

GLADSTONE CAPITAL CORP

Form 497

January 22, 2013

Table of Contents

Filed pursuant to Rule 497  
Registration No. 333-185191

PROSPECTUS

**\$300,000,000**

**COMMON STOCK**

**PREFERRED STOCK**

**SUBSCRIPTION RIGHTS**

**WARRANTS**

**DEBT SECURITIES**

We may offer, from time to time, up to \$300,000,000 aggregate initial offering price of our common stock, \$0.001 par value per share, preferred stock, \$0.001 par value per share, subscription rights to purchase common stock or preferred stock, warrants representing rights to purchase shares of our common stock or preferred stock, or debt securities, or a combined offering of these securities, which we refer to in this prospectus collectively as our Securities, in one or more offerings. The Securities may be offered at prices and on terms to be disclosed in one or more supplements to this prospectus. In the case of our common stock and warrants or rights to acquire such common stock hereunder, the offering price per share of our common stock by us, less any underwriting commissions or discounts, will not be less than the net asset value ( NAV ) per share of our common stock at the time of the offering except (i) in connection with a rights offering to our existing common stockholders, (ii) with the consent of the holders of the majority of our outstanding stock, or (iii) under such other circumstances as the Securities and Exchange Commission ( SEC ) may permit. You should read this prospectus and the applicable prospectus supplement carefully before you invest in our Securities.

Our Securities may be offered directly to one or more purchasers, including existing stockholders in a rights offering, through agents designated from time to time by us, or to or through underwriters or dealers. The prospectus supplement relating to the offering will identify any agents or underwriters involved in the sale of our Securities, and will disclose any applicable purchase price, fee, commission or discount arrangement between us and our agents or underwriters or among our underwriters or the basis upon which such amount may be calculated. See *Plan of Distribution*. We may not sell any of our Securities through agents, underwriters or dealers without delivery of a prospectus supplement describing the method and terms of the offering of such Securities. Our common stock is traded on The NASDAQ Global Select Market ( NASDAQ ) under the symbol GLAD. As of January 17, 2013, the last reported sales price for our common stock was \$8.87. Our 7.125% Series 2016 Term Preferred Stock is also traded on the NASDAQ under the symbol GLADP. As of January 17, 2013, the last reported sales price for our 7.125% Series 2016 Term Preferred Stock was \$25.75.

This prospectus contains information you should know before investing, including information about risks. Please read it before you invest and keep it for future reference. Additional information about us, including our annual, quarterly and current reports, has been filed with the SEC. This information is available free of charge on our corporate website located at [www.gladstonecapital.com](http://www.gladstonecapital.com). See *Additional Information*. This prospectus may not be used to consummate sales of securities unless accompanied by a prospectus supplement.

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

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

January 18, 2013

**Table of Contents****TABLE OF CONTENTS**

	Page
<u>Prospectus Summary</u>	1
<u>Additional Information</u>	7
<u>Risk Factors</u>	9
<u>Special Note Regarding Forward-Looking Statements</u>	26
<u>Use of Proceeds</u>	26
<u>Price Range of Common Stock and Distributions</u>	26
<u>Common Share Price Data</u>	27
<u>Ratio of Earnings to Fixed Charges</u>	28
<u>Consolidated Selected Financial Data</u>	28
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	30
<u>Sales of Common Stock Below Net Asset Value</u>	57
<u>Senior Securities</u>	62
<u>Business</u>	63
<u>Portfolio Companies</u>	76
<u>Management</u>	81
<u>Control Persons and Principal Stockholders</u>	97
<u>Dividend Reinvestment Plan</u>	99
<u>Material U.S. Federal Income Tax Considerations</u>	100
<u>Regulation as a Business Development Company</u>	102
<u>Description of Our Securities</u>	104
<u>Certain Provisions of Maryland Law and of Our Articles of Incorporation and Bylaws</u>	108
<u>Share Repurchases</u>	110
<u>Plan of Distribution</u>	110
<u>Custodian, Transfer and Dividend Paying Agent and Registrar</u>	111
<u>Brokerage Allocation and Other Practices</u>	112
<u>Proxy Voting Policies and Procedures</u>	112
<u>Legal Matters</u>	113
<u>Experts</u>	113
<u>Financial Statements</u>	F-1

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

## **Table of Contents**

### **PROSPECTUS SUMMARY**

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

### **GLADSTONE CAPITAL CORPORATION**

#### **General**

We were incorporated under the General Corporation Laws of the State of Maryland on May 30, 2001 and completed our initial public offering on August 24, 2001. We operate as a closed-end, non-diversified management investment company and we have elected to be treated as a business development company ( BDC ) under the Investment Company Act of 1940, as amended (the 1940 Act ). For federal income tax purposes, we have elected to be treated as a regulated investment company ( RIC ) under Subchapter M of the Internal Revenue Code of 1986, as amended (the Code ). We currently continue to qualify as a RIC for federal income tax purposes and obtain favorable RIC tax treatment by meeting certain requirements, including certain minimum distribution requirements. Our board of directors (the Board of Directors ) recently approved limited revisions to our investment objectives and strategies, which went into effect on January 1, 2013, which are reflected in the descriptions of our investment objectives and strategies below. All of our existing portfolio investments fit within the scope of our revised investment objectives and strategies and no changes were required to be made to our portfolio as a result of these limited revisions.

#### **Our Investment Objectives**

Our investment objectives are to: (1) achieve and grow current income by investing in debt securities of established businesses that we believe will provide stable earnings and cash flow to pay expenses, make principal and interest payments on our outstanding indebtedness and make distributions to stockholders that grow over time; and (2) provide our stockholders with long-term capital appreciation in the value of our assets by investing in equity securities of established businesses that we believe can grow over time to permit us to sell our equity investments for capital gains.

#### **Our Investment Strategy**

To achieve our objectives, we seek to invest in several categories of debt and equity securities, with each investment generally ranging from \$5 million to \$30 million, although investment size may vary, depending upon our total assets or available capital at the time of investment.

In general, our investments in debt securities have a term of no more than seven years, accrue interest at variable rates (based on the London Interbank Offered Rate ( LIBOR )) and, to a lesser extent, at fixed rates. We seek debt instruments that pay interest monthly or, at a minimum, quarterly, have a success fee or deferred interest provision and are primarily interest only with all principal and any accrued but unpaid interest due at maturity. Generally, success fees accrue at a set rate and are contractually due upon a change of control in the business. Some debt securities have deferred interest whereby some portion of the interest payment is added to the principal balance so that the interest is paid, together with the principal, at maturity. This form of deferred interest is often called paid in kind ( PIK ).

Typically, our equity investments consist of common stock, preferred stock, limited liability company interests, or warrants to purchase the foregoing. Often, these equity investments occur in connection with our original investment, recapitalizing a business, or refinancing existing debt. Although at times we may enter into co-investment transactions with Gladstone Investment Corporation ( Gladstone Investment ), in relation to one another, we will generally invest a greater portion of our assets in debt securities, while Gladstone Investment will generally invest a greater portion of its assets in equity securities.

We expect that our target portfolio over time will primarily include the following four categories of investments in private U.S. companies:

## **Table of Contents**

*Senior Debt Securities:* We seek to invest a portion of our assets in senior debt securities also known as senior loans, senior term loans, lines of credit and senior notes. Using its assets as collateral, the borrower typically uses senior debt to cover a substantial portion of the funding needs of the business. The senior debt security usually takes the form of first priority liens on the assets of the business. Senior debt securities may include our participation and investment in the syndicated loan market.

*Senior Subordinated Debt Securities:* We seek to invest a portion of our assets in senior subordinated debt securities, also known as senior subordinated loans and senior subordinated notes. These senior subordinated debts also include second lien notes and may include participation and investment in syndicated second lien loans. Additionally, we may receive other yield enhancements in connection with these senior subordinated debt securities.

*Junior Subordinated Debt Securities:* We seek to invest a portion of our assets in junior subordinated debt securities, also known as subordinated loans, subordinated notes and mezzanine loans. These junior subordinated debts include second lien notes and unsecured loans. Additionally, we may receive other yield enhancements and warrants to buy common and preferred stock or limited liability interests in connection with these junior subordinated debt securities.

*Preferred and Common Equity:* In some cases we will purchase equity securities which consist of preferred and common equity or limited liability company interests, or warrants or options to acquire such securities, and are in combination with our debt investment in a business. Additionally, we may receive equity investments derived from restructurings on some of our existing debt investments. In some cases, we will own a significant portion of the equity and in other cases we may have voting control of the businesses in which we invest. Additionally, pursuant to the 1940 Act, we must maintain at least 70% of our total assets in qualifying assets, which generally include each of the investment types listed above. Therefore, the 1940 Act permits us to invest up to 30% of our assets in other non-qualifying assets.

Because the majority of the loans in our portfolio consist of term debt of private U.S. companies that typically cannot or will not expend the resources to have their debt securities rated by a credit rating agency, we expect that most, if not all, of the debt securities we acquire will be unrated. Investors should assume that these loans would be at rates below what is today considered investment grade quality. Investments rated below investment grade are often referred to as high yield securities or junk bonds and may be considered high risk as compared to investment-grade debt instruments.

## **Our Investment Adviser and Administrator**

Gladstone Management Corporation (the Adviser) is our affiliate, investment adviser, and a privately-held company led by a management team which has extensive experience in our lines of business. The Adviser's affiliate, a privately-held company, Gladstone Administration, LLC (the Administrator), employs our chief financial officer and treasurer, chief accounting officer, chief compliance officer, internal legal counsel and their respective staffs. Excluding our chief financial officer and treasurer and chief accounting officer, all of our executive officers serve as directors or executive officers, or both, of the following of our affiliates: Gladstone Commercial Corporation (Gladstone Commercial), a publicly-traded real estate investment trust; Gladstone Investment, a publicly-traded BDC and RIC; the Adviser; and the Administrator. Our chief financial officer and treasurer is also the chief financial officer and treasurer of Gladstone Investment. David Gladstone, our chairman and chief executive officer, also serves on the board of managers as an outside non-employee manager of our affiliate, Gladstone Securities, LLC (Gladstone Securities), a privately-held broker-dealer registered with the Financial Industry Regulatory Authority (FINRA) and insured by the Securities Investor Protection Corporation.

The Adviser and Administrator also provide investment advisory and administrative services, respectively, to our other affiliates, including, but not limited to, Gladstone Commercial; Gladstone Investment; and Gladstone Land Corporation (Gladstone Land), a private agricultural real estate company owned by David Gladstone, our chairman and chief executive officer. The Adviser and Administrator may provide investment advisory and administrative services, respectively, to other funds and companies, both public and private.

We have been externally managed by the Adviser pursuant to an investment advisory agreement since October 1, 2004. The Adviser was organized as a corporation under the laws of the State of Delaware on July 2, 2002, and is a registered investment adviser under the Investment Advisers Act of 1940, as amended. The Adviser is headquartered in McLean, Virginia, a suburb of Washington, D.C., and also has offices in several other states.

## **Recent Developments**

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On November 28, 2012, we announced that Mr. Stelljes intends to resign from his positions as our president, chief investment officer, assistant secretary and director, as well as his officer and director positions for the other publicly traded Gladstone funds, Gladstone Commercial and Gladstone Investment, to devote his efforts to creating and managing new investment vehicles for the Gladstone family of companies. No effective dates for his resignations have been determined, but we expect the transition to commence in the very near future. In anticipation of Mr. Stelljes' resignation as president of Gladstone Capital, we have begun a search for his replacement.

Mr. Stelljes will continue to perform his duties as an officer and director of the Adviser.

**Table of Contents**

**THE OFFERING**

We may offer, from time to time, up to \$300,000,000 of our Securities, on terms to be determined at the time of the offering. Our Securities may be offered at prices and on terms to be disclosed in one or more prospectus supplements. In the case of an offering of our common stock and warrants or rights to acquire such common stock hereunder in any offering, the offering price per share, exclusive of any underwriting commission or discount, will not be less than the NAV per share of our common stock at the time of the offering except (i) in connection with a rights offering to our existing stockholders, (ii) with the consent of the majority of our common stockholders, or (iii) under such other circumstances as the SEC may permit. If we were to sell shares of our common stock below our then current NAV per share, such sales would result in an immediate dilution to the NAV per share. This dilution would occur as a result of the sale of shares at a price below the then current NAV per share of our common stock and a proportionately greater decrease in a stockholder's interest in our earnings and assets and voting interest in us than the increase in our assets resulting from such issuance.

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

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

Common Stock Trading Symbol (NASDAQ)	GLAD
7.125% Series 2016 Term Preferred Stock Trading Symbol (NASDAQ)	GLADP

Use of Proceeds	Unless otherwise specified in a prospectus supplement, we intend to use the net proceeds from the sale of our Securities first to pay down existing short-term debt, then to make investments in small and mid-sized companies in accordance with our investment objectives, with any remaining proceeds to be used for other general corporate purposes. See <i>Use of Proceeds</i> .
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Dividends and Distributions	We have paid monthly distributions to the holders of our common stock since October 2003 (and prior to that quarterly distributions since January 2002) and generally intend to continue to do so. We made our first distribution on our term preferred stock in December of 2011 and have made monthly distributions thereafter. The amount of monthly distributions on our common stock is determined by our Board of Directors on a quarterly basis and is based on our estimate of our annual investment company taxable income and net short-term taxable capital gains, if any. See <i>Price Range of Common Stock and Distributions</i> . Certain additional amounts may be deemed as distributed to stockholders for income tax purposes. Other types of securities we might offer will likely pay distributions in accordance with their terms.
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Taxation	We intend to continue to elect to be treated for federal income tax purposes as a RIC. So long as we continue to qualify, we generally will pay no corporate-level federal income taxes on any ordinary income or capital gains that we distribute to our stockholders. To maintain our RIC status, we must meet specified source-of-income and asset diversification requirements and distribute annually at least 90% of our taxable ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, out of assets legally available for distribution. See <i>Material U.S. Federal Income Tax Considerations</i> .
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**Table of Contents**

Trading at a Discount	Common shares of closed-end investment companies frequently trade at a discount to their NAV. The possibility that our common shares may trade at a discount to our NAV is separate and distinct from the risk that our NAV per common share may decline. We cannot predict whether our common shares will trade above, at or below NAV, although during the past three years, our common stock has often traded, and at times significantly, below NAV.
Certain Anti-Takeover Provisions	Our Board of Directors is divided into three classes of directors serving staggered three-year terms. This structure is intended to provide us with a greater likelihood of continuity of management, which may be necessary for us to realize the full value of our investments. A staggered board of directors also may serve to deter hostile takeovers or proxy contests, as may certain provisions of Maryland law and other measures we have adopted. See <i>Certain Provisions of Maryland Law and of Our Articles of Incorporation and Bylaws</i> .
Dividend Reinvestment Plan	We have a dividend reinvestment plan for our common stockholders. This is an opt in dividend reinvestment plan, meaning that stockholders may elect to have their cash dividends automatically reinvested in additional shares of our common stock. Stockholders who do not so elect will receive their dividends in cash. Stockholders who receive distributions in the form of stock will be subject to the same federal, state and local tax consequences as stockholders who elect to receive their distributions in cash. See <i>Dividend Reinvestment Plan</i> .
Management Arrangements	Gladstone Management Corporation serves as the investment adviser, and Gladstone Administration, LLC serves as the Administrator. For a description of the Adviser, the Administrator, the Gladstone Companies and the contractual arrangements with these companies, see <i>Management Certain Transactions Investment Advisory and Management Agreement</i> , <i>Management Certain Transactions Administration Agreement</i> and <i>Management Certain Transactions Loan Servicing Agreement</i> .

**FEES AND EXPENSES**

The following table is intended to assist you in understanding the costs and expenses that an investor in this offering will bear directly or indirectly. We caution you that some of the percentages indicated in the table below are estimates and may vary. Except where the context suggests otherwise, whenever this prospectus contains a reference to fees or expenses paid by us or Gladstone Capital, or that we will pay fees or expenses, stockholders will indirectly bear such fees or expenses as investors in Gladstone Capital. The following annualized percentages were calculated based on actual expenses incurred in the quarter ended September 30, 2012 and average net assets for the quarter ended September 30, 2012.

**Stockholder Transaction Expenses:**

Sales load or other commission (as a percentage of offering price)(1)	%
Offering expenses (as a percentage of offering price)(1)	%
Dividend reinvestment plan expenses(2)	None
Total stockholder transaction expenses (1)	%

**Annual expenses (as a percentage of net assets attributable to common stock):**

Management fees(3)	3.20%
Incentive fees payable under investment advisory and management agreement (20% of realized capital gains and 20% of pre-incentive fee net investment income)(4)	2.41%
Interest payments on borrowed funds(5)	2.60%
Dividend expense on mandatorily redeemable preferred stock (6)	1.67%
Other expenses(7)	1.97%
Total annual expenses(3)(7)	11.85%

- (1) The amounts set forth in the table above do not reflect the impact of any sales load, sales commission or other offering expenses borne by Gladstone Capital and its stockholders. The prospectus supplement relating to an offering of securities pursuant to this prospectus will disclose the estimated offering price and the estimated offering expenses and total stockholder transaction expenses borne by Gladstone Capital and its stockholders as a percentage of the offering price. In the event that securities to which this prospectus relates are sold to or through underwriters, the prospectus supplement will also disclose the applicable sales load.





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**Table of Contents**

- (2) The expenses of the reinvestment plan are included in stock record expenses, a component of other expenses. We do not have a cash purchase plan. The participants in the dividend reinvestment plan will bear a pro rata share of brokerage commissions incurred with respect to open market purchases, if any. See *Dividend Reinvestment Plan* for information on the dividend reinvestment plan.
- (3) Our annual base management fee is 2.0% (0.5% quarterly) of our average gross assets, which are defined as total assets of Gladstone Capital, including investments made with proceeds of borrowings, less any uninvested cash or cash equivalents resulting from borrowings. For the three months ended September 30, 2012, the Adviser voluntarily agreed to waive the annual base management fee of 2.0% to 0.5% for those senior syndicated loan participations that we purchase using borrowings from our credit facility. Although there can be no guarantee that the Adviser will continue to waive any portion of the fees due under the amended and restated investment advisory agreement ( *Advisory Agreement* ), on an annual basis after giving effect to this waiver, the estimated management fees as a percentage of net assets attributable to common stock were 3.03% and the total estimated annual expenses as a percentage of net assets attributable to common stock were 11.67%. See *Management Certain Transactions Investment Advisory and Management Agreement*.
- (4) The incentive fee consists of two parts: an income-based fee and a capital gains-based fee. The income-based fee is payable quarterly in arrears, and equals 20.0% of the excess, if any, of our pre-incentive fee net investment income that exceeds a 1.75% quarterly (7.0% annualized) hurdle rate of our net assets, subject to a catch-up provision measured as of the end of each calendar quarter. The catch-up provision requires us to pay 100% of our pre-incentive fee net investment income with respect to that portion of such income, if any, that exceeds the hurdle rate but is less than 125.0% of the quarterly hurdle rate (or 2.1875%) in any calendar quarter (8.75% annualized). The catch-up provision is meant to provide the Adviser with 20.0% of our pre-incentive fee net investment income as if a hurdle rate did not apply when our pre-incentive fee net investment income exceeds 125.0% of the quarterly hurdle rate in any calendar quarter (8.75% annualized). The income-based incentive fee is computed and paid on income that may include interest that is accrued but not yet received in cash. Our pre-incentive fee net investment income used to calculate this part of the income-based incentive fee is also included in the amount of our gross assets used to calculate the 2.0% base management fee (see footnote 2 above). The capital gains-based incentive fee equals 20.0% of our net realized capital gains since our inception, if any, computed net of all realized capital losses and unrealized capital depreciation since our inception, less any prior payments, and is payable at the end of each fiscal year. We have not recorded any capital gains-based incentive fee from our inception through September 30, 2012.

From time to time, the Adviser has voluntarily agreed to waive a portion of the incentive fees, to the extent net investment income did not cover 100% of the distributions to common stockholders during the period, although no waiver was necessary for such purpose, or granted, for the quarter ended September 30, 2012. There can be no guarantee that the Adviser will continue to waive any portion of the fees under the *Advisory Agreement* in the future.

**Table of Contents**

Examples of how the incentive fee would be calculated are as follows:

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

Assuming pre-incentive fee net investment income of 2.00%, the income-based incentive fee would be as follows:  
 $= 100\% \times (2.00\% - 1.75\%)$

$= 0.25\%$

Assuming pre-incentive fee net investment income of 2.30%, the income-based incentive fee would be as follows:  
 $= (100\% \times (\text{catch-up} : 2.1875\% - 1.75\%)) + (20\% \times (2.30\% - 2.1875\%))$

$= (100\% \times 0.4375\%) + (20\% \times 0.1125\%)$

$= 0.4375\% + 0.0225\%$

$= 0.46\%$

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

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

$= 20\% \times 5\%$

$= 1\%$

For a more detailed discussion of the calculation of the two-part incentive fee, see *Management Certain Transactions Investment Advisory and Management Agreement*.

- (5) Includes deferred financing costs. We renewed our revolving credit facility for a three year period, effective January 19, 2012, under which our borrowing capacity is \$137.0 million. We have drawn down on this credit facility and we expect to borrow additional funds in the future up to an amount so that our asset coverage, as defined in the 1940 Act, is at least 200% after each issuance of our senior securities. Assuming that we borrowed \$137.0 million at an interest rate of 5.25% plus an additional fee related to borrowings of 0.45%, for an aggregate rate of 5.70%, interest payments and amortization of deferred financing costs on borrowed funds would have been 4.14% of our average net assets for the quarter ended September 30, 2012.
- (6) In November 2011, we completed a public offering of 7.125% Series 2016 Term Preferred Stock, par value \$0.001 per share, at a public offering price of \$25.00 per share. In the offering, we issued approximately 1.5 million shares of 7.125% Series 2016 Term Preferred Stock. Dividend expense includes the amounts paid to preferred stockholders during the three months ended September 30, 2012. Also included in this line item is the amortization of the offering costs related to our term preferred stock offering. See *Management Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Series 2016 Term Preferred Stock* for additional information.
- (7) Includes our overhead expenses, including payments under the administration agreement based on our projected allocable portion of overhead and other expenses incurred by the Administrator in performing its obligations under the administration agreement. See *Management Certain Transactions Administration Agreement*.

**Examples**

The following examples demonstrate the projected dollar amount of total cumulative expenses that would be incurred over various periods with respect to a hypothetical investment in our Securities. In calculating the following expense amounts, we have assumed that our annual operating expenses would remain at the levels set forth in the table above. The amounts set

**Table of Contents**

forth below do not reflect the impact of sales load or offering expenses to be borne by Gladstone Capital or its stockholders. In the prospectus supplement relating to an offering of securities pursuant to this prospectus, the examples below will be restated to reflect the impact of the estimated offering expenses borne by Gladstone Capital and its stockholders and, in the event that securities to which this prospectus relates are sold to or through underwriters, the impact of the applicable sales load. The examples below and the expenses in the table above should not be considered a representation of our future expenses, and actual expenses (including the cost of debt, incentive fees, if any, and other expenses) may be greater or less than those shown.

	1 Year	3 Years	5 Years	10 Years
You would pay the following expenses on a \$1,000 investment:				
assuming a 5% annual return consisting entirely of ordinary income(1)(2)	\$ 124	\$ 346	\$ 536	\$ 900
assuming a 5% annual return consisting entirely of capital gains(2)(3)	\$ 133	\$ 367	\$ 564	\$ 929

- (1) While the example assumes, as required by the SEC, a 5% annual return, our performance will vary and may result in a return greater or less than 5%. Additionally, we have assumed that the entire amount of such 5% annual return would constitute ordinary income as we have not historically realized positive capital gains (computed net of all realized capital losses) on our investments. For purposes of this example, we have assumed that the entire amount of such 5% annual return would constitute ordinary income as we have not historically realized positive capital gains (computed net of all realized capital losses) on our investments. Because the assumed 5% annual return is significantly below the hurdle rate of 7% (annualized) that we must achieve under the investment advisory and management agreement to trigger the payment of an income-based incentive fee, we have assumed, for purposes of this example, that no income-based incentive fee would be payable if we realized a 5% annual return on our investments.
- (2) While the example assumes reinvestment of all dividends and distributions at NAV, participants in our dividend reinvestment plan will receive a number of shares of our common stock, determined by dividing the total dollar amount of the dividend payable to a participant by the average cost of shares of our common stock purchased in the open market in the period beginning on or before the payment date of the distribution and ending when the plan agent has expended for such purchases all of the cash that would have been otherwise payable to participants. See *Dividend Reinvestment Plan* for additional information regarding our dividend reinvestment plan.
- (3) While the example assumes, as required by the SEC, a 5% annual return, our performance will vary and may result in a return greater or less than 5%. For purposes of this example, we have assumed that the entire amount of such 5% annual return would constitute capital gains.

This example and the expenses in the table above should not be considered a representation of our future expenses, and actual expenses (including the cost of debt, incentive fees, if any, and other expenses) may be greater or less than those shown.

**ADDITIONAL INFORMATION**

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

We also file reports, proxy statements and other information with the SEC under the Securities Exchange Act of 1934, as amended, which we refer to as the Exchange Act. Such reports, proxy statements and other information, as well as the registration statement and the amendments, exhibits and schedules thereto, can be inspected at the public reference facilities maintained by the SEC at 100 F Street, N.E., Washington, D.C. 20549. Information about the operation of the public reference facilities may be obtained by calling the SEC at 1-800-SEC-0330. The SEC maintains a website that contains reports, proxy statements and other information regarding registrants, including us, that file such information electronically with the SEC. The address of the SEC's website is <http://www.sec.gov>. Copies of such material may also be obtained from the Public Reference Section of the SEC at 100 F Street, N.E., Washington, D.C. 20549, at prescribed rates. Our common stock is listed on the NASDAQ and our corporate website is located at [www.gladstonecapital.com](http://www.gladstonecapital.com). The information contained on, or accessible through, our website is not a part of this prospectus.

**Table of Contents**

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

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

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**Table of Contents**

**RISK FACTORS**

You should carefully consider the risks described below and all other information provided and incorporated by reference in this prospectus (or any prospectus supplement) before making a decision to purchase our Securities. The risks and uncertainties described below are not the only ones facing us. Additional risks and uncertainties not presently known to us, or not presently deemed material by us, may also impair our operations and performance. If any of the following risks actually occur, our business, financial condition or results of operations could be materially adversely affected. If that happens, the trading price of our Securities could decline, and you may lose all or part of your investment.

***Risks Related to the Economy***

*The uncertainty surrounding the strength of the U.S. economic recovery and the capital markets volatility in general increases the possibility of adverse effects on our financial position and results of operations. Continued economic adversity could impair our portfolio companies' financial positions and operating results, affect the industries in which we invest, and reduce our volume of new investment activity, thereby possibly harming our operating results. Continued adversity in the capital markets could impact our ability to raise capital and reduce our volume of new investments.*

The U.S. is continuing to recover from the recession that largely began in late 2007. While economic conditions generally appear to be improving, we remain cautious about a long-term economic recovery. The recession in general, and the disruptions in the capital markets in particular, have impacted our liquidity options and increased our cost of debt and equity capital. As a result, we do not know if adverse conditions will again intensify, and we are unable to gauge the full extent to which the disruptions will continue to affect us. The longer these uncertain conditions persist, the greater the probability that these factors could continue to increase our costs of, and significantly limit our access to, debt and equity capital and, thus, have an adverse effect on our operations and financial results. Many of our portfolio companies and the prospective companies in which we may invest are also susceptible to these unstable economic conditions, which may affect the ability of one or more of our portfolio companies to repay our loans or engage in a liquidity event, such as a sale, recapitalization or initial public offering. These unstable economic conditions could also disproportionately impact some of the industries in which we invest, causing us to be more vulnerable to losses in our portfolio, which could cause the number of non-performing assets to increase and the fair value of our portfolio to decrease. The unstable economic conditions may also decrease the value of collateral securing some of our loans as well as the value of our equity investments, which would decrease our ability to borrow under our line of credit or raise equity capital, thereby further reducing our ability to make new investments.

In November 2011, we completed an offering of 1.5 million shares of 7.125% Series 2016 Term Preferred Stock ( "Term Preferred Stock" ); however, there can be no assurance that we will be able to raise additional equity capital in the near future. See *Management Discussion and Analysis of Financial Condition and Results of Operation - Liquidity and Capital Resources - Equity* for additional information on our Term Preferred Stock issuance.

The unstable economic conditions have affected the availability of credit generally. We do not know when market conditions will stabilize, if adverse conditions will intensify or the full extent to which the disruptions will continue to affect us. Also, it is possible that persistent instability of the financial markets could have other unforeseen material effects on our business.

*The downgrade of the United States credit rating and the ongoing economic crisis in Europe could negatively impact our liquidity, financial condition and earnings.*

Recent U.S. debt ceiling and budget deficit concerns, together with signs of deteriorating sovereign debt conditions in Europe, have increased the possibility of additional credit-rating downgrades and economic slowdowns. Although U.S. lawmakers passed legislation to raise the federal debt ceiling, Standard & Poor's Ratings Services lowered its long-term sovereign credit rating on the U.S. from AAA to AA+ in August 2011. The impact of this or any further downgrades to the U.S. government's sovereign credit rating, or its perceived creditworthiness, and the impact of the current crisis in Europe with respect to the ability of certain European Union countries to continue to service their sovereign debt obligations is inherently unpredictable and could adversely affect the U.S. and global financial markets and economic conditions. There can be no assurance that governmental or other measures to aid economic recovery will be effective. These developments, and the government's credit concerns in general, could cause interest rates and borrowing costs to rise, which may negatively impact our ability to access the debt markets on favorable terms. Continued adverse economic conditions could have a material adverse effect on our business, financial condition and results of operations.

## **Table of Contents**

*We may experience fluctuations in our quarterly and annual results based on the impact of inflation in the United States.*

The majority of our portfolio companies are in industries that are directly impacted by inflation, such as consumer goods and services and manufacturing. Our portfolio companies may not be able to pass on to customers increases in their costs of operations which could greatly affect their operating results, impacting their ability to repay our loans. In addition, any projected future decreases in our portfolio companies' operating results due to inflation could adversely impact the fair value of those investments. Any decreases in the fair value of our investments could result in future unrealized losses and therefore reduce our net assets resulting from operations.

### ***Risks Related to Our External Management***

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

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

*Our search for a new president and chief investment officer could cause disruption in our business and may not be successful.*

On November 28, 2012, we announced that Mr. Stelljes intends to resign from his positions as our president, chief investment officer and director to devote his efforts to creating and managing new investment vehicles for the Gladstone family of companies. Although no effective date for Mr. Stelljes' resignation has been determined, we expect the transition to commence in the very near future. Accordingly, we have begun a search for his replacement.

Because we have only recently begun the search for a replacement for Mr. Stelljes, it is unclear how long it will take to identify and recruit a replacement. Additionally, there can be no guarantee that our efforts to recruit a replacement for Mr. Stelljes will be successful, or that the transition to a new president and chief investment officer will be smooth or successful. Leadership transitions can be inherently difficult to manage and may cause uncertainty or a disruption to our business or may increase the likelihood of turnover among our officers or the employees of our Adviser or Administrator, which could adversely affect our business, results of operations and financial condition.

*Our incentive fee may induce the Adviser to make certain investments, including speculative investments.*

The management compensation structure that has been implemented under the Advisory Agreement may cause the Adviser to invest in high-risk investments or take other risks. In addition to its management fee, the Adviser is entitled under the Advisory Agreement to receive incentive compensation based in part upon our achievement of specified levels of income. In evaluating investments and other management strategies, the opportunity to earn incentive compensation based on net income may lead the Adviser to place undue emphasis on the maximization of net income at the expense of other criteria, such as preservation of capital, maintaining sufficient liquidity, or management of credit risk or market risk, in order to achieve higher incentive compensation. Investments with higher yield potential are generally riskier or more speculative. This could result in increased risk to the value of our investment portfolio.

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

The Advisory Agreement entitles the Adviser to incentive compensation for each fiscal quarter in an amount equal to a percentage of the excess of our investment income for that quarter (before deducting incentive compensation, net operating losses and certain other items) above a threshold return for that quarter. When calculating our incentive compensation, our pre-incentive fee net investment income excludes realized and unrealized capital losses that we may incur in the fiscal quarter, even if such capital losses result in a net loss on our statement of operations for that quarter. Thus, we may be required to pay the Adviser incentive compensation for a fiscal quarter even if there is a decline in the value of our portfolio or we incur a net loss for that quarter. For additional information on incentive compensation under the Advisory Agreement with the Adviser, see *Business Investment Advisory and Management Agreements*.



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

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

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## **Table of Contents**

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

Our executive officers and directors, and the officers and directors of the Adviser, serve or may serve as officers, directors, or principals of entities that operate in the same or a related line of business as we do or of investment funds managed by our affiliates. Accordingly, they may have obligations to investors in those entities, the fulfillment of which might not be in the best interests of us or our stockholders. For example, Mr. Gladstone, our chairman and chief executive officer, is the chairman of the board and chief executive officer of the Adviser, Gladstone Investment and Gladstone Commercial and the chairman, chief executive officer, president and sole stockholder of Gladstone Land. In addition, Mr. Brubaker, our vice chairman and chief operating officer, is the vice chairman and chief operating officer of the Adviser and Gladstone Land and co-vice chairman and chief operating officer of Gladstone Investment and Gladstone Commercial, Mr. Stelljes, our president and chief investment officer, is also the president and chief investment officer of the Adviser, and co-vice chairman and chief investment officer of Gladstone Investment and Gladstone Commercial. Moreover, the Adviser may establish or sponsor other investment vehicles which from time to time may have potentially overlapping investment objectives with ours and accordingly may invest in, whether principally or secondarily, asset classes we target. While the Adviser generally has broad authority to make investments on behalf of the investment vehicles that it advises, the Adviser has adopted investment allocation procedures to address these potential conflicts and intends to direct investment opportunities to the Gladstone affiliate with the investment strategy that most closely fits the investment opportunity. Nevertheless, the management of the Adviser may face conflicts in the allocation of investment opportunities to other entities managed by the Adviser. As a result, it is possible that we may not be given the opportunity to participate in certain investments made by other funds managed by the Adviser. On October 10, 2012, our Board of Directors approved a revision of our investment objectives and strategies, which went into effect on January 1, 2013, which may enhance the potential for conflicts in the allocation of investment opportunities to us and other entities managed by the Adviser.

In certain circumstances, we may make investments in a portfolio company in which one of our affiliates has or will have an investment, subject to satisfaction of any regulatory restrictions and, where required, to the prior approval of our Board of Directors. As of September 30, 2012, our Board of Directors has approved the following types of co-investment transactions:

Our affiliate, Gladstone Commercial, may, under certain circumstances, lease property to portfolio companies that we do not control. We may pursue such transactions only if (i) the portfolio company is not controlled by us or any of our affiliates, (ii) the portfolio company satisfies the tenant underwriting criteria of Gladstone Commercial, and (iii) the transaction is approved by a majority of our independent directors and a majority of the independent directors of Gladstone Commercial. We expect that any such negotiations between Gladstone Commercial and our portfolio companies would result in lease terms consistent with the terms that the portfolio companies would be likely to receive were they not portfolio companies of ours.

We may invest simultaneously with our affiliate Gladstone Investment in senior syndicated loans whereby neither we nor any affiliate has the ability to dictate the terms of the loans.

Additionally, pursuant to an exemptive order granted by the SEC in July 2012, under certain circumstances, we may co-invest with Gladstone Investment and any future BDC or closed-end management investment company that is advised by the Adviser (or sub-advised by the Adviser if it controls the fund) or any combination of the foregoing subject to the conditions included therein.

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

In the course of our investing activities, we will pay management and incentive fees to the Adviser and will reimburse the Administrator for certain expenses it incurs. As a result, investors in our common stock will invest on a gross basis and receive distributions on a net basis after expenses, resulting in, among other things, a lower rate of return than one might achieve through our investors themselves making direct investments. As a result of this arrangement, there may be times when the management team of the Adviser has interests that differ from those of our stockholders, giving rise to a conflict. In addition, as a BDC, we make available significant managerial assistance to our portfolio companies and provide other services to such portfolio companies. Although, neither we nor the Adviser currently receives fees in connection with managerial assistance, the Adviser and Gladstone Securities have, at various times, provided other services to certain of our portfolio companies and received fees for these other services.



## **Table of Contents**

*The Adviser is not obligated to provide a waiver of the base management fee, which could negatively impact our earnings and our ability to maintain our current level of distributions to our common stockholders.*

The Advisory Agreement provides for a base management fee based on our gross assets. Since our 2007 fiscal year, our Board of Directors has accepted on a quarterly basis voluntary, unconditional and irrevocable waivers to reduce the annual 2.0% base management fee on senior syndicated loan participations to 0.5% to the extent that proceeds resulting from borrowings were used to purchase such syndicated loan participations, and any waived fees may not be recouped by the Adviser in the future. However, the Adviser is not required to issue these or other waivers of fees under the Advisory Agreement, and to the extent our investment portfolio grows in the future, we expect these fees will increase. If the Adviser does not issue these waivers in future quarters, it could negatively impact our earnings and may compromise our ability to maintain our current level of distributions to our common stockholders, which could have a material adverse impact on the price of our common stock.

*Our business model is dependent upon developing and sustaining strong referral relationships with investment bankers, business brokers and other intermediaries.*

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

### ***Risks Related to Our External Financing***

*In addition to regulatory limitations on our ability to raise capital, our credit facility contains various covenants which, if not complied with, could accelerate our repayment obligations under the facility, thereby materially and adversely affecting our liquidity, financial condition, results of operations and ability to pay distributions.*

We will have a continuing need for capital to finance our loans. As of September 30, 2012, we had \$58.8 million in borrowings outstanding under our fourth amended and restated credit agreement, which provides for maximum borrowings of \$137 million (the Credit Facility). Our Credit Facility permits us to fund additional loans and investments as long as we are within the conditions set forth in the credit agreement. Pursuant to the terms of our Credit Facility, we are subject to certain limitations on the type of loan investments we make, including restrictions on geographic concentrations, sector concentrations, loan size, payment frequency and status, average life and lien property. The credit agreement also requires us to comply with other financial and operational covenants, which require us to, among other things, maintain certain financial ratios, including asset and interest coverage and a minimum net worth and a minimum number of obligors required in the borrowing base of the credit agreement. As of September 30, 2012, we were in compliance with these covenants; however, our continued compliance depends on many factors, some of which are beyond our control. Current market conditions have forced us to write down the value of a portion of our assets, as required by the 1940 Act and fair value accounting rules. These are not realized losses, but constitute adjustments in asset values for purposes of financial reporting and for collateral value for our Credit Facility. As assets are marked down in value, the amount we can borrow on our Credit Facility decreases. As of September 30, 2012, our net assets were \$188.6 million, down from \$213.7 million as of September 30, 2011, primarily a result of unrealized depreciation over the preceding twelve months.

Additionally, under our Credit Facility, we are required to maintain a minimum net worth (which includes the value of our Term Preferred Stock) of \$190.0 million plus 50.0% of all equity and subordinated debt raised after January 19, 2012. At September 30, 2012, we had a minimum net worth of \$227.1 million. Given the continued uncertainty in the capital markets, the cumulative unrealized depreciation in our portfolio may increase in future periods and threaten our ability to comply with the minimum net worth covenant and other covenants under our Credit Facility. Additionally, under our Credit Facility, if any two of Messrs. Gladstone, Brubaker and Stelljes cease to serve as our executive officers the Credit Facility would terminate. In light of Mr. Stelljes' recent decision to resign as our president and chief investment officer, we will be at increased risk of triggering this provision, unless and until we are able to amend our Credit Facility to revise this provision. There can be no guarantee that our lenders will agree to modify this provision on terms that we find acceptable or at all. Under our Credit Facility, we are also required to maintain our status as a BDC under the 1940 Act and as a RIC under the Code. There are no assurances that we will continue to comply with these covenants. Our failure to satisfy these covenants could result in foreclosure by our lenders, which would accelerate our repayment obligations under the facility and thereby have a material adverse effect on our business, liquidity, financial condition, results of operations and ability to pay distributions to our stockholders.

*Any inability to renew, extend or replace our line of credit on terms favorable to us, or at all, could adversely impact our liquidity and ability to fund new investments or maintain distributions to our stockholders.*

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Under certain circumstances, our Credit Facility may be expanded to a maximum of \$237.0 million through the addition of other committed lenders to the facility. If additional lenders are unwilling to join the facility on its terms, we will be unable to

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**Table of Contents**

expand the facility and may have limited availability to finance new investments under our Credit Facility in the future. If not renewed or extended by January 19, 2015 (the Maturity Date), all principal and interest will be due and payable on or before January 19, 2016 (one year after the Maturity Date). There can be no guarantee that we will be able to renew, extend or replace the Credit Facility upon its maturity in 2015 on terms that are favorable to us, if at all. Our ability to expand the Credit Facility, and to obtain replacement financing at the time of its maturity, will be constrained by then-current economic conditions affecting the credit markets. In the event that we are not able to expand the Credit Facility, or to renew, extend or refinance the Credit Facility at the time of its maturity, this could have a material adverse effect on our liquidity and ability to fund new investments, our ability to make distributions to our stockholders and our ability to qualify as a RIC under the Code.

If we are unable to secure replacement financing, we may be forced to sell certain assets on disadvantageous terms, which may result in realized losses, and such realized losses could materially exceed the amount of any unrealized depreciation on these assets as of our most recent balance sheet date, which would have a material adverse effect on our results of operations. Such circumstances would also increase the likelihood that we would be required to redeem some or all of our outstanding Term Preferred Stock, which would potentially require us to sell more assets. In addition to selling assets, or as an alternative, we may issue equity in order to repay amounts outstanding under our Credit Facility. Based on the recent trading prices of our stock, such an equity offering may have a substantial dilutive impact on our existing stockholders' interest in our earnings, assets and voting percentage. If we are able to renew, extend or refinance our Credit Facility prior to maturity, any renewal, extension or refinancing of the Credit Facility may potentially result in significantly higher interest rates and related charges and may impose significant restrictions on the use of borrowed funds to fund investments or maintain distributions to stockholders.

*Our business plan is dependent upon external financing, which is constrained by the limitations of the 1940 Act.*

Although we completed an offering of Term Preferred Stock in November 2011, there can be no assurance that we will be able to raise capital through issuing equity in the near future. Our business requires a substantial amount of cash to operate and grow. We may acquire such additional capital from the following sources:

*Senior Securities.* We may issue debt securities, other evidences of indebtedness (including borrowings under our Credit Facility), senior securities representing indebtedness and senior securities that are stock up to the maximum amount permitted by the 1940 Act. The 1940 Act currently permits us, as a BDC, to issue senior securities representing indebtedness and senior securities which are stock (such as our Term Preferred Stock), which we refer to collectively as Senior Securities, in amounts such that our asset coverage, as defined in Section 18(h) of the 1940 Act, is at least 200% immediately after each issuance of Senior Securities. As a result of incurring indebtedness (in whatever form), we will be exposed to the risks associated with leverage. Although borrowing money for investments increases the potential for gain, it also increases the risk of a loss. A decrease in the value of our investments will have a greater impact on the value of our common stock to the extent that we have borrowed money to make investments. There is a possibility that the costs of borrowing could exceed the income we receive on the investments we make with such borrowed funds. In addition, our ability to pay distributions, issue Senior Securities or repurchase shares of our common stock would be restricted if the asset coverage on our Senior Securities is not at least 200%. If the aggregate value of our assets declines, we might be unable to satisfy that 200% requirement. To satisfy the 200% asset coverage requirement in the event that we are seeking to pay a distribution, we might either have to (i) liquidate a portion of our loan portfolio to repay a portion of our indebtedness or (ii) issue common stock. This may occur at a time when a sale of a portfolio asset may be disadvantageous, or when we have limited access to capital markets on agreeable terms. In addition, any amounts that we use to service our indebtedness or for offering expenses will not be available for distributions to stockholders. Furthermore, if we have to issue common stock at below net asset value (NAV) per common share, any non-participating shareholders will be subject to dilution, as described below. Pursuant to Section 61(a)(2) of the 1940 Act, we are permitted, under specified conditions, to issue multiple classes of senior securities representing indebtedness. However, pursuant to Section 18(c) of the 1940 Act, we are permitted to issue only one class of senior securities that is stock.

*Common and Convertible Preferred Stock.* Because we are constrained in our ability to issue debt or senior securities for the reasons given above, we are dependent on the issuance of equity as a financing source. If we raise additional funds by issuing more common stock, the percentage ownership of our stockholders at the time of the issuance would decrease and our common stock may experience dilution. In addition, under the 1940 Act, we will generally not be able to issue additional shares of our common stock at a price below NAV per common share to purchasers, other than to our existing stockholders through a rights offering, without first obtaining the approval of our stockholders and our independent directors. If we were to sell shares of our common stock below our then current NAV per common share, such sales



**Table of Contents**

would result in an immediate dilution to the NAV per common share. This dilution would occur as a result of the sale of shares at a price below the then current NAV per share of our common stock and a proportionately greater decrease in a stockholder's interest in our earnings and assets and voting percentage than the increase in our assets resulting from such issuance. For example, if we issue and sell an additional 10% of our common stock at a 5% discount from NAV, a stockholder who does not participate in that offering for its proportionate interest will suffer NAV dilution of up to 0.5% or \$5 per \$1,000 of NAV. This imposes constraints on our ability to raise capital when our common stock is trading at below NAV per common share, as it generally has for the last year. As noted above, the 1940 Act prohibits the issuance of multiple classes of senior securities that are stock. As a result, we would be prohibited from issuing convertible preferred stock to the extent that such a security was deemed to be a separate class of stock from our outstanding Term Preferred Stock.

*We finance our investments with borrowed money and capital from the issuance of Senior Securities, which will magnify the potential for gain or loss on amounts invested and may increase the risk of investing in us.*

The following table illustrates the effect of leverage on returns from an investment in our common stock assuming various annual returns on our portfolio, net of expenses. The calculations in the table below are hypothetical, and actual returns may be higher or lower than those appearing in the table below.

	Assumed Return on Our Portfolio (Net of Expenses)				
	(10)%	(5)%	0%	5%	10%
Corresponding return to common stockholder <sup>(1)</sup>	(17.8)%	(10.0)%	(2.3)%	5.5%	13.3%

<sup>(1)</sup> The hypothetical return to common stockholders is calculated by multiplying our total assets as of September 30, 2012 by the assumed rates of return and subtracting all interest accrued on our debt and dividends accrued on our Term Preferred Stock for the quarter ended September 30, 2012; and then dividing the resulting difference by our total assets attributable to common stock. Based on \$293.4 million in total assets, \$58.8 million in debt, \$38.5 million in aggregate liquidation preference of Term Preferred Stock, and \$188.6 million in net assets, each as of September 30, 2012.

Based on an outstanding indebtedness of \$58.8 million as of September 30, 2012, the effective annual interest rate of 6.7% as of that date, and aggregate liquidation preference of our Term Preferred Stock of \$38.5 million, our investment portfolio at fair value would have had to produce an annual return of approximately 2.3% to cover annual interest payments on the outstanding debt and dividends on our Term Preferred Stock.

*A change in interest rates may adversely affect our profitability.*

We anticipate using a combination of equity and long-term and short-term borrowings to finance our investment activities. As a result, a portion of our income will depend upon the difference between the rate at which we borrow funds and the rate at which we loan these funds. Higher interest rates on our borrowings will decrease the overall return on our portfolio.

We ultimately expect approximately 90% of the loans in our portfolio to be at variable rates determined on the basis of the LIBOR and approximately 10% to be at fixed rates, although we reassess the target mix of fixed and variable rate investments on a periodic basis. As of September 30, 2012, our portfolio had approximately 88.4% of the total loan cost value at variable rates with floors, approximately 5.0% of the total of the loan cost value at variable rates without a floor or ceiling and approximately 6.6% of the total loan portfolio cost basis at fixed rates. From time to time, we may enter into hedging instruments to help insulate us against adverse fluctuations in interest rates, however, during the years ended September 30, 2012 and 2011, we did not enter into any such instruments.

**Risks Related to Our Investments**

*We operate in a highly competitive market for investment opportunities.*

A large number of entities compete with us and make the types of investments that we seek to make in small and mid-sized companies. We compete with public and private buyout funds, commercial and investment banks, commercial financing companies, and, to the extent that they provide an alternative form of financing, hedge funds. Many of our competitors are





## Table of Contents

substantially larger and have considerably greater financial, technical and marketing resources than we do. For example, some competitors may have a lower cost of funds and access to funding sources that are not available to us. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which would allow them to consider a wider variety of investments and establish more relationships than us. Furthermore, many of our competitors are not subject to the regulatory restrictions that the 1940 Act imposes on us as a BDC. The competitive pressures we face could have a material adverse effect on our business, financial condition and results of operations. Also, as a result of this competition, we may not be able to take advantage of attractive investment opportunities from time to time and we can offer no assurance that we will be able to identify and make investments that are consistent with our investment objective. We do not seek to compete based on the interest rates we offer, and we believe that some of our competitors may make loans with interest rates that will be comparable to or lower than the rates we offer. We may lose investment opportunities if we do not match our competitors' pricing, terms, and structure. However, if we match our competitors' pricing, terms, and structure, we may experience decreased net interest income and increased risk of credit loss.

*Our investments in small and medium-sized portfolio companies are extremely risky and could cause you to lose all or a part of your investment.*

Investments in small and medium-sized portfolio companies are subject to a number of significant risks including the following:

*Small and medium-sized businesses are likely to have greater exposure to economic downturns than larger businesses.* Our portfolio companies may have fewer resources than larger businesses, and thus the recent recession, and any further economic downturns or recessions, are more likely to have a material adverse effect on them. If one of our portfolio companies is adversely impacted by a recession, its ability to repay our loan or engage in a liquidity event, such as a sale, recapitalization or initial public offering would be diminished.

*Small and medium-sized businesses may have limited financial resources and may not be able to repay the loans we make to them.* Our strategy includes providing financing to portfolio companies that typically do not have readily available access to financing. While we believe that this provides an attractive opportunity for us to generate profits, this may make it difficult for the portfolio companies to repay their loans to us upon maturity. A borrower's ability to repay its loan may be adversely affected by numerous factors, including the failure to meet its business plan, a downturn in its industry, or negative economic conditions. A deterioration in a borrower's financial condition and prospects usually will be accompanied by a deterioration in the value of any collateral and a reduction in the likelihood of us realizing on any guaranties we may have obtained from the borrower's management. As of September 30, 2012, six portfolio companies were either fully or partially on non-accrual status with an aggregate debt cost basis of approximately \$61.1 million, or 17.3% of the cost basis of all debt investments in our portfolio. While we are working with the portfolio companies to improve their profitability and cash flows, there can be no assurance that our efforts will prove successful. Although we will sometimes seek to be the senior, secured lender to a borrower, in most of our loans we expect to be subordinated to a senior lender, and our interest in any collateral would, accordingly, likely be subordinate to another lender's security interest.

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

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

*Small and medium-sized businesses generally have less predictable operating results.* We expect that our portfolio companies may have significant variations in their operating results, may from time to time be parties to litigation, may be engaged in rapidly changing businesses with products subject to a substantial risk of obsolescence, may require substantial additional capital to support their operations, to finance expansion or to maintain their competitive position,



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**Table of Contents**

may otherwise have a weak financial position, or may be adversely affected by changes in the business cycle. Our portfolio companies may not meet net income, cash flow, and other coverage tests typically imposed by their senior lenders. A borrower's failure to satisfy financial or operating covenants imposed by senior lenders could lead to defaults and, potentially, foreclosure on its senior credit facility, which could additionally trigger cross-defaults in other agreements. If this were to occur, it is possible that the borrower's ability to repay our loan would be jeopardized.

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

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

*Debt securities of small and medium-sized private companies typically are not rated by a credit rating agency.* Typically a small or medium-sized private business cannot or will not expend the resources to have their debt securities rated by a credit rating agency. We expect that most, if not all, of the debt securities we acquire will be unrated. Investors should assume that these loans would be at rates below what is today considered investment grade quality. Investments rated below investment grade are often referred to as high yield securities or junk bonds and may be considered high risk as compared to investment-grade debt instruments.

*Because the loans we make and equity securities we receive when we make loans are not publicly-traded, there is uncertainty regarding the value of our privately held securities that could adversely affect our determination of our net asset value.*

Our portfolio investments are, and we expect will continue to be, in the form of securities that are not publicly-traded. The fair value of securities and other investments that are not publicly-traded may not be readily determinable. Our Board of Directors has established an investment valuation policy and consistently applied valuation procedures used to determine the fair value of these securities quarterly. These procedures for the determination of value of many of our debt securities rely on the opinions of value submitted to us by Standard & Poor's Securities Evaluations, Inc. ( SPSE ) or the use of internally developed discounted cash flow ( DCF ) methodologies or indicative bid prices ( IBP ) offered by the respective originating syndication agent's trading desk, or secondary desk, specifically for our syndicated loans, or internal methodologies based on the total enterprise value ( TEV ) of the issuer used for certain of our equity investments. SPSE will only evaluate the debt portion of our investments for which we specifically request evaluation, and SPSE may decline to make requested evaluations for any reason in its sole discretion. However, to date, SPSE has accepted each of our requests for evaluation.

Our use of these fair value methods is inherently subjective and is based on estimates and assumptions of each security. In the event that we are required to sell a security, we may ultimately sell for an amount materially less than the estimated fair value calculated by SPSE, or utilizing the TEV, IBP or the DCF methodology.

Our procedures also include provisions whereby the Adviser will establish the fair value of any equity securities we may hold where SPSE or third-party agent banks are unable to provide evaluations. The types of factors that may be considered in determining the fair value of our debt and equity securities include some or all of the following:

the nature and realizable value of any collateral;

the portfolio company's earnings and cash flows and its ability to make payments on its obligations;

the markets in which the portfolio company does business;

the comparison to publicly-traded companies; and

discounted cash flow 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.

## **Table of Contents**

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

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

We will generally make investments in private companies whose securities are not traded in any public market. Substantially all of the investments we presently hold and the investments we expect to acquire in the future are, and will be, subject to legal and other restrictions on resale and will otherwise be less liquid than publicly-traded securities. The illiquidity of our investments may make it difficult for us to quickly obtain cash equal to the value at which we record our investments if the need arises. This could cause us to miss important investment opportunities. In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may record substantial realized losses upon liquidation. We may also face other restrictions on our ability to liquidate an investment in a portfolio company to the extent that we, the Adviser, or our respective officers, employees or affiliates have material non-public information regarding such portfolio company.

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

*When we are a debt or minority equity investor in a portfolio company, which we expect will generally be the case, we may not be in a position to control the entity, and its management may make decisions that could decrease the value of our investment.*

We anticipate that most of our investments will continue to be either debt or minority equity investments in our portfolio companies. Therefore, we are and will remain subject to risk that a portfolio company may make business decisions with which we disagree, and the shareholders and management of such company may take risks or otherwise act in ways that do not serve our best interests. As a result, a portfolio company may make decisions that could decrease the value of our portfolio holdings.

In addition, we will generally not be in a position to control any portfolio company by investing in its debt securities. This is particularly true when we invest in syndicated loans, which are loans made by a larger group of investors whose investment objectives of the other lenders may not be completely aligned with ours. As of September 30, 2012, syndicated loans made up approximately 21.3% of our portfolio at cost, or \$77.8 million. We therefore are subject to the risk that other lenders in these investments may make decisions that could decrease the value of our portfolio holdings.

*We generally invest in transactions involving acquisitions, buyouts and recapitalizations of companies, which will subject us to the risks associated with change in control transactions.*

Our strategy, in part, includes making debt and equity investments in companies in connection with acquisitions, buyouts and recapitalizations, which subjects us to the risks associated with change in control transactions. Change in control transactions often present a number of uncertainties. Companies undergoing change in control transactions often face challenges retaining key employees and maintaining relationships with customers and suppliers. While we hope to avoid many of these difficulties by participating in transactions where the management team is retained and by conducting thorough due diligence in advance of our decision to invest, if our portfolio companies experience one or more of these problems, we may not realize the value that we expect in connection with our investments, which would likely harm our operating results and financial condition.

*Our portfolio companies may incur debt that ranks equally with, or senior to, our investments in such companies.*

We invest primarily in debt securities issued by our portfolio companies. In some cases portfolio companies will be permitted to have other debt that ranks equally with, or senior to, the debt securities in which we invest. By their terms, such debt instruments may provide that the holders thereof are entitled to receive payment of interest and principal on or before the dates on which we are entitled to receive payments in respect of the debt securities in which we invest. Also, in the event of insolvency, liquidation, dissolution, reorganization, or bankruptcy of a portfolio company, holders of debt instruments



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## **Table of Contents**

ranking senior to our investment in that portfolio company would typically be entitled to receive payment in full before we receive any distribution in respect of our investment. After repaying such senior creditors, such portfolio company may not have any remaining assets to use for repaying its obligation to us. In the case of debt ranking equally with debt securities in which we invest, we would have to share on an equal basis any distributions with other creditors holding such debt in the event of an insolvency, liquidation, dissolution, reorganization, or bankruptcy of a portfolio company.

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

In addition to risks associated with delays in investing our capital, we are also subject to the risk that investments we make in our portfolio companies may be repaid prior to maturity. For the year ended September 30, 2012, we received principal payments of \$60.2 million, of which \$47.5 million resulted from ten portfolio companies who paid off early at par. We will first use any proceeds from prepayments to repay any borrowings outstanding on our Credit Facility. In the event that funds remain after repayment of our outstanding borrowings, then we will generally reinvest these proceeds in government securities, pending their future investment in new debt and/or equity securities. These government securities will typically have substantially lower yields than the debt securities being prepaid and we could experience significant delays in reinvesting these amounts. As a result, our results of operations could be materially adversely affected if one or more of our portfolio companies elect to prepay amounts owed to us. Additionally, prepayments could negatively impact our return on equity, which could result in a decline in the market price of our common stock.

*Higher taxation of our portfolio companies may impact our quarterly and annual operating results.*

The recession's adverse effect on federal, state, and municipality revenues may induce these government entities to raise various taxes to make up for lost revenues. Additional taxation may have an adverse effect on our portfolio companies' earnings and reduce their ability to repay our loans to them, thus affecting our quarterly and annual operating results.

*Our portfolio is concentrated in a limited number of companies and industries, which subjects us to an increased risk of significant loss if any one of these companies does not repay us or if the industries experience downturns.*

As of September 30, 2012, we had investments in 50 portfolio companies, of which there were five investments that comprised approximately \$91.8 million or 33.5% of our total investment portfolio, at fair value. A consequence of a concentration in a limited number of investments is that the aggregate returns we realize may be substantially adversely affected by the unfavorable performance of a small number of such investments or a substantial write-down of any one investment. Beyond our regulatory and income tax diversification requirements, we do not have fixed guidelines for industry concentration and our investments could potentially be concentrated in relatively few industries. In addition, while we do not intend to invest 25.0% or more of our total assets in a particular industry or group of industries at the time of investment, it is possible that as the values of our portfolio companies change, one industry or a group of industries may comprise in excess of 25.0% of the value of our total assets. As a result, a downturn in an industry in which we have invested a significant portion of our total assets could have a materially adverse effect on us. As of September 30, 2012, 15.4% of our total assets at fair value were invested in electronics companies, 12.0% were invested in healthcare, education and childcare companies, and 11.5% were invested in mining, steel, iron and non-precious metal companies. Therefore, we are susceptible to the economic circumstances in these industries, and a downturn in one or more of these industries could have a material adverse effect on our results of operations and financial condition.

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

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

*The disposition of our investments may result in contingent liabilities.*

Currently, all of our investments involve private securities. In connection with the disposition of an investment in private securities, we may be required to make representations about the business and financial affairs of the underlying portfolio company typical of those made in connection with the sale of a business. We may also be required to indemnify the purchasers of such investment to the extent that any such representations turn out to be inaccurate or with respect to certain potential liabilities. These arrangements may result in contingent liabilities that ultimately yield funding obligations that must be satisfied through our return of certain distributions previously made to us.





## **Table of Contents**

*There may be circumstances where our debt investments could be subordinated to claims of other creditors or we could be subject to lender liability claims.*

Even though we have structured some of our investments as senior loans, if one of our portfolio companies were to go bankrupt, depending on the facts and circumstances, including the extent to which we actually provided managerial assistance to that portfolio company, a bankruptcy court might re-characterize our debt investments and subordinate all, or a portion, of our claims to that of other creditors. Holders of debt instruments ranking senior to our investments typically would be entitled to receive payment in full before we receive any distributions. After repaying such senior creditors, such portfolio company may not have any remaining assets to use to repay its obligation to us. We may also be subject to lender liability claims for actions taken by us with respect to a borrower's business or in instances in which we exercised control over the borrower. It is possible that we could become subject to a lender's liability claim, including as a result of actions taken in rendering significant managerial assistance.

*Portfolio company litigation could result in additional costs and the diversion of management time and resources.*

In the course of providing significant managerial assistance to certain of our portfolio companies, our executive officers sometimes serve as directors on the boards of such companies. To the extent that litigation arises out of our investments in these companies, such executive officers may be named as defendants in such litigation, which could result in additional costs and the diversion of management time and resources.

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

When we make a subordinated loan, we may receive warrants to purchase stock issued by the borrower or other yield enhancements, such as success fees. Our goal is to ultimately dispose of these equity interests and realize gains upon our disposition of such interests. We expect that, over time, the gains we realize on these warrants and other yield enhancements will offset any losses we experience on loan defaults. However, any warrants we receive may not appreciate in value and, in fact, may decline in value and any other yield enhancements, such as success fees, may not be realized. Accordingly, we may not be able to realize gains from our equity interests or other yield enhancements and any gains we do recognize may not be sufficient to offset losses we experience on our loan portfolio.

*Any unrealized depreciation we experience on our investment portfolio may be an indication of future realized losses, which could reduce our income available for distribution.*

As a BDC we are required to carry our investments at market value or, if no market value is ascertainable, at fair value as determined in good faith by or under the direction of our Board of Directors. We will record decreases in the market values or fair values of our investments as unrealized depreciation. Since our inception, we have, at times, incurred a cumulative net unrealized depreciation of our portfolio. Any unrealized depreciation in our investment portfolio could result in realized losses in the future and ultimately in reductions of our income available for distribution to stockholders in future periods.

### ***Risks Related to Our Regulation and Structure***

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

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

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**Table of Contents**

corporate taxes could substantially reduce our net assets, the amount of income available for distribution, and the actual amount distributed. Such a failure would have a material adverse effect on us and our shares. For additional information regarding asset coverage ratio and RIC requirements, see *Business Competitive Advantages Leverage and Material U.S. Federal Income Tax Considerations Regulated Investment Company Status*.

From time to time, some of our debt investments may include success fees that would generate payments to us if the business is ultimately sold. Because the satisfaction of these success fees, and the ultimate payment of these fees, is uncertain, we do not recognize them as income until we have received payment. We sought and received approval for a change in accounting method from the IRS related to our tax treatment for success fees. As a result, we, in effect, will continue to account for the recognition of income from the success fees upon receipt, or when the amount becomes fixed. Prior to January 1, 2011, we treated the success fee amount as a capital gain for tax characterization purposes. However, beginning January 1, 2011, the success fee amounts are characterized as ordinary income for tax purposes. The approved change in accounting method does not require us to retroactively change the capital gains treatment of the success fees received prior to January 1, 2011. As a result, we will be required to distribute such amounts to our stockholders in order to maintain RIC status for success fees we receive after January 1, 2011.

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

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

*We are subject to restrictions that may discourage a change of control. Certain provisions contained in our articles of incorporation and Maryland law may prohibit or restrict a change of control and adversely impact the price of our shares.*

Our Board of Directors is divided into three classes, with the term of the directors in each class expiring every third year. At each annual meeting of stockholders, the successors to the class of directors whose term expires at such meeting will be elected to hold office for a term expiring at the annual meeting of stockholders held in the third year following the year of their election. After election, a director may only be removed by our stockholders for cause. Election of directors for staggered terms with limited rights to remove directors makes it more difficult for a hostile bidder to acquire control of us. The existence of this provision may negatively impact the price of our securities and may discourage third-party bids to acquire our securities. This provision may reduce any premiums paid to stockholders in a change in control transaction.

Certain provisions of Maryland law applicable to us prohibit business combinations with:

any person who beneficially owns 10% or more of the voting power of our common stock (an interested stockholder );

an affiliate of ours who at any time within the two-year period prior to the date in question was an interested stockholder; or

an affiliate of an interested stockholder.

These prohibitions last for five years after the most recent date on which the interested stockholder became an interested stockholder. Thereafter, any business combination with the interested stockholder must be recommended by our Board of Directors and approved by the affirmative vote of at least 80% of the votes entitled to be cast by holders of our outstanding shares of common stock and two-thirds of the votes entitled to be cast by holders of our common stock other than shares held by the interested stockholder. These requirements could have the effect of inhibiting a change in control even if a change in control were in our stockholders' interest. These provisions of Maryland law do not apply, however, to business combinations that are approved or exempted by our Board of Directors prior to the time that someone becomes an interested stockholder.



**Table of Contents**

Our articles of incorporation permit our Board of Directors to issue up to 50.0 million shares of capital stock. In addition, our Board of Directors, without any action by our stockholders, may amend our articles of incorporation from time to time to increase or decrease the aggregate number of shares or the number of shares of any class or series of stock that we have authority to issue. Our Board of Directors may classify or reclassify any unissued common stock or preferred stock and establish the preferences, conversion or other rights, voting powers, restrictions, limitations as to distributions, qualifications and terms or conditions of redemption of any such stock. Thus, our Board of Directors could authorize the issuance of preferred stock with terms and conditions that could have a priority as to distributions and amounts payable upon liquidation over the rights of the holders of our common stock, which it did in connection with our issuance of 1.5 million shares of Term Preferred Stock. Preferred stock, including our Term Preferred Stock, could also have the effect of delaying, deferring or preventing a change in control of us, including an extraordinary transaction (such as a merger, tender offer or sale of all or substantially all of our assets) that might provide a premium price for holders of our common stock.

***Risks Related to an Investment in Our Common Stock and Our Preferred Stock***

*We may experience fluctuations in our quarterly and annual operating results.*

We may experience fluctuations in our quarterly and annual operating results due to a number of factors, including, among others, variations in our investment income, the interest rates payable on the debt securities we acquire, the default rates on such securities, the level of our expenses, variations in and the timing of the recognition of realized and unrealized gains or losses, the level of our expenses, the degree to which we encounter competition in our markets, and general economic conditions, including the impacts of inflation. The majority of our portfolio companies are in industries that are directly impacted by inflation, such as manufacturing and consumer goods and services. Our portfolio companies may not be able to pass on to customers increases in their costs of production which could greatly affect their operating results, impacting their ability to repay our loans. In addition, any projected future decreases in our portfolio companies' operating results due to inflation could adversely impact the fair value of those investments. Any decreases in the fair value of our investments could result in future realized and unrealized losses and therefore reduce our net assets resulting from operations. As a result of these factors, results for any period should not be relied upon as being indicative of performance in future periods.

*There is a risk that you may not receive distributions.*

Our current intention is to distribute at least 90% of our ordinary income and short-term capital gains to our stockholders on a quarterly basis by paying monthly distributions. We expect to retain some or all net realized long-term capital gains by first offsetting them with realized capital losses, and secondly through a deemed distribution to supplement our equity capital and support the growth of our portfolio, although our Board of Directors may determine in certain cases to distribute these gains to our common stockholders. In addition, our Credit Facility restricts the amount of distributions we are permitted to make. We cannot assure you that we will achieve investment results or maintain a tax status that will allow or require any specified level of cash distributions.

*Distributions by us have included and may in the future include a return of capital.*

Our Board of Directors declares monthly distributions based on estimates of taxable income for each fiscal year, which may differ, and in the past have differed, from actual results. Because our distributions are based on estimates of taxable income that may differ from actual results, future distributions payable to our stockholders may also include a return of capital. Moreover, to the extent that we distribute amounts that exceed our accumulated earnings and profits, these distributions constitute a return of capital. A return of capital represents a return of a stockholder's original investment in shares of our stock and should not be confused with a distribution from earnings and profits. Although return of capital distributions may not be taxable, such distributions may increase an investor's tax liability for capital gains upon the sale of our shares by reducing the investor's tax basis for such shares. Such returns of capital reduce our asset base and also adversely impact our ability to raise debt capital as a result of the leverage restrictions under the 1940 Act, which could have a material adverse impact on our ability to make new investments.

*The market price of our shares may fluctuate significantly.*

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

**Table of Contents**

general economic trends and other external factors;

price and volume fluctuations in the stock market from time to time, which are often unrelated to the operating performance of particular companies;

significant volatility in the market price and trading volume of shares of RICs, BDCs or other companies in our sector, which is not necessarily related to the operating performance of these companies;

changes in regulatory policies or tax guidelines, particularly with respect to RICs or BDCs;

loss of BDC or RIC status;

changes in our earnings or variations in our operating results;

changes in prevailing interest rates;

changes in the value of our portfolio of investments;

any shortfall in our revenue or net income or any increase in losses from levels expected by securities analysts;

departure of key personnel;

operating performance of companies comparable to us;

short-selling pressure with respect to our shares or BDCs generally;

the announcement of proposed, or completed, offerings of our securities, including a rights offering; and

loss of a major funding source.

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

*The issuance of subscription rights to our existing stockholders may dilute the ownership and voting powers of existing stockholders in our common stock, dilute the net asset value of their shares and have a material adverse effect on the trading price of our common stock.*

There are significant capital raising constraints applicable to us under the 1940 Act when our stock is trading below its NAV per common share. In the event that we issue subscription rights to our existing stockholders, there is a significant possibility that the rights offering will dilute the ownership interest and voting power of stockholders who do not fully exercise their subscription rights. Stockholders who do not fully exercise their subscription rights should expect that they will, upon completion of the rights offering, own a smaller proportional interest in us than would

otherwise be the case if they fully exercised their subscription rights. In addition, because the subscription price of the rights offering is likely to be less than our most recently determined NAV per common share, our common stockholders are likely to experience an immediate dilution of the per common share NAV of their shares as a result of the offering. As a result of these factors, any future rights offerings of our common stock, or our announcement of our intention to conduct a rights offering, could have a material adverse impact on the trading price of our common stock.

## Table of Contents

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

Shares of closed-end investment companies frequently trade at a discount from NAV per common share. Since our inception, our common stock has at times traded above and at times below NAV per common share. During the past year, our common stock has traded consistently, and at times significantly, below NAV per common share. Subsequent to September 30, 2012, our stock has traded at discounts of up to 19.27% of our NAV per common share, which was \$8.98 at September 30, 2012. This characteristic of shares of closed-end investment companies is separate and distinct from the risk that our NAV per common share will decline. As with any stock, the price of our shares will fluctuate with market conditions and other factors. If shares are sold, the price received may be more or less than the original investment. Whether investors will realize gains or losses upon the sale of our shares will not depend directly upon our NAV, but will depend upon the market price of the shares at the time of sale. Since the market price of our shares will be affected by such factors as the relative demand for and supply of the shares in the market, general market and economic conditions and other factors beyond our control, we cannot predict whether the shares will trade at, below or above our net asset value. Under the 1940 Act, we are generally not able to issue additional shares of our common stock at a price below NAV per common share to purchasers other than our existing stockholders through a rights offering without first obtaining the approval of our stockholders and our independent directors. Additionally, at times when our stock is trading below its NAV per common share, our dividend yield may exceed the weighted average returns that we would expect to realize on new investments that would be made with the proceeds from the sale of such stock, making it unlikely that we would determine to issue additional shares in such circumstances. Thus, for as long as our common stock trades below NAV we will be subject to significant constraints on our ability to raise capital through the issuance of common stock. Additionally, an extended period of time in which we are unable to raise capital may restrict our ability to grow and adversely impact our ability to increase or maintain our distributions.

*Common stockholders may incur dilution if we sell shares of our common stock in one or more offerings at prices below the then current NAV per share of our common stock.*

At our most recent annual meeting on February 16, 2012, our stockholders approved a proposal designed to allow us to sell shares of our common stock below the then current NAV per share of our common stock in one or more offerings for a period of one year, subject to certain conditions (including, but not limited to, that the number of common shares issued and sold pursuant to such authority does not exceed 25% of our then outstanding common stock immediately prior to each such sale). At the upcoming annual stockholders meeting scheduled for February 14, 2013, our stockholders will again be asked to vote in favor of renewing this proposal for another year. During the past year, our common stock has traded consistently, and at times significantly, below NAV. Any decision to sell shares of our common stock below the then current NAV per share of our common stock would be subject to the determination by our Board of Directors that such issuance is in our and our stockholders' best interests.

If we were to sell shares of our common stock below NAV per common share, such sales would result in an immediate dilution to the NAV per common share. This dilution would occur as a result of the sale of shares at a price below the then current NAV per share of our common stock and a proportionately greater decrease in a stockholder's interest in our earnings and assets and voting percentage than the increase in our assets resulting from such issuance. The greater the difference between the sale price and the NAV per common share at the time of the offering, the more significant the dilutive impact would be. Because the number of shares of common stock that could be so issued and the timing of any issuance is not currently known, the actual dilutive effect, if any, cannot be predicted. However, if, for example, we sold an additional 10% of our common stock at a 5% discount from NAV, a stockholder who did not participate in that offering for its proportionate interest would suffer NAV dilution of up to 0.5% or \$5 per \$1,000 of NAV.

*If we fail to pay dividends on our Term Preferred Stock for two years, the holders of our Term Preferred Stock will be entitled to elect a majority of our directors.*

The terms of our Term Preferred Stock provide for annual dividends in the amount of \$1.7813 per outstanding share of Term Preferred Stock. In accordance with the terms of our Term Preferred Stock, if dividends on the Term Preferred Stock are unpaid in an amount equal to at least two years of dividends, the holders of Term Preferred Stock will be entitled to elect a majority of our Board of Directors.

*Our Term Preferred Stock magnifies the potential for gain or loss for holders of our common stock and the risks of investing in our common stock in the same way as our borrowings.*

Preferred stock, which is another form of leverage, has the same risks to our common stockholders as borrowings because the dividends on any preferred stock we issue must be cumulative. Payment of such dividends and repayment of the liquidation preference of such preferred stock must take preference over any dividends or other payments to our common stockholders, and preferred stockholders are less subject to our expenses or losses and are not entitled to participate in any income or appreciation in excess of their stated preference.





## **Table of Contents**

*An investment in Term Preferred Stock with a fixed interest rate bears interest rate risk.*

Our Term Preferred Stock, in general, pays dividends at a fixed dividend rate of 7.125% per year. Prices of fixed income investments generally vary inversely with changes in market yields. The market yields on securities comparable to the Term Preferred Stock may increase, which would likely result in a decline in the secondary market price of the Term Preferred Stock prior to the term redemption date. This risk may be even more significant in light of the low nature of the currently prevailing market interest rates.

*A liquid secondary trading market for our Term Preferred Stock may not develop.*

Although our Term Preferred Stock is listed for trading on the NASDAQ, such shares are thinly traded, and the market for such shares is relatively illiquid compared to the market for other types of securities, with the spread between the bid and ask prices considerably greater than the spreads of other securities with comparable terms and features.

*The Term Preferred Stock is not rated.*

We have not had the Term Preferred Stock rated by any rating agency. Unrated securities usually trade at a discount to similar, rated securities. As a result, there is a risk that the shares of our Term Preferred Stock may trade at a price that is lower than they might otherwise trade if they were rated by a rating agency.

*The Term Preferred Stock bears a risk of early redemption by us.*

We may voluntarily redeem some or all of the Term Preferred Stock on or after December 31, 2012, and we may be forced to redeem some or all of the Term Preferred Stock to meet regulatory requirements and the asset coverage requirements of such shares. Any such redemption may occur at a time that is unfavorable to holders of the Term Preferred Stock. We may have an incentive to redeem the Term Preferred Stock voluntarily before the term redemption date if market conditions allow us to issue other preferred stock or debt securities at a rate that is lower than the fixed dividend rate on the Term Preferred Stock.

*Claims of holders of our Term Preferred Stock are subject to a risk of subordination relative to holders of our debt instruments.*

Rights of holders of our Term Preferred Stock are subordinated to the rights of holders of our indebtedness. Therefore, dividends, distributions and other payments to holders of Term Preferred Stock in liquidation or otherwise may be subject to prior payments due to the holders of our indebtedness. In addition, under some circumstances the 1940 Act may provide debt holders with voting rights that are superior to the voting rights of holders of the Term Preferred Stock.

*Holders of our Term Preferred Stock are subject to inflation risk.*

Inflation is the reduction in the purchasing power of money resulting from the increase in the price of goods and services. Inflation risk is the risk that the inflation-adjusted, or real, value of an investment in Term Preferred Stock or the income from that investment will be worth less in the future. As inflation occurs, the real value of the Term Preferred Stock and dividends payable on such shares declines.

*Holders of our Term Preferred Stock bear reinvestment risk.*

Given the five-year term and potential for early redemption of the Term Preferred Stock, holders of such shares may face an increased reinvestment risk, which is the risk that the return on an investment purchased with proceeds from the sale or redemption of the Term Preferred Stock may be lower than the return previously obtained from the investment in such shares.

*Holders of our Term Preferred Stock bear dividend risk.*

We may be unable to pay dividends on the Term Preferred Stock under some circumstances. The terms of our indebtedness preclude the payment of dividends in respect of equity securities, including the Term Preferred Stock, under certain conditions.

## **Table of Contents**

*There is a risk of delay in our redemption of our Term Preferred Stock, and we may fail to redeem such securities as required by their terms.*

We will generally make investments in private companies whose securities are not traded in any public market. Substantially all of the investments we presently hold and the investments we expect to acquire in the future are, and will be, subject to legal and other restrictions on resale and will otherwise be less liquid than publicly-traded securities. The illiquidity of our investments may make it difficult for us to obtain cash equal to the value at which we record our investments quickly if a need arises. If we are unable to obtain sufficient liquidity prior to the term redemption date, we may be forced to engage in a partial redemption or to delay a required redemption. If such a partial redemption or delay were to occur, the market price of the Term Preferred Stock might be adversely affected.

### ***Other Risks***

*We could face losses and potential liability if intrusion, viruses or similar disruptions to our technology jeopardize our confidential information, whether through breach of our network security or otherwise.*

Maintaining our network security is of critical importance because our systems store highly confidential financial models and portfolio company information. Although we have implemented, and will continue to implement, security measures, our technology platform is and will continue to be vulnerable to intrusion, computer viruses or similar disruptive problems caused by transmission from unauthorized users. The misappropriation of proprietary information could expose us to a risk of loss or litigation.

*Terrorist attacks, acts of war, or national disasters may affect any market for our common stock, impact the businesses in which we invest, and harm our business, operating results, and financial conditions.*

Terrorist acts, acts of war, or national disasters have created, and continue to create, economic and political uncertainties and have contributed to global economic instability. Future terrorist activities, military or security operations, or national disasters could further weaken the domestic/global economies and create additional uncertainties, which may negatively impact the businesses in which we invest directly or indirectly and, in turn, could have a material adverse impact on our business, operating results, and financial condition. Losses from terrorist attacks and national disasters are generally uninsurable.

**Table of Contents****SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

All statements contained or incorporated by reference in this prospectus or any accompanying prospectus supplement, 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 may, might, believe, will, provided, anticipate, future, could, growth, plan, intend, expect, should, would, if, seek, possible, potential, likely or the neg comparable terminology. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others: (1) further adverse changes in the economy and the capital markets; (2) risks associated with negotiation and consummation of pending and future transactions; (3) the loss of one or more of our executive officers, in particular David Gladstone and Terry Lee Brubaker; (4) risks associated with our search for a new president and chief investment officer to replace George Stelljes III; (5) changes in our business strategy; (6) availability, terms and deployment of capital; (7) changes in our industry, interest rates, exchange rates or the general economy; (8) the degree and nature of our competition; and (9) those factors described in the Risk Factors section of this prospectus. We caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, after the date of this prospectus. The forward-looking statements contained or incorporated by reference in this prospectus or any accompanying prospectus supplement are excluded from the safe harbor protection provided by the Private Securities Litigation Reform Act of 1995 and Section 27A of the Securities Act.

**USE OF PROCEEDS**

Unless otherwise specified in any prospectus supplement accompanying this prospectus, we intend to use the net proceeds from the sale of the Securities for general corporate purposes. We expect the proceeds to be used first to pay down existing short-term debt, then to make investments in small and mid-sized businesses in accordance with our investment objectives, with any remaining proceeds to be used for other general corporate purposes. Indebtedness under our Credit Facility currently accrues interest at the rate of approximately 5.25% and matures on January 19, 2015. We anticipate that substantially all of the net proceeds of any offering of Securities will be utilized in the manner described above within three months of the completion of such offering. Pending such utilization, we intend to invest the net proceeds of any offering of Securities primarily in cash, cash equivalents, U.S. government securities, and other high-quality debt investments that mature in one year or less from the date of investment, consistent with the requirements for continued qualification as a RIC for federal income tax purposes.

**PRICE RANGE OF COMMON STOCK AND DISTRIBUTIONS**

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

Our common stock is quoted on the NASDAQ under the symbol GLAD. Our common stock has historically traded at prices both above and below its NAV. There can be no assurance, however, that any premium to NAV will be attained or maintained. As of January 14, 2013, there were 57 stockholders of record, meaning individuals or entities that we carry in our records as the registered holder (although not necessarily the beneficial owner) of our common stock.

**Table of Contents**

The following table sets forth the range of high and low intraday sale prices of our common stock as reported on the NASDAQ and the dividends declared by us for the last two completed fiscal years and the current fiscal year through January 17, 2013.

**COMMON SHARE PRICE DATA**

	NAV(1)	High	Low	Dividend Declared	Premium or (Discount) of High Sales Price to NAV(2)	Premium or (Discount) of Low Sales Price to NAV(2)
<b>Fiscal Year ending September 30, 2011</b>						
First Quarter	\$ 11.74	\$ 12.17	\$ 10.83	\$ 0.21	3.7%	(7.8)%
Second Quarter	11.18	12.12	10.46	0.21	8.4	(6.4)
Third Quarter	10.34	11.66	9.22	0.21	12.8	(10.8)
Fourth Quarter	10.16	9.75	6.86	0.21	(4.0)	(32.5)
<b>Fiscal Year ending September 30, 2012</b>						
First Quarter	9.90	8.74	6.46	0.21	(11.7)	(34.7)
Second Quarter	9.62	9.33	7.69	0.21	(3.0)	(20.1)
Third Quarter	8.91	8.46	7.30	0.21	(5.1)	(18.1)
Fourth Quarter	8.98	9.19	7.86	0.21	2.3	(12.5)
<b>Fiscal Year ending September 30, 2013</b>						
First Quarter	*	9.02	7.25	0.21	*	*
Second Quarter (through January 17, 2013)	*	8.97	8.24	0.21	*	*

- (1) NAV per share is determined as of the last day in the relevant quarter and therefore may not reflect the NAV per share on the date of the high and low intraday sale prices. The NAV per shares shown are based on outstanding shares at the end of each period.
- (2) The (discounts) premiums to NAV per share set forth in these columns represent the high or low, as applicable, intraday sale price per share for the relevant quarter minus the NAV per share as of the end of such quarter, and therefore may not reflect the (discount) premium to NAV per share on the date of the high and low intraday sale prices.

\* Not yet available, as the NAV per share as of the end of this quarter has not yet been determined.

The following are our outstanding classes of securities as of September 30, 2012.

Title of Class	Amount Authorized	Amount Held by us or for Our Account	Amount Outstanding Exclusive of Amounts Shown Under
Common Stock	46,000,000		21,000,160
Term Preferred Stock	4,000,000		1,539,882

**Table of Contents****RATIOS OF EARNINGS TO FIXED CHARGES**

For the years ended September 30, 2012, 2011, 2010, 2009, and 2008, the ratios of three income metrics to fixed charges of the Company, computed as set forth below, were as follows:

	Year Ended September 30,				
	2012	2011	2010	2009	2008
Net investment income plus fixed charges to fixed charges	3.3x	5.5x	4.0x	3.0x	3.7x
Net investment income plus realized (losses) gains plus fixed charges to fixed charges	1.8x	5.2x	3.5x	0.5x	3.6x
Net (decrease) increase in net assets resulting from operations plus fixed charges to fixed charges	(0.0x)	(4.2x)	3.8x	1.4x	(1.2x)

For purposes of computing the ratios, fixed charges include interest expense on borrowings, dividend expense on mandatorily redeemable preferred stock and amortization of deferred financing fees.

**CONSOLIDATED SELECTED FINANCIAL DATA**

The following table summarizes our consolidated selected financial data and other data. The consolidated selected financial data as of September 30, 2012 and 2011 and for the fiscal years ended September 30, 2012, 2011 and 2010 is derived from our audited consolidated financial statements included in this prospectus. The consolidated selected financial data as of September 30, 2010, 2009 and 2008 and for the fiscal years ended September 30, 2009 and 2008 is derived from our audited consolidated financial statements that are not included in this prospectus. The other data included in the second table is unaudited. You should read this data together with our consolidated financial statements and notes thereto presented elsewhere in this prospectus and the information under *Management's Discussion and Analysis of Financial Condition and Results of Operations* for more information.

	Year Ended September 30,				
	2012	2011	2010	2009	2008
<b>Statement of operations data:</b>					
Total investment income	\$ 40,322	\$ 35,211	\$ 35,539	\$ 42,618	\$ 45,725
Total expenses net of credits from Adviser	21,278	16,799	17,780	21,587	19,172
Net investment income	19,044	18,412	17,759	21,031	26,553
Net realized and unrealized (loss) gain on investments and other	(27,052)	(39,511)	(1,365)	(17,248)	(47,815)
Net (decrease) increase in net assets resulting from operations	\$ (8,008)	\$ (21,099)	\$ 16,394	\$ 3,783	\$ (21,262)
<b>Per common share data(1):</b>					
Net (decrease) increase in net assets resulting from operations per common share basic and diluted	\$ (0.38)	\$ (1.00)	\$ 0.78	\$ 0.18	\$ (1.08)
Net investment income per common share basic and diluted	0.91	0.88	0.84	1.00	1.35
Cash distributions declared per common share	0.84	0.84	0.84	1.26	1.68
Weighted common shares outstanding basic and diluted	21,011,123	21,039,242	21,060,351	21,087,574	19,699,796
<b>Statement of assets and liabilities data:</b>					
Total assets	\$ 293,402	\$ 317,624	\$ 270,518	\$ 335,910	\$ 425,698
Net assets	188,564	213,721	249,246	249,076	271,748
Net asset value per common share	8.98	10.16	11.85	11.81	12.89
Common shares outstanding	21,000,160	21,039,242	21,039,242	21,087,574	21,087,574
<b>Senior securities data:</b>					

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Borrowings under line of credit, at cost(2)	\$ 58,800	\$ 99,400	\$ 16,800	\$ 83,000	\$ 151,030
Mandatorily redeemable preferred stock	38,497				
Asset coverage ratio(3)	296%	315%	1,419%	396%	279%
Asset coverage per unit(4)	\$ 2,963	\$ 3,150	\$ 14,187	\$ 3,963	\$ 2,792

- (1) Per share data for net (decrease) increase in net assets resulting from operations and for net investment income is based on the weighted average common stock outstanding.
- (2) See *Management's Discussion and Analysis of Financial Condition and Results of Operations* for more information regarding our level of indebtedness.
- (3) As a BDC, we are generally required to maintain an asset coverage ratio (as defined in Section 18(h) of the 1940 Act) of at least 200% on our senior securities representing indebtedness and our senior securities that are stock. Our mandatorily redeemable preferred stock is a senior security that is stock.
- (4) Asset coverage per unit is the asset coverage ratio expressed in terms of dollar amounts per one thousand of indebtedness.

**Table of Contents**

	2012	Year Ended September 30,			2008
		2011	2010	2009	
(Dollar amounts in thousands, except per unit data)					
<b>Other unaudited data:</b>					
Number of portfolio companies as of end of period	50	59	39	48	63
Average size of portfolio company investment at cost	\$ 7,300	\$ 6,488	\$ 7,654	\$ 7,592	\$ 7,315
Principal amount of new investments	(45,050)	(110,903)	(23,245)	(24,911)	(176,550)
Proceeds from loan repayments and investments sold	73,873	50,002	85,634	96,693	70,482
Weighted average yield on investments(1):	10.89%	11.16%	10.85%	10.05%	10.39%
Total return(2)	41.39	(33.77)	37.46	(30.94)	(13.90)

- (1) Weighted average yield on investments equals interest income on investments divided by the annualized weighted average investment balance throughout the period.
- (2) Total return equals the (decrease) increase of the ending market value over the beginning market value, taking into account monthly distributions reinvested in accordance with our dividend reinvestment plan, divided by the monthly beginning market value.



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**Table of Contents**

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

**(dollar amounts in thousands, except per share data or unless otherwise indicated)**

The following analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the notes thereto contained elsewhere herein.

**OVERVIEW**

**General**

We were incorporated under the General Corporation Laws of the State of Maryland on May 30, 2001. We operate as a closed-end, non-diversified management investment company, and have elected to be treated as a business development company ( "BDC" ) under the Investment Company Act of 1940, as amended (the "1940 Act" ). 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" ). Our board of directors (the "Board of Directors" ) recently approved limited revisions to our investment objectives and strategies, which went into effect on January 1, 2013, which revisions are reflected in the descriptions of our investment objectives and strategies below. All of our existing portfolio investments fit within the scope of our revised investment objectives and strategies and no changes were required to be made to our portfolio as a result of these revisions.

*Investment Objectives*

Our investment objectives are to: (1) achieve and grow current income by investing in debt securities of established businesses that we believe will provide stable earnings and cash flow to pay expenses, make principal and interest payments on our outstanding indebtedness and make distributions to stockholders that grow over time; and (2) provide our stockholders with long-term capital appreciation in the value of our assets by investing in equity securities of established businesses that we believe can grow over time to permit us to sell our equity investments for capital gains.

**Business Environment**

While economic conditions generally appear to be improving, we remain cautious about a long-term economic recovery. The recent recession in general, and the disruptions in the capital markets in particular, have impacted our liquidity options and increased our cost of debt and equity capital. Many of our portfolio companies, as well as those that we evaluate for investment, are impacted by these economic conditions, and if these conditions persist, it may affect their ability to repay our loans or engage in a liquidity event, such as a sale, recapitalization or initial public offering. The economic conditions could also disproportionately impact some of the industries in which we have invested, causing us to be more vulnerable to losses in our portfolio, which could cause the number of our non-performing assets to increase and the fair market value of our portfolio to decrease. We do not know if market conditions will continue to improve or if adverse conditions will again intensify, and we do not know the full extent to which the economic downturn will affect us. If market instability persists or intensifies, we may continue to experience difficulty in raising capital.

During 2012, we experienced a net contraction in our overall portfolio, a net decrease of nine portfolio companies when compared to the year ended September 30, 2011. The primary reason was \$60.2 million in unscheduled principal payments with ten portfolio investments paying off early, but also due to fewer new investments made during the year. While we invested in several new proprietary and syndicate investments in 2012, there is increased competitive pressure in the BDC and investment company marketplace for senior and senior subordinated debt resulting in lower yields for increasingly riskier investments. In 2013, we will continue to focus on building our pipeline and making investments that meet our objectives and strategies and that provide appropriate returns, given the risks. Subsequent to September 30, 2012, we have made three new investments for an aggregate total of \$9.5 million.

Despite the challenges during these uncertain economic times, during the year ended September 30, 2012, we completed both a preferred stock offering and a renewal of our \$137.0 million line of credit (our "Credit Facility", described more fully under *Recent Developments - Renewal of Credit Facility* below). In November 2011, we issued 1.5 million shares of term preferred stock (our "Term Preferred Stock", described more fully under *Recent Developments - Term Preferred Stock Offering* below) for gross proceeds of \$38.5 million and in January 2012, and we closed on an amendment to our Credit Facility to extend its maturity until January 2015.



## **Table of Contents**

In addition, in July 2012, the Securities and Exchange Commission ( SEC ) granted an exemptive order that, subject to satisfaction of certain conditions, expands our ability to co-invest in portfolio companies with certain of our affiliated investment funds, which we believe will enhance our ability to further our investment strategy and objectives. See *Recent Developments Co-Investment Order* for more information.

We believe that market conditions have affected the trading price of our common stock and our ability to finance new investments through the issuance of equity. On January 17, 2013, the closing market price of our common stock was \$8.87, a 1.2% discount to our September 30, 2012, net asset value ( NAV ) per share of \$8.98. When our stock trades below NAV per common share, as it has consistently traded over the last three years, our ability to issue equity is constrained by provisions of the 1940 Act, which generally prohibits the issuance and sale of our common stock below NAV per common 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 16, 2012, our stockholders approved a proposal which authorizes us to sell shares of our common stock at a price below our then current NAV per common share subject to certain limitations (including, but not limited to, that the number of shares issued and sold pursuant to such authority does not exceed 25% of our then outstanding common stock immediately prior to each such sale) 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 14, 2013, our stockholders will again be asked to vote in favor of renewing this proposal for another year.

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. Because we are required to 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 Credit Facility. 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 that require us to have an asset coverage ratio (as defined in Section 18(h) of the 1940 Act) of at least 200% on senior securities representing indebtedness and senior securities that are stock, which we refer to collectively as Senior Securities.

We expect that, given these regulatory and contractual constraints in combination with current market conditions, debt and equity capital may be costly for us to access in the near term. However, we believe that our public offering of Term Preferred Stock in November 2011, our three year renewal on our Credit Facility and our new ability to co-invest with Gladstone Investment Corporation ( Gladstone Investment ) and other affiliated investment funds, will increase our ability to make investments in businesses that we believe will weather the current economic conditions and will be likely to produce attractive long-term returns for our stockholders.

## **Investment Highlights**

During the fiscal year ended September 30, 2012, we extended \$45.1 million in new debt and equity investments to five new portfolio companies, and we extended \$23.8 million of investments to existing portfolio companies through revolver draws, additions to term notes and equity. Also, during the fiscal year ended September 30, 2012, we sold our investments in five portfolio companies for aggregate proceeds of approximately \$6.5 million and we received scheduled and unscheduled contractual principal repayments of approximately \$67.4 million from existing portfolio companies, including ten early payoffs at par. Since our initial public offering in August 2001, we have made 316 different loans to, or investments in, 158 companies for a total of approximately \$1.1 billion, before giving effect to principal repayments on investments and divestitures.

### *Investment Activity*

During the fiscal year ended September 30, 2012, we executed the following transactions with certain of our portfolio companies:

## Table of Contents

### Purchases

During the year ended September 30, 2012, we extended an aggregate of \$28.0 million in debt and equity investments to two new proprietary portfolio companies listed in the following bullet points, an aggregate of \$15.5 million in senior or senior subordinated syndicated loan investments to two new portfolio companies, Blue Coat Systems, Inc. ( Blue Coat ) and PLATO Learning, Inc., and \$1.6 million in a senior term debt investment to Ohana Media Group ( Ohana ), which is a proprietary investment that resulted from a restructuring discussed below.

In May 2012, we invested \$16.0 million in Francis Drilling Fluids, Ltd. ( FDF ) through a combination of debt and equity. FDF, headquartered in Crowley, Louisiana, is a logistics network provider of warehousing, transportation and energy field services for oil and natural gas drilling to oilfields and exploration and production customers.

Also in May 2012, we invested \$12.0 million in POP Radio, L.P. ( POP ) through a combination of debt and equity. POP, headquartered in Salt Lake City, Utah, is an advertiser-supported in-store radio network provider to retailers.

### Repayments and Exits

During the year ended September 30, 2012, 34 borrowers made principal repayments totaling \$67.4 million in the aggregate, consisting of \$60.2 million in unscheduled payoffs and exits, as well as \$7.2 million in contractual amortization, revolver repayments and principal payments.

Included in the unscheduled principal payments were the net proceeds at par from early payoffs of the following:

Syndicated investments: Ernest Health, Inc. ( Ernest Health ) of \$2.0 million, Attachmate Corporate ( Attachmate ) of \$4.0 million, Global Brass and Copper, Inc. ( Global Brass ) of \$2.5 million, Covad Communications Groups, Inc. ( Covad ) of \$1.8 million, Allied Specialty Vehicles Inc. ( ASV ) of \$9.9 million and Ulterra Drilling Technologies, LP. ( Ulterra ) of \$1.9 million; and

Proprietary investments: Northern Contours, Inc. ( Northern Contours ) of \$6.1 million, Global Materials Technologies, Inc. ( GMT ) of \$2.4 million, RCS Management Holding Co. ( RCS ) of \$4.4 million, and Winchester Electronics ( Winchester ) of \$12.6 million.

In December 2011, we sold our investments in Newhall Holdings Inc. ( Newhall ) for net proceeds of \$3.3 million, which resulted in a realized loss of \$7.4 million recorded in the three months ended December 31, 2011. Newhall was on non-accrual status at the time of the sale.

In August 2012, we sold our \$1.8 million investment in BERTL, Inc. ( BERTL ) for net proceeds of \$11, which resulted in a realized loss of \$1.8 million. BERTL was on non-accrual status at the time of the sale.

In September 2012, we sold our \$3.2 million investment in U.S. Healthcare Communications, Inc. ( USHC ) for net proceeds of \$16, which resulted in a realized loss of \$3.2 million. USHC was on non-accrual status at the time of the sale.

### Workouts

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Effective October 2011, we restructured our investment in Sunshine Media Holdings ( Sunshine ) by reducing the interest rates on its line of credit, senior debt and last out tranche ( LOT ) senior debt to preserve Sunshine s capital to enable it to invest in new and existing initiatives. We also invested \$2.8 million in additional preferred equity and \$4.0 million in line of credit draws to Sunshine during the year ended September 30, 2012. We placed our investment in Sunshine s LOT senior debt on non-accrual status, effective January 1, 2012, and the remaining senior debt and revolver investments on non-accrual status effective April 1, 2012.

In November 2011, we invested \$1.6 million in Ohana to facilitate its purchase of certain of KMBQ Corporation s ( KMBQ ) assets out of receivership. In connection with this transaction, we received net proceeds of \$1.2 million and recorded a realized loss during the three months ended December 31, 2011, totaling \$1.0 million. Ohana replaced KMBQ on our accompanying *Consolidated Schedule of Investments* as a Non-Control/Non-Affiliate investment at December 31, 2011.

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## **Table of Contents**

Effective January 2012, we restructured our investment in Viapack, Inc. ( *Viapack* ) by reducing the interest rates on its line of credit, senior real estate term debt and senior debt to preserve *Viapack*'s capital to enable it to invest in existing initiatives. We have also invested \$2.3 million in line of credit draws to *Viapack* during the year ended September 30, 2012. We placed our investment in *Viapack*'s LOT senior debt on non-accrual status effective January 1, 2012.

Subsequent to September 30, 2012, our loans to Blue Coat, Mood Media Corporation, HGI Holding, Inc., Keypoint Government Solutions, Inc. and Wall Street Systems Holdings, Inc. were paid off early at par for a combined total of \$27.5 million. Additionally, in November 2012 we invested a combined total of \$9.5 million in three new portfolio companies. Refer to Note 14 *Subsequent Events* in our accompanying *Consolidated Financial Statements* included elsewhere in this prospectus for investment activity occurring subsequent to September 30, 2012.

## **Recent Developments**

### *Renewal of Credit Facility*

On January 19, 2012, we entered into Amendment No. 3 to the fourth amended and restated credit agreement, through Gladstone Business Loan, LLC ( *Business Loan* ), to extend the maturity date of our \$137.0 million line of credit (our *Credit Facility* ), from March 15, 2012 to January 19, 2015 (the *Maturity Date* ). The interest rates remained unchanged. Our *Credit Facility* was arranged by Key Equipment Finance Inc. ( *Keybank* ) as administrative agent. Branch Banking and Trust Company ( *BB&T* ) and ING Capital LLC ( *ING* ) also joined our *Credit Facility* as committed lenders. Subject to certain terms and conditions, our *Credit Facility* may be expanded to a maximum of \$237.0 million through the addition of other committed lenders to the facility. If our *Credit Facility* is not renewed or extended by the *Maturity Date*, all principal and interest will be due and payable on or before January 19, 2016 (one year after the *Maturity Date*). The interest rates on advances under our *Credit Facility* remained unchanged at 30-day London Interbank Offered Rate ( *LIBOR* ) subject to a minimum rate of 1.5%, plus 3.75% per annum, with a commitment fee of 0.5% per annum on undrawn amounts when our *Credit Facility* is drawn more than 50% and 1.0% per annum on undrawn amounts when our *Credit Facility* is drawn less than 50%. All other terms of our *Credit Facility* remained substantially unchanged.

### *Term Preferred Stock Offering*

In November 2011, we completed an offering of 1.5 million shares of 7.125% Series 2016 Term Preferred Stock ( *Term Preferred Stock* ), under a prior registration statement on Form N-2 (File No. 333-162592) at a public offering price of \$25.00 per share. Net proceeds of the offering, after deducting underwriting discounts and offering expenses borne by us were approximately \$36.4 million and were used to repay a portion of outstanding borrowings under our *Credit Facility*. Refer to Note 6 *Mandatorily Redeemable Preferred Stock* in our accompanying *Consolidated Financial Statements* included elsewhere in this prospectus for further discussion of our *Term Preferred Stock* offering.

### *Co-Investment Order*

In an order dated July 26, 2012, the SEC granted us an exemptive order that expands our ability to co-invest with certain of our affiliates by permitting us, under certain circumstances, to co-invest with Gladstone Investment and any future business development company or closed-end management investment company that is advised by Gladstone Management Corporation, our investment adviser (the *Adviser* ) (or sub-advised by the *Adviser* if it controls the fund) or any combination of the foregoing subject to the conditions included therein.

### *Board of Director Actions*

In October 2012, our Board of Directors expanded our board of directors from nine to ten members and appointed Terry Earhart as a new independent director to our Board of Directors to fill the resulting vacancy. Mr. Earhart was also appointed as a member of our compensation and ethics, nominating and corporate governance committees.

Also in October 2012, our Board of Directors approved limited revisions to our investment objectives and strategy (see

*Overview General Investment Objectives* and *Overview Investment Strategy* ), which went into effect on January 1, 2013. All of our existing portfolio investments fit within the scope of our revised investment objectives and strategies and no changes were required to be made to our portfolio as a result of this revision.

## **Table of Contents**

Also in October 2012, we terminated our equity distribution agreement with BB&T Capital Markets, a division of Scott & Stringfellow, LLC, under which we had the ability to issue up to 2 million shares of common stock from time to time. We did not issue any shares of common stock under this agreement. Prepaid costs of \$0.2 million related to the origination of this agreement were expensed in the three months ended September 30, 2012.

## **Investment Strategy**

To achieve our investment objectives, we seek to invest in several categories of debt and equity securities, with each investment generally ranging from \$5 million to \$30 million, although investment size may vary, depending upon our total assets or available capital at the time of investment.

In general, our investments in debt securities have a term of no more than seven years, accrue interest at variable rates (based on LIBOR) and, to a lesser extent, at fixed rates. We seek debt instruments that pay interest monthly or, at a minimum, quarterly, have a success fee or deferred interest provision and are primarily interest only with all principal and any accrued but unpaid interest due at maturity. Generally, success fees accrue at a set rate and are contractually due upon a change of control in the business. Some debt securities have deferred interest whereby some portion of the interest payment is added to the principal balance so that the interest is paid, together with the principal, at maturity. This form of deferred interest is often called "paid in kind" (PIK).

Typically, our equity investments consist of common stock, preferred stock, limited liability company interests, or warrants to purchase the foregoing. Often, these equity investments occur in connection with our original investment, recapitalizing a business, or refinancing existing debt.

## **The Adviser and Administrator**

The Adviser is led by a management team which has extensive experience in our lines of business. The Adviser is controlled by David Gladstone, our chairman and chief executive officer. Mr. Gladstone is also the chairman and chief executive officer of the Adviser. Terry Lee Brubaker, our vice chairman, chief operating officer and director, is a member of the board of directors of the Adviser and its vice chairman and chief operating officer and has substantial experience in acquisitions and operations of companies. George Stelljes III, our president, chief investment officer and director, is a member of the board of directors of the Adviser and its president and chief investment officer and has extensive experience in leveraged finance. Although Mr. Stelljes has recently advised us of his intention to resign as our president and chief investment officer, he will continue to serve in his present capacities with the Adviser. Gladstone Administration, LLC (the "Administrator"), an affiliate of the Adviser, employs our chief financial officer and treasurer, chief accounting officer, chief compliance officer, internal counsel and their respective staffs.

The Adviser and Administrator also provide investment advisory and administrative services to our affiliates, Gladstone Commercial Corporation ( "Gladstone Commercial"), a publicly-traded real estate investment trust; Gladstone Investment, a publicly-traded BDC and RIC; and Gladstone Land Corporation ( "Gladstone Land"), a private agricultural real estate company that has filed a registration statement on Form S-11 with the SEC, but has not yet completed its initial public offering. Excluding our chief financial officer and treasurer and our chief accounting officer, all of our executive officers serve as directors or executive officers, or both, of the Adviser, the Administrator, Gladstone Commercial, Gladstone Investment and will likely serve as directors and executive officers of Gladstone Land (which is owned by our chief executive officer) in the future. Our chief executive officer also serves on the board of managers (as an outside non-employee manager) of our affiliate, Gladstone Securities, LLP ( "Gladstone Securities"), a broker-dealer registered with the Financial Industry Regulatory Authority ( "FINRA") and insured by the Securities Investor Protection Corporation. Additionally, our chief financial officer and treasurer serves as chief financial officer and treasurer of Gladstone Investment. In the future, the Adviser and Administrator may provide investment advisory and administrative services, respectively, to other funds, both public and private.

In addition, as a BDC under the 1940 Act, we are required to make available significant managerial assistance to our portfolio companies. The Adviser provides these services on our behalf through its personnel, some of whom are also our officers. Currently, neither we nor the Adviser charge a fee for managerial assistance.

The Adviser and Gladstone Securities, each an affiliate of ours, receive fees for certain services they separately provide to certain of our portfolio companies. Such fees are generally paid directly to the Adviser or Gladstone Securities, as applicable. When the Adviser receives such fees, 50% of certain of those fees and 100% of others are credited against the base management fee that we pay to the Adviser. Gladstone Securities provides certain of our portfolio companies with investment banking and due diligence services; these fees do not impact the overall fees that we pay the Adviser.





## **Table of Contents**

The 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 the Adviser throughout the life of the investment. Fees of this nature are recorded as revenue by the 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 the Adviser. These fees are paid directly to us and are recognized as other income upon closing of the originated investment.

### **Investment Advisory and Management Agreement**

Under the amended and restated investment advisory agreement ( *Advisory Agreement* ), we pay the Adviser an annual base management fee of 2% of our average gross assets, which is defined as total assets, including investments made with proceeds of borrowings, less any uninvested cash or cash equivalents resulting from borrowings, valued at the end of the two most recently completed calendar quarters and appropriately adjusted for any share issuances or repurchases during the current calendar quarter.

We also pay the Adviser a two-part incentive fee under the *Advisory Agreement*. The first part of the incentive fee is an income-based incentive fee which rewards the Adviser if our quarterly net investment income (before giving effect to any incentive fee) exceeds 1.75% of our net assets (the *hurdle rate* ). The second part of the incentive fee is a capital gains-based incentive fee that is determined and payable in arrears as of the end of each fiscal year (or upon termination of the *Advisory Agreement*, as of the termination date), and equals 20% of our realized capital gains as of the end of the fiscal year. In determining the capital gains-based incentive fee payable to the Adviser, we will calculate the cumulative aggregate realized capital gains and cumulative aggregate realized capital losses since our inception, and the aggregate unrealized capital depreciation as of the date of the calculation, as applicable, with respect to each of the investments in our portfolio. The Adviser has not earned the capital gains-based portion of the incentive fee since our inception.

We pay our direct expenses including, but not limited to, directors' fees, legal and accounting fees, stockholder related expenses, and directors and officers insurance under the *Advisory Agreement*.

Beginning in April 2006, our Board of Directors has accepted from the Adviser, unconditional and irrevocable voluntarily waivers on a quarterly basis to reduce the annual 2.0% base management fee on senior syndicated loans to 0.5% to the extent that proceeds resulting from borrowings were used to purchase such syndicated loan participations. In addition to the base management and incentive fees under the *Advisory Agreement*, 50% of certain fees and 100% of others received by the Adviser from our portfolio companies are credited against the investment advisory fee and paid to the Adviser.

The Adviser services our loan portfolio, pursuant to a loan servicing agreement with our wholly-owned subsidiary Business Loan, in return for a 1.5% annual fee, based on the monthly aggregate outstanding loan balance of the loans pledged under our Credit Facility.

In July 2012, our Board of Directors approved the renewal of the *Advisory Agreement* with the Adviser through August 31, 2013. We expect that our Board of Directors will approve a further one year renewal in July 2013.

### **Administration Agreement**

We entered into an administration agreement with the Administrator (the *Administration Agreement* ), whereby we pay separately for administrative services. The *Administration Agreement* provides for payments equal to our allocable portion of the Administrator's overhead expenses in performing its obligations under the *Administration Agreement* including, but not limited to, rent and our allocable portion of the salaries and benefits expenses of our chief financial officer and treasurer, chief accounting officer, chief compliance officer, internal counsel and their respective staffs. Our allocable portion of expenses is derived by multiplying the Administrator's total expenses by the percentage of our average assets (the total assets at the beginning of each quarter) in comparison to the average total assets of all companies managed by the Adviser under similar agreements. In July 2012, our Board of Directors approved the renewal of this *Administration Agreement* through August 31, 2013. We expect that our Board of Directors will consider a further one year renewal in July 2013.

**Table of Contents****RESULTS OF OPERATIONS***Comparison of the Fiscal Year Ended September 30, 2012 to the Fiscal Year Ended September 30, 2011*

	2012	For the year ended September 30, 2011	\$ Change	% Change
<b>INVESTMENT INCOME</b>				
Interest income	\$ 36,077	\$ 33,068	\$ 3,009	9.1%
Other income	4,245	2,143	2,102	98.1
Total investment income	40,322	35,211	5,111	14.5
<b>EXPENSES</b>				
Base management fee	6,165	5,731	434	7.6
Incentive fee	4,691	4,598	93	2.0
Administration fee	753	729	24	3.3
Interest expense	4,374	2,676	1,698	63.5
Dividend expense on mandatorily redeemable preferred stock	2,491		2,491	NM
Amortization of deferred financing fees	1,243	1,420	(177)	(12.5)
Other	2,609	2,288	321	14.0
Expenses before credits from Adviser	22,326	17,442	4,884	28.0
Credits to fees from Adviser	(1,048)	(643)	(405)	(63.0)
Total expenses net of credits	21,278	16,799	4,479	26.7
NET INVESTMENT INCOME	19,044	18,412	632	3.4
<b>REALIZED AND UNREALIZED (LOSS) GAIN</b>				
Net realized loss on investments	(12,819)	(1,280)	(11,539)	(901.5)
Net unrealized depreciation of investments	(11,194)	(38,759)	27,565	71.1
Net unrealized (appreciation) depreciation of borrowings	(3,039)	528	(3,567)	NM
Net loss from investments and borrowings	(27,052)	(39,511)	12,459	31.5
NET DECREASE IN NET ASSETS RESULTING FROM OPERATIONS	\$ (8,008)	\$ (21,099)	\$ 13,091	62.0

NM = Not Meaningful

**Investment Income**

Interest income from our investments in debt securities increased slightly for the year ended September 30, 2012, by \$3.2 million or 9.7%, as compared to the year ended September 30, 2011, primarily due to the increased investment activity during the second half of fiscal year 2011, offset by several early payoffs of investments in 2012 and a slight decrease in our weighted average yield in 2012 as compared to 2011. The increase in investment activity in 2011 was primarily in syndicated investments. The level of interest income from investments is directly related to the principal balance of our interest-bearing investment portfolio during the period multiplied by the weighted average yield. The weighted average principal balance of our interest-bearing investment portfolio during the year ended September 30, 2012, was \$329.0 million, compared to \$293.8 million for the prior year, an increase of \$35.2 million or 12.0%. The weighted average yield on the principal balance of our interest-bearing investments for the year ended September 30, 2012, was 10.9%, as compared to 11.1% for the prior year. The weighted average yield on our portfolio decreased during the year ended September 30, 2012, as compared to the prior year, due to the early payoffs of several proprietary investments and also the restructuring of certain loans into lower interest rate loans.

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As of September 30, 2012, six portfolio companies were either fully or partially on non-accrual with an aggregate debt cost basis of approximately \$61.1 million, or 17.3% of the cost basis of all debt investments in our portfolio. As of September 30, 2011, eight portfolio companies were on non-accrual with an aggregate debt cost basis of approximately \$41.1 million, or 11.0% of the cost basis of all debt investments in our portfolio.

Other income increased for the year ended September 30, 2012, by \$2.1 million, or 98.1%, as compared to the year ended September 30, 2011, mainly due to increases in success fees, which we recognize when payment is received. We received success fees from the early payoffs of GMT of \$1.1 million, RCS of \$0.9 million, Northern Contours of \$0.8 million and Winchester of \$1.2 million during the year ended September 30, 2012. Success fees earned during the year ended September 30, 2011, totaled \$1.0 million, which we received primarily from Interfilm Holdings, Inc. ( Interfilm ) and Pinnacle Treatment Centers, Inc. ( Pinnacle ) for actual exits in 2011, and also from Westlake Hardware, Inc. ( Westlake ) as a prepaid success fee. In addition, we received \$1.0 million in 2011 in the aggregate from two legal settlements related to portfolio companies that were recorded in other income.

**Table of Contents**

The following tables list the investment income for our five largest portfolio company investments at fair value during the respective years:

Portfolio Company	As of September 30, 2012		Year Ended September 30, 2012 % of Total	
	Fair Value	% of Portfolio	Investment Income	Investment Income
Reliable Biopharmaceutical Holdings, Inc.	\$ 25,439	9.3%	\$ 3,193	7.9%
Westlake Hardware, Inc.	19,360	7.1	2,592	6.4
Midwest Metal Distribution, Inc.	17,824	6.5	2,249	5.6
Francis Drilling Fluids, Ltd. <sup>(A)</sup>	15,385	5.6	750	1.9
CMI Acquisition, LLC	13,766	5.0	2,021	5.0
<b>Subtotal five largest investments</b>	<b>91,774</b>	<b>33.5</b>	<b>10,805</b>	<b>26.8</b>
Other portfolio companies	182,186	66.5	29,257	72.6
Other non-portfolio company income			260	0.6
<b>Total investment portfolio</b>	<b>\$ 273,960</b>	<b>100.0%</b>	<b>\$ 40,322</b>	<b>100.0%</b>

Portfolio Company	As of September 30, 2011		Year Ended September 30, 2011 % of Total	
	Fair Value	% of Portfolio	Investment Income	Investment Income
Reliable Biopharmaceutical Holdings, Inc.	\$ 25,295	8.3%	\$ 3,090	8.8%
Westlake Hardware, Inc.	19,340	6.4	2,935	8.3
Midwest Metal Distribution, Inc.	17,184	5.7	2,242	6.4
Defiance Integrated Technologies, Inc.	15,039	5.0	888	2.5
CMI Acquisition, LLC	14,336	4.7	1,038	3.0
<b>Subtotal five largest investments</b>	<b>91,194</b>	<b>30.1</b>	<b>10,193</b>	<b>29.0</b>
Other portfolio companies	211,753	69.9	24,586	69.8
Other non-portfolio company income			432	1.2
<b>Total investment portfolio</b>	<b>\$ 302,947</b>	<b>100.0%</b>	<b>\$ 35,211</b>	<b>100.0%</b>

<sup>(A)</sup> New investment during the year ended September 30, 2012.

**Operating Expenses**

Operating expenses, net of credits from the Adviser, increased for the year ended September 30, 2012, by \$4.5 million, or 26.7%, as compared to the year ended September 30, 2011. This increase was primarily due to an increase in interest expense on our Credit Facility and the distributions on our Term Preferred Stock for the year ended September 30, 2012.

Interest expense increased by \$1.7 million for the year ended September 30, 2012, as compared to the prior year, due primarily to increased borrowings under our Credit Facility to facilitate the increased investment activity during the year. The weighted average balance outstanding on our Credit Facility during the year ended September 30, 2012 was approximately \$72.2 million, as compared to \$49.2 million in the prior year, an increase of 46.7%.

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During the year ended September 30, 2012, we paid \$2.5 million of dividends on our Term Preferred Stock. We classify these dividends as dividend expense on our accompanying *Consolidated Statements of Operations*. No preferred stock dividends were paid in the year ended September 30, 2011, as our Term Preferred Stock offering occurred in November 2011.

The base management fee increased slightly for the year ended September 30, 2012, as compared to the prior year, primarily due to the greater amount of average total assets subject to the base management fee that we held during the year. Due to the increased syndicated loan holdings, there was a slight increase in the fee reduction for the voluntary, irrevocable waiver of the 2.0% fee on senior syndicated loans to 0.5% per annum, when compared to the prior year. A net incentive fee

**Table of Contents**

of \$4.4 million was earned by the Adviser during the year ended September 30, 2012, as compared to a net incentive fee of \$4.6 million earned during the year ended September 30, 2011. During the years ended September 30, 2012 and 2011, the incentive fee was partially and irrevocably waived voluntarily by the Adviser to ensure distributions to common stockholders were covered entirely by net investment income.

The base management fee, incentive fee and associated credits are computed quarterly as described under *Investment Advisory and Management Agreement* in Note 4 of the notes to our accompanying *Consolidated Financial Statements* and are summarized in the table below:

	<b>Year Ended September 30,</b>	
	<b>2012</b>	<b>2011</b>
<b>Average total assets subject to base management fee<sup>(A)</sup></b>	<b>\$ 308,250</b>	<b>\$ 286,550</b>
Multiplied by annual base management fee of 2%	<b>2.0%</b>	<b>2.0%</b>
<b>Base management fee<sup>(B)</sup></b>	<b>6,165</b>	<b>5,731</b>
Reduction for loan servicing fees	<b>(3,604)</b>	<b>(3,355)</b>
<b>Adjusted base management fee</b>	<b>2,561</b>	<b>2,376</b>
Fee reduction for the voluntary, irrevocable waiver of 2.0% fee on senior syndicated loans to 0.5% per annum	<b>(428)</b>	<b>(383)</b>
Credit for fees received by Adviser from the portfolio companies	<b>(342)</b>	<b>(239)</b>
<b>Net base management fee</b>	<b>\$ 1,791</b>	<b>\$ 1,754</b>
<b>Incentive fee<sup>(B)</sup></b>	<b>\$ 4,691</b>	<b>\$ 4,598</b>
Credit from voluntary, irrevocable waiver issued by Adviser's board of directors	<b>(278)</b>	<b>(21)</b>
<b>Net incentive fee</b>	<b>\$ 4,413</b>	<b>\$ 4,577</b>
Fee reduction for the voluntary, irrevocable waiver of 2.0% fee on senior syndicated loans to 0.5% per annum	<b>\$ (428)</b>	<b>\$ (383)</b>
Credit for fees received by Adviser from portfolio companies	<b>(342)</b>	<b>(239)</b>
Incentive fee credit	<b>(278)</b>	<b>(21)</b>
<b>Credit to base management and incentive fees from Adviser<sup>(B)</sup></b>	<b>\$ (1,048)</b>	<b>\$ (643)</b>

<sup>(A)</sup> Average total assets subject to the base management fee is defined as total assets, including investments made with proceeds of borrowings, less any uninvested cash or cash equivalents resulting from borrowings, valued at the end of the four most recently completed quarters within the respective years and appropriately adjusted for any share issuances or repurchases during the applicable year.

<sup>(B)</sup> Reflected, in total, as a line item on our accompanying *Consolidated Statement of Operations* located elsewhere in this prospectus.

Other expenses also increased for the year ended September 30, 2012, as compared to the prior year, primarily due to expenses of \$0.2 million being recognized in 2012 for the termination of an equity distribution agreement, discussed in detail under *Liquidity and Capital Resources Equity* further below and also due to increases in bad debt expense related to receivables from certain portfolio companies.

**Realized Loss and Unrealized Depreciation on Investments***Realized Losses*

For the year ended September 30, 2012, we recorded a net realized loss on investments of \$12.8 million, which primarily consisted of a realized loss of \$7.4 million related to the sale of Newhall, \$1.0 million related to the restructure of KMBQ, \$1.8 million related to the sale of BERTL and \$3.2 million related to the sale of USHC. These realized losses were partially offset by realized gains of \$0.2 million related to our receipt of escrowed proceeds in connection with our exit in 2010 of our investment in ACE Expeditors, Inc. ( ACE ) and \$0.4 million from unamortized

discounts related to exits of certain investments. There were \$1.3 million in realized losses in the year ended September 30, 2011, relating primarily to a restructuring of our loans to SCI Cable, Inc., ( SCI ) which resulted in a new control portfolio company, Kansas Cable Holdings, Inc. ( Kansas Cable ).

**Table of Contents***Net Unrealized Depreciation*

Net unrealized depreciation of investments is the net change in the fair value of our investment portfolio during the year, including the reversal of previously recorded unrealized appreciation or depreciation when gains and losses are actually realized. During the year ended September 30, 2012, we recorded net unrealized depreciation of investments in the aggregate amount of \$11.2 million, which include the reversal of \$17.0 million in combined aggregate unrealized depreciation primarily related to the sales of Newhall, USHC and BERTL and the restructure of KMBQ.

The net realized (losses) gains and unrealized appreciation (depreciation) across our investments for the year ended September 30, 2012 were as follows:

Portfolio Company	Year Ended September 30, 2012			
	Realized (Loss) Gain	Unrealized Appreciation (Depreciation)	Reversal of Unrealized Depreciation (Appreciation)	Net Gain (Loss)
Newhall Holdings, Inc.	\$ (7,327)	\$	\$ 9,978	\$ 2,651
FedCap Partners, LLC		1,010		1,010
Midwest Metal Distribution, Inc.		630		630
Mood Media Corporation		622		622
Northern Contours, Inc.			444	444
Global Materials Technologies, Inc.		422		422
Vision Solutions, Inc.		374		374
Keypoint Government Solutions, Inc.		271		271
Allison Publications, LLC		264		264
RCS Management Holding Company		(81)	306	225
KMBQ Corporation	(1,044)		1,135	91
US Healthcare Communications, LLC	(3,173)		3,189	16
BERTL, Inc.	(1,771)	(4)	1,782	7
CMI Acquisitions, LLC		(571)		(571)
Francis Drilling Fluids, Ltd.		(614)		(614)
Kansas Cable Holdings, Inc.		(658)		(658)
LocalTel, LLC		(962)		(962)
Precision Acquisition Group Holdings, Inc.		(1,078)		(1,078)
Saunders & Associates		(1,150)		(1,150)
Reliable Pharmaceutical Holdings, Inc.		(1,344)		(1,344)
International Junior Golf Training Acquisition Company		(1,415)		(1,415)
Sunburst Media Louisiana, LLC		(1,612)		(1,612)
Lindmark Acquisition, LLC		(1,739)		(1,739)
Viapack, Inc.		(1,760)		(1,760)
Defiance Integrated Technologies, Inc.		(3,422)		(3,422)
GFRC Holdings, LLC		(3,845)		(3,845)
BAS Broadcasting		(4,367)		(4,367)
Sunshine Media Holdings		(7,847)		(7,847)
Other, net (<\$250)	496	682	166	1,344
<b>Total:</b>	<b>\$ (12,819)</b>	<b>\$ (28,194)</b>	<b>\$ 17,000</b>	<b>\$ (24,013)</b>

The largest drivers of our net unrealized depreciation for the year ended September 30, 2012, were the unrealized depreciation in Sunshine of \$7.8 million, BAS Broadcasting of \$4.4 million, GFRC Holdings, LLC of \$3.8 million and Defiance Integrated Technologies, Inc. ( Defiance ) of \$3.4 million, all primarily due to a decline in these portfolio companies financial and operational performance. Of note, Sunshine was put on non-accrual status during the year ended September 30, 2012.



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During the year ended September 30, 2011, we recorded net unrealized depreciation of investments in the aggregate amount of \$38.8 million. Excluding reversals of net unrealized depreciation of \$4.0 million, over our entire portfolio, the net unrealized depreciation was comprised of approximately \$46.0 million in depreciation on our debt investments and approximately \$3.3 million in appreciation on our equity investments for the year ended September 30, 2011.

The net realized (losses) gains and unrealized appreciation (depreciation) across our investments for the year ended September 30, 2011, were as follows:

**Table of Contents**

Portfolio Company	Year Ended September 30, 2011			
	Realized (Loss) Gain	Net Unrealized Appreciation (Depreciation)	Reversal of Unrealized Depreciation (Appreciation)	Net Gain (Loss)
Defiance Integrated Technologies, Inc.	\$	\$ 5,992	\$	\$ 5,992
Midwest Metal Distribution, Inc.		1,637		1,637
SCI Cable, Inc.	(1,283)	(785)	3,676	1,608
KMBQ Corporation		738		738
Puerto Rico Cable Acquisition Company, Inc.	(16)		732	716
WP Evenflo Group Holdings, Inc.		485		485
Airvana Network Solutions, Inc.	177	267	(216)	228
Westlake Hardware, Inc.		(280)		(280)
Vision Solutions, Inc.		(355)		(355)
BAS Broadcasting		(411)		(411)
LocalTel, LLC		(479)		(479)
Mood Media Corporation		(553)		(553)
International Junior Golf Training Acquisition Company		(666)		(666)
Access Television Network, Inc.		(704)		(704)
Sunburst Media Louisiana, LLC		(847)		(847)
Heartland Communications Group		(871)		(871)
Legend Communications of Wyoming LLC		(975)		(975)
GFRC Holdings LLC		(1,668)		(1,668)
Kansas Cable Holdings, Inc.		(2,665)		(2,665)
Lindmark Acquisition, LLC		(4,547)		(4,547)
Viapack, Inc.		(4,882)		(4,882)
Newhall Holdings, Inc.		(9,339)		(9,339)
Sunshine Media Holdings	(158)	(21,237)		(21,395)
Other, net (<\$250)		(583)	(223)	(806)
<b>Total:</b>	<b>\$ (1,280)</b>	<b>\$ (42,728)</b>	<b>\$ 3,969</b>	<b>\$ (40,039)</b>

The largest driver of our net unrealized depreciation for the year ended September 30, 2011, was the notable depreciation in Sunshine, which was primarily due to a decline in the portfolio company financial and operational performance and the restructure, which occurred during the quarter ended March 31, 2011. In addition, net unrealized depreciation increased in Newhall of \$9.3 million, Viapack of \$4.9 million and Lindmark Acquisition, LLC ( Lindmark ) of \$4.5 million during 2011, due to decline in these portfolio companies financial and operational performances. Offsetting the net unrealized depreciation was the net unrealized appreciation in 2011 on Defiance, which resulted from an improvement in portfolio company performance in certain comparable multiples. Of note, subsequent to September 30, 2011, Newhall was sold and Viapack was partially placed on non-accrual status.

At September 30, 2012, the fair value of our investment portfolio was less than its cost basis by approximately \$91.1 million and our entire investment portfolio was valued at 75.0% of cost, as compared to cumulative net unrealized depreciation of \$79.9 million and a valuation of our entire portfolio at 79.1% of cost at September 30, 2011. This increase year over year in the cumulative unrealized depreciation on investments represents net unrealized depreciation of \$11.2 million for the twelve months ended September 30, 2012. Of our current investment portfolio, 21 portfolio companies originated through December 31, 2007, which represent 57.7% of the entire cost basis of our portfolio, accounted for approximately \$80.2 million, or 88.1%, of the cumulative net unrealized depreciation as of September 30, 2012, including our six investments that were on non-accrual status.

We believe that our aggregate investment portfolio was valued at a depreciated value as of September 30, 2012, primarily due to the lingering effects of the recession that began in late 2007 and its affect on the performance of certain of our portfolio companies and also because we were invested in certain industries that have been disproportionately impacted by the recession. The cumulative net 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 to stockholders.

**Table of Contents****Net Unrealized (Appreciation) Depreciation of Borrowings**

Net unrealized (appreciation) depreciation of borrowings is the net change in the fair value of our Credit Facility during the year, including the reversal of previously recorded unrealized appreciation or depreciation when gains and losses are realized. During the year ended September 30, 2012, we recorded a net unrealized appreciation on borrowings of \$3.0 million. The Credit Facility was fair valued at \$62.5 million and \$100.0 million as of September 30, 2012 and September 30, 2011, respectively.

**Comparison of the Fiscal Year Ended September 30, 2011 to the Fiscal Year Ended September 30, 2010**

	For the year ended September 30,			
	2011	2010	\$ Change	% Change
<b>INVESTMENT INCOME</b>				
Interest income	\$ 33,068	\$ 33,021	\$ 47	0.1%
Other income	2,143	2,518	(375)	(14.9)
Total investment income	35,211	35,539	(328)	(0.9)
<b>EXPENSES</b>				
Base management fee	5,731	6,085	(354)	(5.8)
Incentive fee	4,598	1,823	2,775	152.2
Administration fee	729	807	(78)	(9.7)
Interest expense	2,676	4,390	(1,714)	(39.0)
Amortization of deferred financing fees	1,420	1,490	(70)	(4.7)
Other	2,288	3,605	(1,317)	(36.5)
Expenses before credit from Adviser	17,442	18,200	(758)	(4.2)
Credit to fees from Adviser	(643)	(420)	(223)	(53.1)
Total expenses net of credits	16,799	17,780	(981)	(5.5)
<b>NET INVESTMENT INCOME</b>	<b>18,412</b>	<b>17,759</b>	<b>653</b>	<b>3.7</b>
<b>REALIZED AND UNREALIZED (LOSS) GAIN</b>				
Net realized loss on investments	(1,280)	(2,893)	1,613	55.8
Net unrealized (depreciation) appreciation of investments	(38,759)	2,317	(41,076)	NM
Net unrealized depreciation (appreciation) of borrowings	528	(789)	1,317	NM
Net loss from investments and borrowings	(39,511)	(1,365)	(38,146)	(2,794)
<b>NET (DECREASE) INCREASE IN NET ASSETS RESULTING FROM OPERATIONS</b>	<b>\$ (21,099)</b>	<b>\$ 16,394</b>	<b>\$ (37,493)</b>	<b>NM</b>

NM = Not Meaningful

**Investment Income**

Interest income from our investments in debt securities remained the same at \$32.6 million when comparing the year ended September 30, 2011 and 2010. Interest income from our aggregate investment portfolio remained relatively unchanged year over year, although the second half of 2011 showed significant increases in interest income over the first half of 2011 due to the large number of new investments we made in the second half of fiscal 2011. The increase in investment activity in the latter half of 2011 was primarily in syndicated investments, which typically bear lower interest rates than our existing proprietary investments. The level of interest income from investments is directly related to the principal balance of our interest-bearing investment portfolio during the year multiplied by the weighted average yield. The weighted average cost basis of our interest-bearing investment portfolio during the year ended September 30, 2011, was approximately \$292.9 million, compared

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to approximately \$300.5 million for the prior year. The weighted average yield on the principal balance on our interest-bearing investments was 11.1% for the year ended September 30, 2011, as compared to 10.9% for the prior year. The increase in the weighted average yield on our portfolio for the year ended September 30, 2011, resulted primarily from the repayment of loans with lower stated interest rates and the restructuring of certain loans into higher interest rate loans, partially offset by the purchase of syndicated loans, which generally bear lower interest rates than our existing proprietary debt investments.

We had a net increase of two portfolio companies on non-accrual status as of September 30, 2011, as compared to September 30, 2010. As of September 30, 2011, eight portfolio companies were on non-accrual with an aggregate debt cost basis of approximately \$41.1 million, or 11.0% of the cost basis of all debt investments in our portfolio. As of September 30, 2010, six portfolio companies were on non-accrual with an aggregate debt cost basis of approximately \$29.9 million, or 10.2% of the cost basis of all debt investments in our portfolio.

**Table of Contents**

Interest income from notes to certain employees of the Adviser, in connection with the exercise of employee stock options, decreased slightly, primarily as a result of significant repayments on the principal amounts in 2011. For additional information regarding these notes see *Management Loans*. These decreases were offset almost entirely by increases in the interest rates on the loans due to the fact that certain significant loans were in default, triggering penalty interest provisions for all of fiscal 2011.

Other income decreased for the year ended September 30, 2011, as compared to the prior year, mainly due to decreases in success fees, which we recognize when payment is received. Success fees earned during the year ended September 30, 2011, totaled \$1.0 million, which we received primarily from Interfilm and Pinnacle for actual exits in 2011, and also from Westlake as a prepaid success fee. In addition, we received an aggregate of \$1.0 million from two legal settlements related to portfolio companies during the year ended September 30, 2011, that were recorded in other income. Success fees earned during the year ended September 30, 2010, totaled \$1.9 million, which we received from ActivStyle Acquisition Co., Anitox Acquisition Co., Doe & Ingalls Management LLC, Tulsa Welding School and Visual Edge Technology, Inc. for actual exits and from Saunders & Associates and Northern Contours, Inc. as prepayments.

The following table lists the investment income for our five largest portfolio company investments at fair value during the respective years:

Portfolio Company	As of September 30, 2011		Year Ended September 30, 2011	
	Fair Value	% of Portfolio	Investment Income	% of Total Investment Income
Reliable Biopharmaceutical Holdings, Inc.	\$ 25,295	8.3%	\$ 3,090	8.8%
Westlake Hardware, Inc.	19,340	6.4	2,935	8.3
Midwest Metal Distribution, Inc.	17,184	5.7	2,242	6.4
Defiance Integrated Technologies, Inc.	15,039	5.0	888	2.5
CMI Acquisition, LLC	14,336	4.7	1,038	3.0
<b>Subtotal five largest investments</b>	<b>91,194</b>	<b>30.1</b>	<b>10,193</b>	<b>29.0</b>
Other portfolio companies	211,753	69.9	24,586	69.8
Other non-portfolio company income			432	1.2
<b>Total investment portfolio</b>	<b>\$ 302,947</b>	<b>100.0%</b>	<b>\$ 35,211</b>	<b>100.0%</b>

Portfolio Company	As of September 30, 2010		Year Ended September 30, 2010	
	Fair Value	% of Portfolio	Investment Income	% of Total Investment Income
Sunshine Media, Inc.	\$ 27,286	10.6%	\$ 3,254	9.1%
Reliable Biopharmaceutical Holdings, Inc.	26,574	10.3	3,003	8.4
Westlake Hardware, Inc.	19,620	7.6	2,940	8.3
Midwest Metal Distribution, Inc.	15,539	6.0	2,127	6.0
Winchester Electronics Co.	12,508	4.9	1,589	4.5
<b>Subtotal five largest investments</b>	<b>101,527</b>	<b>39.4</b>	<b>12,913</b>	<b>36.3</b>
Other portfolio companies	155,582	60.6	22,036	62.0
Other non-portfolio company income			590	1.7
<b>Total investment portfolio</b>	<b>\$ 257,109</b>	<b>100.0%</b>	<b>\$ 35,539</b>	<b>100.0%</b>

**Operating Expenses**

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Operating expenses, net of credits from the Adviser, decreased for the year ended September 30, 2011, as compared to the prior year. This reduction was primarily due to a decrease in interest expense incurred on our Credit Facility and a decrease in professional fees, which were partially offset by an increase in the incentive fee.

**Table of Contents**

The base management fee decreased for the year ended September 30, 2011, as compared to the prior year, resulting from maintaining a smaller investment portfolio on average at fair value and from an increase in the fee reduction for the voluntary, irrevocable waiver of the 2.0% fee on senior syndicated loans to 0.5% per annum, when compared to the prior year due to increased syndicated loan investments. The base management fee is computed quarterly, as described under *Investment Advisory and Management Agreement* in Note 4 *Related Party Transactions* of the notes to the accompanying *Consolidated Financial Statements*, and is summarized in the table below. Incentive fees increased for the year ended September 30, 2011, as compared to the prior year, primarily due to increased pre-incentive fee net investment income. During the years ended September 30, 2011 and 2010, the incentive fee was partially and irrevocably waived voluntarily by the Adviser to ensure distributions to common stockholders were covered entirely by net investment income.

The base management fee, incentive fee and associated credits are computed quarterly as described under *Investment Advisory and Management Agreement* in Note 4 of the notes to our accompanying *Consolidated Financial Statements* and are summarized in the table below:

	Year Ended September 30,	
	2011	2010
<b>Average total assets subject to base management fee<sup>(A)</sup></b>	<b>\$ 286,550</b>	\$ 304,250
Multiplied by annual base management fee of 2.0%	2.0%	2.0%
<b>Base management fee<sup>(B)</sup></b>	<b>5,731</b>	6,085
Reduction for loan servicing fees	(3,355)	(3,412)
<b>Adjusted base management fee</b>	<b>2,376</b>	2,673
Fee reduction for the waiver of 2.0% fee on senior syndicated loans to 0.5% per annum	(383)	(42)
Credit for fees received by Adviser from the portfolio companies	(239)	(213)
<b>Net base management fee</b>	<b>\$ 1,754</b>	\$ 2,418
<b>Incentive fee<sup>(B)</sup></b>	<b>\$ 4,598</b>	\$ 1,823
Credit from voluntary, irrevocable waiver issued by Adviser's board of directors	(21)	(165)
<b>Net incentive fee</b>	<b>\$ 4,577</b>	\$ 1,658
Fee reduction for the voluntary, irrevocable waiver of 2.0% fee on senior syndicated loans to 0.5% per annum	\$ (383)	\$ (42)
Credit for fees received by Adviser from the portfolio companies	(239)	(213)
Incentive fee credit	(21)	(165)
<b>Credit to base management and incentive fees from Adviser<sup>(B)</sup></b>	<b>\$ (643)</b>	\$ (420)

(A) Average total assets subject to the base management fee is defined as total assets, including investments made with proceeds of borrowings, less any uninvested cash and cash equivalents resulting from borrowings, valued at the end of the applicable quarters within the respective years and appropriately adjusted for any share issuances or repurchases during the periods.

(B) Reflected as a line item on our accompanying *Consolidated Statements of Operations*.

Interest expense decreased by \$1.7 million for the year ended September 30, 2011, as compared to the prior year, due primarily to decreased borrowing costs under our Credit Facility during the year ended September 30, 2011. The weighted average balance outstanding on our Credit Facility increased only slightly year over year from approximately \$47.9 million during the year ended September 30, 2010, to approximately \$49.2 million during the year ended September 30, 2011. On November 22, 2010, we amended our Credit Facility, resulting in a reduced interest rate on outstanding borrowings. In addition to the lower interest rate, the amendment removed the annual minimum earnings shortfall fee to the committed lenders. During 2011, we reversed \$0.6 million of a minimum earnings shortfall fee which was recorded as a credit to interest expense.

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Other expense decreased by \$1.3 million for the year ended September 30, 2011, as compared to the prior year, due primarily to a larger amount of legal fees incurred during the year ended September 30, 2010, in connection with the restructuring of certain troubled loans.



**Table of Contents****Realized Loss and Unrealized (Depreciation) Appreciation on Investments***Realized Losses*

For the year ended September 30, 2011, we recorded a net realized loss on investments of \$1.3 million, which primarily resulted from a restructuring of our loans to SCI, which resulted in a new control portfolio company, Kansas Cable. For the year ended September 30, 2010, we recorded a net realized loss on investments of \$2.9 million, which consisted of \$4.3 million of losses from the sale of several syndicated loans (Gold Toe Investment Corp., Kinetek Acquisition Corp and Wesco Holdings, Inc.), the Western Directories, Inc. write-off, and the CCS, LLC payoff, partially offset by a \$1.4 million gain from the ACE payoff.

*Unrealized (Depreciation) Appreciation*

Net unrealized (depreciation) appreciation of investments is the net change in the fair value of our investment portfolio during the year, including the reversal of previously recorded unrealized appreciation or depreciation when gains and losses are actually realized. During the year ended September 30, 2011, we recorded net unrealized depreciation of investments in the aggregate amount of \$38.8 million, which included the reversal of \$4.0 million in aggregate unrealized depreciation. Excluding reversals, we had \$42.7 million in net unrealized depreciation for the year ended September 30, 2011.

The net realized (losses) gains and unrealized appreciation (depreciation) across our investments for the year ended September 30, 2011 were as follows:

Portfolio Company	Year Ended September 30, 2011			
	Realized (Loss) Gain	Net Unrealized Appreciation (Depreciation)	Reversal of Unrealized Depreciation (Appreciation)	Net Gain (Loss)
Defiance Integrated Technologies, Inc.	\$	\$ 5,992	\$	\$ 5,992
Midwest Metal Distribution, Inc.		1,637		1,637
SCI Cable, Inc.	(1,283)	(785)	3,676	1,608
KMBQ Corporation		738		738
Puerto Rico Cable Acquisition Company, Inc.	(16)		732	716
WP Evenflo Group Holdings, Inc.		485		485
Airvana Network Solutions, Inc.	177	267	(216)	228
Westlake Hardware, Inc.		(280)		(280)
Vision Solutions, Inc.		(355)		(355)
BAS Broadcasting		(411)		(411)
LocalTel, LLC		(479)		(479)
Mood Media Corporation		(553)		(553)
International Junior Golf Training Acquisition Company		(666)		(666)
Access Television Network, Inc.		(704)		(704)
Sunburst Media Louisiana, LLC		(847)		(847)
Heartland Communications Group		(871)		(871)
Legend Communications of Wyoming LLC		(975)		(975)
GFRC Holdings LLC		(1,668)		(1,668)
Kansas Cable Holdings, Inc.		(2,665)		(2,665)
Lindmark Acquisition, LLC		(4,547)		(4,547)
Viapack, Inc.		(4,882)		(4,882)
Newhall Holdings, Inc.		(9,339)		(9,339)
Sunshine Media Holdings	(158)	(21,237)		(21,395)
Other, net (<\$250)		(583)	(223)	(806)
<b>Total:</b>	<b>\$ (1,280)</b>	<b>\$ (42,728)</b>	<b>\$ 3,969</b>	<b>\$ (40,039)</b>

The largest driver of our net unrealized depreciation for the year ended September 30, 2011, was the notable unrealized depreciation in Sunshine, which was primarily due to a decline in the portfolio company financial and operational performance and the restructure, which

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occurred during the quarter ended March 31, 2011. In addition, net unrealized depreciation increased across Newhall of \$9.3 million, Viapack of \$4.9 million and Lindmark of \$4.5 million during 2011, due to decline in these portfolio companies' financial and operational performances. Offsetting the net unrealized depreciation was the net unrealized appreciation in 2011 on Defiance, which resulted from an improvement in portfolio company performance in certain comparable multiples.

**Table of Contents**

The net realized (losses) gains and unrealized appreciation (depreciation) across our investments for the year ended September 30, 2010 were as follows:

Portfolio Company	Year Ended September 30, 2010			
	Realized Gain (Loss)	Net Unrealized Appreciation (Depreciation)	Reversal of Unrealized Depreciation (Appreciation)	Net Gain (Loss)
Visual Edge Technology, Inc.	\$	\$ 54	\$ 1,662	\$ 1,716
Ace Expeditors, Inc.	1,367	(16)	(105)	1,246
BAS Broadcasting		639	475	1,114
Westlake Hardware, Inc.		951		951
Clinton Holdings, LLC		888		888
WP Evenflo Group Holdings, Inc.		826		826
Puerto Rico Cable Acquisition Company, Inc.		729		729
Defiance Integrated Technologies, Inc.		727		727
Northern Contours, Inc.		613		613
Pinnacle Treatment Centers, Inc.		534		534
Allison Publications, LLC		425		425
Global Materials Technologies, Inc.		259		259
CCS, LLC	(312)	193	312	193
Kinetek Acquisition Corp.	(513)		513	
Wesco Holdings, Inc.	(408)		408	
Western Directories, Inc	(2,865)	(46)	2,865	(46)
Sunshine Media Holdings		(265)		(265)
Precision Acquisitions Group Holdings, Inc.		(337)		(337)
BERTL, Inc.		(390)		(390)
SCI Cable, Inc.		(585)		(585)
Sunburst Media Louisiana, LLC		(696)		(696)
KMBQ Corporation		(807)		(807)
Finn Corporation		(939)		(939)
LocalTel, LLC		(1,381)		(1,381)
Legend Communications of Wyoming LLC		(2,632)	112	(2,520)
Lindmark Acquisition, LLC		(4,803)		(4,803)
Other, net (<\$250)	(162)	1,965	169	1,972
<b>Total:</b>	<b>\$ (2,893)</b>	<b>\$ (4,094)</b>	<b>\$ 6,411</b>	<b>\$ (576)</b>

The largest driver of our net unrealized depreciation for the year ended September 30, 2010, was the unrealized depreciation in Lindmark of \$4.8 million and Legend Communications of Wyoming LLC of \$2.6 million, each primarily due to a decline in these portfolio companies' financial and operational performance.

At September 30, 2011, the fair value of our investment portfolio was less than its cost basis by approximately \$79.9 million and our entire investment portfolio was valued at 79.1% of cost, as compared to cumulative net unrealized depreciation of \$41.1 million, and a valuation of our entire portfolio at 86.2% of cost at September 30, 2010. This increase year over year in the cumulative unrealized depreciation on investments represents net unrealized depreciation of \$38.8 million for the twelve months ended September 30, 2011.

We believe that our aggregate investment portfolio was valued at a depreciated value as of September 30, 2011, due primarily to the lingering effects of the recession that began in late 2007 and its affect on the performances of certain of our portfolio companies and also because we were invested in certain industries that have been disproportionately impacted by the recession.

**Table of Contents****Net Unrealized Depreciation (Appreciation) on Borrowings**

Net unrealized depreciation (appreciation) of borrowings is the net change in the fair value of our Credit Facility during the year, including the reversal of previously recorded unrealized appreciation or depreciation when gains and losses are realized. During the year ended September 30, 2011, we recorded a net unrealized depreciation on borrowings of \$0.5 million. Our Credit Facility was fair valued at \$100.0 million and \$17.9 million as of September 30, 2011 and September 30, 2010, respectively.

**LIQUIDITY AND CAPITAL RESOURCES****Operating Activities**

Net cash provided by operating activities for the year ended September 30, 2012, was \$26.2 million as compared to net cash used in operating activities for the year ended September 30, 2011, of \$68.4 million. The increase in cash from operating activities was primarily due to the decrease in funding of investments and the increase in scheduled and unscheduled principal repayments on investments and proceeds from sales of investments when comparing the two years. The large increase in originations in the second half of fiscal year 2011 contributed to an increase in interest income during the year ended September 30, 2012. The majority of cash from operating activities is generated from the interest and principal payments on debt securities that we receive from our portfolio companies. We utilize this cash primarily to fund new investments, make interest payments on our Credit Facility, make distributions to our stockholders, pay management fees to the Adviser and pay for other operating expenses. For the year ended September 30, 2010, net cash provided by operating activities was \$86.5 million and primarily resulted from scheduled and unscheduled principal repayments on investments, partially offset by the purchase of investments.

As of September 30, 2012, we had investments in loans to, equity of, or syndicated participations in, 50 private companies, with an aggregate cost basis of approximately \$365.0 million. As of September 30, 2011, we had investments in, loans to, equity of, or syndicated participations in, 59 private companies with an aggregate cost basis of approximately \$382.8 million.

The following table summarizes our total portfolio investment activity during the years ended September 30, 2012 and 2011:

	<b>Year Ended September 30,</b>	
	<b>2012</b>	<b>2011</b>
Beginning investment portfolio at fair value	<b>\$ 302,947</b>	\$ 257,109
New investments	<b>45,050</b>	110,903
Disbursements to existing portfolio companies	<b>23,891</b>	25,351
Scheduled principal repayments	<b>(7,149)</b>	(7,004)
Unscheduled principal repayments	<b>(60,221)</b>	(38,831)
Proceeds from sales	<b>(6,487)</b>	(4,167)
Increase in investment balance due to paid in kind interest		12
Increase in investment balance due to rolled-over interest		204
Loan impairment / contra-investment		715
Net unrealized (depreciation)	<b>(28,194)</b>	(42,728)
Reversal of prior period net depreciation on realization	<b>17,000</b>	3,969
Net realized loss	<b>(12,998)</b>	(1,119)
Amortization of premiums and discounts	<b>121</b>	(1,467)
<b>Ending Investment Portfolio at Fair Value</b>	<b>\$ 273,960</b>	\$ 302,947

The following table summarizes the scheduled contractual principal repayment and maturity of our investment portfolio by fiscal year, assuming no voluntary prepayments, at September 30, 2012.

<b>Fiscal Year Ending September 30,</b>	<b>Amount</b>
2013	\$ 101,318
2014	56,719

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2015	27,398
2016	64,628
2017	51,560
Thereafter	53,500
<b>Total Contractual Repayments</b>	<b>\$ 355,123</b>
Equity Investments	10,966
Adjustments to cost basis on debt investments	(1,068)
<b>Total Cost Basis of Investments Held at September 30, 2012:</b>	<b>\$ 365,021</b>

## **Table of Contents**

### **Financing Activities**

Net cash used in financing activities for the fiscal year ended September 30, 2012, was \$22.8 million and consisted primarily of net repayments on our Credit Facility of \$40.6 million, net of distributions to common stockholders of \$17.7 million. These financing activities were partially offset by proceeds from the issuance of Term Preferred Stock of \$38.5 million in November 2011.

Net cash provided by financing activities for the fiscal year ended September 30, 2011, was \$67.4 million and primarily consisted of net borrowings on our Credit Facility of \$82.6 million, partially offset by distributions to common stockholders of \$17.7 million.

Net cash used in financing activities for the fiscal year ended September 30, 2010 was \$84.0 million and primarily consisted of net repayments on our Credit Facility of \$66.2 million, net of distributions to common stockholders of \$17.7 million.

### **Distributions**

To qualify as a RIC and thus avoid corporate level tax on the income we distribute to our stockholders, we are required, under Subchapter M of the Code, to distribute at least 90% of our ordinary income and short-term capital gains to our stockholders on an annual basis. In accordance with these requirements, we declared and paid monthly cash distributions of \$0.07 per common share for each month during the years ended September 30, 2012 and 2011. From October 2008 through March 2009 and from April 2009 through September 2009, we declared and paid monthly cash distributions of \$0.14 and \$0.07 per common share, respectively.

For the years ended September 30, 2012 and 2011, our distribution payments were approximately \$17.7 million, respectively. We declared these distributions based on our estimates of net investment income for the fiscal year.

#### *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 conditions dictate 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 source other than net investment income. The estimates of the source of the distribution are interim estimates based on U.S. GAAP that are subject to revision, and the exact character of the distributions for tax purposes cannot be determined until the final books and records are finalized for the calendar year. Following the calendar year end, after definitive information has been determined by us, 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.

### **Equity**

The registration statement of which this prospectus is a part, permits us to issue, through one or more transactions, up to an aggregate of \$300.0 million in securities, consisting of common stock, preferred stock, subscription rights, debt securities or warrants to purchase common stock or preferred stock, including through a combined offering of such securities.

#### *Common Stock*

We anticipate issuing equity securities to obtain additional capital in the future. However, we cannot determine the terms of any future equity issuances or whether we will be able to issue equity on terms favorable to us, or at all. Additionally, when our common stock is trading below NAV, as it has consistently traded over the last three years, we will have regulatory constraints under the 1940 Act on our ability to issue and sell new shares. Generally, the 1940 Act provides that we may not issue and sell our common stock at a price below our then current NAV per common share, other than to our then existing common stockholders pursuant to a rights offering, without first obtaining approval from our stockholders and our independent directors. At September 30, 2012,

our NAV per common share was \$8.98 and as of January 17, 2013 our



**Table of Contents**

closing market price was \$8.87 per common share, representing a 1.2% discount to our NAV at September 30, 2012. To the extent that our common stock trades at a market price below our NAV per common 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.

At our Annual Meeting of Stockholders held on February 16, 2012, our stockholders approved a proposal that authorizes us to issue and sell shares of our common stock at a price below our then current NAV per common share for a period of one year, provided that our Board of Directors makes certain determinations prior to any such sale. We have not issued any common stock since February 2008 and have never issued common stock below NAV per common share. At the upcoming annual stockholders meeting scheduled for February 14, 2013, our stockholders will again be asked to vote in favor of renewing this proposal for another year.

In October 2012, we terminated an equity distribution agreement (the Agreement) that we and the Adviser had entered into with BB&T Capital Markets, a division of Scott & Stringfellow, LLC (the Agent) on May 17, 2010, under which we could, from time to time, issue and sell through the Agent, as sales agent, up to 2.0 million shares of our common stock, par value \$0.001 per share. At September 30, 2012, we had not issued any shares pursuant to the Agreement and we terminated the Agreement in October 2012. Prepaid costs of \$0.2 million related to the origination of this agreement were expensed in the three months ended September 30, 2012.

*Term Preferred Stock*

Pursuant to a prior shelf registration statement, in November 2011, we completed an offering of 1.5 million shares of Term Preferred Stock at a public offering price of \$25.00 per share. Gross proceeds totaled \$38.5 million and net proceeds, after deducting underwriting discounts and offering expenses borne by us were approximately \$36.4 million and were used to repay a portion of outstanding borrowings under our Credit Facility. We incurred \$2.1 million in total offering costs related to these transactions, which have been recorded as an asset in accordance with GAAP and amortized over the redemption period ending December 31, 2016. No preferred stock had been issued prior to this issuance.

Our Term Preferred Stock provides for a fixed dividend equal to 7.125% per year, payable monthly (which equates to approximately \$2.7 million per year). We are required to redeem all of the outstanding Term Preferred Stock on December 31, 2016 for cash at a redemption price equal to \$25.00 per share plus an amount equal to accumulated but unpaid dividends, if any, to the date of redemption. The Term Preferred Stock has a preference over our common stock with respect to these dividends, whereby no distributions are payable on our common stock unless the stated dividends, including any accrued and unpaid dividends, on the Term Preferred Stock have been paid in full. In addition, there are two other potential redemption triggers for our Term Preferred Stock: (1) if we fail to maintain an asset coverage ratio (as calculated under Section 18(h) of the 1940 Act) of at least 200%, we are required to redeem a portion of the outstanding Term Preferred Stock or otherwise cure the ratio redemption trigger; and (2) at our sole option, at any time on or after December 31, 2012.

The Term Preferred Stock has been recorded as a liability in accordance with GAAP and, as such, affects our asset coverage, exposing us to additional leverage risks. In addition, the Term Preferred Stock is not convertible into our common stock or any other security. The Term Preferred Stock is currently traded on the NASDAQ with a trading symbol of GLADP.

**Revolving Credit Facility**

On January 19, 2012, we, through Business Loan, entered into Amendment No. 3 to our Credit Facility to extend the maturity date of our \$137.0 million revolving line of credit from March 15, 2012 to January 19, 2015. Our Credit Facility was arranged by Key Equipment Finance Inc. (Keybank) as administrative agent. Branch Banking and Trust Company (BB&T) and ING Capital LLC (ING) also joined our Credit Facility as committed lenders. Subject to certain terms and conditions, our Credit Facility may be expanded to a maximum of \$237.0 million through the addition of other committed lenders thereto. The interest rates remained unchanged with advances under our Credit Facility generally bearing interest at a 30-day LIBOR subject to a minimum rate of 1.5%, plus 3.75% per annum, with a commitment fee of 0.5% per annum on undrawn amounts when the facility is drawn more than 50% and 1.0% per annum on undrawn amounts when the facility is drawn less than 50%. If our Credit Facility is not renewed or extended by January 19, 2015, all principal and interest will be due and payable on or before January 19, 2016. All other terms of our Credit Facility remained substantially unchanged. We incurred fees of \$1.5 million in January 2012 in connection with this amendment.



**Table of Contents**

Interest is payable monthly during the term of our Credit Facility. Available borrowings are subject to various constraints imposed under our Credit Facility, based on the aggregate loan balance pledged by Business Loan, which varies as loans are added and repaid, regardless of whether such repayments are prepayments or made as contractually required.

The administrative agent also requires that any interest or principal payments on pledged loans be remitted directly by the borrower into a lockbox account with Keybank as custodian. Keybank, who also serves as the trustee of the account, generally remits the collected funds to us once a month.

Our Credit Facility contains covenants that require Business Loan to maintain its status as a separate legal entity, prohibit certain significant corporate transactions (such as mergers, consolidations, liquidations or dissolutions), and restrict material changes to our credit and collection policies. Our Credit Facility also limits payments on distributions to the aggregate net investment income for each of the twelve month periods ending September 30, 2012, 2013, 2014, and 2015. Business Loan is also subject to certain limitations on the type of loan investments it can apply toward available credit in the borrowing base, including restrictions on geographic concentrations, sector concentrations, loan size, distribution payout, payment frequency and status, average life and lien property. Our Credit Facility further requires Business Loan to comply with other financial and operational covenants that obligate Business Loan to, among other things, maintain certain financial ratios, including asset and interest coverage and a minimum number of obligors required in the borrowing base of the credit agreement. Additionally, we are subject to a performance guaranty that requires us to maintain (i) a minimum net worth (as defined in the Credit Facility, this includes our Term Preferred Stock) of \$190.0 million plus 50.0% of all equity and subordinated debt raised after January 19, 2002, (ii) asset coverage with respect to senior securities representing indebtedness of at least 200%, in accordance with Section 18 of the 1940 Act and (iii) our status as a BDC under the 1940 Act and as a RIC under the Code. At September 30, 2012, we had a minimum net worth of \$227.1 million, asset coverage of 296.3% and an active status as a BDC and RIC, as each is defined in the performance guaranty of our Credit Facility. Our Credit Facility requires a minimum of 20 obligors in the borrowing base and as of September 30, 2012, Business Loan had 34 obligors. Additionally, under our Credit Facility, if any two of Messrs. Gladstone, Brubaker and Stelljes cease to serve as our executive officers the Credit Facility would terminate. In light of Mr. Stelljes' recent decision to resign as our president and chief investment officer, we will be at increased risk of triggering this provision, unless and until we are able to amend our Credit Facility to revise this provision. As of September 30, 2012, we were in compliance with all of the facility covenants.

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

We have lines of credit with certain of our portfolio companies that have not been fully drawn or called, as applicable. Since these commitments have expiration dates and we expect many will never be fully drawn, the total commitment amounts do not necessarily represent future cash requirements.

In addition to the lines of credit with our portfolio companies, we, from time to time, have also extended certain guarantees on behalf of some of our portfolio companies during the normal course of business. As of September 30, 2012, we had one guarantee outstanding to Viapack up to a maximum of \$0.3 million. As of September 30, 2012, we have not been required to make any payments on this guarantee and we consider the credit risks to be remote. As of September 30, 2011, we were not party to any signed guarantees.

We estimate the fair value of our unused line of credit commitments and guarantee as of September 30, 2012 to be minimal; and therefore, they are not recorded on our accompanying *Consolidated Statements of Assets and Liabilities*.

The following table shows our contractual obligations as of September 30, 2012 at cost:

Contractual Obligations <sup>(A)</sup>	Payments Due by Period				Total
	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years	
Credit Facility <sup>(B)</sup>	\$	\$ 58,800	\$	\$	\$ 58,800
Term Preferred Stock, \$0.001 par value, \$25 liquidation preference; 4,000,000 authorized and 1,539,882 shares issued and outstanding			38,497		38,497
Interest on debt obligations <sup>(C)</sup>	6,666	17,273	914		24,853
<b>Total</b>	<b>\$ 6,666</b>	<b>\$ 76,073</b>	<b>\$ 39,411</b>	<b>\$</b>	<b>\$ 122,150</b>

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- (A) Excludes our unused line of credit commitments and guarantee to our portfolio companies in an aggregate amount of \$5.2 million as of September 30, 2012.
- (B) Principal balance of borrowings outstanding under our Credit Facility, based on the current contractual maturity due to the revolving nature of the facility.

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## **Table of Contents**

- (C) Includes estimated interest payments on our Credit Facility and dividend obligations on our Term Preferred Stock. The amount of interest calculated for purposes of this table was based upon rates and balances as of September 30, 2012. Dividend payments on the Term Preferred Stock assume quarterly dividend declarations and monthly distributions through the date of mandatory redemption.

### **Critical Accounting Policies**

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

### **Investment Valuation**

The most significant estimate inherent in the preparation of our accompanying *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.

ASC 820 defines fair value, establishes a framework for measuring fair value and expands disclosures about assets and liabilities measured at fair value. ASC 820 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. ASC 820 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 or inactive 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 reflect assumptions that market participants would use when pricing the asset or liability. Level 3 inputs can also include our own assumptions based upon the best available information.

See Note 3 *Investments* in the accompanying notes to our accompanying *Consolidated Financial Statements* included elsewhere in this prospectus for additional information regarding fair value measurements and our adoption of ASC 820.

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 our investments.

In determining the value of our investments, the 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 the Adviser has applied the *Policy* consistently and votes whether or not to accept the recommended valuation of our investment portfolio. Such determination of fair values may involve subjective judgments and estimates.

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



**Table of Contents**

Publicly-traded securities;

Securities for which a limited market exists; and

Securities for which no market exists.

*Valuation Methods:*

**Publicly-traded securities:** We determine the value of publicly-traded securities based on the closing price for the security on the exchange or securities market on which it is listed and primarily traded on the valuation date. To the extent that we own restricted securities that are not freely tradable, but for which a public market otherwise exists, we will use the market value of that security adjusted for any decrease in value resulting from the restrictive feature. As of September 30, 2012 and 2011, we did not have any investments in publicly traded securities.

**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, which are non-binding. 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 ( IBP ) 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 IBP 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, including but not limited to reviewing a range of indicative bids to the extent the Adviser has ready access to such qualified information.

In the event these limited markets become illiquid such that market prices are no longer readily available, we will value our syndicated loans using alternative methods, such as estimated net present values of the future cash flows or discounted cash flows ( DCF ). 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 valuation of 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 apply the DCF methodology in illiquid markets until quoted prices are available or are deemed reliable based on trading activity.

As of September 30, 2012 and 2011, we determined that the indicative bid prices were reliable indicators of fair value for our syndicate investments. However, because of the private nature of this marketplace (meaning actual transactions are not publicly-reported), we believe that these valuation inputs are classified as Level 3 within the fair value hierarchy as defined in ASC 820.

**Securities for which no market exists:** The valuation methodology for securities for which no market exists falls into four 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; (3) portfolio investments in non-controlled companies comprised of a bundle of investments, which can include debt and equity securities; and (4) portfolio investments comprised of non-publicly-traded non-control equity securities of other funds.

- (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 utilizing opinions of value submitted to us by Standard & Poor's Securities Evaluations, Inc. ( SPSE ). We may also submit paid in kind ( 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 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

**Table of Contents**

include the information described below under Credit Information, the risk ratings of the loans described below under Loan Grading and Risk Rating and the factors described hereunder), this valuation data is forwarded to SPSE for review and analysis. SPSE makes its independent assessment of the data that we have assembled and assesses its independent data to form an opinion as to what they consider to be the market values for the securities. With regard to its work, SPSE has issued the following paragraph:

*SPSE provides evaluated price opinions which are reflective of what SPSE believes the bid side of the market would be for each loan after careful review and analysis of descriptive, market and credit information. Each price reflects SPSE's best judgment based upon careful examination of a variety of market factors. Because of fluctuation in the market and in other factors beyond its control, however, 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 the Adviser's supplemental assessment and recommendation regarding valuation of each of these investments. The Adviser generally accepts the opinion of value given by SPSE, however, in certain limited circumstances, such as when the Adviser may learn new information regarding an investment between the time of submission to SPSE and the date of the board assessment, the Adviser's conclusions as to value may differ from the opinion of value delivered by SPSE. Our Board of Directors then reviews whether the Adviser has followed its established procedures for determinations of fair value, and votes to accept or reject the recommended valuation of our investment portfolio. The Adviser and our management recommended, and the Board of Directors voted to accept, the opinions of value delivered by SPSE on the loans in our portfolio as denoted on the *Consolidated Schedule of Investments* included in our accompanying *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, common 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. We generally exit the debt and equity securities of one issuer together. Applying the liquidity waterfall approach to all of the investments of an issuer, 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

DCF or other pertinent factors.

In gathering the sales to third parties of similar securities, we may reference industry statistics and use outside experts, total enterprise value is only an estimate of value and may not be the value received in an actual sale. 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

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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 we use a valuation by SPSE or, if that is unavailable, a DCF valuation technique.



**Table of Contents**

- (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 or 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 (as amended by the FASB's Accounting Standards Update No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards, (ASU 2011-04)), we have defined our unit of account at the investment level (either debt or equity) and as such we determine the fair value of these non-control investments assuming the sale of an individual security using the standalone 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 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. Furthermore, we may utilize comparable values of similar companies, recent investments and indices with similar structures and risk characteristics or DCF valuation techniques and, in absence of other observable market data, our own assumptions.
- (4) **Portfolio investments comprised of non-publicly-traded non-control equity securities of other funds:** We generally value any uninvested capital of the non-control fund at par value and value any invested capital at the value provided by the non-control fund. Due to the uncertainty inherent in the valuation process, such estimates of fair value may differ significantly and materially from the values that would have been obtained had a ready market for the securities existed. 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 orderly transaction between market participants at the measurement date.

*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:* The 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 the 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, the 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.

**Table of Contents**

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

Company s System	First NRSRO	Second NRSRO	Description <sup>(A)</sup>
>10	<b>Baa2</b>	<b>BBB</b>	Probability of Default (PD) during the next ten years is 4% and the Expected Loss (EL) is 1% or less
10	<b>Baa3</b>	<b>BBB-</b>	PD is 5% and the EL is 1% to 2%
9	<b>Ba1</b>	<b>BB+</b>	PD is 10% and the EL is 2% to 3%
8	<b>Ba2</b>	<b>BB</b>	PD is 16% and the EL is 3% to 4%
7	<b>Ba3</b>	<b>BB-</b>	PD is 17.8% and the EL is 4% to 5%
6	<b>B1</b>	<b>B+</b>	PD is 22% and the EL is 5% to 6.5%
5	<b>B2</b>	<b>B</b>	PD is 25% and the EL is 6.5% to 8%
4	<b>B3</b>	<b>B-</b>	PD is 27% and the EL is 8% to 10%
3	<b>Caa1</b>	<b>CCC+</b>	PD is 30% and the EL is 10% to 13.3%
2	<b>Caa2</b>	<b>CCC</b>	PD is 35% and the EL is 13.3% to 16.7%
1	<b>Caa3</b>	<b>CC</b>	PD is 65% and the EL is 16.7% to 20%
<1	<b>N/A</b>	<b>D</b>	PD is 85% or there is a payment default and the EL is greater than 20%

<sup>(A)</sup> 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. Generally, when a loan becomes 90 days or more past due or if our qualitative assessment indicates that the debtor is unable to service its debt or other obligations, we will place the loan on non-accrual status and cease recognizing interest income on that loan until the borrower has demonstrated the ability and intent to pay contractual amounts due. However, we remain contractually entitled to this interest. Interest payments received on non-accrual loans may be recognized as income or applied to the cost basis depending upon management's judgment. Generally non-accrual loans are restored to accrual status when past due principal and interest are paid in full and, in management's judgment, are likely to remain current, or due to a restructuring such that the interest income is deemed to be collectible. At September 30, 2012, six portfolio companies were either fully or partially on non-accrual with an aggregate debt cost basis of approximately \$61.1 million, or 17.3% of the cost basis of all debt investments in our portfolio, and an aggregate fair value of approximately \$6.8 million, or 2.6% of the fair value of all debt investments in our portfolio. At September 30, 2011, eight portfolio companies were on non-accrual with an aggregate debt cost basis of approximately \$41.1 million, or 11.0% of the cost basis of all debt investments in our portfolio, and an aggregate fair value of approximately \$5.3 million, or 1.8% of the fair value of all debt investments in our portfolio. 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 September 30, 2012 and 2011, representing approximately 78.5% and 70.0%, respectively, of all loans in our portfolio at fair value at the end of each year:

Rating	As of September 30,	
	2012	2011
Highest	10.0	9.0

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Average	5.8	5.5
Weighted Average	5.5	5.9
Lowest	2.0	1.0

**Table of Contents**

The following table lists the risk ratings for all syndicated loans in our portfolio that were not rated by an NRSRO. At September 30, 2012 and 2011, these loans represented 6.8% and 6.3%, respectively, at fair value of all loans in our portfolio at the end of each year:

Rating	As of September 30,	
	2012	2011
Highest	7.0	7.0
Average	5.3	5.0
Weighted Average	5.2	5.0
Lowest	4.0	4.0

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 September 30, 2012 and 2011, representing approximately 14.7% and 23.7%, respectively, at fair value of all loans in our portfolio at fair value at the end of each year:

Rating	As of September 30,	
	2012	2011
Highest	B+/B1	B+/B1
Average	B/B2	B/B2
Weighted Average	B/B2	B/B2
Lowest	NR/Caa1	NR/Caa2

**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 requirements, we are required to distribute to stockholders at least 90% of our investment company taxable income, as defined by the Code. Our policy is to pay out as distributions up to 100% of that amount.

In an effort to avoid certain excise taxes imposed on RICs, we 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) 98.2% 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 from preceding years that were not distributed during such years. Additionally, under the RIC Modernization Act (the RIC Act), we are permitted to carry forward capital losses incurred in taxable years beginning after September 30, 2011, for an unlimited period. However, any losses incurred during those future taxable years will be required to be utilized prior to the losses incurred in pre-enactment taxable years, which carry an expiration date. As a result of this ordering rule, pre-enactment capital loss carryforwards may be more likely to expire unused. Additionally, post-enactment capital loss carryforwards will retain their character as either short-term or long-term capital losses rather than being considered all short-term as permitted under the previous regulation.

We sought and received approval for a change in accounting method from the IRS related to our tax treatment for success fees. As a result, we, in effect, will continue to account for the recognition of income from the success fees upon receipt, or when the amount becomes fixed. Prior to January 1, 2011, we had treated the success fee amount as a capital gain for tax characterization purposes. However, starting January 1, 2011, the tax characterization of the success fee amount was and will be treated as ordinary income. The approved change in accounting method does not require us to retroactively change the capital gains treatment of the success fees received prior to January 1, 2011.

**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. However, we remain contractually entitled to this interest. Interest payments received on non-accrual

loans may be recognized as income

## **Table of Contents**

or applied to the cost basis depending upon management's judgment. Generally, non-accrual loans are restored to accrual status when past due principal and interest are paid in full and, in management's judgment, are likely to remain current, or due to a restructuring such that the interest income is deemed to be collectible. At September 30, 2012, six portfolio companies were either fully or partially on non-accrual with an aggregate debt cost basis of approximately \$61.1 million, or 17.3% of the cost basis of all debt investments in our portfolio, and an aggregate fair value of approximately \$6.8 million, or 2.6% of the fair value of all debt investments in our. At September 30, 2011, eight portfolio companies were on non-accrual with an aggregate debt cost basis of approximately \$41.1 million, or 11.0% of the cost basis of all debt investments in our portfolio, and an aggregate fair value of approximately \$5.3 million, or 1.8% of the fair value of all debt investments in our portfolio.

As of September 30, 2012 and 2011, we had 24 and 27 original issue discount (OID) loans, respectively, primarily from the syndicated loans in our portfolio. We recorded OID income of \$0.3 million for the year ended September 30, 2012, as compared to \$0.2 million for the year ended September 30, 2011. The unamortized balance of OID investments as of September 30, 2012 and 2011 totaled \$1.1 million and \$1.5 million, respectively.

As of September 30, 2012, we had one investment that bore PIK interest and as of September 30, 2011, we had no investments that bore PIK interest. PIK interest, computed at the contractual rate specified in a loan agreement, is added to the principal balance of a loan and recorded as income. To maintain our status as a RIC, this non-cash source of income must be paid out to common stockholders in the form of distributions, even though we have not yet collected the cash. We recorded PIK income of \$20 for the year ended September 30, 2012, as compared to \$12 for the year ended September 30, 2011. We collected no PIK income in cash for the years ended September 30, 2012 and 2011, respectively.

We also transfer past due interest to the principal balance as stipulated in certain loan amendments with portfolio companies. There were no such transfers during the year ended September 30, 2012 and we transferred past due interest to the principal balance of \$0.2 million for the year ended September 30, 2011. For the fiscal year ended September 30, 2010, we also rolled over past due interest to a portfolio company's principal balance of \$0.7 million, and then recorded an adjustment against that principal balance as a contra-investment since the loan was on non-accrual and the collectability of the additional principal was uncertain. As a result of a restructure, we reversed this contra-investment amount of \$0.7 million during 2011. These principal balance adjustments had no net impact on our accompanying *Consolidated Statements of Operations*.

### *Other Income Recognition*

We generally record success fees upon receipt. Success fees are contractually due upon a change of control in a portfolio company and are recorded in other income in our accompanying *Consolidated Statements of Operations*. We recorded \$4.0 million of success fees during the year ended September 30, 2012, which resulted from the exits of GMT, RCS, Northern Contours and Winchester. During the year ended September 30, 2011, we received \$1.0 million in success fees from the exits of Pinnacle and Interfilm and the prepayment of success fees from Westlake.

Dividend income on preferred equity securities is accrued to the extent that such amounts are expected to be collected and if we have the option to collect such amounts in cash, and it is recorded in other income in our accompanying *Consolidated Statements of Operations*. During the years ended September 30, 2012, 2011 and 2010 we did not record or collect any dividend income on preferred equity securities.

In addition, we received \$1.0 million from two legal settlements related to portfolio companies during the year ended September 30, 2011, that were recorded in other income.

### **Recent Accounting Pronouncements**

See Note 2 *Summary of Significant Accounting Policies* in the accompanying notes to our accompanying *Consolidated Financial Statements* included elsewhere in this prospectus for a description and our application of recent accounting pronouncements. Our adoption of these recent accounting pronouncements did not have a material effect on our financial position and results of operations.

**Table of Contents**

**SALES OF COMMON STOCK BELOW NET ASSET VALUE**

At our 2012 annual stockholders meeting, our stockholders approved our ability to sell or otherwise issue shares of our common stock at a price below the then current net asset value, or NAV, per common share during a one year period, which we refer to as the Stockholder Approval, beginning on February 16, 2012, and expiring on the first anniversary of such date. To sell shares of common stock pursuant to this authorization, no further authorization from our stockholders will be solicited but the number of common shares issued and sold pursuant to such authority cannot exceed 25% of our then outstanding common stock immediately prior to such sale and a majority of our directors who have no financial interest in the sale and a majority of our independent directors must (i) find that the sale is in our best interests and in the best interests of our stockholders and (ii) in consultation with any underwriter or underwriters of the offering, make a good faith determination as of a time either immediately prior to the first solicitation by us or on our behalf of firm commitments to purchase such shares of common stock, or immediately prior to the issuance of such common stock, that the price at which such shares of common stock are to be sold is not less than a price which closely approximates the market value of those shares of common stock, less any distributing commission or discount.

Any offering of common stock below its NAV per share will be designed to raise capital for investment in accordance with our investment objective.

In making a determination that an offering of common stock below its NAV per share is in our and our stockholders' best interests, our Board of Directors will consider a variety of factors including:

the effect that an offering below NAV per common share would have on our common stockholders, including the potential dilution they would experience as a result of the offering;

the amount per common share by which the offering price per share and the net proceeds per share are less than our most recently determined NAV per common share;

the relationship of recent market prices of common stock to NAV per share and the potential impact of the offering on the market price per share of our common stock;

whether the estimated offering price would closely approximate the market value of shares of our common stock;

the potential market impact of being able to raise capital during the current financial market difficulties;

the nature of any new investors anticipated to acquire shares of our common stock in the offering;

the anticipated rate of return on and quality, type and availability of investments; and

the leverage available to us.

Our Board of Directors will also consider the fact that sales of shares of common stock at a discount will benefit the Adviser as the Adviser will earn additional investment management fees on the proceeds of such offerings, as it would from the offering of any other of our securities or from the offering of common stock at a premium to NAV per share.

We will not sell shares of our common stock under this prospectus or an accompanying prospectus supplement pursuant to the Stockholder Approval without first filing a post-effective amendment to the registration statement if the cumulative dilution to our NAV per common share from offerings under the registration statement exceeds 15%. This would be measured separately for each offering pursuant to the registration statement by calculating the percentage dilution or accretion to aggregate NAV from that offering and then summing the percentage from each



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offering. For example, if our most recently determined NAV per common share at the time of the first offering is \$10.00 and we have 140 million shares of common stock outstanding, the sale of 35 million shares of common stock at net proceeds to us of \$5.00 per common share (a 50% discount) would produce dilution of 10%. If we subsequently determined that our NAV per common share increased to \$11.00 on the then 175 million shares of common stock outstanding and then made an additional offering, we could, for example, sell approximately an additional 43.75 million shares of common stock at net proceeds to us of \$8.25 per common share, which would produce dilution of 5%, before we would reach the aggregate 15% limit. If we file a new post-effective amendment, the threshold would reset.

## **Table of Contents**

Sales by us of our common stock at a discount from NAV per common share pose potential risks for our existing common stockholders whether or not they participate in the offering, as well as for new investors who participate in the offering. Any sale of common stock at a price below NAV per share would result in an immediate dilution to existing common stockholders who do not participate in such sale on at least a pro-rata basis. See *Risk Factors Risks Related to an Investment in Our Common Stock and Our Preferred Stock*.

The following three headings and accompanying tables explain and provide hypothetical examples of the impact of an offering of our common stock at a price below NAV per common share on three different types of investors:

existing common stockholders who do not purchase any shares of common stock in the offering;

existing common stockholders who purchase a relatively small amount of shares of common stock in the offering or a relatively large amount of shares of common stock in the offering; and

new investors who become common stockholders by purchasing shares of common stock in the offering.

### **Impact on Existing Common Stockholders Who Do Not Participate in an Offering**

An existing common stockholder who does not participate in an offering below NAV per share or who does not buy additional common shares in the secondary market at the same or lower price we obtain in the offering (after expenses and commissions) face the greatest potential risks. These stockholders will experience an immediate decrease (often called dilution) in the NAV of the common shares they hold and their NAV per common share. These common stockholders will also experience a disproportionately greater decrease in their participation in our earnings and assets and their voting power than the increase we will experience in our assets, potential earning power and voting interests due to the offering. These common stockholders may also experience a decline in the market price of their shares, which often reflects to some degree announced or potential decreases in NAV per common share. This decrease could be more pronounced as the size of the offering and level of discounts increase. Further, if current common stockholders do not purchase sufficient shares of common stock to maintain their percentage interest, regardless of whether such offering is above or below the then current NAV, their voting power will be diluted.

The following table illustrates the level of NAV dilution that would be experienced by a nonparticipating common stockholder in three different hypothetical offerings of different sizes and levels of discount from NAV per common share, although it is not possible to predict the level of market price decline that may occur. Actual sales prices and discounts may differ from the presentation below.

The examples assume that we have 1,000,000 common shares outstanding, \$15,000,000 in total assets and \$5,000,000 in total liabilities. The current NAV and NAV per common share are thus \$10,000,000 and \$10.00, respectively. The table illustrates the dilutive effect on a nonparticipating common stockholder of (1) an offering of 50,000 shares of common stock (5% of the outstanding common shares) at \$9.50 per common share after offering expenses and commission (a 5% discount from NAV), (2) an offering of 100,000 shares of common stock (10% of the outstanding common shares) at \$9.00 per common share after offering expenses and commissions (a 10% discount from NAV) and (3) an offering of 200,000 shares of common stock (20% of the outstanding common shares) at \$8.00 per common share after offering expenses and commissions (a 20% discount from NAV). The prospectus supplement pursuant to which any discounted offering is made will include a chart based on the actual number of shares of common stock in such offering and the actual discount to the most recently determined NAV.

**Table of Contents**

	Example 1 5% Offering at 5% Discount		Example 2 10% Offering at 10% Discount		Example 3 20% Offering at 20% Discount		
	Prior to Sale Below NAV	Following Sale	% Change	Following Sale	% Change	Following Sale	% Change
<b>Offering Price</b>							
Price per Common Share to Public		\$ 10.00		\$ 9.47		\$ 8.42	
Net Proceeds per Common Share to Issuer		\$ 9.50		\$ 9.00		\$ 8.00	
<b>Decrease to NAV per Common Share</b>							
Total Common Shares Outstanding	1,000,000	1,050,000	5.00%	1,100,000	10.00%	1,200,000	20.00%
NAV per Common Share	\$ 10.00	\$ 9.98	(0.20)%	\$ 9.91	(0.90)%	\$ 9.67	(3.33)%
<b>Dilution to Common Stockholder</b>							
Common Shares Held by Stockholder	10,000	10,000		10,000		10,000	
Percentage Held by Common Stockholder	1.0%	0.95%	(4.76)%	0.91%	(9.09)%	0.83%	(16.67)%
<b>Total Asset Values</b>							
Total NAV Held by Common Stockholder	\$ 100,000	\$ 99,800	(0.20)%	\$ 99,100	(0.90)%	\$ 96,700	(3.33)%
Total Investment by Common Stockholder (Assumed to be \$10.00 per Common Share)	\$ 100,000	\$ 100,000		\$ 100,000		\$ 100,000	
Total Dilution to Common Stockholder (Total NAV Less Total Investment)		\$ (200)		\$ (900)		\$ (3,300)	
<b>Per Common Share Amounts</b>							
NAV Per Common Share Held by Common Stockholder		\$ 9.98		\$ 9.91		\$ 9.67	
Investment per Common Share Held by Common Stockholder (Assumed to be \$10.00 per Share on Common Shares Held prior to Sale)	\$ 10.00	\$ 10.00		\$ 10.00		\$ 10.00	
Dilution per Common Share Held by Stockholder (NAV per Common Share Less Investment per Common Share)		\$ (0.02)		\$ (0.09)		\$ (0.33)	
Percentage Dilution to Common Stockholder (Dilution per Common Share Divided by Investment per Common Share)			(0.20)%		(0.90)%		(3.33)%
<b>Impact on Existing Common Stockholders Who Do Participate in an Offering</b>							

An existing common stockholder who participates in an offering below NAV per common share or who buys additional shares of common stock in the secondary market at the same or lower price as we obtain in the offering (after expenses and commissions) will experience the same types of NAV dilution as the nonparticipating common stockholders, albeit at a lower level, to the extent they purchase less than the same percentage of the discounted offering as their interest in our common shares immediately prior to the offering. The level of NAV dilution will decrease as the number of common shares such stockholders purchase increases. Existing common stockholders who buy more than such percentage will experience NAV dilution but will, in contrast to existing common stockholders who purchase less than their proportionate share of the offering, experience an increase (often called accretion) in NAV per common share over their investment per common share and will also experience a disproportionately greater increase in their participation in our earnings and assets and their voting power than our increase in assets, potential earning power and voting interests due to the offering. The level of accretion will increase as the excess number of shares such common stockholder purchases increases. Even a common stockholder who over-participates will, however, be subject to the risk that we may make additional discounted offerings in which such common stockholder does not participate, in which case such a stockholder will experience NAV dilution as described above in such subsequent offerings. These stockholders may also experience a decline in the market price of their common shares, which often reflects to some degree announced or potential decreases in NAV per share. This decrease could be more pronounced as the size of the offering and level of discount to NAV increases.

**Table of Contents**

The following chart illustrates the level of dilution and accretion in the hypothetical 20% discount offering from the prior chart for a common stockholder that acquires shares of common stock equal to (1) 50% of its proportionate share of the offering (i.e., 1,000 common shares, which is 0.50% of the offering 200,000 common shares rather than its 1% proportionate share) and (2) 150% of such percentage (i.e., 3,000 common shares, which is 1.50% of an offering of 200,000 common shares rather than its 1% proportionate share). The prospectus supplement pursuant to which any discounted offering is made will include a chart for this example based on the actual number of common shares in such offering and the actual discount from the most recently determined NAV per common share. It is not possible to predict the level of market price decline that may occur.

	Prior to Sale Below NAV	50% Participation		150% Participation	
		Following Sale	% Change	Following Sale	% Change
<b>Offering Price</b>					
Price per Common Share to Public		\$ 8.42		\$ 8.42	
Net Proceeds per Common Share to Issuer		\$ 8.00		\$ 8.00	
<b>Increases in Common Shares and Decrease to NAV per Common Share</b>					
Total Common Shares Outstanding	1,000,000	1,200,000	20.00%	1,200,000	20.00%
NAV per Common Share	\$ 10.00	\$ 9.67	(3.33)%	\$ 9.67	(3.33)%
<b>Dilution/Accretion to Common Stockholder</b>					
Common Shares Held by Stockholder	10,000	11,000	10.00%	13,000	30.00%
Percentage Held by Common Stockholder	1.0%	0.92%	(8.33)%	1.08%	8.33%
<b>Total Asset Values</b>					
Total NAV Held by Common Stockholder	\$ 100,000	\$ 106,333	6.33%	\$ 125,667	25.67%
Total Investment by Common Stockholder (Assumed to be \$10.00 per Share on Common Shares Held prior to Sale)	\$ 100,000	\$ 108,420		\$ 125,260	
Total Dilution/Accretion to Common Stockholder (Total NAV Less Total Investment)		(2,087)		\$ 407	
<b>Per Common Share Amounts</b>					
NAV Per Common Share Held by Common Stockholder		\$ 9.67		\$ 9.67	
Investment per Common Share Held by Stockholder (Assumed to be \$10.00 per Share on Common Shares Held prior to Sale)	\$ 10.00	\$ 9.86	(1.44)%	\$ 9.64	(3.65)%
Dilution/Accretion per Common Share Held by Stockholder (NAV per Common Share Less Investment per Common Share)		\$ (0.19)		\$ 0.03	
Percentage Dilution/Accretion to Common Stockholder (Dilution/Accretion per Common Share Divided by Investment per Common Share)			(1.92)%		0.32%
<b>Impact on New Investors in Common Stock</b>					

Investors who are not currently stockholders, but who participate in an offering below NAV and whose investment per common share is greater than the resulting NAV per share (due to selling compensation and expenses paid by us) will experience an immediate decrease, albeit small, in the NAV of their shares and their NAV per share compared to the price they pay for their shares of common stock. Investors who are not currently stockholders and who participate in an offering below NAV per common share and whose investment per common share is also less than the resulting NAV per common share due to selling compensation and expenses paid by the issuer being significantly less than the discount per common share will experience an immediate increase in the NAV of their shares and their NAV per share compared to the price they pay for their shares of common stock. These investors will experience a disproportionately greater participation in our earnings and assets and their voting power than our increase in assets, potential earning power and voting interests. These investors will, however, be subject to the risk that we may make additional discounted offerings in which such new common stockholder does not participate, in which case such new stockholder will experience dilution as described above in such subsequent offerings. These investors may also experience a decline in the market price of their shares of common stock, which often reflects to some degree announced or potential decreases in NAV per share. This decrease could be more pronounced as the size of the offering and level of discounts increases.

The following chart illustrates the level of dilution or accretion for new investors that would be experienced by a new investor in the same 5%, 10% and 20% discounted offerings as described in the first chart above. The illustration is for a new investor who purchases the same percentage (1%) of the common shares in the offering as the common stockholder in



**Table of Contents**

the prior examples held immediately prior to the offering. The prospectus supplement pursuant to which any discounted offering is made will include a chart for this example based on the actual number of common shares in such offering and the actual discount from the most recently determined NAV per common share. It is not possible to predict the level of market price decline that may occur.

		Example 1 5% Offering at 5% Discount		Example 2 10% Offering at 10% Discount		Example 3 20% Offering at 20% Discount	
	Prior to Sale Below NAV	Following Sale	% Change	Following Sale	% Change	Following Sale	% Change
<b>Offering Price</b>							
Price per Common Share to Public		\$ 10.00		\$ 9.47		\$ 8.42	
Net Proceeds per Common Share to Issuer		\$ 9.50		\$ 9.00		\$ 8.00	
<b>Decrease to NAV per Common Share</b>							
Total Common Shares Outstanding	1,000,000	1,050,000	5.00%	1,100,000	10.00%	1,200,000	20.00%
NAV per Common Share	\$ 10.00	\$ 9.98	(0.20)%	\$ 9.91	(0.90)%	\$ 9.67	(3.33)%
<b>Dilution/Accretion to Common Stockholder</b>							
Common Shares Held by Stockholder		500		1,000		2,000	
Percentage Held by Common Stockholder	0.0%	0.05%		0.09%		0.17%	
<b>Total Asset Values</b>							
Total NAV Held by Common Stockholder		\$ 4,990		\$ 9,910		\$ 19,340	
Total Investment by Common Stockholder		\$ 5,000		\$ 9,470		\$ 16,840	
Total Dilution/Accretion to Common Stockholder (Total NAV Less Total Investment)		\$ (10)		\$ 440		\$ 2,500	
<b>Per Common Share Amounts</b>							
NAV Per Common Share Held by Common Stockholder		\$ 9.98		\$ 9.91		\$ 9.67	
Investment per Common Share Held by Common Stockholder		\$ 10.00		\$ 9.47		\$ 8.42	
Dilution/Accretion per Common Share Held by Stockholder (NAV per Common Share Less Investment per Common Share)		\$ (0.02)		\$ 0.44		\$ 1.25	
Percentage Dilution/Accretion to Common Stockholder (Dilution/Accretion per Common Share Divided by Investment per Common Share)			(0.20)%		4.65%		14.85%

**Table of Contents****SENIOR SECURITIES**

Information about our senior securities is shown in the following table for the audited periods as of September 30, 2012, 2011, 2010, 2009, 2008, 2007, 2006, 2005, 2004, 2003, 2002 and 2001. The information has been derived from our audited financial statement for each respective period, which have been audited by PricewaterhouseCoopers LLP, our independent registered public accounting firm.

<b>Class and Year</b>	<b>Total Amount Outstanding Exclusive of Treasury Securities(1)</b>	<b>Asset Coverage per Unit(2)</b>	<b>Involuntary Liquidating Preference per Unit(3)</b>	<b>Average Market Value per Unit(4)</b>
<b>Revolving Credit Facilities</b>				
September 30, 2012	\$ 58,800,000	\$ 2,963	\$	N/A
September 30, 2011	99,400,000	3,150		N/A
September 30, 2010	16,800,000	14,187		N/A
September 30, 2009	83,000,000	3,963		N/A
September 30, 2008	151,030,000	2,792		N/A
September 30, 2007	144,440,000	2,524		N/A
September 30, 2006	49,993,000	4,435		N/A
September 30, 2005	53,034,000	3,849		N/A
September 30, 2004	40,744,000	3,452		N/A
September 30, 2003		N/A		N/A
September 30, 2002		N/A		N/A
September 30, 2001		N/A		N/A
<b>Series 2016 Term Preferred Stock (5)</b>				
September 30, 2012	\$ 38,497,050	\$ 2,963	\$ 25.00	\$ 25.55
September 30, 2011		N/A		N/A
September 30, 2010		N/A		N/A
September 30, 2009		N/A		N/A
September 30, 2008		N/A		N/A
September 30, 2007		N/A		N/A
September 30, 2006		N/A		N/A
September 30, 2005		N/A		N/A
September 30, 2004		N/A		N/A
September 30, 2003		N/A		N/A
September 30, 2002		N/A		N/A
September 30, 2001		N/A		N/A
<b>Repurchase Agreements</b>				
September 30, 2012		N/A		N/A
September 30, 2011		N/A		N/A
September 30, 2010		N/A		N/A
September 30, 2009		N/A		N/A
September 30, 2008		N/A		N/A
September 30, 2007		N/A		N/A
September 30, 2006		N/A		N/A
September 30, 2005		N/A		N/A
September 30, 2004	21,346,000	3,452		N/A
September 30, 2003	78,449,000	2,667		N/A
September 30, 2002	39,199,000	4,333		N/A
September 30, 2001		N/A		N/A

(1) Total amount of each class of senior securities outstanding at the end of the period presented

(2) Asset coverage ratio for a class of our senior securities representing indebtedness means the ratio of the value of our total assets, less all liabilities and indebtedness not represented by senior securities, to the aggregate amount of senior securities representing indebtedness and asset coverage ratio for a class of our senior securities that are stock means the ratio of the value of our total assets, less all liabilities and

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indebtedness not represented by senior securities, to the aggregate amount of senior securities representing indebtedness plus the aggregate involuntary liquidation preference of a class of senior security which is stock. Asset coverage per unit is the asset coverage ratio expressed in terms of dollar amounts per one thousand dollars of indebtedness.

- (3) The amount to which such class of senior security would be entitled upon the involuntary liquidation of the issuer in preference to any security junior to it.
- (4) All senior securities (with the exception of our Term Preferred Stock) are not registered for public trading. Average market value per unit is the average of the last ten days closing prices on the NASDAQ.
- (5) In November 2011, we issued 1,539,882 shares of Term Preferred Stock through a public offering and subsequent exercise of an overallotment option. At September 30, 2012, we had \$38.5 million outstanding of Term Preferred Stock.



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**Table of Contents****BUSINESS****Overview**

We were incorporated under the General Corporation Laws of the State of Maryland on May 30, 2001 and completed our initial public offering on August 24, 2001. We operate as a closed-end, non-diversified management investment company and we have elected to be treated as a business development company ( BDC ) under the Investment Company Act of 1940, as amended (the 1940 Act ). For federal income tax purposes, we have elected to be treated as a regulated investment company ( RIC ) under Subchapter M of the Internal Revenue Code of 1986, as amended (the Code ). We currently continue to qualify as a RIC for federal income tax purposes and obtain favorable RIC tax treatment by meeting certain requirements, including certain minimum distribution requirements. Our Board of Directors recently approved limited revisions to our investment objectives and strategies, which went into effect on January 1, 2013, which are reflected in the descriptions of our investment objectives and strategies below. All of our existing portfolio investments fit within the scope of our revised investment objectives and strategies and no changes were required to be made to our portfolio as a result of these revisions.

Our investment objectives are to: (1) achieve and grow current income by investing in debt securities of established businesses that we believe will provide stable earnings and cash flow to pay expenses, make principal and interest payments on our outstanding indebtedness and make distributions to stockholders that grow over time; and (2) provide our stockholders with long-term capital appreciation in the value of our assets by investing in equity securities of established businesses that we believe can grow over time to permit us to sell our equity investments for capital gains.

We expect that our target portfolio over time will primarily include the following four categories of investments in private U.S. companies:

*Senior Debt Securities:* We seek to invest a portion of our assets in senior debt securities also known as senior loans, senior term loans, lines of credit and senior notes. Using its assets as collateral, the borrower typically uses senior debt to cover a substantial portion of the funding needs of the business. The senior debt security usually takes the form of first priority liens on the assets of the business. Senior debt securities may include our participation and investment in the syndicated loan market.

*Senior Subordinated Debt Securities:* We seek to invest a portion of our assets in senior subordinated debt securities, also known as senior subordinated loans and senior subordinated notes. These senior subordinated debts also include second lien notes and may include participation and investment in syndicated second lien loans. Additionally, we may receive other yield enhancements in connection with these senior subordinated debt securities.

*Junior Subordinated Debt Securities:* We seek to invest a portion of our assets in junior subordinated debt securities, also known as subordinated loans, subordinated notes and mezzanine loans. These junior subordinated debts include second lien notes and unsecured loans. Additionally, we may receive other yield enhancements and warrants to buy common and preferred stock or limited liability interests in connection with these junior subordinated debt securities.

*Preferred and Common Equity:* In some cases we will purchase equity securities which consist of preferred and common equity or limited liability company interests, or warrants or options to acquire such securities, and are in combination with our debt investment in a business. Additionally, we may receive equity investments derived from restructurings on some of our existing debt investments. In some cases, we will own a significant portion of the equity and in other cases we may have voting control of the businesses in which we invest.

Additionally, pursuant to the 1940 Act, we must maintain at least 70% of our total assets in qualifying assets, which generally include each of the investment types listed above. Therefore, the 1940 Act permits us to invest up to 30% of our assets in other non-qualifying assets.

Because the majority of the loans in our portfolio consist of term debt of private U.S. companies that typically cannot or will not expend the resources to have their debt securities rated by a credit rating agency, we expect that most, if not all, of the debt securities we acquire will be unrated. Investors should assume that these loans would be at rates below what is today considered investment grade quality. Investments rated below investment grade are often referred to as high yield securities or junk bonds and may be considered high risk as compared to investment-grade debt instruments.



**Table of Contents****Investment Concentrations**

As of September 30, 2012, our portfolio consisted of loans to 50 companies in 28 states in 21 different industries with an aggregate fair value of \$274.0 million. As of September 30, 2012, there were 20 syndicated investments totaling \$77.8 million at cost and \$78.2 million at fair value, or 21.3% and 28.5% of the total aggregate portfolio, respectively. Since our initial public offering in 2001, we have invested in 158 different companies, while making over 109 consecutive distributions to common stockholders.

As of September 30, 2012, approximately 64.4% of the aggregate fair value of our portfolio was comprised of senior term debt, 32.5% was senior subordinated term debt, 0.1% was junior subordinated debt and 3.0% was in equity securities. The following table outlines our investments by security type as of September 30, 2012:

(Dollars in thousands)

	September 30, 2012			
	Cost		Fair Value	
Senior debt	\$ 235,158	64.4%	\$ 164,345	60.0%
Senior subordinated debt	118,469	32.5	100,149	36.5
Junior subordinated debt	428	0.1	498	0.2
<b>Total debt investments</b>	<b>354,055</b>	<b>97.0</b>	<b>264,992</b>	<b>96.7</b>
Preferred equity	6,719	1.8	1,103	0.4
Common equity/equivalents	4,247	1.2	7,865	2.9
<b>Total equity investments</b>	<b>10,966</b>	<b>3.0</b>	<b>8,968</b>	<b>3.3</b>
<b>Total Investments</b>	<b>\$ 365,021</b>	<b>100.0%</b>	<b>\$ 273,960</b>	<b>100.0%</b>

Investments at fair value consisted of the following industry classifications at September 30, 2012:

(Dollars in thousands)

Industry Classification	September 30, 2012	
	Fair Value	Percentage of Total Investments
Electronics	\$ 42,111	15.4%
Healthcare, education and childcare	32,867	12.0
Mining, steel, iron and non-precious metals	31,590	11.5
Broadcast and entertainment	25,505	9.3
Retail store	19,360	7.1
Aerospace and defense	16,597	6.0
Oil and gas	15,386	5.6
Printing and publishing	12,760	4.6
Automobile	12,168	4.4
Textiles and leather	9,776	3.6
Personal and non-durable consumer products	8,399	3.1
Machinery	7,618	2.8
Personal, food and miscellaneous services	7,354	2.7
Beverage, food and tobacco	7,258	2.6
Diversified/conglomerate manufacturing	6,824	2.5
Buildings and real estate	5,920	2.2
Leisure, amusement, motion pictures and entertainment	5,380	2.0

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Home and office furnishing, housewares and durable consumer goods	3,357	1.2
Telecommunications	1,070	0.4
Other, < 1%	2,660	1.0
<b>Total Investments</b>	<b>\$ 273,960</b>	<b>100.0%</b>

**Table of Contents**

The investments at fair value were included in the following geographic regions of the United States at September 30, 2012:

(Dollars in thousands)

Geographic Region	September 30, 2012	
	Fair Value	Percent of Total Investments
Midwest	\$ 127,179	46.4%
West	66,268	24.2
South	62,677	22.9
Northeast	9,836	3.6
Outside Continental U.S.	8,000	2.9
<b>Total Investments</b>	<b>\$ 273,960</b>	<b>100.0%</b>

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

**Our Investment Adviser and Administrator**

Gladstone Management Corporation (our Adviser) is our affiliate, investment adviser, and a privately-held company led by a management team which has extensive experience in our lines of business. The Adviser's affiliate, a privately-held company, Gladstone Administration, LLC (our Administrator), employs our chief financial officer and treasurer, chief accounting officer, chief compliance officer, internal counsel and secretary and their respective staffs. Excluding our chief financial officer and treasurer and chief accounting officer, all of our executive officers serve as directors or executive officers, or both, of the following of our affiliates: Gladstone Commercial Corporation (Gladstone Commercial), a publicly-traded real estate investment trust; Gladstone Investment Corporation (Gladstone Investment), a publicly-traded BDC and RIC; the Adviser; and the Administrator. Our chief financial officer and treasurer is also the chief financial officer and treasurer of Gladstone Investment.

The Adviser and Administrator also provide investment advisory and administrative services, respectively, to our other affiliates, including, but not limited to, Gladstone Commercial; Gladstone Investment; Gladstone Land Corporation, a private agricultural real estate company owned by David Gladstone, our chairman and chief executive officer; and Gladstone Securities, LLC (Gladstone Securities), a privately-held broker-dealer registered with the Financial Industry Regulatory Authority (FINRA) and insured by the Securities Investor Protection Corporation. Our chief executive officer also serves on the board of managers of Gladstone Securities as an outside non-employee manager. The Adviser and Administrator may provide investment advisory and administrative services, respectively, to other funds and companies, both public and private.

We have been externally managed by the Adviser pursuant to an investment advisory agreement since October 1, 2004. The Adviser was organized as a corporation under the laws of the State of Delaware on July 2, 2002, and is a registered investment adviser under the Investment Advisers Act of 1940, as amended. The Adviser is headquartered in McLean, Virginia, a suburb of Washington, D.C., and also has offices in several other states.

**Corporate Information**

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

**Our Investment Strategy**

To achieve our objectives, we seek to invest in several categories of debt and equity securities, with each investment generally ranging from \$5 million to \$30 million, although investment size may vary, depending upon our total assets or available capital at the time of investment.



## **Table of Contents**

In general, our investments in debt securities have a term of no more than seven years, accrue interest at variable rates (based on the London Interbank Offered Rate ( LIBOR )) and, to a lesser extent, at fixed rates. We seek debt instruments that pay interest monthly or, at a minimum, quarterly, have a success fee or deferred interest provision and are primarily interest only with all principal and any accrued but unpaid interest due at maturity. Generally, success fees accrue at a set rate and are contractually due upon a change of control in the business. Some debt securities have deferred interest whereby some portion of the interest payment is added to the principal balance so that the interest is paid, together with the principal, at maturity. This form of deferred interest is often called paid in kind ( PIK ).

Typically, our equity investments consist of common stock, preferred stock, limited liability company interests, or warrants to purchase the foregoing. Often, these equity investments occur in connection with our original investment, recapitalizing a business, or refinancing existing debt. Although at times we may enter into co-investment transactions with Gladstone Investment, in relation to one another, we will generally invest a greater portion of our assets in debt securities, while Gladstone Investment will generally invest a greater portion of its assets in equity securities.

The Adviser uses the investment referral networks of Mr. David Gladstone, our chairman and chief executive officer, Mr. Terry Brubaker, our vice chairman and chief operating officer, and Mr. George Stelljes III, our president and chief investment officer, and of its managing directors to identify and make equity investments or finance senior and subordinated loans to borrowers that need funds to grow, restructure their balance sheets or effect a change of control. We believe that our business strategy will enable us to achieve a high level of current income by investing in equity securities and debt securities, consisting primarily of senior notes, senior subordinated notes and junior subordinated notes of established private businesses that are backed by leveraged buyout funds, venture capital funds or others. In addition, from time to time we might acquire existing loans that meet this profile from leveraged buyout funds, venture capital funds and others. We also seek to provide our stockholders with long-term capital growth through the appreciation in the value of warrants or other equity instruments that we might receive when we make loans.

We target small and medium-sized private businesses that meet certain criteria, including some but not necessarily 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 may achieve liquidity in an equity position 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, although we cannot assure you that we will always have these rights. We can also achieve a similar effect by requiring the borrower to pay us conditional interest, which we refer to as a success fee, upon the occurrence of certain events. Success fees are dependent upon the success of the borrower and the occurrence of a triggering event, and are paid in lieu of warrants to purchase common stock of the borrower.

## **Investment Process**

### ***Overview of Investment and Approval Process***

To originate investments, the Adviser's investment professionals use an extensive referral network comprised primarily of venture capitalists, leveraged buyout funds, investment bankers, attorneys, accountants, commercial bankers and business brokers. The Adviser's investment professionals review informational packages from these and other sources in search of potential investment opportunities. If a potential opportunity matches our investment objectives, the investment professionals will seek an initial screening of the opportunity from the Adviser's investment committee which is composed of Messrs. Gladstone, Brubaker and Stelljes. Further, if the potential opportunity matches our investment objectives and strategies and the investment objectives and strategies of another fund advised by the Adviser that is covered by the co-investment order, dated July 26, 2012, the investment could be allocated to more than one fund as a co-investment. If the prospective portfolio company passes this initial screening, the investment professionals conduct a due diligence investigation and create a detailed profile summarizing the prospective portfolio company's historical financial statements, industry and management team and analyzing its conformity to our general investment criteria. The investment professionals then present this profile to the Adviser's investment committee, which must approve each investment. Further, each investment is available for review by the members of our Board of Directors, a majority of whom are not interested persons as defined in Section 2(a)(19) of the 1940 Act.

## **Table of Contents**

### ***Prospective Portfolio Company Characteristics***

We have identified certain characteristics that we believe are important in identifying and investing in prospective portfolio companies. The criteria listed below provide general guidelines for our investment decisions, although not all of these criteria may be met by each portfolio company.

*Value-and-Income Orientation and Positive Cash Flow.* Our investment philosophy places a premium on fundamental analysis from an investor's perspective and has a distinct value-and-income orientation. In seeking value, we focus on companies in which we can invest at relatively low multiples of earnings before interest, taxes, depreciation and amortization ( EBITDA ), and that have positive operating cash flow at the time of investment. In seeking income, we typically invest in companies that generate relatively stable to growing sales and cash flow to provide some assurance that they will be able to service their debt and pay any required distributions on preferred stock. Typically, we do not expect to invest in start-up companies or companies with what we believe to be speculative business plans.

*Experienced Management.* We generally require that the businesses in which we invest have an experienced management team. We also require the businesses to have in place proper incentives to induce management to succeed and act in concert with our interests as investors, including having significant equity or other interests in the financial performance of their companies.

*Strong Competitive Position in an Industry.* We seek to invest in businesses that have developed strong market positions within their respective markets and that we believe are well-positioned to capitalize on growth opportunities. We seek businesses that demonstrate significant competitive advantages versus their competitors, which we believe will help to protect their market positions and profitability.

*Liquidation Value of Assets.* The projected liquidation value of the assets, if any, is an important factor in our investment analysis in collateralizing our debt securities.

### ***Extensive Due Diligence***

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

a review of the prospective portfolio company's historical and projected financial information;

visits to the prospective portfolio company's business site(s);

interviews with the prospective portfolio company's management, employees, customers and vendors;

review of loan documents;

background checks on the prospective portfolio company's management team; and

research on the prospective portfolio company's products, services or particular industry.



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Upon completion of a due diligence investigation and a decision to proceed with an investment, the Adviser's investment professionals who have primary responsibility for the investment present the investment opportunity to the Adviser's investment committee. The investment committee determines whether to pursue the potential investment. Additional due diligence of a potential investment may be conducted on our behalf by attorneys and independent accountants, as well as other outside advisers, prior to the closing of the investment, as appropriate.

We also rely on the long-term relationships that the Adviser's investment professionals have with venture capitalists, leveraged buyout funds, investment bankers, commercial bankers, private equity sponsors, and business brokers. In addition, the extensive direct experience of our executive officers and managing directors in the operations of and providing debt and equity capital to small and medium-sized private businesses plays a significant role in our investment evaluation and assessment of risk.

## **Table of Contents**

### ***Investment Structure***

Once we have determined that a prospective acquisition, buyout or recapitalization meets our standards and investment criteria, we work with the management of that company and other capital providers to structure the transaction in a way that we believe will provide us with the greatest opportunity to maximize our return on the investment, while appropriately incentivizing company management. As discussed above, the capital classes through which we typically structure a deal include subordinated and mezzanine debt, senior secured debt and preferred and common equity. Through our risk management process, we seek to limit the downside risk of our investments by:

making investments with an expected total return (including both interest and potential equity appreciation) that we believe compensates us for the credit risk of the investment;

seeking collateral or superior positions in the portfolio company's capital structure where possible;

incorporating put rights and call protection into the investment structure where possible; and

negotiating covenants in connection with our investments that afford our portfolio companies as much flexibility as possible in managing their businesses, consistent with the preservation of our capital.

We expect to hold most of our investments in subordinated debt, mezzanine debt or equity interests until maturity or repayment, but may sell our investments earlier if a liquidity event takes place, such as the sale or recapitalization of a portfolio company or, in the case of an equity investment in a company, its initial public offering.

### ***Hedging Strategies***

Although it has not yet happened, nor do we expect it to happen in the near future, if one of our portfolio companies goes public, we may undertake hedging strategies with regard to any equity interests that we may have in that company. We may mitigate risks associated with the volatility of publicly-traded securities by, for example, selling securities short or writing or buying call or put options. Hedging against a decline in the value of such investments in public companies would not eliminate fluctuations in the values of such investments or prevent losses if the values of such investments decline, but would establish or enhance a hedging strategy to seek to protect our investment in such securities. Therefore, by engaging in hedging transactions, we would seek to moderate the decline in the value of our hedged investments in public companies. However, such hedging transactions would also limit our opportunity to gain from an increase in the value of our investment in the public company. In the future, we may enter into hedging transactions, such as interest rate cap agreements, in connection with the borrowings that we make under our line of credit. We currently do not hold any interest rate cap agreements, although we have done so in the past. Hedging strategies can pose risks to us and our stockholders; however we believe that such activities are manageable because they will be limited to only a portion of our portfolio.

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

### ***Competitive Advantages***

A large number of entities compete with us and make the types of investments that we seek to make in small and medium-sized privately-owned businesses. Such competitors include private equity funds, leveraged buyout funds, venture capital funds, investment banks and other equity and non-equity based investment funds, and other financing sources, including traditional financial services companies such as commercial banks. Many of our competitors are substantially larger than we are and have considerably greater funding sources that are not available to us; however, the ability to co-invest with other funds advised by our Adviser could help alleviate the disparity of available funding sources between us and our larger competitors. In addition, certain of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments, establish more relationships and build their market shares. Furthermore, many of these

competitors are not subject to the regulatory restrictions that the 1940 Act imposes on us as a BDC. However, we believe that we have the following competitive advantages over other providers of financing to small and mid-sized businesses.

## **Table of Contents**

### ***Management Expertise***

David Gladstone, our chairman and chief executive officer, is also the chairman and chief executive officer of the Adviser and certain of its affiliated companies, (the Gladstone Companies ), and has been involved in all aspects of the Gladstone Companies' investment activities, including serving as a member of the Adviser's investment committee. Terry Lee Brubaker is our vice chairman and chief operating officer, and has substantial experience in acquisitions and operations of companies. George Stelljes III is our president and chief investment officer and has extensive experience in leveraged finance. Messrs. Gladstone, Brubaker and Stelljes have principal management responsibility for the Adviser constituting the majority of its senior executive officers. These individuals dedicate a significant portion of their time to managing our investment portfolio. Our senior management has extensive experience providing capital to small and mid-sized companies and has worked together for more than 10 years. In addition, we have access to the resources and expertise of the Adviser's investment professionals and supporting staff who possess a broad range of transactional, financial, managerial and investment skills.

### ***Increased Access to Investment Opportunities Developed Through Proprietary Research Capability and an Extensive Network of Contacts***

The Adviser seeks to identify potential investments both through active origination and due diligence and through its dialogue with numerous management teams, members of the financial community and potential corporate partners with whom the Adviser's investment professionals have long-term relationships. We believe that the Adviser's investment professionals have developed a broad network of contacts within the investment, commercial banking, private equity and investment management communities, and that their reputation in investment management enables us to identify well-positioned prospective portfolio companies which provide attractive investment opportunities. Additionally, the Adviser expects to generate information from its professionals' network of accountants, consultants, lawyers and management teams of portfolio companies and other companies.

### ***Disciplined, Value and Income-Oriented Investment Philosophy with a Focus on Preservation of Capital***

In making its investment decisions, the Adviser focuses on the risk and reward profile of each prospective portfolio company, seeking to minimize the risk of capital loss without foregoing the potential for capital appreciation. We expect the Adviser to use the same value and income-oriented investment philosophy that its professionals use in the management of the other Gladstone Companies and to commit resources to management of downside exposure. The Adviser's approach seeks to reduce our risk in investments by using some or all of the following approaches:

focusing on companies with good market positions and good cash flow;

investing in businesses with experienced and established management teams;

engaging in extensive due diligence from the perspective of a long-term investor;

investing at low price-to-cash flow multiples; and

adopting flexible transaction structures by drawing on the experience of the investment professionals of the Adviser and its affiliates.

### ***Longer Investment Horizon with Attractive Publicly-traded Model***

Unlike private equity and venture capital funds that are typically organized as finite-life partnerships, we are not subject to standard periodic capital return requirements. The partnership agreements of most private equity and venture capital funds typically provide that these funds may only invest investors' capital once and must return all capital and realized gains to investors within a finite time period, often seven to ten years. These provisions often force private equity and venture capital funds to seek returns on their investments by causing their portfolio companies to pursue mergers, public equity offerings, or other liquidity events more quickly than might otherwise be optimal or desirable, potentially resulting in both a lower overall return to investors and an adverse impact on their portfolio companies. We believe that our flexibility to make investments with a long-term view and without the capital return requirements of traditional private investment vehicles provides us with the opportunity to achieve greater long-term returns on invested capital.



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**Table of Contents*****Flexible Transaction Structuring***

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

***Leverage***

For the purpose of making investments and to take advantage of favorable interest rates, we may issue senior securities up to the maximum amount permitted by the 1940 Act. The 1940 Act currently permits us to issue senior securities representing indebtedness and senior securities that are stock, to which we refer collectively as Senior Securities, in amounts such that our asset coverage, as defined in Section 18(h) of the 1940 Act, is at least 200% immediately after each issuance of Senior Securities. We may also incur indebtedness to repurchase our common stock. As a result of incurring indebtedness generally (for example, through our Credit Facility) or issuing senior securities representing indebtedness, we are exposed to the risks of leverage. Although borrowing money for investments increases the potential for gain, it also increases the risk of a loss. A decrease in the value of our investments will have a greater impact on the value of our common stock to the extent that we have borrowed money to make investments. There is a possibility that the costs of borrowing could exceed the income we receive on the investments we make with such borrowed funds.

Our Board of Directors is authorized to provide for the issuance of Senior Securities with such preferences, powers, rights and privileges as it deems appropriate, subject to the requirements of the 1940 Act. See *Regulation as a Business Development Company Asset Coverage* for a discussion of our leveraging constraints.

In addition, our ability to pay dividends or distributions (other than dividends payable in our stock) to holders of any class of our capital stock would be restricted if our senior securities representing indebtedness fail to have an asset coverage of at least 200% (measured at the time of declaration of such distribution and accounting for such distribution). The 1940 Act does not apply this limitation to privately arranged debt that is not intended to be publicly distributed, unless this limitation is specifically negotiated by the lender. In addition, our ability to pay dividends or distributions (other than dividends payable in our common stock) to our common stockholders would be restricted if our senior securities that are stock fail to have an asset coverage of at least 200% (measured at the time of declaration of such distribution and accounting for such distribution). If the value of our assets declines, we might be unable to satisfy these asset coverage requirements. To satisfy the 200% asset coverage requirement in the event that we are seeking to pay a distribution, we might either have to (i) liquidate a portion of our loan portfolio to repay a portion of our indebtedness or (ii) issue common stock. This may occur at a time when a sale of a portfolio asset may be disadvantageous, or when we have limited access to capital markets on agreeable terms. In addition, any amounts that we use to service our indebtedness or for offering expenses will not be available for distributions to our stockholders. If we are unable to regain asset coverage through these methods, we may be forced to suspend the payment of such dividends.

In November 2011, we completed a public offering of an aggregate of approximately 1.5 million shares of 7.125% Series 2016 Term Preferred Stock, par value \$0.001 per share (the Term Preferred Stock), at a public offering price of \$25.00 per share. The Term Preferred Stock has an aggregate liquidation preference of \$38.5 million, which we have recorded as a liability in accordance with the U.S. generally accepted accounting principles and as such will affect our asset coverage, exposing us to additional leverage risks. For a further discussion of the terms of our Term Preferred Stock, see *Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Equity*.

***Ongoing Relationships with and Monitoring of Portfolio Companies***

The Adviser's investment professionals actively oversee each investment by continuously evaluating the portfolio company's performance and working collaboratively with the portfolio company's management to identify and incorporate best resources and practices that help us achieve our investment expectations.



## **Table of Contents**

### ***Monitoring***

The Adviser's investment professionals monitor the financial performance, trends, and changing risks of each portfolio company on an ongoing basis to determine if each company is performing within expectations and to guide the portfolio company's management in taking the appropriate courses of action. The Adviser employs various methods of evaluating and monitoring the performance of our investments in portfolio companies, which may include the following:

Monthly analysis of financial and operating performance;

Assessment of the portfolio company's performance against its business plan and our investment expectations;

Assessment of the investment's risks;

Participation in the portfolio company's board of directors or management meetings;

Assessment of portfolio company management, sponsor, governance and strategic direction;

Assessment of the portfolio company's industry and competitive environment; and

Review and assessment of the portfolio company's operating outlook and financial projections.

### ***Relationship Management***

The Adviser's investment professionals interact with various parties involved with a portfolio company, or investment, by actively engaging with internal and external constituents, including:

Management;

Boards of directors;

Financial sponsors;

Capital partners; and

Advisers and consultants.

### ***Managerial Assistance and Services***

As a BDC, we make available significant managerial assistance to our portfolio companies and may provide other services to such portfolio companies. Neither we nor the Adviser currently receives fees in connection with the managerial assistance we make available. At times, the



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Adviser provides other services to certain of our portfolio companies and it receives fees for these other services with 50% of certain of these fees, and 100% of others, credited against the base management fee that we would otherwise be required to pay to the Adviser.

In February 2011, Gladstone Securities started providing other services (such as investment banking and due diligence services) to certain of our portfolio companies. The fees the portfolio companies paid to Gladstone Securities do not impact the overall fees we pay to the Adviser or the overall fees credited against the base management fee.

### ***Valuation Process***

The following is a general description of the steps we take each quarter to determine the value of our investment portfolio. We value our investments in accordance with the requirements of the 1940 Act. We value securities for which market quotations are readily available at their market value. We value all other securities and assets at fair value as determined in good faith by our Board of Directors. In determining the value of our investments, the Adviser has established an investment valuation policy (the Policy). The Policy has been approved by our 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 our investment portfolio. 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. Investments for which market quotations are readily available are recorded in our financial statements at such market quotations. With respect to any investments for which market quotations are not readily available, we perform the following valuation process each quarter:

## **Table of Contents**

Our quarterly valuation process begins with each portfolio company or investment being initially assessed by the Adviser's investment professionals responsible for the investment, using the Policy.

Preliminary valuation conclusions are then discussed with our management, and documented, along with any independent opinions of value provided by Standard & Poor's Securities Evaluations, Inc. (SPSE), for review by our Board of Directors.

Our Board of Directors reviews this documentation and discusses the information provided by our management, and the opinions of value provided by SPSE to arrive at a determination that the Policy has been followed for determining the aggregate fair value of our portfolio of investments.

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

## **Investment Advisory and Management Agreements**

We are externally managed pursuant to contractual arrangements with the Adviser under which the Adviser and Administrator employ all of our personnel and pay our payroll, benefits and general expenses directly. In 2004, we entered into an investment advisory agreement with the Adviser (as amended, the *Advisory Agreement*), which is controlled by our chairman and chief executive officer. In accordance with the *Advisory Agreement*, we pay the Adviser fees as compensation for its services, consisting of a base management fee and an incentive fee. On July 10, 2012, our Board of Directors approved the renewal of the *Advisory Agreement* through August 31, 2013.

### ***Base Management Fee***

The base management fee is computed and payable quarterly and is assessed at an annual rate of 2.0% computed on the basis of the value of our average gross assets at the end of the two most recently completed quarters, which are total assets, including investments made with proceeds of borrowings, less any uninvested cash or cash equivalents resulting from borrowings. Overall, the base management fee cannot exceed 2.0% of total assets (as reduced by cash and cash equivalents pledged to creditors) during any given fiscal year. In addition, the following three items are potential adjustments to the base management fee calculation.

#### *Loan Servicing Fees*

The Adviser also services the loans held by our wholly-owned subsidiary, Business Loan, in return for which the Adviser generally receives a 1.5% annual fee based on the monthly aggregate outstanding balance of loans pledged under our line of credit. Since we own these loans, all loan servicing fees paid to the Adviser are treated as reductions directly against the 2.0% base management fee under the *Advisory Agreement*.

#### *Portfolio Company Fees*

Under the *Advisory Agreement*, the Adviser has also provided and continues to provide managerial assistance and other services to our portfolio companies and may receive fees for services other than managerial assistance with 50% of certain of these fees, and 100% of others, credited against the base management fee that we would otherwise be required to pay to the Adviser.

#### *Senior Syndicated Loan Fee Waiver*

Our Board of Directors accepted an unconditional and irrevocable voluntary waiver from the Adviser to reduce the annual 2.0% base management fee on senior syndicated loan participations to 0.5%, to the extent that proceeds resulting from borrowings were used to purchase such syndicated loan participations, for the years ended September 30, 2012, 2011, 2010 and 2009.

### ***Incentive Fee***

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The incentive fee consists of two parts: an income-based incentive fee and a capital gains-based incentive fee. The income-based incentive fee rewards the Adviser if our quarterly net investment income (before giving effect to any incentive fee) exceeds 1.75% of our net assets (the hurdle rate ). We will pay the Adviser an income-based incentive fee with respect to our pre-incentive fee net investment income in each calendar quarter as follows:

**Table of Contents**

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

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

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

***Quarterly Incentive Fee Based on Net Investment Income***

Pre-incentive fee net investment income

(expressed as a percentage of the value of net assets)

Percentage of pre-incentive fee net investment income

allocated to income-based portion of incentive fee

The second part of the incentive fee is a capital gains-based incentive fee that is determined and payable in arrears as of the end of each fiscal year (or upon termination of the Advisory Agreement, as of the termination date), and equals 20% of our realized capital gains as of the end of the fiscal year. In determining the capital gains-based incentive fee payable to the Adviser, we calculate the cumulative aggregate realized capital gains and cumulative aggregate realized capital losses since our inception, and the aggregate unrealized capital depreciation as of the date of the calculation, as applicable, with respect to each of the investments in our portfolio. For this purpose, cumulative aggregate realized capital gains, if any, equals the sum of the differences between the net sales price of each investment, when sold, and the original cost of such investment since our inception. Cumulative aggregate realized capital losses equals the sum of the amounts by which the net sales price of each investment, when sold, is less than the original cost of such investment since our inception. Aggregate unrealized capital depreciation equals the sum of the difference, if negative, between the valuation of each investment as of the applicable calculation date and the original cost of such investment. At the end of the applicable year, the amount of capital gains that serves as the basis for our calculation of the capital gains-based incentive fee equals the cumulative aggregate realized capital gains less cumulative aggregate realized capital losses, less aggregate unrealized capital depreciation, with respect to our portfolio of investments. If this number is positive at the end of such year, then the capital gains-based incentive fee for such year equals 20% of such amount, less the aggregate amount of any capital gains-based incentive fees paid in respect of our portfolio in all prior years. We have not incurred capital gains-based incentive fees from inception through September 30, 2012, as cumulative unrealized capital depreciation has exceeded cumulative realized capital gains net of cumulative realized capital losses.

Additionally, in accordance with accounting principles generally accepted in the U.S. ( GAAP ), we have not accrued a capital gains-based incentive fee since inception. This GAAP accrual is calculated using the aggregate cumulative realized capital gains and losses and aggregate cumulative unrealized capital depreciation included in the calculation of the capital gains-based incentive fee plus the aggregate cumulative unrealized capital appreciation. If such amount is positive at the end of a period, then GAAP requires us to record a capital gains-based incentive fee equal to 20% of such amount, less the aggregate amount of actual capital gains-based incentive fees paid in all prior years. If such amount is negative, then there is no accrual for such year. GAAP requires that the capital gains-based incentive fee accrual consider the cumulative aggregate unrealized capital appreciation in the calculation, as a capital gains-based incentive fee would be payable if such unrealized capital appreciation were realized. In such instances, however, there could be no assurance that any such unrealized capital appreciation would be realized in the future.

## **Table of Contents**

Our Board of Directors accepted an unconditional and irrevocable voluntary waiver from the Adviser to reduce the income-based incentive fee to the extent net investment income did not cover 100% of the distributions to stockholders for the fiscal years ended September 30, 2012, 2011, 2010 and 2009. For the years ended September 30, 2012, 2011, 2010 and 2009, these credits totaled approximately \$278,000, \$21,000, \$165,000 and \$3,326,000, respectively.

### ***Administration Agreement***

In 2004, we entered into an administration agreement with the Administrator (as amended, the Administration Agreement), whereby we pay separately for administrative services. The Administration Agreement provides for quarterly payments equal to our allocable portion of the Administrator's overhead expenses in performing its obligations under the Administration Agreement, including, but not limited to, rent and salaries and benefits expenses of our chief financial officer, chief accounting officer, chief compliance officer, internal counsel and their respective staffs. Our allocable portion of expenses is generally derived by multiplying the Administrator's total allocable expenses by the percentage of our total assets at the beginning of the quarter in comparison to the total assets at the beginning of the quarter of all companies managed by the Adviser under similar agreements. On July 10, 2012, our Board of Directors approved the renewal of the Administration Agreement through August 31, 2013.

### **Code of Ethics**

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

### **Compliance Policies and Procedures**

We and the Adviser have adopted and implemented written policies and procedures reasonably designed to prevent violation of the federal securities laws, and our Board of Directors is required to review these compliance policies and procedures annually to assess their adequacy and the effectiveness of their implementation. We have designated a chief compliance officer, John Dellafiora, Jr., who also serves as chief compliance officer for the Adviser.

### **Competition**

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

### **Staffing**

We do not currently have any employees and do not expect to have any employees in the foreseeable future. Currently, services necessary for our business are provided by individuals who are employees of the Adviser and the Administrator pursuant to the terms of the Advisory Agreement and the Administration Agreement, respectively. No employee of the Adviser or the Administrator will dedicate all of his or her time to us. However, we expect that 25-30 full time employees of the Adviser and the Administrator will spend substantial time on our matters during calendar year 2013. To the extent we acquire more investments, we anticipate that the number of employees of the Adviser and the Administrator who devote time to our matters will increase.



**Table of Contents**

As of December 31, 2012, the Adviser and the Administrator collectively had 56 full-time employees. A breakdown of these employees is summarized by functional area in the table below:

<b>Number of Individuals</b>	<b>Functional Area</b>
10	Executive Management
34	Investment Management, Portfolio Management and Due Diligence
12	Administration, Accounting, Compliance, Human Resources, Legal and Treasury

**Properties**

We do not own any real estate or other physical properties materially important to our operations. The Adviser is the current leaseholder of all properties in which we operate. We occupy these premises pursuant to our Advisory and Administration Agreements with the Adviser and Administrator, respectively. The Adviser and Administrator are both headquartered in McLean, Virginia and the Adviser also has offices in several other states.

**Legal Proceedings**

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

**Table of Contents****PORTFOLIO COMPANIES**

The following table sets forth certain information as of September 30, 2012, regarding each portfolio company in which we had a debt or equity security as of such date. All such investments have been made in accordance with our investment policies and procedures described in this prospectus.

(Dollars in thousands)

Company	Industry	Investment	% of Class Held on Fully Diluted Basis	Cost	Fair Value
<b>NON-CONTROL/NON-AFFILIATE INVESTMENTS</b>					
<b>Non-syndicated Loans:</b>					
Access Television Network, Inc. 2600 Michelson Drive, Ste 1650 Irvine, California 91612	Broadcasting and entertainment	Senior Term Debt		\$ 903	\$
Allison Publications, LLC 4311 Oak Lawn, Suite 100 Dallas, Texas 75219	Printing and publishing	Senior Term Debt		7,864	7,510
BAS Broadcasting 905 West State St. Fremont, OH 43420	Broadcasting and entertainment	Senior Term Debt			