GLADSTONE INVESTMENT CORPORATION\DE
Form 10-Q
February 06, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTER ENDED DECEMBER 31, 2006

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

COMMISSION FILE NUMBER: 000-51233

GLADSTONE INVESTMENT CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE	**83-0423116**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1521 WESTBRANCH DRIVE, SUITE 200

MCLEAN, VIRGINIA 22102

(Address of principal executive office)

(703) 287-5800

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer o Non-accelerated filer x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12 b-2 of the Exchange Act).

Yes o No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. The number of shares of the issuer s Common Stock, $0.001 par value, outstanding as of February 1, 2007 was 16,560,100.

GLADSTONE INVESTMENT CORPORATION

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GLADSTONE INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES
(UNAUDITED)

	December 31, 2006	March 31, 2006
ASSETS		
Non-Control/Non-Affiliate investments (Cost 12/31/06: $141,804,619; 3/31/06: $97,423,004)	$ 140,777,989	$ 97,585,972
Control investments (Cost 12/31/06: $80,601,004; 3/31/06: $55,846,318)	80,188,063	55,796,318
Affiliate investments (Cost 12/31/06: $19,550,000)	19,550,000	
Total investments at fair value (Cost 12/31/06: $241,955,623; 3/31/06: $153,269,322)	240,516,052	153,382,290
Cash and cash equivalents	1,890,942	75,672,605
Interest receivable	1,444,705	761,388
Due from custodian	2,798,620	
Deferred finance costs	459,347	
Prepaid directors fees	37,900	
Prepaid insurance	145,382	99,874
Due from Adviser		234,551
Other assets	180,114	173,099
TOTAL ASSETS	$ 247,473,062	$ 230,323,807
LIABILITIES		
Administration fee payable to Administrator	$ 124,101	$ 110,002
Fees due to Adviser	407,221	
Borrowings under line of credit	20,000,000	
Accrued expenses	812,864	367,031
Other liabilities	43,120	5,077
Total Liabilities	21,387,306	482,110
NET ASSETS	$ 226,085,756	$ 229,841,697
ANALYSIS OF NET ASSETS:		
Common stock, $0.001 par value, 100,000,000 shares authorized and 16,560,100 shares issued and outstanding	$ 16,560	$ 16,560
Capital in excess of par value	230,096,572	230,229,279
Net unrealized (depreciation) appreciation of investment portfolio	(1,439,571)	112,968
Distributions in excess of net investment income	(2,587,805)	(517,110)
TOTAL NET ASSETS	$ 226,085,756	$ 229,841,697
NET ASSETS PER SHARE	$ 13.65	$ 13.88

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

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GLADSTONE INVESTMENT CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS
December 31, 2006

(UNAUDITED)

Company (1)	Industry	Investment (2)	Cost	Fair Value
NON-CONTROL/NON-AFFILIATE INVESTMENTS				
ACS Media, LLC	Service - directory advertising	Senior Term Debt (7.9%, Due 11/2013)(3)	$ 2,627,096	$ 2,626,550
Activant	Service - enterprise software and services	Senior Term Debt (7.4%, Due 5/2013)(3)	3,848,960	3,792,675
American Safety Razor Company Inc.	Manufacturing - razors and blades	Senior Term Debt (7.9%, Due 7/2013)(3)	1,494,998	1,499,963
Aspect Software, Inc.	Service - call center software	Senior Term Debt (8.4%, Due 7/2011)(3)	2,996,361	2,992,500
Bankruptcy Management Solutions, Inc.	Service - software and service to bankrupcy trustees	Senior Term Debt (8.1%, Due 7/2012)(3)	1,000,942	1,004,981
Brock Holdings II, Inc.	Service - industrial specialty maintenance	Senior Term Debt (7.9%, Due 8/2013)(3)(5)	3,000,480	3,011,203
Compsych Investments Corp.	Service - independent employee assistance programs	Senior Term Debt (8.1%, Due 2/2012)(3) (5)	3,926,043	3,919,775
CRC Health Group, Inc.	Service - substance abuse treatment	Senior Term Debt (7.9%, Due 2/2012)(3)	10,041,596	10,005,278
CST Industries Acquisition, Inc.	Manufacturing - metal storage units	Senior Term Debt (8.5%, Due 8/2013)(3)	999,523	1,002,488
Dealer Computer Services, Inc.	Manufacturing & Service - systems for automotive retailers	Senior Term Debt (7.9%, Due 9/2013)(3)	1,045,380	1,051,914
Dresser Holdings, Inc.	Manufacturing - oilfield & energy products	Senior Term Debt (8.1%, Due 10/2013)(3)	2,015,898	2,033,537
Generac Acquisition Corp.	Manufacturing - standby power products	Senior Term Debt (7.8%, Due 11/2013)(3)	2,620,000	2,629,825
Graham Packaging Holdings Co.	Manufacturing - custom blow molded plastic containers	Senior Term Debt (7.6%, Due 10/2011)(3)	10,745,127	10,711,271
Hudson Products Holdings, Inc.	Manufacturing - heat transfer solutions	Senior Term Debt (8.1%, Due 12/2013)(3)	1,310,000	1,313,275
IPC Information Systems, LLC	Manufacturing - specialized telephony systems	Senior Term Debt (7.9%, Due 9/2013)(3)	262,000	263,310
J. Crew Operating Corp.	Retail - apparel	Senior Term Debt (7.1%, Due 5/2013)(3)	1,406,089	1,399,999
Latham Manufacturing Corp.	Manufacturing - swimming pool components accessories	Senior Term Debt (8.9%, Due 6/2012)(3)	2,435,461	2,369,505
Lexicon Marketing USA, Inc.	Service - marketing to Hispanic community	Senior Term Debt (7.9%, Due 5/2012)(3) (5)	2,979,159	3,006,478
LVI Services, Inc.	Service - asbestos and mold remediation	Senior Term Debt (10.4%, Due 11/2010)(3) (5)	6,458,112	5,920,200

Madison River Capital LLC	Service - communications and information	Senior Term Debt (7.6%, Due 7/2012)(3)	5,729,255	5,702,357
Maidenform, Inc.	Manufacturing - intimate apparel	Senior Term Debt (7.2%, Due 5/2010)(3)	2,569,468	2,566,667
MedAssets, Inc.	Service - pharmaceuticals and healthcare GPO	Senior Term Debt (7.9%, Due 10/2013)(3) (5)	3,502,680	3,500,000
MediMedia USA, LLC	Service - healthcare and pharmeceutical marketing	Senior Term Debt (7.8%, Due 10/2013)(3)	1,183,505	1,180,463
National Mentor Holdings, Inc.	Service - home health care	Senior Term Debt (7.7%, Due 6/2013)(3)	1,991,799	2,000,503
NPC International Inc.	Service - Pizza Hut franchisee	Senior Term Debt (7.1%, Due 5/2013)(3)	3,018,085	2,995,367
Nutro Products, Inc.	Manufacturing - pet food	Senior Term Debt (7.4%, Due 4/2012)(3)	2,503,442	2,484,352
Ozburn-Hessey Holding Co. LLC	Service - third party logistics	Senior Term Debt (8.6%, Due 8/2012)(3)	7,791,254	7,714,823
Patriot Media & Communications CNJ, LLC	Service - telecommunications	Senior Term Debt (7.4%, Due 3/2013)(3)	4,169,901	4,136,293
Radio Systems Corporation	Service - design electronic pet containment products	Senior Term Debt (8.1%, Due 9/2013)(3)	1,048,000	1,051,930
Rally Parts, Inc.	Manufacturing - aftermarket motorcycle parts and accessories	Senior Term Debt (7.9%, Due 11/2013)(3)	262,000	262,655
RPG Holdings, Inc.	Manufacturing and design - greeting cards	Senior Term Debt (8.9%, Due 12/2011)(3)	5,001,158	4,975,000
SGS International, Inc.	Service - digital imaging and graphics	Senior Term Debt (7.9%, Due 12/2011)(3)	1,616,364	1,612,774
Stolle Machinery Company	Manufacturing - can-making equipment and parts	Senior Term Debt (7.9%, Due 9/2012)(3)	262,000	263,310

Company (1)	**Industry**	**Investment (2)**	**Cost**	**Fair Value**
NON-CONTROL/NON-AFFILIATE INVESTMENTS (Continued)				
SunGard Data Systems, Inc.	Service & Manufacturing - integrated software and processing solutions and information availability services	Senior Term Debt (7.9%, Due 2/2013)(3)	$ 9,946,579	$ 9,960,813
Survey Sampling, LLC	Service - telecommunications-based sampling	Senior Term Debt (8.6%, Due 5/2011)(3)	3,373,571	3,331,493
Triad Laboratory Alliance, LLC	Service - regional medical laboratories	Senior Term Debt (8.6%, Due 12/2011)(3) (5)	4,966,908	4,912,875
US Investigative Services, Inc.	Service - background investigations	Senior Term Debt (7.9%, Due 10/2012)(3)	10,943,766	10,927,767
Wastequip, Inc.	Service - process and transport waste materials	Senior Term Debt (7.6%, Due 7/2011)(3)	5,471,659	5,390,720
West Corporation	Service - business process outsourcing	Senior Term Debt (8.1%, Due 10/2013)(3)	5,240,000	5,253,100
Total Non-Control/Non-Affiliate Investments			**$141,804,619**	**$ 140,777,989**
CONTROL INVESTMENTS				
Acme Cryogenics Corporation	Manufacturing - manifolds and pipes for industrial gasses	Senior Subordinated Term Debt (11.5% Due 3/2013)(6)	$ 14,500,000	$ 14,500,000
		Redeemable Preferred Stock(4) (6)	7,245,634	7,245,634
		Common Stock(4) (6)	1,084,366	1,084,366
		Common Stock Warrants(4) (6)	24,686	24,686
			22,854,686	22,854,686
Chase II Holdings Corp.	Manufacturing - traffic doors	Revolving Credit Facility(7)		
		Senior Term Debt (9.9%, Due 3/2011)(5)	12,900,000	12,835,500
		Senior Term Debt (12.0% Due 3/2011)(5)	8,000,000	7,910,000
		Subordinated Term Debt (13% Due 3/2013)(5)	6,167,810	6,036,744
		Redeemable Preferred Stock(4) (6)	6,960,806	6,960,806
		Common Stock Warrants(4) (6)	61,384	61,384
			34,090,000	33,804,434
Hailey Transport Corporation	Retail and Service - school buses and parts	Senior Subordinated Term Debt (12.0%, Due 1/2012)(5)	4,000,000	3,900,000
		Preferred Stock(4) (6)	2,500,000	2,500,000
			6,500,000	6,400,000
Quench Holdings Corp.	Service - sales, installation and service of water coolers	Revolving Credit Facility (9.4%, Due 3/2009)(5) (8)	1,900,000	1,897,625

		Senior Term Debt (9.4%, Due 3/2011)(5)	4,000,000	4,005,000
		Subordinated Term Debt (11.5%, Due 3/2011)(5)	8,000,000	7,970,000
		Common Stock(4) (6)	3,256,318	3,256,318
			17,156,318	17,128,943
Total Control Investments			**$ 80,601,004**	**$ 80,188,063**
AFFILIATE INVESTMENTS				
Noble Logistics, Inc.	Service - aftermarket auto parts delivery	Revolving Credit Facility(9)	$ 1,800,000	$ 1,800,000
		Senior Term Debt (9.8%, Due 3/2011)(6)	7,000,000	7,000,000
		Senior Term Debt (12.0% Due 3/2011)(6)	7,000,000	7,000,000
		Senior Subordinated Term Debt (13% Due 3/2013)(6)	500,000	500,000
		Preferred Stock(4) (6)	1,750,000	1,750,000
		Common Stock(4) (6)	1,500,000	1,500,000
			19,550,000	19,550,000
Total Affiliate Investments			**$ 19,550,000**	**$ 19,550,000**
Total Investments			**$241,955,623**	**$ 240,516,052**

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(1) Certain of the listed securities are issued by affiliate(s) of the indicated portfolio company.

(2) Percentage represents the weighted average interest rates in effect at December 31, 2006 and due date represents the contractual maturity date.

(3) Marketable securities are valued based on the indicative bid price, as of December 31, 2006, from the respective originating syndication agent s trading desk.

(4) Security is non-income producing.

(5) Valued using Standard & Poor s Securities Evaluations, Inc. opinions of value at December 31, 2006.

(6) Fair value is equal to cost due to recent acquisition.

(7) Total available under the revolving credit facility is $500,000 which was undrawn as of December 31, 2006.

(8) Total available under the revolving credit facility is $2,000,000, of which $100,000 remains undrawn at December 31, 2006.

(9) Total available under the revolving credit facility is $2,000,000, of which $200,000 remains undrawn at December 31, 2006.

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

GLADSTONE INVESTMENT CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS
March 31, 2006
(UNAUDITED)

Company (1)	Industry	Investment (2)	Cost	Fair Value
NON-CONTROL/NON-AFFILIATE INVESTMENTS				
CRC Health Group, Inc.	Service - substance abuse treatment	Senior Term Debt (6.9%, Due 2/2016)(3)	$ 5,056,761	$ 5,056,250
Graham Packaging Holdings Co.	Manufacturing - custom blow molded	Senior Term Debt (7.0%, Due 10/2011)(3)	10,071,296	10,061,087
Hertz Equipment Rental Corporation	Service - car rentals	Senior Term Debt (6.7%, Due 12/2010)(3)	871,388	876,560
Latham Manufacturing Corp.	Manufacturing - swimming pool components accessories	Senior Term Debt (7.8%, Due 12/2010)(3)	4,454,333	4,461,188
Le-Natures, Inc.	Marketing & development - natural beverages	Senior Term Debt (7.7%, Due 6/2010)(3)	5,042,467	5,074,713
LVI Services, Inc.	Service - asbestos and mold remediation	Senior Term Debt (7.3%, Due 11/2010)(3)	6,511,390	6,540,483
Madison River Capital LLC	Service - communications and information information	Senior Term Debt (6.8%, Due 7/2012)(3)	5,788,660	5,829,062
Maidenform, Inc.	Manufacturing - intimate apparel	Senior Term Debt (6.5%, Due 5/2010)(3)	3,118,448	3,122,787
MedAssets, Inc.	Service - pharmaceuticals and healthcare GPO	Senior Term Debt (7.7%, Due 7/2010)(3)(7)	2,340,111	2,348,526
Ozburn-Hessey Holding Co. LLC	Service - third party logistics	Senior Term Debt (7.3%, Due 8/2012)(3)	6,382,673	6,376,646
Patriot Media & Communications CNJ, LLC	Service - telecommunications	Senior Term Debt (7.0%, Due 3/2013)(3)	4,360,777	4,359,125
Revere Industries, LLC	Manufacturing-plastic and metal components	Senior Term Debt (7.6%, Due 9/2010)(3)	3,508,831	3,504,546
RPG Holdings, Inc.	Manufacturing and design - greeting cards	Senior Term Debt (8.2%, Due 12/2011)(3)	5,001,332	5,000,000
SGS International, Inc.	Service - digital imaging and graphics	Senior Term Debt (7.2%, Due 12/2011)(3)	1,404,081	1,415,702
SunGard Data Systems, Inc.	Service & manufacturing - integrated software and processing	Senior Term Debt (7.2%, Due 2/2013)(3)	10,033,531	10,049,063
Triad Laboratory Alliance, LLC	Service - regional medical laboratories	Senior Term Debt (7.8%, Due 12/2011)(3)(7)	5,006,982	5,012,438
TexStar Operating, L.P.	Manufacturing - midstream natural gas processing	Senior Term Debt (8.3%, Due 12/2011)(3)(7)	3,000,161	2,999,981
US Investigative Services, Inc.	Service - background investigations	Senior Term Debt (7.4%, Due 10/2012)(3)	9,948,345	9,984,478
Wastequip, Inc.	Manufacturing - waste removal equipment	Senior Term Debt (7.0%, Due 7/2011)(3)	5,521,437	5,513,337

Total Non-Control/Non-Affiliate Investments	**97,423,004**	**97,585,972**

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Company (1)	Industry	Investment (2)	Cost	Fair Value
CONTROL INVESTMENTS				
Chase II Holdings Corporation	Manufacturing - Traffic doors	Revolving Credit Facility (5)		
		Senior Term Debt (9.1%, Due 3/2011)	12,900,000	12,900,000
		Senior Term Debt (12.0% Due 3/2011)	8,000,000	8,000,000
		Subordinated Term Debt (13% Due 3/2013)	6,167,810	6,167,810
		Redeemable Preferred Stock (4) (8)	6,960,806	6,960,806
		Common Stock (4) (8)	61,384	61,384
			34,090,000	34,090,000
Hailey Transport Corporation	Retail and Service - school buses and parts	Senior Subordinated Term Debt (12.0%, Due 1/2012) (7)	4,000,000	3,950,000
		Common Stock (4) (8)	2,500,000	2,500,00
			6,500,000	6,450,000
Quench Holdings Corporation	Service - sales, installation and service of water coolers	Revolving Credit Facility (6)		
		Senior Term Debt (9.1%, Due 3/2011)	4,000,000	4,000,000
		Subordinated Term Debt (11.5%, Due 3/2011)	8,000,000	8,000,000
		Common Stock (4) (8)	3,256,318	3,256,318
			15,256,318	15,256,318
Total Control Investments			**55,846,318**	**55,796,318**
Total Investments			**$ 153,269,322**	**$ 153,382,290**
Cash equivalents				
	Government	US Treasury Bill (4.2%, 4/20/2006)	3,989,800	3,989,800
	Government	US Treasury Bill (4.4%, 4/27/2006)	15,241,694	15,241,694
	Government	US Treasury Bill (4.4%, 5/4/2006)	35,132,347	35,132,347
	Government	US Treasury Bill (4.4%, 5/25/2006)	15,243,245	15,243,245
Total cash equivalents:			**69,607,086**	**69,607,086**
Total investments and cash equivalents:			**$ 222,876,408**	**$ 222,989,376**

(1) Certain of the listed securities are issued by affiliate(s) of the indicated portfolio company.

(2) Percentage represents the weighted average interest rates in effect at March 31, 2006 and due date represents the contractual maturity date.

(3) Marketable securities are valued based on the indicative bid price, as of March 31, 2006, from the respective originating syndication agent s trading desk.

(4) Security is non-income producing.

(5) Total available under the revolving credit facility is $500,000 which was undrawn as of March 31, 2006.

(6) Total available under the revolving credit facility is $2,000,000 which was undrawn as of March 31, 2006.

(7) Valued using Standard & Poor s Securities Evaluations, Inc. opinions of value at March 31, 2006.

(8) Fair value is equal to cost due to recent acquisition.

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

GLADSTONE INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	For the three months ended December 31, 2006	For the three months ended December 31, 2005
INVESTMENT INCOME		
Interest income		
Non-Control/Non-Affiliate investments	$ 2,586,171	$ 790,879
Control investments	1,264,451	
Affiliate investments	114,668	
Cash and cash equivalents	332,586	1,530,809
Total interest income	4,297,876	2,321,688
Other income	1,492	
Total investment income	4,299,368	2,321,688
EXPENSES		
Base management fee	551,235	265,522
Loan servicing fee	508,691	
Administration fee	124,101	73,424
Directors fees	54,800	51,000
Professional fees	186,537	69,570
Insurance expense	60,696	69,552
Stockholder related costs	28,643	24,363
Interest expense	68,748	
Amortization of deferred finance costs	91,392	
Taxes and licenses	41,550	
Other expenses	60,132	15,687
Expenses before credit from Adviser	1,776,525	569,118
Credit to base management fee for fees collected by Adviser (Refer to Note 3)	(375,225)	
Total expenses net of credit to management fee	1,401,300	569,118
NET INVESTMENT INCOME	2,898,068	1,752,570
REALIZED AND UNREALIZED LOSS ON INVESTMENTS		
Realized (loss) gain on sale of Non-Control/Non-Affiliate investments	(2,283)	38,056
Net unrealized depreciation of investment portfolio	(211,242)	(175,879)
Net loss on investments	(213,525)	(137,823)
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS (Refer to Note 6)	$ 2,684,543	$ 1,614,747
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS PER COMMON SHARE:		
Basic and Diluted	$ 0.16	$ 0.10
SHARES OF COMMON STOCK OUTSTANDING:		
Basic and diluted weighted average shares	16,560,100	16,560,100

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

GLADSTONE INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	For the nine months ended December 31, 2006	For the period June 22, 2005 (Commencement of Operations) to December 31, 2005
INVESTMENT INCOME		
Interest income		
Non-Control/Non-Affiliate investments	$ 6,938,026	$ 984,457
Control investments	3,711,056	
Affiliate investments	114,668	
Cash and cash equivalents	1,610,506	3,192,019
Total interest income	12,374,256	4,176,476
Other income	2,478	
Total investment income	12,376,734	4,176,476
EXPENSES		
Base management fee	2,214,437	357,630
Loan servicing fee	508,691	
Administration fee	364,351	178,469
Directors fees	154,300	103,000
Professional fees	354,325	135,872
Insurance expense	200,933	112,030
Stockholder related costs	187,509	67,901
Interest expense	68,748	378
Amortization of deferred finance costs	91,392	
Taxes and licenses	139,994	
Other expenses	104,161	35,920
Expenses before credit from Gladstone Management	4,388,841	991,200
Credit to management fee for fees collected by Adviser (Refer to Note 3)	(375,225)	
Total expenses net of credit to management fee	4,013,616	991,200
NET INVESTMENT INCOME	8,363,118	3,185,276
REALIZED AND UNREALIZED LOSS ON INVESTMENTS		
Realized (loss) gain on sale of Non-Control/Non-Affiliate investments	(944)	38,056
Net unrealized depreciation of investment portfolio	(1,552,539)	(112,053)
Net loss on investments	(1,553,483)	(73,997)
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS (Refer to Note 6)	$ 6,809,635	$ 3,111,279
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS PER COMMON SHARE:		
Basic and Diluted	$ 0.41	$ 0.19
SHARES OF COMMON STOCK OUTSTANDING:		
Basic and diluted weighted average shares	16,560,100	16,560,100

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

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GLADSTONE INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS
(UNAUDITED)

	For the nine months ended December 31, 2006	For the period June 22, 2005 (Commencement of Operations) to December 31, 2005
Operations:		
Net investment income	$ 8,363,118	$ 3,185,276
Realized (loss) gain on sale of investments	(944)	38,056
Unrealized depreciation of portfolio	(1,552,539)	(112,053)
Increase in net assets from operations	6,809,635	3,111,279
Capital transactions:		
Issuance of common stock		230,244,339
Shelf registration offering costs	(132,707)	
Dividends from net investment income	(10,432,869)	(2,980,818)
Total change in net assets from capital transactions	(10,565,576)	227,263,521
Total change in net assets	(3,755,941)	230,374,800
Net Assets		
Beginning of period	229,841,697	1,500
End of period	$ 226,085,756	$ 230,376,300

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

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GLADSTONE INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	For the nine months ended December 31, 2006	For the period June 22, 2005 (Commencement of Operations) to December 31, 2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Net increase in net assets resulting from operations	$ 6,809,635	$ 3,111,279
Adjustments to reconcile net increase in net assets		
resulting from operations to net cash used in operating activities:		
Purchase of investments	(118,850,626)	(64,221,339)
Principal repayments of investments	10,448,688	1,376,483
Proceeds from the sale of investments	19,589,945	2,038,056
Net unrealized depreciation of investment portfolio	1,552,539	112,053
Net realized loss (gain) on sales of investments	944	(38,056)
Net amortization of premiums and discounts	124,748	21,797
Increase in interest receivable	(683,317)	(317,233)
Increase in due from custodian	(2,798,620)	
Increase in prepaid assets	(67,993)	(214,485)
Increase in other assets	(22,429)	(108,604)
Increase in other liabilities	38,042	
Increase in administration fee payable to Administrator	410,561	73,424
Increase in base management fee payable to Adviser	14,099	192,787
Increase in loan servicing fee payable to Adviser	231,211	
Increase in accounts payable		2,207
Increase in accrued expenses	445,833	53,933
Net cash used in operating activities	(82,756,740)	(57,917,698)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net proceeds from the issuance of common stock		230,292,203
Borrowings from line of credit	23,500,000	
Repayments of line of credit	(3,500,000)	
Deferred finance costs	(459,347)	
Shelf offering registration costs	(132,707)	
Distributions paid	(10,432,869)	(2,980,818)
Decrease in loan payable to affiliate		(50,000)
Net cash provided by financing activities	8,975,077	227,261,385
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS (1)	(73,781,663)	169,343,687
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	75,672,605	3,636
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 1,890,942	$ 169,347,323
CASH PAID DURING PERIOD FOR INTEREST TO AFFILIATE	$	$ 378

(1) Cash and cash equivalents consist of demand deposits and highly liquid investments with original maturities of three months or less when purchased.

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

GLADSTONE INVESTMENT CORPORATION
FINANCIAL HIGHLIGHTS
(UNAUDITED)

	For the three months ended December 31, 2006	For the three months ended December 31, 2005
Per Share Data (1)		
Balance at beginning of period	$ 13.71	$ 13.93
Income from investment operations:		
Net investment income (2)	0.18	0.11
Realized gain on sale of investments (2)		
Net unrealized depreciation of investments (2)	(0.02)	(0.01)
Total from investment operations	0.16	0.10
Distributions	(0.21)	(0.12)
Net asset value at end of period	$ 13.65	$ 13.91
Per share market value at beginning of period	$ 14.46	$ 15.05
Per share market value at end of period	15.31	13.59
Total return (3)	7.38 %	(6.63 %)
Shares outstanding at end of period	16,560,100	16,560,100
Ratios/Supplemental Data		
Net assets at end of period	$ 226,085,756	$ 230,376,300
Average net assets (4)	$ 225,338,878	$ 229,896,936
Ratio of expenses to average net assets (annualized)	3.15 %	0.99 %
Ratio of net expenses to average net assets (annualized)	2.49 %	0.99 %
Ratio of net investment income to average net assets (annualized)	5.14 %	3.05 %

(1) Based on actual shares outstanding.

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

(3) Total return equals the change in the market value of the Company s common stock from the beginning of the period taking into account dividends reinvested in accordance with the terms of our dividend reinvestment plan.

(4) Calculated using the average of the ending monthly net assets for the respective periods.

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

GLADSTONE INVESTMENT CORPORATION
FINANCIAL HIGHLIGHTS
(UNAUDITED)

	For the nine months ended December 31, 2006	For the period June 22, 2005 (Commencement of Operations) to December 31, 2005
Per Share Data (1)		
Balance at beginning of period	$ 13.88	$
Net proceeds from initial public offering (2)		13.95
Offering costs		(0.05)
Income from investment operations:		
Net investment income (3)	0.51	0.20
Realized gain on sale of investments (3)		
Net unrealized depreciation of investments (3)	(0.10)	(0.01)
Total from investment operations	0.41	0.19
Distributions	(0.63)	(0.18)
Net asset value at end of period	$ 13.65	$ 13.91
Per share market value at beginning of period	$ 14.90	$ 15.00
Per share market value at end of period	15.31	13.59
Total return (4)	7.28 %	(8.25 %)
Shares outstanding at end of period	16,560,100	16,560,100
Ratios/Supplemental Data		
Net assets at end of period	$ 226,085,756	$ 230,376,300
Average net assets (5)	$ 226,399,367	$ 225,793,817
Ratio of expenses to average net assets (annualized)	2.59 %	0.75 %
Ratio of net expenses to average net assets (annualized)	2.36 %	0.75 %
Ratio of net investment income to average net assets (annualized)	4.93 %	2.42 %

(1) Based on actual shares outstanding.

(2) Net of initial underwriting discount of $1.05 per share.

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

(4) Total return equals the change in the market value of the Company s common stock from the beginning of the period taking into account dividends reinvested in accordance with the terms of our dividend reinvestment plan.

(5) Calculated using the average of the ending monthly net assets for the respective periods.

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

GLADSTONE INVESTMENT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2006
(UNAUDITED)

NOTE 1. ORGANIZATION

Gladstone Investment Corporation (the Company) was incorporated under the General Corporation Laws of the State of Delaware on February 18, 2005 and completed an initial public offering on June 22, 2005. The Company is a closed-end, non-diversified management investment company that has elected to be treated as a business development company under the Investment Company Act of 1940, as amended (the 1940 Act). In addition, the Company has elected to be treated for tax purposes as a regulated investment company, or RIC, under the Internal Revenue Code of 1986, as amended (the Code). The Company s investment objectives are to achieve a high level of current income and capital gains by investing in debt and equity securities of established private businesses.

Gladstone Business Investment LLC, (Business Investment) a wholly-owned subsidiary of the Company, was established on August 11, 2006 for the sole purpose of owning the Company s portfolio of investments in connection with the establishment of its line of credit facility with Deutsche Bank AG, which recently closed on October 19, 2006. The financial statements of Business Investment are consolidated with those of the Company.

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

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Unaudited Interim Financial Statements

Interim financial statements of the Company are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain disclosures accompanying annual financial statements prepared in accordance with GAAP are omitted. In the opinion of management, all adjustments, consisting solely of normal recurring accruals, necessary for the fair statement of financial statements for the interim periods have been included. The current period s results of operations are not necessarily indicative of results that ultimately may be achieved for the year. The interim financial statements and notes thereto should be read in conjunction with the financial statements and notes thereto included in the Company s Form 10-K for the fiscal year ended March 31, 2006, as filed with the Securities and Exchange Commission on June 14, 2006.

Use of Estimates

The preparation of financial statements in conformity with GAAP 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 reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Classification of Investments

The 1940 Act requires classification of the Company s investments by its respective level of control. As defined in the 1940 Act, Control Investments are investments in those portfolio companies that the Company is deemed to Control . Affiliate Investments are investments in those portfolio companies that are Affiliated Companies of the Company, as defined in the 1940 Act, other than Control Investments. Non-Control/Non-Affiliate Investments are those that are neither Control Investments nor Affiliate Investments. In general, the 1940 Act prescribes that the Company has control over a portfolio company if it owns greater than 25% of the voting securities of the portfolio company. The Company is deemed to be an affiliate of a portfolio company if it owns between 5% and 25% of the voting securities of such portfolio company or has one or more seats on the affiliated company s board of directors. However, if the Company holds 50% or more representation on a portfolio company s board of directors, the Company will be deemed to have control over the portfolio company.

Investment Valuation

The Company carries its investments at fair value, as determined by its Board of Directors. Securities that are publicly traded are valued at the closing price on the valuation date. Securities for which a limited market exists, such as participations in syndicated loans, are valued at the indicative bid price on the valuation date from the respective originating syndication agent s trading desk. Debt and equity securities that are not publicly traded are valued at fair value. The Company s Board of Directors has established a valuation policy and consistently applied valuation procedures used to determine the fair value of these securities quarterly. These procedures for the determination of value of 13 of the Company s debt securities rely on the opinions of value submitted to us by Standard & Poor s Securities Evaluations, Inc. (SPSE). SPSE will only evaluate the debt portion of the Company s investments for which the Company specifically requests evaluation, and may decline to make requested evaluations for any reason in its sole discretion. SPSE opinions of value are submitted to the Board of Directors along with the Adviser s supplemental assessment and recommendation regarding valuation of each of these investments. The Board of Directors then reviews whether the Adviser has followed its established procedures for determinations of fair value, and votes to accept or not accept the recommended valuation of the Company s investment portfolio. The Company s fair valuation procedures provide for valuation of non-convertible debt securities at cost plus amortized original issue discount (OID) plus paid in kind (PIK) interest, if any, unless adverse factors lead to a determination of a lesser valuation. The fair value of convertible debt, equity, success or exit fees or other equity-like securities is determined based on the collateral, the enterprise value of the issuer, the issuer s ability to make payments, the earnings of the issuer, sales to third parties of similar securities, the comparison to publicly traded securities, discounted cash flow and other pertinent factors. Due to the uncertainty inherent in the valuation process, such estimates of fair value may differ significantly from the values that would have resulted 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 valuation currently assigned. Because there is a delay between when the Company closes an investment and when the investment can be evaluated by SPSE, new investments are not valued immediately by SPSE; rather, the Adviser makes its own determination about the recommended value of these investments in accordance with the Company s valuation policy without the input of SPSE during the specific quarter in which the investment is made. Because SPSE does not currently perform independent valuations of mortgage loans or equity securities for the Company, the Adviser also determines a recommendation for the fair value of these investments without the input of SPSE. The Adviser considers a number of qualitative and quantitative factors in current market conditions when performing valuations. The Board of Directors then determines whether or not to accept the Adviser s recommendations for the aggregate valuation of the Company s portfolio of investments. The Board of Directors is ultimately responsible for setting the fair value and disclosure of investments in the financial statements.

Interest and Dividend Income Recognition

Interest income, adjusted for amortization of premiums and acquisition costs and for the accretion of discounts, is recorded on the accrual basis to the extent that such amounts are expected to be collected. The Company stops accruing interest on its investments when it is determined that interest is no longer collectible. There were no uncollectible accounts at December 31, 2006. Conditional interest or a success fee is recorded upon full repayment of a loan investment. Dividend income on preferred equity securities is accrued to the extent that such amounts are expected to be collected and that the Company has the option to collect such amounts in cash. To date, the Company has not accrued any dividend income.

Services Provided to Portfolio Companies

The 1940 Act requires that a business development company make available managerial assistance to its portfolio companies by providing significant guidance and counsel concerning the management, operations, or business objectives and policies of the respective portfolio company. The Company provides these and other services to portfolio companies through its Adviser. Currently, neither the Company nor the Adviser receives fees in connection with managerial assistance.

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

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

The Company may receive fees for the origination and closing services it provides to portfolio companies through its Adviser. These fees are paid directly to the Company and are recognized as revenue upon closing of the originated investment and are reported as fee income in the consolidated statements of operations.

Cash and Cash Equivalents

The Company considers all short-term, highly liquid investments that are both readily convertible to cash and have a maturity of three months or less at the time of purchase to be cash equivalents. Items classified as cash equivalents include temporary investments in U.S. Treasury bills and can also include commercial paper and money-market funds. All of the Company s cash at December 31, 2006 was deposited with two financial institutions, and the Company s balances exceed federally insurable limits. The Company seeks to mitigate this risk by depositing funds with major financial institutions.

Realized Gain or Loss and Unrealized Appreciation or Depreciation of Portfolio Investments

Realized gain or loss is recognized when an investment is sold and is computed as the difference between the Company s cost basis in the investment at the date of sale and the net proceeds received from such sale. Unrealized appreciation or depreciation reflects the difference between the fair market value of the investment and the cost basis of such investment.

Federal Income Taxes

The Company intends to continue to qualify for treatment as a RIC under subchapter M of the Code. As a RIC, the Company will not be subject to federal income tax on the portion of its taxable income and gains distributed to stockholders. To qualify as a RIC, the Company is required to distribute at least 90% of investment company taxable income, as defined by the Code. The Company intends to distribute at least 90% of its ordinary income, and as a result, no income tax provisions have been recorded. The Company may, but does not intend to, pay out a return of capital.

Recent Accounting Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurments* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in GAAP and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is required to adopt the provisions of SFAS 157 beginning with the fiscal year ended March 31, 2009. The Company is currently evaluating the impact of this pronouncement on its consolidated financial statements.

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108 (SAB 108). SAB 108 addresses how the effects of prior year uncorrected misstatements should be considered when quantifying misstatements in current year financial statements and requires registrants to consider the effect of all carry over and reversing effects of prior year misstatements when quantifying errors in current year financial statements. SAB 108 does not change the SEC s previous guidance in SAB No. 99, *Materiality*, on evaluating the materiality of misstatements. A registrant applying the new guidance for the first time that identifies material errors in existence at the beginning of the first fiscal year ending after November 15, 2006, may correct those errors through a one-time cumulative effect adjustment to beginning-of-year retained earnings. The cumulative effect alternative is available only if the application of the new guidance results in a conclusion that a material error exists as of the beginning of the first fiscal year ending after November 15, 2006, and those misstatements were determined to be immaterial based on a proper application of the registrant s previous method

for quantifying misstatements. The Company is currently evaluating the impact of this pronouncement on its consolidated financial statements

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109,* which clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. SFAS No. 109 is effective as of the beginning of an entity s first fiscal year that begins after December 15, 2006. The Company will adopt this Interpretation effective April 1, 2007. The Company is currently evaluating the impact of this pronouncement on its consolidated financial statements.

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments, an amendment of FASB statements No. 133 and 140* (SFAS No. 155). SFAS No. 155 allows financial instruments that have embedded derivatives to be accounted for as a whole (eliminating the need to bifurcate the derivative from its host) as long as the entire instrument is valued on a fair value basis. The statement also resolves and clarifies other specific SFAS No. 133 and SFAS No. 140 related issues. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity s first fiscal year that begins after September 15, 2006. The Company will be required to adopt SFAS No. 155 on April 1, 2007. The Company is currently evaluating the impact of this pronouncement on its consolidated financial statements.

NOTE 3. RELATED PARTY TRANSACTIONS

Investment Advisory and Management Agreement

We have entered into an investment advisory and management agreement with the Adviser (the Advisory Agreement), which is controlled by our chairman and chief executive officer. In accordance with the Advisory Agreement, we pay the Adviser a fee, as compensation for its services, consisting of a base management fee and an incentive fee.

The base management fee is assessed at an annual rate of 2.0% computed on the basis of the average value of the Company s gross invested assets at the end of the two most recently completed quarters, which are total assets less the cash proceeds and cash and cash equivalents from the proceeds of the Company s initial public offering that are not invested in debt and equity securities of portfolio companies. Through December 31, 2006, the base management fee was computed and payable quarterly. Beginning in periods subsequent to December 31, 2006, the base management fee will be computed and payable quarterly and will be assessed at an annual rate of 2.0% computed on the basis of the value of the Company s average gross assets at the end of the two most recently completed quarters, which are total assets, including investments made with proceeds of borrowings, less any uninvested cash or cash equivalents resulting from borrowings. This new calculation was originally scheduled to begin in periods after March 31, 2006; however, on April 11, 2006, July 11, 2006 and October 10, 2006, the Company s Board of Directors accepted voluntary waivers from the Adviser that allowed the current calculation of the base management fee to be effective through June 30, 2006, September 30, 2006 and December 31, 2006, respectively.

On January 9, 2007, the Company s Board of Directors accepted a voluntary waiver from the Adviser to reduce the annual 2.0% base management fee on senior syndicated loan participations to 0.5% to the extent that proceeds resulting from borrowings were used to purchase such syndicated loan participations.

When the Adviser receives fees from portfolio companies, as discussed in Note 2 under Services Provided to Portfolio Companies, 50% of certain of these fees will be credited against the base management fee that the Company would otherwise be required to pay to the Adviser.

For the three and nine months ended December 31, 2006, the Company incurred a base management fee to the Adviser of $551,235 and $2,214,437, respectively. For the three months ended December 31, 2005 and for the period June 22, 2005 (commencement of operations) to December 31, 2005, the Company incurred a base management fee to the Adviser of $265,522 and $357,630, respectively. As of December 31, 2006, $176,010 was unpaid and included in fees due to Adviser in the accompanying consolidated statements of assets and liabilities. For the three and nine months ended December 31, 2006, the Company recognized aggregate credits against the base management fee of $375,225 resulting from investment banking fees paid to the Adviser during the respective periods.

In addition, the Adviser services the loans held by Business Investment, in return for which the Adviser receives a 2.0% annual fee based on the monthly aggregate balance of loans held by Business Investment. Since the Company owns these loans, all loan servicing fees paid to the Adviser are treated as reductions against the 2.0% base management fee payable to the Adviser. Overall, the management fee due to the Adviser cannot exceed 2.0% of total assets (as reduced by cash and cash equivalents pledged to creditors) during any given fiscal year.

For the three and nine months ended December 31, 2006, the Company recorded loan servicing fees to the Adviser of $508,691, of which $231,211 was unpaid at December 31, 2006 and included in fees due to Adviser in the accompanying consolidated statements of assets and liabilities.

The incentive fee consists of two parts: an income-based incentive fee and a capital gains incentive fee. The income-based incentive fee is calculated and payable quarterly in arrears based on the Company s pre-incentive fee net investment income for the immediately preceding calendar quarter. The capital gains incentive fee is determined and payable annually in arrears as of the end of each fiscal year (or upon termination of the Advisory Agreement, as of the termination date) and equals 20.0% of the Company s realized capital gains since inception through the end of the current fiscal year, if any, computed net of all realized capital losses since inception, and unrealized capital depreciation at the end of each fiscal year. Refer to the Company s Form 10-K for the fiscal year ended March 31, 2006 for more information regarding the calculation of the incentive fee.

Because pre-incentive fee net investment income was below the hurdle rate of 1.75% of net assets, no income-based incentive fee was recorded for the three or nine months ended December 31, 2006, the three months ended December 31, 2005 or the period June 22, 2005 (commencement of operations) to December 31, 2005.

Administration Agreement

The Company has entered into an administration agreement (the Administration Agreement) with Gladstone Administration, LLC (Gladstone Administration or the Administrator), a wholly-owned subsidiary of the Adviser. Under the Administration Agreement, the Company pays separately for administrative services. The Administration Agreement provides for payments equal to the Company s allocable portion of the Administrator s overhead expenses in performing its obligations under the Administration Agreement, including but not limited to, rent for employees of the Administrator, and the allocable portion of salaries and benefits expenses of the Company s chief financial officer, controller, chief compliance officer, treasurer and their respective staffs. The Company recorded fees to the Administrator on the consolidated statements of operations of $124,101 and $73,424 for the three months ended December 31, 2006 and 2005, respectively. The Company recorded fees to the Administrator on the consolidated statements of operations of $364,351 and $178,469 for the nine months ended December 31, 2006 and the period June 22, 2005 (commencement of operations) to December 31, 2005, respectively. As of December 31, 2006 and March 31, 2006, $124,101 and 110,002, respectively, was unpaid and included in the administration fee payable to Administrator in the accompanying consolidated statements of assets and liabilities.

Loan Payable to Affiliate

On June 30, 2005, the Company repaid a $50,000 loan payable to its chairman and chief executive officer. The demand recourse promissory note accrued interest at the rate of 3.0% per annum and was repaid with accrued interest of $378 using a portion of the net proceeds from the Company s initial public offering.

NOTE 4. LINE OF CREDIT

Through the Company s wholly-owned subsidiary, Business Investment, the Company has obtained a $100 million revolving credit facility (the Credit Facility). On October 19, 2006, the Company executed a Purchase and Sale Agreement pursuant to which it agreed to sell certain loans to Business Investment in consideration of a membership interest therein. Simultaneously, Business Investment executed a Credit Agreement (the Credit Agreement) with Deutsche Bank AG, New York Branch (Deutsche Bank), as administrative agent, pursuant to which Business Investment pledged the loans purchased from the Company to secure future advances by certain institutional lenders. Availability under the Credit Facility will terminate on October 18, 2007, unless extended in the discretion of the lenders, at the request of Business Investment. Interest will be payable monthly during the term of the Credit Facility and principal will be payable out of collections on loans purchased from the Company during the period following the date of which availability for advances has terminated through maturity. The Credit Facility will mature two years following the date on which availability for advances has terminated and on such date, all principal, interest and other amounts owing under the Credit Facility will be due and payable. Interest rates charged on the advances under the facility are based on the rate paid by the lenders on commercial paper notes issued by such lenders to fund some or all of the advances, the London Interbank Offered Rate (LIBOR), the

Prime Rate or the Federal Funds Rate, depending on market conditions, and adjust periodically. Available borrowings are subject to various constraints imposed under the Credit Agreement, based on the aggregate loan balance pledged by Business Investment, which varies as loans are added and repaid, regardless of whether such repayments are early prepayment or are made as contractually required.

The Credit Facility contains covenants that require Business Investment to maintain its status as a separate entity; prohibit certain significant corporate transactions (such as mergers, consolidations, liquidations or dissolutions); and restrict material changes to the Company s credit and collection policies. The facility also restricts some of the terms and provisions (including interest rates, terms to maturity and payments schedules) and limits the borrower and industry concentrations of loans that are eligible to secure advances. As of December 31, 2006, Business Investment was in compliance with all of the facility covenants. As of December 31, 2006 there was $20 million of borrowings outstanding on the Credit Facility and the remaining borrowing capacity under the Credit Facility was $80 million.

The administrative agent also requires that any interest or principal payments on pledged loans be remitted directly by the borrower into a lockbox account with the Bank of New York as custodian. Deutsche Bank is also the trustee of the account and once a month remits the collected funds to the Company. At December 31, 2006, the amount due from the custodian was $2,798,620.

The Adviser services the loans pledged under the Credit Facility. As a condition to this servicing arrangement, the Company executed a performance guaranty pursuant to which it guaranteed that the Adviser would comply fully with all of its obligations under the Credit Facility. The performance guaranty requires the Company to maintain a minimum net worth of $100 million and to maintain asset coverage with respect to senior securities representing indebtedness of at least 200%, in accordance with Section 18 of the 1940 Act. As of December 31, 2006, the Company was in compliance with the covenants under the performance guaranty.

NOTE 5. COMMON STOCK

As of December 31, 2006 and March 31, 2006, 100,000,000 shares of $0.001 par value common stock were authorized and 16,560,100 shares were outstanding.

NOTE 6. INCREASE IN NET ASSETS PER SHARE RESULTING FROM OPERATIONS

The following table sets forth the computation of basic and diluted net increase in net assets per share resulting from operations:

	For the three months ended December 31, 2006	**For the three months ended December 31, 2005**	**For the nine months ended December 31, 2006**	**For the period June 22, 2005 (Commencement of Operations) to December 31, 2005**
Numerator for basic and diluted net increase in net assets resulting from operations per share	$ 2,684,543	$ 1,614,747	$ 6,809,635	$ 3,111,279
Denominator for basic and diluted shares	16,560,100	16,560,100	16,560,100	16,560,100
Basic and diluted net increase in net assets per share resulting from operations	$ 0.16	$ 0.10	$ 0.41	$ 0.19

NOTE 7. DIVIDENDS

The Company is required to pay out as a dividend, 90% of its ordinary income and realized net short-term capital gains in excess of realized net short-term capital losses, if any, for each taxable year in order to maintain its status as a RIC under

Subtitle A, Chapter 1 of Subchapter M of the Code. It is the policy of the Company to pay out as a dividend up to 100% of those amounts. The amount to be paid out monthly as a dividend is determined by the Board of Directors each quarter and is based on the annual earnings estimated by the management of the Company. Based on that estimate, three monthly dividends are declared each quarter. At year-end the Company may pay a bonus dividend, in addition to the monthly dividends, to ensure that it has paid out at least 90% of its ordinary income and realized net short-term capital gains for the year. Long-term capital gains are composed of success fees, prepayment fees and gains from the sale of securities held from one year or more. The Company intends to retain long-term capital gains from the sale of securities, if any, and not pay them out as dividends, however, the Board of Directors may decide to declare and pay out capital gains during any fiscal year. If the Company decides to retain long-term capital gains, the portion of the retained capital gains will be subject to 35% tax. The Company currently pays a monthly dividend. The tax characteristics of all dividends will be reported to stockholders on Form 1099 at the end of each calendar year. The Company s Board of Directors declared the following monthly dividends for the nine months ended December 31, 2006 and the period June 22, 2005 (commencement of operations) to December 31, 2005:

Fiscal Year 2007

Declaration Date	Record Date	Payment Date	Dividend per Share	
October 10, 2006	December 20, 2006	December 29, 2006	$	0.07
October 10, 2006	November 21, 2006	November 30, 2006	$	0.07
October 10, 2006	October 23, 2006	October 31, 2006	$	0.07
July 11, 2006	September 21, 2006	September 29, 2006	$	0.07
July 11, 2006	August 21, 2006	August 31, 2006	$	0.07
July 11, 2006	July 19, 2006	July 31, 2006	$	0.07
April 11, 2006	June 22, 2006	June 30, 2006	$	0.07
April 11, 2006	May 22, 2006	May 31, 2006	$	0.07
April 11, 2006	April 20, 2006	April 28, 2006	$	0.07

Fiscal Year 2006

Declaration Date	Record Date	Payment Date	Dividend per Share	
October 7, 2005	December 21, 2005	December 31, 2005	$	0.04
October 7, 2005	November 21, 2005	November 31, 2005	$	0.04
October 7, 2005	October 21, 2005	October 30, 2005	$	0.04
July 7, 2005	September 22, 2005	September 30, 2005	$	0.02
July 7, 2005	August 23, 2005	August 31, 2005	$	0.02
July 7, 2005	July 21, 2005	July 29, 2005	$	0.02

NOTE 8. CONTRACTUAL OBLIGATIONS

As of December 31, 2006, the Company was a party to signed and non-binding term sheets for two allocations of syndicated loan participations for $3.0 million. The future scheduled contractual payments at December 31, 2006 are as follows:

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

In January 2007, all of the investment purchase obligations summarized above were funded.

NOTE 9. SUBSEQUENT EVENTS

Loan Participations

In Janaury and February 2007, the Company purchased additional loan participations of 4 new and 2 existing portfolio companies of approximately $6.7 million.

Dividends

On January 9, 2007, the Company s Board of Directors declared the following monthly dividends:

Declaration Date	Record Date	Payment Date	Dividend per Share	
January 10, 2007	January 23, 2007	January 31, 2007	$	0.075
January 10, 2007	February 20, 2007	February 28, 2007	$	0.075
January 10, 2007	March 22, 2007	March 30, 2007	$	0.075

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

All statements contained herein, 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, expect, should, would, if, seek, possible, potential, likely or the negative of such terms or comparable terminology. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others: (1) our future operating results as we are a company with a limited operating history; (2) the loss of one or more of our executive officers, in particular, David Gladstone, George Stelljes III, or Terry Lee Brubaker; (3) the impact of the investments that we make and the ability of these investments to achieve their objectives; (4) our contractual relationships with third parties; (5) the adequacy of our cash resources and working capital; (6) our ability to obtain future financing, if at all; and (7) those factors listed under the caption Risk Factors of the Company s Annual Report on Form 10-K dated March 31, 2006, as filed with the Securities and Exchange Commission on June 14, 2006, and in the Company s Pre-effective Amendment No. 1 to Registration Statement on Form N-2 as filed with the Securities and Exchange Commission on December 22, 2006. 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 Form 10-Q.

The following analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the notes thereto contained elsewhere in this report and our annual report on Form 10-K for the fiscal year ended March 31, 2006.

OVERVIEW

We were incorporated under the General Corporation Laws of the State of Delaware on February 18, 2005. We were primarily established for the purpose of investing in subordinated loans, mezzanine debt, preferred stock and warrants to purchase common stock of small and medium-sized companies in connection with buyouts and recapitalizations. We also may invest in common stock and from time to time, we also may invest in senior and subordinated syndicated loans. Our investment objective is to generate both current income and capital gains through these debt and equity instruments. We operate as a closed-end, non-diversified management investment company, and have elected to be treated as a business development company under the Investment Company Act of 1940, as amended (the 1940 Act).

Our Investment Strategy

We seek to achieve returns from current income and capital gains from senior, subordinated and mezzanine debt, as well as preferred stock and warrants to purchase common stock representing controlling investments that we make in connection with buyouts and recapitalizations of small and mid-sized companies with established management teams. We expect that our investments will generally range between $10 million and $30 million each, although this investment size may vary proportionately as the size of our capital base changes. We may invest either by ourselves or jointly with other buyout funds, depending on the opportunity. If we are participating in an investment with one or more co-investors, then our investment is likely to be smaller than if we were to be investing alone.

We expect that our target portfolio over time will include mostly subordinated loans, mezzanine debt, preferred stock, and warrants to buy common stock. Structurally, subordinated loans and mezzanine loans usually rank lower in priority of payment to senior debt, such as senior bank debt, and may be unsecured. However, subordinated debt and mezzanine loans rank senior to common and preferred equity in a borrower s capital structure. Typically, subordinated debt and mezzanine loans have elements of both debt and equity instruments, offering the returns in the form of interest payments associated with senior debt, while providing lenders an opportunity to participate in the capital appreciation of a borrower, if any, through an equity interest. This equity interest typically takes the form of warrants. Due to its higher risk profile and often less restrictive

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covenants as compared to senior debt, mezzanine debt generally earns a higher return than senior secured debt. The warrants associated with mezzanine loans are typically detachable, which allows lenders to receive repayment of their principal on an agreed amortization schedule while retaining their equity interest in the borrower. Mezzanine debt also may include a put feature, which permits the holder to sell its equity interest back to the borrower at a price determined through an agreed formula.

Non-Control/Non-Affiliate Investments

Following the completion of our initial public offering in June 2005, we began investing the proceeds of our initial public offering in senior secured syndicated loans because these investments typically may be originated more quickly than investments in small businesses that are undergoing a buyout or recapitalization. We have employed this strategy in order to more quickly invest our initial capital to generate current income. Senior secured syndicated loans typically involve a number of banks or other financial institutions and are generally more marketable than loans that are not syndicated. In order to invest in certain senior secured syndicated loans, we may purchase these investments at a premium or discount.We amortize premiums and discounts over the contractual life of the investment. In the event that an investment is sold prior to its contractual maturity date, we recognize a loss on any unamortized premium or a gain on any unamortized discount.

While we expect that, over time, our investment portfolio will consist primarily of subordinated debt, mezzanine debt and preferred stock that we receive when making investments in connection with buyouts and recapitalizations, our Board of Directors has recommended that we continue our current strategy of investing in senior syndicated loans, primarily in order to build a portfolio that may be securitized in the future to obtain financing to pay down borrowings and invest in additional buyout and recapitalization investments. To date, we have acquired interests in 39 such syndicated loans in the aggregate principal amount, net of any repayments, of approximately $142.0 million. We expect to continue purchasing syndicated loans using borrowings from our credit facility.

Control and Affiliate Investments

At December 31, 2006, we had investments of approximately $75.8 million in revolving credit facilities, senior debt and subordinated debt of five portfolio companies. In addition, at December 31, 2006 we had invested approximately $24.4 million in preferred and common equity of those companies. These investments are the result of buyout and recapitalization transactions and represent our primary investment focus. A summary of the investments made during the nine months ended December 31, 2006 is as follows:

- $22.9 million in Acme Cryogenics Inc., including senior subordinated debt of $14.5 million, $7.3 million in preferred equity and $1.1 million in common equity; and

- $19.6 million in Noble Logistics Services, Inc., including senior debt of $14.0 million, senior subordinated debt of $0.5 million, a revolving credit facility of $2.0 million (of which $0.2 million remains undrawn at December 31, 2006), $1.8 million in preferred equity and $1.5 million in common equity.

Certain loan investments may have a form of interest that is not paid currently but is accrued and added to the loan balance and paid at the end of the term. This interest is called paid in kind interest or PIK. We will generally seek investments that do not generate PIK interest as we have to pay out this accrued interest as dividends to our stockholders and we may have to borrow money or raise additional capital in order to meet the tax test for a regulated investment company (RIC) by having to pay out at least 90% of our ordinary income. As of December 31, 2006, none of our investments bore PIK interest.

We may also encounter original issue discount income, or OID income, which arises when an investor simultaneously purchases a warrant and a note from a company. This transaction requires an allocation of a portion of the purchase price to the warrant and reduces the note by the same amount. This would cause us to have to record the note as if we paid less than the face amount of the note and, therefore, we would have to amortize the OID over the life of the loan. This would create income that would be required to be paid out as dividends to our stockholders in accordance with the tax test for RICs to pay out at least 90% of our income. We will seek to purchase warrants from the issuer at fair market value in order to avoid OID income.

As a business development company under the 1940 Act, we are required to make available significant managerial assistance to our portfolio companies. We provide these services through Gladstone Management Corporation (the Adviser or GMC),who provides these services on our behalf through its officers who are also our officers. If a portfolio company is charged for managerial assistance then our Adviser will credit all such managerial assistance fees against the base management fee. In addition, our Adviser provides other services to our portfolio companies, for which it receives fees, in connection with our investments. These fees are generally non-recurring, however in some instances they may have a recurring component that is also paid to our Adviser. One half of certain of these fees received by our Adviser are credited against the base management advisory fee payable to our Adviser pursuant to the terms of our advisory agreement, which has the effect of reducing our expenses to the extent of any such credit. The specific services our Adviser provides to portfolio companies vary by investment, but generally include a broad array of services such as investment banking, arranging bank and equity financing, structuring financing from multiple lenders and investors, reviewing existing credit facilities, restructuring existing loans, raising equity and debt capital, turnaround management, merger and acquisition services and recruiting new management personnel.

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

Our Investment Adviser and Administrator

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

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

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

Investment Advisory and Management Agreement

Pursuant to the advisory agreement with our Adviser we pay our Adviser a fee, as compensation for its services, consisting of a base management fee and an incentive fee.

The base management fee is assessed at an annual rate of 2.0% computed on the basis of the average value of our gross invested assets at the end of the two most recently completed quarters, which are total assets less the cash proceeds and cash and cash equivalent investments from the proceeds of our initial public offering that are not invested in debt and equity securities of portfolio companies. Through December 31, 2006, the base management fee was computed and payable quarterly. Beginning in periods subsequent to December 31, 2006, the base management fee will be computed and payable

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quarterly and will be assessed at an annual rate of 2.0% computed on the basis of the value of our average gross assets at the end of the two most recently completed quarters, which are total assets, including investments made with proceeds of borrowings, less any uninvested cash or cash equivalents resulting from borrowings. This new calculation was originally scheduled to begin in periods after March 31, 2006; however, on April 11, 2006, July 11, 2006 and October 10, 2006, our Board of Directors accepted voluntary waivers from our Adviser that allowed the current calculation of the base management fee to be effective through June 30, 2006, September 30, 2006 and December 31, 2006, respectively.

On January 9, 2007, our Board of Directors accepted a voluntary waiver from the Adviser to reduce the annual 2.0% base management fee on senior syndicated loan participations to 0.5% to the extent that proceeds resulting from borrowings were used to purchase such syndicated loan participations.

When our Adviser receives fees from our portfolio companies, such as investment banking fees, structuring fees or executive recruiting services fees, 50% of certain of these fees will be credited against the base management fee that we would otherwise be required to pay to our Adviser.

In addition, our Adviser services the loans held by Business Investment, in return for which the Adviser receives a 2.0% annual fee based on the monthly aggregate balance of loans held by Business Investment. Since we own these loans, all loan servicing fees paid to our Adviser are treated as reductions against the 2.0% base management fee. Overall, the base management fee due to our Adviser cannot exceed 2.0% of total assets (as reduced by cash and cash equivalents pledged to creditors) during any given fiscal year.

The incentive fee consists of two parts: an income-based incentive fee and a capital gains incentive fee. The income-based incentive fee will reward our Adviser if our quarterly net investment income (before giving effect to the incentive fee) exceeds 1.75% of our net assets. Our Adviser will receive a capital gains incentive fee that is determined and payable annually in arrears as of the end of each fiscal year (or upon termination of the Advisory Agreement, as of the termination date) and equals 20.0% of the Company s realized capital gains since inception through the end of the current fiscal year, if any, computed net of all realized capital losses since inception, and unrealized capital depreciation at the end of each fiscal year.

Administration Agreement

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

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States (GAAP) 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 materially from those estimates. Our accounting policies are more fully described in the *Notes to Consolidated Financial Statements* contained elsewhere in this report. We have identified our investment valuation process as our most critical accounting policy.

Investment Valuation

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

General Valuation Policy: Using procedures established by our Board of Directors, we value our investment portfolio each quarter. We carry our investments at fair value, as determined in good faith by or under the direction of our Board of Directors. Securities that are publicly traded, if any, are valued at the closing price of the exchange or securities market on

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which they are listed on the valuation date. Securities that are not traded on a public exchange or securities market, but for which a limited market exists and that have been rated by a nationally recognized statistical rating organizations (NRSRO), (such as certain participations in syndicated loans) are valued at the indicative bid price offered by the syndication agent on the valuation date.

Debt and equity securities that are not publicly traded, for which a limited market does not exist, or for which a limited market exists but that have not been rated by a NRSRO (or for which we have various degrees of trading restrictions) are valued at fair value as determined in good faith by or under the direction of our Board of Directors. In making the good faith determination of the value of these securities, we start with the cost basis of the security, which includes the amortized OID and PIK interest, if any. We then apply the methods set out below in *Valuation Methods*. Members of our Adviser s portfolio management team prepare the valuations of our investments in portfolio companies using the most recent portfolio company financial statements and forecasts. These individuals also consult with portfolio company senior management and ownership to obtain further updates on the portfolio company s performance, including information such as industry trends, new product development, and other operational issues. Due to the uncertainty inherent in the valuation process, such estimates of fair value may differ significantly from the values that would have been obtained had a ready market for the securities existed, and the differences could be material. Additionally, changes in the market environment and other events that may occur over the life of the investments may cause the gains or losses ultimately realized on these investments to be different than the valuations currently assigned. There is no single standard for determining fair value in good faith, as fair value depends upon circumstances of each individual case. In general, fair value is the amount that we might reasonably expect to receive upon the current sale of the security.

At December 31, 2006, we engaged Standard and Poor s Securities Evaluations, Inc. (SPSE) to submit opinions of value for 13 of our loan securities. We request that SPSE also evaluate and assign values to success fees (conditional interest included in some loan securities) when we determine that the probability of receiving a success fee on a given loan is above 6-8%, a threshold of significance. Upon completing our collection of data with respect to the investments (including the information described under *Credit Information*, the risk ratings of the loans described under *Loan Grading and Risk Rating* and the factors described under *Valuation Methods*), this valuation data is forwarded to SPSE for review and analysis. SPSE makes its independent assessment of the data that we have assembled and assesses its independent data to form an opinion as to what they consider to be the market values for the securities. With regard to its work, SPSE has issued the following paragraph:

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

SPSE opinions of value are submitted to our Board of Directors along with our Adviser s supplemental assessment and recommendation regarding valuation of each of these investments. our Adviser generally accepts the opinion of value given by SPSE, however in certain limited circumstances, such as when our Adviser may learn new information regarding an investment between the time of submission to SPSE and the date of the board assessment, our Adviser s conclusions as to value may differ from the opinion of value delivered by SPSE. Our Board of Directors then reviews whether our Adviser has followed its established procedures for determinations of fair value, and votes to accept or not accept the recommended valuation of our investment portfolio. Our Adviser and our management recommended, and the Board of Directors elected to accept, the opinions of value delivered by SPSE on the 13 loans in our portfolio as denoted on the Schedule of Investments as of December 31, 2006 included in our consolidated financial statements.

Because there is a delay between when we close an investment and when the investment can be evaluated by SPSE, new loans are not valued immediately by SPSE; rather, management makes its own determination about the value of these investments in accordance with our valuation policy. Because SPSE does not provide values for equity securities, our Adviser determines the fair value of these investments using valuation policies approved by our Board of Directors.

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

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

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

Company s System	**First NRSRO**	**Second NRSRO**	**Gladstone Investment s Description(a)**
>10	Baa2	BBB	Probability of Default (PD) during the next ten years is 4% and the Expected Loss (EL) is 1% or less
10	Baa3	BBB-	PD is 5 and the EL is 1 to 2%
9	Ba1	BB+	PD is 10 and the EL is 2 to 3%
8	Ba2	BB	PD is 16 and the EL is 3 to 4%
7	Ba3	BB-	PD is 17.8 and the EL is 4 to 5%
6	B1	B+	PD is 22.0 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 set forth are for a ten year term debt security. If the company s debt security is less than ten years then the probability of default is adjusted to a lower percentage for the shorter period which may move the security higher on the company s risk rating scale.

The above scale gives an indication of the probability of default and the magnitude of the loss if there is a default. Our policy is to stop accruing interest on an investment if we determine that interest is no longer collectible. At December 31, 2006, no payments were past due on any of our debt securities. Additionally, we do not risk rate our equity securities.

The following table lists the risk ratings for all non-syndicated loans in our portfolio at December 31, 2006 and March 31, 2006, representing approximately 35% and 31%, respectively, of all loans in our portfolio:

Rating	December 31, 2006	March 31, 2006
Highest	7.0	6.0
Average	6.0	5.3
Weighted Average	5.8	5.3
Lowest	5.0	5.0

The following table lists the risk ratings for syndicated loans in our portfolio that are not currently rated by an NRSRO at December 31, 2006 and March 31, 2006, representing approximately 14% and 12%, respectively, of all loans in our portfolio:

Rating	December 31, 2006	March 31, 2006
Highest	9.0	9.0
Average	7.8	7.8
Weighted Average	7.8	7.7
Lowest	7.0	7.0

For syndicated loans that are currently rated by an NRSRO, we risk rate such loans in accordance with the risk rating systems of major risk rating organizations such as those provided by a NRSRO. The following table lists the risk ratings for all syndicated loans in our portfolio that are currently rated by an NRSRO at December 31, 2006 and March 31, 2006, representing approximately 51% and 57%, respectively, of all loans in our portfolio:

Rating	December 31, 2006	March 31, 2006
Highest	BB-/Ba2	BB/Ba2
Average	B+/B1	B+/B1
Weighted Average	B+/B1	B/B2
Lowest	B/B1	B/B2

Valuation Methods: We determine the value of publicly-traded debt securities based on the closing price for the security on the exchange or securities market on which it is listed on the valuation date. We value debt securities that are not publicly traded, but for which a limited market for the security exists, such as participations in syndicated loans, at the indicative bid price offered by the syndication agent on the valuation date. At December 31, 2006, none of the debt securities in our portfolio were publicly traded and there was a limited market for 28 debt securities in our portfolio.

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

- the cost basis and the type of the security;
- the nature and realizable value of the collateral;
- the portfolio company s ability to make payments and discounted cash flow;
- reports from portfolio company senior management and board meetings;
- reported values of similar securities of the portfolio company or comparable companies; and
- changes in the economy affecting the portfolio company.

We value convertible debt, equity, success fees or other equity-like securities for which there is a market based on the market prices for such securities, even if that market is not robust. At March 31, 2006 and December 31, 2006 there was no market for any of the equity securities we owned. To value convertible debt, equity, success fees or other equity-like securities for which no market exists, we use the same information we would use for a debt security valuation described above, except risk-rating, as well as standard valuation techniques used by major valuation firms to value the equity securities of private companies. These valuation techniques consist of discounted cash flow of the expected sale price in the future, valuation of the securities based on recent sales in comparable transactions, and a review of similar companies that are publicly traded and the market multiple of their equity securities. At December 31, 2006 we had $24.4 million invested, at cost, in equity securities compared to our debt portfolio with a cost basis of $217.6 million. At March 31, 2006 we had $12.8 million invested, at cost, in equity securities compared to our debt portfolio with a cost basis of $140.5 million.

At December 31, 2006 we had total unrealized depreciation of approximately $1.4 million, which was primarily composed of net unrealized depreciation of our syndicated loan investments. At March 31, 2006 we had total unrealized appreciation of approximately $113,000, which was mainly composed of net unrealized appreciation of our syndicated loan investments.

Tax Status

Federal Income Taxes

We currently qualify and intend to continue to qualify for treatment as a RIC under Subtitle A, Chapter 1 of Subchapter M of the Internal Revenue Code of 1986, as amended (the Code). As a RIC, we are not subject to federal income tax on the portion of our taxable income and gains distributed to stockholders. To qualify as a RIC, we are required to distribute to stockholders at least 90% of investment company taxable income, as defined by the Code. It is our policy to pay out as a dividend up to 100% of those amounts.

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

Revenue Recognition

Interest and Dividend Income Recognition

Interest income is recorded on the accrual basis to the extent that such amounts are expected to be collected. We will stop accruing interest on investments when it is determined that interest is no longer collectible. There were no uncollectible accounts at December 31, 2006. Conditional interest, or a success fee, is recorded when earned upon full repayment of a loan investment. Dividend income on preferred equity securities is accrued to the extent that such amounts are expected to be collected and that we have the option to collect such amounts in cash. To date, we have not accrued any dividend income.

Services Provided to Portfolio Companies

The 1940 Act requires that a business development company make available managerial assistance to its portfolio companies by providing significant guidance and counsel concerning the management, operations, or business objectives and policies of the respective portfolio company. We provide these and other services to portfolio companies through our Adviser. Currently, neither we nor our Adviser receive fees in connection with managerial assistance.

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

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

We may receive fees for the origination and closing services we provide to portfolio companies through our Adviser. These fees are paid directly to us and are recognized as revenue upon closing of the originated investment.

RESULTS OF OPERATIONS

Three months ended December 31, 2006 compared to the three months ended December 31, 2005