GLADSTONE CAPITAL CORP
Form N-2/A
February 28, 2003

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As filed with the Securities and Exchange Commission on February 28, 2003

Registration No. 333-100385

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM N-2

**REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933**

**ý Pre-Effective Amendment No. 2
o Post-Effective Amendment No.**

Gladstone Capital Corporation

(Exact name of registrant as specified in its charter)

Maryland	**54-2040781**
(State of Incorporation)	(I.R.S. Employer Identification No.)

**1616 Anderson Road, Suite 208
McLean, Virginia 22102
(703) 286-7000**
(Address and telephone number, including area code, of principal executive offices)

**David Gladstone
Chairman and Chief Executive Officer
Gladstone Capital Corporation
1616 Anderson Road, Suite 208
McLean, Virginia 22102**
(Name and address of agent for service)

Copies of information to:
**Thomas R. Salley, Esq.
Darren K. DeStefano, Esq.
Cooley Godward LLP
One Freedom Square
Reston Town Center
11951 Freedom Drive
Reston, Virginia 20190
(703) 456-8000**

Approximate Date of Proposed Public Offering: From time to time after the effective date of the Registration Statement.

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

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

Gladstone Capital Corporation
Cross Reference Sheet

No.	Description	Location
Part A Information Required In a Prospectus		
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Item 4.	Financial Highlights	Selected Consolidated Financial Statements; Management's Discussion and Analysis of Financial Condition and Results of Operations
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Item 7.	Use of Proceeds	Use of Proceeds
Item 8.	General Description of the Registrant	Outside Front Cover; Prospectus Summary; Business; Risk Factors; Investment Objectives and Policies; Portfolio Companies
Item 9.	Management	Management; Executive Officers and Directors; Control Persons and Principal Stockholders
Item 10.	Capital Stock, Long-Term Debt and Other Securities	Description of Our Securities; Price Range of Common Stock and Distributions; Dividend Reinvestment Plan
Item 11.	Defaults and Arrears on Senior Securities	Not Applicable
Item 12.	Legal Proceedings	Not Applicable
Item 13.	Table of Contents of the Statement of Additional Information	Not Applicable
Part B Information Required in a Statement of Additional Information*		
Item 14.	Cover Page	Not Applicable
Item 15.	Table of Contents	Not Applicable
Item 16.	General Information and History	Prospectus Summary; Business

No.	Description	Location
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Item 18.	Management	Management
Item 19.	Control Persons and Principal Holders of Securities	Control Persons and Principal Stockholders
Item 20.	Investment Advisory and Other Services	Investment Advisor
Item 21.	Brokerage Allocation and Other Practices	Fees and Expenses; Prospectus Summary; Plan of Distribution; Brokerage Allocation and Other Practices
Item 22.	Tax Status	Price Range of Common Stock and Distributions; U.S. Federal Income Tax Considerations
Item 23.	Financial Statements	Financial Statements

** Pursuant to the General Instructions to Form N-2, all information required to be set forth in Part B "Statement of Additional Information" has been included in the prospectus and, accordingly, no statement of additional information has been filed as a part of this registration statement.*

Part C Other Information

Information required to be included in Part C is set forth under the appropriate item, so numbered, in Part C of this Registration Statement.

Subject to Completion, dated February 28, 2003

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

PROSPECTUS

$75,000,000

Gladstone Capital Corporation

Common Stock
Preferred Stock
Debt Securities

We may offer, from time to time, up to $75 million aggregate initial offering price of our common stock, $0.001 par value per share, preferred stock or debt securities, which we refer to in this prospectus collectively as our securities, in one or more offerings. We will offer our securities at prices and on terms to be set forth in one or more supplements to this prospectus. In the case of our common stock, the offering price per share, less any underwriting commissions or discounts, will not be less than the net asset value per share of our common stock at the time we make the offering. You should read this prospectus and the applicable prospectus supplement carefully before you invest in our securities.

We may offer our securities directly to one or more purchasers, through agents that we designate from time to time, or to or through underwriters or dealers. The prospectus supplement relating to the particular offering will identify any agents or underwriters involved in the sale of our securities, and will set forth 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. For more information about the manners which we may use to offer our securities, 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. Our common stock is traded on the Nasdaq National Market under the symbol "GLAD." As of February 27, 2003, the last reported sales price for our common stock was $15.64.

We operate as a closed-end, non-diversified management investment company, and have elected to be treated as a business development company under the 1940 Act. Our investment objectives are to achieve a high level of current income by investing in debt securities, consisting primarily of senior term debts, senior subordinated term debts and junior subordinated term debts, of established private businesses that are backed by leveraged buyout funds, venture capital funds or others. In some instances some of the senior term debts may be "last out tranches" meaning our debt is part of the senior term debt but is paid last from those payments coming to the senior term debt holders if the borrower is liquidated. We also provide first and second mortgage debt secured by business real estate. We normally do not provide revolving lines of credit. In addition, we may acquire existing loans made by others if those loans meet our profile. We also seek to provide our stockholders with long-term capital growth through the appreciation in the value of warrants, success fees or other equity-type instruments that we may receive when we provide debt.

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

Additional information about Gladstone Capital Corporation has been filed with the Securities and Exchange Commission and is available to the public without charge upon written or oral request. Such information is also available on the SEC's website at www.sec.gov.

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 "Risk Factors" section, beginning on page 9 of this prospectus. Shares of closed-end investment companies frequently trade at a discount to their net asset value and this may increase the risk of loss of purchasers of our securities. You should carefully consider these risks together with all of the other information contained in this prospectus and any prospectus supplement before making a decision to purchase our securities.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

February , 2003

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 covers only. Our business, financial condition, results of operations and prospects may have changed since such dates.

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PROSPECTUS SUMMARY

This summary highlights some of the information in this prospectus. It is not complete and does not contain all of the information that you may want to consider. You should read carefully the more detailed information set out in this prospectus and the accompanying prospectus supplement, including "Risk Factors." Except where the context requires otherwise, when we use the terms "we," "us" or "Gladstone Capital Corporation," we are referring solely to Gladstone Capital Corporation and not to its wholly-owned subsidiary, Gladstone Advisers, Inc.

General

We are a specialty finance company that was incorporated under the General Corporation Laws of the State of Maryland on May 30, 2001. Our investment objectives are to achieve a high level of current income by investing in debt securities, consisting primarily of senior term debts, senior subordinated term debts and junior subordinated term debts, of established private businesses that are backed by leveraged buyout funds, venture capital funds or others. In some instances some of the senior term debts may be "last out tranches" meaning our debt is part of the senior term debt but is paid last from those payments coming to the senior term debt holders if the borrower is liquidated. We also provide first and second mortgage debt secured by business real estate. We normally do not provide revolving lines of credit. In addition, we may acquire existing loans made by others if those loans meet our profile. We also seek to provide our stockholders with long-term capital growth through the appreciation in the value of warrants, success fees or other equity-type instruments that we may receive when we provide debt. Our headquarters are in McLean, Virginia, a suburb of Washington, DC. We also have offices in New York, New York and Pittsburgh, Pennsylvania.

Our Structure and Our Management

We operate as a closed-end, non-diversified management investment company, and have elected to be treated as a business development company under the Investment Company Act of 1940, which we refer to in this prospectus as the 1940 Act. In addition, we have elected to be treated for tax purposes as a regulated investment company, or RIC, under the Internal Revenue Code of 1986. As a RIC, we generally do not have to pay corporate level tax on any income we distribute to our stockholders as dividends, allowing us to substantially reduce or eliminate our corporate level tax liability. For further information, see "Regulation," "US Federal Income Tax Considerations" and "Dividend Reinvestment Plan."

We are internally managed by our officers and directors. We do not have a separate investment advisor and, therefore, we do not pay an investment advisory fee. We have established a wholly-owned subsidiary that conducts our daily administrative operations and through which we provide managerial assistance to our portfolio companies. For the year ended September 30, 2002 and the three months ended December 31, 2002, our operating expenses were approximately 2.1% and 2.4% (annualized), respectively, of our total assets (exclusive of temporary investments acquired near the end of a quarter for the purpose of satisfying regulatory requirements). We currently estimate that over time our annual operating expenses will be approximately 2% of our total assets (exclusive of such temporary investments), however there can be no assurance that our actual annual operating expenses will not exceed this amount.

We have assembled a management team which has extensive experience in our lines of business. Our executive officers include David Gladstone, chairman and chief executive officer, and Terry Lee Brubaker, president and chief operating officer. Mr. Gladstone has a total of over 25 years of debt and equity financing experience at Gladstone Capital Corporation, Allied Capital Corporation (NYSE: ALD) and American Capital Strategies Ltd. (NASDAQ: ACAS). Mr. Brubaker has over 25 years of operational expertise in acquiring and managing companies, much of it at James River Corporation.

Our management, including Messrs. Gladstone and Brubaker, makes available significant managerial assistance to the businesses in which we invest, including operational, financial and strategic advice.

Our Investment Objectives and Our Strategy

Our investment objectives are to achieve a high level of current income by investing in debt securities, consisting primarily of senior term debts, senior subordinated term debts and junior subordinated term debts, of established private businesses that are backed by leveraged buyout funds, venture capital funds or others. In some instances some of the senior term debts may be "last out tranches" meaning our debt is part of the senior term debt but is paid last from those payments coming to the senior term debt holders if the borrower is liquidated. We also provide first and second mortgage debt secured by business real estate. We normally do not provide revolving lines of credit. In addition, we may acquire existing loans made by others if those loans meet our profile. We also seek to provide our stockholders with long-term capital growth through the appreciation in the value of warrants, success fees or other equity-type instruments that we may receive when we provide debt. There can be no assurance that we will realize our investment objectives. We seek to invest primarily in three categories of debt of private companies:

Senior Term Debt. We seek to invest a small portion of our assets in senior term debt of borrowers. Using the assets and cash flow of the underlying business as collateral, a business typically uses senior term debt to cover a substantial portion of the funding needed to operate. Senior lenders are exposed

to the least risk of all providers of debt because they command a senior position with respect to scheduled interest and principal payments. However, unlike senior subordinated and junior subordinated lenders, these senior lenders typically do not receive any stock or warrants to purchase stock of the borrowers. As such, they generally do not participate in the equity appreciation of the value of the business. We intend to make senior loans on a limited basis and some of these will only be as bridge financings. In most cases, these loans will be refinanced at a later date.

Senior Subordinated Term Debt. We seek to invest a majority of our assets in senior subordinated term debt. Senior subordinated term debt is subordinated in its rights to receive its principal and interest payments from the borrower to the rights of the holders of senior debt. As a result, senior subordinated term debt is riskier than senior term debt. Although such loans are sometimes secured by significant collateral, many of these lenders principally rely on the borrower's cash flow for repayment. Additionally, lenders often receive warrants to acquire shares of stock in borrowers in connection with these loans.

Junior Subordinated Term Debt. We also seek to invest a small portion of our assets in junior subordinated term debt. Junior subordinated term debt is subordinated in its rights to receive its principal and interest payments from the borrower to the rights of the holders of senior debt and senior subordinated debt. The risk profile of junior subordinated term debt is high, which permits the junior subordinated lender to obtain higher interest rates and warrants to purchase a greater portion of the borrower's stock.

We use the established loan referral network of Messrs. Gladstone and Brubaker and our principals to identify and make senior and subordinated loans to selected businesses that we do not believe have sufficient access to traditional sources of lending.

We target small and medium sized private businesses that meet certain criteria, including the potential for growth, adequate assets for loan collateral, experienced management teams with significant ownership interest in the business, adequate capitalization, profitable operations based on cash flow, substantial ownership by leveraged buyout funds or venture capital funds and potential opportunities for us to realize appreciation and gain liquidity in our equity position. We may achieve liquidity 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 buy back our warrants, though there can be no assurance that we will always have these rights.

We expect that our loans typically will range from $5 million to $15 million, mature in no more than seven years, and accrue interest at a fixed or variable rate that exceeds the prime rate. Because these loans will generally be subordinated term debt of private companies who typically cannot or will not expend the resources to have their debt securities rated by a credit rating agency, we expect that most if not all of the debt securities we acquire will be unrated. Accordingly, we cannot accurately predict what ratings these loans might receive if they were in fact rated, and therefore we cannot determine whether or not they could be considered to be "investment grade" quality.

In order to acquire the capital for investment purposes needed to execute our business strategy, we intend to issue debt securities, other evidences of indebtedness and possibly preferred stock, and we may securitize interests in our portfolio assets. As a result of these activities, we will be exposed to the risks of leverage. For additional information about our proposed borrowing activities, see "Business Leverage" and "Risk Factors Our business plan is dependent upon external financing which may expose us to risks associated with leverage."

Offering

We may offer, from time to time, up to $75 million of our securities, on terms to be determined at the time of the offering. We will offer our securities at prices and on terms to be set forth in one or more supplements to this prospectus. In the case of an offering of our common stock, the offering price per share, less any underwriting commissions or discounts, will not be less than the net asset value per share of our common stock at the time of the offering.

We may offer our securities directly to one or more purchasers, through agents that we designate from time to time, 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 set forth 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 our securities.

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

Nasdaq National Market Symbol	GLAD
Use of Proceeds	Unless otherwise specified in a prospectus supplement, we intend to use the net proceeds from the sale of our securities for general corporate purposes, which may include investment in small and medium sized businesses in accordance with our investment objectives, repayment of any indebtedness that we may have used to make investments and other general corporate purposes. See "Use of Proceeds."

Distributions	We have paid quarterly dividends to the holders of our common stock

	and generally intend to continue to do so. The amount of the quarterly dividends is determined by our board of directors and is based on our estimate of taxable ordinary income and net short-term capital gains. See "Price Range of Common Stock and Distributions." In addition to cash dividends, certain additional amounts may be deemed to be distributed to stockholders for income tax purposes. See "US Federal Income Tax Consequences." Other types of securities will likely pay distributions in accordance with their terms.
Principal Risk Factors	An investment in our securities involves certain risks relating to our structure and investment objectives that prospective investors should consider, including but not limited to:
	We have a limited operating history upon which you can evaluate our business.
	As a business development company, our portfolio includes securities primarily issued by privately held companies. These investments may involve a high degree of business and financial risk, and are generally less liquid than public securities. Also, our determinations of fair value of these securities may differ materially from the values that would exist if there was a ready market for these investments.
	A large number of entities compete for the same kind of investment opportunities as we do.
	Our business requires a substantial amount of cash to operate and to grow, and we are dependent on external financing.
	We expect that in the future we will borrow funds to make investments in and loans to small and medium sized businesses. In addition to borrowing funds, we may issue preferred stock and debt securities and may securitize interests in our portfolio assets. As a result of these activities, we will be exposed to the risks of leverage, which may be considered a speculative investment technique.
	Our failure to qualify as a RIC eligible for pass-through tax treatment under Subchapter M of the Code on income distributed to stockholders could have a materially adverse effect on the total return, if any, obtainable from an investment in our securities.
	The companies to which we make loans may not have the financial resources to repay them.

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	Fluctuations in interest rates could have an adverse effect on our profitability.
	Certain of our officers and directors may have obligations to other entities that may not always be consistent with our best interests or those of our stockholders.
	Because of the small number of companies in our portfolio, our overall performance could be adversely affected by the unfavorable performance of a small number of loans.

	See "Risk Factors" for a discussion of these and other risks of investing in our securities.
Certain Anti-Takeover Provisions	Our articles of incorporation and bylaws, as well as certain statutory and regulatory requirements, contain certain provisions that may have the effect of discouraging a third party from making an acquisition proposal for us and thereby inhibit a change in control of us in circumstances that could give the holders of our common stock the opportunity to realize a premium over the then prevailing market price for our common stock. See "Risk Factors Provisions of our articles of incorporation and bylaws could deter takeover attempts and adversely impact the price of our shares" and "Certain Provisions of our Articles of Incorporation and Bylaws and Maryland General Corporation Law."
Dividend Reinvestment Plan	Cash we distribute to holders of our common stock may be reinvested under our dividend reinvestment plan in additional whole and fractional shares of our common stock if you or your representative elects to enroll in the reinvestment plan. For more information, see "Dividend Reinvestment Plan."
Available Information	We are subject to the Securities Exchange Act of 1934 and are required to file reports, proxy statements and other information with the SEC. This information is available at the SEC's public reference room in Washington, DC and on the SEC's Internet site at http://www.sec.gov.

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Fees And Expenses

The purpose of the following table is to assist a prospective investor in understanding the various costs and expenses that an investor in this offering will bear directly or indirectly.

Stockholder Transaction Expenses	
Sales Load (as a percentage of offering price)	None(1)
Dividend Reinvestment Plan Fees	(2)
Total Stockholder Transaction Expenses	%
Annual Expenses (as a percentage of net assets attributable to common stock)(3)	
Management Fees	None
Interest Payments on Borrowed Funds	0.0%(4)
Other Expenses	2.5%(4)
Total Annual Expenses (estimated)	2.5%(4)

(1) *In the event that the securities to which this prospectus relates are sold to or through underwriters, a corresponding prospectus supplement will disclose the applicable sales load.*

(2) *The expenses of our dividend reinvestment plan are included in stock record expenses, a component of other expenses. We have no cash purchase plan.*

(3) *Consolidated net assets attributable to common shares equal our net assets (i.e., total assets less total liabilities) at December 31, 2002.*

(4) *Estimates of interest payments on borrowed funds, other expenses and total annual expenses have been based on our projected operating expenses (including interest costs) for the current fiscal year divided by our net assets as of December 31, 2002. The*

percentage in the table assumes that we have not issued any securities that are senior to our equity securities. We intend to borrow funds up to an amount so that our asset coverage, as defined in the 1940 Act, is at least 200% immediately after each issuance of senior securities. We expect that our interest payments on borrowed funds and total annual expenses would be higher than the levels set forth in the table when and if we borrow funds or issue senior securities. For additional information about our proposed borrowings, see "Business Leverage" and "Risk Factors Our business plan is dependent upon external financing which may expose us to risks associated with leverage."

Example

The following example demonstrates the projected dollar amount of total cumulative expenses that would be incurred over various periods with respect to a hypothetical investment in our common stock. These amounts are based upon our payment of operating expenses at the levels set forth in the table above which, as indicated above, does not include leverage or related expenses. In the event that the shares to which this prospectus relates are sold to or through underwriters, the corresponding prospectus supplement will restate this example to reflect the applicable sales load.

	1 YEAR	3 YEARS	5 YEARS	10 YEARS
You would pay the following expenses on a $1,000 investment, assuming a 5% annual return	$ 25	$ 78	$ 133	$ 284

This example and the expenses in the table above should not be considered a representation of our future expenses, and actual expenses may be greater or less than those shown. Moreover, 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%. In addition, while the example assumes reinvestment of all dividends and distributions at net asset value, participants in our dividend reinvestment plan may receive shares purchased by the plan administrator at the market price in effect at that time, which may be at, above or below net asset value. See "Dividend Reinvestment Plan" for additional information regarding our dividend reinvestment plan.

RISK FACTORS

The purchase of our securities involves a number of significant risks and other factors relating to our structure and investment objectives. As a result, we cannot assure you that we will achieve our investment objectives. You should consider carefully the following information before making an investment in our securities.

We are a new company with a limited operating history.

We were incorporated in May 2001 and, to date, have only made investments in nine companies. Thus far, we have conducted only limited operations as a lender to small and medium sized companies. In addition, we are subject to all of the business risks and uncertainties associated with any new business enterprise. We may not meet our investment objectives and the value of your investment in us may decline substantially or be reduced to zero.

We are dependent upon our key management personnel for our future success, particularly David Gladstone, George Stelljes, III and Terry Lee Brubaker.

We are dependent on the diligence, skill and network of business contacts of our senior management and other management members for the final selection, structuring, closing and monitoring of our investments. Our future success depends to a significant extent on the continued service and coordination of our senior management team, particularly David Gladstone, our chairman and chief executive officer, George Stelljes, III, our chief investment officer, and Terry Lee Brubaker, our president and chief operating officer. The departure of any of our executive officers or key employees could have a material adverse effect on our ability to implement our business strategy and to achieve our investment objectives.

Our financial condition and results of operations will depend on our ability to effectively manage our future growth.

Our ability to achieve our investment objectives will depend on our ability to sustain continued growth, which will depend on our ability to identify, evaluate, finance and invest in suitable companies that meet our investment criteria. Accomplishing this result on a cost-effective basis is largely a function of our marketing capabilities, our management of the investment process, our ability to provide competent, attentive and efficient services and our access to financing sources on acceptable terms. As we grow, we will also be required to hire, train, supervise and manage new employees. Failure to effectively manage our future growth could have a material adverse effect on our business, financial condition and results of operations.

We operate in a highly competitive market for investment opportunities.

A large number of entities compete with us and make the types of investments that we seek to make in small and medium sized privately owned businesses. We compete with a large number of private equity funds, leveraged buyout funds and venture capital funds, investment banks and other equity and non-equity based investment funds, and other sources of financing, including traditional financial services companies such as commercial banks. Many of our competitors are substantially larger and have considerably greater financial, technical and marketing resources than we do. For example, some competitors may have a lower cost of funds and access to funding sources that are not available to us. In addition, certain of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more relationships and build their market shares. Furthermore, many of our potential competitors are not subject to the regulatory restrictions that the 1940 Act imposes on us as a business development company. We cannot assure you that the competitive pressures we face will not have a material adverse

effect on our business, financial condition and results of operations. Also, as a result of this competition, we may not be able to take advantage of attractive investment opportunities from time to time and there can be no assurance that we will be able to identify and make investments that satisfy our investment objectives or that we will be able to fully invest our available capital.

Our business model is dependent upon the development of strong referral relationships with leveraged buyout funds and venture capital funds.

We are dependent upon informal relationships with leveraged buyout funds and venture capital funds to provide us with deal flow. The investments we made in Finn Corporation and ARI Holdings, Inc. and a number of the loans we are currently considering are with portfolio companies of Three Cities Fund II, L.P. and Three Cities Fund III, L.P., leveraged buyout funds that are managed by Three Cities Research Inc. Moreover, we have a mutual referral relationship with American Capital Strategies Ltd. The relationship with American Capital led to our mutual investment in Marcal Paper Mills, Inc. If we fail to maintain our relationship with funds such as Three Cities and American Capital, or if we fail to establish strong referral relationships with other funds, we will not be able to grow our portfolio of loans and fully execute our business plan.

Our loans to small and medium sized borrowers are extremely risky and you could lose your entire investment.

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

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

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

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

Small and medium sized businesses generally have less predictable operating results. We expect that our borrowers may have significant variations in their operating results, may from time to time be parties to litigation, may be engaged in rapidly changing businesses with products subject to a

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

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

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

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

We may not realize gains from our equity investments.

When we make a subordinated loan, we generally expect to receive warrants to purchase stock issued by the borrower. 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 will offset any losses we experience on loan defaults. However, the warrants we receive may not appreciate in value and, in fact, may decline in value. Accordingly, we may not be able to realize gains from our equity interests and any gains we do recognize on the disposition of equity interests may not be sufficient to offset losses we experience on our loan portfolio.

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

None of our portfolio loans or equity securities, at least initially, will be publicly traded or have a readily determinable market value. We value these securities based on a determination of their fair value made in good faith by management and approved by our board of directors. Due to the uncertainty inherent in valuing these securities, our determinations of fair value may differ materially from the values that would exist if a ready market for these securities existed. Our net asset value could be materially affected if our determinations regarding the fair value of our investments are materially different from the values that we ultimately realize on our disposal of such securities.

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

Most of our investments presently consist of, and will continue to consist of, loans and warrants acquired in private transactions directly from borrowers or from the originators of loans to such borrowers. Substantially all of the securities we presently hold are, and the securities we expect to acquire in the future will be, subject to restrictions on resale, including, in some instances, legal restrictions, or will otherwise be less liquid than publicly traded securities. The illiquidity of our

investments may make it difficult for us to obtain cash equal to the value at which we record our investments if the need arises. This could cause us to miss important business opportunities. In addition, if we are required to quickly liquidate all or a portion of our portfolio, we may realize significantly less than the value at which we have previously recorded our investments.

Our portfolio will be 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.

We intend to have outstanding loans to approximately 20 to 40 companies at any given time. A consequence of 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 loans or a substantial writedown 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% 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% of the value of our total assets. As a result, a downturn in an industry in which we have made multiple loans could have a materially adverse effect on us.

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

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

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

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

Securitization. In addition to issuing securities to raise capital as described above, we anticipate that in the future we will securitize our loans to generate cash for funding new investments. An inability to successfully securitize our loan portfolio could limit our ability to grow our business, fully execute our business strategy and impact our profitability. Moreover, successful securitization of our

loan portfolio might expose us to losses as the loans in which we do not plan to sell interests will be those that are riskier and more apt to generate losses.

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

We anticipate using a combination of equity and long-term and short-term borrowings to finance our lending activities. As a result, a portion of our income will depend upon the difference between the rate at which we borrow funds and the rate at which we loan these funds. Certain of our borrowings may be at fixed rates and others at variable rates. Currently, we expect approximately 50% of the loans in our portfolio to be at fixed rates and approximately 50% to be at variable rates determined on the basis of a benchmark prime rate. We will typically seek to hedge against the risk of adverse movement in interest rates on our borrowings relative to our portfolio of assets. We expect to hedge against interest rate fluctuations by using standard hedging instruments such as futures, options and forward contracts. While hedging activities may insulate us against adverse fluctuations in interest rates, they may also limit our ability to participate in the benefits of lower interest rates with respect to the hedged portfolio. Adverse developments resulting from changes in interest rates or hedging transactions could have a material adverse effect on our business, financial condition and results of operations.

We may be unable to obtain a credit facility on terms that are acceptable to us.

We will have a continuing need for capital to finance our loans. In order to maintain RIC status, we will be required to distribute to our stockholders at least 90% of our ordinary income and short-term capital gains on an annual basis. Accordingly, such earnings will not be available to fund additional loans. Therefore, we will need to raise additional capital which we expect to finance through a credit facility. A credit facility is an agreement with a bank or other traditional lending institution that would allow us to borrow funds, either through a term loan or a line of credit, to make investments. We can not assure you that we will be able to obtain a credit facility on terms that we find acceptable, if at all. The unavailability of funds from commercial banks or other sources on favorable terms could inhibit the growth of our business and have a material adverse effect on us.

Our expected credit facility will likely impose certain limitations on us.

While there can be no assurance that we will be able to borrow from banks and other financial institutions, we expect that we will at some time in the future obtain a credit facility. The lender or lenders under this credit facility will have fixed dollar claims on our assets that are senior to the claims of our stockholders and, thus, will have a preference over our stockholders with respect to our assets. We also expect our credit facility to contain customary default provisions such as a minimum net worth amount, a profitability test, a restriction on changing our business and loan quality standards. An event of default under our expected credit facility would likely result, among other things, in termination of further funds available under that facility and an accelerated maturity date for all amounts outstanding under the facility. This would likely disrupt the portfolio companies whose loans we financed through the facility, could reduce our revenues and, by delaying any cash payment allowed to us under our facility until the lender has been paid in full, could reduce our liquidity and cash flow.

Our investments will typically be long term and it may require several years to realize liquidation events.

Since we generally intend to make five to seven year term loans and to hold our loans and related warrants 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 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.

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

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

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

Our executive officers and directors may serve as officers and directors of entities that operate in the same or similar lines of business as we do. 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. It is possible that new investment opportunities that meet our investment objectives may come to the attention of one of our executive officers or directors, such as Mr. Gladstone, in his role as an officer or director of another entity, and, if so, such opportunity might not be offered, or otherwise made available, to us.

Changes in laws or regulations governing our operations may adversely affect our business.

We and our portfolio companies will be subject to regulation by laws at the local, state and federal level. These laws and regulations, as well as their interpretation, may be changed from time to time. Accordingly, any change in these laws or regulations could have a material adverse impact on our business. For additional information regarding the regulations to which we are subject, see "Regulation."

We may experience fluctuation in our quarterly results.

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

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

Our current intention is to distribute at least 90% of our ordinary income and short-term capital gains to our stockholders on a quarterly basis. We expect to retain net realized long-term capital gains

to supplement our equity capital and support the growth of our portfolio, although our board of directors may determine in certain cases to distribute these gains. We cannot assure you that we will achieve investment results or maintain a tax status that will allow or require any specified level of cash distributions or year-to-year increases in cash distributions.

Failure to deploy new capital may reduce our return on equity.

In the past, we have experienced delays in investing the proceeds of our initial public offering as compared to the original timetable that we expected at the time of our initial public offering. As of December 31, 2002, we had invested approximately $93 million of the net proceeds of approximately $131 million raised in our initial public offering, which closed on August 29, 2001. If we fail to invest our new capital effectively, our return on equity may be negatively impacted, which could result in a decline in the market price of our common stock.

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

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

Provisions of our articles of incorporation and bylaws could deter takeover attempts and adversely impact the price of our shares.

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

Acts of war or terrorist attacks in the United States may cause disruption in our business and may adversely affect the markets in which we operate, which could affect our profitability and the ability of our portfolio companies to make required payments to us.

Terrorist attacks in the United States in September 2001 caused major instability in the U.S. financial markets. The national and global responses to terrorist attacks, many of which responses are still being formulated, including a possible war with Iraq and other recent military, diplomatic and financial responses, and any possible reprisals as a consequence of those actions, may contribute to a further decline in economic conditions. In addition, uncertainty regarding U.S. involvement in military actions overseas and threats of terrorism in the U.S. could also contribute to such a decline. These events could materially adversely impact the ability of our portfolio companies to make required payments on our investments and our ability to find suitable investment opportunities. To the extent these events occur, our profitability and cash flow could be reduced, the recorded value of our assets may be required to be written down and our investment pace could be slowed, any of which could result in a decline in the market price of our common stock.

The market price of our shares may fluctuate significantly.

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

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

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

changes in regulatory policies or tax guidelines, particularly with respect to RICs or business development companies;

loss of RIC status;

changes in our earnings or variations in our operating results;

changes in the value of our portfolio of investments;

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

departure of key personnel;

operating performance of companies comparable to us;

short-selling pressure with respect to our shares or business development companies generally;

price and volume fluctuations in the stock market as a result of terrorist attacks, or speculation regarding future terrorist attacks, in the U.S. or abroad;

price and volume fluctuations in the stock market as a result of involvement of the United States in armed hostilities (e.g., Iraq) or uncertainty regarding U.S. involvement in such activities;

general economic trends and other external factors; and

loss of a major funding source.

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

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

Shares of closed-end investment companies frequently trade at a discount from net asset value. This characteristic of shares of closed-end investment companies is separate and distinct from the risk that our net asset value per share will decline. It is not possible to predict whether our common stock will trade at, above, or below net asset value.

Sales of substantial amounts of our common stock in the public market may have an adverse effect on the market price of our common stock.

As of February 24, 2003, we have 10,071,844 shares of common stock outstanding, of which 9,216,213 are freely tradable without restriction. The remaining 855,631 shares are held by employees,

officers and directors, most of which were purchased upon exercise of stock options. Of these, 843,965 may currently be resold publicly in compliance with the volume limitations and other restrictions of Rule 144 of the Securities Act. Following the filing of this registration statement, we intend to file a registration statement to register for public resale up to 2,000,000 shares under our Amended and Restated 2001 Equity Incentive Plan (including the shares that have already been issued upon option exercises). Following the filing of such registration statement, all of these shares will be freely tradable without restriction, although certain of the options have not yet been granted and a portion of the options that have been granted are not yet vested and the shares underlying such options will, accordingly, not be eligible for resale until vested. Sales of substantial amounts of our common stock in the public market, pursuant to such registration, under Rule 144 or otherwise, or the availability of such shares for sale, could adversely affect the prevailing market prices for our common stock. If this occurs, it could impair our ability to raise additional capital through the sale of equity securities should we desire to do so.

USE OF PROCEEDS

Unless otherwise specified in the prospectus supplement accompanying this prospectus, we intend to use the net proceeds from the sale of securities for general corporate purposes, which may include investments in debt securities of small and medium sized businesses in accordance with our investment objectives, repayment of any indebtedness that we may have used to make investments and other general corporate purposes.

We anticipate that we will utilize substantially all of the net proceeds of any offering of securities in the manner described above within six months of the offering, and in any event within two years. Pending such utilization, we intend to invest the net proceeds of any offering of securities in money market instruments. We can not guarantee that we will be able to achieve our targeted investment pace.

PRICE RANGE OF COMMON STOCK AND DISTRIBUTIONS

We have distributed, and currently intend to continue to distribute in the form of dividends, a minimum of 98% of our investment company taxable income including 98% of our net realized short-term capital gains, if any, on a quarterly basis to our stockholders. Net realized long-term capital gains may be retained and treated as a distribution for federal tax purposes, to supplement our equity capital and support growth in our portfolio, unless our board of directors determines in certain cases to make a distribution. 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 our common stock, all cash distributions can be reinvested automatically through 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 the dividend reinvestment plan on the stockholder's behalf**.** For additional information, see "Risk Factors We will be subject to corporate level tax if we are unable to satisfy Internal Revenue Code requirements for RIC qualification" and "Dividend Reinvestment Plan."

Our common stock is traded on the Nasdaq National Market under the symbol "GLAD." We completed our initial public offering of our common stock in August 2001 at a price of $15 per share. Prior to such date there was no public market for our common stock. Our common stock has historically traded at prices above its net asset value. There can be no assurance, however, that such premium to net asset value will be maintained. The following table reflects, by quarter, the high and low closing prices per share of our common stock on the Nasdaq National Market and the dividends we have declared for the period since August 24, 2001, when public trading of our common stock began following our initial public offering, through February 27, 2003.

	Net Asset Value per share (1)	High	Low	Premium of High to Net Asset Value	Premium of Low to Net Asset Value	Dividend Declared

	Net Asset Value per share (1)	High	Low	Premium of High to Net Asset Value	Premium of Low to Net Asset Value	Dividend Declared
FY 2001						
Fourth Quarter (beginning August 24, 2001)	$ 13.05	$ 17.48	$ 15.98	$ 4.43	$ 2.93	$ 0
FY 2002						
First Quarter	$ 12.98	$ 19.10	$ 15.90	$ 6.12	$ 2.92	$ 0.18
Second Quarter	$ 12.91	$ 18.05	$ 16.60	$ 5.14	$ 3.69	$ 0.21
Third Quarter	$ 12.91	$ 19.52	$ 17.10	$ 6.61	$ 4.19	$ 0.21
Fourth Quarter	$ 12.97	$ 18.74	$ 16.00	$ 5.77	$ 3.03	$ 0.21
FY 2003						
First Quarter	$ 12.98	$ 17.00	$ 14.90	$ 4.02	$ 1.92	$ 0.23
Second Quarter (through February 27, 2003) (2)		$ 16.78	$ 15.60			

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

(2) *Net asset value per share has not yet been determined for the second fiscal quarter of 2003.*

CONSOLIDATED SELECTED FINANCIAL DATA

The following consolidated selected financial data for the year ended September 30, 2002, the period ended September 30, 2001 and the three months ended December 31, 2002 are derived from our consolidated financial statements included elsewhere in this prospectus. The data should be read in conjunction with our consolidated financial statements and notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this prospectus.

	September 30, 2001	May 30, 2001 (inception)	Year ended September 30, 2002	(unaudited) Three months ended December 31, 2002
Investment income	$ 394,855		$ 10,455,703	$ 3,235,432
Net investment income (loss)	$ (92,644)		$ 7,616,601	$ 2,412,154
Net investment income (loss) per common share (basic)	$ (0.03)		$ 0.76	$ 0.24
Net investment income (loss) per common share (diluted)	$ (0.03)		$ 0.75	$ 0.24
Total assets	$ 132,205,486	$ 652,631	$ 172,922,039	$ 173,410,821
Cash dividends declared per common share			$ 0.81	$ 0.23

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

FORWARD-LOOKING STATEMENTS

All statements contained in this prospectus, other than historical facts, may constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. 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" or the negative of such terms or comparable terminology. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others: (1) adverse changes in interest rates; (2) our failure or inability to establish or maintain referral arrangements with leveraged buyout funds and venture capital funds to generate loan opportunities; (3) the loss of one or more of our executive officers, in particular David Gladstone, George Stelljes, III or Terry Lee Brubaker; (4) our inability to establish or maintain a credit facility on terms reasonably acceptable to us, if at all; (5) our inability to successfully securitize our loan portfolio on terms reasonably acceptable to us, if at all; (6) the decision of our competitors to aggressively seek to make senior and subordinated loans to small and medium-sized businesses on terms more favorable than we intend to provide; and (7) those factors described in the "Risk Factors" section of this prospectus. We caution readers not to place undue reliance on any such forward-looking statements, which are made pursuant to the Private Securities Litigation Reform Act of 1995 and, as such, speak only as of the date made. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, after the date of this prospectus.*

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

OVERVIEW

We were incorporated under the General Corporation Laws of the State of Maryland on May 30, 2001. Our investment objectives are to achieve a high level of current income by investing in debt securities, consisting primarily of senior term debts, senior subordinated term debts and junior subordinated term debts, of established private businesses that are backed by leveraged buyout funds, venture capital funds or others. In some instances some of the senior term debts may be "last out tranches" meaning our debt is part of the senior term debt but is paid last from those payments coming to the senior term debt holders if the borrower is liquidated. We also provide first and second mortgage debt secured by business real estate. We normally do not provide revolving lines of credit. In addition, we may acquire existing loans made by others if those loans meet our profile. We also seek to provide our stockholders with long-term capital growth through the appreciation in the value of warrants, success fees or other equity-type instruments that we may receive when we provide debt. We operate as a closed-end, non-diversified management investment company, and have elected to be treated as a business development company under the 1940 Act.

We seek out small and medium-sized businesses that meet certain criteria, including (1) the potential for growth in cash flow, (2) adequate assets for loan collateral, (3) experienced management teams with a significant ownership interest in the borrower, (4) profitable operations based on the borrower's cash flow, (5) reasonable capitalization of the borrower (usually by leveraged buyout funds or venture capital funds) and (6) the potential to realize appreciation and gain liquidity in our equity position, if any. We anticipate that liquidity in our equity position will be achieved through a merger or acquisition of the borrower, a public offering by the borrower or by exercise of our right to require the borrower to buy back its warrants. We lend to borrowers that need funds to finance growth, restructure their balance sheets or effect a change of control.

Our loans typically range from $5 million to $15 million, mature in no more than seven years and accrue interest at a fixed or variable rate that exceeds the prime rate. A number of our loans have a provision that calls for some portion of the interest payments to be deferred and added to the principal balance so that the interest is paid, together with the principal, at maturity. This form of deferred interest is often called "paid-in-kind" or "PIK" interest, and, when earned, we record PIK interest as interest income and add the PIK interest to the principal balance of the loans. The amount of PIK interest accrued and on our books as of December 31, 2002 was approximately $608,000.

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

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

In addition, as a business development company under the 1940 Act, we are required to make available significant managerial assistance to our portfolio companies. We provide these services, for which we receive fees, through our wholly owned subsidiary, Gladstone Advisers, Inc.

Such fees are typically paid in part at the time a prospective portfolio company signs a non-binding term sheet with us, with the remainder paid at the closing of the investments. These fees are generally non-recurring, however in some instances they may have a recurring component. The specific services we provide vary by portfolio company, but generally consist of reviewing existing credit facilities, arranging bank

financing, arranging equity financing, structuring financing from multiple lenders, structuring financing from equity investors, restructuring existing loans, raising equity and debt capital and providing general financial advice. We record these fees as managerial assistance fee revenue in the period in which the fees are earned.

Our business plan calls for managerial assistance fee revenue to equal or exceed our operating expenses (excluding interest expense). However, during the year ended September 30, 2002 and the quarter ended December 31, 2002, operating expenses (excluding interest expense) exceeded managerial assistance fee revenue by approximately $1.2 million and $820,000, respectively. Because we typically generate managerial assistance fee revenue only when we make new loans, our relatively slow pace of loans during the year ended September 30, 2002 and the quarter ending December 31, 2002 led to this shortfall. In the future, we will need to make loans at a faster pace in order to meet this objective. However, we believe that, as the economic environment improves, we will be able to make sufficient new investments so that over time our managerial assistance fee revenue will equal or exceed our operating expenses (excluding interest expense), although there can be no guarantee that we will be able to do so.

Prior to making an investment, we ordinarily enter into a non-binding term sheet with the potential borrower. These non-binding term sheets are generally subject to a number of conditions, including but not limited to the satisfactory completion of our due diligence investigations of the potential borrower's business and reaching agreement on the legal documentation for the loan. Typically, upon execution of the non-binding term sheet, the potential borrower pays us a non-refundable fee for our services rendered through the date of the non-binding term sheet. Where the fee paid is non-refundable, we recognize this fee as revenue upon execution of the non-binding term sheet.

In the event that we expend significant effort in considering and negotiating a potential investment that ultimately is not consummated, we generally will seek reimbursement from the proposed borrower for our reasonable expenses incurred in connection with the proposed transaction. Any amounts collected are recognized as "other income" in the quarter in which such reimbursement is received. Also, in the event that we have incurred significant legal fees in connection with the transaction, we will typically also seek reimbursement for these expenses from the proposed borrower. However, there can be no guarantee that we will be successful in collecting any such reimbursements.

The only significant continuing revenue associated with the investments we have already closed is interest paid and, potentially, capital gains received in connection with the liquidation of any associated equity interest (e.g., warrants). While in some instances we may also receive on-going managerial assistance fee revenue in connection with a consummated investment, any such amounts have been, and in the future are expected to be, insignificant.

The general economic climate during the fiscal year ended September 30, 2002 and the three months ended December 31, 2002 was unfavorable. Many businesses saw their sales and business prospects decline during this time. Consequently, many of these companies were forced to lay off employees and engage in other cost cutting measures. As a result of the difficult business climate, we determined it prudent to proceed cautiously in making loans during the 2002 fiscal year and in the three months ended December 31, 2002. Since our initial public offering in August 2001, we have made 11 different loans to, or investments in, nine companies for a total of approximately $98.5 million (including the maximum aggregate amount outstanding under an $8 million line of credit in favor of one of our portfolio companies, that has subsequently been retired). This was below our objective set at the beginning of the 2002 fiscal year. In the fourth quarter of the 2002 fiscal year, one of our investments, including all amounts outstanding under a $7 million senior term loan and an $8 million senior line of credit, was repaid in full.

In spite of the economic environment, we are earnestly working toward the consummation of more investments. These prospective loans are subject to, among other things, the satisfactory completion of

our due diligence investigation of each borrower, acceptance of terms and structure and necessary consents. With respect to each prospective loan, we will only agree to provide the loan if, among other things, the results of our due diligence investigations are satisfactory, the terms and conditions of the loan are acceptable and all necessary consents are received. Our management has initiated its due diligence investigations of the potential borrowers, however we can not assure you that we will not discover facts in the course of completing our due diligence that would render a particular investment imprudent or that any of these loans will actually be made.

Critical Accounting Policies

Our accounting policies are more fully described in the footnotes to our consolidated financial statements contained elsewhere in this prospectus. As disclosed in the footnotes to our consolidated financial statements, the preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, and revenues and expenses during the period reported. Actual results could differ from those estimates. Refer to note 2 "Summary of Significant Accounting Policies" in the "Notes to Financial Statements" for the fiscal year ended September 30, 2002 contained elsewhere in this prospectus.

In December 2002, the Financial Accounting Standards Board approved the issuance of FASB Statement No. 148 "Accounting for Stock-Based Compensation Transition and Disclosure." The statement amends FASB Statement No. 123 "Accounting for Stock-Based Compensation" to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock based employee compensation. In addition Statement No. 148 amends the disclosure requirements of Statement No. 123 to require more prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. This statement is effective for financial statements for fiscal years ending and for interim periods beginning after December 15, 2002. We are analyzing the additional requirements of this statement and will include the required disclosures in our Form 10-Q for the quarter ending March 31, 2003.

Investment Valuation

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

We value our investment portfolio each quarter. Members of our portfolio management team prepare the portfolio company valuations using the most recent portfolio company financial statements and forecasts. These individuals consult with the management of the portfolio company to obtain further updates on the portfolio company's performance, including information such as industry trends, new product development, and other operational issues. The valuations are presented to our board of directors, which reviews and approves the portfolio valuations in accordance with our General Valuation Policy, Credit Information, Loan Grading and Risk Rating and Valuation Methodology.

General Valuation Policy. We carry our investments at fair value, as determined by our board of directors. Securities that are publicly traded, if any, are valued at the closing price on the valuation date. Debt and equity securities that are not publicly traded or for which we have various degrees of trading restrictions, are valued at fair value as determined in good faith by our board of directors. In making the good faith determination of the securities, we start with the cost basis of the security, which includes the amortized original issue discount and PIK interest, if any. We then apply the methods set out below in "Valuation Methods." Due to the uncertainty inherent in the valuation process, such estimates of fair value may differ significantly from the values that would have been obtained had a ready market for the securities existed, and the differences could be material. Additionally, changes in

the market environment and other events that may occur over the life of the investments may cause the gains or losses ultimately realized on these investments to be different than the valuations currently assigned. No single standard for determining fair value in good faith exists since 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.

Credit Information. We monitor a wide variety of key credit statistics that provide information regarding our portfolio companies to help us assess credit quality and portfolio performance. We require our portfolio companies to provide annual audited and monthly, unaudited financial statements. Using these statements, we calculate and evaluate the credit statistics. For purposes of analyzing the financial performance of our portfolio companies, we may make certain adjustments to their cash flow statements (EBITDA) to reflect the pro forma results of a company consistent with a change of control transaction, to reflect anticipated cost savings resulting from a merger or restructuring, costs related to new product development, compensation to previous owners, and other acquisition or restructuring related items.

Loan Grading and Risk Rating. As of December 31, 2002 we increased the scale of our loan grading system from one that had a scale of 1 to 4, to a scale that uses 0 to 10. This system is used to estimate the probability of default on our 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. We risk rate each of our debt securities. The risk rating system covers both qualitative and quantitative aspects of the business and the securities we hold.

We seek to have our risk rating system mirror the risk rating systems of major risk rating organizations such as those provided by nationally recognized statistical rating organizations ("NRSRO") as defined in Rule 2a-7 under the 1940 Act. While we seek to mirror the NRSRO systems, we cannot provide any assurance that our risk rating system provides the same risk rating as a NRSRO would if it were to rate the debt securities we hold. 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 we have established our system to rate 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. It is our understanding that most debt securities of middle market companies do not exceed the grade of BBB on a NRSRO scale; so there would be no debt securities in the middle market that would meet the definition of AAA (Aaa), AA (Aa2) or A (A2). Therefore, our scale begins with the designation BBB (Baa2) as the best risk rating.

Company's System	First NRSRO	Second NRSRO	Gladstone Capital's Description(a)
>10	Baa2	BBB	Probability of Default (PD) during the next ten years is 4% and the Expected Loss (EL) is 1% or less
10	Ba3	BBB-	PD is 5% and the EL is 1% to 2%
9	Ba1	BB+	PD is 10% and the EL is 2% to 3%
8	Ba2	BB	PD is 16% and the EL is 3% to 4%
7	Ba3	BB-	PD is 17.8% and the EL is 4% to 5%
6	B1	B+	PD is 22.0% and the EL is 5% to 6.5%
5	B2	B	PD is 25% and the EL is 6.5% to 8%
4	B3	B-	PD is 27% and the EL is 8% to 10%
3	Caa1	CCC+	PD is 30% and the EL is 10.0% to 13.3%
2	Caa2	CCC	PD is 35% and the EL is 13.3% to 16.7%
1	Caa3	CC	PD is 65% and the EL is 16.7% to 20%
0	N/A	D	PD is 85% or there is a Payment Default: and the EL is greater than 20%

(a) the default rates above are for a ten year term debt. If the maturity of the borrower's debt security is less than ten years then the probability of default is adjusted to a lower percentage for the shorter period which may move the security higher on the company's risk rating scale.

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At September 30, 2002, all debt investments were grade 3 under the 1-to-4 loan grading system. The rating of 3 on the 1-4 system means that the portfolio companies were performing as agreed and they have paid on time. Using the expanded scale, at December 31, 2002 the average debt security was risk rated 7.5 for all debt securities and the weighted average risk rating was 7.5 for all debt securities. The highest rated loan was 9.0 and the lowest was 6.0. The above scale gives an indication of the probability of default and the magnitude of the loss if there is a default using the expanded risk rating scale.

Our policy is to stop accruing interest on an investment if we determine that interest is no longer collectible. To date we have not placed any investments on non-accrual. At September 30, 2002 and December 31, 2002, no payments were past due on any of our debt securities. We do not risk rate our equity securities.

Valuation Methods. For debt securities, we first determine if there is a market for the debt security. If there is a market, then we will determine the value based on the market prices for the security, even if that market is not robust. At December 31, 2002 and September 30, 2002 there was no market for any of the debt securities we hold. If there is no market for the debt securities, then we begin with the risk rating designation of the security described above. Using the risk rating designation above, we seek to determine the value of the security as if we intended to sell the security in a current sale. To determine the current sale price of the security, we may use some or all of the following items: financial standing of the issuer of the security, comparison of the business and financial plan of the issuer with actual results, the cost of the security, the size of the security held as it relates to the liquidity of the market for such securities, contractual restrictions on the disposition of the security, pending public offering of the issuer of the security, pending reorganization activity affecting the issuer such as mergers or debt restructuring, reported prices of similar securities of the issuer or comparable issuers, ability of the issuer to obtain needed financing, changes in the economy affecting the issuer, recent purchases or sale of a security of the issuer, pricing by other buyers or sellers of similar securities, financial statements of the borrower, the type of security, cost at date of purchase, size of holding, discount from market value of unrestricted securities of the same class at the time of purchase, special reports prepared by analysts, information as to any transactions or offers with respect to the security, existence of merger proposals or tender offers affecting the securities, the collateral, the issuer's ability to make payments, the current and forecasted earnings of the issuer, sales to third parties of similar securities, statistical ratios compared to lending standards, statistical ratios compared to other similar securities and other pertinent factors.

For equity securities, we first determine if there is any market for the equity security. If there is a market, then we determine the value based on the market prices for the security, even if that market is not robust. At December 31, 2002 and September 30, 2002 there was no market for any of the equity securities we owned. If there is no market for the equity securities, then we use the same information we would use for a debt security valuation described above, as well as standard valuation techniques used by major valuation firms to value the equity securities of private companies. These valuation techniques consist of: discounted cash flow of the expected sales price in the future, the value of the securities based on the recent sale of comparable transactions and a review of similar companies that are publicly traded and the market multiple of their equity securities. At December 31, 2002 we had $37,000 invested in equity securities compared to our debt portfolio of $83,789,434.

Our new risk rating system is more detailed than our prior system. Due to the more detailed nature of the risk rating system there is the likelihood that future valuations will change more frequently.

Managerial Assistance Fees

The 1940 Act requires that a business development company make available managerial assistance to its portfolio companies. We provide managerial assistance to our portfolio companies in connection with our investments through our wholly owned subsidiary, Gladstone Advisers, Inc. and receive fees

for our managerial assistance services. These fees are normally paid at the closing of our investments in our portfolio companies, are generally non-recurring and are recognized as revenue when earned. The managerial assistance services we provide vary by investment, but generally consist of reviewing existing credit facilities, arranging bank financing, arranging equity financing, structuring financing from multiple lenders, structuring financing from equity investors, restructuring existing loans, raising equity and debt capital, and providing general financial advice. From time to time, we are invited to participate as a co-lender in a transaction. In the event that we do not provide significant managerial assistance services in connection with our investment, loan fees paid to us in such situations are deferred and amortized over the life of the loan.

RESULTS OF OPERATIONS

Explanatory Note

Beginning with the three months ended December 31, 2002, we changed certain terminology used in our consolidated statement of operations. For all periods prior to the three months ended December 31, 2002, we used the terms "operating income" and "net operating income" which should be treated as being synonymous with "investment income" and "net investment income," respectively, for the three months ended December 31, 2002 and future periods.

Comparison of the three months ended December 31, 2002 to the three months ended December 31, 2001

Investment Income

Investment income for the three months ended December 31, 2002 was approximately $3.2 million as compared to $1.7 million for the three months ended December 31, 2001. This increase was primarily a result of increased interest income from investments.

Interest income from our investments in debt securities of private companies was approximately $2.9 million for the three months ended December 31, 2002 as compared to $329,000 for the three months ended December 31, 2001. This increase was primarily a result of the increase in new investments of $41.8 million.

The weighted average yield on our portfolio for the three months ended December 31, 2002 was 13.36% (without giving effect to PIK interest) and 14.30% (after giving effect to PIK interest). The weighted average yield for the three months ended December 31, 2001 was 12.51%. There was no PIK interest recorded for the three months ended December 31, 2001. The weighted average portfolio outstanding including PIK for the fourth quarter was $81,863,584.

Interest income from invested cash and cash equivalents for the three months ended December 31, 2002 was approximately $198,000, as compared to $640,000 for the three months ended December 31, 2001. This decrease was primarily a result of the $41.8 million of new investments made between December 31, 2001 and December 31, 2002.

For the three months ended December 31, 2002, we recorded approximately $109,000 in interest income from loans to our employees in connection with the exercise of employee stock options, as compared to approximately $107,000 in interest income from such loans for the three months ended December 31, 2001. This increase was primarily a result of $186,000 in new employee loans.

Managerial assistance fees were $0 for the three months ended December 31, 2002, as compared to $611,809 for the three months ended December 31, 2001. This decrease was the result of no new investment closings during the quarter with related fees.

Operating Expenses

Operating expenses for the three months ended December 31, 2002 were approximately $823,000, as compared to approximately $492,000 for the three months ended December 31, 2001. This increase

was primarily a result of six new employees, new office space and operating expenses related to the increase in staff and overall operations.

Salaries and benefits for the three months ended December 31, 2002 were approximately $433,000, as compared to approximately $277,000 for the three months ended December 31, 2001. This increase was a result of the hiring of six new employees.

General and administrative expenses, consisting primarily of insurance, office operations, travel and stockholder related expenses for the three months ended December 31, 2002 were approximately $183,000, as compared to approximately $101,000 for the three months ended December 31, 2001. This increase was primarily a result of the related expenses to new employees and increased operations.

Professional fees, consisting primarily of legal and audit fees, for the three months ended December 31, 2002 were approximately $115,000, as compared to approximately $101,000 for the three months ended December 31, 2001. This increase was primarily a result of an increase in audit fees associated with more investments.

Rent expense for the three months ended December 31, 2002 was approximately $55,000, as compared to approximately $11,000 for the three months ended December 31, 2001. This increase was primarily a result of new office space acquired in September 2002.

Directors' fees for the three months ended December 31, 2002 were approximately $13,500, as compared to approximately $2,000 for the three months ended December 31, 2001. This increase was primarily a result of the accounting for the annual directors fee pro rated over the 2003 fiscal year.

We believe that our current level of operating expenses is not necessarily indicative of our future operating expenses. We estimate that over time, as we continue to more fully deploy the proceeds of our initial public offering, our operating expenses will be approximately two percent of our total assets (exclusive of temporary assets acquired near the end of a quarter for the purpose of satisfying regulatory requirements).

Net Investment Income

As a result of the investment income and operating expenses described above, we had net investment income of approximately $2.4 million for the three months ended December 31, 2002. Based on a weighted-average of 10,071,844 (basic) and 10,124,197 (diluted) shares outstanding, our net investment income per common share for the three months ended December 31, 2002 was $0.24 (basic) and $0.24 (diluted).

For the three months ended December 31, 2001, we had net investment income of approximately $1.2 million. Based on a weighted-average of 10,060,178 (basic) and 10,146,030 (diluted) shares outstanding, our net investment income per common share for the three months ended December 31, 2001 was $0.12 (basic) and $0.12 (diluted).

Unrealized appreciation and depreciation did not occur for the quarters ending December 31, 2001 and 2002. However, we expect that for the quarter ending March 31, 2003 there will be changes in the unrealized appreciation and depreciation as we become better at using our more detailed risk rating system. There were no realized gains or losses for the quarters ending December 31, 2001 or 2002.

Comparison of the fiscal year ended September 30, 2002 to the period from inception (May 30, 2001) through September 30, 2001

Operating Income

Operating income for the fiscal year ended September 30, 2002 was approximately $10.5 million as compared to $395,000 for the period from inception (May 30, 2001) through September 30, 2001. This increase was primarily a result of the inclusion of a full year of operations in the results for the 2002 fiscal year as contrasted to our limited operations during the prior period. In addition, during the 2002

fiscal year, we began investing the proceeds of our initial public offering in debt securities of private companies. These debt securities provide a higher yield than the short-term investment grade securities that represented substantially all of our assets as of September 30, 2001.

Interest income from our investments in debt securities of private companies was approximately $6.6 million for the fiscal year ended September 30, 2002, including $462,000 of PIK interest. Because we did not make any such investments prior to November 2001, we did not record interest income from debt securities of private companies for the period from inception through September 30, 2001.

The weighted average yield on our portfolio for the fiscal year ended September 30, 2002 was 13.82% (without giving effect to PIK interest) and 14.79% (after giving effect to PIK interest).

Interest income from invested cash and cash equivalents for the fiscal year ended September 30, 2002 was approximately $1.6 million, as compared to approximately $350,000 for the period from inception through September 30, 2001. This increase was primarily a result of our investment of the net proceeds of our initial public offering for the full year. By comparison, the results for the period from inception through September 30, 2001 include interest income earned on the investment of the net proceeds of our initial public offering from August 29, 2001 (the date of the closing of our initial public offering) through September 30, 2001. As we continue to acquire debt securities of private companies, which we anticipate will be at interest rates significantly greater than the rates that we are currently receiving on our deposited cash and cash equivalents, we expect that income from invested cash and cash equivalents will decline as a percentage of total revenue and that interest income from debt securities will increase and become our predominant source of revenue.

For the fiscal year ended September 30, 2002, we recorded approximately $433,000 in interest income from loans to our employees in connection with the exercise of employee stock options, as compared to approximately $45,000 in interest income from such loans for the period from inception through September 30, 2001. The increase is primarily the result of the inclusion in the results of operations for the year ended September 30, 2002 of a full year of interest income on the majority of such employee loans (which were made at the time of our initial public offering) and, to a lesser extent, the inclusion of interest income on employee loans entered into during the 2002 fiscal year. By comparison, the results for the period from inception through September 30, 2001 include interest earned on such employee loans from the time of exercise of such options (August 23, 2001) through September 30, 2001.

Managerial assistance fees were approximately $1.7 million for the fiscal year ended September 30, 2002. Fee income for the fiscal year ended September 30, 2002 consists primarily of managerial assistance fees received in connection with investments we closed during the fiscal year. It also includes approximately $47,000 in fees associated with a line of credit we extended to one of our portfolio companies that is no longer outstanding. Because we did not make any investments in debt securities of private companies prior to November 2001, we did not record any managerial assistance fee income for the period from inception through September 30, 2001.

Other income was approximately $131,000 for the fiscal year ended September 30, 2002. This amount was comprised of approximately $81,000 in up-front fees received in connection with five proposed investments that ultimately were not consummated and approximately $50,000 in other fees. Because we did not experience the termination of any such negotiations during the period from inception through September 30, 2001, we did not record any other income for such period.

Operating Expenses

Operating expenses for the fiscal year ended September 30, 2002 were approximately $2.8 million, compared to approximately $487,000 for the period from inception through September 30, 2001. This increase was primarily a result of the inclusion of a full year of operations in the results for the 2002 fiscal year, as contrasted to our limited operations during the period from inception through September 30, 2001. However, this increase was partially offset by substantial nonrecurring costs associated with the organization of the company and our commencement of operations incurred during the period from inception through September 30, 2001.

Salaries and benefits for the fiscal year ended September 30, 2002 were approximately $1.4 million, as compared to approximately $229,000 for the period from inception through September 30, 2001. This increase was primarily a result of the inclusion of a full year of operations in the results for the 2002 fiscal year, as contrasted to our limited operations during the period from inception through September 30, 2001. Salaries and benefits also increased as a result of our hiring additional employees during the year. We expect salaries and benefits to continue to increase as we hire additional personnel.

General and administrative expenses, consisting primarily of insurance, office operations, travel and stockholder related expenses, for the fiscal year ended September 30, 2002 were approximately $775,000, as compared to approximately $145,000 during the period from inception through September 30, 2001. This increase was primarily a result of the inclusion of a full year of operations in the results for the 2002 fiscal year, as contrasted to our limited operations during the period from inception through September 30, 2001. General and administrative expense also increased as a result of the general expansion of our operations during the year.

Professional fees, consisting primarily of legal and audit fees, for the fiscal year ended September 30, 2002 were approximately $550,000, as compared to approximately $72,000 during the period from inception through September 30, 2001. This increase was primarily a result of the inclusion of a full year of operations in the results for the 2002 fiscal year, as contrasted to our limited operations during the period from inception through September 30, 2001.

Rent expense for the fiscal year ended September 30, 2002 was approximately $125,000, as compared to approximately $3,000 during the period from inception through September 30, 2001. This increase was primarily a result of the inclusion of a full year of operations in the results for the 2002 fiscal year, as contrasted to our limited operations during the period from inception through September 30, 2001. This amount also increased as a result of our relocation of our principal executive offices following the completion of our initial public offering.

Directors fees for the fiscal year ended September 30, 2002 were approximately $22,000, as compared to approximately $38,000 during the period from inception through September 30, 2001. We anticipate that annual directors fees will approximate $18,000 per non-employee director over time.

We believe that our current level of operating expenses is not necessarily indicative of our future operating expenses. We estimate that over time, as we continue to more fully deploy the proceeds of our initial public offering, our operating expenses will be approximately two percent of our total assets (exclusive of temporary investments acquired near the end of a quarter for the purpose of satisfying regulatory requirements).

Net Operating Income

As a result of the operating income and operating expenses described above, we had net operating income of approximately $7.6 million for the fiscal year ended September 30, 2002. Based on a weighted-average of 10,064,900 (basic) and 10,166,752 (diluted) shares outstanding, our net operating income per common share for the fiscal year ended September 30, 2002 was $0.76 (basic) and $0.75 (diluted).

For the period from inception through September 30, 2001, we incurred a net operating loss of approximately $93,000. Based on a weighted-average of 3,219,525 shares outstanding, our net operating loss per common share for the period from inception through September 30, 2001 was $(0.03), basic and diluted.

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2002, we had investments in debt securities of, or loans to, seven private companies, totaling approximately $83.8 million of total investment assets. This number includes approximately $608,000 in accrued PIK interest, which, as described in "Overview," is added to the carrying value of our investments.

In January 2003, we closed a $5.5 million investment in Wing Stop Restaurants International, Inc., a franchiser of fast food chicken restaurants. The investment consisted of a loan with added income from a success fee if the business is successful. In February 2003, we closed in escrow a loan for $12 million and believe the escrow will be released and the loan will be funded in March 2003.

The following table summarizes, as of December 31, 2002, the contractual principal amortization and maturity of our investment portfolio by fiscal year:

Year	Amount
2003	$ 1,475,000
2004	$ 10,494,368
2005	$ 11,539,497
2006	$ 15,957,000
2007	$ 27,260,569
Thereafter	$ 17,100,000
Total	$ 83,826,434

Cash provided by operating activities for the fiscal year ended September 30, 2002, consisting primarily of the items described in "Results of Operations," was approximately $7.0 million. Net cash used in investing activities was approximately $40.2 million for the fiscal year ended September 30, 2002. The net cash used consisted of investments in our portfolio companies, partially offset by a net increase in cash of approximately $39.2 million in connection with repurchase agreements and the repayment, by our portfolio companies, of investments in principal amount of approximately $18.4 million. Net cash used in financing activities was approximately $6.7 million for the fiscal year ended September 30, 2002 and consisted primarily of the payment of dividends of approximately $6.0 million and the repayment of accrued costs of approximately $641,000 associated with our initial public offering.

Cash provided by operating activities for the three months ended December 31, 2002, consisting primarily of the items described in "Results of Operations," was approximately $2.2 million. Net cash used in investing activities was approximately $3.9 million during the three months ended December 31, 2002. The net cash used consisted of investments in our portfolio companies of $4.0 million, partially offset the repayment, by our portfolio companies, of investments in principal amount of $100,000. Net cash used in financing activities was approximately $2.1 million for the three months ended December 31, 2002 and consisted of the payment of dividends.

During the fiscal year ended September 30, 2002, cash and cash equivalents decreased from approximately $131.8 million at the beginning of the year to approximately $91.9 million at the end of the year. This decrease of approximately $39.9 million was largely the result of our investing activities, partially offset by an increase in cash and cash equivalents in connection with a repurchase agreement.

During the three months ended December 31, 2002, cash and cash equivalents decreased from approximately $91.9 million at the beginning of the period to approximately $88.1 million at the end of the period. This decrease of approximately $3.8 million was largely the result of our new $4.0 million investment.

On December 31, 2002, we entered into a repurchase agreement with UBS Paine Webber for approximately $40.0 million. The repurchase agreement was fully collateralized by a United States

treasury bill with a fair value of approximately $40.0 million that matured on January 9, 2003. The interest rate on the repurchase agreement was 1.18%. This repurchase agreement was reflected on our balance sheet as of December 31, 2002 as an increase in cash and cash equivalents pledged to creditors of $40.0 million, along with a corresponding liability for approximately the same amount. The repurchase agreement was settled on January 2, 2003. In the future, we plan to use a similar form of repurchase agreement as an investment option or in order to satisfy certain asset diversification requirements and maintain our status as a RIC.

In order to qualify as a regulated investment company and to avoid corporate level tax on the income we distribute to our stockholders, we are required, under Subchapter M of the Internal Revenue 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 quarterly cash dividends of $0.18, $0.21, $0.21 and $0.21 per share on our common stock for the first, second, third and fourth quarters, respectively, of the fiscal year ended September 30, 2002 and $0.23 per share for the quarter ended December 31, 2002.

Aggregate dividends declared and paid for the 2002 fiscal year were approximately $8.2 million. We declared these dividends based upon our estimate of net operating income for the year. Because of the difficult economic climate during the year, our investment pace was slower than we had originally anticipated, and consequently, our net operating income was lower than we had originally projected. This resulted in our dividends related to our 2002 fiscal year exceeding our net operating income for the year by approximately $0.5 million. Additionally, dividends related to our 2002 fiscal year exceeded our current and accumulated earnings and profits and, as a result, a portion of our dividends will be treated as a return of capital to our stockholders.

We anticipate borrowing funds and issuing additional equity securities to obtain additional capital once the proceeds of our initial public offering have been fully invested. We also intend to pursue a strategy of securitizing our loan portfolio in approximately one to two years. We would use the cash we receive upon the sale of interests in our loans to repay bank borrowings and make additional loans. We can not assure you that this securitization strategy will be successful.

Quantitative and Qualitative Disclosure About Market Risk

We are subject to financial market risks, including changes in interest rates. We expect that ultimately approximately 50% of the loans in our portfolio will be made at fixed rates, with approximately 50% made at variable rates, however, to date all but one of our loans have been made at fixed rates.

We expect to borrow funds to finance future lending activities after we have substantially fully invested the proceeds of our initial public offering. These future borrowings may be at fixed rates or variable rates. To date, we have not yet borrowed any funds.

We expect to hedge against interest rate fluctuations in the future by using standard hedging instruments such as futures, options and forward contracts. While hedging activities may insulate us against adverse fluctuations in interest rates, they may also limit our ability to participate in the benefits of lower interest rates with respect to our portfolio of investments.

BUSINESS

Gladstone Capital Corporation is a specialty finance company that was incorporated under the General Corporation Laws of the State of Maryland on May 30, 2001 and that commenced its initial public offering on August 24, 2001. Our investment objectives are to achieve a high level of current income by investing in debt securities, consisting primarily of senior term debts, senior subordinated term debts and junior subordinated term debts, of established private businesses that are backed by leveraged buyout funds, venture capital funds or others. In some instances some of the senior term debts may be "last out tranches" meaning our debt is part of the senior term debt but is paid last from those payments coming to the senior term debt holders if the borrower is liquidated. We also provide first and second mortgage debt secured by business real estate. We normally do not provide revolving lines of credit. In addition, we may acquire existing loans made by others if those loans meet our profile. We also seek to provide our stockholders with long-term capital growth through the appreciation in the value of warrants, success fees or other equity-type instruments that we may receive when we provide debt. Our headquarters are in McLean, Virginia, a suburb of Washington, DC and we have offices in New York, New York and Pittsburgh, Pennsylvania. We have elected to be treated as a business development company under the 1940 Act.

David Gladstone, our chairman and chief executive officer, has over 25 years experience in making loans to and investing in small and medium sized companies at Gladstone Capital Corporation, Allied Capital Corporation and American Capital Strategies. Allied Capital Corporation is a publicly traded subordinated debt lender and American Capital Strategies is a publicly traded buyout and subordinated debt lender.

Terry Lee Brubaker, our president and chief operating officer, has over 25 years experience in acquisitions and managing companies after the acquisition. Prior to joining Gladstone Capital Corporation, he was a member of the management team that designed and implemented the acquisition strategy of James River Corporation.

Our chief financial officer, Harry Brill, brings significant experience from his role as the chief accounting officer of Allied Capital where he was responsible for the public filings of a family of five public companies and oversaw the preparation of the operating reports and financial statements of these companies and three private funds.

In addition to Messrs. Gladstone and Brubaker, we currently have a chief investment officer, George Stelljes, III, and five principals who are involved in structuring and arranging financing for small and medium sized businesses. As our business expands, we plan to hire additional principals with business lending experience. We believe that the expertise of our investing principals will help us to be successful in lending to small and medium sized businesses.

We typically make loans to companies that are substantially owned by leveraged buyout or venture capital funds. Messrs. Gladstone and Brubaker have an extensive referral network of venture capitalists, leveraged buyout funds, investment bankers, attorneys, commercial bankers and business and financial brokers. We believe that these entities have been and will continue to be an important source of loan opportunities. We intend to enter into additional informal relationships with other leveraged buyout funds and venture capital funds, but we can not assure you that we will be able to do so or that any such relationships will lead to the origination of loans.

We have a wholly owned subsidiary, Gladstone Advisers, Inc., through which we conduct our day-to-day administrative functions and provide managerial assistance to our portfolio companies.

Strategy

Our strategy is to make loans at favorable interest rates to small and medium sized businesses that we believe have traditionally been underserved by conventional lenders. We use the loan referral

networks of Messrs. Gladstone, Brubaker and Stelljes and of our principals to identify and make senior and subordinated loans to selected businesses that we believe do not have sufficient access to traditional sources of lending. We make loans to borrowers that need funds to finance growth, restructure their balance sheets or effect a change of control, all of which we believe are typically underserved by banks and other traditional institutional lenders. Our business strategy contemplates that we will achieve a high level of current income by investing in debt securities, consisting primarily of senior term debts, senior subordinated term debts and junior subordinated term debts, of established private businesses that are backed by leveraged buyout funds, venture capital funds or others. In addition, we may acquire existing loans made by others that meet our profile. We also seek to provide our stockholders with long-term capital growth through the appreciation in the value of warrants, success fees or other equity-type instruments that we may receive when we provide debt. Our financial plan presumes that (1) the net capital gains from the sale of the warrants (as well as other profit enhancements) we receive in connection with our lending activities will exceed any losses we may experience from loans that are not repaid and (2) the managerial assistance fee income we derive from assisting our portfolio companies will provide us with a source of revenue that approximates our operating expenses (excluding interest expense). We cannot assure you that we will be able to achieve our investment objectives or that our business strategy will be successful.

We believe that we are well positioned to provide financing to small and medium sized businesses that are undergoing a change of ownership, including management-led and third party leveraged buyouts, and to those businesses that have good growth characteristics. We are not burdened with the capital and other regulatory requirements of the banking and savings and loan industries and we have relatively low overhead and administrative expenses. Moreover, our strategy of accepting warrants to purchase stock of our borrowers is intended to closely align our interests with those of our portfolio companies, thereby reducing transaction costs, conveying our commitment to the borrowers and enhancing our attractiveness as a financing source. Perhaps most importantly, we believe that we have the experience and expertise to satisfy the financing needs of such businesses. In particular, we believe that we benefit from Mr. Gladstone's 25 years of experience in financing small to medium sized private businesses and Mr. Brubaker's extensive experience in acquisitions and operations to realize a competitive advantage. We believe that our established network of loan referral sources, consisting of relationships established over many years by Messrs. Gladstone, Brubaker, Stelljes and our principals will generate opportunities to identify and make senior and subordinated loans to selected businesses that satisfy our investment criteria. We intend to enter into additional informal relationships with leveraged buyout funds and venture capital funds, but we can not give any assurance that we will be able to do so. We target small and medium sized private businesses that meet certain criteria, including the potential for growth, adequate assets for loan collateral, experienced management teams with significant ownership interest in the business, adequate capitalization, profitable operations based on cash flow and potential opportunities for us to realize appreciation and gain liquidity in our various equity positions. 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 buy back our warrants, although we can not assure you that we will always have these rights.

As a business development company, we make available significant managerial assistance to our portfolio companies. Such assistance will typically involve closely monitoring the operations of each borrower, participating in its board and management meetings, being available for consultation with its officers and providing organizational and financial guidance.

We typically invest in senior, senior subordinated and junior subordinated notes. Our loans typically range from $5 million to $15 million, mature in no more than seven years and accrue interest at a fixed or variable rate that exceeds the prime rate. A number of our loans have a provision that calls for some portion of the interest payments to be deferred and added to the principal balance so that the interest is paid, together with the principal, at maturity. This form of deferred interest is often called "paid in kind" (or "PIK") interest, and, when earned, we record PIK interest as interest income and add the PIK interest to the principal balance of the loans.

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

To the extent possible, our loans generally are collateralized by a security interest in the borrower's assets though we may not have the first claim on these assets. Interest payments on loans we make will generally be made monthly or quarterly with amortization of principal generally being deferred for several years. The principal amount of the loans and any accrued but unpaid interest will generally become due at maturity at five to seven years. We will focus on making loans accompanied by warrants to purchase stock in the borrowers. These warrants will typically have an exercise price equal to the fair value of the portfolio company's common stock at the time of the loan and entitle us to purchase a modest percentage of the borrower's stock.

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

As noted above, we expect to receive warrants to purchase stock in many of our borrowers. If a financing is successful, not only will our debt securities have been repaid with interest, but we will be in a position to realize a gain on the accompanying equity interests. The opportunity to realize such gain may occur if the borrower is sold to new owners or if it makes a public offering of its stock. In most cases, we will not have the right to require that a borrower undergo an initial public offering by registering securities under the Securities Act of 1933, to which we refer as the Securities Act, but we generally will have the right to sell our equity interests in any subsequent public offering by the borrower. Even when we have the right to participate in a borrower's public offering, the underwriters might insist, particularly if we own a large amount of equity securities, that we retain all or a substantial portion of our shares for a specified period of time. Moreover, we may decide not to sell an equity position even when we have the right and the opportunity to do so. Thus, although we expect to dispose of an equity interest after a certain time, situations may arise in which we hold equity securities for a longer period.

In certain cases, we may receive the right, to which we refer as a put right, to require the borrower to repurchase the warrants from us. When no public offering is available, we may exercise our put rights to dispose of our equity interest in the borrower, although our ability to exercise put rights may be limited or nonexistent if a business does not have the money to repurchase our warrants. Similarly, we anticipate that we may obtain the right, to which we refer as an unlocking right, to require that the borrower purchase our warrants or stock if it rejects a bona fide third party acquisition offer. The unlocking rights may allow us to sell our equity interests back to the borrower at the price offered by the potential acquirer.

In addition to the put rights and unlocking rights described above, when one of our portfolio companies does go public, we may undertake hedging strategies with regard to our equity interests in it. We may mitigate risks associated with the volatility of publicly traded securities by, for instance, selling securities short or writing or buying call or put options. Hedging against a decline in the value of such investments in public companies would not eliminate fluctuations in the values of such investments or

prevent losses if the values of such investments decline, but would establish other investments designed to gain from those same developments. Therefore, by engaging in hedging transactions we can moderate the decline in the value of our hedged investments in public companies. However, such hedging transactions would also limit our opportunity to gain from an increase in the value of our investment in the public company. While we currently hold no securities of any publicly traded companies, and therefore have no immediate plans to undertake any such hedging activities, it may be prudent for us to do so in the future. Hedging strategies do pose risks to us and our stockholders, however we believe that such activities, because they will be limited to only a portion of our portfolio, are manageable.

Moreover, Section 12(a)(3) of the 1940 Act prohibits us "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 . . . to effect a short sale of any security. . . ."

However, to date, the SEC has not promulgated regulations under this statute. It is possible that such regulations could be promulgated in the future in a way that would require us to change any hedging strategies that we may adopt. We will only engage in any hedging activities in compliance with applicable law and regulations.

Selection of Loan Opportunities

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

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

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

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

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

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

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

Loan Origination Process

To originate loans, our lending officers use an extensive referral network comprised of venture capitalists, leveraged buyout funds, investment bankers, attorneys, accountants, commercial bankers and business brokers. We intend to enter into additional informal relationships with leveraged buyout funds and venture capital funds, but we can give no assurance that we will be able to do so.

Approval Process

Our lending professionals review informational packages in search of potential financing opportunities and conduct a due diligence investigation of each applicant that passes an initial screening process. This due diligence investigation generally includes one or more on-site visits, a review of the potential borrower's historical and projected financial information, interviews with management, employees, customers and vendors of the applicant and background checks and research on the applicant's product, service or particular industry. Upon completion of the due diligence investigation, our financial professional creates a borrower profile summarizing the prospective borrower's historical financial statements, industry and management team and analyzing its conformity to our general investment criteria. Our lending professional then presents this profile to our credit committee, which is comprised of David Gladstone and Terry Lee Brubaker. Our credit committee must unanimously approve each loan and each member of our board of directors must review each financing.

Temporary Investments

Pending investment in other types of "qualifying assets," we invest our otherwise uninvested cash primarily in cash, cash items, government securities or high quality debt securities maturing in one year or less from the time of investment, to which we refer collectively as temporary investments, so that 70% of our assets are qualifying assets. For information regarding regulations to which we are subject and the definition of "qualifying assets," see "Regulation." Typically, we invest in US Treasury bills or in repurchase obligations of a "primary dealer" in government securities, as designated by the Federal Reserve Bank of New York, or of any other dealer whose credit has been established to the satisfaction of our board of directors. There is no percentage restriction on the proportion of our assets that may be invested in such repurchase agreements. A repurchase agreement involves the purchase by an investor, such as us, of a specified security and the simultaneous agreement by the seller to repurchase it at an agreed-upon future date and at a price which is greater than the purchase price by an amount that reflects an agreed-upon interest rate. Such interest rate is effective for the period of time during which the investor's money is invested in the arrangement and is related to current market interest rates rather than the coupon rate on the purchased security. Our custodian, or the correspondent in its account with the Federal Reserve/Treasury Book Entry System, will be required to constantly maintain underlying securities in an amount at least equal to the repurchase price. If the seller were to default on its repurchase obligation, we might suffer a loss to the extent that the proceeds from the sale of the underlying security were less than the repurchase price. A seller's bankruptcy could delay or prevent a sale of the underlying securities. Our board of directors has established procedures, which it will review periodically, requiring us to monitor the creditworthiness of the dealers with which we enter into repurchase agreement transactions.

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 and 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 financial, technical and marketing resources than we do. For example, some competitors may have a lower cost of funds and access to funding sources that are not available to us. In addition, certain of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments, 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. We cannot assure you that the competitive pressures we face will not have a material adverse effect on our business, financial condition and results of operations.

Employees

We currently have fifteen employees. We believe that our relations with our employees are excellent. We intend to hire additional professionals with business lending experience as our business grows and to maintain a relatively low level of overhead by outsourcing most job functions not directly related to marketing, underwriting our investments or executive management.

Leverage

For the purpose of making investments other than temporary investments and to take advantage of favorable interest rates, we intend to issue senior securities, up to the maximum amount permitted by the 1940 Act. The 1940 Act currently permits us to issue debt securities and preferred stock, which we refer to collectively as senior securities, in amounts such that our asset coverage, as defined in the 1940 Act, is at least 200% after each issuance of senior securities. We may also incur such indebtedness to repurchase our common stock. As a result of issuing senior securities, we would become 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 if we borrow money to make investments. There is a possibility that the costs of borrowing could exceed the income we receive on the investments we make with such borrowed funds. In addition, our ability to pay dividends or incur additional indebtedness would be restricted if asset coverage is less than twice our indebtedness. If the value of our assets declines, we might be unable to satisfy that test. If this happens, we may be required to liquidate a portion of our loan portfolio and repay a portion of our indebtedness at a time when a sale may be disadvantageous. Furthermore, any amounts that we use to service our indebtedness will not be available for distributions to our stockholders. Our board of directors is authorized to provide for the issuance of preferred stock with such preferences, powers, rights and privileges as it deems appropriate, except that such an issuance must adhere to the requirements of the 1940 Act. See "Regulation Business Development Company Asset Coverage" for a discussion of leveraging constraints. We do not intend to leverage ourselves so long as we hold cash or temporary investments in an amount sufficient to fund the investments, other than temporary investments, we plan to make in the next nine months.

Securitization

In an effort to increase our returns and the number of loans that we can make, we anticipate that we will seek to securitize our loans. To securitize loans, we would create a wholly-owned subsidiary and contribute a pool of loans to it. Then we would seek to have the pool of loans in the subsidiary rated by rating agencies. Once the pool of loans is rated, we would sell interests in the pool of loans to purchasers who we would expect to be willing to accept a lower interest rate to invest in investment-grade loan pools. We would use the proceeds of such sales to pay down bank debt or to make or purchase new loans. There are risks associated with this strategy since we intend to retain the non-investment grade portion of the subsidiary, rather than to securitize it, and the unrated portion of the subsidiary is the one most likely to generate losses. We do not intend to securitize any warrants we receive in connection with any loans we make.

Investment Objectives and Policies

We seek to achieve a high level of current income by investing in debt securities, consisting primarily of senior term debts, senior subordinated term debts and junior subordinated term debts, of established private businesses that are backed by leveraged buyout funds, venture capital funds or others. In some instances some of the senior term debts may be "last out tranches" meaning our debt is part of the senior term debt but is paid last from those payments coming to the senior term debt holders if the borrower is liquidated. We also provide first and second mortgage debt secured by business real estate. We normally do not provide revolving lines of credit. In addition, we may acquire existing loans made by others if those loans meet our profile. We also seek to provide our stockholders with long-term capital growth through the appreciation in the value of warrants, success fees or other equity-type instruments that we may receive when we provide debt. The following restrictions, along with these investment objectives, are our only fundamental policies, which are policies that may not be changed without the approval of the holders of the majority of our outstanding voting securities, as defined in the 1940 Act. For a fuller explanation of the regulatory framework in which we operate, see "Regulation." The percentage restrictions set forth below, other than the restriction pertaining to the issuance of senior securities, as well as those contained elsewhere in this prospectus, apply at the time we effect a transaction and a subsequent change in a percentage resulting from market fluctuations or any cause other than an action by us will not require us to dispose of portfolio securities or to take other action to satisfy the percentage restriction. We will at all times conduct our business so as to retain our status as a business development company. In order to retain that status, we may not acquire any assets (other than non-investment assets necessary and appropriate to our operations as a business development company) if after giving effect to such acquisition the value of our "qualifying assets" is less than 70% of the value of our total assets. We anticipate that the securities we seek to acquire (provided that we control or, through our officers or other participants in the financing transaction, make significant managerial assistance available to the issuers of these securities), as well as temporary investments, will generally be qualifying assets.

We may invest up to 100% of our assets in securities acquired directly from issuers in privately negotiated transactions. With respect to such securities, we may, for the purpose of public resale, be deemed an "underwriter" as that term is defined in the Securities Act. We may invest up to 20% of our assets in securities of a particular issuer. We may exceed this limitation in connection with bridge financings, although these bridge investments will never exceed 25% of our total assets at any time. We do not intend to concentrate our investments in any particular industry or group of industries. However, 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% of the value of our total assets.

We will at all times endeavor to conduct our business so as to retain our status as a regulated investment company under Subchapter M of the Internal Revenue Code of 1986 (the "Code"). In order to do so, we must meet income source, asset diversification and annual distribution requirements. We may issue senior securities, such as debt or preferred stock, to the extent permitted by the 1940 Act for the purpose of making investments, to fund share repurchases, or for temporary emergency or other purposes. For a discussion of the risks associated with the resulting leverage, see "Business Leverage" and Risk Factors Our business is dependent upon external financing which may expose us to the risks associated with leverage."

We will not (1) act as an underwriter of securities of other issuers (except to the extent that we may be deemed an "underwriter" of securities we purchase that must be registered under the Securities Act before they may be offered or sold to the public); (2) purchase or sell real estate or interests in real estate or real estate investment trusts (except that we may (a) purchase and sell real estate or interests in real estate in connection with the orderly liquidation of investments, (b) own the securities of companies or participate in a partnership or partnerships that are in the business of buying, selling or developing real estate or (c) finance the purchase of real estate by our portfolio companies); (3) sell

securities short (except with regard to managing the risks associated with publicly-traded securities issued by our portfolio companies); (4) purchase securities on margin (except to the extent that we may purchase securities with borrowed money); (5) write or buy put or call options (except (a) to the extent of warrants or conversion privileges in connection with our acquisition financing or other investments and rights to require the issuers of such investments or their affiliates to repurchase them under certain circumstances, (b) with regard to managing risks associated with publicly-traded securities issued by our portfolio companies or (c) with regard to managing the risks associated with interest rate fluctuations); (6) engage in the purchase or sale of commodities or commodity contracts, including futures contracts (except where necessary in working out distressed loan or investment situations or in managing the risks associated with interest rate fluctuations); or (7) acquire more than 3% of the voting stock of, or invest more than 5% of our total assets in, any securities issued by any other investment company (except as they may be acquired as part of a merger, consolidation or acquisition of assets). That portion of our investments that is in securities issued by other investment companies may subject our stockholders to additional expenses.

Investment Advisor

We have no investment advisor and are internally managed by our executive officers under the supervision of our board of directors.

PORTFOLIO COMPANIES

The following table sets forth certain information as of February 27, 2003, regarding each portfolio company in which we currently have a debt or equity security. All such investments have been made in accordance with our investment policies and procedures described in this prospectus.

Name and Address of Portfolio Company	Nature of Business	Type of Security	% of Class Owned on a Fully Diluted Basis (1)	Cost or Initial Value of Investment	Value of Investment as of December 31, 2002
ARI Holdings, Inc. 1600 N. Kramer Blvd. Anaheim, CA 92806	Manufacturing auto parts	Jr. Subordinated Term Debt		$ 8,354,368	$ 8,354,368
Finn Corporation 9281 LeSaint Drive Fairfield, OH 45014	Manufacturing landscape equipment	Sr. Subordinated Term Debt Common Stock Warrants	 2%	$ 10,500,000 $ 37,000	$ 10,500,000 $ 37,000
Home Care Supply, Inc. 2155 IH-10 East Beaumont, TX 77701	Medical equipment rental	Sr. Term Debt		$ 18,000,000	$ 18,000,000
Kozy Shack Enterprises, Inc. 83 Ludy Street Hicksville, NY 11802	Food preparations and sales	Sr. Term Debt		$ 4,200,000	$ 4,200,000
Marcal Paper Mills, Inc. One Market Street Elmwood Park, NJ 07407	Manufacturing paper products	Sr. Term Debt First Mortgage Debt		$ 7,500,000 $ 9,099,497	$ 7,500,000 $ 9,099,497
Coyne International Enterprises Corp. 140 Cortland Avenue Syracuse, NY 13202	Uniform cleaning and rental	Sr. Term Debt		$ 20,135,569	$ 20,135,569
Inca Metal Products Corporation 501 East Purnell St. Lewisville, TX 75067	Material handling and storage products	Sr. Term Debt		$ 6,000,000	$ 6,000,000
Wing Stop Restaurants International, Inc.	Restaurant franchisor	Sr. Term Debt		$ 5,500,000	n/a (2)

(1) Percentages shown for warrants held represent the percentage of class of security we may own, on a fully diluted basis, assuming we exercise our warrants.

(2) Our investment in Wing Stop Restaurants International, Inc. was made on January 10, 2003. Therefore, this investment was not considered in the board's quarterly valuation of our assets as of December 31, 2002. In accordance with SEC regulations, our board of directors will value this investment quarterly beginning on March 31, 2003.

Set forth below is a brief description of each portfolio company in which we have made an investment that represents greater than 5% of our total assets. Because of the relative size of our investments in these companies, we are exposed to a greater degree to the risks associated with these companies.

ARI Holdings, Inc.

In exchange for a loan of approximately $8 million, we received a senior subordinated debt interest in ARI Holdings, Inc. The interest rate on our loan to ARI is 13% per annum plus 5% paid-in-kind, or PIK, interest. The loan matures in December 2003.

Founded in 1997, ARI is one of the largest remanufacturers of auto parts in the United States and ranks second in each of its product lines. ARI rebuilds and sells under-car automobile parts that are subject to high wear, including axles, brake calipers and pads and power steering components. ARI rebuilds parts at facilities in California, Arizona, Ohio and Canada using conventional technology and sells the parts to installers and distributors throughout the United States.

Because this investment constitutes approximately 6.3% of our total assets, we are significantly exposed to the risks associated with ARI's business. In particular, the automotive remanufacturing industry in which ARI competes is very competitive and certain competitors and potential competitors have greater financial resources than it does. In 2001, 58% of ARI's sales were consolidated among five customers. Any loss of a significant customer by ARI could adversely impact ARI and its ability to repay our loan, which would likely have an adverse impact on us.

Three Cities Research, a private equity firm, owns a controlling interest in ARI with 62% ownership.

ARI's principal executive office is located at 1600 N. Kramer Boulevard, Anaheim, California 92806.

Finn Corporation

In exchange for a loan of $10.5 million, we received a senior subordinated debt interest in Finn Corporation. The interest rate on our loan to Finn is 13% per annum and we have a warrant to purchase two percent of Finn's stock on a fully diluted basis for a nominal exercise price. The loan matures in February 2006.

Finn Corporation was founded in 1932 and is a leading designer, manufacturer and marketer of landscape and erosion control equipment. Finn's product line includes HydroSeeders , straw blowers, bark blowers, compact skid steers and other related products and services, which it manufactures in two plants in Ohio and Oregon using conventional technology. Finn is the dominant competitor in each of its main product lines, holding from 41% to 94% share of the national market.

Because this investment constitutes approximately 7.9% of our total assets, we are significantly exposed to the risks associated with Finn's business. In particular, the landscape and erosion control equipment market in which Finn competes is very cyclical and dependent upon new commercial construction. In 2001, less than 50% of Finn's sales were consolidated among ten customers with no single customer accounting for more than 9% of sales. However, any loss of a significant customer or downturn in construction spending could have a materially adverse impact on Finn and its ability to repay our loan, which would likely have an adverse impact on us.

Three Cities Research, a private equity firm, purchased Finn in July 1998 and is its majority stockholder, owning approximately 89% of the company's stock.

Finn's principal executive office is located at 9281 LeSaint Drive, Fairfield, Ohio 45014.

Home Care Supply, Inc.

In exchange for a loan of $18 million, we received a senior subordinated debt interest in Home Care Supply, Inc. The interest rate on our loan to Home Care Supply is 12% per annum. The loan matures in June 2008.

Founded in 1998 by the senior management team and private equity firm, Harvest Partners, Home Care Supply rents and sells medical equipment to patients who are in home medical care. It competes in a number of business segments, including respiratory therapy, durable medical equipment and rehab mobility. In addition, Home Care Supply provides services such as infusion therapy, respiratory drug distribution and equipment customization. Home Care Supply is building a network of homecare

equipment and supply distributors through a series of business acquisitions, having completed 31 to date, using standardized procedures, and central billing to ensure compliance and to manage receivables. The company has a highly diversified customer base served from 52 branch locations across the United States.

Because this investment constitutes approximately 13.5% of our total assets, we are significantly exposed to the risks associated with Home Care Supply's business. In particular, the company's acquisition strategy presents potential integration difficulties and potential for billing compliance issues with Medicare and Medicaid. In addition, the threat of Medicare cuts and competitive bidding could compress margins and jeopardize its ability to repay our loan, which would likely have an adverse impact on us.

Home Care Supply is owned by the Harvest Group, which holds 98% of the company's common stock.

Home Care Supply's principal executive office is located at 2155 IH-10 East, Beaumont, TX 77701.

Marcal Paper Mills, Inc.

In exchange for two separate loans in the aggregate principal amount of $16.5 million, we received debt interests in Marcal Paper Mills, Inc. These loans were part of a larger recapitalization of Marcal that consisted of four tranches of debt: a senior loan, a senior subordinated loan, a junior subordinated loan and a first mortgage loan facility. We provided a senior subordinated loan in the amount of $7.5 million, which represents half of the $15 million senior subordinated debt received by Marcal as part of its recapitalization. The interest rate on the senior subordinated loan is 13% per annum and the loan matures in December 2006. We also provided $9 million of the first mortgage facility, which represents half of the total $18 million first mortgage received by Marcal as part of the recapitalization. The interest rate on the first mortgage facility is 16% per annum plus a 1% PIK interest. The loan matures in December 2004 but may be extended for up to two additional years.

Founded in 1932, Marcal manufacturers and markets value priced paper products to wholesalers and retailers in the northeast and mid-Atlantic United States. The company produces a range of towel and tissue products including napkins, bath tissue, facial tissue and paper towels. Marcal is a strong regional brand with market share ranging from 9% to 24% for individual product lines. No single customer accounts for more than 9% of Marcal's sales and its ten largest customers account for 49% of sales.

Marcal also operates a small business that produces coated wax paper at a converting plant located in Chicago. In this segment, Marcal is one of two leading producers of wax paper in the United States with national distribution.

Because this investment constitutes approximately 12.4% of our total assets, we are significantly exposed to the risks associated with Marcal's business. In particular, certain of Marcal's competitors and potential competitors have greater financial resources and market share than it does. In addition, Marcal's financial performance is very sensitive to fluctuations in industry capacity utilization and intense price competition that typifies a commodity industry in which competitors utilize similar technology and sell similar products. Any sustained downturn in the economy or loss of a significant customer could adversely affect Marcal and its ability to repay our loan, which would likely have an adverse impact on us.

Marcal is 100% owned by the Marcalus family.

Marcal's principal executive office is located at One Market Street, Elmwood Park, NJ 07407.

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Coyne International Enterprises Corp.

In exchange for a loan of $20 million, we received a senior subordinated debt interest in Coyne International Enterprises Corp. The interest rate on our loan to Coyne is 13% per annum plus a 2% PIK interest. The loan matures in July 2007.

Founded in 1929, Coyne provides uniform rental and cleaning services for uniform and career apparel, protective clothing, dust control products, shop towels and other reusable absorbent products to customers mainly in the industrial segment of the textile rental industry. The products are typically rented under three to five year rental service agreements. Coyne processes more than two million work garments, seven million shop towels, and several hundred thousand gloves, floor mats and dust mops each week. Coyne markets to 45,000 customers, with the ten largest customers representing 14% of sales and no one customer accounting for more than 7% of sales. Coyne is the fourth largest competitor in this segment, holding a 4% market share.

Because this investment constitutes approximately 15.1% of our total assets, we are significantly exposed to the risks associated with Coyne's business. In particular, the textile rental industry in which Coyne competes is very fragmented and competitive and dependent on overall economic growth and employment. In addition, Coyne is highly leveraged with $42 million in debt and $3.8 million in equity.

The Coyne family founded and owns 100% of Coyne.

Coyne's principal executive office is located at 140 Cortland Avenue, Syracuse, NY 13202.

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MANAGEMENT

Our business and affairs are managed under the direction of our board of directors. Our board of directors currently consists of six members, four of whom are not "interested persons" of Gladstone Capital Corporation as defined in Section 2(a)(19) of the 1940 Act, who we refer to as our independent, or non-interested, directors. Our board of directors elects our officers who serve at the discretion of the board of directors. The address of each of the executive officers and directors is c/o Gladstone Capital Corporation, 1616 Anderson Road, Suite 208, McLean, Virginia 22102.

Executive Officers and Directors

Our executive officers and directors and their positions are set forth below:

Name	Age	Position(s)
Interested Directors and Executive Officers		
David Gladstone	60	Chairman of the Board of Directors and Chief Executive Officer (1)(4)
Terry Lee Brubaker	58	President, Chief Operating Officer and Director (1)
Harry Brill	55	Chief Financial Officer and Treasurer (1)
George Stelljes, III	40	Chief Investment Officer (1)
Non-Interested Directors		
David A.R. Dullum	54	Director (2)(3)(4)
Anthony W. Parker	56	Director (2)(3)
Michela A. English	52	Director (3)
Paul W. Adelgren	60	Director

(1) Interested person as defined in Section 2(a)(19) of the 1940 Act.

(2) Member of the compensation committee.

(3) Member of the audit committee.

(4) Member of the executive committee.

The following is a summary of certain biographical information concerning our executive officers, principals and directors:

Interested Directors and Executive Officers

David Gladstone. Mr. Gladstone is a founder of Gladstone Capital Corporation and has been our chief executive officer and chairman of our board of directors since inception. Mr. Gladstone's current term as director is scheduled to expire at our 2004 annual meeting of stockholders. Prior to founding Gladstone Capital Corporation, Mr. Gladstone served as either chairman or vice chairman of the board of directors of American Capital Strategies, a publicly traded leveraged buyout fund and mezzanine debt finance company, from June 1997 to August 2001. From 1974 to February 1997, Mr. Gladstone held various positions, including chairman and chief executive officer, with Allied Capital Corporation, Allied Capital Corporation II, Allied Capital Lending Corporation, Allied Capital Commercial Corporation and Allied Capital Advisors Inc. The Allied companies were the largest group of publicly traded mezzanine debt funds and were managers of two private venture capital limited partnerships. From 1992 to 1997, Mr. Gladstone served as a director, president and chief executive officer of Business Mortgage Investors, a private mortgage REIT managed by Allied Capital. Mr. Gladstone served as a director of The Riggs National Corporation (the parent of Riggs Bank) from 1993 to May 1997. He has served as a trustee of The George Washington University and currently is a trustee