GLADSTONE CAPITAL CORP
Form 497
April 17, 2007

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PROSPECTUS

75,000,000

COMMON STOCK
PREFERRED STOCK
DEBT SECURITIES

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

Our Securities may be offered directly to one or more purchasers, including existing stockholders in a rights offering, through agents designated from time to time by us, or to or through underwriters or dealers. The prospectus supplement relating to the offering will identify any agents or underwriters involved in the sale of our Securities, and will disclose any applicable purchase price, fee, commission or discount arrangement between us and our agents or underwriters or among our underwriters or the basis upon which such amount may be calculated. See Plan of Distribution. We may not sell any of our Securities through agents, underwriters or dealers without delivery of a prospectus supplement describing the method and terms of the offering of such Securities. Our common stock is traded on The Nasdaq Global Select Market under the symbol GLAD. As of April 16, 2007, the last reported sales price for our common stock was $24.41.

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

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

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

April 16, 2007

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

PROSPECTUS SUMMARY

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

GLADSTONE CAPITAL CORPORATION

General

We were incorporated under the General Corporation Laws of the State of Maryland on May 30, 2001. Our investment objectives are to achieve a high level of current income by investing in debt securities, consisting primarily of senior notes, second lien notes, and senior subordinated notes of established private businesses that are backed by leveraged buyout funds, venture capital funds or others, with a particular emphasis on second lien and senior subordinated notes. In addition, we may acquire existing loans, which meet this profile, from leveraged buyout funds, venture capital funds and others. We also seek to provide our stockholders with long-term capital growth through the appreciation in the value of warrants, or other equity instruments that we may receive when we extend loans. We operate as a closed-end, non-diversified management investment company, and have elected to be treated as a business development company under the Investment Company Act of 1940, as amended, which we refer to in this prospectus as the 1940 Act.

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

Our Investment Adviser and Administrator

Our affiliate, the Adviser, is our investment adviser and is led by a management team which has extensive experience in our lines of business. All of our directors and executive officers serve as either directors or executive officers, or both, of Gladstone Commercial Corporation, a publicly traded real estate investment trust; Gladstone Investment Corporation, a publicly traded business development company; our Adviser; and our Administrator. The Adviser also has a wholly-owned subsidiary, 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, Gladstone Investment and Gladstone Land Corporation, an agricultural real estate company owned by Mr. Gladstone. In the future, the 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 the Adviser pursuant to an investment advisory and management agreement since October 1, 2004. The Adviser was organized as a corporation under the laws of the State of Delaware on July 2, 2002, and is a registered investment adviser under the Investment Advisers Act of 1940, as amended. The Adviser is headquartered in McLean, Virginia, a suburb of Washington D.C., and also has offices in New York, New Jersey, Pennsylvania, Illinois, Texas and Kentucky.

Our Investment Objectives and Our Strategy

We seek to achieve a high level of current income by investing in debt securities, consisting primarily of senior notes, senior subordinated notes and junior subordinated notes, of established private businesses that are backed by leveraged buyout funds, venture capital funds or others. We also seek to provide our stockholders with long-term capital growth through the appreciation in the value of warrants or other equity instruments that we may receive when we make loans. There can be no assurance that we will realize our investment objectives. We seek to invest primarily in three categories of debt of private companies:

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

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

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

THE OFFERING

We may offer, from time to time, up to $75,000,000 of our Securities, on terms to be determined at the time of the offering. Our Securities may be offered at prices and on terms to be disclosed in one or more prospectus supplements. In the case of the offering of our common stock, the offering price per share less any underwriting commissions or discounts will not be less than the net asset value per share of our common stock at the time of the offering.

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

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

The Nasdaq Global Select Market Symbol	GLAD
Use of Proceeds	Unless otherwise specified in a prospectus supplement, we intend to use the net proceeds from the sale of our Securities for general corporate purposes. We expect the proceeds to be used first to pay down existing short-term debt, then to make investments in small and medium sized businesses in accordance with our investment objectives, and any remaining proceeds to be used for other general corporate purposes. See Use of Proceeds.
Dividends and Distributions	We have paid monthly dividends to the holders of our common stock and generally intend to continue to do so. The amount of the monthly dividends is determined by our board of directors on a quarterly basis and is based on our estimate of our annual investment company taxable income and net short-term taxable capital gains. See Price Range of Common Stock and Distributions. Certain additional amounts may be deemed as distributed to stockholders for income tax purposes. Other types of securities will likely pay distributions in accordance with their terms.
Taxation	We intend to continue to elect to be treated for federal income tax purposes as a regulated investment company, which we refer to as a RIC. Accordingly, we generally will pay no corporate-level federal income taxes on any ordinary income or capital gains that we distribute to our stockholders. To maintain our RIC status, we must meet specified source-of-income and asset diversification requirements and distribute annually at least 90% of our taxable ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, out of assets legally available for distribution. See Price Range of Common Stock and Distributions.
Trading at a Discount	Shares of closed-end investment companies frequently trade at a discount to their net asset value. The possibility that our shares may trade at a discount to our net asset value is separate and distinct from the risk that our net asset value per share may decline. We cannot predict whether our shares will trade above, at or below net asset value.
Certain Anti-Takeover Provisions	Our board of directors is divided into three classes of directors serving staggered three-year terms. This structure is intended to provide us with a greater likelihood of continuity of management, which may be necessary for us to realize the full value of our investments. A staggered board of directors also may serve to deter hostile takeovers or proxy contests, as may certain provisions of Maryland law and other measures we have adopted. See Certain Provisions of Maryland Law and of Our Articles of Incorporation and Bylaws.

Dividend Reinvestment Plan	We have a dividend reinvestment plan for our stockholders. This is an opt in dividend reinvestment plan, meaning that stockholders may elect to have their cash dividends automatically reinvested in additional shares of our common stock. Stockholders who do not so elect will receive their dividends in cash. Stockholders who receive distributions in the form of stock will be subject to the same federal, state and local tax consequences as stockholders who elect to receive their distributions in cash. See Dividend Reinvestment Plan.
Management Arrangements	Gladstone Management Corporation serves as our investment adviser, and Gladstone Administration serves serve as our administrator. We have entered into a license agreement with our Adviser, pursuant to which our Adviser has agreed to grant us a non-exclusive license to use the name Gladstone and the Diamond G logo. For a description of our Adviser, the Administrator, the Gladstone Companies and our contractual arrangements with these companies, see Management Certain Transactions Advisory and Administration Agreements, and Management Certain Transactions License Agreement.

Fees and Expenses

The following table is intended to assist you in understanding the costs and expenses that an investor in this offering will bear directly or indirectly. We caution you that some of the percentages indicated in the table below are estimates and may vary. Except where the context suggests otherwise, whenever this prospectus contains a reference to fees or expenses paid by us or Gladstone Capital, or that we will pay fees or expenses, stockholders will indirectly bear such fees or expenses as investors in Gladstone Capital. The following percentages were calculated based on net assets as of December 31, 2006.

	Current	
Stockholder Transaction Expenses		
Sales load (as a percentage of offering price)		%
Dividend reinvestment plan expenses (1)	None	
Estimated annual expenses (as a percentage of net assets attributable to common stock)		
Management fees (2)	2.99	%
Incentive fees payable under investment advisory and management agreement (20% of realized capital gains and 20% of pre-incentive fee net investment income) (3)	2.70	%
Interest Payments on Borrowed Funds (4)	2.77	%
Other expenses	1.19	%
Total annual expenses (estimated)(2)(5)	9.65	%

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

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

(3) The incentive fee consists of two parts: an income-based fee and a capital gains-based fee. The income-based fee will be payable quarterly in arrears, and will equal 20% of the excess, if any, of our pre-incentive fee net investment income that exceeds a 1.75% quarterly (7.0% annualized) hurdle rate, subject to a catch-up provision measured as of the end of each calendar quarter. The catch-up provision requires us to pay 100% of our pre-incentive fee net

investment income with respect to that portion of such income, if any, that exceeds the hurdle rate but is less than 125% of the quarterly hurdle rate (or 2.1875%) in any calendar quarter (8.75% annualized). The catch-up provision is meant to provide our Adviser with 20% of our pre-incentive fee net investment income as if a hurdle rate did not apply when our pre-incentive fee net investment income exceeds 125% of the quarterly hurdle rate in any calendar quarter (8.75% annualized). The income-based incentive fee will be computed and paid on income that may include interest that is accrued but not yet received in cash. Our pre-incentive fee net investment income used to calculate this part of the income incentive fee is also included in the amount of our gross assets used to calculate the 2% base management fee (see footnote 2 above). The quarter ended December 31, 2006 was the first quarter under our new advisory agreement and, as a result, was the first quarter in which the incentive fee was earned. For purposes of this computation, the gross amount of the December 31, 2006 fee, exclusive of any credits, was annualized to determine the percentage the fee represents of net assets. After giving effect to credits against the incentive fee, the annualized incentive fee was 1.36% of net assets as of December 31, 2006. There can be no assurance that our Adviser will give any credits against the incentive fee in the future. The capital gains-based portion of the fee did not have an effect on the incentive fee for purposes of this calculation since we have not realized overall net capital gains to date.

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

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

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

= 100% × (2.00% - 1.75%)

= 0.25%

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

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

= (100% × 0.4375%) + (20% × 0.1125%)

= 0.4375% + 0.0225%

= 0.46%

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

= 20% × (6% - 1%)

= 20% × 5%

= 1%

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

(4) We have entered into a revolving credit facility, under which our borrowing capacity is $170 million, effective February 9, 2007. We have drawn down on this credit facility and we expect to borrow additional funds in the future up to an amount so that our asset coverage, as defined in the 1940 Act, is at least 200% after each issuance of our senior securities. Assuming that we borrowed $170 million at an interest rate of 6%,

interest payments on borrowed funds would have been 6% of our net assets as of December 31, 2006.

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

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Example

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

	1 Year	3 Years	5 Years	10 Years
You would pay the following expenses on a $1,000 investment, assuming a 5% annual return	$69	$203	$331	$631

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

This example and the expenses in the table above should not be considered a representation of our future expenses, and actual expenses (including the cost of debt and incentive fees, if any, and other expenses) may be greater or less than those shown. As noted in the Fees and Expenses table above, we estimate that annual incentive fees payable under the investment advisory and management agreement will be 2.70% of net assets attributable to common stock.

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

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

	Year Ended September 30, 2006	Year Ended September 30, 2005	Year Ended September 30, 2004	Year Ended September 30, 2003	Year Ended September 30, 2002	Three Months Ended December 31, 2006 (unaudited)	Three Months Ended December 31, 2005 (unaudited)
Total Investment Income	$ 26,899,846	$ 23,949,759	$ 20,395,968	$ 15,154,874	$ 10,455,703	$ 8,233,718	$ 6,030,319
Total Net Expenses	$ 7,549,266	$ 6,663,614	$ 7,103,193	$ 3,858,953	$ 2,839,102	$ 3,070,792	$ 1,587,905
Net Investment Income	$ 19,350,580	$ 17,286,145	$ 13,292,775	$ 11,295,921	$ 7,616,601	$ 5,162,926	$ 4,442,414
Net Increase in Net Assets Resulting from Operations	$ 24,430,235	$ 15,490,682	$ 10,570,290	$ 11,073,581	$ 7,616,601	$ 4,163,603	$ 8,233,349
Per Share Data:							
Net Increase in Net Assets Resulting from Operations:							
Basic	$ 2.15	$ 1.37	$ 1.05	$ 1.10	$ 0.76	$ 0.34	$ 0.73
Diluted	$ 2.10	$ 1.33	$ 1.02	$ 1.09	$ 0.75	$ 0.34	$ 0.71
Cash Distributions Declared per Share	$ 1.635	$ 1.515	$ 1.365	$ 1.10	$ 0.81	$ 0.42	$ 0.405
Statement of Assets and Liabilities Data:							
Total Assets	$ 225,783,215	$ 205,793,094	$ 215,333,727	$ 214,566,663	$ 172,922,039	$ 257,420,187	$ 212,106,143
Net Assets	$ 172,570,487	$ 151,610,683	$ 152,226,655	$ 130,802,382	$ 130,663,273	$ 170,083,122	$ 155,417,011
Other Data:							
Number of Portfolio Companies at Period End	32	28	16	11	7	48	27
Principal Amount of Loan Originations	$ 135,954,879	$ 143,794,006	$ 86,267,500	$ 47,011,278	$ 97,705,054	$ 52,311,008	$ 26,688,457
Principal Amount of Loan Repayments	$ 124,009,929	$ 88,019,136	$ 47,158,995	$ 18,005,827	$ 18,387,191	$ 23,967,229	$ 38,702,066
Total Return (1)	5.21 %	5.93 %	24.40 %	21.74 %	9.60 %	10.31 %	(3.44 %)
Weighted Average Yield on Investments (2):							
With PIK Interest (3)	12.74 %	12.36 %	13.78 %	13.86 %	14.79 %	n/a	12.57 %

Without PIK Interest (3)	12.74 %	12.23 %	13.44 %	13.14 %	13.82 %	13.68 %	12.58 %

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

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

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

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ADDITIONAL INFORMATION

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

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

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

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

RISK FACTORS

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

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

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

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

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

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

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

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

We operate in a highly competitive market for investment opportunities.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

of any collateral, the portfolio company s earnings and cash flows and its ability to make payments on its obligations, the markets in which the portfolio company does business, comparison to publicly traded companies, discounted cash flow, and other relevant factors. Because such valuations, particularly valuations of private securities and private companies, are inherently uncertain, may fluctuate over short periods of time, and may be based on estimates, our determinations of fair value may differ materially from the values that might have resulted from a readily available market for these securities.

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

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

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

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

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

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

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

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

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

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

We anticipate using a combination of equity and long-term and short-term borrowings to finance our lending activities. As a result, a portion of our income will depend upon the difference between the rate at which we borrow funds and the rate at which we loan these funds. Certain of our borrowings may be at fixed rates and others at variable rates. Ultimately, we expect approximately 20% of the loans in our portfolio to be at fixed rates and approximately 80% to be at variable rates determined on the basis of a benchmark prime rate. As of December 31, 2006, our portfolio had approximately 58% of the total of the loan cost value at variable rates with a floor, approximately 3% of the total loan cost value at variable rates with a floor and ceiling, and the remaining 39% at variable rates. Pursuant to our initial line of credit, we agreed to enter into hedging transactions such as interest rate cap agreements, futures, options and forward contracts. To date, we hold only one interest rate cap agreement. In the event that we securitize a portion of our loan portfolio in the future, we believe that we will likely be required to enter into similar arrangements with respect to the securitized loans. While hedging activities may insulate us against adverse fluctuations in interest rates, they may also limit our ability to participate in the benefits of lower interest rates with respect to the hedged portfolio. Adverse developments resulting from changes in interest rates or hedging transactions could have a material adverse effect on our business, financial condition and results of operations.

Our credit facility imposes certain limitations on us.

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

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

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

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

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

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

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

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

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

Our executive officers and directors, and the officers and directors of our Adviser and our Administrator serve or may serve as officers, directors or principals of entities that operate in the same or a related line of business as we do or of investment funds managed by our affiliates. Accordingly, they may have obligations to investors in those entities, the fulfillment of which might not be in the best interests of us or our stockholders. In addition, all of our directors and executive officers serve as either directors or executive officers, or both, of Gladstone Commercial and Gladstone Investment and our Adviser and Administrator also provide investment advisory and administrative services to these affiliates as well as Gladstone Land. In the future, the Adviser and the Administrator may provide investment advisory and administrative services, as applicable, to other funds, both public and private, of which it is the sponsor. Moreover, the Adviser may establish or sponsor other investment vehicles which from time to time may have potentially overlapping investment objectives with those of ours and accordingly may invest in, whether principally or secondarily, asset classes similar to those we targeted. While the Adviser generally has broad authority to make investments on behalf of the investment vehicles that it advises, the Adviser has adopted investment allocation procedures to address these potential conflicts and intends to direct investment opportunities to the Gladstone affiliate with the investment strategy that most closely fits the investment opportunity to ensure the fair and equitable treatment of all the funds it manages. Nevertheless, the management of the Adviser may face conflicts in the allocation of investment opportunities to other entities managed by the Adviser. As a result, it is possible that we may not be given the opportunity to participate in certain investments made by other members of the Gladstone Companies or investment funds managed by investment managers affiliated with the Adviser.

In certain circumstances, we may make investments in a portfolio company in which one of our affiliates has or will have an investment, subject to satisfaction of any regulatory restrictions and, where required, to the prior approval of our board of directors. As of December 31, 2006, our board of directors has approved the following types of co-investment transactions:

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

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

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

In the course of our investing activities, we will pay management and incentive fees to the Adviser and will reimburse the Administrator for certain expenses it incurs. As a result, investors in our common stock will invest on a gross basis and receive distributions on a net basis after expenses, resulting in, among other things, a lower rate of return than one might achieve through our investors themselves making direct investments. As a result of this arrangement, there may be times when the management team of the Adviser or the Administrator has interests that differ from those of our stockholders, giving rise to a conflict.

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

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

We may experience fluctuation in our quarterly results.

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

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

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

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

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

The market price of our shares may fluctuate significantly.

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

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

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

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

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

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

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

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

USE OF PROCEEDS

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

PRICE RANGE OF COMMON STOCK AND DISTRIBUTIONS

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

Our common stock is quoted on The Nasdaq Global Select Market under the symbol GLAD. Our common stock has historically traded at prices above its net asset value. There can be no assurance, however, that any premium to net asset value will be maintained. As of April 6, 2007, we had 82 stockholders of record. The following table sets forth the range of high and low sales prices of our common stock as reported on The Nasdaq Global Select Market (for periods prior to July 1, 2006, The Nasdaq National Market) and the dividends declared by us for the last two completed fiscal years and the current fiscal year through April 16, 2007.

	Net Asset Value Per Share	Closing Price High	Low	Premium of High to Net Asset Value	Premium of Low to Net Asset Value	Dividends Declared
FY 2005						
First Quarter	$ 13.58	$ 25.35	$ 22.61	$ 11.77	$ 9.03	$ 0.360
Second Quarter	$ 13.64	$ 24.80	$ 20.94	$ 11.16	$ 7.30	$ 0.360
Third Quarter	$ 13.61	$ 23.96	$ 21.18	$ 10.35	$ 7.57	$ 0.390
Fourth Quarter	$ 13.41	$ 26.00	$ 22.55	$ 12.59	$ 9.14	$ 0.405
FY 2006						
First Quarter	$ 13.74	$ 23.68	$ 20.36	$ 9.94	$ 6.62	$ 0.405
Second Quarter	$ 13.84	$ 22.42	$ 19.96	$ 8.58	$ 6.12	$ 0.405
Third Quarter	$ 13.95	$ 23.50	$ 20.79	$ 9.55	$ 6.84	$ 0.405
Fourth Quarter	$ 14.02	$ 23.08	$ 21.10	$ 9.06	$ 7.08	$ 0.420
FY 2007						
First Quarter	$ 13.88	$ 25.21	$ 21.96	$ 11.33	$ 8.08	$ 0.420
Second Quarter	*	$ 24.24	$ 21.24	*	*	$ 0.420
Third Quarter (through April 16, 2007)	*	$ 24.41	$ 23.59	*	*	$ 0.420

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

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

* Not available.

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

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

	Year Ended September 30, 2006	Year Ended September 30, 2005	Year Ended September 30, 2004	Year Ended September 30, 2003	Year Ended September 30, 2002	Three Months Ended December 31, 2006 (unaudited)	Three Months Ended December 31, 2005 (unaudited)
Total Investment Income	$ 26,899,846	$ 23,949,759	$ 20,395,968	$ 15,154,874	$ 10,455,703	$ 8,233,718	$ 6,030,319
Total Net Expenses	$ 7,549,266	$ 6,663,614	$ 7,103,193	$ 3,858,953	$ 2,839,102	$ 3,070,792	$ 1,587,905
Net Investment Income	$ 19,350,580	$ 17,286,145	$ 13,292,775	$ 11,295,921	$ 7,616,601	$ 5,162,926	$ 4,442,414
Net Increase in Net Assets Resulting from Operations	$ 24,430,235	$ 15,490,682	$ 10,570,290	$ 11,073,581	$ 7,616,601	$ 4,163,603	$ 8,233,349
Per Share Data:							
Net Increase in Net Assets Resulting from Operations:							
Basic	$ 2.15	$ 1.37	$ 1.05	$ 1.10	$ 0.76	$ 0.34	$ 0.73
Diluted	$ 2.10	$ 1.33	$ 1.02	$ 1.09	$ 0.75	$ 0.34	$ 0.71
Cash Distributions Declared per Share	$ 1.635	$ 1.515	$ 1.365	$ 1.10	$ 0.81	$ 0.42	$ 0.405
Statement of Assets and Liabilities Data:							
Total Assets	$ 225,783,215	$ 205,793,094	$ 215,333,727	$ 214,566,663	$ 172,922,039	$ 257,420,187	$ 212,106,143
Net Assets	$ 172,570,487	$ 151,610,683	$ 152,226,655	$ 130,802,382	$ 130,663,273	$ 170,083,122	$ 155,417,011
Other Data:							
Number of Portfolio Companies at Period End	32	28	16	11	7	48	27
Principal Amount of Loan Originations	$ 135,954,879	$ 143,794,006	$ 86,267,500	$ 47,011,278	$ 97,705,054	$ 52,311,008	$ 26,688,457
Principal Amount of Loan Repayments	$ 124,009,929	$ 88,019,136	$ 47,158,995	$ 18,005,827	$ 18,387,191	$ 23,967,229	$ 38,702,066
Total Return (1)	5.21 %	5.93 %	24.40 %	21.74 %	9.60 %	10.31 %	(3.44 %)
Weighted Average Yield on Investments (2):							
	12.74 %	12.36 %	13.78 %	13.86 %	14.79 %	n/a	12.57 %

With PIK Interest (3)							
Without PIK Interest (3)	12.74	% 12.23	% 13.44	% 13.14	% 13.82	% 13.68	% 12.58 %

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

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

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

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

OVERVIEW

We were incorporated under the General Corporation Laws of the State of Maryland on May 30, 2001. Our investment objectives are to achieve a high level of current income by investing in debt securities, consisting primarily of senior notes, second lien notes, and senior subordinated notes of established private businesses that are backed by leveraged buyout funds, venture capital funds or others, with a particular emphasis on second lien and senior subordinated notes. In addition, we may acquire existing loans, which meet this profile, from leveraged buyout funds, venture capital funds and others. We also seek to provide our stockholders with long-term capital growth through the appreciation in the value of warrants, or other equity instruments that we may receive when we extend loans. We operate as a closed-end, non-diversified management investment company, and have elected to be treated as a business development company under the 1940 Act.

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

Our loans typically range from $5 million to $15 million, although this investment size may vary proportionately as the size of our capital base changes, generally mature in no more than seven years and accrue interest at fixed or variable rates. Some of our loans may contain a provision that calls for some portion of the interest payments to be deferred and added to the principal balance so that the interest is paid, together with the principal, at maturity. This form of deferred interest is often called paid in kind or PIK interest, and, when earned, we record PIK interest as interest income and add the PIK interest to the principal balance of the loans. We seek to avoid PIK interest with all potential investments under review. We currently do not hold any investments with PIK and, therefore, there was no PIK accrued on our balance sheet as of December 31, 2006.

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

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

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

In addition, as a business development company under the 1940 Act, we are required to make available significant managerial assistance to our portfolio companies. We provide these services through our Adviser, who provides these services on our behalf through its officers who are also our officers. Currently, neither we nor the Adviser charges a fee for managerial assistance.

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

Our Adviser also receives fees for monitoring and reviewing portfolio company investments. These fees are recurring and are generally paid annually or quarterly in advance to our Adviser throughout the life of the investment. Fees of this nature are recorded as revenue by our Adviser when earned and are not credited against the base management fees. While our Adviser receives all fees in connection with our investments, such fees received by our Adviser, with the exception of monitoring and review fees, are entirely credited to us as a reduction of the advisory fee payable under the advisory agreement between us.

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

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

During the three months ended December 31, 2006, we extended, directly or through participations, approximately $52.3 million of new loans to a total of 20 companies. Also, during the three months ended December 31, 2006, one borrower repaid its loans ahead of contractual maturity and we sold or were repaid in full on two syndicated loans, and we received scheduled contractual principal repayments of approximately $3.1 million, for total principal repayments of approximately $24.0 million. During the fiscal year ended September 30, 2006, we extended, directly or through participations, approximately $136 million of new loans to a total of 22 companies. Also, during the fiscal year ended September 30, 2006, 7 borrowers repaid their loans ahead of contractual maturity and we sold or repaid in full on 9 syndicated loans, and sold 3 loan investments at a loss for an aggregate return of capital of approximately $20 million and we received scheduled contractual principal repayments of approximately $20 million, for total principal repayments of approximately $124 million. Since our initial public offering in August 2001, we have made 157 different loans to, or investments in, 88 companies for a total of approximately $550.4 million, before giving effect to principal repayments on investments and divestitures.

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

Our Investment Adviser and Administrator

Our affiliate, the Adviser, is our investment adviser and is led by a management team which has extensive experience in our lines of business. All of our directors and executive officers serve as either directors or executive officers, or both, of Gladstone Commercial Corporation, a publicly traded real estate investment trust; Gladstone Investment Corporation, a publicly traded business development company; our Adviser; and our Administrator. The Adviser also has a wholly-owned subsidiary, Gladstone Administration, LLC, 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, Gladstone Investment and Gladstone Land Corporation, an agricultural real estate company owned by Mr. Gladstone. In the future, the Adviser may provide investment advisory and administrative services to other funds, both public and private, of which it is the sponsor.

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

Investment Advisory and Management Agreements

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

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

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

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

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

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

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

Quarterly Incentive Fee Based on Net Investment Income

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

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

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

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

In addition to the base management and incentive fees under the Amended Advisory Agreement, certain fees received by our Adviser from our portfolio companies were credited against the investment advisory fee under the Initial Advisory Agreement, and will continue to be paid to our Adviser and credited under the Amended Advisory Agreement.

Our Adviser services our loan portfolio pursuant to a loan servicing agreement with Gladstone Business Loan, LLC in return for a 1.5% annual fee, based on the monthly aggregate outstanding loan balance of the loans pledged under our credit facility. Effective in April 2006, our Adviser s board of directors voted to reduce the portion of the annual fee to 0.5% for senior syndicated loans. This fee directly reduces the amount of fee payable under both the Initial and Amended Advisory Agreements.

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 allocable expenses by the percentage of our average total assets (the total assets at the beginning and end of each quarter) in comparison to the average total assets of all companies managed by our Adviser under similar agreements.

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States, which we refer to as GAAP, requires management to make estimates and assumptions that affect the reported consolidated amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, and revenues and expenses during the period reported. Actual results could differ materially from those estimates. Our accounting policies are more fully described in the Notes to Consolidated Financial Statements contained elsewhere in the registration statement of which this prospectus is a part. We have identified our investment valuation process as our most critical accounting policy.

Investment Valuation

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

General Valuation Policy: Using procedures established by our board of directors, we value our investment portfolio each quarter. We carry our investments at fair value, as determined in good faith by or under the direction of our board of directors. Securities that are publicly traded, if any, are valued at the closing price of the exchange or securities market on which they are listed on the valuation date. Securities that are not traded on a public exchange or securities market, but for which a limited market exists and that have been rated by a nationally recognized statistical rating organizations, which we refer to as an 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 SPSE to submit opinions of value for most of our loan securities. We request that SPSE also evaluate and assign values to success fees (conditional interest included in some loan securities) when we determine that the probability of receiving a success fee on a given loan is above 6-8%, a threshold of significance. Upon completing our collection of data with respect to the investments (including the information described under Credit Information, the risk ratings of the loans described under Loan Grading and Risk Rating and the factors described under Valuation Methods), this valuation data is forwarded along to SPSE for review and analysis. SPSE makes its independent assessment of the data that we have assembled and assesses its independent data to form an opinion as to what they consider to be the market values for the securities. With regard to its work, SPSE has issued the following paragraph:

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

SPSE opinions of value are submitted to our board of directors along with our Adviser s supplemental assessment and recommendation regarding valuation of each of these investments. Our Adviser generally accepts the opinion of value given by SPSE, however in certain limited circumstances, such as when our Adviser may learn new information regarding an investment between the time of submission to SPSE and the date of the board assessment, our Adviser s conclusions as to value may differ from the opinion of value delivered by SPSE. Our board of directors then reviews whether our Adviser has followed its established procedures for determinations of fair value, and votes 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 loans in our portfolio as denoted on the schedule of investments as of December 31, 2006, September 30, 2006 and September 30, 2005, included in our consolidated financial statements.

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

Credit Information: Our Adviser monitors a wide variety of key credit statistics that provide information regarding our portfolio companies to help us assess credit quality and portfolio performance. If we held a controlled or affiliate investment, we and our Adviser would participate in periodic board meetings of such portfolio companies and also require them to provide annual audited and monthly unaudited financial statements. Using these statements and board discussions, our Adviser would calculate and evaluate the credit statistics.

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

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

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

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

The above scale gives an indication of the probability of default and the magnitude of the loss if there is a default. Our policy is to stop accruing interest on an investment if we determine that interest is no longer collectible. Currently, none of our investments are on non-accrual. At 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, September 30, 2006 and September 30, 2005, representing approximately 64%, 73% and 62%, respectively, of all loans in our portfolio:

Rating	Dec. 31, 2006	Sept. 30, 2006	Sept. 30, 2005
Average	**7.1**	**7.2**	**7.6**
Weighted Average	**7.1**	**7.2**	**7.6**
Highest	**10.0**	**9.0**	**9.0**
Lowest	**6.0**	**6.0**	**6.0**

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

Rating	Dec. 31, 2006	Sept. 30, 2006	Sept. 30, 2005
Average	**6.0**	**6.1**	**6.2**
Weighted Average	**6.0**	**6.3**	**6.3**
Highest	**8.0**	**8.0**	**7.0**
Lowest	**4.0**	**4.0**	**5.0**

For syndicated loans that are currently rated by an NRSRO, we risk rate such loans in accordance with the risk rating systems of major risk rating organizations such as those provided by a NRSRO. The following table lists the risk ratings for all syndicated loans in our portfolio that are currently rated by an NRSRO at December 31, 2006, September 30, 2006 and September 30, 2005, representing approximately 19%, 10% and 6%, respectively, of all loans in our portfolio:

Rating	Dec. 31, 2006	Sept. 30, 2006	Sept. 30, 2005
Average	**CCC+/Caa1**	**B/B2**	**CCC+/Caa1**
Weighted Average	**CCC+/Caa1**	**B-/B3**	**CCC/Caa2**
Highest	**B-/B3**	**BB-/Ba2**	**CCC+/B3**
Lowest	**CCC/Caa1**	**CCC/Caa1**	**CCC+/Caa2**

Valuation Methods: We determine the value of publicly-traded debt securities based on the closing price for the security on the exchange or securities market on which it is listed on the valuation date. We value debt securities that are not publicly traded, but for which a limited market for the security exists, such as participations in syndicated loans, at the indicative bid price offered by the syndication agent on the valuation date. At December 31, 2006, none of the debt securities in our portfolio were publicly traded and there was a limited market for 24 debt securities in our portfolio. At September 30, 2006, none of the debt securities in our portfolio were publicly traded and there was a limited market for 9 debt securities in our portfolio. At September 30, 2005, none of the debt securities in our portfolio were publicly traded and there was a limited market for 12 debt securities in our portfolio.

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

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

We value convertible debt, equity, success fees or other equity-like securities for which there is a market based on the market prices for such securities, even if that market is not robust. At December 31, 2006 and September 30, 2006, there was no market for any of the equity securities we owned. To value equity securities for which no market exists, we use the same information we would use for a debt security valuation described above, except risk-rating, as well as standard valuation techniques used by major valuation firms to value the equity securities of private companies. These valuation techniques consist of discounted cash flow of the expected sale price in the future, valuation of the securities based on recent sales in comparable transactions, and a review of similar companies that are publicly traded and the market multiple of their equity securities. At December 31, 2006, September 30, 2006 and September 30, 2005, we had $37,000 invested, at cost, in equity securities compared to our debt portfolio with a cost basis of $244,500,584, $216,165,986 and $205,338,554, respectively.

At December 31, 2006, we had total unrealized appreciation of $1,788,014, which was mainly comprised of unrealized appreciation of $731,616 on our warrants of Finn Corporation and a $360,068 success fee value on Badanco Acquisition Corp. The unrealized appreciation was partially offset by unrealized depreciation of $1,352,629, primarily comprised of unrealized depreciation of $538,281 on LocalTel Inc., $350,000 on Visual Edge Technology, Inc., and $261,888 on Consolidated Bedding, Inc. In the aggregate, we recorded net unrealized appreciation of $435,385.

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

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

Tax Status

Federal Income Taxes

We currently qualify and intend to continue to qualify for treatment as a RIC under Subtitle A, Chapter 1 of Subchapter M of the Code. As a RIC, we are not subject to federal income tax on the portion of our taxable income and gains distributed to stockholders. To qualify as a RIC, we are required to distribute to stockholders at least 90% of investment company taxable income, as defined by the Code. We have a policy to pay out as a dividend up to 100% of that amount. In an effort to avoid certain excise taxes imposed on RICs, we currently intend to distribute during each calendar year, an amount at least equal the sum of (1) 98% of our ordinary income for the calendar year, (2) 98% of our capital gains in excess of capital losses for the one-year period ending on October 31 of the calendar year and (3) any ordinary income and net capital gains for preceding years that were not distributed during such years.

Revenue Recognition

Interest Income Recognition

Interest income is recorded on the accrual basis to the extent that such amounts are expected to be collected. We will stop accruing interest on investments and write off any previously accrued and uncollected interest when it is determined that interest is no longer collectible. Conditional interest or a success fee is recorded when earned upon full repayment of a loan investment.

Paid in Kind Interest

In the future, we may hold loans in our portfolio which contain a PIK interest provision. The PIK interest, computed at the contractual rate specified in each loan agreement, is added to the principal balance of the loan and recorded as interest income. To maintain our status as a RIC, this non-cash source of income must be paid out to stockholders in the form of dividends, even though we have not yet collected the cash.

RESULTS OF OPERATIONS

Comparison of the Three Months Ended December 31, 2006 to the Three Months Ended December 31, 2005

Investment Income

Investment income for the three months ended December 31, 2006 was $8,233,718, as compared to $6,030,319 for the three months ended December 31, 2005. Interest income from our investment portfolio increased from December 31, 2005 due to the increase in new loans of $52,311,008, offset by principal repayments and investment sales of approximately $23,967,229.

Interest income from our investments in debt securities of private companies was $7,898,600 for the three months ended December 31, 2006 as compared with $5,847,107 for the three months ended December 31, 2005, which included approximately $33,000 of PIK interest. This increase consisted of $52,311,008 of new investments, offset by principal repayments and investment sales of $23,967,229. As a result of a full repayment by Mistras Holdings Corp. in November 2006, we recorded a success fee of approximately $1,200,000.

The annualized weighted average yield on our portfolio for the three months ended December 31, 2006 was 13.7%; there was no PIK interest accrued during the three months ended December 31, 2006. The annualized weighted average yield on our portfolio for the three months ended December 31, 2005 was 12.6% (with and without giving effect to PIK interest).

Interest income from invested cash and cash equivalents for the three months ended December 31, 2006 was $37,269, as compared to $8,912 for the three months ended December 31, 2005.

For the three months ended December 31, 2006 and December 31, 2005, we recorded $138,191 and $107,093, respectively, in interest income from loans to our employees in connection with the exercise of employee stock options. The increase is the result of additional loans issued in connection with employee stock option exercises during the fourth quarter of the previous fiscal year.

For the three months ended December 31, 2006, we recorded $159,658 of prepayment fees and other income as compared to $67,207 for the three months ended December 31, 2005. The income for both periods consisted of prepayment penalty fees received upon the full repayment of certain loan investments ahead of contractual maturity and prepayment fees received upon the early unscheduled principal repayments which, in both instances, were based on a percentage of the outstanding principal amount of the loan at the date of prepayment.

Operating Expenses

Operating expenses for the three months ended December 31, 2006 were $3,070,792, as compared to $1,537,668 for the three months ended December 31, 2005. Operating expenses for the three months ended December 31, 2006 reflected a significant increase in interest expense and management fees, as well as the addition of the incentive and administration fees, under the Amended Advisory and Administration Agreements.

Loan servicing fees of $719,152 were incurred for the three months ended December 31, 2006, as compared to $715,415 for the three months ended December 31, 2005. These fees were incurred in connection with a loan servicing agreement between Business Loan and our Adviser, which is based on the size of the portfolio. These fees were reduced against the amount of the base management fee due to our Adviser.

For the three months ended December 31, 2006, we incurred a gross base management fee of $398,432 less credits for fees received by our Adviser of $311,000, for a net base management fee of $87,432 as compared to the three months ended December 31, 2005, in which we incurred a gross base management fee of $268,701, less credits for fees received by our Adviser of $550,000, for a net base management credit of $281,299. The base management fee is computed quarterly as described under *Investment Advisory and Management Agreement.* The fees increased in the current period due to the growth of the investment portfolio as compared to the same period of the prior year and fewer credits for fees received by our Adviser which reduce the base management fee.

Effective October 1, 2006, the income based incentive fee became effective and as such we recorded a gross incentive fee of $1,148,483, which was reduced by a voluntary waiver issued by our Adviser s board of directors of $568,944, which resulted in a net incentive fee of $579,489, which is recorded in fees due to Adviser on our consolidated statements of assets and liabilities. There was no incentive fee recorded for the three months ended December 31, 2005, as the Amended Advisory Agreement was not in effect.

Effective October 1, 2006, the Administration Agreement became effective in which we provide payments equal to our allocable portion of our Administrator s overhead expenses in performing its obligations under the Administration Agreement including, but not limited to, rent for employees of our Administrator, and our allocable portion of the salaries and benefits expenses of our chief financial officer, chief compliance officer and controller and their respective staffs. We incurred an administration fee of $126,085 for the three months ended December 31, 2006. There was no administration fee recorded during the three months ended December 31, 2005, as the Administration Agreement was not in effect.

Professional fees, consisting primarily of legal and audit fees, for the three months ended December 31, 2006 were $110,920, as compared to $122,466 for the three months ended December 31, 2005. The slight decrease is due to the reimbursement of certain legal fees at the time of the funding of an investment.

Amortization of deferred financing costs, in connection with our line of credit, was $58,300 for the three months ended December 31, 2006 and $26,250 for the three months ended December 31, 2005. The increase is due to the amortization of additional fees incurred with our line of credit which were not in place during the prior year period.

Interest expense for the three months ended December 31, 2006 was $1,120,257, as compared to $652,078 for the three months ended December 31, 2005. This increase is primarily a result of increased borrowings under our line of credit during the three months ended December 31, 2006, which borrowings were used, in part, to finance our increased investments, borrowings remaining outstanding for longer periods of time and an increase in the interest rates on our borrowings.

Stockholder related costs for the three months ended December 31, 2006 were $63,728, as compared to $128,935 for the three months ended December 31, 2005. Stockholder related costs include such recurring items as transfer agent fees, NASDAQ listing fees, SEC filing fees and annual report printing fees. These fees decreased during the three months ended December 31, 2006 since there was no special proxy solicitation filed as there was during the three months ended December 31, 2005.

Directors fees for the three months ended December 31, 2006 were $54,250, as compared to $24,000 for the three months ended December 31, 2005 due to the increase in annual stipend fees and their related monthly amortization.

Insurance expense for the three months ended December 31, 2006 was $62,694, as compared to $50,777 for the three months ended December 31, 2005. The increase is primarily the result of an increase in the amortization of our directors and officers insurance policy premiums.

There was no stock option compensation expense recorded for the three months ended December 31, 2006 as there was no longer a stock option plan in effect. Stock option compensation expense for the three months ended December 31, 2005 was $43,257 and was the result of the adoption of the SFAS No. 123 (revised 2004) *Share-based Payment*.

Other expenses were $88,485 for the three months ended December 31, 2006, as compared to $55,789 for the three months ended December 31, 2005. The expenses primarily represent direct expenses such as travel related specifically to our portfolio companies, loan evaluation services for our portfolio companies, press releases and backup servicer expenses.

Income Tax Expense

During the three months ended December 31, 2005, Gladstone Capital Corporation recorded approximately $50,000 in connection with penalties incurred on misclassified revenue on its fiscal year 2004 corporate tax return.

Net Realized Gain (Loss) on Sale of Investments

During the three months ended December 31, 2006, we sold a syndicate loan investment for a gain of $2,314 as compared to an aggregate loss of $1,180,595 from the sale of two investments during the three months ended December 31, 2005.

Realized Gain on Settlement of Derivative

During the three months ended December 31, 2006, we received interest rate cap agreement payments of $12,554 as a result of the one month LIBOR exceeding 5%. There was no realization during the three months ended December 31, 2005 as the one month LIBOR was below 5%.

Net Unrealized Depreciation on Derivative

During the three months ended December 31, 2006, we recorded net unrealized depreciation of $9,812 due to a decrease in the fair market value of our interest rate cap agreement, as compared to unrealized depreciation of $892 during the three months ended December 31, 2005.

Net Unrealized Appreciation (Depreciation) on Investments

For the three months ended December 31, 2006, we recorded net unrealized depreciation on investments of $1,004,379, as compared to net unrealized appreciation of $4,972,422, for the three months ended December 31, 2005. The unrealized depreciation is mainly attributable to the depreciated fair value on certain investments. The unrealized appreciation for the three months ended December 31, 2005 is mainly attributable to the early repayment or sale of underperforming loans.

Net Increase in Net Assets from Operations

Overall, we realized a net increase in net assets resulting from operations of $4,163,603 for the three months ended December 31, 2006. Based on a weighted-average of 12,294,340 basic and diluted shares outstanding, our net increase in net assets from operations per weighted-average common share for the three months ended December 31, 2006 was $0.34, basic and diluted.

For the three months ended December 31, 2005, we realized a net increase in net assets resulting from operations of $8,233,349. Based on a weighted-average of 11,306,510 (basic) and 11,573,620 (diluted) shares outstanding, our net increase in net assets from operations per weighted-average common share for the three months ended December 31, 2005 was $0.73 (basic) and $0.71 (diluted).

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

Investment Income

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

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

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

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

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

Operating Expenses

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Income Tax Expense

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

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

Realized (Loss) Gain on Sale of Investments

During the fiscal year ended September 30, 2006, we sold our investments in ARI Holdings, Inc. and Marcal Paper Mills, Inc. for an aggregate loss of approximately $1.18 million and were repaid on several syndicated loans which contained unamortized premiums resulting in realized gains of approximately $149,000 for a total net realized loss of approximately $904,000. During the fiscal year ended September 30, 2005, we sold our $975,000 syndicated participation in Burt s Bees, Inc. for a gain of $9,750 and we sold our $2.0 million syndicated participation in Marietta Corp. for a gain of $20,000.

Realized Gain on Settlement of Derivative

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

Net Unrealized Depreciation on Derivative

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

Net Unrealized Appreciation (Depreciation) on Investments

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

Net Increase in Net Assets from Operations

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

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

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

Investment Income

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

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

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

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

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

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

Operating Expenses

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

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

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

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

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

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

Professional fees, consisting primarily of legal and audit fees, for the fiscal year ended September 30, 2005 were approximately $725,000, as compared to approximately $580,000 for the fiscal year ended September 30, 2004. The increase is due primarily to an increase in non-reimbursable legal fees and audit costs incurred in connection with internal control procedures.

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

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

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

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

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

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

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

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

Income Tax Expense

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

Realized Gain on Sale of Investments

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

Net Unrealized Depreciation on Derivative

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

Net Unrealized Appreciation (Depreciation) on Investments

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

Net Increase in Net Assets from Operations

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

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

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2006, we had investments in debt securities of, or loans to, 48 private companies, totaling approximately $244.5 million (cost basis) of total assets.

During the three months ended December 31, 2006 and December 31, 2005, the following investment activity occurred:

Quarter Ended	New Investments	Principal Repayments	Net Gain/(Loss) on Disposal
December 31, 2006	$ 52,311,008	$ 23,967,229	$ 2,314
December 31, 2005	$ 26,688,457	$ 38,702,066	$ (1,180,595)

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

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

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

Fiscal Year Ended September 30,	Amount
2007	$ 7,084,860
2008	11,938,211
2009	18,404,148
2010	38,386,079
2011	78,476,810
Thereafter	90,247,476
	$ 244,537,584

Net cash used in operating activities for the three months ended December 31, 2006, consisting primarily of the items described in Results of Operations and the investment activity described above, was approximately $23.3 million as compared to net cash provided by operating activities of approximately $16.7 million for the three months ended December 31, 2005. Net cash provided by investing activities consisted of $152 and $23,094 for the three months ended December 31, 2006 and December 31, 2005, respectively, and consisted of the principal repayment of employee loans. Net cash provided by financing activities for the three months ended December 31, 2006 was approximately $28.5 million and mainly consisted of borrowings on our line of credit of approximately $69.9 million, offset by repayments of line of credit borrowings of approximately $34.7 million, and approximately $5.2 million for the payment of dividends. Net cash used in financing activities was approximately $1.8 million for the three months ended December 31, 2005 and consisted primarily of net cash provided from borrowings on our line of credit, net of repayments, of approximately $2.7 million, offset by the payment of dividends of approximately $4.6 million.

During the three months ended December 31, 2006, cash and cash equivalents increased from approximately $732,000 to approximately $6.0 million.

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

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

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

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

Net cash used in operating activities for the fiscal year ended September 30, 2004, consisting primarily of the items described in Results of Operations and the investment activity described above, was approximately $82.7 million. At September 30, 2004, the net cash used was due largely in part to $57.1 million used in connection with the purchase of the repurchase agreement and the repayments of the repurchase agreement, and new investments of approximately $86.3 million, partially offset by principal repayments of $47.2 million. Net cash provided by investing activities for the fiscal year ended September 30, 2004 was approximately $0.2 million and consisted of principal repayments on employee loans. Net cash provided by financing activities was approximately $47.3 million for the fiscal year ended September 30, 2004 and consisted primarily of proceeds from a public shelf offering of common stock which yielded net proceeds of approximately $24.4 million, the borrowings, net of repayments, on the lines of credit for net proceeds of approximately $40.7 million, partially offset by the payment of dividends of approximately $17.1 million.

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

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

Subsequent to December 31, 2006, we funded approximately $24.5 million of loan originations, including the acquisition of warrants in connection with one investment, extended approximately $1.2 million in revolver borrowings to existing portfolio companies and purchased approximately $21.6 million of syndicated loan participations. Also, an existing portfolio company refinanced their $13.3 million senior term loan investments in exchange for a new $9.8 million senior subordinated term loan investment. In connection with this refinancing, we received approximately $533,000 of success fees.

In order to qualify as a RIC and to avoid corporate level tax on the income we distribute to our stockholders, we are required, under Subchapter M of the Code, to distribute at least 90% of our ordinary income and short-term capital gains to our stockholders on an annual basis. In accordance with these requirements, we declared and paid monthly cash dividends of $0.14 per common share for July, August, September, October, November and December 2006 and $0.135 per common share for January, February, March, April, May and June 2006, and October, November and December 2005. In January 2007, our board of directors declared a monthly dividend of $0.14 per common share for each January, February and March 2007. In April 2007, our board of directors declared a monthly dividend of $0.14 per common share for each of April, May and June 2007.

We anticipate continuing to borrow funds and, from time to time issuing additional equity securities, to obtain additional capital to make further investments. To this end, we have an effective registration statement on file, of which this prospectus forms a part, with the SEC that would permit us to issue, through one or more transactions, up to an aggregate of $48.8 million in securities, which may consist of shares of our common stock, preferred stock, and/or debt securities. The terms of the future debt and equity issuances cannot be determined and there can be no assurances that the debt or equity markets will be available to us on terms we deem favorable.

Revolving Credit Facility

Through our wholly-owned subsidiary, Business Loan, we have a $170 million revolving credit facility, which we refer to as the DB Facility, with Deutsche Bank AG, as administrative agent, which is scheduled to mature on May 27, 2007 and which is available for general corporate purposes. Pursuant to the DB Facility, Business Loan has pledged the loans it holds to secure future advances by certain institutional lenders. Interest rates charged on the advances under the DB Facility will be based on LIBOR, the Prime Rate or the Federal Funds Rate, depending on market conditions, and will adjust periodically. As of December 31, 2006, our outstanding principal balance under the DB Facility was approximately $85.2 million at an interest rate of approximately 5.3%. Available borrowings are subject to various constraints imposed by Deutsche Bank AG, based on the aggregate loan balance pledged by Business Loan, which varies as loans are added and repaid, regardless of whether such repayments are early prepayment or are made as contractually required. At December 31, 2006, the remaining borrowing capacity available under the DB Facility was approximately $64.8 million.

The DB Facility contains covenants that, among other things, require Business Loan to maintain its status as a separate entity; prohibit certain significant corporate transactions (such as mergers, consolidations, liquidations or dissolutions); and restrict material changes to our credit and collection policies. The DB Facility also restricts some of the terms and provisions (including interest rates, terms to maturity and payments schedules) and limits the borrower and industry concentrations of loans that are eligible to secure advances. As of December 31, 2006, Business Loan was in compliance with all of the DB Facility covenants. We currently intend to securitize all or a portion of the loans held by Business Loan and to use the proceeds from the securitization to pay down any amounts then outstanding under the revolving credit facility. However, there can be no assurance that we will be able to successfully securitize any of these loans on terms acceptable to us, if at all.

The administrative agent also requires that any interest or principal payments on pledged loans be remitted directly by the borrower into a lockbox account with the Bank of New York as custodian. Deutsche Bank AG is also the trustee of the account and once a month remits the collected funds to us. For the three months ended December 31, 2006, the amount due from custodian decreased by approximately $297,000.

Our Adviser services the loans pledged under the DB Facility. As a condition to this servicing arrangement, we executed a performance guaranty pursuant to which we guaranteed that our Adviser would comply fully with all of its obligations under the facility. The performance guaranty requires us to maintain a minimum net worth of $100 million 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, we were in compliance with our covenants under the performance guaranty.

Contractual Obligations and Off-Balance Sheet Arrangements

As of December 31, 2006, we were party to signed and non-binding term sheets for four allocations of syndicate loan participations for $7.5 million. We expect to fund these potential investments as follows:

		Payment Due by Period			
Contractual Obligations	**Total**	**Less than 1 Year**	**1-3 Years**	**3-5 Years**	**More than 5 Years**
Investments	$ 7,500,000	$ 7,500,000			
Total	$ 7,500,000	$ 7,500,000	$	$	$

As of the date of this prospectus, all of the investment purchase obligations summarized above have been funded. See Note 11 Subsequent Events in our unaudited Consolidated Financial Statements for further information.

We did not have any significant off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K, as of December 31, 2006.

Quantitative and Qualitative Disclosures about Market Risk.

We are subject to financial market risks, including changes in interest rates. We estimate that ultimately approximately 20% of the loans in our portfolio will be made at fixed rates and approximately 80% will be made at variable rates. Currently our portfolio has approximately 58% of the total loan portfolio cost basis at variable rates with a floor, approximately 3% of the total loan portfolio cost basis at a variable rate with a floor and ceiling, and the remaining 39% of the total loan portfolio cost basis at variable rates without a floor or ceiling.

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

In February 2004, we entered into an interest rate cap agreement in order to fulfill an obligation under our line of credit to enter into certain hedging transactions in connection with our borrowings under the line of credit. We purchased this interest rate cap agreement with a notional amount of $35 million (which is amortized quarterly) for a one-time, up-front payment of $304,000. The interest rate cap agreement entitles us to receive payments, if any, equal to the amount by which interest payments on the current notional amount at one month LIBOR exceed the payments on the current notional amount at 5%. The cap expires in February 2009. This interest rate cap agreement effectively caps our interest payments on our line of credit borrowing, up to the notional amount of the interest rate cap, at five percent. This mitigates our exposure to increases in interest rates on our borrowings on our lines of credit, which are at variable rates. At December 31, 2006, the cap agreement had a fair market value of $40,472 and a current notional amount of $13.0 million. At December 29, 2006, the one month LIBOR rate was approximately 5.33%.

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To illustrate the potential impact of changes in interest rates on our net increase in net assets resulting from operations, we have performed the following analysis, which assumes that our balance sheet remains constant and no further actions beyond the interest rate cap agreement are taken to alter our existing interest rate sensitivity. Under this analysis, a hypothetical increase in the one month LIBOR by 1% would increase our net increase in net assets resulting from operations by approximately $2.3 million or 11.5%, over the next twelve months, compared to the net increase in net assets resulting from operations for the twelve months ended December 31, 2006. A hypothetical decrease in the one month LIBOR by 1% would decrease net increase in net assets resulting from operations by approximately $2.3 million, or 11.5%, over the next twelve months, compared to the net increase in net assets resulting from operations for the twelve months ended December 31, 2006. Although management believes that this analysis is indicative of our existing interest rate sensitivity, it does not adjust for potential changes in credit quality, size and composition of our loan portfolio on the balance sheet and other business developments that could affect net increase in net assets resulting from operations. Accordingly, no assurances can be given that actual results would not differ materially from the results under this hypothetical analysis.

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

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

BUSINESS

Overview

We were incorporated under the General Corporation Laws of the State of Maryland on May 30, 2001. Our investment objectives are to achieve a high level of current income by investing in debt securities, consisting primarily of senior notes, second lien notes, and senior subordinated notes of established private businesses that are backed by leveraged buyout funds, venture capital funds or others, with a particular emphasis on second lien and senior subordinated notes. In addition, we may acquire existing loans, which meet this profile, from leveraged buyout funds, venture capital funds and others. We also seek to provide our stockholders with long-term capital growth through the appreciation in the value of warrants, or other equity instruments that we may receive when we extend loans. We operate as a closed-end, non-diversified management investment company, and have elected to be treated as a business development company under the 1940 Act.

Our Investment Strategy

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

We believe that our business strategy will enable us to achieve a high level of current income by investing in debt securities, consisting primarily of senior notes, senior subordinated notes and junior subordinated notes of established private businesses that are backed by leveraged buyout funds, venture capital funds or others. In addition, from time to time we might acquire existing loans that meet this profile from leveraged buyout funds, venture capital funds and others. We also seek to provide our stockholders with long-term capital growth through the appreciation in the value of warrants or other equity instruments that we might receive when we make loans. Our loans typically range from $5 million to $15 million, although this investment size may vary proportionately as the size of our capital base changes. Our loans generally mature in no more than seven years and accrue interest at fixed or variable rates.

Our Investment Adviser and Administrator

Our affiliate, the Adviser, is our investment adviser and is led by a management team which has extensive experience in our lines of business. All of our directors and executive officers serve as either directors or executive officers, or both, of Gladstone Commercial Corporation, a publicly traded real estate investment trust; Gladstone Investment Corporation, a publicly traded business development company; our Adviser; and our Administrator. The Adviser also has a wholly-owned subsidiary, Gladstone Administration, LLC, 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, Gladstone Investment and Gladstone Land Corporation, an agricultural real estate company owned by Mr. Gladstone. In the future, the Adviser may provide investment advisory and administrative services to other funds, both public and private, of which it is the sponsor.

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

Corporate Information

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

Investment Process

Overview of Loan Origination and Approval Process

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

Prospective Portfolio Company Characteristics

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

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

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

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

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

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

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

Extensive Due Diligence

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

- a review of the potential borrower s historical and projected financial information;
- interviews with management, employees, customers and vendors of the applicant;
- background checks; and
- research on the applicant s products, services or particular industry.

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

Investment Structure

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

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

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

As noted above, we expect to receive yield enhancements in connection with many of our loans, which may include warrants to purchase stock. If a financing is successful, not only will our debt securities have been repaid with

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

Temporary Investments

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

Hedging Strategies

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

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

Extensive Loan Referral Network

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

Flexible Transaction Structuring

We believe our management team s broad expertise and its ability to draw upon many years of combined experience enables the Adviser to identify, assess, and structure investments successfully across all levels of a company s capital structure and manage potential risk and return at all stages of the economic cycle. We are not subject to many of the regulatory limitations that govern traditional lending institutions such as banks. As a result, we expect to be flexible in selecting and structuring investments, adjusting investment criteria and transaction structures, and, in some cases, the types of securities in which we invest. We believe that this approach should enable our Adviser to identify attractive investment opportunities that will continue to generate current income and capital gain potential throughout the economic cycle, including during turbulent periods in the capital markets. One example of our flexibility is our ability to exchange our publicly-traded stock for the stock of an acquisition target in a tax-free reorganization under the Internal Revenue Code of 1986, as amended, which we refer to as the Code. After completing an acquisition in such an exchange, we can restructure the capital of the small company to include senior and subordinated debt.

Leverage

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

Securitization

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

Ongoing Relationships with and Monitoring of Portfolio Companies

Monitoring

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

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

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

Managerial Assistance and Services

The 1940 Act requires that a business development company make available managerial assistance to its portfolio companies by providing significant guidance and counsel concerning the management, operations, or business objectives and policies of the respective portfolio company. We provide these and other services to our portfolio companies through our Adviser. Currently, neither we nor the Adviser charges a fee for managerial assistance. Our Adviser receives fees for other services it provides to portfolio companies. These other fees are typically non-recurring, are recognized as revenue when earned and are generally paid directly to our Adviser by the borrower or potential borrower upon closing of the investment. The services our Adviser provides to portfolio companies vary by investment, but generally include a broad array of services, such as investment banking services, arranging bank and equity financing, structuring financing from multiple lenders and investors, reviewing existing credit facilities, restructuring existing loans, raising equity and debt capital, turnaround management, merger and acquisition services and recruiting new management personnel. When our Adviser receives fees for these services, all of those fees are credited to the base management fees we pay to the Adviser. Any services of this nature subsequent to the closing would typically generate a separate fee at the time of completion.

Our Adviser also receives fees for monitoring and reviewing portfolio company investments. These fees are recurring and are generally paid annually or quarterly in advance to our Adviser throughout the life of the investment. Fees of this nature are recorded as revenue by our Adviser when earned and are not credited against the base management fees. While our Adviser receives all fees in connection with our investments, such fees received by our Adviser, with the exception of monitoring and review fees, are entirely credited to us as a reduction of the advisory fee payable under the advisory agreement between us.

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

Valuation Process

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

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

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

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

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

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

Investment Advisory and Administration Agreements

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

Management services and fees in effect through September 30, 2006

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

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

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

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

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

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

Quarterly Incentive Fee Based on Net Investment Income

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

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

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

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

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

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

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

License Agreement

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

Code of Ethics

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

Compliance Policies and Procedures

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

Competition

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

Staffing

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

As of March 31, 2007, the Adviser and the Administrator had 51 full-time employees. A breakdown of these full-time employees is summarized by functional area in the table below:

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

Properties

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

Legal Proceedings

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

PORTFOLIO COMPANIES

The following table sets forth certain information as of December 31, 2006, regarding each portfolio company in which we had a debt or equity security as of such date. All such investments have been made in accordance with our investment policies and procedures described in this prospectus.

Portfolio Company	Nature of Business	Type of Security	% of Class Owned on a Fully Diluted Basis (1)	Cost or Initial Value of Investment ($)	Value of Investment as of December 31, 2006 ($)
ACS Media LLC 3601 C St Suite 1424 Anchorage, AK 99503	Service - directory advertising in Alaska	Senior Term Debt (a) (b)		2,386,446	2,385,950
ActivStyle Acquisition Company ActivStyle, Inc. 3100 Pacific Street North Minneapolis, MN 55411	Service - Medical products distribution	Line of Credit (a) (d) Senior Term Debt Senior Term Debt (n)		 3,120,000 2,500,000	 3,120,000 2,500,000
Advanced Homecare Management, Inc. 7502 Greenville Ave., Suite 100 Dallas, TX 75231	Service-home health nursing services	Senior Subordinated Term Debt (b)		6,100,000	6,100,000
Allied Extruders, LLC P&O Packaging Acquisition, LLC 36-08 Review Avenue Long Island City, NY 11101	Manufacturing-polyethylene film	Senior Real Estate Term Debt (a) Senior Term Debt (n)		1,000,000 8,000,000	1,000,000 7,990,000
Badanco Acquisition Corp. 994 Riverview Drive Totowa, NJ 07512	Service - Luggage design and distribution	Senior Term Debt Senior Term Debt (n)(p)		4,777,519 8,552,688	4,783,491 9,073,118
Benetech, Inc. 1851 Albright Rd. Montgomery, IL 60538	Service & Manufacturing-dust management systems for coal and electric utility industries	Senior Term Debt Senior Term Debt (n)		1,950,000 3,006,250	1,981,688 3,070,133
Bresnan Communications, LLC One Manhattanville Rd. Purchase, NY 10577-2596	Service - telecommunications	Senior Term Debt (a) (b) Senior Subordinated Term Debt (a)(b)		1,002,036 1,511,167	1,000,000 1,533,750
Consolidated Bedding, Inc. 500 S. Falkenburg Road Tampa, Florida 33619	Manufacturing-mattresses	Senior Subordinated Term Debt		2,436,016	2,174,128
Country Road Communications LLC Country Road Management, Inc. 1500 Mt. Kemble Avenue, Suite 203 Morristown, NJ 07960	Service-telecommunications	Senior Subordinated Term Debt (b)		5,963,007	6,000,000
Defiance Acquisition Corp. 1090 Perry Street Defiance, OH 43512	Manufacturing-trucking parts	Senior Term Debt (n)		6,325,000	6,325,000
Doe & Ingalls Management, LLC Doe & Ingalls of North Carolina Operating LLC Doe & Ingalls of Florida Operating LLC Doe & Ingalls of Virginia Operating LLC 1301 Person Street Durham, NC 27703	Service-chemical distribution	Senior Term Debt Senior Term Debt (n)		4,700,000 4,500,000	4,723,500 4,516,875

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Portfolio Company	Nature of Business	Type of Security	% of Class Owned on a Fully Diluted Basis (1)	Cost or Initial Value of Investment ($)	Value of Investment as of December 31, 2006 ($)
Dresser Holdings, Inc. 15455 Dallas Parkway Addison, TX 75001	Manufacturing-oilfield & energy products	Senior Term Debt (a) (b)		1,831,236	1,847,259
Emdeon Business Services, Inc. 26 Century Blvd. Nashville, TN 37214	Service - healthcare technology solutions	Senior Term Debt (a) (b)		1,500,000	1,505,625
Employment Solutions Management, Inc. Employbridge 1040 Crown Pointe Parkway Suite 1040 Atlanta, GA 30338	Service - specialty staffing	Senior Term Debt (b)		3,000,513	3,000,000
		Senior Subordinated Term Debt (b)		3,000,516	3,000,000
Express Courier International, Inc. P.O. Box 290279 Nashville, TN 37229-0279	Service - Ground delivery and logistics	Line of Credit (a) (e)			
		Senior Term Debt		4,582,500	4,588,228
		Senior Term Debt (n)		3,950,000	3,954,938
Finn Corporation 9281 Lesaint Drive Fairfield, OH 45014	Manufacturing-landscape equipment	Common Stock Warrants (a)	2.8%	37,000	768,616
Generac Acquisition Corp. Hwy. 59 & Hillside Road P.O. Box 8 Waukesha, WI 53187	Manufacturing - standby power products	Senior Term Debt (a) (b)		2,380,000	2,388,925
Global Materials Technologies, Inc. 1540 E. Dundee Road Palatine, IL 60067	Manufacturing-steel wool products and metal fibers	Senior Term Debt (n)		5,250,000	5,177,813
GTM Holdings, Inc. Gold Toe Investment Corp. 514 West 21st Street P.O. Box 580 Newton, NC 28658	Manufacturing - socks	Senior Term Debt (a) (b)		500,000	503,750
		Senior Subordinated Term Debt (a) (b)		500,000	507,500
Hudson Products Holdings, Inc. 1307 Soldiers Field Drive Sugar Land, TX 77479	Manufacturing - heat transfer solutions	Senior Term Debt (a) (b)		1,190,000	1,192,975
IPC Information Systems, LLC 88 Pine Street Wall Street Plaza New York, NY 10005	Manufacturing - specialized telephony systems	Senior Term Debt (a) (b)		238,000	239,190
It s Just Lunch International, LLC 44-489 Town Center Way Suite 500 Palm Desert, CA 92260	Service - Dating services	Line of Credit (f)		500,000	499,375
		Senior Term Debt		3,400,000	3,395,750
		Senior Term Debt (n) (f)		400,000	400,000
John Henry Holdings, Inc. Multi Packaging Solutions, Inc. 5800 W. Grand River Ave PO Box 17099 Lansing, MI 48901	Manufacturing-packaging products	Senior Subordinated Term Debt (a) (b)		8,000,000	8,000,000
Kinetek Acquisition Corp. ArborLake Center, Suite 550 1751 Lake Cook Road Deerfield, IL 60015	Manufacturing - Custom engineered motors and controls	Senior Term Debt (a) (b)		1,506,174	1,505,625
		Senior Subordinated Term Debt (a) (b)		1,509,887	1,509,375
LocalTel, Inc. 210 Bear Hill Rd. Suite 400 Waltham, MA 02451	Service - Yellow pages publishing	Line of Credit (g)			
		Senior Term Debt		2,687,500	2,479,219
		Senior Term Debt (n)		2,750,000	2,420,000
MediMedia USA Inc. 26 Main Street, 1st Floor Chatham, NJ 07928	Service - Healthcare and pharmaceutical marketing	Senior Term Debt (a) (b)		1,075,087	1,072,329

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Portfolio Company	Nature of Business	Type of Security	% of Class Owned on a Fully Diluted Basis (1)	Cost or Initial Value of Investment ($)	Value of Investment as of December 31, 2006 ($)
Rally Parts, Inc. Motorsport Aftermarket Group, Inc. 2146 Michelson Drive, Suite B Irvine, CA 92612	Manufacturing - Aftermarket motorcycle parts and accessories	Senior Term Debt (a) (b)		238,000	238,595
Network Solutions, LLC 13200 Woodland Park Road Herndon, VA 20171	Service - internet domain registry and hosting	Senior Term Debt (b)		4,453,198	4,488,413
Northern Contours, Inc. Northern Contours of Kentucky, Inc. Norcon Holding LLC, Norcon Lewis LLC 409 South Roberts Street Fergus Falls, MN 56537	Manufacturing-veneer and laminate components	Senior Subordinated Term Debt		7,000,000	7,017,500
FR X Ohmstede Holdings LLC FR X Ohmstede Acquisitions Co. 895 North Main Street P.O. Box 2431 Beaumont, TX 77701	Service & Manufacturing - Heat exchangers	Senior Term Debt (a) (b) Senior Subordinated Term Debt (a) (b)		2,843,478 3,011,976	2,875,467 3,045,000
Pinnacle Treatment Centers, Inc. 59 31st Street Pittsburgh, PA 15201	Service - Addiction treatment centers	Line of Credit (a) (c) (h) Senior Term Debt (a) (c) Senior Term Debt (a) (c) (n)		 2,500,000 4,500,000	 2,500,000 4,500,000
Precision Acquisition Group Holdings, Inc. Precision Asset Acquisition Company, LLC 435 Burt Street Sistersville, WV 26175	Manufacturing - consumable components for the aluminum industry	Equipment Note (i) Senior Term Debt Senior Term Debt (n)		 5,000,000 4,200,000	 5,006,250 4,205,250
PROFITSystems Acquisition Company PROFITSystems, Inc. 422 E. Vermijo Suite 100 Colorado Springs, CO 80903	Service - Design and develop ERP software	Line of Credit (a) (j) Senior Term Debt Senior Term Debt (n)		 3,025,000 2,900,000	 3,028,781 2,903,625
Puerto Rico Cable Acquisition Company Inc. d/b/a Choice Cable, Inc. 996 Street San Roberto Reparto Loyola, Bo. Monacillos San Juan, PR 00926	Service-telecommunications	Senior Subordinated Term Debt (b)		7,809,590	7,775,183
QCE, LLC (d/b/a Quiznos Corp.) 1475 Lawrence Street, Suite 400 Denver, CO 80202	Service - Restaurant franchisor	Senior Term Debt (b) Senior Subordinated Term Debt (b)		3,002,529 3,043,949	2,981,269 3,048,750
Radio Systems Corporation 10427 Electric Avenue Knoxville, TN 37932	Service - design electronic pet containment products	Senior Term Debt (a) (b)		952,000	955,570
RCS Management Holding Company 16535 Southpark Drive Westfield, IN 46074	Service - healthcare supplies	Senior Term Debt (n) Senior Term Debt (o)		3,000,000 3,000,000	2,996,250 2,996,250
RedPrairie Holding Inc. RedPrairie Corporation Blue Cube Software, Inc. 20700 Swenson Drive Waukesha, WI 53186	Service - Design and develop supply chain software	Senior Term Debt (a) (b) Senior Subordinated Term Debt (a) (b)		3,980,000 2,000,000	3,980,000 2,010,000

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Portfolio Company	Nature of Business	Type of Security	% of Class Owned on a Fully Diluted Basis (1)	Cost or Initial Value of Investment ($)	Value of Investment as of December 31, 2006 ($)
Dealer Computer Services, Inc. (d/b/a Reynolds & Reynolds) One Reynolds Way Dayton, OH 45430	Manufacturing & Service - Systems for automotive retailers	Senior Term Debt (a) (b)		949,620	955,555
SCPH Holdings, Inc. Sea Con Phoenix, Inc. Phoenix Optix, Inc. 52 Airport Road Westerly, Rhode Island 02891	Manufacturing-underwater and harsh environment components	Line of Credit (a) (k)			
		Senior Term Debt		2,450,000	2,456,125
		Senior Term Debt (n)		2,850,000	2,860,688
SCS Acquisition Corp. (d/b/a Specialty Coatings Systems) 7645 Woodland Drive Indianapolis, IN 46278	Service-chemically treated equipment distribution	Senior Term Debt (l)		5,625,000	5,639,063
		Senior Term Debt (l) (n)		6,550,000	6,566,375
LJ Can Holdings, Inc. Stolle Machinery Company, LLC 6949 South Potomac Street Centennial, CO 80112-4036	Manufacturing - Can-making equipment and parts	Senior Term Debt (a) (b)		238,000	239,190
Thibaut Acquisition Company 480 Frelinghuysen Avenue Newark, NJ 07114	Design and Distribution - wall coverings	Line of Credit (a) (m)			
		Senior Term Debt		3,237,500	3,241,547
		Senior Term Debt (n)		3,000,000	3,003,750
Visual Edge Technology, Inc. Graphic Enterprises, Inc. Copeco, Inc. 3874 Highland Park NW North Canton, OH 44720	Service-office supplies distribution	Senior Subordinated Term Debt		5,000,000	4,650,000
Wesco Holdings, Inc. Wesco Aircraft Hardware Corp. 27727 Avenue Scott Valencia, CA 91355	Service - Aerospace parts and distribution	Senior Term Debt (a) (b)		2,526,100	2,518,750
		Senior Subordinated Term Debt (a) (b)		2,273,102	2,306,250
West Corporation 11808 Miracle Hills Drive Omaha, NE 68154	Service - business process outsourcing	Senior Term Debt (a) (b)		4,760,000	4,771,900
Westlake Hardware, Inc. WHI Holding Corp. 14000 Marshall Dr. Lenexa, KS 66215	Retail Stores - hardware and variety	Senior Subordinated Term Debt		15,000,000	14,962,500
Winchester Electronics 62 Barnes Industrial Road North Wallingford, CT 06492	Manufacturing - high bandwidth connectors and cables	Senior Term Debt (n)		6,000,000	6,015,000
Total: 48				**$ 244,537,584**	**$ 244,972,971**

(1) Percentage shown for warrants held represents the percentage of common stock we may own, on a fully diluted basis, assuming we exercise our warrants.

(a) Not valued by SPSE as of December 31, 2006.

(b) Marketable securities are valued based on the bid price, as of December 29, 2006, from the respective originating syndication agent s trading desk.

(c) Valued at cost due to recent purchase.

(d) Availability under the credit facility totals $1,500,000. There were no borrowings outstanding as of December 31, 2006.

(e) Availability under the credit facility totals $1,500,000. There were no borrowings outstanding as of December 31, 2006.

(f) Remaining availability under the revolving credit facility totals $250,000. The company may borrow an additional $1.85 million of the Senior Term Debt LOT facility, subject to certain conditions including our approval.

(g) Availability under the credit facility totals $2,000,000. There were no borrowings outstanding as of December 31, 2006.

(h) Availability under the revolving credit facility totals $500,000. There were no borrowings outstanding as of December 31, 2006.

(i) The company has the ability to borrow up to $1,000,000 for purposes of acquiring equipment. There were no borrowings outstanding as of December 31, 2006.

(j) Availability under the credit facility totals $1,250,000. There were no borrowings outstanding as of December 31, 2006.

(k) Availability under the credit facility totals $500,000. There were no borrowings outstanding as of December 31, 2006.

(l) The company may borrow up to an additional $875,000 to finance capital expenditures.

(m) Availability under the credit facility totals $1,000,000. There were no borrowings outstanding as of December 31, 2006.

(n) Last out tranche of the senior debt.

(o) Last out tranche of the senior debt, but junior to another last out tranche.

(p) Includes a success fee with a $360,068 fair value and no cost basis.

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

Clinton Holdings, LLC

In January 2007, we loaned $15.5 million to Clinton Holdings, LLC and its subsidiaries, which we refer to collectively as Clinton. The investment is a six year senior subordinated loan in the amount of $15.5 million due in full at maturity, which is January 31, 2013. The interest rate is LIBOR plus 725 basis points with a floor of 12% and a 4.25% exit fee. We also have a warrant that is exercisable for 7% of Clinton Holdings, LLC s common equity.

Clinton is based in Clinton, Ohio with three distribution centers located in Pennsylvania, Michigan and Ohio and a production and distribution center in Wisconsin. The company is a supplier of custom cut aluminum sheet, plate, bar/extrusions, angle as well as stainless steel. Clinton is focused on serving customers in the Midwest and Great Lakes region that require just-in-time, or JIT, order and delivery service.

Because of the relative size of this investment, we are significantly exposed to the risks associated with Clinton s business. The company has exposure to commodity price risk in aluminum and stainless steel. When compared to larger national service centers for companies in its industry, Clinton is relatively small. Also, despite a fragmented customer base, Clinton may have some exposure to industrial production economic cycles, such as domestic automotive original equipment manufacturers.

Clinton s principal offices are located at 6270 Van Buren Road, Clinton, Ohio 44216.

Westlake Hardware, Inc.

We have loaned $15 million to Westlake Hardware, Inc., which we refer to as Westlake. The investment is in a second lien loan in the amount of $15 million to be repaid at maturity over a five year period. The interest rate is LIBOR plus 725 basis points with a floor of 10.75%. Conditional interest will accrue at the rate of 1.25% per annum. The maturity date of the loan is January 6, 2011.

Westlake is a family-owned business with a 100-year history as a retailer of home hardware. Westlake is the largest member of the ACE Hardware Corporation buying cooperative. Westlake operates 78 retail locations, averaging 20,000 square feet each, in seven Midwestern states that sell a variety of products and services to predominantly "do-it-yourself," or DIY, customers and some professionals. Westlake has a strong brand name in the Midwest, gained by providing customers quality products, a broad selection and superior service in a neighborhood retail setting.

Because of the relative size of this investment, we are significantly exposed to the risks associated with Westlake s business. Big-box retailers dominate the home improvement market and have impacted Westlake s revenue growth historically. There is a risk that they may change strategy and compete with stores like Westlake with smaller stores similar to Westlake. Westlake plans on growing through infill store growth and new market store growth. Westlake may not, however, be able to find enough attractive locations for new stores. Store expansion strategy may also create high capital expenditure requirements. Westlake will need to execute store openings well. Slowdown in the economy could reduce personal incomes, leading to lower retail hardware purchases if customers defer repairs.

The principal executive offices of Westlake are located at 14000 Marshall Dr., Lenexa, Kansas 66215.

Subsequent Portfolio Activity

In March 2007 and April 2007, we have either outright sold or sold to our affiliate, Gladstone Investment, via an independent agent, approximately $22.0 million of our investments in syndicated loans, of which approximately $18.0 million was held at December 31, 2006. Sales to Gladstone Investment were made in reliance on Rule 17a-7 of the 1940 Act. The proceeds from the sales were used to reduce our borrowings on our line of credit. As of April 11, 2007, our outstanding balance on our line of credit was $108.0 million.

MANAGEMENT

Our business and affairs are managed under the direction of our board of directors. Our board of directors currently consists of ten members, seven of which are not considered to be interested persons of Gladstone Capital as defined in Section 2(a)(19) of the 1940 Act. We refer to these individuals as our independent directors. Our board of directors elects our officers, who serve at the discretion of the board of directors.

Board of Directors

Under our articles of incorporation, our directors are divided into three classes. Each class consists, as nearly as possible, of one-third of the total number of directors, and each class has a three year term. At each annual meeting of our stockholders, the successors to the class of directors whose term expires at such meeting will be elected to hold office for a term expiring at the annual meeting of stockholders held in the third year following the year of their election. Each director will hold office for the term to which he or she is elected and until his or her successor is duly elected and qualifies. Information regarding our board of directors is as follows (the address for each director is c/o Gladstone Capital Corporation, 1521 Westbranch Drive, Suite 200, McLean, Virginia 22102):

Name	Age	Position	Director Since	Expiration of Term
Interested Directors				
David Gladstone	64	Chairman of the Board and Chief Executive Officer(1)(2)	2001	2010
Terry Lee Brubaker	63	Vice Chairman, Chief Operating Officer, Secretary and Director(1)(2)	2001	2009
George Stelljes III	45	President, Chief Investment Officer and Director(1)	2003	2008
Independent Directors				
Anthony W. Parker	61	Director(2)(3)	2001	2008
David A.R. Dullum	59	Director(3)	2001	2009
Michela A. English	57	Director(3)	2002	2008
Paul W. Adelgren	64	Director(3*)(4)	2003	2010
Maurice W. Coulon	64	Director(3*)(4)(5)	2003	2009
John H. Outland	61	Director(5)	2003	2010
Gerard Mead	63	Director(5)	2005	2009

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

(2) Member of the executive committee.

(3) Member of the audit committee.

(4) Member of the ethics, nominating, and corporate governance committee.

(5) Member of the compensation committee.

(*) Alternate member of the committee.

Executive Officers Who Are Not Directors

Information regarding our executive officers who are not directors is as follows (the address for each executive officer is c/o Gladstone Capital Corporation, 1521 Westbranch Drive, Suite 200, McLean, Virginia 22102):

Name	Age	Position
Harry T. Brill, Jr.	60	Chief Financial Officer
Gary Gerson	42	Treasurer

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Independent Directors (in alphabetical order)

Paul W. Adelgren. Mr. Adelgren has served as a director since January 2003. Mr. Adelgren has also served as a director of Gladstone Commercial since August 2003 and a director of Gladstone Investment since June 2005. From 1997 to the present, Mr. Adelgren has served as the pastor of Missionary Alliance Church. From 1991 to 1997, Mr. Adelgren was pastor of New Life Alliance Church. From 1988 to 1991, Mr. Adelgren was vice president-finance and materials for Williams & Watts, Inc., a logistics management and procurement business located in Fairfield, NJ. Prior to joining Williams & Watts, Mr. Adelgren served in the United States Navy, where he served in a number of capacities, including as the director of the Strategic Submarine Support Department, as an executive officer at the Naval Supply Center, and as the director of the Joint Uniform Military Pay System. He is a retired Navy Captain. Mr. Adelgren holds an MBA from Harvard Business School and a BA from the University of Kansas.

Maurice W. Coulon. Mr. Coulon has served as a director since August 2003. Mr. Coulon has also served as a director of Gladstone Commercial since August 2003 and of Gladstone Investment since June 2005. Since 2000, Mr. Coulon has been a private investor in real estate. From 1991 through his retirement in 2000, Mr. Coulon served as director of portfolio management for the Morgan Stanley Real Estate Fund. From 1980 to 1991, Mr. Coulon served as senior vice president of asset management for the Boston Company Real Estate Counsel, Inc. Mr. Coulon was a founder of the National Association of Real Estate Investment Managers and is a past president of the National Council of Real Estate Investment Fiduciaries. Mr. Coulon holds an MBA from Harvard Business School and a BSE from the University of Missouri.

David A.R. Dullum. Mr. Dullum has served as a director since August 2001. Mr. Dullum has also served as a director of Gladstone Commercial since August 2003 and of Gladstone Investment since June 2005. From 1995 to the present, Mr. Dullum has been a partner at New England Partners, a venture capital firm focused on investments in small and medium-sized businesses in the Mid-Atlantic and New England regions. Mr. Dullum is also the president and a director of Harbor Acquisition Corporation, an operating business with emphasis in the consumer and industrial sectors. Mr. Dullum also serves as a director of Simkar Corporation, a manufacturer of industrial and consumer lighting products and Fetco Home Decor, Inc., a designer and manufacturer of home decor products. From 1976 to 1990, Mr. Dullum was a managing general partner of Frontenac Company, a Chicago-based venture capital firm. Mr. Dullum holds an MBA from Stanford Graduate School of Business and a BME from the Georgia Institute of Technology.

Michela A. English. Ms. English has served as director since June 2002. Ms. English is President and CEO of Fight for Children, a non-profit charitable organization focused on providing high quality education and health care services to underserved youth in Washington, D.C. Ms. English has also been a director of Gladstone Commercial Corporation since August 2003, and a director of Gladstone Investment since June 2005. From March 1996 to March 2004, Ms. English held several positions with Discovery Communications, Inc., including president of Discovery Consumer Products, president of Discovery Enterprises Worldwide and president of Discovery.com. From 1991 to 1996, Ms. English served as senior vice president of the National Geographic Society and was a member of the National Geographic Society s Board of Trustees and Education Foundation Board. Prior to 1991, Ms. English served as vice president, corporate planning and business development for Marriott Corporation and as a senior engagement manager for McKinsey & Company. Ms. English currently serves as director of the Educational Testing Service (ETS), as a director of D.C. Preparatory Academy, and as a member of the Virginia Institute of Marine Science Council. Ms. English is an emeritus member of the board of Sweet Briar College. Ms. English holds a Bachelor of Arts in International Affairs from Sweet Briar College and a Master of Public and Private Management degree from Yale University s School of Management.

Gerard Mead. Mr. Mead has served as a director since January 2006. Mr. Mead is chairman of Gerard Mead Capital Management, a firm which he founded in 2003 that provides investment management services to pension funds, endowments, insurance companies, and high net worth individuals. From 1966 to 2003 Mr. Mead was employed by the Bethlehem Steel Corporation, where he held a series of engineering, corporate finance and investment positions with increasing management responsibility. From 1987 to 2003 Mr. Mead served as chairman and pension fund manager of the Pension Trust of Bethlehem Steel Corporation and Subsidiary Companies. From 1972 to 1987 he served successively as investment analyst, director of investment research, and trustee of the Pension Trust, during which time he was also a corporate finance analyst and investor relations contact for institutional investors of Bethlehem Steel. Prior to that time Mr. Mead was a steel plant engineer. Mr. Mead has served as a director of Gladstone Commercial Corporation and Gladstone Investment Corporation, since January 2006. Mr. Mead holds an MBA from the Harvard Business School and a BSCE from Lehigh University.

John H. Outland. Mr. Outland has served as a director since December 2003. Mr. Outland has also served as a director of Gladstone Commercial since December 2003 and of Gladstone Investment since June 2005. From March 2004 to June 2006, he served as vice president of Genworth Financial, Inc. From 2002 to March 2004, Mr. Outland served as a managing director for 1789 Capital Advisors, where he provided market and transaction structure analysis and advice on a consulting basis for multifamily commercial mortgage purchase programs. From 1999 to 2001, Mr. Outland served as vice president of mortgage-backed securities at Financial Guaranty Insurance Company where he was team leader for bond insurance transactions, responsible for sourcing business, coordinating credit, loan files, due diligence and legal review processes, and negotiating structure and business issues. From 1993 to 1999, Mr. Outland was senior vice president for Citicorp Mortgage Securities, Inc., where he securitized non-conforming mortgage product. From 1989 to 1993, Mr. Outland was vice president of real estate and mortgage finance for Nomura Securities International, Inc., where he performed due diligence on and negotiated the financing of commercial mortgage packages in preparation for securitization. Mr. Outland holds an MBA from Harvard Business School and a bachelor s degree in Chemical Engineering from Georgia Institute of Technology.

Anthony W. Parker. Mr. Parker has served as a director since August 2001. He has also been a director of Gladstone Investment since June 2005 and of Gladstone Commercial since August 2003. In 1997 Mr. Parker founded Medical Funding Corporation, a company which purchased medical receivables, and has served as its chairman from inception to present. In the summer of 2000, Medical Funding Corporation purchased a Snelling Personnel Agency franchise in Washington, DC which provides full staffing services for the local business community. From 1992 to 1996, Mr. Parker was chairman of, and a 50 percent stockholder of, Capitol Resource Funding, Inc., or CRF, a commercial finance company. Mr. Parker practiced corporate and tax law for over 15 years; from 1980 to 1983, he practiced at Verner, Liipfert, Bernhard & McPherson and from 1983 to 1992, in private practice. From 1973 to 1977, Mr. Parker served as executive assistant to the administrator of the U.S. Small Business Administration. Mr. Parker received his J.D. and Masters in Tax Law from Georgetown Law Center and his undergraduate degree from Harvard College.

Interested Directors

David Gladstone. Mr. Gladstone is our founder and has served as our chief executive officer and chairman of our board of directors since our inception. Mr. Gladstone is also the founder of the Adviser and has served as its chief executive officer and chairman of its board of directors since its inception. Mr. Gladstone also founded and serves as the chief executive officer and chairman of the boards of directors of our affiliates Gladstone Investment, Gladstone Commercial and the Adviser. Prior to founding Gladstone Capital, Mr. Gladstone served as either chairman or vice chairman of the board of directors of American Capital Strategies, Ltd., a publicly traded leveraged buyout fund and mezzanine debt finance company, from June 1997 to August 2001. From 1974 to February 1997, Mr. Gladstone held various positions, including chairman and chief executive officer, with Allied Capital Corporation (a mezzanine debt lender), Allied Capital Corporation II (a subordinated debt lender), Allied Capital Lending Corporation (a small business lending company), Allied Capital Commercial Corporation (a real estate investment company), and Allied Capital Advisers, Inc., a registered investment adviser that managed the Allied companies. The Allied companies were the largest group of publicly-traded mezzanine debt funds in the United States and were managers of two private venture capital limited partnerships (Allied Venture Partnership and Allied Technology Partnership) and a private REIT (Business Mortgage Investors). From 1992 to 1997, Mr. Gladstone served as a director, president and chief executive officer of Business Mortgage Investors, a privately held mortgage REIT managed by Allied Capital Advisors, which invested in loans to small and medium-sized businesses. Mr. Gladstone is also a past director of Capital Automotive REIT, a real estate investment trust that purchases and net leases real estate to automobile dealerships. Mr. Gladstone served as a director of The Riggs National Corporation (the parent of Riggs Bank) from 1993 to May 1997 and of Riggs Bank from 1991 to 1993. He has served as a trustee of The George Washington University and currently is a trustee emeritus. He is a past member of the Listings and Hearings Committee of the National Association of Securities Dealers, Inc. He is a past member of the advisory committee to the Women s Growth Capital Fund, a venture capital firm that finances women-owned small businesses. Mr. Gladstone was the founder and managing member of The Capital Investors, LLC, a group of angel investors, and is currently a member emeritus. He is also the past chairman and past owner of Coastal Berry Company, LLC, a large strawberry farming operation in California. He is also the chairman and owner of Gladstone Land Corporation, a privately held company that has substantial farmland holdings in agriculture real estate in California. Mr. Gladstone holds an MBA from the Harvard Business School, an MA from American University and a BA from the University of Virginia. Mr. Gladstone has co-authored two books on financing for small and medium-sized businesses, *Venture Capital Handbook* and *Venture Capital Investing*.

Terry Lee Brubaker. Mr. Brubaker has been our chief operating officer, secretary and a director since our inception. He also served as our president from May 2001 through April 2004, when he assumed the duties of vice chairman. Mr. Brubaker has also served as a director of the Adviser since its inception. He also served as president of the Adviser from its inception through February 2006, when he assumed the duties of vice chairman, chief operating officer and secretary. He has served as vice president, secretary, chief operating officer and as a director of Gladstone Investment since its inception. Mr. Brubaker has also served as president, chief operating officer, secretary and as a director of Gladstone Commercial since February 2003. In March 1999, Mr. Brubaker founded and, until May 1, 2003, served as chairman of Heads Up Systems, a company providing process industries with leading edge technology. From 1996 to 1999, Mr. Brubaker served as vice president of the paper group for the American Forest & Paper Association. From 1992 to 1995, Mr. Brubaker served as president of Interstate Resources, a pulp and paper company. From 1991 to 1992, Mr. Brubaker served as president of IRI, a radiation measurement equipment manufacturer. From 1981 to 1991, Mr. Brubaker held several management positions at James River Corporation, a forest and paper company, including vice president of strategic planning from 1981 to 1982, group vice president of the Groveton Group and Premium Printing Papers from 1982 to 1990, and vice president of human resources development in 1991. From 1976 to 1981, Mr. Brubaker was strategic planning manager and marketing manager of white papers at Boise Cascade. Previously, Mr. Brubaker was a senior engagement manager at McKinsey & Company from 1972 to 1976. Mr. Brubaker holds an MBA from the Harvard Business School and a BSE from Princeton University.

George Stelljes III. Mr. Stelljes has been our chief investment officer since September 2002 and a director from August 2001 to September 2002, and then rejoined the board of directors in July 2003. He also served as our executive vice president from September 2002 through April 2004, when he assumed the duties of president. Mr. Stelljes has served as the Adviser s chief investment officer and a director of the Adviser since May 2003. He also served as executive vice president of the Adviser until February 2006, when he assumed the duties of president. Mr. Stelljes has served as president, chief investment officer and a director of Gladstone Investment since its inception. Mr. Stelljes has served as executive vice president and chief investment officer of Gladstone Commercial since February 2003. Prior to joining Gladstone Capital, Mr. Stelljes served as a managing member of St. John s Capital, a vehicle used to make private equity investments. From 1999 to 2001, Mr. Stelljes was a co-founder and managing member of Camden Partners and Cahill Warnock & Company, private equity firms which finance high growth companies in the communications, education, healthcare, and business services sectors. From 1997 to 1999, Mr. Stelljes was a managing director and partner of Columbia Capital, a venture capital firm focused on investments in communications and information technology. From 1989 to 1997, Mr. Stelljes held various positions, including executive vice president and principal, with the Allied companies. Mr. Stelljes currently serves as a general partner and investment committee member of Patriot Capital, a private equity fund, and serves on the board of Intrepid Capital Management, a money management firm. He is also a former board member and regional president of the National Association of Small Business Investment Companies. Mr. Stelljes holds an MBA from the University of Virginia and a BA in Economics from Vanderbilt University.

Executive Officers Who Are Not Directors

Harry T. Brill, Jr. Mr. Brill has served as our chief financial officer since May 2001 and served as treasurer from inception through February 2006. Mr. Brill has served as chief financial officer of the Adviser since its inception. Mr. Brill has also served as chief financial officer of Gladstone Commercial since February 2003 and as treasurer from inception through February 2006. Mr. Brill has also served as chief financial officer of Gladstone Investment since June 2005 and as treasurer from June 2005 to February 2006. From 1995 to April 2001, Mr. Brill served as a personal financial advisor. From 1975 to 1995, Mr. Brill held various positions, including treasurer, chief accounting officer, and controller with Allied Capital Corporation where Mr. Brill was responsible for all of the accounting work for Allied Capital and its family of funds. Mr. Brill received his degree in accounting from Ben Franklin University.

Gary Gerson. Mr. Gerson has served as our treasurer since April 2006. Mr. Gerson has also served as treasurer of Gladstone Investment since April 2006, of Gladstone Commercial since February 2006 and of the Adviser since May 2006. From 2004 to early 2006 Mr. Gerson was Assistant Vice President of Finance at the Bozzuto Group, a real estate developer, manager and owner, where he was responsible for the financing of multi-family and for-sale residential projects. From 1995 to 2004 he held various finance positions, including Director, Finance from 2000 to 2004, at PG&E National Energy Group where he led, and assisted in, the financing of power generation assets. Mr. Gerson holds an MBA from the Yale School of Management, a B.S. in mechanical engineering from the U.S. Naval Academy, and is a CFA charter holder.

Employment Agreements

We are not a party to any employment agreements. Messrs. Gladstone, Brubaker and Stelljes have entered into employment agreements with the Adviser, whereby they are direct employees of the Adviser. The employment agreement of Mr. Stelljes provides for his nomination to serve as our president and chief investment officer.

Director Independence

As required under The Nasdaq Global Select Market listing standards, a majority of the members of a listed company s board of directors must qualify as independent, as affirmatively determined by the board of directors. The board of directors consults with our outside counsel to ensure that the board s determinations are consistent with all relevant securities and other laws and regulations regarding the definition of independent, including those set forth in pertinent listing standards of The Nasdaq Global Select Market, as in effect from time to time.

Consistent with these considerations, after review of all relevant transactions or relationships between each director, or any of his or her family members, and Gladstone Capital, its senior management and its independent registered public accounting firm and their respective affiliates, our board of directors affirmatively has determined that all of our directors are independent directors within the meaning of the applicable Nasdaq listing standards and are not interested persons as defined in Section 2(a)(19) of the 1940 Act, except for Mr. Gladstone, our chairman and chief executive officer, Mr. Brubaker, our vice chairman, chief operating officer and secretary, and Mr. Stelljes, our president and chief investment officer.

Committees of Our Board of Directors

Executive Committee. Membership of our executive committee is comprised of Messrs. Gladstone, Brubaker, and Parker. The executive committee has the authority to exercise all powers of our board of directors except for actions that must be taken by the full board of directors under the Maryland General Corporation Law, including electing our chairman and president. Mr. Gladstone serves as chairman of the executive committee. The Executive Committee did not meet during the last fiscal year.

Audit Committee. The members of the audit committee are Messrs. Parker and Dullum and Ms. English, and Messrs. Adelgren and Coulon serve as alternate members of the committee. Alternate members of the audit committee serve only in the event of an absence of a regular committee member. Mr. Parker serves as chairman of the audit committee. Each member and alternate member of the audit committee is an independent director as defined by Nasdaq rules and our own standards, and none of the members or alternate members of the audit committee are interested persons as defined in Section 2(a)(19) of the 1940 Act. The board has unanimously determined that all members and alternate members of the audit committee qualify as audit committee financial experts within the meaning of the SEC rules and regulations. In addition, the board has unanimously determined that all audit committee members and alternate members are financially literate under current Nasdaq rules and that at least one member has financial management expertise. The audit committee operates pursuant to a written charter and is primarily responsible for oversight of our financial statements and controls, assessing and ensuring the independence, qualifications and performance of the independent registered public accounting firm, approving the independent registered public accounting firm services and fees and reviewing and approving our annual audited financial statements before issuance, subject to board approval. The audit committee met eight times during the last fiscal year.

Compensation Committee. The members of the compensation committee are Messrs. Coulon, Outland and Mead, each of whom is independent for purposes of the 1940 Act and The Nasdaq Global Select Market listing standards. Mr. Coulon serves as chairman of the compensation committee. The compensation committee operates pursuant to a written charter and conducts periodic reviews of our investment advisory and management agreement with the Adviser and our administration agreement with the Administrator to evaluate whether the fees paid to the Adviser under the Advisory Agreement, and the fees paid to the Administrator under the Administration Agreement, are in the best interests of us and our stockholders. The committee considers in such periodic reviews, among other things, whether the salaries and bonuses paid to our executive officers by the Adviser and the Administrator are consistent with our compensation philosophies and the performance of the Adviser, are reasonable in relation to the nature and quality of services performed, and whether the provisions of the Advisory and Administration Agreements are being satisfactorily performed. The compensation committee met four times during the last fiscal year.

Ethics, Nominating, and Corporate Governance Committee. The members of the ethics, nominating, and corporate governance committee are Messrs. Adelgren and Coulon, each of whom is independent for purposes of the 1940 Act and The Nasdaq Global Select Market listing standards. Mr. Adelgren serves as chairman of the ethics, nominating, and corporate governance committee. The ethics, nominating, and corporate governance committee operates pursuant to a written charter and is responsible for selecting, researching, and nominating directors for election by our stockholders, selecting nominees to fill vacancies on the board or a committee of the board, developing and recommending to the board a set of corporate governance principles, and overseeing the evaluation of the board and our management. The committee is also responsible for our Code of Business Conduct and Ethics. The committee met four times during the last fiscal year.

Nominations for election to our board of directors may be made by our board of directors, or by any stockholder entitled to vote for the election of directors. Although there is not a formal list of qualifications, in discharging its responsibilities to nominate candidates for election to our board of directors, the ethics, nominating and corporate governance committee believes that candidates for director should have certain minimum qualifications, including being able to read and understand basic financial statements, being over 21 years of age, having business experience, and possessing high moral character. In nominating candidates to fill vacancies created by the expiration of the term of a member, the committee s process for identifying and evaluating nominees includes reviewing such directors overall service to us during their term, including the number of meetings attended, level of participation, quality of performance, and any transactions of such directors with us during their term. In addition, the committee may consider recommendations for nomination from any reasonable source, including officers, directors and stockholders of our company according to the foregoing standards.

Nominations made by stockholders must be made by written notice (setting forth the information required by our bylaws) received by the secretary of our company at least 120 days in advance of an annual meeting or within 10 days of the date on which notice of a special meeting for the election of directors is first given to our stockholders.

Meetings. During the fiscal year ended September 30, 2006, each board member attended 75% or more of the aggregate of the meetings of the board and of the committees on which he or she served.

Compensation of Executive Officers and Directors

Executive Compensation

The following table shows, for the fiscal year ended September 30, 2006, certain information regarding options exercised by our three highest paid executive officers. No additional information has been provided with respect to our executive officers because our executive officers are employees of the Adviser and do not receive any direct compensation from us in the last fiscal year. We did not issue any stock options during the last fiscal year, and we terminated our 2001 Amended and Restated Equity Incentive Plan, which we refer to as the 2001 Plan, and all outstanding options under the 2001 Plan, on September 30, 2006 and therefore have no information to report relating to stock option grants and exercises for our three highest paid executive officers. The 2001 Plan was terminated in connection with the effectiveness of the Amended Advisory Agreement, which provides for an incentive fee payable to our Adviser. Regulations promulgated by the SEC prohibit us, as a business development company, from implementing an incentive advisory fee while having in place a stock option plan or any outstanding stock options. Thus, in connection with the approval of the Amended Advisory Agreement, and pursuant to an offer approved by our board of directors on April 11, 2006, we extended an offer to the then-current stock option holders to amend the terms of all outstanding stock options under the 2001 Plan to accelerate the contractual expiration date of these options to September 30, 2006. The offer was filed with the SEC on April 12, 2006, was conducted in accordance with the federal tender offer rules and regulations, and was conditioned upon the acceptance by 100% of the current stock option holders. Our board of directors also accelerated in full the vesting of all outstanding options other than options held by the non-employee directors effective April 11, 2006, resulting in accelerated vesting of 34,500 outstanding options. On May 31, 2006, 100% of the then-current stock option holders accepted the offer to amend the options, and on September 30, 2006, all outstanding stock options and the 2001 Plan were terminated.

**Aggregated Option Exercises in Fiscal 2006
and Value of Options at End of Fiscal 2006**

Name	Shares Acquired on Exercise (#)	Value Realized ($)(1)	Number of Securities Underlying Unexercised Options at FY-End (#) Vested	Unvested	Value of Unexercised In-the-Money Options FY-End ($) Vested	Unvested
David Gladstone	406,666	3,171,994.80	0	0	$0.00	0.00
Terry Lee Brubaker	106,666	741,328.70	0	0	$0.00	0.00
George Stelljes III	150,000	615,009.00	0	0	$0.00	0.00

(1) Value realized is calculated as the closing market price on the date of exercise, net of option exercise price, but before any tax liabilities or transaction costs.

Compensation of Directors

The following table shows, for the fiscal year ended September 30, 2006, compensation awarded to or paid to our directors who are not executive officers, which we refer to as our non-employee directors for all services rendered to us during this period. No compensation is paid to directors who are our executive officers for their service on the board of directors.

Name of Person, Position	Aggregate Compensation from the Company	Pension or Retirement Benefits Accrued as Part of Company Expenses	Securities Underlying Options	Total Compensation from Company Paid to Directors
Paul Adelgren *Director*	$ 15,000	$ 0	0	$ 15,000
Maurice W. Coulon *Director*	$ 15,000	$ 0	0	$ 15,000
David A.R. Dullum *Director*	$ 19,000	$ 0	0	$ 19,000
Michela A. English *Director*	$ 19,000	$ 0	0	$ 19,000
John H. Outland *Director*	$ 15,000	$ 0	0	$ 15,000
Anthony W. Parker *Director*	$ 19,000	$ 0	0	$ 19,000
Gerard Mead *Director*	$ 11,500	$ 0	0	$ 11,500

During the last fiscal year, as compensation for serving on the board of directors, each of our non-employee directors received an annual fee of $10,000, $1,000 per board meeting attended, and an additional $1,000 for attending each committee meeting if such committee meeting took place on a day other than when the full board met. We reimburse our directors for reasonable out-of-pocket expenses incurred in attending meetings of the board. In the fiscal year ended September 30, 2006, the total cash compensation paid to non-employee directors was $113,500.

Effective with the December 2, 2005 stockholder approval of the Amended Advisory Agreement, we ceased granting stock options under the 2001 Plan. Prior to that time, in addition to the cash compensation described above, each of our non-employee directors was eligible to receive stock option grants under the 2001 Plan pursuant to an order of the SEC granted in January 2003. Under our prior director compensation program, each non-employee director received an option to purchase 10,000 shares of common stock at the time of appointment to the board, and received an additional grant of 10,000 shares of common stock at the time of each annual meeting of stockholders. No new options have been issued to our non-employee directors since our 2005 annual meeting of stockholders, and no new options will be granted as long as the Amended Advisory Agreement is in place. Because our directors will no longer receive stock options as additional compensation for their services, beginning in fiscal year 2007 we have adjusted the fees paid to non-employee directors to provide cash compensation in lieu of the compensation formerly provided to them through stock options. Each non-employee director is now entitled to receive an annual fee of $20,000, $1,000 per board meeting attended, and an additional $1,000 for attending each committee meeting if such meeting takes place on a day other than when the full board meets. In addition, the chairperson of the audit committee will receive an annual fee of $3,000, and the chairpersons of each of the compensation and ethics, nominating and corporate governance committees will receive annual fees of $1,000 for their additional services in these capacities.

Deferred Compensation Plan

On July 11, 2006, we adopted the Joint Directors Nonqualified Excess Plan of Gladstone Commercial Corporation, Gladstone Capital Corporation and Gladstone Investment Corporation, which we refer to as the Deferred Compensation Plan. Effective January 1, 2007, the Deferred Compensation Plan will provide our non-employee directors the opportunity to voluntarily defer director fees on a pre-tax basis, and to invest such deferred amounts in self-directed investment accounts. The Deferred Compensation Plan does not allow us to make discretionary contributions to the account of any director.

Certain Transactions

Advisory and Administration Agreements

During the fiscal year ended September 30, 2006, we were externally managed under a contractual investment advisory arrangement with our Adviser pursuant to which our Adviser was responsible for managing our day-to-day operations and administration, record keeping and regulatory compliance functions. Specifically, these responsibilities include, but are not limited to: managing the investment and reinvestment of our assets, including identifying, evaluating, and structuring such investments; continuously reviewing, supervising and administering our investment program to determine in its discretion the securities to be purchased or sold and the portion of our assets to be held uninvested; offering to provide significant managerial assistance to the issuers of securities in which we are invested as required by the 1940 Act; arranging our debt financing; providing us with all required records concerning our Adviser s efforts on our behalf; and providing regular reports to our board concerning our Adviser s activities on our behalf. In return for providing such services, we paid our Adviser an annual advisory fee of 1.25% of our total assets (as reduced by cash and cash equivalents pledged to creditors), payable in quarterly increments of 0.3125%, and an annual administrative fee of 0.75% of our total assets (as reduced by cash and cash equivalents pledged to creditors), payable in quarterly increments of 0.1875%. Based upon an analysis of publicly available information, the board believed that these fees were reasonable in light of our specialized investment program and in line with the customary external fees paid in the industry for mezzanine fund and subordinated debt funds that are externally managed and have in place an equity incentive plan.

On October 1, 2006 we entered into the Amended Advisory Agreement with our Adviser and the Administration Agreement with the Administrator. The Amended Advisory Agreement provides for an annual base management fee equal to 2% of our assets and an income-based incentive fee which rewards our Adviser if our quarterly net investment income (before giving effect to the incentive fee) exceeds 1.75% of our net assets (the hurdle rate). We will pay our Adviser an income incentive fee with respect to its pre-incentive fee net investment income in each calendar quarter as follows:

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

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

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

The Amended Advisory Agreement also provides for a capital gains-based incentive fee, whereby our Adviser receives a fee equal to 20% of our realized capital gains (net of realized capital losses and unrealized capital depreciation). Under the Administration Agreement, we pay separately for our allocable portion of the Administrator s overhead expenses in performing its obligations, including, but not limited to, rent, and our allocable portion of the salaries and benefits expenses of our chief financial officer, treasurer, chief compliance officer, controller and their respective staff. Based on an analysis of publicly available information, the board believes that the terms and the fees payable under both the Amended Advisory Agreement and the Administration Agreement are similar to those of the agreements of other business development companies that do not have equity incentive plans with their external investment advisers.

David Gladstone, Terry Lee Brubaker, George Stelljes III, Harry Brill and Gary Gerson are all officers or directors, or both, of our Adviser and the Administrator. David Gladstone is the controlling stockholder of our Adviser, which is the sole member of the Administrator. Although we believe that the terms of the Amended Advisory Agreement and the Administration Agreement are no less favorable to us than those that could be obtained from unaffiliated third parties in arms length transactions, our Adviser, its officers and its directors have a material interest in the terms of these agreements.

Loans

At December 31, 2006, we had loans outstanding in the principal amount of $5,900,010 to Mr. Gladstone, $1,400,010 to Mr. Brubaker and $150,000 to Mr. Brill, each of whom is an executive officer of ours. These loans were extended in connection with the exercise of stock options by each of the executive officers. Each such loan is evidenced by a full recourse promissory note secured by the shares of common stock purchased upon the exercise of the options. The interest rate on each such loan is 4.9% per annum. Interest is due quarterly and each of the executive officers has made each of his quarterly interest payments to date. The outstanding principal amount of each loan is due and payable in cash on August 23, 2010. The Sarbanes-Oxley Act of 2002 prohibits us from making loans to our executive officers, although certain loans outstanding prior to July 30, 2002, including the promissory notes we have received from Messrs. Gladstone, Brubaker and Brill, were expressly exempted from this prohibition. In addition, these loans meet the requirements set forth in Section 57(j) of the 1940 Act.

Also at December 31, 2006, we had two loans outstanding in the principal amounts of $275,010 and $474,990, respectively, to Laura Gladstone, a managing director of ours and the daughter of our chief executive officer, Mr. Gladstone. These loans were extended in connection with the exercise of stock options under the 2001 Plan by Ms. Gladstone, and were made on terms available to all eligible participants of the 2001 Plan. The interest rates on the loans are 4.9% and 8.26%, respectively, and the outstanding principal amounts of each loan are due and payable in cash on August 23, 2010 and July 13, 2015, respectively. Mr. Gladstone has not received, nor will he receive in the future, any direct or indirect benefit from these loans.

Indemnification

In our articles of incorporation and bylaws, we have agreed to indemnify certain officers and directors by providing, among other things, that we will indemnify such officer or director, under the circumstances and to the extent provided for therein, for expenses, damages, judgments, fines and settlements he or she may be required to pay in actions or proceedings which he or she is or may be made a party by reason of his or her position as our director, officer or other agent, to the fullest extent permitted under Maryland law and our bylaws. Notwithstanding the foregoing, the indemnification provisions shall not protect any officer or director from liability to us or our stockholders as a result of any action that would constitute willful misfeasance, bad faith or gross negligence in the performance of such officer s or director s duties, or reckless disregard of his or her obligations and duties.

License Agreement

We have entered into a license agreement with our Adviser pursuant to which our Adviser has granted us a non-exclusive license to use the name Gladstone and the Diamond G logo. Under this agreement, we have the right to use the Gladstone name and the Diamond G logo for so long as the Adviser remains our investment adviser. Other than with respect to this limited license, we have no legal right to use either the Gladstone name or the Diamond G logo.

The license agreement requires us to pay to our Adviser a royalty fee of $1 per quarter for the use of the Gladstone name and the Diamond G logo. The amount of the licensing fee is to be negotiated every year by our compensation committee and approved by a majority of our independent directors. The license arrangement will terminate in the event that the Adviser is no longer our adviser.

CONTROL PERSONS AND PRINCIPAL STOCKHOLDERS

The following table sets forth, as of April 6, 2007 (unless otherwise indicated), the beneficial ownership of each current director, each of the executive officers, the executive officers and directors as a group and each stockholder known to our management to own beneficially more than 5% of the outstanding shares of common stock. Except as otherwise noted, the address of the individuals below is c/o Gladstone Capital Corporation, 1521 Westbranch Drive, Suite 200, McLean, VA 22102.

Name and Address	Number of Shares	Percent of Total	Beneficial Ownership(1) Dollar Range of Equity Securities of the Company Owned by Directors and Executive Officers(2)	Aggregate Dollar Range of Equity Securities of all Funds by Directors and Executive Officers in Family of Investment Companies(2)(3)
Executive Officers and Directors:				
David Gladstone(4)	999,778	8.16%	Over $100,000	Over $100,000
Terry Lee Brubaker(5)	196,024	1.60%	Over $100,000	Over $100,000
George Stelljes III	4,057	*	$ 50,001 - $100,000	Over $100,000
Harry T. Brill, Jr.(6)	10,500	*	Over $100,000	Over $100,000
Gary Gerson	0	*	None	$ 10,001 - $50,000
Anthony W. Parker	4,145	*	$ 50,001 - $100,000	Over $100,000
David A.R. Dullum	2,037	*	$ 10,001 - $50,000	Over $100,000
Michela A. English	2,500	*	$ 50,001 - $100,000	Over $100,000
Paul Adelgren	1,008	*	$ 10,001 - $50,000	$ 10,001 - $50,000
Maurice Coulon	0	*	None	$ 10,001 - $50,000
John H. Outland	1,000	*	$ 10,001 - $50,000	$ 50,001 - $100,000
Gerard Mead	812	*	$ 10,001 - $50,000	$ 10,001 - $50,000
All executive officers and directors as a group (12 persons)	1,221,861	9.97%	n/a	n/a

* Less than 1%

(1) This table is based upon information supplied by officers, directors and principal stockholders. Unless otherwise indicated in the footnotes to this table and subject to community property laws where applicable, we believe that each of the stockholders named in this table has sole voting and sole investment power with respect to the shares indicated as beneficially owned. Applicable percentages are based on 12,249,683 shares outstanding on April 6, 2007, adjusted as required by rules promulgated by the SEC.

(2) Ownership calculated in accordance with Rule 16a-1(a)(2) of the Exchange Act. The dollar range of our equity securities beneficially owned is calculated by multiplying the closing price of Common Stock as reported on The Nasdaq Global Select Market as of April 5, 2007, times the number of shares beneficially owned.

(3) Each of our directors and executive officers is also a director or executive officer, or both, of Gladstone Investment Corporation, our affiliate and a business development company, and Gladstone Commercial Corporation, our affiliate and a real estate investment trust, each of which is also externally managed by the Adviser.

(4) 393,334 of these shares of common stock are pledged to us as security for a promissory note issued in connection with Mr. Gladstone s acquisition of these shares through a stock option exercise on August 23, 2001. Mr. Gladstone retains voting power with respect to these shares.

(5) 177,500 of these shares of common stock are pledged to secure indebtedness incurred for their acquisition, including 93,334 shares that are pledged to us as security for a promissory note issued in connection with Mr. Brubaker s acquisition of these shares through a stock option exercise on August 23, 2001. Mr. Brubaker retains voting power with respect to these shares.

(6) 10,000 of these shares of common stock are pledged to us as security for a promissory note issued in connection with the acquisition of these shares through a stock option exercise on August 23, 2001. Mr. Brill retains voting power with respect to these shares.

DIVIDEND REINVESTMENT PLAN

We have adopted a dividend reinvestment plan that provides for reinvestment of our distributions on behalf of our stockholders upon their election as provided below. As a result, if our board of directors authorizes, and we declare, a cash dividend, then our stockholders who have opted in to our dividend reinvestment plan will not receive cash dividends but, instead, such cash dividends will automatically be reinvested in additional shares of our common stock.

Pursuant to our dividend reinvestment plan, if your shares of our common stock are registered in your own name you can have all distributions reinvested in additional shares of our common stock by The Bank of New York, the plan agent, if you enroll in the dividend reinvestment plan by delivering an authorization form to the plan agent prior to the corresponding dividend declaration date. The plan agent will effect purchases of our common stock under the dividend reinvestment plan in the open market. If you do not elect to participate in the dividend reinvestment plan, you will receive all distributions in cash paid by check mailed directly to you (or if you hold your shares in street or other nominee name, then to your nominee) as of the relevant record date, by the plan agent, as our dividend disbursing agent. If your shares are held in the name of a broker or nominee or if you are transferring such an account to a new broker or nominee, you should contact the broker or nominee to determine whether and how they may participate in the dividend reinvestment plan.

The plan agent serves as agent for the holders of our common stock in administering the dividend reinvestment plan. After we declare a dividend, the plan agent will, as agent for the participants, receive the cash payment and use it to buy common stock on The Nasdaq Global Select Market or elsewhere for the participants accounts. The price of the shares will be the average market price at which such shares were purchased by the plan agent.

Participants in the dividend reinvestment plan may withdraw from the dividend reinvestment plan upon written notice to the plan agent. Such withdrawal will be effective immediately if received not less than ten days prior to a dividend record date; otherwise, it will be effective the day after the related dividend distribution date. When a participant withdraws from the dividend reinvestment plan or upon termination of the dividend reinvestment plan as provided below, certificates for whole shares of common stock credited to his or her account under the dividend reinvestment plan will be issued and a cash payment will be made for any fractional share of common stock credited to such account.

The plan agent will maintain each participant s account in the dividend reinvestment plan and will furnish monthly written confirmations of all transactions in such account, including information needed by the stockholder for personal and tax records. Common stock in the account of each dividend reinvestment plan participant will be held by the plan agent in non-certificated form in the name of such participant. Proxy materials relating to our stockholders meetings will include those shares purchased as well as shares held pursuant to the reinvestment plan.

In the case of participants who beneficially own shares that are held in the name of banks, brokers or other nominees, the plan agent will administer the dividend reinvestment plan on the basis of the number of shares of common stock certified from time to time by the record holders as the amount held for the account of such beneficial owners. Shares of our common stock may be purchased by the plan agent through any of the underwriters, acting as broker or dealer.

We pay the plan agent s fees for the handling or reinvestment of dividends and other distributions. Each participant in the dividend reinvestment plan pays a pro rata share of brokerage commissions incurred with respect to the plan agent s open market purchases in connection with the reinvestment of distributions. There are no other charges to participants for reinvesting distributions.

Distributions are taxable whether paid in cash or reinvested in additional shares, and the reinvestment of distributions pursuant to the dividend reinvestment plan will not relieve participants of any U.S. federal income tax or state income tax that may be payable or required to be withheld on such distributions. For more information regarding taxes that our stockholders may be required to pay, see Material U.S. Federal Income Tax Considerations.

Experience under the dividend reinvestment plan may indicate that changes are desirable. Accordingly, we reserve the right to amend or terminate the dividend reinvestment plan as applied to any distribution paid subsequent to written notice of the change sent to participants in the dividend reinvestment plan at least 90 days before the record date for the distribution. The dividend reinvestment plan also may be amended or terminated by the plan agent with our prior written consent, on at least 90 days written notice to participants in the dividend reinvestment plan. All correspondence concerning the reinvestment plan should be directed to the plan agent by mail at 100 Church Street, 14th Floor, New York, New York 10286 or by phone at 800-274-2944.

MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS

The following discussion is a general summary of the material U.S. federal income tax considerations applicable to us and to an investment in our shares. This summary does not purport to be a complete description of the income tax considerations applicable to such an investment. For example, we have not described tax consequences that we assume to be generally known by investors or certain considerations that may be relevant to certain types of holders subject to special treatment under federal income tax laws, including stockholders subject to the alternative minimum tax, tax-exempt organizations, insurance companies, regulated investment companies, dealers in securities, pension plans and trusts, financial institutions, and those who hold our common stock as part of a straddle, conversion or other risk-reduction strategy. This summary assumes that investors hold our common stock as capital assets. The discussion is based upon the Code, Treasury regulations, and administrative and judicial interpretations, each as in effect as of the date of this prospectus and all of which are subject to change, possibly retroactively, which could affect the continuing validity of this discussion. We have not sought and will not seek any ruling from the Internal Revenue Service, which we refer to as the IRS, regarding this offering. This summary does not discuss any aspects of U.S. estate or gift tax or foreign, state or local tax. It does not discuss the special treatment under federal income tax laws that could result if we invested in tax-exempt securities or certain other investment assets in which we do not currently intend to invest.

Taxation of the Company

In order to maintain the qualification for treatment as a RIC under Subchapter M of the Code, we must distribute to our stockholders, for each taxable year, at least 90% of our investment company taxable income, which is generally our ordinary income plus short-term capital gains. We refer to this as the annual distribution requirement. We must also meet several additional requirements, including:

Income source requirements. At least 90% of our gross income for each taxable year must be from dividends, interest, payments with respect to securities loans, gains from sales or other dispositions of securities or other income derived with respect to our business of investing in securities, and

Asset diversification requirements. As of the close of each quarter of our taxable year: (1) at least 50% of the value of our assets must consist of cash, cash items, U.S. government securities, the securities of other regulated investment companies and other securities to the extent that (a) we do not hold more than 10% of the outstanding voting securities of an issuer of such other securities and (b) such other securities of any one issuer do not represent more than 5% of our total assets, and (2) no more than 25% of the value of our total assets may be invested in the securities of one issuer (other than U.S. government securities or the securities of other regulated investment companies), or of two or more issuers that are controlled by us and are engaged in the same or similar or related trades or businesses.

Failure to Qualify as a RIC. If we are unable to qualify for treatment as a RIC, we will be subject to tax on all of our taxable income at regular corporate rates. We would not be able to deduct distributions to stockholders, nor would we be required to make such distributions. Distributions would be taxable to our stockholders as dividend income to the extent of our current and accumulated earnings and profits. Subject to certain limitations under the Code, corporate distributees would be eligible for the dividends received deduction. Distributions in excess of our current and accumulated earnings and profits would be treated first as a return of capital to the extent of the stockholder s tax basis, and then as a gain realized from the sale or exchange of property. If we fail to meet the RIC requirements for more than two consecutive years and then seek to requalify as a RIC, we would be required to recognize a gain to the extent of any unrealized appreciation on our assets unless we make a special election to pay corporate-level tax on any such unrealized appreciation recognized during the succeeding 10-year period. Absent such special election, any gain we recognized would be deemed distributed to our stockholders as a taxable distribution.

Qualification as a RIC. If we qualify as a RIC and distribute to stockholders each year in a timely manner at least 90% of our investment company taxable income, we will not be subject to federal income tax on the portion of our taxable income and gains we distribute to stockholders. We would, however, be subject to a 4% nondeductible federal excise tax if we do not distribute, actually or on a deemed basis, 98% of our income, including both ordinary income and capital gains. The excise tax would apply only to the amount by which 98% of our income exceeds the amount of income we distribute, actually or on a deemed basis, to stockholders. We will be subject to regular corporate income tax, currently at rates up to 35%, on any undistributed income, including both ordinary income and capital gains. We intend to retain some or all of our capital gains, but to designate the retained amount as a deemed distribution. In that case, among other consequences, we will pay tax on the retained amount, each stockholder will be required to include its share of the deemed distribution in income as if it had been actually distributed to the stockholder and the stockholder will be entitled to claim a credit or refund equal to its allocable share of the tax we pay on the retained capital gain. The amount of the deemed distribution net of such tax will be added to the stockholder s cost basis for its common stock. Since we expect to pay tax on any retained capital gains at our regular corporate capital gain tax rate, and since that rate is in excess of the maximum rate currently payable by individuals on long-term capital gains, the amount of tax that individual stockholders will be treated as having paid will exceed the tax they owe on the capital gain dividend and such excess may be claimed as a credit or refund against the stockholder s other tax obligations. A stockholder that is not subject to U.S. federal income tax or tax on long-term capital gains would be required to file a U.S. federal income tax return on the appropriate form in order to claim a refund for the taxes we paid. In order to utilize the deemed distribution approach, we must provide written notice to the stockholders prior to the expiration of 60 days after the close of the relevant tax year. We will also be subject to alternative minimum tax, but any tax preference items would be apportioned between us and our stockholders in the same proportion that dividends, other than capital gain dividends, paid to each stockholder bear to our taxable income determined without regard to the dividends paid deduction.

If we acquire debt obligations that were originally issued at a discount, which would generally include loans we make that are accompanied by warrants, that bear interest at rates that are not either fixed rates or certain qualified variable rates or that are not unconditionally payable at least annually over the life of the obligation, we will be required to include in taxable income each year a portion of the original issue discount that accrues over the life of the obligation. Such original issue discount will be included in our investment company taxable income even though we receive no cash corresponding to such discount amount. As a result, we may be required to make additional distributions corresponding to such original issue discount amounts in order to satisfy the annual distribution requirement and to continue to qualify as a RIC or to avoid the 4%

excise tax. In this event, we may be required to sell temporary investments or other assets to meet the RIC distribution requirements. Through December 31, 2006, we incurred no original issue discount income.

Taxation of Our U.S. Stockholders

Distributions. For any period during which we qualify for treatment as a RIC for federal income tax purposes, distributions to our stockholders attributable to our investment company taxable income generally will be taxable as ordinary income to stockholders to the extent of our current or accumulated earnings and profits. Any distributions in excess of our earnings and profits will first be treated as a return of capital to the extent of the stockholder s adjusted basis in his or her shares of common stock and thereafter as gain from the sale of shares of our common stock. Distributions of our long-term capital gains, designated by us as such, will be taxable to stockholders as long-term capital gains regardless of the stockholder s holding period for its common stock and whether the distributions are paid in cash or invested in additional common stock. Corporate stockholders are generally eligible for the 70% dividends received deduction with respect to ordinary income, but not to capital gains dividends to the extent such amount designated by us does not exceed the dividends received by us from domestic corporations. Any dividend declared by us in October, November or December of any calendar year, payable to stockholders of record on a specified date in such a month and actually paid during January of the following year, will be treated as if it were paid by us and received by the stockholders on December 31 of the previous year. In addition, we may elect to relate a dividend back to the prior taxable year if we (1) declare such dividend prior to the due date for filing our return for that taxable year, (2) make the election in that return, and (3) distribute the amount in the 12-month period following the close of the taxable year but not later than the first regular dividend payment following the declaration. Any such election will not alter the general rule that a stockholder will be treated as receiving a dividend in the taxable year in which the distribution is made, subject to the October, November, December rule described above.

In general, the tax rates applicable to our dividends other than dividends designated as capital gain dividends will be the standard ordinary income tax rates, and not the lower federal income tax rate applicable to qualified dividend income. If we distribute dividends that are attributable to actual dividend income received by us that is eligible to be, and is, designated by us as qualified dividend income, such dividends would be eligible for such lower federal income tax rate. For this purpose, qualified dividend income means dividends received by us from United States corporations and qualifying foreign corporations, provided that both we and the stockholder recipient of our dividend satisfy certain holding period and other requirements in respect of our shares (in the case of our stockholder) and the stock such corporations (in our case). However, we do not anticipate receiving or distributing a significant amount of qualified dividend income.

Sale of our Shares. A U.S. stockholder generally will recognize taxable gain or loss if the U.S. stockholder sells or otherwise disposes of his, her or its shares of our common stock. Any gain arising from such sale or disposition generally will be treated as long-term capital gain or loss if the U.S. stockholder has held his, her or its shares for more than one year. Otherwise, it will be classified as short-term capital gain or loss. However, any capital loss arising from the sale or disposition of shares of our common stock held for six months or less will be treated as long-term capital loss to the extent of the amount of capital gain dividends received, or undistributed capital gain deemed received, with respect to such shares. For taxable years beginning before January 1, 2011, individual U.S. stockholders are subject to a maximum federal income tax rate of 15% on their net capital gain (*i.e.*, the excess of realized net long-term capital gain over realized net short-term capital loss for a taxable year) including any long-term capital gain derived from an investment in our shares. Such rate is lower than the maximum rate on ordinary income currently payable by individuals. Corporate U.S. stockholders currently are subject to federal income tax on net capital gain at the maximum 35% rate also applied to ordinary income. Capital losses are subject to limitations on use for both corporate and non-corporate stockholders.

Backup Withholding. We may be required to withhold federal income tax, or backup withholding, currently at a rate of 28%, from all taxable distributions to any non-corporate U.S. stockholder (1) who fails to furnish us with a correct taxpayer identification number or a certificate that such stockholder is exempt from backup withholding, or (2) with respect to whom the IRS notifies us that such stockholder has failed to properly report certain interest and dividend income to the IRS and to respond to notices to that effect. An individual s taxpayer identification number is generally his or her social security number. Any amount withheld under backup withholding is allowed as a credit against the U.S. stockholder s federal income tax liability, provided that proper information is provided to the IRS.

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REGULATION AS A BUSINESS DEVELOPMENT COMPANY

We are a closed-end, non-diversified management investment company that has elected to be regulated as a business development company under Section 54 of the 1940 Act. As such, we are subject to regulation under the 1940 Act. The 1940 Act contains prohibitions and restrictions relating to transactions between business development companies and their affiliates, principal underwriters and affiliates of those affiliates or underwriters and requires that a majority of the directors be persons other than interested persons, as defined in the 1940 Act. In addition, the 1940 Act provides that we may not change the nature of our business so as to cease to be, or to withdraw our election as, a business development company unless approved by a majority of our outstanding voting securities.

We intend to conduct our business so as to retain our status as a business development company. A business development company may use capital provided by public shareholders and from other sources to invest in long-term private investments in businesses. A business development company provides shareholders the ability to retain the liquidity of a publicly traded stock while sharing in the possible benefits, if any, of investing in primarily privately owned companies. In general, a business development company must have been organized and have its principal place of business in the United States and must be operated for the purpose of making investments in the types of securities described in (1) below.

Qualifying Assets

Under the 1940 Act, a business development company may not acquire any asset other than assets of the type listed in Section 55(a) of the 1940 Act, which are referred to as qualifying assets, unless, at the time the acquisition is made, qualifying assets represent at least 70% of the company s total assets. The types of qualifying assets in which we may invest under the 1940 Act include, but are not limited to the following:

(1) Securities purchased in transactions not involving any public offering from the issuer of such securities, which issuer is an eligible portfolio company. An eligible portfolio company is generally defined in the 1940 Act as any issuer which:

- is organized under the laws of, and has its principal place of business in, the United States;

- is neither an investment company as defined in Section 3 of the 1940 Act (other than a small business investment company which is licensed by the Small Business Administration to operate under the Small Business Investment Act of 1958 and which is a wholly-owned subsidiary of the business development company) nor a company which would be an investment company except for the exclusion from the definition of investment company in Section 3(c) of the 1940 Act; and

- satisfies one of the following: (i) it does not have any class of securities with respect to which a member of a national securities exchange, broker, or dealer may extend or maintain credit to or for a customer pursuant to rules or regulations adopted by the Board of Governors of the Federal Reserve System under Section 7 of the Exchange Act; (ii) it is controlled by a business development company, either alone or as part of a group acting together, and such business development company in fact exercises a controlling influence over the management or policies of such eligible portfolio company and, as a result of such control, has an affiliated person who is a director of such eligible portfolio company; (iii) it has total assets of not more than $4,000,000, and capital and surplus (shareholders equity less retained earnings) of not less than $2,000,000, except that the SEC may adjust such amounts by rule, regulation, or order to reflect changes in one or more generally accepted indices or other indicators for small businesses; or (iv) all private domestic operating companies and those public domestic operating companies whose securities are not listed on a national securities exchange.

(2) Securities received in exchange for or distributed on or with respect to securities described in (1) above or pursuant to the exercise of options, warrants or rights relating to such securities.

(3) Cash, cash items, government securities or high quality debt securities maturing in one year or less from the time of investment.

Asset Coverage

We are permitted, under specified conditions, to issue multiple classes of indebtedness and one class of stock senior to our common stock if our asset coverage, as defined in the 1940 Act, is at least 200% immediately after each such issuance. In addition, while senior securities are outstanding, we must make provisions to prohibit any distribution to our stockholders or the repurchase of such securities or shares unless we meet the applicable asset coverage ratios at the time of the distribution or repurchase. We may also borrow amounts up to 5% of the value of our total assets for temporary purposes. The 1940 Act requires, among other things, that (1) immediately after issuance and before any dividend or distribution is made with respect to our common stock or before any purchase of common stock is made, the preferred stock, together with all other senior securities, must not exceed an amount equal to 50% of our total assets after deducting the amount of such dividend, distribution or purchase price, as the case may be, and (2) the holders of outstanding shares of preferred stock, if any, must be entitled as a class to elect two directors at all times and to elect a majority of the directors if dividends on the preferred stock are in arrears by two years or more.

Significant Managerial Assistance

For portfolio securities to be qualifying assets for the 70% test described above, the business development company must either exercise a controlling influence over the issuer of the securities or must make available to the issuer of the securities significant managerial assistance. However, with respect to certain but not all such securities, where the business development company purchases such securities in conjunction with one or more other persons acting together, one of the other persons in the group may make available such managerial assistance, or the business development company may exercise such control jointly. Making available significant managerial assistance means, among other things, any arrangement whereby the business development company, through its directors, officers or employees, offers to provide, and, if accepted, does so provide, significant guidance and counsel concerning the management, operations or business objectives and policies of a portfolio company.

Fundamental Investment Policies

We seek to achieve a high level of current income and capital gains through investments in debt securities and preferred and common stock that we acquired in connection with buyout and other recapitalizations. The following restrictions, along with these investment objectives, are our only fundamental policies, which are policies that may not be changed without the approval of the holders of the majority of our outstanding voting securities, as defined in the 1940 Act. For a fuller explanation of the regulatory framework in which we operate, see Business-Regulation as a Business Development Company. The percentage restrictions set forth below, other than the restriction pertaining to the issuance of senior securities, as well as those contained elsewhere in this prospectus, apply at the time we effect a transaction, and a subsequent change in a percentage resulting from market fluctuations or any cause other than an action by us will not require us to dispose of portfolio securities or to take other action to satisfy the percentage restriction. We will at all times conduct our business so as to retain our status as a business development company. In order to retain that status, we may not acquire any assets (other than non-investment assets necessary and appropriate to our operations as a business development company) if, after giving effect to such acquisition, the value of our qualifying assets is less than 70% of the value of our total assets. We anticipate that the securities we seek to acquire (provided that we control or, through our officers or other participants in the financing transaction, make significant managerial assistance available to the issuers of these securities), as well as temporary investments, will generally be qualifying assets.

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

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

We will not (1) act as an underwriter of securities of other issuers (except to the extent that we may be deemed an underwriter of securities we purchase that must be registered under the Securities Act before they may be offered or sold to the public); (2) purchase or sell real estate or interests in real estate or real estate investment trusts (except that we may (a) purchase and sell real estate or interests in real estate in connection with the orderly liquidation of investments, (b) own the securities of companies or participate in a partnership or partnerships that are in the business of buying, selling or developing real estate, or (c) finance the purchase of real estate by our portfolio companies); (3) sell securities short (except with regard to managing the risks associated with publicly-traded securities issued by our portfolio companies); (4) purchase securities on margin (except to the extent that we may purchase securities with borrowed money); (5) write or buy put or call options (except (i) to the extent of warrants or conversion privileges in connection with our acquisition financing or other investments and rights to require the issuers of such investments or their affiliates to repurchase them under certain circumstances, (ii) with regard to managing risks associated with publicly-traded securities issued by our portfolio companies, or (iii) with regard to managing the risks associated with interest rate fluctuations); (6) engage in the purchase or sale of commodities or commodity contracts, including futures contracts (except where necessary in working out distressed loan or investment situations or in managing the risks associated with interest rate fluctuations); or (7) acquire more than 3% of the voting stock of, or invest more than 5% of our total assets in, any securities issued by any other investment company (except as they may be acquired as part of a merger, consolidation or acquisition of assets). That portion of our investments that is in securities issued by other investment companies may subject our stockholders to additional expenses.

DESCRIPTION OF OUR SECURITIES

Our authorized capital stock consists of 50,000,000 shares of capital stock, $0.001 par value per share, all of which is currently designated as common stock. Under our articles of incorporation, our board of directors is authorized to classify and reclassify any unissued shares of capital stock without requiring stockholder approval. The following summary description of our capital stock is not necessarily complete and is subject to, and qualified in its entirety by, our articles of incorporation. Please review our articles of incorporation for a more detailed description of the provisions summarized below.

Common Stock

All shares of our common stock have equal rights as to earnings, assets, dividends and voting privileges and, when issued, will be duly authorized, validly issued, fully paid and nonassessable. Distributions may be paid to the holders of our common stock if, as and when declared by our board of directors out of funds legally available therefor. Shares of our common stock have no preemptive, conversion or redemption rights and are freely transferable, except where their transfer is restricted by federal and state securities laws. In the event of our liquidation, dissolution or winding up, each share of our common stock is entitled to share ratably in all of our assets that are legally available for distribution after we pay all debts and other liabilities and subject to any preferential rights of holders of our preferred stock, if any is outstanding at the time. Each share of our common stock is entitled to one vote and does not have cumulative voting rights, which means that holders of a majority of such shares, if they so choose, could elect all of the directors, and holders of less than a majority of such shares would, in that case, be unable to elect any director. Our common stock is listed on The Nasdaq Global Select Market under the ticker symbol GLAD.

Preferred Stock

Our articles of incorporation gives the board of directors the authority, without further action by stockholders, to issue shares of preferred stock in one or more series and to fix the rights, preferences, privileges, qualifications and restrictions granted to or imposed upon such preferred stock, including dividend rights, conversion rights, voting rights, rights and terms of redemption, and liquidation preference, any or all of which may be greater than the rights of the common stock. Thus, the board of directors could authorize the issuance of shares of preferred stock with terms and conditions which could have the effect of delaying, deferring or preventing a transaction or a change in control that might involve a premium price for holders of our common stock or otherwise be in their best interest. The issuance of preferred stock could adversely affect the voting power of holders of common stock and reduce the likelihood that such holders will receive dividend payments and payments upon liquidation, and could also decrease the market price of our common stock.

You should note, however, that any issuance of preferred stock must comply with the requirements of the 1940 Act. The 1940 Act requires, among other things, that (1) immediately after issuance and before any dividend or other distribution is made with respect to our common stock and before any purchase of common stock is made, such preferred stock together with all other senior securities must not exceed an amount equal to 50% of our total assets after deducting the amount of such dividend, distribution or purchase price, as the case may be, and (2) the holders of shares of preferred stock, if any are issued, must be entitled as a class to elect two directors at all times and to elect a majority of the directors if dividends on such preferred stock are in arrears by two years or more. Certain matters under the 1940 Act require the separate vote of the holders of any issued and outstanding preferred stock. For example, holders of preferred stock would vote separately from the holders of common stock on a proposal to cease operations as a business development company. We have no present plans to issue any shares of our preferred stock, but believe that the availability for issuance of preferred stock will provide us with increased flexibility in structuring future financings. Additionally, we will not issue any preferred stock under this prospectus unless we receive confirmation that we may do so from the staff of the SEC. If we offer preferred stock under this prospectus, we will issue an appropriate prospectus supplement. You should read that prospectus supplement for a description of our preferred stock, including, but not limited to, whether there will be an arrearage in the payment of dividends or sinking fund installments, if any, restrictions with respect to the declaration of dividends, requirements in connection with the maintenance of any ratio or assets, or creation or maintenance of reserves, or provisions for permitting or restricting the issuance of additional securities.

Debt Securities

Any debt securities that we issue may be senior or subordinated in priority of payment. If we offer debt securities under this prospectus, we will provide a prospectus supplement that describes the ranking, whether senior or subordinated, the specific designation, the aggregate principal amount, the purchase price, the maturity, the redemption terms, the interest rate or manner of calculating the interest rate, the time of payment of interest, if any, the terms for any conversion or exchange, including the terms relating to the adjustment of any conversion or exchange mechanism, the listing, if any, on a securities exchange, the name and address of the trustee and any other specific terms of the debt securities.

**CERTAIN PROVISIONS OF MARYLAND LAW AND OF
OUR ARTICLES OF INCORPORATION AND BYLAWS**

Our articles of incorporation and bylaws and the Maryland General Corporation Law contain certain provisions that could make more difficult the acquisition of us by means of a tender offer, a proxy contest or otherwise. These provisions are expected to discourage certain types of coercive takeover practices and inadequate takeover bids and to encourage persons seeking to acquire control of us to negotiate first with our board of directors. We believe that the benefits of these provisions outweigh the potential disadvantages of discouraging such proposals because, among other things, negotiation of such proposals might result in an improvement of their terms. The description set forth below is intended as a summary only and is qualified in its entirety by reference to our articles of incorporation and bylaws.

Classified Board of Directors

In accordance with our bylaws, our board of directors is divided into three classes of directors serving staggered three-year terms. Under the Maryland General Corporation Law, each class must consist as nearly as possible of one-third of the directors then elected to our board of directors and our board is currently divided into three classes two of which have three directors and one of which has four directors. A classified board may render more difficult a change in control of us or removal of our incumbent management. We believe, however, that the longer time required to elect a majority of a classified board of directors will help to ensure continuity and stability of our management and policies.

Number of Directors; Removal; Vacancies

Our articles of incorporation provide that the number of directors will be determined pursuant to our bylaws and our bylaws provide that a majority of our entire board of directors may at any time increase or decrease the number of directors. In addition, our bylaws provide that the number of directors shall not be increased by 50% or more in any 12-month period without the approval of at least 66⅔% of the members of our board of directors then in office. Our bylaws provide that any vacancies will be filled by the vote of a majority of the remaining directors, even if less than a quorum, and the directors so appointed shall hold office until the next annual meeting of stockholders and until their successors are elected and qualified. Accordingly, our board of directors could temporarily prevent any stockholder from enlarging the board of directors and filling the new directorships with such stockholder s own nominees.

Our bylaws also provide that, except as may be required by law or our articles of incorporation, our directors may only be removed for cause and only by the affirmative vote of 75% of the voting power of all of the shares of our capital stock then entitled to vote generally in the election of directors, voting together as a single class.

Stockholder Approval Requirements

Maryland General Corporation Law provides that stockholder action can be taken only at an annual or special meeting of stockholders or by unanimous written consent in lieu of a meeting. These provisions may have the effect of delaying consideration of a stockholder proposal until the next annual meeting.

Advance Notice Provisions for Stockholder Nominations and Stockholder Proposals

Our bylaws establish an advance notice procedure for stockholders to make nominations of candidates for election as directors or to bring other business before an annual meeting of our stockholders, which we refer to as the stockholder notice procedure.

The stockholder notice procedure provides that (1) only persons who are nominated by, or at the direction of, the board of directors, or by a stockholder who has given timely written notice containing specified information to our secretary prior to the meeting at which directors are to be elected, will be eligible for election as directors and (2) at an annual meeting only such business may be conducted as has been brought before the meeting by, or at the direction of, our board of directors or by a stockholder who has given timely written notice to our secretary of such stockholder s intention to bring such business before the meeting. Except for stockholder proposals submitted in accordance with the federal proxy rules as to which the requirements specified therein shall control, notice of stockholder nominations or business to be conducted at an annual meeting must be received by us prior to the first anniversary of the previous year s annual meeting. If we call a special meeting of stockholders for the purpose of electing directors, stockholder nominations must be received by us not earlier than the 90th day prior to such meeting and not later than the later of the 60th day prior to such meeting or the 10th day following the day on which notice of the date of a special meeting of stockholders was given.

The purpose of requiring stockholders to give us advance notice of nominations and other business is to afford our board of directors a meaningful opportunity to consider the qualifications of the proposed nominees and the advisability of the other proposed business and, to the extent deemed necessary or desirable by the board of directors, to inform stockholders and make recommendations about such qualifications or business, as well as to provide a more orderly procedure for conducting meetings of stockholders. Although our bylaws do not give our board of directors any power to disapprove stockholder nominations for the election of directors or proposals for action, they may have the effect of precluding a contest for the election of directors or the consideration of stockholder proposals if proper procedures are not followed and of discouraging or deterring a third party from conducting a solicitation of proxies to elect its own slate of directors or to approve its own proposal without regard to whether consideration of such nominees or proposals might be harmful or beneficial to us and our stockholders.

Amendment of Articles of Incorporation and Bylaws

Our articles of incorporation may be amended, altered, changed or repealed, subject to the resolutions providing for any class or series of preferred stock, only by the affirmative vote of both a majority of the members of our board of directors then in office and a majority of the voting power of all of the shares of our capital stock entitled to vote generally in the election of directors, voting together as a single class.

Our articles of incorporation also provide that the bylaws may be adopted, amended, altered, changed or repealed by the affirmative vote of the majority of our board of directors then in office. Any action taken by our stockholders with respect to adopting, amending, altering, changing or repealing our bylaws may be taken only by the affirmative vote of the holders of at least 75% of the voting power of all of the shares of our capital stock then entitled to vote generally in the election of directors, voting together as a single class.

These provisions are intended to make it more difficult for stockholders to circumvent certain other provisions contained in our articles of incorporation and bylaws, such as those that provide for the classification of our board of directors. These provisions, however, also will make it more difficult for stockholders to amend the articles of incorporation or bylaws without the approval of the board of directors, even if a majority of the stockholders deems such amendment to be in the best interests of all stockholders.

Limitation on Liability of Directors

We have adopted provisions in our articles of incorporation, which, to the fullest extent permitted by Maryland law and as limited by the 1940 Act, limit the liability of our directors and officers for monetary damages. Under our articles of incorporation we shall indemnify (1) our directors and officers to the fullest extent permitted by the General Laws of the State of Maryland as limited by the 1940 Act or any valid rule, regulation or order of the Securities and Exchange Commission thereunder, including the advance of expenses under the procedures and to the fullest extent permitted by law and (2) other employees and agents to such extent as shall be authorized by our board of directors or our bylaws and be permitted by law. The effect of these provisions is to eliminate our rights and the rights of our stockholders (through stockholders derivative suits on our behalf) to recover monetary damages against one of our directors or officers for breach of the fiduciary duty of care as a director or officer (including breaches resulting from negligent or grossly negligent behavior) except to the extent this limitation is not permitted under applicable law, including the 1940 Act. These provisions do not limit or eliminate our rights or the rights of any of our stockholders to seek non-monetary relief such as an injunction or rescission in the event one of our directors or officers breaches his or her duty of care. These provisions also will not alter the liability of our directors or officers under federal securities laws.

PLAN OF DISTRIBUTION

We may sell the Securities through underwriters or dealers, directly to one or more purchasers, including existing stockholders in a rights offering, or through agents or through a combination of any such methods of sale. In the case of a rights offering, the applicable prospectus supplement will set forth the number of shares of our common stock issuable upon the exercise of each right and the other terms of such rights offering. Any underwriter or agent involved in the offer and sale of the Securities will also be named in the applicable prospectus supplement.

The distribution of the Securities may be effected from time to time in one or more transactions at a fixed price or prices, which may be changed, at prevailing market prices at the time of sale, at prices related to such prevailing market prices, or at negotiated prices, provided, however, that in the case of our common stock, the offering price per share less any underwriting commissions or discounts must equal or exceed the net asset value per share of our common stock.

In connection with the sale of the Securities, underwriters or agents may receive compensation from us or from purchasers of the Securities, for whom they may act as agents, in the form of discounts, concessions or commissions. Underwriters may sell the Securities to or through dealers and such dealers may receive compensation in the form of discounts, concessions or commissions from the underwriters and/or commissions from the purchasers for whom they may act as agents. Underwriters, dealers and agents that participate in the distribution of the Securities may be deemed to be underwriters under the Securities Act, and any discounts and commissions they receive from us and any profit realized by them on the resale of the Securities may be deemed to be underwriting discounts and commissions under the Securities Act. Any such underwriter or agent will be identified and any such compensation received from us will be described in the applicable prospectus supplement. The maximum commission or discount to be received by any NASD member or independent broker-dealer will not exceed 8%. In connection with any rights offering to our stockholders, we may also enter into a standby underwriting arrangement with one or more underwriters pursuant to which the underwriter(s) will purchase our common stock remaining unsubscribed for after the rights offering.

We may enter into derivative transactions with third parties, or sell securities not covered by this prospectus to third parties in privately negotiated transactions. If the applicable prospectus supplement indicates, in connection with those derivatives, the third parties may sell Securities covered by this prospectus and the applicable prospectus supplement, including in short sale transactions. If so, the third party may use securities pledged by us or borrowed from us or others to settle those sales or to close out any related open borrowings of stock, and may use securities received from us in settlement of those derivatives to close out any related open borrowings of stock. The third parties in such sale transactions will be underwriters and, if not identified in this prospectus, will be identified in the applicable prospectus supplement (or a post-effective amendment).

Any of our common stock sold pursuant to a prospectus supplement will be listed on The Nasdaq Global Select Market, or another exchange on which our common stock is traded.

Under agreements into which we may enter, underwriters, dealers and agents who participate in the distribution of the Securities may be entitled to indemnification by us against certain liabilities, including liabilities under the Securities Act. Underwriters, dealers and agents may engage in transactions with, or perform services for, us in the ordinary course of business.

If so indicated in the applicable prospectus supplement, we will authorize underwriters or other persons acting as our agents to solicit offers by certain institutions to purchase the Securities from us pursuant to contracts providing for payment and delivery on a future date. Institutions with which such contracts may be made include commercial and savings banks, insurance companies, pension funds, investment companies, educational and charitable institutions and others, but in all cases such institutions must be approved by us. The obligations of any purchaser under any such contract will be subject to the condition that the purchase of the Securities shall not at the time of delivery be prohibited under the laws of the jurisdiction to which such purchaser is subject. The underwriters and such other agents will not have any responsibility in respect of the validity or performance of such contracts. Such contracts will be subject only to those conditions set forth in the prospectus supplement, and the prospectus supplement will set forth the commission payable for solicitation of such contracts.

In order to comply with the securities laws of certain states, if applicable, the Securities offered hereby will be sold in such jurisdictions only through registered or licensed brokers or dealers. In addition, in certain states, the Securities may not be sold unless they have been registered or qualified for sale in the applicable state or an exemption from the registration or qualification requirement is available and is complied with.

SHARE REPURCHASES

Shares of closed-end investment companies frequently trade at discounts to net asset value. We cannot predict whether our shares will trade above, at or below net asset value. The market price of our common stock is determined by, among other things, the supply and demand for our shares, our investment performance and investor perception of our overall attractiveness as an investment as compared with alternative investments. Our board of directors has authorized our officers, in their discretion and subject to compliance with the 1940 Act and other applicable law, to purchase on the open market or in privately negotiated transactions, outstanding shares of our common stock in the event that our shares trade at a discount to net asset value. We can not assure you that we will ever conduct any open market purchases and if we do conduct open market purchases, we may terminate them at any time.

In addition, if our shares publicly trade for a substantial period of time at a substantial discount to our then current net asset value per share, our board of directors will consider authorizing periodic repurchases of our shares or other actions designed to eliminate the discount. Our board of directors would consider all relevant factors in determining whether to take any such actions, including the effect of such actions on our status as a RIC under the Internal Revenue Code and the availability of cash to finance these repurchases in view of the restrictions on our ability to borrow. We can not assure you that any share repurchases will be made or that if made, they will reduce or eliminate market discount. Should we make any such repurchases in the future, we expect that we would make them at prices at or below the then current net asset value per share. Any such repurchase would cause our total assets to decrease, which may have the effect of increasing our expense ratio. We may borrow money to finance the repurchase of shares subject to the limitations described in this prospectus. Any interest on such borrowing for this purpose would reduce our net income.

CUSTODIAN, TRANSFER AND DIVIDEND PAYING AGENT AND REGISTRAR

Our securities are held under a custodian agreement with The Bank of New York. The address of the custodian is 30 Broad Street, New York, NY 10005. Securities held through our wholly-owned subsidiary, Gladstone Business Loan, LLC, are held under a custodian agreement with The Bank of New York Trust Company, N.A., which acts as collateral custodian pursuant to Gladstone Business Loan s credit facility with Deutsche Bank AG and certain other parties. The address of the custodian is 2 North LaSalle St., Suite 1020, Chicago, Illinois 60602. The Bank of New York acts as our transfer and dividend paying agent and registrar. The principal business address of The Bank of New York is 100 Church Street, 14th Floor, New York, New York 10286, telephone number (800) 274-2944. The Bank of New York also maintains an internet web site at http://stock.bankofny.com.

BROKERAGE ALLOCATION AND OTHER PRACTICES

Since we generally acquire and dispose of our investments in privately negotiated transactions, we will infrequently use securities brokers or dealers in the normal course of our business. Subject to policies established by our board of directors, the Adviser will be primarily responsible for the execution of transactions involving publicly traded securities and the allocation of brokerage commissions in respect thereof, if any. In the event that the Adviser executes such transactions, we do not expect the Adviser to execute transactions through any particular broker or dealer, but we would expect the Adviser to seek to obtain the best net results for us, taking into account such factors as price (including the applicable brokerage commission or dealer spread), size of order, difficulty of execution, and operational facilities of the firm and the firm s risk and skill in positioning blocks of securities. While we expect that the Adviser generally will seek reasonably competitive trade execution costs, we will not necessarily pay the lowest spread or commission available. Subject to applicable legal requirements, the Adviser may select a broker based partly upon brokerage or research services provided to us, the Adviser and any of its other clients. In return for such services, we may pay a higher commission than other brokers would charge if the Adviser determines in good faith that such commission is reasonable in relation to the value of the brokerage and research services provided by such broker or dealer viewed in terms either of the particular transaction or the Adviser s overall responsibilities with respect to all of the Adviser s clients.

LEGAL MATTERS

The legality of securities offered hereby will be passed upon for us by Cooley Godward Kronish LLP, Reston, Virginia. Certain legal matters will be passed upon for the underwriters, if any, by the counsel named in the accompanying prospectus supplement.

EXPERTS

The financial statements as of September 30, 2006 and 2005 and for each of the three years in the period ended September 30, 2006 and management s assessment of the effectiveness of internal control over financial reporting (which is included in Management s Report on Internal Control over Financial Reporting) as of September 30, 2006 included in this Prospectus have been so included in reliance on the report of PricewaterhouseCoopers LLP, an independent registered public accounting firm, given on the authority of said firm as experts in auditing and accounting.

Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors of Gladstone Capital Corporation:

We have completed integrated audits of Gladstone Capital Corporation s 2006 and 2005 consolidated financial statements and of its internal control over financial reporting as of September 30, 2006, and audits of its 2004 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB). Our opinions, based on our audits, are presented below.

<u>Consolidated financial statements and financial statement schedules</u>

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Gladstone Capital Corporation and its subsidiaries (the Company) at September 30, 2006 and September 30, 2005, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 2006 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedules listed in the accompanying index present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These consolidated financial statements and financial statement schedules are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedules based on our audits. We conducted our audits of these statements in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

<u>Internal control over financial reporting</u>

Also, in our opinion, management s assessment, included in Management s Annual Report on Internal Control over Financial Reporting appearing under Item 9A, that the Company maintained effective internal control over financial reporting as of September 30, 2006 based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of September 30, 2006, based on criteria established in *Internal Control - Integrated Framework* issued by the COSO. The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management s assessment and on the effectiveness of the Company s internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP
McLean, Virginia
December 6, 2006

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GLADSTONE CAPITAL CORPORATION
CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES

	September 30, 2006	September 30, 2005
ASSETS		
Investments at fair value (Cost 9/30/2006: $216,202,986; 9/30/2005: $205,375,554)	$ 217,642,750	$ 200,846,763
Cash and cash equivalents	731,744	503,776
Interest receivable investments in debt securities	1,394,942	1,406,212
Interest receivable employees	37,396	27,067
Due from custodian	3,587,152	2,624,074
Deferred financing fees	145,691	70,000
Prepaid assets	226,747	177,848
Due from employees	1,803,283	
Other assets	213,510	137,354
TOTAL ASSETS	$ 225,783,215	$ 205,793,094
LIABILITIES		
Accounts payable	$ 4,072	$ 21,893
Interest payable	247,530	183,707
Fees due to Adviser	240,363	391,322
Borrowings under lines of credit	49,993,000	53,034,064
Withholding taxes payable	1,803,283	
Accrued expenses and deferred liabilities	721,287	350,665
Funds held in escrow	203,193	200,760
TOTAL LIABILITIES	53,212,728	54,182,411
NET ASSETS	$ 172,570,487	$ 151,610,683
ANALYSIS OF NET ASSETS		
Common stock, $0.001 par value, 50,000,000 shares authorized and 12,305,008 and 11,303,510 shares issued and outstanding, respectively	$ 12,305	$ 11,304
Capital in excess of par value	181,270,565	164,610,873
Notes receivable employees	(10,248,308)	(8,745,781)
Net unrealized appreciation (depreciation) on investments	1,439,764	(4,528,791)
Unrealized depreciation on derivative	(253,716)	(253,747)
Realized (loss) gain on sale of investments	(861,695)	42,250
Realized gain on settlement of derivative	15,014	
Accumulated undistributed net investment income	1,196,558	474,575
TOTAL NET ASSETS	$ 172,570,487	$ 151,610,683
NET ASSETS PER SHARE	$ 14.02	$ 13.41

The accompanying notes are an integral part of these consolidated financial statements.

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GLADSTONE CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS
SEPTEMBER 30, 2006

Company (1)	Industry	Investment (2)	Cost	Fair Value
ActivStyle Acquisition Co. ActivStyle, Inc.	Service-medical products distribution	Line of Credit (16) (9.6%, Due 7/2009)	$	$
		Senior Term Debt (5) (9.6%, Due 7/2011)	3,200,000	3,200,000
		Senior Term Debt (3) (5) (11.8%, Due 7/2011)	2,500,000	2,500,000
Advanced Homecare Management, Inc.	Service-home health nursing services	Senior Subordinated Term Debt(5)(6) (11.33%, Due 12/2013)	5,000,000	5,000,000
Allied Extruders, LLC P&O Packaging Acquisition LLC	Manufacturing-polyethylene film	Senior Real Estate Term Debt (9.8%, Due 3/2011)	1,000,000	1,000,000
		Senior Term Debt (3) (5) (11.3%, Due 3/2011)	8,000,000	8,030,000
Badanco Acquisition Corp.	Manufacturing-luggage	Senior Term Debt (5) (10.8%, Due 2/2010)	5,145,019	5,157,881
		Senior Term Debt (3) (5) (13.8%, Due 2/2010)	8,585,125	8,628,051
Benetech, Inc.	Service & Manufacturing-dust management systems for the coal and electric utility	Senior Term Debt (5) (10.3%, Due 5/2009)	2,112,500	2,144,187
		Senior Term Debt (3) (5)	3,046,875	