)			(920)
Reversal of prior period depreciation on realization (b)	999	407			1,406
Unrealized appreciation (depreciation) (b)	(19)	1,829		(617)	1,193
New investments, repayments, and settlements, net (c)	(14,180)	(1,014)		(816)	(16,010)
Transfers in (out) of Level 3					
Fair value as of December 31, 2009	$ 198,577	$ 106,609	$	$ 1,452	$ 306,638
Three months ended December 31, 2008:					
Fair value at September 30, 2008	$ 265,297	$ 140,676	$	$ 1,960	$ 407,933
Realized losses (a)	(1,758)	27			(1,731)
Reversal of prior period depreciation on realization (b)	1,185				1,185
Unrealized depreciation (b)	(8,891)	(5,586)		38	(14,438)
New investments, repayments and settlements, net (c)	(7,948)	(423)			(8,371)
Transfers in (out) of Level 3					
Fair value as of December 31, 2008	$ 247,886	$ 134,694	$	$ 1,998	$ 384,578

(a)

Included in net realized loss on investments on the accompanying condensed consolidated statements of operations for the three months ended December 31, 2009 and 2008.

(b) Included in unrealized appreciation (depreciation) on investments on the accompanying condensed consolidated statements of operations for the three months ended December 31, 2009 and 2008.

(c) Includes increases in the cost basis of investments resulting from new portfolio investments, the amortization of discounts, premiums and closing fees as well as decreases in the cost basis of investments resulting from principal repayments or sales.

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Non-Control/Non-Affiliate Investments

At December 31, 2009 and September 30, 2009, the Company held Non-Control/Non-Affiliate investments in the aggregate of approximately $272,380 and $286,997, at fair value, respectively.

Control Investments

At December 31, 2009 and September 30, 2009, the Company held Control investments in the aggregate of approximately $34,258 and $33,972, at fair value, respectively. At December 31, 2009, the Control investments were comprised of BERTL, Inc. (BERTL), Clinton Holdings, LLC (Clinton), Defiance Integrated Technologies, Inc. (Defiance), Lindmark Acquisition, LLC (Lindmark), LYP Holdings Corp. (LYP Holdings), U.S. Healthcare Communications, Inc. (U.S. Healthcare) and Western Directories, Inc. (Western Directories).

- *BERTL:* The Company originally purchased a past due debt instrument in MCA Communications, LLC and the Company accepted a deed in lieu of foreclosure in satisfaction of BERTL s obligations under the debt instrument on September 28, 2007. BERTL is a web-based evaluator of digital imaging products.

- *Clinton:* In September 2009, the Company took control of certain Clinton entities by exercising contractual rights under the investment documents. Clinton is a distributor of aluminum sheets and stainless steel.

- *Defiance:* In July 2009, the Company acquired from the previous owner certain assets of Defiance Acquisition Corp., consisting of tangible and intangible personal property. The Company acquired these assets through a newly formed subsidiary, Defiance, and intends to continue the business under its control. Defiance is a manufacturer of trucking parts.

- *Lindmark:* On March 18, 2009, the Company acquired from the previous owner certain assets of Lindmark Outdoor Advertising, LLC, consisting of all tangible and intangible personal property. The Company acquired these assets through a newly formed subsidiary, Lindmark, and intends to continue the business under its control. Lindmark is a billboard advertising company.

- *LYP Holdings:* On July 2, 2008, the Company acquired from the previous owner certain assets of LocalTel, Inc., consisting of all tangible and intangible personal property. The Company acquired these assets through a newly formed subsidiary, LYP Holdings, and intends to continue the business under its control. LYP Holdings is a publisher of community yellow page directories.

- *U.S. Healthcare:* The Company offered at public sale certain assets of U.S. Healthcare Communications, LLC on January 30, 2008, consisting generally of all fixtures of tangible and intangible personal property. The Company acquired these assets in the sale through a newly formed subsidiary, U.S. Healthcare, and intends to continue the business under its control. U.S. Healthcare is a trade magazine operator.

- *Western Directories:* On August 27, 2008, the Company acquired from the previous owner certain assets of West Coast Yellow Pages, Inc., consisting of all tangible and intangible personal property. The Company acquired these assets through a newly formed subsidiary, Western Directories, and intends to continue the business under its control. Western Directories is a publisher of community yellow page directories.

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Investment Concentrations

At December 31, 2009, the Company had aggregate investments in 46 portfolio companies and approximately 64.8% of the aggregate fair value of such investments was senior term debt, approximately 34.8% was senior subordinated term debt, no investments were in junior subordinated debt and approximately 0.4% was in equity securities. The following table outlines the Company s investments by type at December 31, 2009 and September 30, 2009:

	December 31, 2009		September 30, 2009	
	Cost	**Fair Value**	**Cost**	**Fair Value**
Senior Term Debt	$ 224,663	$ 198,577	$ 240,172	$ 212,290
Senior Subordinated Term Debt	117,323	106,609	118,743	105,794
Preferred Equity Securities	2,028		2,028	
Common Equity Securities	3,450	1,452	3,450	2,885
Total Investments	$ 347,464	$ 306,638	$ 364,393	$ 320,969

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

	December 31, 2009			September 30, 2009		
		Percentage			Percentage	
Industry Classification	**Fair Value**	**Total Investments**	**Net Assets**	**Fair Value**	**Total Investments**	**Net Assets**
Aerospace & Defense	$			$ 1,857	0.6%	0.7%
Automobile	7,355	2.4%	2.9%	7,999	2.5%	3.2%
Broadcast (TV & Radio)	43,192	14.1%	17.2%	43,403	13.5%	17.4%
Buildings & Real Estate	13,015	4.3%	5.2%	12,882	4.0%	5.2%
Cargo Transport	5,462	1.8%	2.2%	5,427	1.7%	2.2%
Chemicals, Plastics & Rubber	15,813	5.2%	6.3%	15,884	4.9%	6.4%
Diversified/Conglomerate Manufacturing	1,573	0.5%	0.6%	1,236	0.4%	0.5%
Diversified Natural Resources, Precious Metals & Minerals	13,590	4.4%	5.4%	13,589	4.2%	5.5%
Electronics	27,092	8.8%	10.8%	27,899	8.7%	11.2%
Farming & Agriculture	8,982	2.9%	3.6%	9,309	2.9%	3.7%
Healthcare, Education & Childcare	45,817	14.9%	18.2%	58,054	18.1%	23.3%
Home & Office Furnishings	16,825	5.5%	6.7%	16,744	5.2%	6.7%
Leisure, Amusement, Movies & Entertainment	5,037	1.6%	2.0%	5,091	1.6%	2.0%
Machinery	8,926	2.9%	3.5%	9,202	2.9%	3.7%
Mining, Steel, Iron & Non-Precious Metals	22,969	7.5%	9.1%	21,926	6.8%	8.8%
Personal & Non-durable Consumer Products	8,586	2.8%	3.4%	8,714	2.7%	3.5%
Printing & Publishing	37,854	12.4%	15.1%	37,864	11.8%	15.2%
Retail Stores	24,213	7.9%	9.6%	23,669	7.4%	9.5%
Textiles & Leather	337	0.1%	0.1%	220	0.1%	0.1%
Total	$ 306,638	100.0%		$ 320,969	100.0%	

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

Geographic Region	December 31, 2009 Fair Value	December 31, 2009 Percentage Total Investments	December 31, 2009 Percentage Net Assets	September 30, 2009 Fair Value	September 30, 2009 Percentage Total Investments	September 30, 2009 Percentage Net Assets
Midwest	$ 160,523	52.4%	63.8%	$ 172,263	53.7%	69.2%
West	62,970	20.5%	25.0%	65,678	20.5%	26.4%
Southeast	34,626	11.3%	13.8%	34,708	10.8%	13.9%
Mid-Atlantic	28,633	9.3%	11.4%	28,437	8.8%	11.4%
Northeast	13,887	4.5%	5.5%	14,170	4.4%	5.7%
U.S. Territory	5,999	2.0%	2.4%	5,713	1.8%	2.3%
	$ 306,638	100.0%		$ 320,969	100.0%	

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

Investment Principal Repayments

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

		Amount
For the remaining nine months ending September 30:	2010	$ 36,599
For the fiscal year ending September 30:	2011	92,485
	2012	72,816
	2013	121,017
	2014	11,773
	2015	6,851
	Total Contractual Repayments	341,541
	Investments in equity securities	5,478
	Unamortized premiums, discounts and investment acquisition costs on debt securities	445
	Total	$ 347,464

NOTE 4. RELATED PARTY TRANSACTIONS

Loans to Employees

The Company provided loans to employees of the Adviser, who at the time of the loans were joint employees of the Company and either the Adviser or the Company s previous investment adviser, Gladstone Capital Advisers, Inc., for the exercise of options under the Amended and Restated 2001 Equity Incentive Plan, which has since been terminated and is no longer in operation. The loans require the quarterly payment of interest at the market rate in effect at the date of issue, have varying terms not exceeding ten years and have been recorded as a reduction of net assets. The loans are evidenced by full recourse notes that are due upon maturity or 60 days following termination of employment, and the shares of common stock purchased with the proceeds of the loan are posted as collateral. No new loans were issued during the three months ended December 31, 2009 or December 31, 2008. The Company received $0 and $4 of principal repayments during the three months ended December 31, 2009 and December 31, 2008, respectively. The Company recognized interest income from all employee stock option loans of $113 and $117 for the three months ended December 31, 2009 and 2008, respectively.

During the three months ended December 31, 2009, $514 of an employee stock option loan to a former employee of the Adviser was transferred from notes receivable employees to other assets in connection with the termination of her employment with the Adviser and the later amendment of the loan. The interest on the loan from the time the employee stopped working for the Adviser is included in other income on the condensed consolidated statement of operations.

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Investment Advisory and Management Agreement

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

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

	Three months ended December 31, 2009		December 31, 2008	
Base management fee (1)	$	721	$	434
Credit for fees received by Adviser from the portfolio companies				(5)
Fee reduction for the voluntary, irrevocable waiver of 2.0% fee on senior syndicated loans to 0.5% per annum (2)		(7)		(105)
Net base management fee	$	714	$	324
Incentive fee	$	375	$	1,176
Credit from voluntary, irrevocable waiver issued by Adviser s board of directors		(22)		(1,176)
Net incentive fee	$	353	$	
Credit for fees received by Adviser from the portfolio companies	$		$	(5)
Fee reduction for the voluntary, irrevocable waiver of 2.0% fee on senior syndicated loans to 0.5% per annum		(7)		(105)
Incentive fee credit		(22)		(1,176)
Credit to base management and incentive fees from Adviser	$	(29)	$	(1,286)

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

(2) The board of our Adviser voluntarily, irrevocably and unconditionally waived, for the three months ended December 31, 2009 and 2008, the annual 2.0% base management fee to 0.5% for senior syndicated loan participations. Fees waived cannot be recouped by the Adviser in the future.

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

	December 31, 2009	September 30, 2009
Unpaid base management fee to Adviser	$ 714	$ 617
Unpaid incentive fee to Adviser	353	
Unpaid loan servicing fees to Adviser	218	217
Total Due to Adviser	$ 1,285	$ 834

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

Loan Servicing and Portfolio Company Fees

The Adviser also services the loans held by Business Loan, in return for which it receives a 1.5% annual fee based on the monthly aggregate outstanding balance of the loans pledged under the Company s line of credit. Since the Company owns these loans, all loan servicing fees paid to the Adviser have been and continue to be treated as reductions directly against the 2% base management fee under the Advisory Agreement. For the three months ended December 31, 2009 and 2008, these loan servicing fees totaled $929 and $1,623, respectively, all of which were deducted against the 2% base management fee in order to derive the base management fee,

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which is presented as the line item Base management fee in the accompanying condensed consolidated statements of operations. As of December 31, 2009 and September 30, 2009, the Company owed $218 and $217, respectively, of unpaid loan servicing fees to the Adviser, which are recorded in Fees due to Adviser in the accompanying condensed consolidated statements of assets and liabilities.

Administration Agreement

On October 1, 2006, the Company entered into an administration agreement (the Administration Agreement) with Gladstone Administration, LLC (the Administrator), an affiliate of the Adviser. Under the Administration Agreement, the Company pays separately for administrative services. The Administration Agreement provides for payments equal to the Company s allocable portion of the Administrator s overhead expenses in performing its obligations under the Administration Agreement, including, but not limited to, rent for employees of the Administrator, and the allocable portion of salaries and benefits expenses of the Company s chief financial officer, chief compliance officer, internal counsel, treasurer and their respective staffs. For the three months ended December 31, 2009 and 2008, the Company recorded administration fees of $178 and $227, respectively. As of December 31, 2009 and September 30, 2009, the Company owed $178 and $216, respectively, of unpaid administration fees to the Adviser, which is recorded in the Fee due to Administrator in the accompanying condensed consolidated statements of assets and liabilities.

NOTE 5. LINE OF CREDIT

On May 15, 2009, the Company, through Business Loan, entered into a third amended and restated credit agreement which currently provides for a $102,000 revolving line of credit arranged by Key Equipment Finance Inc. (KEF) as administrative agent, replacing Deutsche Bank, A.G. as administrative agent (the KEF Facility). Branch Banking and Trust Company (BB&T) also joined the KEF Facility as a committed lender. Advances under the KEF Facility will generally bear interest at the 30-day LIBOR or the commercial paper rate (subject to a minimum rate of 2%), plus 4% per annum, with a commitment fee of 0.75% per annum on undrawn amounts. As of December 31, 2009, there was a cost basis of approximately $73,400 of borrowings outstanding under the KEF Facility at an average interest rate of 7.30%, and the remaining borrowing capacity under the KEF Facility was $28,600. Available borrowings are subject to various constraints imposed under the KEF Facility, based on the aggregate loan balance pledged by Business Loan. Interest is payable monthly during the term of the KEF Facility. The KEF Facility matures on May 14, 2010 and, if the facility is not renewed or extended by this date, all principal and interest will be due and payable within one year of maturity. In addition, after May 14, 2010, if the KEF Facility is not renewed, all principal collections from the Company s loans are required to be used to pay outstanding principal on the KEF Facility.

During the three months ended December 31, 2009, the Company reduced the size of the KEF Facility by $25,000, from $127,000 to $102,000. Without the addition of other committed lenders, the KEF Facility provides a total commitment of $102,000 from January 1, 2010 to May 11, 2010 and $77,000 thereafter.

The KEF Facility contains covenants that require Business Loan to maintain its status as a separate entity, prohibit certain significant corporate transactions (such as mergers, consolidations, liquidations or dissolutions), and restrict material changes to the Company s credit and collection policies. The facility also limits payments of distributions. As of December 31, 2009, Business Loan was in compliance with all of the facility covenants.

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

	As of December 31, 2009			
	Level 1	**Level 2**	**Level 3**	**Total Fair Value Reported in Condensed Consolidated Statement of Assets and Liabilities**
Borrowings under Line of Credit	$	$	$ 73,531	$ 73,531
Total	$	$	$ 73,531	$ 73,531

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

Changes in Level 3 Fair Value Measurements

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

Fair value measurements using unobservable data inputs (Level 3)

	Borrowings under line of credit
Three months ended December 31, 2009:	
Fair value at September 30, 2009	$ 83,350
Unrealized depreciation (a)	(219)
Net borrowings (b)	(9,600)
Transfers in (out) of Level 3	
Fair value as of December 31, 2009	$ 73,531

(a) Included in unrealized depreciation on borrowings under line of credit on the accompanying condensed consolidated statements of operations for the three months ended December 31, 2009.

(b) Includes borrowings and principal repayments on the line of credit.

NOTE 6. COMMON STOCK TRANSACTIONS

Transactions in common stock were as follows:

	Shares	Total Value

Balance at September 30, 2009	21,087,574	$	328,224
Shelf offering costs			(39)
Balance at December 31, 2009	21,087,574	$	328,185

NOTE 7. NET INCREASE (DECREASE) IN NET ASSETS RESULTING FROM OPERATIONS PER COMMON SHARE

The following table sets forth the computation of basic and diluted net increase (decrease) in net assets resulting from operations per common share for the three months ended December 31, 2009 and 2008:

	Three months ended December 31,			
	2009		2008	
Numerator for basic and diluted net increase (decrease) in net assets resulting from operations per share	$	6,326	$	(9,103)
Denominator for basic and diluted shares		21,087,574		21,087,574
Basic and diluted net increase (decrease) in net assets resulting from operations per common share	$	0.30	$	(0.43)

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NOTE 8. DISTRIBUTIONS

The following table lists the per share distributions paid for the three months ended December 31, 2009 and 2008:

Fiscal Year	Record Date	Payment Date		Distribution per Share
2010	October 22, 2009	October 30, 2009	$	0.07
	November 19, 2009	November 30, 2009	$	0.07
	December 22, 2009	December 31, 2009	$	0.07
		Total	$	0.21
2009	October 23, 2008	October 31, 2008	$	0.14
	November 19, 2008	November 28, 2008	$	0.14
	December 22, 2008	December 31, 2008	$	0.14
		Total	$	0.42

Aggregate distributions declared and paid for the three months ended December 31, 2009 and 2008 were approximately $4,428 and $8,856, respectively. All distributions were declared based on estimates of net investment income for the respective fiscal years, and some of the distributions include a return of capital.

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

NOTE 9. COMMITMENTS AND CONTINGENCIES

At December 31, 2009, the Company was not party to any signed term sheets for potential investments. The Company had one guaranty totaling $250, which relates to Defiance Integrated Technologies, Inc., for which the Company considers the credit risk to be remote. The Company reports off-balance sheet guarantees on its condensed consolidated schedule of investments, as required by the 1940 Act.

NOTE 10. SUBSEQUENT EVENTS

The Company evaluated all events that occurred subsequent to December 31, 2009 through the date of the filing of this Form 10-Q on February 1, 2010.

Distributions

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

Record Date	Payment Date	Distribution per Share	
January 21, 2010	January 29, 2010	$	0.070
February 18, 2010	February 26, 2010	$	0.070
March 23, 2010	March 31, 2010	$	0.070

Investment Activity

Subsequent to December 31, 2009, the Company extended approximately $2,727 of revolver draws and additional investments to existing portfolio companies. The Company also received approximately $6,779 from scheduled and unscheduled loan repayments and a syndicated loan sale. This included $4,000 payoff from ActivStyle s senior term debt. In addition, the Company entered into an agreement to sell the GTM Holdings syndicated loan that was held in its portfolio of investments at December 31, 2009 to an investor in the syndicated loan market. The loan had a cost of approximately $500 and fair value of $337. This loan is included in the Company s condensed consolidated assets as of December 31, 2009 and the loan was valued at the sales price.

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Registration Statement

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

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

All statements contained herein, other than historical facts, may constitute forward-looking statements. These statements may relate to, among other things, future events or our future performance or financial condition. In some cases, you can identify forward-looking statements by terminology such as estimate, may, might, believe, will, provided, anticipate, future, could, growth, pla should, would, if, seek, possible, potential, likely or the negative of such terms or comparable terminology. These forward-look statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. We caution readers not to place undue reliance on any such forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, after the date of this Form 10-Q.

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

OVERVIEW

General

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

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

Business Environment

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

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

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

Recent market conditions have also affected the trading price of our common stock and thus our ability to finance new investments through the issuance of equity. On January 29, 2010, the closing market price of our common stock was $7.38, which price represented a 38% discount to our December 31, 2009 net asset value (NAV) per share. When our stock is trading below NAV, as it has consistently traded subsequent to September 30, 2008, our ability to issue equity is constrained by provisions of the 1940 Act which generally prohibit the issuance and sale of our common stock below NAV per share without stockholder approval other than through sales to our then-existing stockholders pursuant to a rights offering. At our annual meeting of stockholders held on February 19, 2009, stockholders approved a proposal which authorizes us to sell shares of our common stock at a price below our then current NAV per share for a period of one year from the date of approval, provided that our Board of Directors makes certain determinations prior to any such sale. At the upcoming annual stockholders meeting scheduled for February 18, 2010, our stockholders will be asked to vote in favor of renewing this proposal for another year.

The recession may also continue to decrease the value of collateral securing some of our loans, as well as the value of our equity investments, which has impacted and may continue to impact our ability to borrow under our credit facility. For the three months ended December 31, 2009, we recorded net unrealized appreciation on our portfolio of investments of $2,599. We may see decreases in the value of our portfolio, which will further limit our ability to borrow under our current credit facility. Additionally, our credit facility contains covenants regarding the maintenance of certain minimum net worth requirements which are affected by the decrease in value of our portfolio. Failure to meet these requirements would result in a default which, if we are unable to obtain a waiver from our lenders, would result in the acceleration of our repayment obligations under our credit facility. As of December 31, 2009, we were in compliance with all of the facility covenants.

We expect that, given these regulatory and contractual constraints in combination with current market conditions, debt and equity capital may be costly or difficult for us to access for some time. For so long as this is the case, we will continue to focus our near-term strategy primarily on retaining capital and building the value of our existing portfolio companies to increase the likelihood of maintaining potential future returns. We will also, where prudent and possible, continue to consider the sale of lower-yielding investments. This has resulted, and may continue to result, in significantly reduced investment activity, as our ability to make new investments under these conditions is largely dependent on availability of proceeds from the sale or exit of existing portfolio investments, which events may be beyond our control. As capital constraints improve, we intend to continue our strategy of making conservative investments in businesses that we believe will weather the current economy and that are likely to produce attractive long-term returns for our stockholders.

Syndicated Loan Valuations

In monitoring the market activity during the quarter ended December 31, 2009, we noted markets conditions indicating continued liquidity and a better functioning secondary market for syndicated loans. Therefore, in accordance with ASC 820, and following our valuation procedures which specify the use of third-party indicative bid quotes for valuing syndicated loans where there is a liquid public market for those loans and market pricing quotes are readily available, a third-party bid quote was used to value the remaining syndicated loans not sold during the quarter ended December 31, 2009. In January 2010, we sold the GTM Holdings syndicated loan. This loan is included in our consolidated assets as of December 31, 2009 and was valued as of December 31, 2009 at the respective sale price. The sale price was deemed to be an accurate reflection of the fair value as of December 31, 2009.

Investment Highlights

Purchases: During the three months ended December 31, 2009, we extended $180 of investments to a new portfolio company and $1,991 of investments to existing portfolio companies through revolver draws or the additions of new term notes, for total investments of $2,171.

Repayments: During the three months ended December 31, 2009, one borrower made an unscheduled payoff of $12,104, one borrower made an unscheduled partial payoff of $950, and we experienced contractual amortization, revolver repayments and some principal payments received ahead of schedule for an aggregate of $2,350, for total principal repayments of $15,404.

Sales: During the three months ended December 31, 2009, we sold two syndicated loans (which resulted in our exit from two portfolio companies) for an aggregate of $2,782 in net proceeds.

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Since our initial public offering in August 2001, we have made 262 different loans to, or investments in, 127 companies for a total of approximately $952,633, before giving effect to principal repayments on investments and divestitures.

Financing Highlights

On May 15, 2009, through our wholly-owned subsidiary, Gladstone Business Loan, LLC (Business Loan), we entered into a third amended and restated credit agreement which initially provided for a $127,000 revolving line of credit(the KEF Facility). During the three months ended December 31, 2009, we reduced the size of the KEF Facility by $25,000 from $127,000 to $102,000. Under the KEF Facility, the first $50,000 of commitment reductions are applied against Key Equipment Finance Inc. s (KEF s) commitment. Therefore, the entire $25,000 was subtracted from KEF s commitment, reducing it from $100,000 to $75,000 and leaving Branch Banking and Trust Company s (BB&T s) commitment unchanged at $27,000. As a result of the manner in which our borrowing base is calculated under the KEF Facility, the reduction did not affect our availability under the KEF Facility.

During the three months ended December 31, 2009, we applied Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 825, Financial Instruments, specifically to our KEF Facility, which requires us to apply a fair value methodology to the KEF Facility as of December 31, 2009. The KEF Facility was fair valued at $73,531 as of December 31, 2009, and the outstanding balance was $73,400.

Registration Statement

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

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RESULTS OF OPERATIONS

Comparison of the Three Months Ended December 31, 2009 to the Three Months Ended December 31, 2008

A comparison of our operating results for the three months ended December 31, 2009 and 2008 is shown below:

	For the three months ended December 31,			
	2009	**2008**	**$ Change**	**% Change**
INVESTMENT INCOME				
Interest income non control/non affiliate investments	$ 8,984	$ 11,661	$ (2,677)	(23.0)%
Interest income control investments	693	20	673	3,365.0%
Interest income cash		10	(10)	(100.0)%
Interest income notes receivable from employees	113	117	(4)	(3.4)%
Prepayment fees and other income	14		14	
Total investment income	9,804	11,808	(2,004)	(17.0)%
EXPENSES				
Interest expense	1,535	2,461	(926)	(37.6)%
Loan servicing fee	929	1,623	(694)	(42.8)%
Base management fee	721	434	287	66.1%
Incentive fee	375	1,176	(801)	(68.1)%
Administration fee	178	227	(49)	(21.6)%
Professional fees	912	313	599	191.4%
Amortization of deferred financing fees	494	719	(225)	(31.3)%
Stockholder related costs	78	89	(11)	(12.4)%
Directors fees	48	48		
Insurance expense	68	57	11	19.3%
Other expenses	67	66	1	1.5%
Expenses before credit from Adviser	5,405	7,213	(1,808)	(25.1)%
Credit to base management and incentive fees from Adviser	(29)	(1,286)	1,257	(97.7)%
Total expenses net of credit to base management and incentive fees	5,376	5,927	(551)	(9.3)%
NET INVESTMENT INCOME	4,428	5,881	(1,453)	(24.7)%
REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS, DERIVATIVE AND BORROWINGS UNDER LINE OF CREDIT:				
Net realized loss on investments	(920)	(1,731)	811	(46.9)%
Net unrealized appreciation (depreciation) on investments	2,599	(13,253)	15,852	(119.6)%
Net unrealized depreciation on borrowings under line of credit	219		219	
Net gain (loss) on investments, derivative and borrowings under line of credit	1,898	(14,984)	16,882	(112.7)%
	$ 6,326	$ (9,103)	$ 15,429	(169.5)%

NET INCREASE (DECREASE) IN NET ASSETS
RESULTING FROM OPERATIONS

Investment Income

Investment income for the three months ended December 31, 2009 was $9,804, as compared to $11,808 for the three months ended December 31, 2008. Interest income from our aggregate investment portfolio decreased for the three months ended December 31, 2009, as compared to the prior year period. The level of interest income from investments is directly related to the balance, at cost, of the interest-bearing investment portfolio outstanding during the period multiplied by the weighted average yield. The weighted average yield varies from period to period based on the current stated interest rate on interest-bearing investments and the amounts of loans for which interest is not accruing. Interest income from our investments decreased primarily due to the overall reduction in the cost basis of our investments, resulting from the exit of loans subsequent to December 31, 2008 partially offset by an increase in the weighted average yield on our portfolio. The annualized weighted average yield on our portfolio, excluding cash and cash equivalents, was 10.6% for the three months ended December 31, 2009 as compared to 9.8% for the prior year period. During the three months ended December 31, 2009, five investments were on non-accrual, for an aggregate of approximately $10,056 at cost, or 2.9% of the aggregate cost of our investment portfolio, and during the prior year period, three investments were on non-accrual, for an aggregate of approximately $9,227 at cost, or 2.0% of the aggregate cost of our investment portfolio.

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Interest income from Non-Control/Non-Affiliate investments decreased for the three months ended December 31, 2009, as compared to the prior year period. The decrease was primarily attributable to an overall decrease in the aggregate Non-Control/Non-Affiliate investments held at December 31, 2009 compared to the prior year period. In addition, we reversed previously recorded interest of approximately $508 during the three months ended December 31, 2009. The success fees earned during the three months ended December 31, 2009 and December 31, 2008, included in interest income, were $538 and $0, respectively. Success fees earned during the three months ended December 31, 2009 resulted from a refinancing by Tulsa Welding and an amendment to senior term debt issued to Doe & Ingalls.

Interest income from Control investments increased for the three months ended December 31, 2009, as compared to the prior year period. The increase was attributable to three additional Control investments held during the quarter ended December 31, 2009, which were converted from Non-Control/Non-Affiliate investments, as compared to the prior year period. In addition, we reversed previously recorded interest of approximately $75 during the three months ended December 31, 2009.

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

Three months ended December 31, 2009

Company		Interest Income	% of Total
Westlake Hardware	$	924	9.5%
Sunshine Media		846	8.7%
Reliable Biopharma		759	7.8%
Tulsa Welding		541	5.6%
Clinton Aluminum		522	5.4%
Subtotal	**$**	**3,592**	**37.0%**
Other companies		6,085	63.0%
Total interest income	**$**	**9,677**	**100.0%**

Three months ended December 31, 2008

Company		Interest Income	% of Total
Sunshine Media	$	843	7.2%
Reliable Biopharma		772	6.6%
Westlake Hardware		616	5.3%
Clinton Aluminum		475	4.1%
VantaCore		441	3.8%
Subtotal	**$**	**3,147**	**27.0%**
Other companies		8,534	73.0%
Total interest income	**$**	**11,681**	**100.0%**

Interest income from invested cash for the three months ended December 31, 2009 and 2008 was nominal. Interest income is based on the amount of cash held in interest bearing accounts and the interest earned on our custodial account prior to disbursement.

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

Prepayment fees and other income increased for the three months ended December 31, 2009 as compared to the prior year period. The income for the current period consisted of prepayment penalty fees received upon unscheduled principal repayments as well as interest from stock option loans of former employees.

Operating Expenses

Operating expenses, net of credits from the Adviser for fees earned and voluntary and irrevocable waivers applied to the base management and incentive fees, decreased for the three months ended December 31, 2009, as compared to the prior year period. This reduction was primarily due to a decrease in interest expense and the amortization of deferred financing fees incurred in connection with the KEF Facility, as well as a decrease in incentive fees, which were offset by a reduction in the Adviser s voluntary credit to the incentive fee and an increase in professional fees.

Interest expense decreased for the three months ended December 31, 2009 as compared to the prior year period due primarily to decreased borrowings under our line of credit during the three months ended December 31, 2009 as well as a lower weighted average annual interest cost, which is determined by using the annual stated interest rate plus commitment and other fees, plus the amortization of deferred financing fees divided by the weighted average debt outstanding.

Loan servicing fees decreased for the three months ended December 31, 2009 as compared to the prior year period. These fees are incurred in connection with a loan servicing agreement between Business Loan and our Adviser, which is based on the size of our investment portfolio. The decrease was primarily due to the reduction in the size of our investment portfolio, in particular the loans in our borrowing base. Due to voluntary, irrevocable and unconditional waivers applied during these periods, senior syndicated loans incurred a 0.5% annual fee, whereas proprietary loans incurred a 1.5% annual fee. All of these fees were offset against the amount of the base management fee due to our Adviser.

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Base management fee (which is net of loan servicing fees) increased for the three months ended December 31, 2009 as compared to the prior year period. However, the gross management fee (consisting of the loan servicing fees plus the base management fee) decreased from the prior year period as shown below:

	Three months ended	
	December 31, 2009	December 31, 2008
Loan servicing fee	$ 929	$ 1,623
Base management fee	720	434
Gross management fee	$ 1,649	$ 2,057

Gross management fee decreased due to fewer total assets held during the three months ended December 31, 2009. Furthermore, due to the liquidation of the majority of our syndicated loans, the credit received against the gross base management fee for investments in syndicated loans has also been reduced. The base management fee is computed quarterly as described under *Investment Advisory and Management Agreement* in Note 4 of the notes to the consolidated financial statements in our Annual Report on Form 10-K as filed with the SEC on November 23, 2009, and is summarized in the table below:

	Three months ended	
	December 31, 2009	December 31, 2008
Base management fee (1)	$ 721	$ 434
Credit for fees received by Adviser from the portfolio companies		(5)
Fee reduction for the voluntary, irrevocable waiver of 2.0% fee on senior syndicated loans to 0.5% per annum (2)	(7)	(105)
Net base management fee	$ 714	$ 324

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

(2) The board of our Adviser voluntarily and irrevocably waived, for the three months ended December 31, 2009 and 2008, the annual 2.0% base management fee to 0.5% for senior syndicated loan participations. Fees waived cannot be recouped by the Adviser in the future.

Incentive fee decreased for the three months ended December 31, 2009 as compared to the prior year period. The board of our Adviser voluntarily, irrevocably and unconditionally waived a portion of the incentive fee for the three months ended December 31, 2009 and the entire incentive fee for the three months ended December 31, 2008. The incentive fee and associated credits are summarized in the table below:

	Three months ended	
	December 31, 2009	December 31, 2008
Incentive fee	$ 375	$ 1,176
Credit from voluntary, irrevocable waiver issued by Adviser s board of directors	(22)	(1,176)
Net incentive fee	$ 353	$

Administration fee decreased for the three months ended December 31, 2009 as compared to the prior year period, due to a decrease of administration staff and related expenses, as well as a decrease in our total assets in comparison to the total assets of all companies managed by our Adviser under similar agreements. The calculation of the administrative fee is described in detail above under *Investment Advisory and*

Management Agreement in Note 4 of the notes to the consolidated financial statements in our Annual Report on Form 10-K as filed with the SEC on November 23, 2009.

Other operating expenses (including professional fees, deferred financing fees, stockholder related costs, director s fees, insurance and other direct expenses) increased for the three months ended December 31, 2009 as compared to the prior year period, due primarily to legal fees incurred in connection with troubled loans during the three months ended December 31, 2009.

Net Realized Loss on Investments

Net realized loss on investments for the three months ended December 31, 2009 was $920, which consisted of losses of $513 and $407 from the Kinetek and Wesco syndicated loan sales, respectively. Net realized loss for the three months ended December 31, 2008 was $1,731, which consisted of a $1,758 loss from the sale of the Greatwide syndicated loan, offset by a $27 gain from the Country Road payoff.

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Net Unrealized Appreciation (Depreciation) on Investments

Net unrealized appreciation (depreciation) on investments is the net change in the fair value of our investment portfolio during the reporting period, including the reversal of previously recorded unrealized appreciation or depreciation when gains and losses are realized. The net unrealized appreciation on investments for the three months ended December 31, 2009 consisted of the following:

• Control investments	$	(1,000)
• Non-Control/Non-Affiliate investments		2,193
• Reversal of previously recorded unrealized depreciation upon realization of losses		1,406
Total	$	2,599

Although our investment portfolio appreciated during the three months ended December 31, 2009, our entire portfolio was fair valued at 88% of cost as of December 31, 2009. The cumulative unrealized depreciation of our investments does not have an impact on our current ability to pay distributions to stockholders; however, it may be an indication of future realized losses, which could ultimately reduce our income available for distribution.

Net Unrealized Depreciation on Borrowings under Line of Credit

Unrealized depreciation on borrowings under line of credit is the net change in the fair value of our line of credit borrowings during the year, including the reversal of previously recorded unrealized appreciation or depreciation when gains and losses are realized. We elected to apply ASC 825, Financial Instruments, which requires that we apply a fair value methodology to the KEF Facility. We estimated the fair value of the KEF Facility using estimates of value provided by an independent third party and our own assumptions in the absence of observable market data, including estimated remaining life, current market yield and interest rate spreads of similar securities as of the measurement date. The KEF Facility was fair valued at $73,531 as of December 31, 2009, and unrealized depreciation of $219 was recorded for the three months ended December 31, 2009.

Net Increase (Decrease) in Net Assets Resulting from Operations

For the three months ended December 31, 2009, we realized a net increase in net assets resulting from operations of $6,326 as a result of the factors discussed above. For the three months ended December 31, 2008, we realized a net decrease in net assets resulting from operations of $9,103. Our net increase (decrease) in net assets resulting from operations per basic and diluted weighted average common share for the three months ended December 31, 2009 and December 31, 2008 were $0.30 and ($0.43), respectively.

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LIQUIDITY AND CAPITAL RESOURCES (dollar amounts in thousands, unless otherwise indicated)

Operating Activities

At December 31, 2009, we had investments in debt securities of, or loans to, 46 private companies with a cost basis totaling approximately $347,464. During the three months ended December 31, 2009 and December 31, 2008, the following investment activity occurred:

Quarter Ended	New Investments (1)	Principal Repayments (2)	Proceeds from Sales/Exits (3)	Net Loss on Disposal
December 31, 2009	$ 2,171	$ 15,404	$ 2,782	$ (920)
December 31, 2008	$ 8,702	$ 14,927	$ 2,212	$ (1,731)

(1) New Investments:

Quarter Ended	New Investments Companies	New Investments Investments	Disbursements to Existing Portfolio Companies	Total Disbursements
December 31, 2009	1(a)	$ 180	$ 1,991	$ 2,171
December 31, 2008		$	$ 8,702	$ 8,702

(a) Northstar Broadband

(2) Principal Repayments:

Quarter Ended	Number of Companies Fully Exited	Unscheduled Principal Repayments (*)	Scheduled Principal Repayments	Total Principal Repayments
December 31, 2009	1(a)	$ 13,054	$ 2,350	$ 15,404
December 31, 2008	2(b)	$ 6,966	$ 7,961	$ 14,927

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

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

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

(3) Proceeds from Sales/Exits:

Quarter Ended	Number of Companies Fully Exited		Proceeds Received		Position (Principal) Exited	Unamortized Loan Costs (*)		Net Loss on Exit
December 31, 2009	2(a)	$	2,782	$	(3,685)	(17)	$	(920)
December 31, 2008	(b)	$	2,212	$	(3,950)	7	$	(1,731)

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

(a) Complete sale of Kinetek senior term debt and Wesco Holdings senior subordinated term debt.

(b) Partial sale of Greatwide Logistics syndicated loan (senior term debt).

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

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			Amount
For the remaining nine months ending September 30:	2010	$	36,599
For the fiscal year ending September 30:	2011		92,485
	2012		72,816
	2013		121,017
	2014		11,773
	2015		6,851
	Total Contractual Repayments		341,541
	Investments in Equity Securities		5,478
	Unamortized premiums, discounts and investment acquisition costs on debt securities		445
	Total	$	347,464

Net cash provided by operating activities for the three months ended December 31, 2009, consisting primarily of the items described in *Results of Operations* and the investment activity described above, was $15,069 as compared to net cash provided by operating activities of $12,701 for the three months ended December 31, 2008.

Financing Activities

Net cash used in financing activities for the three months ended December 31, 2009 was $13,971 and mainly consisted of net payments on the KEF Facility of $9,600 and distributions to stockholders of $4,428. Net cash used in financing activities for the three months ended December 31, 2008 was $13,438 and primarily consisted of distributions to stockholders of $8,856 and net repayments our line of credit of $4,560.

Distributions

In order to qualify as a RIC and to avoid corporate level tax on the income we distribute to our stockholders, we are required, under Subchapter M of the Code, to distribute at least 90% of our ordinary income and short-term capital gains to our stockholders on an annual basis. Further, our KEF Facility requires us to pay distributions only from estimated net investment income. In accordance with these requirements, we declared and paid monthly cash distributions of $0.07 per common share for October, November and December 2009. In January 2010, our Board of Directors declared a monthly distribution of $0.07 per common share for each of January, February and March 2010.

Section 19(a) Disclosure

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

The following GAAP estimates were made by our Board of Directors during the quarter ended December 31, 2009:

Month Ended	Ordinary Income	Return of Capital	Total Distribution
October 31, 2009	$ 0.080	$ (0.010)	$ 0.070
November 30, 2009	0.079	(0.009)	0.070
December 31, 2009	0.078	(0.008)	0.070

Because our Board of Directors declares distributions at the beginning of a quarter, it is difficult to estimate how much of our monthly distributions, based on GAAP, will come from ordinary income, capital gains and returns of capital. Subsequent to the quarter ended December 31, 2009, the following corrections were made to the above listed estimates for that quarter:

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Month Ended	Ordinary Income	Return of Capital	Total Distribution
October 31, 2009	$ 0.099	$ (0.029)	$ 0.070
November 30, 2009	0.082	(0.012)	0.070
December 31, 2009	0.029	0.041	0.070

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

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

Issuance of Equity

On October 20, 2009, we filed a registration statement on Form N-2 with the SEC, which was declared effective on January 28, 2010. The registration statement permits us to issue, through one or more transactions, up to an aggregate of $300,000 in securities, consisting of common stock, senior common stock, preferred stock, subscription rights, debt securities and warrants to purchase common stock, or a combination of these securities.

We anticipate issuing equity securities to obtain additional capital in the future. However, we cannot determine the terms of any future equity issuances or whether we will be able to issue equity on terms favorable to us, or at all. Additionally, when our common stock is trading below NAV, we will have regulatory constraints under the 1940 Act on our ability to obtain additional capital in this manner. Generally, the 1940 Act provides that we may not issue and sell our common stock at a price below our NAV per share, other than to our then existing stockholders pursuant to a rights offering, without first obtaining approval from our stockholders and our independent directors. As of December 31, 2009, our NAV per share was $11.92 and our closing market price was $7.69 per share. To the extent that our common stock continues to trade at a market price below our NAV per share, we will generally be precluded from raising equity capital through public offerings of our common stock, other than pursuant to stockholder approval or a rights offering. The asset coverage requirement of a business development company under the 1940 Act effectively limits our ratio of debt to equity to 1:1. To the extent that we are unable to raise capital through the issuance of equity, our ability to raise capital through the issuance of debt may also be inhibited to the extent of our regulatory debt to equity ratio limits.

At our Annual Meeting of Stockholders held on February 19, 2009, our stockholders approved a proposal that authorizes us to sell shares of our common stock at a price below our then current NAV per share for a period of one year, provided that our Board of Directors makes certain determinations prior to any such sale. At the upcoming Annual Meeting of Stockholders scheduled for February 18, 2010, our stockholders will be asked to vote in favor of renewing this proposal for another year.

Revolving Credit Facility

On May 15, 2009, we entered into the KEF Facility, which currently provides for $102,000 revolving line of credit. . Advances under the KEF Facility will generally bear interest at the 30-day LIBOR or the commercial paper rate (subject to a minimum rate of 2%), plus 4% per annum, with a commitment fee of 0.75% per annum on undrawn amounts. As of December 31, 2009, there was a cost basis of approximately $73,400 of borrowings outstanding under the KEF Facility at an average interest rate of 7.30%, and the remaining borrowing capacity under the KEF Facility was $28,600. Available borrowings are subject to various constraints imposed under the KEF Facility, based on the aggregate loan balance pledged by Business Loan. Interest is payable monthly during the term of the KEF Facility. The KEF Facility matures on May 14, 2010 and, if the facility is not renewed or extended by this date, all principal and interest will be due and payable within one year of maturity. In addition, after May 14, 2010, if the KEF Facility is not renewed, all principal collections from our loans are required to be used to pay outstanding principal on the KEF Facility.

During the three months ended December 31, 2009, we reduced the size of the KEF Facility by $25,000, from $127,000 to $102,000. Without the addition of other committed lenders, the KEF Facility provides a total commitment of $102,000 from January 1, 2010 to May 11, 2010 and $77,000 thereafter.

The KEF Facility contains covenants that require Business Loan to maintain its status as a separate entity, prohibit certain significant corporate transactions (such as mergers, consolidations, liquidations or dissolutions), and restrict material changes to our credit and collection policies. The facility also limits payments of distributions. Further, the KEF Facility requires us to pay distributions only from estimated net investment income. As a result of that change from our prior credit facility, we reduced our distribution from

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$0.14 per share per month to $0.07 per share per month. As of December 31, 2009, Business Loan was in compliance with all of the facility covenants.

We applied ASC 825, Financial Instruments, specifically for the KEF Facility, which was consistent with our application of ASC 820 to our investments. ASC 825 requires that we apply a fair value methodology to the KEF Facility. We estimated the fair value of the KEF Facility using estimates of value provided by an independent third party and our own assumptions in the absence of observable market data, including estimated remaining life, current market yield and interest rate spreads of similar securities as of the measurement date. We also considered our own credit risk. The following table presents the KEF Facility carried at fair value as of December 31, 2009, by caption on the accompanying consolidated statements of assets and liabilities for each of the three levels of hierarchy established by ASC 820-10:

	As of December 31, 2009			
	Level 1	**Level 2**	**Level 3**	**Total Fair Value Reported in Condensed Consolidated Statement of Assets and Liabilities**
Borrowings under Line of Credit	$	$	$ 73,531	$ 73,531
Total	$	$	$ 73,531	$ 73,531

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

Changes in Level 3 Fair Value Measurements

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

Fair value measurements using unobservable data inputs (Level 3)

	Borrowings under line of credit
Three months ended December 31, 2009:	
Fair value at September 30, 2009	$ 83,350
Unrealized depreciation (a)	(219)

Net borrowings (b)		(9,600)
Transfers in (out) of Level 3		
Fair value as of December 31, 2009	$	73,531

(a) Included in unrealized depreciation on borrowings under line of credit on the accompanying condensed consolidated statements of operations for the three months ended December 31, 2009.

(b) Includes borrowings and principal repayments on the line of credit.

Contractual Obligations

As of December 31, 2009, we were not party to any signed term sheets for potential investments.

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Off-Balance Sheet Arrangements

We did not have any off-balance sheet arrangements as defined in Item 303(a)(4)(ii) of Regulation S-K as of December 31, 2009.

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported consolidated amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, and revenues and expenses during the period reported. Actual results could differ materially from those estimates. We have identified our investment valuation process, which was modified during the three months ended September 30, 2009, as our most critical account policy.

Investment Valuation

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

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

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

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

- *Level 2* inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. Level 2 inputs are in those markets for which there are few transactions, the prices are not current, little public information exists or instances where prices vary substantially over time or among brokered market makers; and

- *Level 3* inputs to the valuation methodology are unobservable and significant to the fair value measurement. Unobservable inputs are those inputs that reflect our own assumptions that market participants would use to price the asset or liability based upon the best available information.

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

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

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

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

- Publicly-traded securities;
- Securities for which a limited market exists; and
- Securities for which no market exists.

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Valuation Methods:

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

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

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

As of December 31, 2009, we assessed trading activity in syndicated loan assets and determined that there continued to be market liquidity and a functioning secondary market for these assets. Thus, firm bid prices or indicative bids were used to fair value our remaining syndicated loans at December 31, 2009. However, for the syndicated loan sale completed after December 31, 2009, we used the sales price to value such syndicated loan.

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

(1) **Portfolio investments comprised solely of debt securities:** Debt securities that are not publicly traded on an established securities market, or for which a limited market does not exist (Non-Public Debt Securities), and that are issued by portfolio companies where we have no equity or equity-like securities, are fair valued in accordance with the terms of the policy, which utilizes opinions of value submitted to us by

Standard & Poor s Securities Evaluations, Inc. (SPSE). We may also submit PIK interest to SPSE for their evaluation when it is determined that PIK interest is likely to be received.

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

SPSE provides evaluated price opinions which are reflective of what SPSE believes the bid side of the market would be for each loan after careful review and analysis of descriptive, market and credit information. Each price reflects SPSE s best judgment based upon careful examination of a variety of market factors. Because of fluctuation in the market and in other

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

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

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

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

In gathering the sales to third parties of similar securities, we may reference industry statistics and use outside experts. Once we have estimated the total enterprise value of the issuer, we subtract the value of all the debt securities of the issuer; which are valued at the contractual principal balance. Fair values of these debt securities are discounted for any shortfall of total enterprise value over the total debt outstanding for the issuer.

Once the values for all outstanding senior securities (which include the debt securities) have been subtracted from the total enterprise value of the issuer, the remaining amount, if any, is used to determine the value of the issuer s equity or equity-like securities. If, in our Adviser s judgment, the liquidity waterfall approach does not accurately reflect the value of the debt component, our Adviser may recommend that we use a valuation by SPSE or, if that is unavailable, a DCF valuation technique.

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

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investments and indices with similar structures and risk characteristics or our own assumptions in the absence of other observable market data and may also employ DCF valuation techniques.

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

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

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

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

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

Loan Grading and Risk Rating: As part of our valuation procedures above, we risk rate all of our investments in debt securities. For syndicated loans that have been rated by an NRSRO (as defined in Rule 2a-7 under the 1940 Act), we use the NRSRO s risk rating for such security. For all other debt securities, we use a proprietary risk rating system. Our risk rating system uses a scale of 0 to 10, with 10 being the lowest probability of default. This system is used to estimate the probability of default on debt securities and the probability of loss if there is a default. These types of systems are referred to as risk rating systems and are used by banks and rating agencies. The risk rating system covers both qualitative and quantitative aspects of the business and the securities we hold.

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

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

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

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

Rating	**Dec. 31, 2009**	**Sept. 30, 2009**
Average	**7.2**	**7.1**
Weighted Average	**7.1**	**7.2**
Highest	**9.0**	**9.0**
Lowest	**5.0**	**3.0**

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

Rating	**Dec. 31, 2009**	**Sept. 30, 2009**
Average	**8.0**	**7.0**
Weighted Average	**8.0**	**7.0**
Highest	**8.0**	**7.0**
Lowest	**8.0**	**7.0**

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

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

Tax Status

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

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

Revenue Recognition

Interest Income Recognition

Interest income, adjusted for amortization of premiums and acquisition costs and for the accretion of discounts, is recorded on the accrual basis to the extent that such amounts are expected to be collected. Generally, when a loan becomes 90 days or more past due or if our qualitative assessment indicates that the debtor is unable to service its debt or other obligations, we will place the loan on non-accrual status and cease recognizing interest income on that loan until the borrower has demonstrated the ability and intent to pay contractual amounts due. However, we remain contractually entitled to this interest. At December 31, 2009, two Non-Control/Non-Affiliate investments and four Control investments were on non-accrual with an aggregate cost basis of approximately $13,001 or 3.7% of the cost basis of all investments in our portfolio. At September 30, 2009, one Non-Control/Non-Affiliate investment and four Control investments were on non-accrual with an aggregate cost basis of approximately $10,022 or 2.8% of the cost basis of all investments in our portfolio. Conditional interest, or a success fee, is recorded when earned or upon full repayment of a loan investment.

Paid in Kind Interest

Two loans in our portfolio contain PIK provisions. The PIK interest, computed at the contractual rate specified in each loan agreement, is added to the principal balance of the loan and recorded as interest income. To maintain our status as a RIC, this non-cash source of income must be paid out to stockholders in the form of distributions, even though we have not yet collected the cash. For the three months ended December 31, 2009 and 2008, we recorded PIK income of $51 and $17, respectively.

Services Provided to Portfolio Companies

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

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

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

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

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Recent Accounting Pronouncements

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

We are subject to financial market risks, including changes in interest rates. We estimate that ultimately approximately 20% of the loans in our portfolio will be made at fixed rates and approximately 80% will be made at variable rates. As of December 31, 2009, our portfolio consisted of the following:

84%	variable rates with a floor
2%	variable rates with a floor and ceiling
10%	variable rates without a floor or ceiling
4%	fixed rate
100%	total

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

ITEM 4. CONTROLS AND PROCEDURES.

a) Evaluation of Disclosure Controls and Procedures

As of December 31, 2009, we, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)). Based on that evaluation, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective in timely alerting management, including the Chief Executive Officer and Chief Financial Officer, of material information about us required to be included in periodic Securities and Exchange Commission filings. However, in evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

b) Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2009, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

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

ITEM 1A. RISK FACTORS.

Our business is subject to certain risks and events that, if they occur, could adversely affect our financial condition and results of operations and the trading price of our common stock. For a discussion of these risks, please refer to the Risk Factors section of our Annual Report on Form 10-K for the fiscal year ended September 30, 2009, filed by us with the SEC on November 23, 2009.

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

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

Not applicable.

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

Not applicable

ITEM 5. OTHER INFORMATION.

Not applicable

ITEM 6. EXHIBITS

See the exhibit index.

SIGNATURE

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

GLADSTONE CAPITAL CORPORATION

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

Date: February 1, 2010

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EXHIBIT INDEX

Exhibit	Description
3.1	Articles of Amendment and Restatement of the Articles of Incorporation, incorporated by reference to Exhibit a.2 to Pre-Effective Amendment No. 1 to the Registration Statement on Form N-2 (File No. 333-63700), filed July 27, 2001.
3.2	By-laws, incorporated by reference to Exhibit b to Pre-Effective Amendment No. 1 to the Registration Statement on Form N-2 (File No. 333-63700), filed July 27, 2001.
3.3	Amendment to By-laws, incorporated by reference to Exhibit 3.3 to the Company s Quarterly Report on Form 10-Q for the quarter ended December 31, 2003 (File No. 814-00237), filed February 17, 2004.
3.4	Second amendment to By-laws, incorporated by reference to Exhibit 99.1 to the Company s Current Report on Form 8-K (File No. 814-00237), filed July 10, 2007.
11	Computation of Per Share Earnings (included in the notes to the unaudited condensed consolidated financial statements contained in this report).
31.1	Certification of Chief Executive Officer pursuant to section 302 of The Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to section 302 of The Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to section 906 of The Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to section 906 of The Sarbanes-Oxley Act of 2002.

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