
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTER ENDED MARCH 31, 2003.

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

(State or other jurisdiction of incorporation or organization)

54-2040781

(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 No .

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12 b-2 of the Securities Exchange Act of 1934).

Yes 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 April 23, 2003 was 10,071,844.

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PART I—FINANCIAL INFORMATION

Gladstone Capital Corporation

Consolidated Financial Statements

(Unaudited)

March 31, 2003

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GLADSTONE CAPITAL CORPORATION

CONSOLIDATED BALANCE SHEETS

	March 31, 2003	September 30, 2002
	(Unaudited)	
ASSETS		
Investments at fair value (Cost 3/31/2003: \$101,294,476; 9/30/2002: \$79,718,354)	\$ 102,036,900	\$ 79,718,354
Cash and cash equivalents	31,154,246	51,930,529
Cash and cash equivalents pledged as collateral	65,011,213	39,998,799
Interest receivable – investments in debt securities	942,777	685,274
Interest receivable – cash and cash equivalents	969	4,389
Interest receivable – officers	109,737	109,874
Prepaid assets	312,165	357,955
Other assets	278,750	116,865
TOTAL ASSETS	\$ 199,846,757	\$ 172,922,039
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Dividends Payable	\$ 2,517,961	\$ 2,115,087
Accrued expenses and deferred liabilities	1,715,561	944,960
Repurchase agreement	63,710,277	39,198,719
Total Liabilities	\$ 67,943,799	\$ 42,258,766
STOCKHOLDERS' EQUITY		
Common stock, \$0.001 par value, 50,000,000 shares authorized and 10,071,844 shares issued and outstanding	\$ 10,072	\$ 10,072
Capital in excess of par value	140,266,684	140,266,684
Notes receivable – officers	(8,983,796)	(8,983,796)
Net unrealized appreciation on investments	742,424	—
Declared distributions in excess of undistributed earnings	(132,426)	(629,687)
Total Stockholders' Equity	\$ 131,902,958	\$ 130,663,273
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 199,846,757	\$ 172,922,039

SEE ACCOMPANYING NOTES.

GLADSTONE CAPITAL CORPORATION

SCHEDULE OF INVESTMENTS

AS OF MARCH 31, 2003

(UNAUDITED)

COMPANY(1)	INDUSTRY	INVESTMENT	COST	FAIR VALUE
America's Water Heater Rentals, LLC	Water heater rentals and servicing	Senior Term Debt(2)	\$ 12,000,000	\$ 12,000,000
ARI Holdings, Inc.	Manufacturing auto parts	Junior Subordinated Term Debt(3)(4)	8,459,234	8,448,660
Coyne International Enterprises Corp.	Industrial services	Senior Term Debt(2)(3)(4)	20,231,286	20,003,684
Finn Corporation	Manufacturing landscape equipment	Senior Subordinated Term Debt(4) Common Stock Warrants for 2% ownership	10,500,000 37,000	10,500,000 490,323
Home Care Supply, Inc.	Medical equipment rental	Senior Term Debt(2)(4)(5)	18,000,000	18,576,964
Inca Metal Products Corp. Kingway Acquisition, Inc. Clymer Acquisition, Inc.	Material handling and storage products	Senior Term Debt(2)	5,925,000	5,925,000
Kozy Shack Enterprises, Inc.	Food production and sales	Senior Term Debt(2)(4)	4,200,000	4,205,250
Marcal Paper Mills, Inc.	Manufacturing paper products	Senior Subordinated Term Debt(2)(4) First Mortgage Debt(3)	7,325,000 9,116,956	7,270,063 9,116,956
Wing Stop Restaurants International, Inc.	Restaurant – fast food	Senior Term Debt Senior Term Debt	2,000,000 3,500,000	2,000,000 3,500,000
Totals			\$ 101,294,476	\$ 102,036,900

(1) We do not "Control," and are not an "Affiliate" of, any of our portfolio companies, each as defined in the Investment Company Act of 1940, as amended (the "1940 Act"). In general, under the 1940 Act, we would "Control" a portfolio company if we owned 25% or more of its voting securities and would be an "Affiliate" of a portfolio company if we owned 5% or more of its voting securities.

(2) Last Out Tranche of senior debt, meaning if the company is liquidated then the holder of the Last Out Tranche is paid after the senior debt.

(3) Has some paid in kind (PIK) interest. Refer to Note 2 "Summary of Significant Accounting Policies" of Form 10-K for the fiscal year ended September 30, 2002.

(4) Fair value was based on valuation prepared and provided by Standard & Poor's Loan Evaluation Services.

(5) Includes a success fee with a fair value of \$666,964.

SEE ACCOMPANYING NOTES.

GLADSTONE CAPITAL CORPORATION

SCHEDULE OF INVESTMENTS

AS OF SEPTEMBER 30, 2002

COMPANY(1)	INDUSTRY	INVESTMENT	COST	FAIR VALUE
ARI Holdings, Inc.	Manufacturing auto parts	Junior Subordinated Term Debt (3)	\$ 8,250,803	\$ 8,250,803
Coyne International Enterprises Corp.	Uniform cleaning and rental	Senior Term Debt(2)(3)	16,054,268	16,054,268
Finn Corporation	Manufacturing landscape equipment	Senior Subordinated Term Debt Common Stock Warrants for 2% ownership	10,500,000 37,000	10,500,000 37,000
Home Care Supply, Inc.	Medical equipment rental	Senior Term Debt(2)	18,000,000	18,000,000
Inca Metal Products Corporation	Manufacturing material handling products	Senior Term Debt(2)	6,000,000	6,000,000
Kozy Shack Enterprises, Inc.	Food production and sales	Senior Term Debt(2)	4,300,000	4,300,000
Marcal Paper Mills, Inc.	Manufacturing paper products	Senior Term Debt(2) First Mortgage Debt(3)	7,500,000 9,076,283	7,500,000 9,076,283

Totals	\$ 79,718,354	\$ 79,718,354
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(1) We do not “Control,” and are not an “Affiliate” of, any of our portfolio companies, each as defined in the Investment Company Act of 1940, as amended (the “1940 Act”). In general, under the 1940 Act, we would “Control” a portfolio company if we owned 25% or more of its voting securities and would be an “Affiliate” of a portfolio company if we owned 5% or more of its voting securities.

(2) Last Out Tranche of senior debt, meaning if the company is liquidated then the holder of the Last Out Tranche is paid after the senior debt.

(3) Has some paid in kind (PIK) interest. Refer to Note 2 “Summary of Significant Accounting Policies” of Form 10-K for the fiscal year ended September 30, 2002.

SEE ACCOMPANYING NOTES.

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GLADSTONE CAPITAL CORPORATION
CONSOLIDATED STATEMENT OF OPERATIONS
(UNAUDITED)

	Three Months Ended March 31, 2003	Three Months Ended March 31, 2002
INVESTMENT INCOME		
Interest income – investments	\$ 3,275,962	\$ 1,596,970
Interest income – cash and cash equivalents	113,338	368,570
Interest income – notes receivable from officers	109,737	107,409
Managerial assistance fees	358,000	29,102
Other income	2,256	47,500
Total Investment Income	<u>\$ 3,859,293</u>	<u>\$ 2,149,551</u>
EXPENSES		
Salaries and benefits	\$ 477,861	\$ 327,158
Rent	54,525	36,227
Professional fees	86,577	114,061
Directors fees	20,857	5,000
Insurance	73,686	50,329
Stockholder related costs	74,342	62,045
General and administrative	151,854	146,249
Total Expenses	<u>\$ 939,702</u>	<u>\$ 741,069</u>
NET INVESTMENT INCOME	<u>\$ 2,919,591</u>	<u>\$ 1,408,482</u>
Net unrealized appreciation on investments	742,424	—
NET INCREASE IN STOCKHOLDERS’ EQUITY RESULTING FROM OPERATIONS	<u>\$ 3,662,015</u>	<u>\$ 1,408,482</u>
NET INCREASE IN STOCKHOLDERS’ EQUITY RESULTING FROM OPERATIONS PER COMMON SHARE		
Basic	\$ 0.36	\$ 0.14
Diluted	\$ 0.36	\$ 0.14
WEIGHTED AVERAGE SHARES OF COMMON STOCK OUTSTANDING		
Basic	10,071,844	10,060,178
Diluted	10,100,062	10,160,417

SEE ACCOMPANYING NOTES.

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GLADSTONE CAPITAL CORPORATION
CONSOLIDATED STATEMENT OF OPERATIONS
(UNAUDITED)

	Six Months Ended March 31, 2003	Six Months Ended March 31, 2002
INVESTMENT INCOME		
Interest income – investments	\$ 6,203,625	\$ 1,926,627
Interest income – cash and cash equivalents	311,504	1,009,085
Interest income – notes receivable from officers	219,341	214,827
Managerial assistance fees	358,000	640,911
Other income	2,256	47,500
Total Investment Income	<u>\$ 7,094,726</u>	<u>\$ 3,838,950</u>
EXPENSES		
Salaries and benefits	\$ 911,101	\$ 604,342
Rent	109,145	47,280
Professional fees	201,267	215,482
Directors fees	34,357	7,000
Insurance	144,841	97,664

Stockholder related costs	111,432	71,262
General and administrative	250,837	190,458
Total Expenses	\$ 1,762,980	\$ 1,233,488
NET INVESTMENT INCOME	\$ 5,331,746	\$ 2,605,462
Net unrealized appreciation on investments	742,424	—
NET INCREASE IN STOCKHOLDERS' EQUITY RESULTING FROM OPERATIONS	\$ 6,074,170	\$ 2,605,462
NET INCREASE IN STOCKHOLDERS' EQUITY RESULTING FROM OPERATIONS PER COMMON SHARE		
Basic	\$ 0.60	\$ 0.26
Diluted	\$ 0.60	\$ 0.26
WEIGHTED AVERAGE SHARES OF COMMON STOCK OUTSTANDING		
Basic	10,071,844	10,060,178
Diluted	10,112,129	10,153,223

SEE ACCOMPANYING NOTES.

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

	Common Stock		Capital in Excess of Par Value	Notes Receivable From Sale of Common Stock	(Distributions) in Excess of Undistributed Earnings	Unrealized Appreciation (Depreciation) of Investments	Total Stockholders' Equity
	Shares	Amount					
For the Six Months Ended March 31, 2002:							
Balance at September 30, 2001	10,060,178	\$ 10,060	\$ 140,131,778	\$ (8,800,050)	\$ (92,644)	\$ —	\$ 131,249,144
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 Declared (\$0.18 per common share)					(3,923,469)		(3,923,469)
Balance at March 31, 2002	10,060,178	\$ 10,060	\$ 140,080,807	\$ (8,799,119)	\$ (1,410,651)	\$ —	\$ 129,881,097
For the Six Months Ended March 31, 2003:							
Balance at September 30, 2002	10,071,844	\$ 10,072	\$ 140,266,684	\$ (8,983,796)	\$ (629,687)	\$ —	\$ 130,663,273
Net Increase in Stockholders' Equity Resulting from Operations					5,331,746	742,424	6,074,170
Distributions Declared (\$0.48 per common share)					(4,834,485)		(4,834,485)
Balance at March 31, 2003	10,071,844	\$ 10,072	\$ 140,266,684	\$ (8,983,796)	\$ (132,426)	\$ 742,424	\$ 131,902,958

SEE ACCOMPANYING NOTES.

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GLADSTONE CAPITAL CORPORATION
CONSOLIDATED STATEMENT OF CASH FLOWS
(UNAUDITED)

	Six Months Ended March 31, 2003	Six Months Ended March 31, 2002
CASH FLOWS FROM OPERATING ACTIVITIES		
Net increase in stockholders' equity resulting from operations	\$ 6,074,170	\$ 2,605,462
Adjustments to reconcile net increase in stockholders' equity resulting from operations to net cash provided by (used) in operating activities:		
Depreciation	13,791	—
Net unrealized (appreciation)	(742,424)	—
Increase in interest receivable	(253,946)	(465,006)
Increase in other assets	(121,559)	(200,358)
Increase in accrued expenses and deferred liabilities	770,601	18,834
Decrease in prepaid assets	45,790	69,678
Increase in accounts payable	—	130,500
Increase in investment balance due to payment in kind interest	(426,122)	(96,927)

Net Cash Provided by Operating Activities	\$ 5,360,301	\$ 2,062,183
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of furniture and equipment	\$ (54,115)	\$ —
Purchase of investments	(21,500,000)	(42,083,211)
Principal repayments on investments	350,000	—
Proceeds from repurchase agreements	102,915,974	—
Repayment of repurchase agreements	(78,404,416)	—
Net Cash Provided by (Used in) Investing Activities	\$ 3,307,443	\$ (42,083,211)
CASH FLOWS FROM FINANCING ACTIVITIES		
Offering costs	\$ —	\$ (50,971)
Increase (decrease) in accrued offering costs	—	(590,382)
Repayment of principal on notes receivable – officers	—	931
Distributions paid	(4,431,613)	(1,810,832)
Net Cash (Used in) Financing Activities	\$ (4,431,613)	\$ (2,451,254)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	\$ 4,236,131	\$ (42,472,282)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD(1)	\$ 91,929,328	\$ 131,824,080
CASH AND CASH EQUIVALENTS, END OF PERIOD (Note 9)	\$ 96,165,459	\$ 89,351,798

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

SEE ACCOMPANYING NOTES.

GLADSTONE CAPITAL CORPORATION

FINANCIAL HIGHLIGHTS

(UNAUDITED)

	Three Months Ended March 31, 2003	Three Months Ended March 31, 2002
Per Share Data(1)		
Net asset value at beginning of period	\$ 12.98	\$ 12.98
Net investment income	0.29	0.14
Net unrealized gain on investments	0.07	0
Distributions from net investment income	(0.25)	(0.21)
Net asset value at end of period	\$ 13.09	\$ 12.91
Per share market value at beginning of period	\$ 16.47	\$ 18.69
Per share market value at end of period	16.18	17.80
Total Return(2)(3)	-0.24%	-3.64%
Shares outstanding at end of period	10,071,844	10,060,178
Ratios/Supplemental Data		
Net assets at end of period	\$ 131,902,958	\$ 129,881,097
Average net assets	\$ 132,125,265	\$ 130,819,578
Ratio of operating expenses to average net assets – annualized	2.85%	2.28%
Ratio of net investment income to average net assets – annualized	11.09%	4.32%
Per Share Data(1)		
Net asset value at beginning of period	\$ 12.97	\$ 13.05
Net investment income	0.53	0.26
Net unrealized gain on investments	0.07	0
Distributions from net investment income	(0.48)	(0.39)
Offering costs	0	(0.01)
Net asset value at end of period	\$ 13.09	\$ 12.91
Per share market value at beginning of period	\$ 16.88	\$ 16.14
Per share market value at end of period	16.18	17.80
Total Return(2)(3)	-1.30%	12.70%
Shares outstanding at end of period	10,071,844	10,060,178
Ratios/Supplemental Data		
Net assets at end of period	\$ 131,902,958	\$ 129,881,097
Average net assets	\$ 131,844,204	\$ 131,052,167
Ratio of operating expenses to average net assets – annualized	2.67%	1.88%
Ratio of net investment income to average net assets – annualized	9.21%	1.99%

(1) Basic per share data.

(2) Amounts were not annualized for the results of the three and six month periods ended March 31, 2003 and March 31, 2002.

(3) Total return equals the increase of the ending market value over the beginning market value plus dividends divided by the beginning market value.

GLADSTONE CAPITAL CORPORATION

NOTES TO FINANCIAL STATEMENTS

MARCH 31, 2003

(UNAUDITED)

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 statement of financial statements for the interim periods have been included. The current period's results of operations are not necessarily indicative of results that ultimately may be achieved for the year. The interim financial statements and notes thereto should be read in conjunction with the financial statements and notes thereto included in the Company's Form 10-K for the fiscal year ended September 30, 2002, 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, or BDC, 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 of the Company, conducts the daily administrative operations of the Company. The financial statements of this subsidiary are consolidated with those of the Company.

NOTE 3. STOCK OPTIONS

In December 2002, the Financial Accounting Standards Board (FASB) approved the issuance of Statement of Financial Accounting Standards (SFAS) Statement No. 148 "Accounting for Stock-Based Compensation — Transition and Disclosure". The statement amended SFAS Statement No. 123 "Accounting for Stock-Based Compensation" to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock based employee compensation. Furthermore, SFAS No. 148 amended the disclosure requirements of SFAS No. 123 to require more prominent disclosures in both annual and interim financial statements about the method and related effect on results of accounting for stock-based employee compensation, effective for fiscal year and interim periods beginning after December 15, 2002.

The following tables set forth the pro-forma effect of fair value option accounting for the three and six months ended March 31, 2003 and March 31, 2002:

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	<u>Three Months Ended March 31, 2003</u>	<u>Three Months Ended March 31, 2002</u>
Increase in stockholders' equity from operations, as reported	\$ 3,662,015	\$ 1,408,482
Deduct: total stock-based employee compensation expense determined under fair value method for all awards	(157,720)	(29,850)
Pro-forma increase in stockholders' equity from operations	<u>\$ 3,504,295</u>	<u>\$ 1,378,632</u>
Increase in stockholders' equity from operations per share		
Basic, as reported	\$ 0.36	\$ 0.14
Basic, pro-forma	<u>\$ 0.35</u>	<u>\$ 0.14</u>
Diluted, as reported	\$ 0.36	\$ 0.14
Diluted, pro-forma	<u>\$ 0.35</u>	<u>\$ 0.14</u>
	<u>Six Months Ended March 31, 2003</u>	<u>Six Months Ended March 31, 2002</u>
Increase in stockholders' equity from operations, as reported	\$ 6,074,170	\$ 2,605,462
Deduct: total stock-based employee compensation expense determined under fair value method for all awards	(315,441)	(59,700)
Pro-forma increase in stockholders' equity from operations	<u>\$ 5,758,729</u>	<u>\$ 2,545,762</u>
Increase in stockholders' equity from operations per share		
Basic, as reported	\$ 0.60	\$ 0.26
Basic, pro-forma	<u>\$ 0.57</u>	<u>\$ 0.25</u>
Diluted, as reported	\$ 0.60	\$ 0.26
Diluted, pro-forma	<u>\$ 0.57</u>	<u>\$ 0.25</u>

NOTE 4. INCREASE IN STOCKHOLDERS' EQUITY FROM OPERATIONS PER SHARE

The following tables set forth the computation of basic and diluted increase in stockholders' equity from operations per share for the three and six months ended March 31, 2003 and March 31, 2002:

	Three Months Ended March 31, 2003	Three Months Ended March 31, 2002
Numerator for basic and diluted increase in stockholders' equity from operations per share	\$ 3,662,015	\$ 1,408,482
Denominator for basic weighted average shares	10,071,844	10,060,178
Dilutive potential shares	28,218	100,239
Denominator for diluted weighted average shares	10,100,062	10,160,417
Employee stock options	931,664	723,330
Basic increase in stockholders' equity from operations per common share	0.36	0.14
Diluted increase in stockholders' equity from operations per common share	0.36	0.14

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	Six Months Ended March 31, 2003	Six Months Ended March 31, 2002
Numerator for basic and diluted increase in stockholders' equity from operations per share	\$ 6,074,170	\$ 2,605,462
Denominator for basic weighted average shares	10,071,844	10,060,178
Dilutive potential shares	40,285	93,045
Denominator for diluted weighted average shares	10,112,129	10,153,223
Employee stock options	931,664	723,330
Basic increase in stockholders' equity from operations per common share	0.60	0.26
Diluted increase in stockholders' equity from operations per common share	0.60	0.26

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, if any, and not paying them out as dividends.

On April 7, 2003, the Company paid a dividend of \$0.25 per share on its common stock to stockholders of record as of March 31, 2003 and on January 7, 2003, the Company paid a dividend of \$0.23 per share on its common stock to its stockholders of record as of December 31, 2002. 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 and 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.

NOTE 6. INVESTMENT VALUATION

The Company carries its investments at fair value, as determined by its Board of Directors. Securities that are publicly traded are valued at the closing price on the valuation date. Debt and equity securities that are not publicly traded are valued at fair value as determined in good faith by the Board of Directors. Beginning in March 2003, the Company engaged Standard & Poor's Loan Evaluation Service (S&P) to perform independent valuations of our investments. The Board of Directors uses the recommended valuations as prepared by S&P as a component of the foundation for the final fair value determination. In making such determination, the Board of Directors values non-convertible debt securities at cost plus amortized original issue discount plus PIK interest, if any, unless adverse factors lead to a determination of a lesser valuation. In valuing convertible debt, equity, success fees or other equity like 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, discounted cash flow and other pertinent factors. Due to the uncertainty inherent in the valuation process, such estimates of fair value may differ significantly from the values that would have resulted had a ready market for the securities existed, and the differences could be material. Additionally, changes in the market environment and other events that may occur over the life of the investments may cause the gains 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

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financing from equity investors, restructuring existing loans, raising equity and debt capital, and providing general financial advice. These fees totaled \$358,000 for the three and six months ended March 31, 2003, \$29,102 for the three months ended March 31, 2002 and \$640,911 for the six months ended March 31, 2002.

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 ("PIK") provision. 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 (as discussed in Note 6, above), this non-cash source of income must be paid out to stockholders in the form of dividends, even though the Company has not yet collected the cash. For the three months ended March 31, 2003 and March 31, 2002, the Company recorded PIK income of \$223,754 and \$130,459 respectively and for the six months ended March 31, 2003 and March 31, 2002, PIK income of \$435,076 and \$130,459 respectively. At March 31, 2003 and September 30, 2002 the Company had accrued on its balance sheet, a total in PIK income of \$819,022 and \$400,490 respectively. The Company does not have any original issue discount income.

NOTE 9. REPURCHASE AGREEMENT

A repurchase agreement involves the purchase by an investor, such as the Company, of a specified security and the simultaneous agreement by the seller to repurchase it at an agreed upon future date and at a price which is greater than the purchase price by an amount that reflects an agreed-upon interest rate. Such interest rate is effective for the period of time during which the investor's money is invested in the arrangement and is related to current market interest rates rather than the coupon rate on the purchased security. The Company requires the continual maintenance by its custodian or the correspondent in its account with the Federal Reserve/Treasury Book Entry System of underlying securities in an amount at least equal to the repurchase price. If the seller were to default on its repurchase obligation, the Company might suffer a loss to the extent that the proceeds from the sale of the underlying securities were less than the repurchase price. A seller's bankruptcy could delay or prevent a sale of the underlying securities.

On March 31, 2003, the Company entered into a Repurchase Agreement with UBS Paine Webber for \$63,710,277, which was settled on April 1, 2003. The Repurchase Agreement was recorded at cost and was fully collateralized by a United States Treasury Bill with a fair value of \$65,045,000 and a carrying value of \$65,011,213 that matured on April 17, 2003. The interest rate on the Repurchase Agreement was 1.16%. On September 30, 2002, the Company entered into a Repurchase Agreement with UBS Paine Webber for \$39,198,719, which agreement was settled on October 1, 2002. The Repurchase Agreement was recorded at cost and was fully collateralized by a United States Treasury Bill with a fair value of \$40,004,000 and a carrying value of \$39,998,799 that matured on October 1, 2002. The interest rate on the Repurchase Agreement was 1.85%. In the future the Company plans to use a similar form of repurchase agreements as an investment option or in order to satisfy certain asset diversification requirements and maintain the Company's status as a RIC.

NOTE 10. DEFERRED COMPENSATION PLAN

The Company has adopted a deferred compensation plan (the "Plan") effective January 1, 2002. The Plan permits an employee to defer the lesser of 75% of his or her total compensation or the applicable Internal Revenue Service ("IRS") limit. The employees are eligible to participate in the Plan upon completion of 1,000 hours of service within the first six months of employment or after one year of service. The service requirement is waived for those employees who were employed as of January 1, 2002. The Company has funded \$23,569 in contributions to the Plan that were recorded for the fiscal year ended September 30, 2002. The Company has received a determination letter from the IRS concurring that the deferred compensation plan satisfies the qualification requirements of the Code.

NOTE 11. SUBSEQUENT EVENT

The Company has agreed to sell its Inca Metal Products Corp., Kingway Acquisition Inc., Clymer Acquisitions, Inc. note to American Capital Strategies and expects to complete the sale in May 2003.

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 11, 2002. We caution readers not to place undue reliance on any such forward-looking statements, which are made pursuant to the Private Securities Litigation Reform Act of 1995 and, as such, speak only as of the date made. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, after the date of this Form 10-Q.

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

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

Our loans typically range from \$5 million to \$15 million, mature in no more than seven years and accrue interest at a fixed or variable rate that exceeds the prime

rate. A number of our loans have a provision that calls for some portion of the interest payments to be deferred and added to the principal balance so that the interest is paid, together with the principal, at maturity. This form of deferred interest is often called "paid-in-kind" or "PIK" interest, and, when earned, we record PIK interest as interest income and add the PIK interest to the principal balance of the loans. The amount of PIK interest accrued and on our books as of March 31, 2003 was approximately \$819,000.

Because our loans will generally be subordinated debt of private companies who typically cannot or will not expend the resources to have their debt securities rated by a credit rating agency, we expect that most, if not all, of the debt securities

we acquire will be unrated. We cannot accurately predict what ratings these loans might receive if they were in fact rated, and therefore we cannot determine whether or not they could be considered to be "investment grade" quality.

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

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

Our business plan calls for managerial assistance fee revenue to equal or exceed our operating expenses (excluding interest expense). During the quarter and six months ended March 31, 2003, the Company recorded managerial assistance fee revenue of \$358,000, stemming from two new investments during the quarter. However, during the quarter and six months ended March 31, 2003, operating expenses (excluding interest expense) exceeded managerial assistance fee revenue by approximately \$582,000 and \$1.4 million, respectively. Because we typically generate managerial assistance fee revenue only when we make new loans, our relatively slow pace of loans during the quarter and six months ended March 31, 2003 led to this shortfall. In the future, we will need to make loans at a faster pace in order to meet this objective. However, we believe that, as the economic environment improves, we will be able to make sufficient new investments so that over time our managerial assistance fee revenue will equal or exceed our operating expenses (excluding interest expense), although there can be no guarantee that we will be able to do so.

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

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

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

The general economic climate during the fiscal year ended September 30, 2002 and the quarter and six months ended March 31, 2003 was unfavorable. Many businesses saw their sales and business prospects decline during this time. Consequently, many of these companies were forced to lay off employees and engage in other cost cutting measures. As a result of the difficult business climate, we determined it prudent to proceed cautiously in making loans during the 2002 fiscal year and in the quarter and six months ended March 31, 2003. Since our initial public offering in August 2001, we have made 13 different loans to, or investments in, 10 companies for a total of approximately \$110 million (including the maximum aggregate amount outstanding under an \$8 million line of credit in favor of one of our portfolio companies, that has subsequently been retired). This was below our objective set at the beginning of the 2002 fiscal year.

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

Dividend History

The Company is classified as a registered investment company (RIC), and in order to qualify as a RIC and to avoid corporate level tax on the income distributed to stockholders, we are required, in accordance with 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 compliance with these requirements, we declared and paid quarterly cash dividends as follows:

Quarter Ended	Dividend Per Share
March 31, 2003	\$ 0.25
December 31, 2002	\$ 0.23
September 30, 2002	\$ 0.21
June 30, 2002	\$ 0.21
March 31, 2002	\$ 0.21
December 31, 2001	\$ 0.18

Critical Accounting Policies

Our accounting policies are more fully described in the “Notes to Financial Statements” contained elsewhere in this report. As disclosed in the “Notes to Financial Statements”, the preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, and revenues and expenses during the period reported. Actual results could differ from those estimates. Refer to note 2 “Summary of Significant Accounting Policies” in the “Notes to Financial Statements” of our form 10-K for the fiscal year ended September 30, 2002.

In December 2002, the Financial Accounting Standards Board approved the issuance of FASB Statement No. 148 “Accounting for Stock-Based Compensation – Transition and Disclosure.” The statement amends FASB Statement No. 123 “Accounting for Stock-Based Compensation” to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock based employee compensation. In addition Statement No. 148 amends the disclosure requirements of Statement No. 123 to require more prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. This statement is effective for financial statements for fiscal years ending and for interim periods beginning after December 15, 2002, accordingly our “Notes to Financial Statements” now include these new disclosures.

Investment Valuation

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

We value our investment portfolio each quarter. Members of our portfolio management team prepare the portfolio company valuations using the most recent portfolio company financial statements and forecasts. These individuals also consult with the respective principal who originated the portfolio investment to obtain further updates on the portfolio company’s performance, including information such as industry trends, new product development, and other operational issues. Beginning with this quarter, the Company has engaged Standard & Poor’s to help evaluate the value of some of its loan securities. Upon completing gathering of data, the valuation data is then presented to Standard & Poor’s Loan Evaluation Service (S&P). S&P makes its own assessment of the data and applies its own data in order to determine the value for the securities. With regard to its work, S&P has issued the following paragraph:

S&P provides evaluated price opinions which are reflective of what S&P believes the bid side of the

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market would be for each loan after careful review and analysis of descriptive, market and credit information. Each price reflects S&P’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, S&P cannot guarantee these evaluations. The evaluations reflect the market prices, or estimate 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, S&P cannot guarantee their accuracy.

Once the board reviews the S&P prices, it votes to accept or not accept the price data presented by S&P. At March 31, 2003, the board elected to accept the prices set by S&P on those loans as denoted on the Schedule of Investments in the Consolidated Financial Statements. Because there is a lag between when we close a loan and when we can get the loan evaluated by S&P, new loans are not valued immediately by S&P but rather the board makes its own determination about the value of the loan in accordance with the Company’s valuation policy. Since S&P does not provide values for mortgage loans, equity securities or the success fees (conditional interest), the directors determine their fair value using the following policy:

General Valuation Policy: We carry our investments at fair value, as determined by our board of directors. Securities that are publicly traded, if any, are valued at the closing price on the valuation date. Debt and equity securities that are not publicly traded or for which we have various degrees of trading restrictions, are valued at fair value as determined in good faith by our board of directors. In making the good faith determination of the securities, we start with the cost basis of the security, which includes the amortized original issue discount, success fee (defined interest) and PIK interest, if any. We then apply the methods set out below in Valuation Methods. Due to the uncertainty inherent in the valuation process, such estimates of fair value may differ significantly from the values that would have been obtained had a ready market for the securities existed, and the differences could be material. Additionally, changes in the market environment and other events that may occur over the life of the investments may cause the gains or losses ultimately realized on these investments to be different than the valuations currently assigned. No single standard for determining fair value in good faith exists since fair value depends upon circumstances of each individual case. In general, fair value is the amount that the company might reasonably expect to receive upon the current sale of the security.

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

Loan Grading and Risk Rating: As of December 31, 2002 we expanded the scale of our loan grading system from one that had a scale of 1 to 4, to a scale that uses 0 to 10. This system is used to estimate the probability of default on our debt securities and the probability of loss if there is a default. These types of systems are referred to as risk rating systems and are used by banks and rating agencies. We risk rate each of our debt securities. The risk rating system covers both qualitative and quantitative aspects of the business and the securities we hold.

We seek to have our risk rating system mirror the risk rating systems of major risk rating organizations such as those provided by nationally recognized statistical rating organizations (“NRSRO”) as defined in Rule 2a-7 under the 1940 Act. While we seek to mirror the NRSRO systems, we cannot provide any assurance that our risk rating system provides the same risk rating as a NRSRO. The following chart is an estimate of the relationship of our risk rating system to the designations used by two NRSROs as they risk rate debt securities of major companies. Because we have established our system to rate debt securities of companies that are unrated by any NRSRO there can be no assurance that the correlation to the NRSRO set out below is accurate. It is our understanding that most debt securities of middle market companies do not exceed the grade of BBB on a NRSRO scale; so there would be no debt securities in the middle market that would meet the definition of AAA, AA or A. Therefore, our scale begins with the designation BBB as the best risk rating.

Company's System	First NRSRO	Second NRSRO	Gladstone Capital's Description(a)
>10	Baa2	BBB	Probability of Default (PD) during the next ten years is 4% and the Expected Loss (EL) is 1% or less
10	Ba3	BBB-	PD is 5% and the EL is 1% to 2%
9	Ba1	BB+	PD is 10% and the EL is 2% to 3%
8	Ba2	BB	PD is 16% and the EL is 3% to 4%
7	Ba3	BB-	PD is 17.8% and the EL is 4% to 5%
6	B1	B+	PD is 22.0% and the EL is 5% to 6.5%
5	B2	B	PD is 25% and the EL is 6.5% to 8%
4	B3	B-	PD is 27% and the EL is 8% to 10%
3	Caa1	CCC+	PD is 30% and the EL is 10.0% to 13.3%

2	Caa2	CCC	PD is 35% and the EL is 13.3% to 16.7%
1	Caa3	CC	PD is 65% and the EL is 16.7% to 20%
0	N/a	D	PD is 85% or there is a Payment Default: and the EL is greater than 20%

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

At September 30, 2002, all debt investments were grade 3 under the 1-to-4 loan grading system. The rating of 3 on the 1-4 system means that the portfolio companies were performing as agreed and they have paid on time. Using the expanded scale, at December 31, 2002 and March 31, 2003, the average, weighted average and highest rated loan and lowest rated loan were as follows:

Rating	December 31, 2002	March 31, 2003
Average	7.5	7.7
Weighted Average	7.5	7.7
Highest	9.0	9.0
Lowest	6.0	6.0

The above scale gives an indication of the probability of default and the magnitude of the loss if there is a default using the expanded risk rating scale.

Our policy is to stop accruing interest on an investment if we determine that interest is no longer collectible. To date we have not placed any investments on non-accrual. At September 30, 2002 and March 31, 2003, no payments were past due on any of our debt securities. We do not risk rate our equity securities.

Valuation Methods: For debt securities, we first determine if there is a market for the debt security. If there is a market, then we will determine the value based on the market prices for the security, even if that market is not robust. At March 31, 2003 and September 30, 2002 there was no market for any of the debt securities we hold. If there is no market for the debt securities, then we begin with the risk rating designation of the security described above. Using the risk rating designation above, we seek to determine the value of the security as if we intended to sell the security in a current sale. To determine the current sale price of the security, we may use some or all of the following items: financial standing of the issuer of the security, comparison of the business and financial plan of the issuer with actual results, the cost of the security, the size of the security held as it relates to the liquidity of the market for such securities, contractual restrictions on the disposition of the security, pending public offering of the issuer of the security, pending reorganization activity affecting the issuer such as mergers or debt restructuring, reported prices of similar securities of the issuer or comparable issuers, ability of the issuer to obtain needed financing, changes in the economy affecting the issuer, recent purchases or sale of a security of the issuer, pricing by other buyers or sellers of similar securities, financial statements of the borrower, the type of security, cost at date of purchase, size of holding, discount from market value of unrestricted securities of the same class at the time of purchase, special reports prepared by analysts, information as to any transactions or offers with respect to the security, existence of merger proposals or tender offers affecting the securities, the collateral, the issuer's ability to make payments, the current and forecasted earnings of the issuer, sales to third parties of similar securities, statistical ratios compared to lending standards, statistical ratios compared to other similar securities and other pertinent factors.

For equity securities, we first determine if there is any market for the equity security. If there is a market, then we determine the value based on the market prices for the security, even if that market is not robust. At December 31, 2002 and September 30, 2002 there was no market for any of the equity securities we owned. If there is no market for the equity securities, then we use the same information we would use for a debt security valuation described above, as well as standard valuation techniques used by major valuation firms to value the equity securities of private companies. These valuation techniques consist of: discounted cash flow of the expected sales price in the future, the value of the securities based on the recent sale of comparable transactions and a review of similar companies that are publicly traded and the market multiple of their equity securities. At March 31, 2003 we had \$37,000 invested, at cost, in equity securities compared to our debt portfolio with a cost basis of \$101,257,476.

At March 31, 2003 we determined that the probability of our receiving the success fee (conditional interest) on one of our loans had increased to the point that an appreciated value should be used. To determine this value we estimated the probability of the payment and discounted the value over time. The Home Care Supply, Inc. senior loan has an appreciated value (as determined by the Board and not S&P) of \$666,964 in its value as a result of the value applied to the success fee (conditional interest). Further, the value of our warrants in Finn Corporation became more valuable during the quarter ended March 31, 2003 and were valued at \$490,323. This appreciation totaling \$1,120,287 offset depreciation of \$377,863.

Our new risk rating system is more detailed than our prior system. Due to the more detailed nature of the risk rating system there is the likelihood that future valuations will change more frequently. S&P determines what a loan might trade at if it was publicly traded, which also adds volatility to our valuations.

Managerial Assistance Fees

The 1940 Act requires that a business development company make available managerial assistance to its portfolio companies. We provide managerial assistance to our portfolio companies in connection with our investments through our wholly owned subsidiary, Gladstone Advisers, Inc. and receive fees for our managerial assistance services. These fees are normally paid at the closing of our investments in our portfolio companies, are generally non-recurring and are recognized as revenue when earned. The managerial assistance services we provide vary by investment, but generally consist of reviewing existing credit facilities, arranging bank financing, arranging equity financing, structuring financing from multiple lenders, structuring financing from equity investors, restructuring existing loans, raising equity and debt capital, and providing general financial advice. From time to time, we are invited to participate as a co-lender in a transaction. In the event that we do not provide significant managerial assistance services in connection with our investment, loan fees paid to us in such situations are deferred and amortized over the life of the loan.

RESULTS OF OPERATIONS

Comparison of the three months ended March 31, 2003 to the three months ended March 31, 2002

Investment Income

Investment income for the three months ended March 31, 2003 was approximately \$3.9 million as compared to \$2.1 million for the three months ended March 31, 2002. This increase was primarily a result of increased interest income from new investments and managerial fees.

Interest income from our investments in debt securities of private companies was approximately \$3.3 million for the three months ended March 31, 2003 as compared to \$1.6 million for the three months ended March 31, 2002. This increase was primarily a result of the increase in new investments of \$68.0 million.

The weighted average yield on our portfolio for the three months ended March 31, 2003 was 14.69% (without giving effect to PIK interest) and 15.89% (after giving effect to PIK interest). The weighted average yield for the three months ended March 31, 2002 was 13.98% (without giving effect to PIK interest) and 15.18% (after giving effect to PIK interest).

Interest income from invested cash and cash equivalents for the three months ended March 31, 2003 was approximately \$113,000, as compared to \$369,000 for the three months ended March 31, 2002. This decrease was primarily a result of the \$68.0 million of new investments made between March 31, 2002 and March 31, 2003.

For the three months ended March 31, 2003, we recorded approximately \$110,000 in interest income from loans to our employees in connection with the exercise of employee stock options, as compared to approximately \$107,000 in interest income from such loans for the three months ended March 31, 2002. This increase was primarily a result of \$185,000 in new employee loans.

Managerial assistance fees were \$358,000 for the three months ended March 31, 2003, as compared to \$29,000 for the three months ended March 31, 2002. This increase was the result of two new investment closings during the quarter with related fees.

Operating Expenses

Operating expenses for the three months ended March 31, 2003 were approximately \$940,000, as compared to approximately \$741,000 for the three months ended March 31, 2002. This increase was primarily a result of eight new employees, new office space and operating expenses related to the increase in staff and overall operations.

Salaries and benefits for the three months ended March 31, 2003 were approximately \$478,000, as compared to approximately \$327,000 for the three months ended March 31, 2002. This increase was a result of the hiring of eight new employees.

Rent expense for the three months ended March 31, 2003 was approximately \$55,000, as compared to approximately \$36,000 for the three months ended March 31, 2002. This increase was primarily a result of new office space acquired in September 2002.

Professional fees, consisting primarily of legal and audit fees, for the three months ended March 31, 2003 were approximately \$87,000, as compared to approximately \$114,000 for the three months ended March 31, 2002. This decrease was primarily a result of a decline in legal fees.

Directors' fees for the three months ended March 31, 2003 were approximately \$21,000, as compared to approximately \$5,000 for the three months ended March 31, 2002. This increase was primarily a result of the accounting for the annual directors fee pro rated over the 2004 fiscal year.

Insurance expense for the three months ended March 31, 2002 was approximately \$74,000, as compared to approximately \$50,000 for the three months ended March 31, 2002. The majority of this increase is due to an increase in directors' and officers' insurance premiums.

Stockholder related costs for the three months ended March 31, 2003 were approximately \$74,000, as compared to approximately \$62,000 for the three months ended March 31, 2002. The increase was attributable to the printing of the annual report and the annual stockholders' meeting.

General and administrative expenses, consisting primarily of office operations, travel and data communications expenses for the three months ended March 31, 2003 were approximately \$152,000, as compared to approximately \$146,000 for the three months ended March 31, 2002. This slight increase was primarily a result of the related expenses to new employees and increased operations.

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

Net Increase in Stockholders' Equity from Operations

As a result of the investment income and operating expenses described above, we had net increase in stockholders' equity from operations of approximately \$3.7 million for the three months ended March 31, 2003. Based on a weighted-average of 10,071,844 (basic) and 10,100,062 (diluted) shares outstanding, our net increase in stockholders' equity from operations per common share for the three months ended March 31, 2003 was \$0.36 (basic) and \$0.36 (diluted).

For the three months ended March 31, 2002, we had net increase in stockholders' equity from operations of approximately \$1.4 million. Based on a weighted-average of 10,060,178 (basic) and 10,160,417 (diluted) shares outstanding, our net increase in stockholders' equity from operations per common share for the three months ended March 31, 2002 was \$0.14 (basic) and \$0.14 (diluted).

Net increase in stockholders' equity from operations includes approximately \$742,000 of net unrealized appreciation for the quarter ended March 31, 2003. This was the first period in which the Board of Directors approved the fair values of the investment portfolios based on recommendations prepared by Standard & Poor's. There was no unrealized appreciation or depreciation for the quarter ended March 31, 2002.

Comparison of the six months ended March 31, 2003 to the six months ended March 31, 2002

Investment Income

Investment income for the six months ended March 31, 2003 was approximately \$7.1 million as compared to \$3.8 million for the six months ended March 31, 2002. This increase was primarily a result of increased interest income from investments.

Interest income from our investments in debt securities of private companies was approximately \$6.2 million for the six months ended March 31, 2003 as compared to \$1.9 million for the six months ended March 31, 2002. This increase was primarily a result of the increase in new investments of \$68.0 million.

The weighted average yield on our portfolio for the six months ended March 31, 2003 was 13.31% (without giving effect to PIK interest) and 14.21% (after giving effect to PIK interest). The weighted average yield for the six months ended March 31, 2002 was 15.01% (without giving effect to PIK interest) and 15.0% (after giving effect to PIK interest).

Interest income from invested cash and cash equivalents for the six months ended March 31, 2003 was approximately \$312,000, as compared to \$1.0 million for the six months ended March 31, 2002. This decrease was primarily a result of the \$68.0 million of new investments made between March 31, 2002 and March 31, 2003.

For the six months ended March 31, 2003, we recorded approximately \$219,000 in interest income from loans to our employees in connection with the exercise of employee stock options, as compared to approximately \$215,000 in interest income from such loans for the six months ended March 31, 2002. This increase was primarily a result of \$185,000 in new employee loans.

Managerial assistance fees were \$358,000 for the six months ended March 31, 2003, as compared to \$641,000 for the six months ended March 31, 2002. This

decrease was the result of two new investment closings during the six months ended March 31, 2003 as compared to five new investment closings during the six months ended March 31, 2002 with related fees.

Operating Expenses

Operating expenses for the six months ended March 31, 2003 were approximately \$1.8 million, as compared to approximately \$1.2 million for the six months ended March 31, 2002. This increase was primarily a result of eight new employees, new office space and operating expenses related to the increase in staff and overall operations.

Salaries and benefits for the six months ended March 31, 2003 were approximately \$911,000, as compared to approximately \$604,000 for the six months ended March 31, 2002. This increase was a result of the hiring of eight new employees.

Rent expense for the six months ended March 31, 2003 was approximately \$109,000, as compared to approximately \$47,000 for the six months ended March 31, 2002. This increase was primarily a result of new office space acquired in September 2002.

Professional fees, consisting primarily of legal and audit fees, for the six months ended March 31, 2003 were approximately \$201,000, as compared to approximately \$215,000 for the six months ended March 31, 2002. This decrease was primarily a result of a decrease in legal fees.

Directors' fees for the six months ended March 31, 2003 were approximately \$34,000, as compared to approximately \$7,000 for the six months ended March 31, 2002. This increase was primarily a result of the accounting for the annual directors fee pro rated over the 2004 fiscal year.

Insurance expense for the six months ended March 31, 2003 was approximately \$145,000, as compared to approximately \$98,000 for the six months ended March 31, 2002. This increase was mainly attributable to an increase in directors' and officers' insurance premiums.

Stockholder related costs for the six months ended March 31, 2003 were approximately \$111,000, as compared to \$71,000 for the six months ended March 31, 2002. This increase is due to costs associated with the printing of the annual report and the annual stockholders' meeting.

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General and administrative expenses, consisting primarily of office operations, travel and data communications related expenses for the six months ended March 31, 2003 were approximately \$251,000, as compared to approximately \$190,000 for the six months ended March 31, 2002. This increase was primarily a result of the related expenses to new employees and increased operations.

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

Net Increase in Stockholders' Equity from Operations

As a result of the investment income and operating expenses described above, we had net increase in stockholders' equity from operations of approximately \$6.1 million for the six months ended March 31, 2003. Based on a weighted-average of 10,071,844 (basic) and 10,112,129 (diluted) shares outstanding, our net increase in stockholders' equity from operations per common share for the six months ended March 31, 2003 was \$0.60 (basic) and \$0.60 (diluted).

For the six months ended March 31, 2002, we had net increase in stockholders' equity from operations of approximately \$2.6 million. Based on a weighted-average of 10,060,178 (basic) and 10,153,223 (diluted) shares outstanding, our net increase in stockholders' equity from operations per common share for the six months ended March 31, 2002 was \$0.26 (basic) and \$0.26 (diluted).

Net increase in stockholders' equity from operations includes approximately \$742,000 of net unrealized appreciation for the six months ended March 31, 2003. This was the first period in which the Board of Directors approved the fair values of the investment portfolios based on recommendations prepared by Standard & Poor's. There was no unrealized appreciation or depreciation for the six months ended March 31, 2002.

LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2003, we had investments in debt securities of, or loans to, 9 private companies, totaling approximately \$101.4 million of total investment assets. This number includes approximately \$819,000 in accrued PIK interest, which as described in "Overview," is added to the carrying value of our investments.

In January 2003, we closed a \$5.5 million investment in Wing Stop Restaurants International, Inc., a franchiser of fast food chicken restaurants. The investment consisted of a loan with added income from a success fee if the business is successful. In February 2003 we closed and funded a loan for \$12 million to America's Water Heater Rentals, LLC.

In April 2003, we closed a \$5.5 million investment in Fugate and Associates, Inc., an imaging supply company. The investment consisted of a loan with added income from a success fee if the business is successful.

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

Fiscal Year	Amount
2003	\$ 1,225,000
2004	\$ 10,849,233
2005	\$ 12,056,956
2006	\$ 16,457,000
2007	\$ 27,856,287
Thereafter	\$ 32,850,000
Total	\$ 101,294,476

Cash provided by operating activities for the six months ended March 31, 2003, consisting primarily of the items described in "Results of Operations," was approximately \$5.4 million. Net cash provided by investing activities was approximately \$3.3 million during the six months ended March 31, 2003. The net cash provided by investing activities consisted of net proceeds of \$24.5 million from the repurchase agreement and repayment of \$350,000 of investment principal from our portfolio companies. Partially offsetting the cash provided by investing activities was the \$21.5 million of new investments. Net cash used in financing activities was approximately \$4.4 million for the six months ended March 31, 2003 and consisted of the payment of dividends.

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During the six months ended March 31, 2003, cash and cash equivalents increased from approximately \$91.9 million at the beginning of the period to approximately

\$96.1 million at the end of the period. The increase of approximately \$4.2 million was mainly the result of the net proceeds from the repurchase agreement.

On March 31, 2003, we entered into a repurchase agreement with UBS Paine Webber for approximately \$63.7 million. The repurchase agreement was fully collateralized by a United States treasury bill with a fair value of approximately \$65.0 million that matured on April 17, 2003. The interest rate on the repurchase agreement was 1.16%. This repurchase agreement was reflected on our balance sheet as of March 31, 2003 as an increase in cash and cash equivalents pledged to creditors of \$65.0 million, along with a corresponding liability for approximately the same amount. The repurchase agreement was settled on April 1, 2003. In the future, we plan to use a similar form of repurchase agreement as an investment option or in order to satisfy certain asset diversification requirements and maintain our status as a RIC.

In order to qualify as a regulated investment company and to avoid corporate level tax on the income we distribute to our stockholders, we are required, under Subchapter M of the Code, to distribute at least 90% of our ordinary income and short-term capital gains to our stockholders on an annual basis. In accordance with these requirements, we declared and paid quarterly cash dividends of \$0.25 for the quarter ended March 31, 2003 and \$0.23 for the quarter ended December 31, 2002.

We anticipate borrowing funds and issuing additional equity securities to obtain additional capital once the proceeds of our initial public offering have been fully invested. To this end, we have filed with the Securities and Exchange Commission ("SEC") a registration statement that would permit us to issue, through one or more transactions, up to an aggregate of \$75 million in our securities, which may consist of shares of our common stock, preferred stock, or debt securities. On March 19, 2003, the SEC declared the registration statement effective, and we currently have no immediate plans to issue any securities under the registration statement.

In addition to borrowing funds and issuing additional securities, we also intend to pursue a strategy of securitizing our loan portfolio in approximately one to two years. We may use the cash we receive upon the sale of interests in our loans to repay bank borrowings and make additional loans. We can not provide assurance 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 ultimately approximately 50% of the loans in our portfolio will be made at fixed rates, with approximately 50% made at variable rates; however, to date all of our loans have been made at fixed rates.

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

- (a) Evaluation of disclosure controls and procedures.

Within the 90 days prior to the filing date of this quarterly report on Form 10-Q, we carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures. This evaluation was carried out under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are adequate and effective.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Exchange Act is accumulated and communicated to management,

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including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

- (b) Changes in internal controls.

There have been no significant changes, including corrective actions with regard to significant deficiencies or material weaknesses, in our internal controls or in other factors that could significantly affect internal controls subsequent to the date we carried out the evaluation discussed in paragraph (a) above.

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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 2. CHANGES IN SECURITIES AND USE OF PROCEEDS.

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

Not applicable.

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

The Annual Meeting of Stockholders (the "Annual Meeting") was held on February 24, 2003. The stockholders voted and approved of the following matters:

- The election of two directors to hold office until the 2006 Annual Meeting of Stockholders.

Nominee

Shares Voted For

Authority Withheld

Terry Lee Brubaker	9,176,400	551,837
David A.R. Dullum	9,622,415	105,822

- An amendment to the Company's Amended and Restated 2001 Equity Incentive plan, as amended, to increase the aggregate number of shares of common stock authorized for issuance under such plan by 500,000 shares.

Shares voted for	7,774,810
Shares voted against	1,900,257
Shares abstained	53,170

- The ratification of PricewaterhouseCoopers LLP as independent auditors of the Company for the fiscal year ending September 30, 2003.

Shares voted for	9,646,770
Shares voted against	68,540
Shares abstained	12,927

ITEM 5. OTHER INFORMATION.

On January 3, 2003, Paul Adelgren was appointed director in order to expand the Board of Directors and will serve until the 2004 annual meeting of stockholders of the Company.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) **EXHIBITS**

See the exhibit index on page 30.

(b) **REPORTS ON FORM 8-K**

None.

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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

Harry Brill
Chief Financial Officer and Treasurer

Date: May 12, 2003

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CERTIFICATIONS

I, David Gladstone, certify that:

- I have reviewed this quarterly report on Form 10-Q of Gladstone Capital Corporation;
- Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
- Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
- The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
- The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 12, 2003

/s/ DAVID GLADSTONE

David Gladstone
Chief Executive Officer and
Chairman of the Board of Directors

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I, Harry Brill, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Gladstone Capital Corporation;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 12, 2003

/s/ HARRY BRILL

Harry Brill
Chief Financial Officer and Treasurer

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EXHIBIT INDEX

Exhibit	Description
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 Increase in Stockholders' Equity from Operations (included in the notes to the unaudited financial statements contained in this report).
99.1	Certification.

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.

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CERTIFICATION

Pursuant to Section 906 of the Public Company Accounting Reform and Investor Protection Act of 2002 (18 U.S.C. § 1350, as adopted), David Gladstone, the Chief Executive Officer of Gladstone Capital Corporation (the "Company"), and Harry Brill, the Chief Financial Officer of the Company, each hereby certifies that, to the best of his knowledge:

1. The Company's Quarterly Report on Form 10-Q for the period ended March 31, 2003, to which this Certification is attached as Exhibit 99.1 (the "Periodic Report"), fully complies with the requirements of Section 13 (a) or Section 15(d) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Periodic Report fairly presents, in all material respects, the financial condition of the Company at the end of the period covered by the Periodic Report and results of operations of the Company for the period covered by the Periodic Report.

Dated: May 12, 2003

/s/ David Gladstone
David Gladstone
Chief Executive Officer

/s/ Harry Brill
Harry Brill
Chief Financial Officer
