

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTER ENDED MARCH 31, 2002.

/\_/ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

COMMISSION FILE NUMBER: 814-00237

GLADSTONE CAPITAL CORPORATION

(Exact name of registrant as specified in its charter)

MARYLAND

54-2040781

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer Identification No.)

1616 ANDERSON ROAD, SUITE 208  
MCLEAN, VIRGINIA 22102

(Address of principal executive office)

(703) 286-7000

(Registrant's telephone number, including area code)

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

Indicate the number of shares outstanding of each of the issuer's classes of  
common stock, as of the latest practicable date. The number of shares of the  
issuer's Common Stock, \$0.001 par value, outstanding as of May 1, 2002 was  
10,060,178.

GLADSTONE CAPITAL CORPORATION  
TABLE OF CONTENTS

<Table>  
<Caption>

	PAGE
PART I.	3
Item 1.	3
Consolidated Balance Sheets as of March 31, 2002 (unaudited) and September 30, 2001.....	4
Schedule of Investments as of March 31, 2002 (unaudited).....	5
Consolidated Statement of Operations for the three and six months ended March 31, 2002 (unaudited).....	6
Consolidated Statements of Stockholders' Equity for the six months ended March 31, 2002 (unaudited).....	7
Consolidated Statement of Cash Flows for the six months ended March 31, 2002 (unaudited).....	8
Notes to Financial Statements (unaudited).....	9
Item 2.	12
Management's Discussion and Analysis of Financial Condition and Results of Operations.....	12
Overview.....	12
Results of Operations.....	14
Liquidity and Capital Resources.....	16
Item 3.	17
Quantitative and Qualitative Disclosure About Market Risk.....	17
Item 4.	17
Submission of Matters to a Vote of Security Holders.....	17

PART II.	OTHER INFORMATION.....	18
Item 1.	Legal Proceedings.....	18
Item 6.	Exhibits and Reports on Form 8-K.....	18

SIGNATURES  
</Table>

Page 2

<Page>

PART I--FINANCIAL INFORMATION  
GLADSTONE CAPITAL CORPORATION  
CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2002

CONTENTS

<Table>		
<S>		<C>
Consolidated Balance Sheets.....	4	
Schedule of Investments.....	5	
Consolidated Statements of Operations.....	6	
Consolidated Statements of Stockholders' Equity.....	7	
Consolidated Statement of Cash Flows.....	8	
Notes to Consolidated Financial Statements.....	9	
</Table>		

Page 3

<Page>

GLADSTONE CAPITAL CORPORATION  
CONSOLIDATED BALANCE SHEETS

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ASSETS

	(UNAUDITED) MARCH 31,	SEPTEMBER
	2002	2001
	-----	-----
30,		
---		
<S>	<C>	<C>
ASSETS		
Investments at fair value (Cost 3/31/2002: \$42,180,138; 9/30/2001: \$0)	\$ 42,180,138	\$ -
Cash and cash equivalents	89,351,798	131,824,080
Interest receivable-- debt securities	413,837	-
Interest receivable	23,659	
34,544		
Interest receivable-- officers	107,409	45,355
Prepaid assets	96,572	
166,250		
Other assets	335,615	
135,257		
---		
TOTAL ASSETS	\$ 132,509,028	\$
132,205,486		
	=====	

LIABILITIES AND STOCKHOLDERS' EQUITY

LIABILITIES

Dividends Payable	\$ 2,112,637	\$
-		
Accounts Payable	130,500	
-		
Accrued offering costs	-	
590,382		
Accrued expenses and deferred liabilities	384,794	365,960
---		
Total Liabilities	\$ 2,627,931	\$
956,342		

---		
STOCKHOLDERS' EQUITY		
Common stock, \$0.001 par value, 50,000,000 shares authorized and 10,060,178 shares issued and outstanding	\$ 10,060	\$ 10,060
Capital in excess of par value	140,080,807	140,131,778
Notes receivable-- officers (8,800,050)	(8,799,119)	
Net realized loss (92,644)	-	
Distributions in excess of undistributed net realized earnings	(1,410,651)	-
---		
Total Stockholders' Equity	\$ 129,881,097	\$ 131,249,144
---		
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 132,509,028	\$ 132,205,486
=====		

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SEE ACCOMPANYING NOTES.

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GLADSTONE CAPITAL CORPORATION  
SCHEDULE OF INVESTMENTS  
AS OF MARCH 31, 2002  
(UNAUDITED)

<Table>

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COMPANY	INDUSTRY	INVESTMENT	COST	FAIR VALUE
-----				
<S>	<C>	<C>	<C>	<C>
ARI Holdings, Inc.	Manufacturing--auto parts	Sr. Subordinated Debt	\$ 8,047,508	\$ 8,047,508
-----				
Finn Corporation	Manufacturing--landscape equipment	Sr. Subordinated Debt Common Stock Warrants for 2% ownership	10,500,000 37,000	10,500,000 37,000
-----				
Marcal Paper Mills, Inc.	Manufacturing--paper products	Sr. Subordinated Debt First Mortgage Facility	7,500,000 9,030,282	7,500,000 9,030,282
-----				
Nextira, LLC	Service--network-related services	Term Loan Credit Facility(1)	6,248,613 816,735	6,248,613 816,735
-----				
Totals			\$42,180,138	\$42,180,138
			=====	=====

</Table>

(1) This is an \$8 million credit facility.

SEE ACCOMPANYING NOTES.

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GLADSTONE CAPITAL CORPORATION  
CONSOLIDATED STATEMENT OF OPERATIONS  
(UNAUDITED)

<Table>

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	THREE MONTHS ENDED MARCH 31, 2002	SIX MONTHS ENDED MARCH 31, 2002
-----		
<S>	<C>	<C>
OPERATING INCOME		
Interest income - debt	\$ 1,596,970	\$ 1,926,627
Interest income - cash and cash equivalents	368,570	1,009,085
Interest income - officer loans	107,409	214,827
Loan and managerial assistance fees	29,102	640,911
Other income	47,500	47,500
-----		
Total Operating Income	\$ 2,149,551	\$ 3,838,950
-----		

OPERATING EXPENSES		
Salaries and benefits	\$ 327,158	\$ 604,342
Rent	36,227	47,280
Professional fees	114,061	215,482
Directors' fees	5,000	7,000
General and administrative	258,623	359,384
	-----	-----
Total Operating Expenses	\$ 741,069	\$ 1,233,488
	-----	-----
NET OPERATING INCOME (LOSS)	\$ 1,408,482	\$ 2,605,462
	=====	=====
NET INCREASE (DECREASE) IN STOCKHOLDERS' EQUITY RESULTING FROM OPERATIONS	\$ 1,408,482	\$ 2,605,462
	=====	=====
NET OPERATING INCOME PER COMMON SHARE:		
Basic	\$ 0.14	\$ 0.26
Diluted	\$ 0.14	\$ 0.26
WEIGHTED AVERAGE SHARES OF COMMON STOCK OUTSTANDING:		
Basic	10,060,178	10,060,178
Diluted	10,160,417	10,153,223

</Table>

SEE ACCOMPANYING NOTES.

Page 6

<Page>

GLADSTONE CAPITAL CORPORATION  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
(UNAUDITED)

<Table>

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TOTAL STOCKHOLDERS' EQUITY	COMMON STOCK		CAPITAL IN	NOTES RECEIVABLE FROM SALE OF	(DISTRIBUTIONS IN EXCESS OF) UNDISTRIBUTED
	SHARES	AMOUNT	EXCESS OF PAR VALUE	COMMON STOCK	NET REALIZED EARNINGS
-----	-----	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>	<C>
Balance at September 30, 2001 \$ 131,249,144	10,060,178	\$ 10,060	\$ 140,131,778	\$ (8,800,050)	\$ (92,644)
Offering Costs (50,971)			(50,971)		
Repayment of Principal on Notes Receivable 931				931	
Net Increase in Stockholders' Equity Resulting from Operations 2,605,462					2,605,462
Distributions (3,923,469)	-	-	-	-	(3,923,469)
-----	-----	-----	-----	-----	-----
Balance at March 31, 2002 \$ 129,881,097	10,060,178	\$ 10,060	\$ 140,080,807	\$ (8,799,119)	\$ (1,410,651)
=====	=====	=====	=====	=====	=====

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SEE ACCOMPANYING NOTES.

Page 7

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GLADSTONE CAPITAL CORPORATION  
CONSOLIDATED STATEMENT OF CASH FLOWS AND CASH EQUIVALENTS  
(UNAUDITED)

<Table>  
<Caption>

	SIX MONTHS ENDED MARCH 31, 2002
	-----
<S>	<C>
CASH FLOWS FROM OPERATING ACTIVITIES	
Net increase in stockholders' equity resulting from operations	\$ 2,605,462
Adjustments to reconcile net decrease in stockholders' equity resulting from operations to net cash provided by operating activities:	
Increase in interest receivable	(465,006)
Increase in other assets	(200,358)
Increase in accrued expenses and deferred liabilities	18,834
Decrease in prepaid assets	69,678
Increase in accounts payable	130,500
Increase in payment in kind interest	(96,927)
	-----
Net Cash Provided by Operating Activities	\$ 2,062,183
	-----
CASH FLOWS FROM INVESTING ACTIVITIES	
Purchase of investments	\$ (42,083,211)
	-----
CASH FLOWS FROM FINANCING ACTIVITIES	
Offering costs	\$ (50,971)
Decrease in accrued offering costs	(590,382)
Repayment of principal on notes receivable--officers	931
Distributions paid	(1,810,832)
	-----
Net Cash Used in Financing Activities	\$ (2,451,254)
	-----
NET DECREASE IN CASH AND CASH EQUIVALENTS	\$ (42,472,282)
	-----
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	\$ 131,824,080
	-----
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 89,351,798
	=====

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SEE ACCOMPANYING NOTES.

Page 8

<Page>

GLADSTONE CAPITAL CORPORATION  
NOTES TO FINANCIAL STATEMENTS  
(UNAUDITED)  
MARCH 31, 2002

NOTE 1. UNAUDITED INTERIM FINANCIAL STATEMENTS

Interim financial statements of Gladstone Capital Corporation (the "Company") are prepared in accordance with generally accepted accounting principles ("GAAP") for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain disclosures accompanying annual financial statements prepared in accordance with GAAP are omitted. In the opinion of management, all adjustments, consisting solely of normal recurring accruals, necessary for the fair presentation of financial statements for the interim periods have been included. The current period's results of operations are not necessarily indicative of results that ultimately may be achieved for the year. The interim financial statements and notes thereto should be read in conjunction with the financial statements and notes thereto included in the Company's Form 10-K for the fiscal year ended September 30, 2001, as filed with the Securities and Exchange Commission.

NOTE 2. ORGANIZATION

The Company was incorporated under the General Corporation Laws of the State of Maryland on May 30, 2001 as a closed-end investment company. The Company has elected to be treated as a business development company under the Investment Company Act of 1940, as amended (the "1940 Act"). In addition, the Company has elected to be treated for tax purposes as a regulated investment company, or RIC, under the Internal Revenue Code of 1986, as amended (the "Code"). The Company's investment objectives are to achieve a high level of current income by investing in debt and equity securities of established private businesses.

Gladstone Advisers, Inc., a wholly-owned subsidiary, conducts the daily administrative operations of the Company.

#### NOTE 3. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share for the six months ended March 31, 2002:

<S>	<C>
Numerator for basic and diluted earnings per share	\$ 2,605,462
Denominator for basic weighted average shares	10,060,178
Employee stock options	723,330
Dilutive potential shares	93,045
Denominator for diluted weighted average shares	10,153,223
Basic earnings per common share	0.26
Diluted earnings per common share	0.26

Page 9

<Page>

The following table sets forth the computation of basic and diluted earnings per share for the three months ended March 31, 2002:

<S>	<C>
Numerator for basic and diluted earnings per share	\$ 1,408,482
Denominator for basic weighted average shares	10,060,178
Employee stock options	723,330
Dilutive potential shares	100,239
Denominator for diluted weighted average shares	10,160,417
Basic earnings per common share	0.14
Diluted earnings per common share	0.14

#### NOTE 4. NET ASSET VALUE PER SHARE

The Company's net asset value per share was \$12.91 and \$13.05 at March 31, 2002 and September 30, 2001, respectively.

#### NOTE 5. DIVIDENDS

The Company is required to pay out as a dividend 90% of its ordinary income and short-term capital gains for each taxable year in order to maintain its status as a RIC under Subtitle A, Chapter 1 of Subchapter M of the Code. It is the policy of the Company to pay out as a dividend up to 100% of those amounts. The amount to be paid out as a dividend is determined by the Board of Directors each quarter and is based on the annual earnings estimated by the management of the Company. Based on that estimate, a dividend is declared each quarter. At year-end the Company may pay a bonus dividend, in addition to the quarterly dividends, to ensure that it has paid out at least 90% of its ordinary income and short-term capital gains for the year. The Company has a policy of retaining long-term capital gains and not paying them out as dividends.

On January 15, 2002, the Company paid a dividend of \$0.18 per share on its common stock to its stockholders of record as of December 31, 2001. On April 8, 2002, the Company paid a dividend of \$0.21 per share on its common stock to its stockholders of record as of March 28, 2002.

#### NOTE 6. INVESTMENT VALUATION

The Company carries its investments at fair value, as determined by the Board of Directors. Securities that are publicly traded are valued at the closing price on the valuation date. Debt and equity securities that are not publicly traded are valued at fair value as determined in good faith by the Board of Directors. In making such determination, the Board of Directors values non-convertible debt securities at cost plus amortized original issue discount, if any, unless adverse factors lead to a determination of a lesser valuation. In valuing convertible debt, equity or other securities, the Board of Directors determines the fair value based on the collateral, the issuer's ability to make payments, the earnings of the issuer, sales to third parties of similar securities, the comparison to publicly traded securities and other pertinent factors. Due to the uncertainty inherent in the valuation process, such estimates of fair value may differ significantly from the values that would have resulted had a ready market for the securities existed, and the differences could be material. Additionally, changes in the market environment and other events that may occur over the life of the investments may cause the gains ultimately realized on these investments to be different than the valuation currently assigned.

#### NOTE 7. LOAN AND MANAGERIAL ASSISTANCE FEES

The 1940 Act requires that a business development company make available managerial assistance to its portfolio companies. The company provides managerial assistance to its portfolio companies through its wholly-owned subsidiary, Gladstone Advisers, Inc. The Company receives fee income for managerial assistance it renders to portfolio companies in connection with its investments. Such fees are normally paid at the closing of the Company's investments and are generally non-recurring. These managerial assistance services vary by investment, but generally consist of reviewing existing credit facilities, arranging bank financing, arranging equity financing, structuring financing from multiple lenders, structuring financing from equity investors, restructuring existing loans,

Page 10

<Page>

raising equity and debt capital and providing general financial advice. For the three and six months ended March 31, 2002, these fees totaled \$29,102 and \$640,911, respectively.

From time to time, the Company will be invited to participate as a co-lender in a transaction. Where the Company does not provide significant managerial assistance services in connection with its investment, loan fees paid to the Company in such situations will be deferred and amortized over the life of the loan.

#### NOTE 8. PAYMENT IN KIND INTEREST

The Company has loans in its portfolio which contain a payment in kind provision ("PIK"). The PIK interest is added to the principal balance of the loan and recorded as income. To maintain the Company's status as a RIC, this non-cash source of income must be paid out to shareholders in the form of dividends, even though the Company has not yet collected the cash. For the three and six months ended March 31, 2002, the Company recorded \$130,458 of PIK income.

Page 11

<Page>

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

ALL STATEMENTS CONTAINED HEREIN, OTHER THAN HISTORICAL FACTS, MAY CONSTITUTE "FORWARD-LOOKING STATEMENTS" WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT OF 1933, AS AMENDED, AND SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED. THESE STATEMENTS MAY RELATE TO, AMONG OTHER THINGS, FUTURE EVENTS OR OUR FUTURE PERFORMANCE OR FINANCIAL CONDITION. IN SOME CASES, YOU CAN IDENTIFY FORWARD-LOOKING STATEMENTS BY TERMINOLOGY SUCH AS "MAY," "MIGHT," "BELIEVE," "WILL," "PROVIDED," "ANTICIPATE," "FUTURE," "COULD," "GROWTH," "PLAN," "INTEND," "EXPECT," "SHOULD," "WOULD," "IF," "SEEK," "POSSIBLE," "POTENTIAL" OR THE NEGATIVE OF SUCH TERMS OR COMPARABLE TERMINOLOGY. THESE FORWARD-LOOKING STATEMENTS INVOLVE KNOWN AND UNKNOWN RISKS, UNCERTAINTIES AND OTHER FACTORS THAT MAY CAUSE OUR ACTUAL RESULTS, LEVELS OF ACTIVITY, PERFORMANCE OR ACHIEVEMENTS TO BE MATERIALLY DIFFERENT FROM ANY FUTURE RESULTS, LEVELS OF ACTIVITY, PERFORMANCE OR ACHIEVEMENTS EXPRESSED OR IMPLIED BY SUCH FORWARD-LOOKING STATEMENTS. SUCH FACTORS INCLUDE, AMONG OTHERS, (1) ADVERSE CHANGES IN INTEREST RATES; (2) OUR FAILURE OR INABILITY TO ESTABLISH OR MAINTAIN REFERRAL ARRANGEMENTS WITH LEVERAGED BUYOUT FUNDS AND VENTURE CAPITAL FUNDS TO GENERATE LOAN OPPORTUNITIES; (3) THE LOSS OF ONE OR MORE OF OUR EXECUTIVE OFFICERS, IN PARTICULAR DAVID GLADSTONE OR TERRY LEE BRUBAKER; (4) OUR INABILITY TO ESTABLISH OR MAINTAIN A CREDIT FACILITY ON TERMS REASONABLY ACCEPTABLE TO US, IF AT ALL; (5) OUR INABILITY TO SUCCESSFULLY SECURITIZE OUR LOAN PORTFOLIO ON TERMS REASONABLY ACCEPTABLE TO US, IF AT ALL; (6) THE DECISION OF OUR COMPETITORS TO AGGRESSIVELY SEEK TO MAKE SENIOR AND SUBORDINATED LOANS TO SMALL AND MEDIUM-SIZED BUSINESSES ON TERMS MORE FAVORABLE THAN WE INTEND TO PROVIDE; AND (7) THOSE FACTORS LISTED UNDER THE CAPTION "RISK FACTORS" OF THE ANNUAL REPORT ON FORM 10-K AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON DECEMBER 21, 2001. 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 ON 1995 AND, AS SUCH, SPEAK ONLY AS OF THE DATE MADE. WE UNDERTAKE NO OBLIGATION TO PUBLICLY UPDATE OR REVISE ANY FORWARD-LOOKING STATEMENTS, WHETHER AS A RESULT OF NEW INFORMATION, FUTURE EVENTS OR OTHERWISE AFTER THE DATE OF THIS FORM 10-Q.

THE FOLLOWING ANALYSIS OF OUR FINANCIAL CONDITION AND RESULTS OF OPERATIONS SHOULD BE READ IN CONJUNCTION WITH OUR FINANCIAL STATEMENTS AND THE NOTES THERETO CONTAINED ELSEWHERE IN THIS REPORT.

#### 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, senior subordinated notes and junior subordinated notes, of

established private businesses that are backed by leveraged buyout funds, venture capital funds or others, with a particular emphasis on senior subordinated notes. In addition, we may acquire existing loans that meet this profile from leveraged buyout funds, venture capital funds and others. We will also seek to provide our stockholders with long-term capital growth through the appreciation in the value of warrants or other equity instruments that we may receive when we make loans. We operate as a closed-end, non-diversified management investment company, and have elected to be treated as a business development company under the Investment Company Act of 1940, as amended (the "1940 Act").

Page 12

<Page>

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

Our loans typically range from \$5 million to \$15 million, mature in no more than seven years and accrue interest at a fixed rate or an annualized variable rate that exceeds the prime rate. Most, if not all, of the debt securities we acquire are unrated by credit rating agencies. 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 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 a nominal exercise price and entitle us to purchase a modest percentage of the borrower's stock.

In addition, as a business development company under the 1940 Act, we are required to provide significant managerial assistance to our portfolio companies. We provide these services, for which we receive fees, through our wholly-owned subsidiary, Gladstone Advisers, Inc. Such fees are typically only paid to us at the closing of the investments and are generally non-recurring, however in some instances they may have a recurring component. The specific services we provide vary by portfolio company, but generally consist of reviewing existing credit facilities, arranging bank financing, arranging equity financing, structuring financing from multiple lenders, structuring financing from equity investors, restructuring existing loans, raising equity and debt capital and providing general financial advice. We record these fees as managerial assistance fee revenue in the period in which the fees are paid.

Prior to making an investment, we ordinarily enter into a non-binding commitment letter with the potential borrower. These non-binding commitments 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. Typically, upon execution of this non-binding commitment letter, the potential borrower pays us a small non-refundable fee (usually no more than 0.1% of our proposed investment) for our services rendered through the commitment date. We recognize this fee as revenue upon execution of the non-binding commitment letter.

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

To date, we have made seven different loans to, or investments in, five companies for a total of approximately \$46.7 million, including one investment that we closed after the end of the second fiscal quarter. We have a further commitment to lend up to, approximately, an additional \$7.2 million to one of our portfolio companies under a credit facility. In addition, we are earnestly working toward the consummation of more

Page 13

<Page>



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

We carry our investments on our balance sheet at fair value, as determined by our board of directors. Securities that are publicly traded will be valued at their respective closing price prices on the valuation date. Debt and equity securities that are not publicly traded are valued at fair value as determined in good faith by our board of directors. In making such determination, our board of directors values non-convertible debt securities at cost plus amortized original issue discount, if any, unless adverse factors lead to a determination of a lesser valuation. In valuing convertible debt, equity or other securities, our board of directors determines the fair value based on the collateral, the issuer's ability to make payments, the earnings of the issuer, sales to third parties of similar securities, the comparison to publicly traded securities and other pertinent factors. Due to the uncertainty inherent in the valuation process, such estimates of fair value may differ significantly from the values that would have resulted had a ready market for the securities existed, and the differences could be material. Additionally, changes in the market environment and other events that may occur over the life of the investments may cause the gains ultimately realized on these investments to be different than the valuation currently assigned.

We initially expected that it would take approximately one year to substantially fully invest the proceeds from our initial public offering. However, the terrorist attacks on the United States on September 11, 2001 and the ensuing economic uncertainty have resulted in a delay in the rate at which we have been able to enter into loans. We anticipate that we are approximately six months behind our original schedule for closing loans.

#### RESULTS OF OPERATIONS

FOR THE SIX MONTHS ENDED MARCH 31, 2002

#### OPERATING INCOME

Operating income for the six months ended March 31, 2002 was approximately \$3.8 million. This amount consisted of approximately \$1 million in interest income from our invested cash and cash equivalents, approximately \$1.9 million in interest income from our investments in debt securities of private companies, approximately \$641,000 in fee income, approximately \$215,000 in interest income from loans to our employees in connection with the exercise of employee stock options and approximately \$47,000 of other income related to fees collected from companies with whom investment negotiations have been terminated.

The interest on invested cash and cash equivalents primarily reflects the interest we received on the investment of the proceeds of our initial public offering in short-term investment grade securities during the six months. As we acquire debt securities, we expect that income from invested cash and cash equivalents will decline as a percentage of total revenue and that interest income from debt securities will increase and become our predominant source of revenue.

Income from investments in debt securities of private companies was modest for the six months ended March 31, 2002 since we did not close our first investment until November 6, 2001 and the remaining three investments did not close until late December 2001 and because we made no new investments in the most recent quarter. As we continue to invest the proceeds of our initial public offering in debt securities of private companies, we expect that we will generate additional income from these debt securities, which we anticipate will be at interest rates significantly greater than the rates that we are currently receiving on our deposited cash and cash equivalents.

Fee income for the six months ended March 31, 2002 consisted primarily of managerial assistance fees received in the first fiscal quarter in connection with investments we closed in that quarter. It also includes \$12,000 of income from an up-front fee paid by a company with which we consummated an investment after the end of the

<Page>

quarter, but prior to the filing of this Form 10-Q, and approximately \$17,000 in fees associated with our outstanding credit facility with Nextira, LLC.

For the six months ended March 31, 2002, other income was comprised of \$20,000 in up-front fees for two proposed investments that were ultimately terminated and approximately \$27,000 in reimbursed expenses incurred in

connection with one of those investments.

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

#### OPERATING EXPENSES

Operating expenses for the six months ended March 31, 2002 were approximately \$1.2 million. This amount consisted primarily of salaries and benefits, professional fees, rent and general and administrative expenses.

Salaries and benefits consisted of approximately \$604,000 for the six months ended March 31, 2002; we expect this expense to increase as we hire additional loan officers. The remainder of the operating expenses incurred for the six months ended March 31, 2002 consisted of approximately \$215,000 in professional fees, \$47,000 in rent and \$359,000 in general and administrative expenses.

We believe that this level of operating expenses is not necessarily indicative of our future operating expenses. We estimate that over time, as we begin to more fully deploy the proceeds of our initial public offering, our operating expenses will be approximately two percent of our net assets.

#### NET OPERATING INCOME

As a result of the operating income and operating expenses described above, we had net operating income of approximately \$2.6 million for the six months ended March 31, 2002. Based on a weighted-average of 10,060,178 (basic) and 10,153,223 (fully diluted) shares outstanding, our net operating income per common share for the six months ended March 31, 2002 was \$0.26 (basic and fully diluted).

FOR THE THREE MONTHS ENDED MARCH 31, 2002

#### OPERATING INCOME

Operating income for the quarter ended March 31, 2002 was approximately \$2.1 million. This amount consisted of approximately \$369,000 in interest income from our invested cash and cash equivalents, approximately \$1.6 million in interest income from our investments in debt securities of private companies, approximately \$29,000 in fee income, approximately \$107,000 in interest income from loans to our employees in connection with the exercise of employee stock options and approximately \$47,000 of other income related to fees collected from companies with whom investment negotiations have been terminated.

The interest on invested cash and cash equivalents primarily reflects the interest we received on the investment of the proceeds of our initial public offering in short-term investment grade securities during the quarter. As we acquire debt securities, we expect that income from invested cash and cash equivalents will decline as a percentage of total revenue and that interest income from debt securities will increase and become our predominant source of revenue.

Income from investments in debt securities of private companies increased during the quarter ended March 31, 2002 as compared to the quarter ended December 31, 2001 as a result of the fact we were able to realize interest income on all four of our investments for the entire quarter. We did not close our first investment until November 6, 2001 and the remaining three investments did not close until late December 2001. However, as noted above we did not make any additional investments during the three months ended March 31, 2002.

Page 15

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Fee income for the quarter ended March 31, 2002 consisted of a \$12,000 up-front fee paid by a borrower with whom we consummated an investment after the end of the quarter, but prior to the filing of this Form 10-Q, and approximately \$17,000 in fees associated with our outstanding credit facility with Nextira, LLC.

Other income for the quarter ended March 31, 2002 was comprised of \$20,000 in up-front fees for two proposed investments that were ultimately terminated and approximately \$27,000 in reimbursed expenses incurred in connection with one of those investments.

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

## OPERATING EXPENSES

Operating expenses for the quarter ended March 31, 2002 were approximately \$741,000. This amount consisted primarily of salaries and benefits, professional fees, rent and general and administrative expenses.

Salaries and benefits consisted of approximately \$327,000 for the quarter ended March 31, 2002; we expect this expense to increase as we hire additional loan officers. The remainder of the operating expenses incurred for the quarter ended March 31, 2002 consisted of approximately \$114,000 in professional fees, \$36,000 in rent and \$259,000 in general and administrative expenses.

We believe that this level of operating expenses is not necessarily indicative of our future operating expenses. We estimate that over time, as we begin to more fully deploy the proceeds of our initial public offering, our operating expenses will be approximately two percent of our net assets.

## NET OPERATING INCOME

As a result of the operating income and operating expenses described above, we had net operating income of approximately \$1.4 million for the quarter ended March 31, 2002. Based on a weighted-average of 10,060,178 (basic) and 10,160,417 (fully diluted) shares outstanding, our net operating income per common share for the quarter ended March 31, 2002 was \$0.14 (basic and fully diluted).

## LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2002, we had investments in debt securities of, or loans to, four private companies, totaling approximately \$41.4 million of total investment assets. We have also loaned approximately \$800,000 to one portfolio company under an \$8 million credit facility.

On May 2, 2002, we closed an investment in Kozy Shack Enterprises, Inc., a processed food manufacturing and distributing company. The investment consisted of a senior subordinated loan of \$4.5 million with a term of four years and carries an interest rate of 18%. This investment was part of a larger \$18.8 million credit facility.

We currently have a number of non-binding investment commitments outstanding that we hope to close in the next ninety days.

Cash provided by operating activities for the six months ended March 31, 2002, consisting primarily of the items described in "Results of Operations," was approximately \$2.1 million. Net cash used in investing activities was approximately \$42 million for the six months ended March 31, 2002 and primarily consisted of the amounts used to make investments in our four portfolio companies. Net cash used in financing activities was approximately \$2.5 million for the six months ended March 31, 2002 and consisted primarily of the repayment of accrued costs of approximately \$640,000 associated with our initial public offering and the payment of our first quarter dividend of approximately \$1.8 million.

Page 16

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During the quarter ended March 31, 2002, cash and cash equivalents decreased from approximately \$90.4 million at the beginning of the quarter to approximately \$89.4 million at the end of the quarter. This decrease of approximately \$1 million was largely the result of our operating and financing activities, described above.

In order to qualify as a regulated investment company and to avoid corporate level tax on the income we distribute to our stockholders, we are required, under Subchapter M of the Internal Revenue Code, to distribute at least 90% of our ordinary income and short-term capital gains to our stockholders on an annual basis. In accordance with these requirements, on December 10, 2001, we declared a quarterly cash dividend of \$0.18 per share on our common stock which was paid on January 15, 2002 to stockholders of record as of December 31, 2002 and on March 14, 2002 we declared a quarterly cash dividend of \$0.21 per share which was paid on April 8, 2002 to stockholders of record as of March 28, 2002. These dividends were paid from ordinary income.

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

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

We are subject to financial market risks, including changes in interest rates. We expect that approximately 50% of the loans in our portfolio will be made at fixed rates, with approximately 50% made at variable rates. To date, we

have made only four investments and substantially all of the remainder of our assets are invested in money market instruments.

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

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

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

On March 26, 2002 the Company held its 2002 Annual Stockholders' Meeting (the "Annual Meeting"). At the Annual Meeting, the Company's stockholders voted to ratify the selection of Ernst & Young LLP as the Company's independent auditors for the fiscal year ended September 30, 2002. Votes for this proposal, and for the election of Anthony W. Parker as a director of the Company, are listed in the table below.

<u>&lt;Table&gt;</u> <Caption>	PROPOSAL 1: ELECTION OF DIRECTOR	PROPOSAL 2: RATIFICATION OF INDEPENDENT AUDITORS
<S>	<C>	<C>
Votes in favor of the proposal	9,648,126	9,633,686
Votes against the proposal/withheld	34,308	22,328
Exceptions/abstentions	0	26,420
Total shares voted	----- 9,682,434 =====	----- 9,682,434 =====

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PART II--OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

Neither the Company nor its subsidiary is currently subject to any material legal proceeding, nor, to the Company's knowledge, is any material legal proceeding threatened against the Company or its subsidiary.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) EXHIBITS

- 3.1 Articles of Amendment and Restatement of the Articles of Incorporation, incorporated by reference to Exhibit a.2 to Pre-Effective Amendment No. 1 to the Registration Statement on Form N-2 (File No. 333-63700), filed July 27, 2001.
- 3.2 By-laws, incorporated by reference to Exhibit b to Pre-Effective Amendment No. 1 to the Registration Statement on Form N-2 (File No. 333-63700), filed July 27, 2001.
- 11 Computation of Per Share Earnings (included in the notes to the unaudited financial statements contained in this report).

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

(b) REPORTS ON FORM 8-K

No reports on Form 8-K were filed by the Company during the period for which this report is filed.

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SIGNATURE

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

GLADSTONE CAPITAL CORPORATION

BY: /s/ Harry Brill

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Harry Brill  
Chief Financial Officer and Treasurer

Date: May 14, 2002