

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

1933 Act File No. 333-

Form N-2

REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933
PRE-EFFECTIVE AMENDMENT NO.
POST-EFFECTIVE AMENDMENT NO.

GLADSTONE CAPITAL CORPORATION

(Exact name of registrant as specified in charter)

1521 WESTBRANCH DRIVE, SUITE 200
MCLEAN, VA 22102

(Address of principal executive offices)

Registrant's telephone number, including area code: (703) 287-5800

DAVID GLADSTONE
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
GLADSTONE CAPITAL CORPORATION
1521 WESTBRANCH DRIVE, SUITE 200
MCLEAN, VIRGINIA 22102
(Name and address of agent for service)

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Approximate date of proposed public offering: From time to time after the effective date of this registration statement.

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

CALCULATION OF REGISTRATION FEE UNDER THE SECURITIES ACT OF 1933

Title of Securities Being Registered	Proposed Maximum Aggregate Offering Price	Amount of Registration Fee
Common Stock, \$0.001 par value per share, and Debt Securities	\$ 300,000,000	\$9,210
Total	\$ 300,000,000	\$9,210

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

SUBJECT TO COMPLETION, DATED MAY 16, 2007

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

PROSPECTUS



\$300,000,000

**COMMON STOCK
DEBT SECURITIES**

We may offer, from time to time, up to \$300 million aggregate initial offering price of our common stock, \$0.001 par value per share, or debt securities, which we refer to in this prospectus collectively as our Securities, in one or more offerings. The Securities may be offered at prices and on terms to be set forth in one or more supplements to this prospectus. In the case of our common stock, the offering price per share, less any underwriting commissions or discounts, will not be less than the net asset value per share of our common stock at the time we make the offering. You should read this prospectus and the applicable prospectus supplement carefully before you invest in our Securities.

Our Securities may be offered directly to one or more purchasers, including existing stockholders in a rights offering, through agents designated from time to time by us, or to or through underwriters or dealers. The prospectus supplement relating to the offering will identify any agents or underwriters involved in the sale of our Securities, and will disclose any applicable purchase price, fee, commission or discount arrangement between us and our agents or underwriters or among our underwriters or the basis upon which such amount may be calculated. See "Plan of Distribution." We may not sell any of our Securities through agents, underwriters or dealers without delivery of a prospectus supplement describing the method and terms of the offering of such Securities. Our common stock is traded on The Nasdaq Global Select Market under the symbol "GLAD." As of May 11, 2007, the last reported sales price for our common stock was \$23.48.

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

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

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

, 2007

TABLE OF CONTENTS

	<u>Page</u>
Prospectus Summary	1
Additional Information	9
Risk Factors	9
Special Note Regarding Forward-Looking Statements	19
Use of Proceeds	19
Price Range of Common Stock and Distributions	20
Consolidated Selected Financial Data	21
Management's Discussion and Analysis of Financial Condition and Results of Operations	22
Business	51
Portfolio Companies	62
Management	69
Control Persons and Principal Stockholders	81
Dividend Reinvestment Plan	83
Material U.S. Federal Income Tax Considerations	85
Regulation as a Business Development Company	88
Description of Our Securities	91
Certain Provisions of Maryland Law and of our Articles of Incorporation and Bylaws	92
Plan of Distribution	94
Share Repurchases	95
Custodian, Transfer and Dividend Paying Agent and Registrar	96
Brokerage Allocation and Other Practices	96
Legal Matters	96
Experts	96
Financial Statements	F-1

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

PROSPECTUS SUMMARY

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

GLADSTONE CAPITAL CORPORATION

General

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

prospectus as the 1940 Act.

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

Our Investment Adviser and Administrator

Our Adviser, is our affiliate and investment adviser and is led by a management team which has extensive experience in our lines of business. All of our directors and executive officers serve as either directors or executive officers, or both, of Gladstone Commercial, a publicly traded real estate investment trust; Gladstone Investment, a publicly traded business development company; our Adviser; and our Administrator. Our Adviser also has a wholly-owned subsidiary, our Administrator, which employs our chief financial officer, chief compliance officer, controller, treasurer and their respective staffs.

Our Adviser and our Administrator also provide investment advisory and administrative services to our affiliates Gladstone Commercial, Gladstone Investment and Gladstone Land Corporation, an agricultural real estate company owned by Mr. Gladstone. In the future, our Adviser may provide

investment advisory and administrative services to other funds, both public and private, of which it is the sponsor.

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

Our Investment Objectives and Our Strategy

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

- *Senior Subordinated Notes.* We seek to invest a portion of our assets in senior subordinated notes. Holders of senior subordinated notes are subordinated to the rights of holders of senior debt in their right to receive principal and interest payments or, in the case of last out tranches of senior debt, liquidation proceeds from the borrower. As a result, senior subordinated notes are riskier than senior notes. Although such loans are sometimes secured by significant collateral, the lender is largely dependent on the borrower's cash flow for repayment. Additionally, lenders may receive warrants to acquire shares of stock in borrowers or other yield enhancements in connection with these loans. Senior subordinated notes include second lien loans and syndicated second lien loans.
- *Senior Notes.* We seek to invest a portion of our assets in senior notes of borrowers. Using its assets and cash flow as collateral, the borrower typically uses senior notes to cover a substantial portion of the funding needed to operate. Senior lenders are exposed to the least risk of all providers of debt because they command a senior position with respect to scheduled interest and principal payments. However, unlike senior subordinated and junior subordinated lenders, these senior lenders typically do not receive any stock, warrants to purchase stock of the borrowers or other yield enhancements. As such, they generally do not participate in the equity appreciation of the value of the business. Senior notes may include revolving lines of credit, senior term loans, senior syndicated loans and senior last-out tranche loans.
- *Junior Subordinated Notes.* We also seek to invest a small portion of our assets in junior subordinated notes. Holders of junior subordinated notes are subordinated to the rights of the holders of senior debt and senior subordinated debt in their rights to receive principal and interest payments from the borrower. The risk profile of junior subordinated notes is high, which permits the junior subordinated lender to obtain higher interest rates and more equity and equity-like compensation.

THE OFFERING

We may offer, from time to time, up to \$300,000,000 of our Securities, on terms to be determined at the time of the offering. Our Securities may be offered at prices and on terms to be disclosed in one or more prospectus supplements. In the case of the offering of our common stock, the offering price per share less any underwriting commissions or discounts will not be less than the net asset value per share of our common stock at the time of the offering.

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

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

The Nasdaq Global Select Market Symbol

GLAD

Use of Proceeds

Unless otherwise specified in a prospectus supplement, we intend to use the net proceeds from the sale of our Securities for general corporate purposes. We expect the proceeds to be used first to pay down existing short-term debt, then to make investments in small and medium sized businesses in accordance with our investment objectives, and any remaining proceeds to be used for other general corporate purposes. See "Use of Proceeds."

Dividends and Distributions

We have paid monthly dividends to the holders of our common stock and generally intend to continue to do so. The amount of the monthly dividends is determined by our Board of Directors on a quarterly basis and is based on our estimate of our annual investment company taxable income and net short-term taxable capital gains. See "Price Range of Common Stock and Distributions." Certain additional amounts may be deemed as distributed to stockholders for income tax purposes. Other types of securities will likely pay distributions in accordance with their terms.

Taxation	We intend to continue to elect to be treated for federal income tax purposes as a regulated investment company, which we refer to as a RIC. Accordingly, we generally will pay no corporate-level federal income taxes on any ordinary income or capital gains that we distribute to our stockholders. To maintain our RIC status, we must meet specified source-of-income and asset diversification requirements and distribute annually at least 90% of our taxable ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, out of assets legally available for distribution. See “Price Range of Common Stock and Distributions.”
Trading at a Discount	Shares of closed-end investment companies frequently trade at a discount to their net asset value. The possibility that our shares may trade at a discount to our net asset value is separate and distinct from the risk that our net asset value per share may decline. We cannot predict whether our shares will trade above, at or below net asset value.

Certain Anti-Takeover Provisions	Our Board of Directors is divided into three classes of directors serving staggered three-year terms. This structure is intended to provide us with a greater likelihood of continuity of management, which may be necessary for us to realize the full value of our investments. A staggered board of directors also may serve to deter hostile takeovers or proxy contests, as may certain provisions of Maryland law and other measures we have adopted. See “Certain Provisions of Maryland Law and of Our Articles of Incorporation and Bylaws.”
Dividend Reinvestment Plan	We have a dividend reinvestment plan for our stockholders. This is an “opt in” dividend reinvestment plan, meaning that stockholders may elect to have their cash dividends automatically reinvested in additional shares of our common stock. Stockholders who do not so elect will receive their dividends in cash. Stockholders who receive distributions in the form of stock will be subject to the same federal, state and local tax consequences as stockholders who elect to receive their distributions in cash. See “Dividend Reinvestment Plan.”
Management Arrangements	Gladstone Management Corporation serves as our investment adviser, and Gladstone Administration, LLC serves as our administrator. We have entered into a license agreement with our Adviser, pursuant to which our Adviser has agreed to grant us a non-exclusive license to use the name “Gladstone” and the Diamond G logo. For a description of our Adviser, our Administrator, the Gladstone Companies and our contractual arrangements with these companies, see “Management—Certain Transactions—Advisory and Administration Agreements,” and “Management—Certain Transactions—License Agreement.”

Fees and Expenses

The following table is intended to assist you in understanding the costs and expenses that an investor in this offering will bear directly or indirectly. We caution you that some of the percentages indicated in the table below are estimates and may vary. Except where the context suggests otherwise, whenever this prospectus contains a reference to fees or expenses paid by “us” or “Gladstone Capital,” or that “we” will pay fees or expenses, stockholders will indirectly bear such fees or expenses as investors in Gladstone Capital. The following percentages were calculated based on net assets as of March 31, 2007.

	<u>Current</u>
Stockholder Transaction Expenses	
Sales load (as a percentage of offering price)	—%
Dividend reinvestment plan expenses(1)	None
Estimated annual expenses (as a percentage of net assets attributable to common stock)	
Management fees(2)	3.44%
Incentive fees payable under investment advisory and management agreement (20% of realized capital gains and 20% of pre-incentive fee net investment income)(3)	2.74%
Interest Payments on Borrowed Funds(4)	4.44%
Other expenses	1.26%
Total annual expenses (estimated)(2)(5)	11.88%

- (1) The expenses of the reinvestment plan are included in stock record expenses, a component of “Other expenses.” We do not have a cash purchase plan. The participants in the dividend reinvestment plan will bear a pro rata share of brokerage commissions incurred with respect to open market purchases, if any. See “Dividend Reinvestment Plan” for information on the dividend reinvestment plan.
- (2) Our annual base management fee is 2.0% (0.5% quarterly) of our average gross assets, which is defined as total assets of Gladstone Capital, including investments made with proceeds of borrowings, less any uninvested cash or cash equivalents pledged to creditors. See “Management—Advisory and Administration Agreements” and footnote 3 below.
- (3) The incentive fee consists of two parts: an income-based fee and a capital gains-based fee. The income-based fee will be payable quarterly in arrears, and will equal 20% of the excess, if any, of our pre-incentive fee net investment income that exceeds a 1.75% quarterly (7.0% annualized) hurdle rate, subject to a “catch-up” provision measured as of the end of each calendar quarter. The “catch-up” provision requires us to pay 100% of our pre-incentive fee net investment income with respect to that portion of such income, if any, that exceeds the hurdle rate but is less than 125% of the quarterly hurdle rate (or 2.1875%) in any calendar quarter (8.75% annualized). The catch-up provision is meant to provide our Adviser with 20% of our pre-incentive fee net investment income as if a hurdle rate did not apply when our pre-incentive fee net investment income exceeds 125% of the quarterly hurdle rate in any calendar quarter (8.75% annualized). The income-based incentive fee will be computed and paid on income that may include interest that is accrued but not yet received in cash. Our pre-incentive fee net investment income used to calculate this part of the income incentive fee is also included in the amount of our gross assets used to calculate the 2% base management fee (see footnote 2 above). The quarter ended December 31, 2006 was the first quarter under our new advisory agreement and, as a result, was the first quarter in which the incentive fee was earned. For purposes of this computation, the aggregate gross amount of the December 31, 2006 and March 31, 2007 fees, exclusive of any credits, was annualized to determine the percentage the fee represents of net assets.

After giving effect to credits against the incentive fee, the annualized incentive fee was 0.17% of net assets as of March 31, 2007. There can be no assurance that our Adviser will give any credits against the incentive fee in the future. The capital gains-based portion of the fee did not have an effect on the incentive fee for purposes of this calculation since we have not realized overall net capital gains to date.

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

- Assuming pre-incentive fee net investment income of 0.55%, there would be no income-based incentive fee because such income would not exceed the hurdle rate of 1.75%.
- Assuming pre-incentive fee net investment income of 2.00%, the income-based incentive fee would be as follows:
 - = $100\% \times (2.00\% - 1.75\%)$
 - = 0.25%
- Assuming pre-incentive fee net investment income of 2.30%, the income-based incentive fee would be as follows:
 - = $(100\% \times (\text{"catch-up": } 2.1875\% - 1.75\%)) + (20\% \times (2.30\% - 2.1875\%))$
 - = $(100\% \times 0.4375\%) + (20\% \times 0.1125\%)$
 - = 0.4375% + 0.0225%
 - = 0.46%

- Assuming net realized capital gains of 6% and realized capital losses and unrealized capital depreciation of 1%, the capital gains-based incentive fee would be as follows:
 - = $20\% \times (6\% - 1\%)$
 - = $20\% \times 5\%$
 - = 1%

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

- (4) We have entered into a revolving credit facility, under which our borrowing capacity is \$170 million, effective February 9, 2007. We have drawn down on this credit facility and we expect to borrow additional funds in the future up to an amount so that our asset coverage, as defined in the 1940 Act, is at least 200% after each issuance of our senior securities. Assuming that we borrowed \$170 million at an interest rate of 6.38%, interest payments on borrowed funds would have been 6.41% of our net assets as of March 31, 2007.
- (5) Includes our overhead expenses, including payments under the administration agreement based on our projected allocable portion of overhead and other expenses incurred by our Administrator in performing its obligations under the administration agreement. See “Management—Certain Transactions—Advisory and Administration Agreements.”

Example

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

	<u>1 Year</u>	<u>3 Years</u>	<u>5 Years</u>	<u>10 Years</u>
You would pay the following expenses on a \$1,000 investment, assuming a 5% annual return	\$89	\$257	\$412	\$745

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

plan will receive a number of shares of our common stock, determined by dividing the total dollar amount of the dividend payable to a participant by the market price per share of our common stock at the close of trading on the valuation date for the dividend. See “Dividend Reinvestment Plan” for additional information regarding our dividend reinvestment plan.

This example and the expenses in the table above should not be considered a representation of our future expenses, and actual expenses (including the cost of debt and incentive fees, if any, and other expenses) may be greater or less than those shown. As noted in the Fees and Expenses table above, we estimate that annual incentive fees payable under the investment advisory and management agreement will be 2.74% of net assets attributable to common stock.

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

The following table summarizes our consolidated financial data. The summary financial data as of and for the years ended September 30, 2006, 2005 and 2004 is derived from our audited consolidated financial statements included in this prospectus. The summary financial data as of and for the years ended September 30, 2003 and 2002 is derived from our audited consolidated financial statements that are not included in this prospectus. The summary financial data as of and for the six months ended March 31, 2007 and 2006 is derived from our unaudited consolidated financial statements included in this prospectus. You should read this data together with our consolidated financial statements and notes thereto presented elsewhere in this prospectus and the information under "Consolidated Selected Financial Data" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" for more information.

	Year Ended September 30, 2006	Year Ended September 30, 2005	Year Ended September 30, 2004	Year Ended September 30, 2003	Year Ended September 30, 2002	Six Months Ended March 31, 2007 (unaudited)	Six Months Ended March 31, 2006 (unaudited)
Total Investment Income	\$ 26,899,846	\$ 23,949,759	\$ 20,395,968	\$ 15,154,874	\$ 10,455,703	\$ 16,877,496	\$ 13,031,019
Total Net Expenses	\$ 7,549,266	\$ 6,663,614	\$ 7,103,193	\$ 3,858,953	\$ 2,839,102	\$ 5,990,213	\$ 3,384,789
Net Investment Income	\$ 19,350,580	\$ 17,286,145	\$ 13,292,775	\$ 11,295,921	\$ 7,616,601	\$ 10,887,283	\$ 9,646,230
Net Increase in Net Assets Resulting from Operations	\$ 24,430,235	\$ 15,490,682	\$ 10,570,290	\$ 11,073,581	\$ 7,616,601	\$ 8,248,454	\$ 13,823,730
Per Share Data:							
Net Increase in Net Assets Resulting from Operations:							
Basic	\$ 2.15	\$ 1.37	\$ 1.05	\$ 1.10	\$ 0.76	\$ 0.67	\$ 1.22
Diluted	\$ 2.10	\$ 1.33	\$ 1.02	\$ 1.09	\$ 0.75	\$ 0.67	\$ 1.20
Cash Distributions Declared per Share	\$ 1.635	\$ 1.515	\$ 1.365	\$ 1.10	\$ 0.81	\$ 0.84	\$ 0.81
Statement of Assets and Liabilities Data:							
Total Assets	\$ 225,783,215	\$ 205,793,094	\$ 215,333,727	\$ 214,566,663	\$ 172,922,039	\$ 291,015,954	\$ 217,725,319
Net Assets	\$ 172,570,487	\$ 151,610,683	\$ 152,226,655	\$ 130,802,382	\$ 130,663,273	\$ 169,323,895	\$ 156,461,511
Other Data:							
Number of Portfolio Companies at Period End	32	28	16	11	7	51	28
Principal Amount of Loan Originations	\$ 135,954,879	\$ 143,794,006	\$ 86,267,500	\$ 47,011,278	\$ 97,705,054	\$ 127,641,175	\$ 65,159,566
Principal Amount of Loan Repayments	\$ 124,009,929	\$ 88,019,136	\$ 47,158,995	\$ 18,005,827	\$ 18,387,191	\$ 62,230,246	\$ 63,517,133
Total Return(1)	5.21%	5.93%	24.40%	21.74%	9.60%	11.50%	(0.75)%
Weighted Average Yield on Investments(2):							
With PIK Interest(3)	12.74%	12.36%	13.78%	13.86%	14.79%	n/a	12.56%
Without PIK Interest(3)	12.74%	12.23%	13.44%	13.14%	13.82%	12.58%	12.56%

- (1) For the fiscal years ended September 30, 2006, 2005 and 2004, the total return equals the increase of the ending market value over the beginning market value plus monthly dividends divided by the monthly beginning market value. For the fiscal years ended September 30, 2003 and 2002, total return equals the increase of the ending market value over the beginning market value, plus distributions, divided by the beginning market value.
- (2) Weighted average yield on investments equals interest income on investments divided by the average investment balance throughout the year.
- (3) Refer to Note 2 of the "Notes to Consolidated Financial Statements" for an explanation of PIK, or "Paid-in-Kind," interest.

ADDITIONAL INFORMATION

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

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

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

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

RISK FACTORS

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

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

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

We have no employees. Our chief executive officer, chief operating officer, chief investment officer and chief financial officer, and the employees of our Adviser, do not spend all of their time managing our activities and our investment portfolio. We are particularly dependent upon David Gladstone, George Stelljes III and Terry Lee Brubaker in this regard. Our executive officers and the employees of our Adviser allocate some, and in some cases a material portion, of their time to businesses and activities that are not related to our business. We have no separate facilities and are completely reliant on our Adviser, which has significant discretion as to the implementation and execution of our business strategies and risk

management practices. We are subject to the risk of discontinuation of our Adviser's operations or termination of the investment advisory agreement and the risk that, upon such event, no suitable replacement will be found. We believe that our success depends to a significant extent upon our Adviser and that discontinuation of its operations could have a material adverse effect on our ability to achieve our investment objectives.

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

On December 2, 2005, our stockholders approved a proposal to enter into an amended and restated investment advisory agreement with our Adviser, which we refer to as the Amended Advisory Agreement. On October 1, 2006, the Amended Advisory Agreement became effective. The Amended Advisory Agreement entitles our Adviser to incentive compensation for each fiscal quarter in an amount equal to a percentage of the excess of our investment income for that quarter (before deducting incentive compensation, net operating losses and certain other items) above a threshold return for that quarter. Our pre-incentive fee net investment income for incentive compensation purposes excludes realized and unrealized capital losses that we may incur in the fiscal quarter, even if such capital losses result in a net loss on our statement of operations for that quarter. Thus, we may be required to pay our Adviser incentive compensation for a fiscal quarter even if there is a decline in the value of our portfolio or we incur a net loss for that quarter. For additional information on incentive compensation under the Amended Advisory Agreement with our Adviser, see "Business—Investment Advisory and Administration Agreements—Management services and fees under the amended and restated investment advisory agreement."

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

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

We operate in a highly competitive market for investment opportunities.

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

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

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

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

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

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

- **Small and medium-sized businesses may have limited financial resources and may not be able to repay the loans we make to them.** Our strategy includes providing financing to borrowers that typically is not readily available to them. While we believe that this provides an attractive opportunity for us to generate profits, this may make it difficult for the borrowers to repay their loans to us upon maturity. A borrower's ability to repay its loan may be adversely affected by numerous factors, including the failure to meet its business plan, a downturn in its industry or negative economic conditions. Deterioration in a borrower's financial condition and prospects usually will be accompanied by deterioration in the value of any collateral and a reduction in the likelihood of us realizing on any guarantees we may have obtained from the borrower's management. Although we will sometimes seek to be the senior, secured lender to a borrower, in most of our loans we expect to be subordinated to a senior lender, and our interest in any collateral would, accordingly, likely be subordinate to another lender's security interest.
- **Small and medium-sized businesses typically have narrower product lines and smaller market shares than large businesses.** Because our target borrowers are smaller businesses, they will tend to be more vulnerable to competitors' actions and market conditions, as well as general economic downturns. In addition, our portfolio companies may face intense competition, including competition from companies with greater financial resources, more extensive development, manufacturing, marketing and other capabilities and a larger number of qualified managerial and technical personnel.
- **There is generally little or no publicly available information about these businesses.** Because we seek to make loans to privately owned businesses, there is generally little or no publicly available operating and financial information about our potential borrowers. As a result, we rely on our officers, our Adviser and its employees and consultants to perform due diligence investigations of these borrowers, their operations and their prospects. We may not learn all of the material information we need to know regarding these businesses through our investigations.
- **Small and medium-sized businesses generally have less predictable operating results.** We expect that our borrowers may have significant variations in their operating results, may from time to time be parties to litigation, may be engaged in rapidly changing businesses with products subject to a substantial risk of obsolescence, may require substantial additional capital to support their operations, to finance expansion or to maintain their competitive position, may otherwise have a weak financial position or may be adversely affected by changes in the business cycle. Our portfolio

companies may not meet net income, cash flow and other coverage tests typically imposed by their senior lenders. A borrower's failure to satisfy financial or operating covenants imposed by senior lenders could lead to defaults and, potentially, foreclosure on its senior credit facility, which could additionally trigger cross-defaults in other agreements. If this were to occur, it is possible that the borrower's ability to repay our loan would be jeopardized.

- **Small and medium-sized businesses are more likely to be dependent on one or two persons.** Typically, the success of a small or medium-sized business also depends on the management talents and efforts of one or two persons or a small group of persons. The death, disability or resignation of one or more of these persons could have a material adverse impact on our borrower and, in turn, on us.
- **Small and medium-sized businesses are likely to have greater exposure to economic downturns than larger businesses.** We expect that our borrowers will have fewer resources than larger businesses and an economic downturn is more likely to have a material adverse effect on them. If one of our borrowers is adversely impacted by an economic downturn, its ability to repay our loan would be diminished.
- **Small and medium-sized businesses may have limited operating histories.** While we intend to target stable companies with proven track records, we may make loans to new companies that meet our other investment criteria. Borrowers with limited operating histories will be exposed to all of the operating risks that new businesses face and may be particularly susceptible to, among other risks, market downturns, competitive pressures and the departure of key executive officers.

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

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

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

Our procedures also include provisions whereby our Adviser will establish the fair value of any equity securities we may hold where SPSE is unable to provide evaluations. The types of factors that may be considered in determining the fair value of our debt and equity investments include some or all of the following: the nature and realizable value of any collateral, the portfolio company's earnings and cash flows and its ability to make payments on its obligations, the markets in which the portfolio company does

business, comparison to publicly traded companies, discounted cash flow, and other relevant factors. Because such valuations, particularly valuations of private securities and private companies, are inherently uncertain, may fluctuate over short periods of time, and may be based on estimates, our determinations of fair value may differ materially from the values that might have resulted from a readily available market for these securities.

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

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

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

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

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

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

- **Senior Securities.** We intend to issue debt securities, other evidences of indebtedness (including borrowings under our line of credit) and possibly preferred stock, up to the maximum amount permitted by the 1940 Act. The 1940 Act currently permits us, as a business development company, to issue debt securities and preferred stock, to which we refer collectively as senior securities, in amounts such that our asset coverage, as defined in the 1940 Act, is at least 200% after each issuance of senior securities. As a result of issuing senior securities, we will be exposed to the risks associated with leverage. Although borrowing money for investments increases the potential for gain, it also increases the risk of a loss. A decrease in the value of our investments will have a greater impact on the value of our common stock to the extent that we have borrowed money to make investments. There is a possibility that the costs of borrowing could exceed the income we receive on the investments we make with such borrowed funds. In addition, our ability to pay

dividends or incur additional indebtedness would be restricted if asset coverage is not at least twice our indebtedness. If the value of our assets declines, we might be unable to satisfy that test. If this happens, we may be required to liquidate a portion of our loan portfolio and repay a portion of our indebtedness at a time when a sale may be disadvantageous. Furthermore, any amounts that we use to service our indebtedness will not be available for distributions to our stockholders.

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

future may have rights, preferences and privileges more favorable than those of our common stock.

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

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

We anticipate using a combination of equity and long-term and short-term borrowings to finance our lending activities. As a result, a portion of our income will depend upon the difference between the rate at which we borrow funds and the rate at which we loan these funds. Certain of our borrowings may be at fixed rates and others at variable rates. Ultimately, we expect approximately 20% of the loans in our portfolio to be at fixed rates and approximately 80% to be at variable rates determined on the basis of a benchmark prime rate. As of March 31, 2007, our portfolio had approximately 56% of the total of the loan cost value at variable rates with a floor, approximately 2% of the total loan cost value at variable rates with a floor and ceiling, 40% at variable rates without a floor or ceiling and approximately 1% of the total loan portfolio cost basis at a fixed rate. Pursuant to our initial line of credit, we agreed to enter into hedging transactions such as interest rate cap agreements, futures, options and forward contracts. To date, we hold only one interest rate cap agreement. In the event that we securitize a portion of our loan portfolio in the future, we believe that we will likely be required to enter into similar arrangements with respect to the securitized loans. While hedging activities may insulate us against adverse fluctuations in interest rates, they may also limit our ability to participate in the benefits of lower interest rates with respect to the hedged portfolio. Adverse developments resulting from changes in interest rates or hedging transactions could have a material adverse effect on our business, financial condition and results of operations.

Our credit facility imposes certain limitations on us.

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

14

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

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

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

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

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

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

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

15

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

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

In certain circumstances, we may make investments in a portfolio company in which one of our affiliates has or will have an investment, subject to satisfaction of any regulatory restrictions and, where required, to the prior approval of our Board of Directors. As of March 31, 2007, our Board of Directors has approved the following types of co-investment transactions:

- Our affiliate, Gladstone Commercial, may lease property to portfolio companies that we do not control under certain circumstances. We may pursue such transactions only if (i) the portfolio company is not controlled by us or any of our affiliates, (ii) the portfolio company satisfies the tenant underwriting criteria of Gladstone Commercial, and (iii) the transaction is approved by a majority of our independent directors and a majority of the independent directors of Gladstone Commercial. We expect that any such negotiations between Gladstone Commercial and our portfolio companies would result in lease terms consistent with the terms that the portfolio companies would be likely to receive were they not portfolio companies of ours.
- We may invest simultaneously with our affiliate Gladstone Investment in senior syndicated loans whereby neither we nor any affiliate has the ability to dictate the terms of the loans.

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

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

Our Adviser is not obligated to provide a waiver of the incentive fee, which could negatively impact our earnings and our ability to maintain our current level of, or increase, distributions to our stockholders.

On October 1, 2006, we implemented the Amended Advisory Agreement with our Adviser. In addition to providing for a base management fee based on our total assets, this agreement contemplates a quarterly incentive fee based on our pre-incentive fee net investment income and an annual incentive fee based on our capital gains, if any. Our Adviser has the ability to issue a full or partial waiver of the incentive fee for current and future periods, however our Adviser is not required to issue this waiver. If our Adviser does not issue this waiver in future quarters, it could negatively impact our earnings and may compromise our ability to maintain our current level of, or increase, distributions to our stockholders, which could have a material adverse impact on our stock price.

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

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

We may experience fluctuation in our quarterly results.

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

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

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

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

The market price of our shares may fluctuate significantly.

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

- price and volume fluctuations in the stock market from time to time, which are often unrelated to the operating performance of particular companies;
- significant volatility in the market price and trading volume of shares of RICs, business development companies or other companies in our sector, which is not necessarily related to the operating performance of these companies;
- changes in regulatory policies or tax guidelines, particularly with respect to RICs or business development companies;
- loss of business development company status;
- loss of RIC status;
- changes in our earnings or variations in our operating results;
- changes in the value of our portfolio of investments;
- any shortfall in our revenue or net income or any increase in losses from levels expected by securities analysts;

- departure of key personnel;
- operating performance of companies comparable to us;
- short-selling pressure with respect to our shares or business development companies generally;
- general economic trends and other external factors; and
- loss of a major funding source.

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

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

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

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

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

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

USE OF PROCEEDS

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

PRICE RANGE OF COMMON STOCK AND DISTRIBUTIONS

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

Our common stock is quoted on The Nasdaq Global Select Market under the symbol “GLAD.” Our common stock has historically traded at prices above its net asset value. There can be no assurance, however, that any premium to net asset value will be maintained. As of May 11, 2007, we had 81 stockholders of record. The following table sets forth the range of high and low sales prices of our common stock as reported on The Nasdaq Global Select Market (for periods prior to July 1, 2006, The Nasdaq National Market) and the dividends declared by us for the last two completed fiscal years and the current fiscal year through May 11, 2007.

	Net Asset Value Per Share(1)	Closing Price		Premium of High to Net Asset Value(2)	Premium of Low to Net Asset Value(2)	Dividends Declared
		High	Low			
FY 2005						
First Quarter	\$ 13.58	\$ 25.35	\$ 22.61	\$ 11.77	\$ 9.03	\$ 0.360
Second Quarter	\$ 13.64	\$ 24.80	\$ 20.94	\$ 11.16	\$ 7.30	\$ 0.360
Third Quarter	\$ 13.61	\$ 23.96	\$ 21.18	\$ 10.35	\$ 7.57	\$ 0.390
Fourth Quarter	\$ 13.41	\$ 26.00	\$ 22.55	\$ 12.59	\$ 9.14	\$ 0.405
FY 2006						
First Quarter	\$ 13.74	\$ 23.68	\$ 20.36	\$ 9.94	\$ 6.62	\$ 0.405
Second Quarter	\$ 13.84	\$ 22.42	\$ 19.96	\$ 8.58	\$ 6.12	\$ 0.405

Third Quarter	\$ 13.95	\$ 23.50	\$ 20.79	\$ 9.55	\$ 6.84	\$ 0.405
Fourth Quarter	\$ 14.02	\$ 23.08	\$ 21.10	\$ 9.06	\$ 7.08	\$ 0.420
FY 2007						
First Quarter	\$ 13.88	\$ 25.21	\$ 21.96	\$ 11.33	\$ 8.08	\$ 0.420
Second Quarter	\$ 13.82	\$ 24.24	\$ 21.24	\$ 10.42	\$ 7.42	\$ 0.420
Third Quarter (through May 11, 2007)	*	\$ 24.60	\$ 23.16	*	*	\$ 0.420

- (1) Net asset value per share is determined as of the last day in the relevant quarter and therefore may not reflect the net asset value per share on the date of the high and low sale price. The net asset values shown are based on outstanding shares at the end of each period.
- (2) The premiums set forth in these columns represent the high or low, as applicable, closing price per share for the relevant quarter minus the net asset value per share as of the end of such quarter, and therefore may not reflect the premium to net asset value per share on the date of the high and low closing prices.

* Not available.

20

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

The following consolidated selected financial data as of and for the years ended September 30, 2006, 2005 and 2004 is derived from our audited consolidated financial statements included in this prospectus. The consolidated selected financial data as of and for the years ended September 30, 2003 and 2002 is derived from our audited consolidated financial statements that are not included in this prospectus. The consolidated selected financial data as of and for the six months ended March 31, 2007 and 2006 is derived from our unaudited consolidated financial statements included in this prospectus. You should read this data together with our consolidated financial statements and notes thereto presented elsewhere in this prospectus and the information under "Management's Discussion and Analysis of Financial Condition and Results of Operations" for more information.

	Year Ended September 30, 2006	Year Ended September 30, 2005	Year Ended September 30, 2004	Year Ended September 30, 2003	Year Ended September 30, 2002	Six Months Ended March 31, 2007 (unaudited)	Six Months Ended March 31, 2006 (unaudited)
Total Investment Income	\$ 26,899,846	\$ 23,949,759	\$ 20,395,968	\$ 15,154,874	\$ 10,455,703	\$ 16,877,496	\$ 13,031,019
Total Net Expenses	\$ 7,549,266	\$ 6,663,614	\$ 7,103,193	\$ 3,858,953	\$ 2,839,102	\$ 5,990,213	\$ 3,384,789
Net Investment Income	\$ 19,350,580	\$ 17,286,145	\$ 13,292,775	\$ 11,295,921	\$ 7,616,601	\$ 10,887,283	\$ 9,646,230
Net Increase in Net Assets							
Resulting from Operations	\$ 24,430,235	\$ 15,490,682	\$ 10,570,290	\$ 11,073,581	\$ 7,616,601	\$ 8,248,454	\$ 13,823,730
Per Share Data:							
Net Increase in Net Assets							
Resulting from Operations:							
Basic	\$ 2.15	\$ 1.37	\$ 1.05	\$ 1.10	\$ 0.76	\$ 0.67	\$ 1.22
Diluted	\$ 2.10	\$ 1.33	\$ 1.02	\$ 1.09	\$ 0.75	\$ 0.67	\$ 1.20
Cash Distributions							
Declared per Share	\$ 1.635	\$ 1.515	\$ 1.365	\$ 1.10	\$ 0.81	\$ 0.84	\$ 0.81
Statement of Assets and Liabilities Data:							
Total Assets	\$ 225,783,215	\$ 205,793,094	\$ 215,333,727	\$ 214,566,663	\$ 172,922,039	\$ 291,015,954	\$ 217,725,319
Net Assets	\$ 172,570,487	\$ 151,610,683	\$ 152,226,655	\$ 130,802,382	\$ 130,663,273	\$ 169,323,895	\$ 156,461,511
Other Data:							
Number of Portfolio Companies at Period End	32	28	16	11	7	51	28
Principal Amount of Loan Originations	\$ 135,954,879	\$ 143,794,006	\$ 86,267,500	\$ 47,011,278	\$ 97,705,054	\$ 127,641,175	\$ 65,159,566
Principal Amount of Loan Repayments	\$ 124,009,929	\$ 88,019,136	\$ 47,158,995	\$ 18,005,827	\$ 18,387,191	\$ 62,230,246	\$ 63,517,133
Total Return(1)	5.21%	5.93%	24.40%	21.74%	9.60%	11.50%	(0.75)%
Weighted Average Yield on Investments(2):							
With PIK Interest(3)	12.74%	12.36%	13.78%	13.86%	14.79%	n/a	12.56%
Without PIK Interest(3)	12.74%	12.23%	13.44%	13.14%	13.82%	12.58%	12.56%

- (1) For the fiscal years ended September 30, 2006, 2005 and 2004, the total return equals the increase of the ending market value over the beginning market value plus monthly dividends divided by the monthly beginning market value. For the fiscal years ended September 30, 2003 and 2002, total return equals the increase of the ending market value over the beginning market value, plus distributions, dividend by the beginning market value.
- (2) Weighted average yield on investments equals interest income on investments divided by the average investment balance throughout the year.
- (3) Refer to Note 2 of the "Notes to Consolidated Financial Statements" for an explanation of PIK, or "Paid-in-Kind," interest.

21

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

OVERVIEW

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

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

control, restructure their balance sheets, or finance growth, including acquisitions.

Our loans typically range from \$5 million to \$15 million, although this investment size may vary proportionately as the size of our capital base changes, generally mature in no more than seven years and accrue interest at fixed or variable rates. Some of our loans may contain a provision that calls for some portion of the interest payments to be deferred and added to the principal balance so that the interest is paid, together with the principal, at maturity. This form of deferred interest is often called "paid in kind" or PIK interest, and, when earned, we record PIK interest as interest income and add the PIK interest to the principal balance of the loans. We seek to avoid PIK interest with all potential investments under review. We currently do not hold any investments with PIK and, therefore, there was no PIK accrued on our balance sheet as of March 31, 2007.

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

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

Original issue discount, or OID, arises when we extend a loan and receive an equity interest in the borrower at the same time. To the extent that the price paid for the equity is not at market value, we must

allocate part of the price paid for the loan to the value of the equity. Then the amount allocated to the equity, the OID, must be amortized over the life of the loan. As with PIK interest, the amortization of OID also produces income that must be recognized for purposes of satisfying the distribution requirements for a RIC under Subchapter M of the Internal Revenue Code, which we refer to as the Code, whereas the cash is received, if at all, when the equity instrument is sold. We seek to avoid OID and to date do not hold any investments with OID.

In addition, as a business development company under the 1940 Act, we are required to make available significant managerial assistance to our portfolio companies. We provide these services through our Adviser, who provides these services on our behalf through its officers who are also our officers. In addition, our Adviser provides other services to our portfolio companies, for which it receives fees, in connection with our investments. The fees for these services are generally paid to our Adviser in part at the time a prospective portfolio company signs a non-binding term sheet with us (as further described in the following paragraph), with the remainder paid at the closing of the investment. These fees are generally non-recurring, however in some instances they may have a recurring component which is also paid to our Adviser. Any fees received for other services, with the exception of recurring monitoring and review fees, by our Adviser are currently credited against the base management fee payable to our Adviser pursuant to the terms of the Amended Advisory Agreement, which has the effect of reducing our expenses to the extent of any such credits. The specific other services our Adviser provides vary by portfolio company, but generally include a broad array of services to the portfolio companies such as investment banking services, arranging bank financing, arranging equity financing, structuring financing from multiple lenders and investors, reviewing existing credit facilities, restructuring existing loans, raising equity and debt capital, turnaround management, merger and acquisition services and recruiting new management personnel. To date our Adviser has not charged for managerial assistance services, however, if our Adviser does receive fees for such managerial assistance, our Adviser will credit the managerial assistance fees to the base management fee due from us to our Adviser.

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

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

During the six months ended March 31, 2007, we extended, directly or through participations, approximately \$127.6 million of new loans to a total of 32 companies. Also, during the six months ended March 31, 2007, one borrower repaid its loans ahead of contractual maturity, one borrower refinanced its investment and we sold or were repaid in full on 11 syndicated loans of approximately \$56.9 million, and we received scheduled contractual principal repayments of approximately \$5.1 million, for total principal repayments of approximately \$62.0 million. During the fiscal year ended September 30, 2006, we extended, directly or through participations, approximately \$136 million of new loans to a total of 22 companies. Also, during the fiscal year ended September 30, 2006, 7 borrowers repaid their loans ahead of contractual

maturity and we sold or repaid in full on 9 syndicated loans, and sold 3 loan investments at a loss for an aggregate return of capital of approximately \$20 million and we received scheduled contractual principal repayments of approximately \$20 million, for total principal repayments of approximately \$124 million. Since our initial public offering in August 2001, we have made 190 different loans to, or investments in, 100 companies for a total of approximately \$622.2 million, before giving effect to principal repayments on investments and divestitures.

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

Our Investment Adviser and Administrator

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

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

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

Investment Advisory and Management Agreements

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

fees, legal and accounting fees, and stockholder related expenses under the Amended Advisory Agreement.

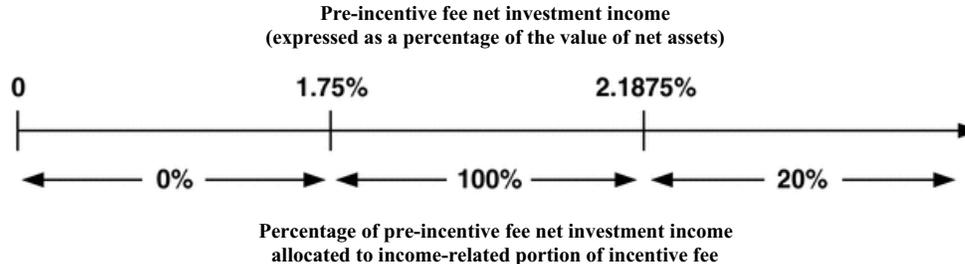
Pursuant to the Initial Advisory Agreement, we paid our Adviser an annual advisory fee of 1.25% of our total assets (as reduced by cash and cash equivalents pledged to creditors), payable in quarterly computed increments of 0.3125%, and an annual administrative fee of 0.75% of our total assets (as reduced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

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

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

- no incentive fee in any calendar quarter in which our pre-incentive fee net investment income does not exceed the hurdle rate (7% annualized);
- 100% of our pre-incentive fee net investment income with respect to that portion of such pre-incentive fee net investment income, if any, that exceeds the hurdle rate but is less than 2.1875% in any calendar quarter (8.75% annualized); and
- 20% of the amount of our pre-incentive fee net investment income, if any, that exceeds 2.1875% in any calendar quarter (8.75% annualized).

Quarterly Incentive Fee Based on Net Investment Income



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

Our Adviser's board of directors agreed to voluntarily waive 1.5% of the annual 2.0% base management fee to 0.5% for senior syndicated loans for each of the three months ended December 31, 2006 and March 31, 2007.

In addition to the base management and incentive fees under the Amended Advisory Agreement, certain fees received by our Adviser from our portfolio companies were credited against the investment advisory fee under the Initial Advisory Agreement, and will continue to be paid to our Adviser and credited under the Amended Advisory Agreement. Our Adviser services our loan portfolio pursuant to a loan servicing agreement with Gladstone Business Loan, LLC, which we refer to as Business Loan, in return for a 1.5% annual fee, based on the monthly aggregate outstanding loan balance of the loans pledged under our credit facility. Effective in April 2006, our Adviser's board of directors voted to reduce the portion of the annual fee to 0.5% for senior syndicated loans. This fee directly reduces the amount of the fees payable under both the Initial and Amended Advisory Agreements. For the three months ended March 31, 2007 and 2006, we incurred \$760,623 and \$734,644, respectively, and for the six months ended March 31, 2007 and 2006 we incurred \$1,479,775 and \$1,450,059, respectively, in loan servicing fees.

For the three months ended March 31, 2007, the gross base management fee, based on the Amended Advisory Agreement, before reductions for loan servicing and other fees was \$1,211,108, as compared to \$1,087,023 for the three months ended March 31, 2006. After being reduced by loan servicing fees of \$760,623 and other fees received by our Adviser of \$775,000, our net base management fee was a credit of \$324,516 for the three months ended March 31, 2007, as compared to reductions for loan servicing fees of \$734,644 and other fees received by our Adviser of \$673,000, our net base management fee was a credit of \$320,621 for the three months ended March 31, 2006. For the six months ended March 31, 2007, the gross base management fee, based on the Amended Advisory Agreement, before reductions for loan servicing fees and other fees was \$2,328,692. After being reduced by loan servicing fees of \$1,479,775 and other fees received by our Adviser of \$1,086,000, our net base management fee for the six months ended March 31, 2007 was a credit of \$237,084. For the six months ended March 31, 2006, the gross base management fee, before reductions for loan servicing fees and other fees was \$2,071,139. After being reduced by loan servicing fees of \$1,450,059 and other fees received by our Adviser of \$1,223,000, our net base management fee

for the six months ended March 31, 2006 was a credit of \$601,920. At March 31, 2007, \$217,631 of unpaid loan servicing fees and \$324,516 of base management fee due to us was recorded net in fees due from Adviser in the accompanying consolidated statement of assets and liabilities.

For the three and six months ended March 31, 2007, we recorded a gross incentive fee of \$1,158,995 and \$2,307,478, respectively, which was offset by a waiver voluntarily issued by our Adviser's board of directors of \$1,088,378 and \$1,657,372, respectively, which resulted in a net incentive fee due to our Adviser of \$70,617 and \$650,106, respectively, of which \$70,617 is unpaid and is netted and recorded in fees due from Adviser on our consolidated statements of assets and liabilities. There was no incentive fee recorded for the three and six months ended March 31, 2006 as the Amended Advisory Agreement was not in effect.

Administration Agreement

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

26

Critical Accounting Policies

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

Investment Valuation

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

General Valuation Policy: Using procedures established by our Board of Directors, we value our investment portfolio each quarter. We carry our investments at fair value, as determined in good faith by or under the direction of our Board of Directors. Securities that are publicly traded, if any, are valued at the closing price of the exchange or securities market on which they are listed on the valuation date. Securities that are not traded on a public exchange or securities market, but for which a limited market exists and that have been rated by a nationally recognized statistical rating organizations, or NRSRO, (such as certain participations in syndicated loans) are valued at the indicative bid price offered by the syndication agent on the valuation date.

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

At March 31, 2007, we engaged Standard & Poor's Securities Evaluations, Inc., or SPSE, to submit opinions of value for most of our loan securities. We request that SPSE also evaluate and assign values to success fees (conditional interest included in some loan securities) when we determine that the probability of receiving a success fee on a given loan is above 6-8%, a threshold of significance. Upon completing our collection of data with respect to the investments (including the information described under "Credit Information," the risk ratings of the loans described under "Loan Grading and Risk Rating" and the factors described under "Valuation Methods"), this valuation data is forwarded along to SPSE for review

27

and analysis. SPSE makes its independent assessment of the data that we have assembled and assesses its independent data to form an opinion as to what they consider to be the market values for the securities. With regard to its work, SPSE has issued the following paragraph:

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

SPSE opinions of value are submitted to our Board of Directors along with our Adviser's supplemental assessment and recommendation regarding valuation of each of these investments. Our Adviser generally accepts the opinion of value given by SPSE, however, in certain limited circumstances, such as when our Adviser may learn new information regarding an investment between the time of submission to SPSE and the date of the Board assessment, our Adviser's conclusions as to value may differ from the opinion of value delivered by SPSE. Our Board of Directors then reviews whether our Adviser has followed its established procedures for determinations of fair value, and votes whether to accept the recommended valuation of our investment portfolio. Our Adviser and our management recommended, and the Board of Directors elected to accept, the opinions of value delivered by SPSE on the loans in our portfolio as denoted on the schedule of investments as of March 31, 2007, September 30, 2006 and September 30, 2005, included in our consolidated financial statements.

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

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

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

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

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

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

The above scale gives an indication of the probability of default and the magnitude of the loss if there is a default. Our policy is to stop accruing interest on an investment if we determine that interest is no longer collectible. Currently, none of our investments are on non-accrual. At March 31, 2007, no payments were past due on any of our debt securities. Additionally, we do not risk rate our equity securities.

The following table lists the risk ratings for all non-syndicated loans in our portfolio at March 31, 2007, September 30, 2006 and September 30, 2005, representing approximately 64%, 73% and 62%, respectively, of all loans in our portfolio:

Rating	Mar. 31, 2007	Sept. 30, 2006	Sept. 30, 2005
Average	7.1	7.2	7.6
Weighted Average	7.0	7.2	7.6
Highest	10.0	9.0	9.0
Lowest	5.0	6.0	6.0

The following table lists the risk ratings for syndicated loans in our portfolio that are not currently rated by an NRSRO at March 31, 2007, September 30, 2006 and September 30, 2005, representing approximately 14%, 17% and 32%, respectively, of all loans in our portfolio:

Rating	Mar. 31, 2007	Sept. 30, 2006	Sept. 30, 2005
Average	6.2	6.1	6.2
Weighted Average	6.1	6.3	6.3
Highest	9.0	8.0	7.0
Lowest	4.0	4.0	5.0

For syndicated loans that are currently rated by an NRSRO, we risk rate such loans in accordance with the risk rating systems of major risk rating organizations such as those provided by a NRSRO. The following table lists the risk ratings for all syndicated loans in our portfolio that are currently rated by an NRSRO at March 31, 2007, September 30, 2006 and September 30, 2005, representing approximately 22%, 10% and 6%, respectively, of all loans in our portfolio:

Rating	Mar. 31, 2007	Sept. 30, 2006	Sept. 30, 2005
Average	B-/B3	CCC+/Caa1	CCC+/Caa1
Weighted Average	CCC+/Caa1	CCC+/Caa1	CCC/Caa2
Highest	BB-/Ba2	B-/B3	CCC+/B3
Lowest	CCC/Caa3	CCC/Caa1	CCC+/Caa2

Valuation Methods: We determine the value of publicly-traded debt securities based on the closing price for the security on the exchange or securities market on which it is listed on the valuation date. We value debt securities that are not publicly traded, but for which a limited market for the security exists, such as participations in syndicated loans, at the indicative bid price offered by the syndication agent on the valuation date. At March 31, 2007, none of the debt securities in our portfolio were publicly traded and there was a limited market for 31 debt securities in our portfolio. At September 30, 2006, none of the debt securities in our portfolio were publicly traded and there was a

limited market for 9 debt securities in our portfolio. At September 30, 2005, none of the debt securities in our portfolio were publicly traded and there was a limited market for 12 debt securities in our portfolio.

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

- the cost basis and the type of the security;
- the nature and realizable value of the collateral;
- the portfolio company's ability to make payments and discounted cash flow;

30

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- reports from portfolio company senior management and board meetings;
 - reported values of similar securities of the portfolio company or comparable companies; and
 - changes in the economy affecting the portfolio company.

We value convertible debt, equity, success fees or other equity-like securities for which there is a market based on the market prices for such securities, even if that market is not robust. At March 31, 2007, September 30, 2006 and September 30, 2005, there was no market for any of the equity securities we owned. To value equity securities for which no market exists, we use the same information we would use for a debt security valuation described above, except risk-rating, as well as standard valuation techniques used by major valuation firms to value the equity securities of private companies. These valuation techniques consist of discounted cash flow of the expected sale price in the future, valuation of the securities based on recent sales in comparable transactions, and a review of similar companies that are publicly traded and the market multiple of their equity securities. At March 31, 2007, September 30, 2006 and September 30, 2005, we had \$146,124, \$37,000 and \$37,000, respectively, invested, at cost, in equity securities compared to our debt portfolio with a cost basis of \$281,379,326, \$216,165,986 and \$205,338,554, respectively.

At March 31, 2007, we had total unrealized depreciation of \$3,037,674, which was mainly comprised of unrealized depreciation of \$1,250,000 on our senior subordinated term debt investment in Visual Edge Technology, Inc., unrealized depreciation of \$733,000, on the aggregate of our investments in LocalTel, Inc. and unrealized depreciation of \$482,488 on our senior subordinated term debt investment in Consolidated Bedding, Inc. Unrealized appreciation of \$1,754,910 was primarily composed of unrealized appreciation of \$789,061 on our warrants in Finn Corporation, a \$180,800 success fee value on our senior term debt investment in Allied Extruders, Inc. and a \$94,219 success fee value on our senior term debt investment in SCPH Holdings, Inc. In the aggregate, we recorded net unrealized depreciation of \$1,282,764 on our total investment portfolio as of March 31, 2007.

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

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

31

Tax Status

Federal Income Taxes

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

Revenue Recognition

Interest Income Recognition

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

Paid in Kind Interest

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

RESULTS OF OPERATIONS

Comparison of the Six Months Ended March 31, 2007 to the Six Months Ended March 31, 2006

Investment Income

Investment income for the six months ended March 31, 2007 was \$16,877,496, as compared to \$13,031,019 for the six months ended March 31, 2006. Interest income from our investment portfolio increased from March 31, 2006 due to the increase in new loans of \$127,641,175, offset by principal repayments and investment sales of

approximately \$62,230,246.

Interest income from our investments in debt securities of private companies was \$16,153,059 for the six months ended March 31, 2007 as compared with \$12,722,371 for the six months ended March 31, 2006, which included approximately \$63,000 of PIK interest. This increase consisted of net new investments of approximately \$65.4 million for the six months ended March 31, 2007, as compared to net new investments of approximately \$1.6 million for the six months ended March 31, 2006. As a result of a refinancing by Badanco Acquisition Corp. and a full repayment by Mistras Holdings Corp., we recorded success fees of approximately \$1,733,000 during the six months ended March 31, 2007.

The annualized weighted average yield on our portfolio for the six months ended March 31, 2007 was 12.6%; there was no PIK interest accrued during the six months ended March 31, 2007. The annualized weighted average yield on our portfolio for the six months ended March 31, 2006 was 12.6% (with and without giving effect to PIK interest).

Interest income from invested cash and cash equivalents for the six months ended March 31, 2007 was \$68,914, as compared to \$13,536 for the six months ended March 31, 2006 due to an increase in cash held in the custodial account which is interest bearing.

For the six months ended March 31, 2007 and March 31, 2006, we recorded \$271,122 and \$214,126, respectively, in interest income from loans to our employees in connection with the exercise of employee stock options. The increase is the result of additional loans issued in connection with employee stock option exercises during the fourth quarter of the previous fiscal year.

For the six months ended March 31, 2007, we recorded \$384,401 of prepayment fees and other income, as compared to \$80,986 for the six months ended March 31, 2006. The income for both periods consisted of prepayment penalty fees received upon the full repayment of certain loan investments ahead of contractual maturity and prepayment fees received upon the early unscheduled principal repayments which, in both instances, were based on a percentage of the outstanding principal amount of the loan at the date of prepayment.

Operating Expenses

Operating expenses, prior to credits from our Adviser, for the six months ended March 31, 2007 were \$8,733,585, as compared to \$4,557,552 for the six months ended March 31, 2006. Operating expenses for the six months ended March 31, 2007 reflected a significant increase in interest expense and management fees, prior to credits, as well as the addition of the incentive and administration fees, prior to credits, under the Amended Advisory and Administration Agreements.

Loan servicing fees of \$1,479,775 were incurred for the six months ended March 31, 2007, as compared to \$1,450,059 for the six months ended March 31, 2006. These fees were incurred in connection with a loan servicing agreement between Business Loan and our Adviser, which is based on the size of the portfolio. These fees were reduced against the amount of the base management fee due to our Adviser.

For the six months ended March 31, 2007, we incurred a gross base management fee of \$848,916, less credits for fees received by our Adviser of \$1,086,000, for a net base management fee credit of \$237,084, as compared to the six months ended March 31, 2006, in which we incurred a gross base management fee of \$621,080, less credits for fees received by our Adviser of \$1,223,000, for a net base management credit of \$601,920. The base management fee is computed quarterly as described under "Investment Advisory and Management Agreement." The fees increased in the current period due to the growth of the investment portfolio as compared to the same period of the prior year and fewer credits for fees received by our Adviser which reduce the base management fee.

Effective October 1, 2006, the income based incentive fee became effective and as such we recorded a gross incentive fee of \$2,307,478, which was reduced by a voluntary waiver issued by our Adviser's board of directors of \$1,657,372, which resulted in a net incentive fee of \$650,106, which is recorded in fees due to Adviser on our consolidated statements of assets and liabilities. There was no incentive fee recorded for the six months ended March 31, 2006, as the Amended Advisory Agreement was not in effect.

Effective October 1, 2006, the Administration Agreement became effective in which we provide payments equal to our allocable portion of our Administrator's overhead expenses in performing its obligations under the Administration Agreement including, but not limited to, rent for employees of our Administrator, and our allocable portion of the salaries and benefits expenses of our chief financial officer, chief compliance officer and controller and their respective staffs. We incurred an administration fee of \$294,851 for the six months ended March 31, 2007. There was no administration fee recorded during the six months ended March 31, 2006, as the Administration Agreement was not in effect.

Professional fees, consisting primarily of legal and audit fees, for the six months ended March 31, 2007 were \$220,001, as compared to \$233,353 for the six months ended March 31, 2006. The slight decrease is due to the reimbursement of certain legal fees at the time of investment funding.

Amortization of deferred financing costs, in connection with our line of credit, was \$126,500 for the six months ended March 31, 2007 and \$58,536 for the six months ended March 31, 2006. The increase is due to the amortization of additional fees incurred with our line of credit which were not in place during the prior year period.

Interest expense for the six months ended March 31, 2007 was \$2,931,276, as compared to \$1,600,244 for the six months ended March 31, 2006. This increase is primarily a result of increased borrowings under our line of credit during the six months ended March 31, 2007, which borrowings were partially used to finance our increased investments, borrowings remaining outstanding for longer periods of time and an increase in the interest rates on our borrowings.

Stockholder related costs for the six months ended March 31, 2007 were \$151,016, as compared to \$244,799 for the six months ended March 31, 2006. Stockholder related costs include such recurring items as transfer agent fees, NASDAQ listing fees, SEC filing fees and annual report printing fees. These fees decreased during the six months ended March 31, 2007 since there was no special proxy solicitation filed as there was during the six months ended March 31, 2006.

Directors' fees for the six months ended March 31, 2007 were \$111,220, as compared to \$54,212 for the six months ended March 31, 2006 due to the increase in annual stipend fees and their related monthly amortization.

Insurance expense for the six months ended March 31, 2007 was \$125,092, as compared to \$101,367 for the six months ended March 31, 2006. The increase is primarily the result of an increase in the amortization of our directors and officers insurance policy premiums.

There was no stock option compensation expense recorded for the six months ended March 31, 2007 as there was no longer a stock option plan in effect. Stock option compensation expense for the six months ended March 31, 2006 was \$77,322 and was the result of the adoption of the SFAS No. 123 (revised 2004) "Share-based Payment."

Other expenses were \$137,460 for the six months ended March 31, 2007, as compared to \$116,580 for the six months ended March 31, 2006. The expenses primarily represent direct expenses such as travel related specifically to our portfolio companies, loan evaluation services for our portfolio companies, press releases and backup servicer expenses.

Income Tax Expense

During the six months ended March 31, 2006, we recorded approximately \$50,000 in connection with penalties incurred on misclassified revenue on its fiscal year 2004

corporate tax return.

Net Realized Gain (Loss) on Sale of Investments

During the six months ended March 31, 2007, we sold or were repaid in full on eleven syndicate loan investments for a net gain of \$86,519, as compared to an aggregate net loss of \$803,095, which was composed of \$1,180,595 loss from the sale of two investments and a gain of \$377,500 from the sale of a syndicate investment during the six months ended March 31, 2006.

Realized Gain on Settlement of Derivative

During the six months ended March 31, 2007, we received interest rate cap agreement payments of \$22,793 as a result of the one month LIBOR, the Prime Rate or the Federal Funds Rate, exceeding 5%.

34

There was no realization during the six months ended March 31, 2006 as the one month LIBOR was below 5%.

Net Unrealized (Depreciation) Appreciation on Derivative

During the six months ended March 31, 2007, we recorded net unrealized depreciation of \$25,613 due to a decrease in the fair market value of our interest rate cap agreement, as compared to unrealized appreciation of \$23,766 during the six months ended March 31, 2006.

Net Unrealized (Depreciation) Appreciation on Investments

For the six months ended March 31, 2007, we recorded net unrealized depreciation on investments of \$2,722,528, as compared to net unrealized appreciation of \$4,956,829, for the six months ended March 31, 2006. The unrealized depreciation is mainly attributable to the depreciated fair value on certain investments.

Net Increase in Net Assets from Operations

Overall, we realized a net increase in net assets resulting from operations of \$8,248,454 for the six months ended March 31, 2007. Based on a weighted-average of 12,272,012 basic and diluted shares outstanding, our net increase in net assets from operations per weighted-average common share for the six months ended March 31, 2007 was \$0.67, basic and diluted.

For the six months ended March 31, 2006, we realized a net increase in net assets resulting from operations of \$13,823,730. Based on a weighted-average of 11,307,510 (basic) and 11,555,479 (diluted) shares outstanding, our net increase in net assets from operations per weighted-average common share for the six months ended March 31, 2006 was \$1.22 (basic) and \$1.20 (diluted).

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

Investment Income

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

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

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

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

35

sales and principal repayments of portfolio investments of approximately \$124 million for the fiscal year ended September 30, 2006.

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

Operating Expenses

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

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

Effective October 1, 2004, we entered into an advisory agreement with our Adviser whereby our Adviser serves as our external adviser. As compensation for the services of our Adviser, we pay our Adviser an annual advisory fee of 1.25% of total assets (as reduced by cash and cash equivalents pledged to creditors), payable in quarterly computed increments of 0.3125%, and an annual administrative fee of 0.75% of total assets (as reduced by cash and cash equivalents pledged to creditors), payable in quarterly computed increments of 0.1875%, for a total fee of 2% of total assets (as reduced by cash and cash equivalents pledged to creditors). Effective in April 2006, our Adviser's board of directors voluntarily waived the advisory fee on a temporary basis by reducing the 1.25% annual fee to 0.5% per annum applicable only to the senior syndicated loans in which we already have a second lien position. We continue to pay direct expenses including, but not limited to, directors' fees, legal and accounting fees, stockholder related expenses, and directors and officers insurance. Under the advisory agreement, our Adviser provides the managerial assistance and other services to our

portfolio companies and likewise our Adviser directly receives any fees for such services. Any such fees are credited directly against the 2% management fee payable to our Adviser. The 2% management fee is also directly reduced by the amount of the monthly loan servicing fees we pay to our Adviser. Overall, the management fee due to our Adviser cannot exceed 2% of total assets (as reduced by cash and cash equivalents pledged to creditors) during any given fiscal year. On October 1, 2006, we entered into the Amended Advisory Agreement with our Adviser and the Administration Agreement with our Administrator.

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

	September 30, 2006	June 30, 2006	March 31, 2006	December 31, 2005
Fee:				
Total assets at	\$ 223,979,932(a)	\$ 207,265,095	\$ 217,404,695	\$ 211,823,244
Less: Senior syndicated loans subject to reduced fee	(11,011,616)(b)	(3,018,897)(b)	—	—
Less: Borrowings under line of credit at	—	—	—	(15,000,000)(c)
Total assets subject to quarterly fee of 0.50% as of	212,968,316	204,246,198	217,404,695	196,823,244
Quarterly fee rate	0.50%	0.50%	0.50%	0.50%
Management fee before senior syndicated loan advisory fee	1,064,841	1,021,231	1,087,023	984,116
Total senior syndicated loan advisory fee at quarterly rate 0.125%	13,765(d)	3,774(d)	—	—
Gross management fee before loan servicing fee credit	1,078,606	1,025,005	1,087,023	984,116
Less: loan servicing fee from Business Loan	763,851	693,965	734,644	715,415
Management fee before credit	314,755	331,040	352,379	268,701
Direct Credit to Management Fee:				
Fee revenue recorded by our Adviser	289,000	539,000	673,000	550,000
Net management fee for the three months ended(e)	\$ 25,755	\$ (207,960)	\$ (320,621)	\$ (281,299)
	September 30, 2005	June 30, 2005	March 31, 2005	December 31, 2004
Fee:				
Total assets	\$ 205,793,094	\$ 209,320,463	\$ 213,753,998	\$ 194,085,591
Less: Borrowings under line of credit	—	—	(18,644,179)(f)	(22,435,000)(f)
Total assets subject to quarterly fee of 0.50% as of	205,793,094	209,320,463	195,109,819	171,650,591
Quarterly fee rate	0.50%	0.50%	0.50%	0.50%
Gross management fee before loan servicing fee credit	1,028,965	1,046,602	975,549	858,254
Less: loan servicing fee from Business Loan	745,263	687,971	585,542	530,952
Management fee before credit	283,702	358,631	390,007	327,302
Direct Credit to Management Fee:				
Fee revenue recorded by our Adviser	100,000	240,600	450,000	286,500
Net management fee for the three months ended	\$ 183,702	\$ 118,031	\$ (59,993)	\$ 40,802

- (a) Excludes amounts due from employees in connection with tax withholdings related to the exercise of non-qualified stock options during the third and fourth quarters of fiscal 2006. (Refer to Note 5 of the "Notes to Consolidated Financial Statements")
- (b) In April 2006, our Adviser's board of directors waived on a temporary basis the annual advisory fee from 1.25% to 0.5% (0.125% quarterly) for those senior syndicated loans in which we also hold a syndicated second lien position.
- (c) This amount represents borrowings under one of our lines of credit that were held in cash and cash equivalents as of December 31, 2005. The \$15.0 million was to be used to fund a new loan investment, however, the investment did not fund until January 2006. Solely for the purposes of calculating the amount of the management fee due to our Adviser, we treat any such amounts as "cash and cash equivalents pledged to creditors" under the terms of our advisory agreement with our Adviser. As a result, such amounts are deducted from our total assets for purposes of computing the asset base upon which the management fee is determined.
- (d) This amount represents the reduced quarterly advisory fee applicable only to the senior syndicated loans.
- (e) If the amount presented is in parentheses it denotes the amount is due back to us from our Adviser; if the amount is positive, it indicates that we owe our Adviser the stated amount.
- (f) This amount represents borrowings under one of our lines of credit that were held in cash and cash equivalents as of March 31, 2005 and December 31, 2004, for the purpose of satisfying our asset diversification requirements under the Code. Solely for the purposes of calculating the amount of the management fee due to our Adviser, we treat any such amounts as "cash and cash equivalents pledged to creditors" under the terms of our advisory agreement with our Adviser. As a result, such amounts are deducted from our total assets for purposes of computing the asset base upon which the management fee is determined.

Professional fees, consisting primarily of legal and audit fees, for the fiscal year ended September 30, 2006 were approximately \$548,000, as compared to approximately

\$725,000 for the fiscal year ended September 30, 2005. The decrease is due primarily to a decrease in non-reimbursable legal fees and extra audit fees in the prior year in connection with internal control procedures.

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

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

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

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

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

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

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

Income Tax Expense

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

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

Realized (Loss) Gain on Sale of Investments

During the fiscal year ended September 30, 2006, we sold our investments in ARI Holdings, Inc. and Marcal Paper Mills, Inc. for an aggregate loss of approximately \$1.18 million and were repaid on several syndicated loans which contained unamortized premiums resulting in realized gains of approximately

\$149,000 for a total net realized loss of approximately \$904,000. During the fiscal year ended September 30, 2005, we sold our \$975,000 syndicated participation in Burt's Bees, Inc. for a gain of \$9,750 and we sold our \$2.0 million syndicated participation in Marietta Corp. for a gain of \$20,000.

Realized Gain on Settlement of Derivative

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

Net Unrealized Depreciation on Derivative

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

Net Unrealized Appreciation (Depreciation) on Investments

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

Net Increase in Net Assets from Operations

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

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

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

Investment Income

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

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

was the result of scheduled principal repayments for one loan containing a PIK provision and an early repayment for another loan containing a PIK provision.

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

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

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

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

Operating Expenses

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

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

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

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

	September 30, 2005	June 30, 2005	March 31, 2005	December 31, 2004
Fee:				
Total assets	\$ 205,793,094	\$ 209,320,463	\$ 213,753,998	\$ 194,085,591
Less: Borrowings under line of credit(a)	—	—	(18,644,179)	(22,435,000)
Total assets subject to quarterly fee	205,793,094	209,320,463	195,109,819	171,650,591

Quarterly fee rate	0.50%	0.50%	0.50%	0.50%
Gross management fee before loan servicing fee credit	1,028,965	1,046,602	975,549	858,254
Less: loan servicing fee from Business Loan	745,263	687,971	585,542	530,952
Management fee before credit	283,702	358,631	390,007	327,302
Direct Credit to Management Fee:				
Fee revenue recorded by our Adviser	100,000	240,600	450,000	286,500
Net management fee for the three months ended	\$ 183,702	\$ 118,031	\$ (59,993)	\$ 40,802

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

Professional fees, consisting primarily of legal and audit fees, for the fiscal year ended September 30, 2005 were approximately \$725,000, as compared to approximately \$580,000 for the fiscal year ended

42

September 30, 2004. The increase is due primarily to an increase in non-reimbursable legal fees and audit costs incurred in connection with internal control procedures.

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

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

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

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

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

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

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

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

43

Income Tax Expense

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

Realized Gain on Sale of Investments

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

Net Unrealized Depreciation on Derivative

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

Net Unrealized Appreciation (Depreciation) on Investments

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

Net Increase in Net Assets from Operations

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

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

LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2007, we had investments in debt securities of, or loans to, 51 private companies, totaling approximately \$281.5 million (cost basis) of total assets.

During the six months ended March 31, 2007 and March 31, 2006, the following investment activity occurred:

Quarter Ended	New Investments	Principal Repayments	Net Gain/(Loss) on Disposal
March 31, 2007	\$ 75,330,167	\$ 38,263,017	\$ 84,205
December 31, 2006	52,311,008	23,967,229	2,314
	<u>\$ 127,641,175</u>	<u>\$ 62,230,246</u>	<u>\$ 86,519</u>
March 31, 2006	\$ 38,471,109	\$ 24,815,067	\$ 377,500
December 31, 2005	26,688,457	38,702,066	(1,180,595)
	<u>\$ 65,159,566</u>	<u>\$ 63,517,133</u>	<u>\$ (803,095)</u>

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

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

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

Fiscal Year Ended September 30,	Amount
2007	\$ 3,467,481
2008	10,569,881
2009	18,976,253
2010	30,422,730
2011	80,548,730
Thereafter	137,540,375
	<u>\$ 281,525,450</u>

Net cash used in operating activities for the six months ended March 31, 2007, consisting primarily of the items described in "Results of Operations" and the investment activity described above, was approximately \$56.5 million as compared to net cash provided by operating activities of approximately \$1.6 million for the six months ended March 31, 2006. Net cash provided by investing activities consisted of \$300,941 and \$23,094 for the six months ended March 31, 2007 and March 31, 2006, respectively, and consisted of the principal repayment of employee loans. Net cash provided by financing activities for the six months ended March 31, 2007 was approximately \$58.5 million and mainly consisted of borrowings on our line of credit of approximately \$146.9 million, offset by repayments on line of credit borrowings of approximately \$76.6 million, and approximately \$10.3 million for the payment of dividends. Net cash used in financing activities was approximately \$1.8 million for the six months ended March 31, 2006 and consisted primarily of net cash provided from borrowings on our line of credit, net of repayments, of approximately \$7.3 million, offset by the payment of dividends of approximately \$9.2 million.

During the six months ended March 31, 2007, cash and cash equivalents increased from approximately \$732,000 to approximately \$3.0 million.

Subsequent to March 31, 2007, we sold either outright or to our affiliate Gladstone Investment approximately \$16.9 million of syndicated loan participations via an independent broker and were repaid in full on one loan origination investment of approximately \$5.6 million and received a success fee of approximately \$195,000. Sales to Gladstone Investment were made in reliance on Rule 17a-7 of the 1940 Act. The proceeds from the sales were used to reduce our borrowings on our line of credit. We also funded approximately \$39.4 million of loan originations, increased our positions in certain syndicate investments by approximately \$4.4 million and funded approximately \$1.0 million of lines of credit already held in our portfolio, for total aggregate funding of approximately \$44.8 million. As of May 11, 2007, our outstanding balance on our line of credit was approximately \$90.2 million.

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

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

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

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

Net cash used in operating activities for the fiscal year ended September 30, 2004, consisting primarily of the items described in "Results of Operations" and the investment activity described above, was approximately \$82.7 million. At September 30, 2004, the net cash used was due largely in part to \$57.1 million used in connection with the purchase of the repurchase agreement and the repayments of the repurchase agreement, and new investments of approximately \$86.3 million, partially offset by principal repayments of \$47.2 million. Net cash provided by investing activities for the fiscal year ended

46

September 30, 2004 was approximately \$0.2 million and consisted of principal repayments on employee loans. Net cash provided by financing activities was approximately \$47.3 million for the fiscal year ended September 30, 2004 and consisted primarily of proceeds from a public shelf offering of common stock which yielded net proceeds of approximately \$24.4 million, the borrowings, net of repayments, on the lines of credit for net proceeds of approximately \$40.7 million, partially offset by the payment of dividends of approximately \$17.1 million.

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

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

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

We anticipate continuing to borrow funds and, from time to time issuing additional equity securities, to obtain additional capital to make further investments. On May 2, 2007, we completed a public offering of 2,000,000 shares of our common stock, at a price of \$24.25 per share, under a shelf registration statement and pursuant to the terms set forth in a prospectus dated April 16, 2007, as supplemented by a final prospectus dated April 27, 2007. Net proceeds of the offering, after underwriting discounts and offering expenses were approximately \$45,625,000 and were used to repay outstanding borrowings under our line of credit.

We have filed a registration statement with the SEC, of which this prospectus is a part, that once declared effective by the SEC, would permit us to issue, through one or more transactions, up to an aggregate of \$300 million in securities, consisting of common stock and/or debt securities. We may not issue any securities under this registration statement until the SEC has declared the registration statement effective, and we currently have no immediate plans to issue any securities under the registration statement.

Revolving Credit Facility

Through our wholly-owned subsidiary, Business Loan, we have a \$170 million revolving credit facility, which we refer to as the DB Facility, with Deutsche Bank AG, as administrative agent, which is scheduled to mature on May 25, 2007. Pursuant to the DB Facility, Business Loan has pledged the loans it holds to secure future advances by certain institutional lenders. Interest rates charged on the advances under the

47

DB Facility will be based on LIBOR, depending on market conditions, and will adjust periodically. As of May 11, 2007, our outstanding principal balance under the DB Facility was approximately \$90.2 million at an interest rate of approximately 6.3%. Available borrowings are subject to various constraints imposed by Deutsche Bank AG, based on the aggregate loan balance pledged by Business Loan, which varies as loans are added and repaid, regardless of whether such repayments are early prepayment or are made as contractually required. At May 11, 2007, the remaining borrowing capacity available under the DB Facility was approximately \$79.8 million.

The DB Facility, which is available for general corporate purposes, contains covenants that, among other things, require Business Loan to maintain its status as a separate entity; prohibit certain significant corporate transactions (such as mergers, consolidations, liquidations or dissolutions); and restrict material changes to our credit and collection policies. The DB Facility also restricts some of the terms and provisions (including interest rates, terms to maturity and payments schedules) and limits the borrower and industry concentrations of loans that are eligible to secure advances. As of March 31, 2007, Business Loan was in compliance with all of the DB Facility covenants. We currently intend to securitize all of the loans held by Business Loan and to use the proceeds from the securitization to pay down any amounts then outstanding under the revolving credit facility. However, there can be no assurance that we will be able to successfully securitize any of these loans on terms acceptable to us, if at all.

The administrative agent also requires that any interest or principal payments on pledged loans be remitted directly by the borrower into a lockbox account with the Bank of New York as custodian. Deutsche Bank AG is also the trustee of the account and once a month remits the collected funds to us. For the six months ended March 31, 2007, the amount due from custodian increased by approximately \$1.2 million.

Our Adviser services the loans pledged under the DB Facility. As a condition to this servicing arrangement, we executed a performance guaranty pursuant to which we guaranteed that our Adviser would comply fully with all of its obligations under the facility. The performance guaranty requires us to maintain a minimum net worth of \$100 million plus 75% of any new equity or subordinated debt issued. The performance guaranty also requires us to maintain "asset coverage" with respect to "senior securities representing indebtedness" of at least 200%, in accordance with Section 18 of the 1940 Act. As of March 31, 2007, we were in compliance with our covenants under the

performance guaranty.

Contractual Obligations and Off-Balance Sheet Arrangements

As of March 31, 2007, we were party to signed and non-binding term sheets for two loan originations for \$14.0 million. We expect to fund these potential investments as follows:

Contractual Obligations	Total	Payment Due by Period			
		Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Investments	\$ 14,000,000	\$ 14,000,000	—	—	—
Total	\$ 14,000,000	\$ 14,000,000	\$—	\$—	\$—

As of the date of this prospectus, one of the investment purchase obligations summarized above in an aggregate amount of \$7.0 million has been funded. See Note 11 “Contractual Obligations” in our unaudited Consolidated Financial Statements for further information.

All prospective investments are subject to, among other things, the satisfactory completion of our due diligence investigation of each borrower, acceptance of terms and structure and receipt of necessary consents. With respect to each prospective loan, we will only agree to provide the loan if, among other things, the results of our due diligence investigations are satisfactory, the terms and conditions of the loan are acceptable and all necessary consents are received. We have initiated our due diligence investigations

48

of the potential borrowers, however, there can be no guarantee that facts will not be discovered in the course of completing the due diligence that would render a particular investment imprudent or that any of these investments will actually be made.

We did not have any significant off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K, as of March 31, 2007.

Quantitative and Qualitative Disclosures about Market Risk.

We are subject to financial market risks, including changes in interest rates. We estimate that ultimately approximately 20% of the loans in our portfolio will be made at fixed rates and approximately 80% will be made at variable rates. As of March 31, 2007, our portfolio had approximately 56% of the total loan portfolio cost basis at variable rates with a floor, approximately 2% of the total loan portfolio cost basis at a variable rate with a floor and ceiling, 40% of the total loan portfolio cost basis at variable rates without a floor or ceiling and approximately 1% of the total loan portfolio cost basis at a fixed rate.

We have a \$170 million revolving credit facility, based on variable rates, with Deutsche Bank AG, which matures May 25, 2007.

In February 2004, we entered into an interest rate cap agreement in order to fulfill an obligation under our line of credit to enter into certain hedging transactions in connection with our borrowings under the line of credit. We purchased this interest rate cap agreement with a notional amount of \$35 million (which is amortized quarterly) for a one-time, up-front payment of \$304,000. The interest rate cap agreement entitles us to receive payments, if any, equal to the amount by which interest payments on the current notional amount at one month LIBOR exceed the payments on the current notional amount at 5%. The cap expires in February 2009. This interest rate cap agreement effectively caps our interest payments on our line of credit borrowing, up to the notional amount of the interest rate cap, at five percent. This mitigates our exposure to increases in interest rates on our borrowings on our lines of credit, which are at variable rates. At March 31, 2007, the cap agreement had a fair market value of \$24,671 and a current notional amount of \$10.9 million. At March 31, 2007, the one month LIBOR rate was approximately 5.32%.

To illustrate the potential impact of changes in interest rates on our net increase in net assets resulting from operations, we have performed the following analysis, which assumes that our balance sheet remains constant and no further actions beyond the interest rate cap agreement are taken to alter our existing interest rate sensitivity. Under this analysis, a hypothetical increase in the one month LIBOR by 1% would increase our net increase in net assets resulting from operations by approximately \$1.5 million or 8.2%, over the next twelve months, compared to the net increase in net assets resulting from operations for the twelve months ended March 31, 2007. A hypothetical decrease in the one month LIBOR by 1% would decrease net increase in net assets resulting from operations by approximately \$1.5 million, or 8.2%, over the next twelve months, compared to the net increase in net assets resulting from operations for the twelve months ended March 31, 2007. Although management believes that this analysis is indicative of our existing interest rate sensitivity, it does not adjust for potential changes in credit quality, size and composition of our loan portfolio on the balance sheet and other business developments that could affect net increase in net assets resulting from operations. Accordingly, no assurances can be given that actual results would not differ materially from the results under this hypothetical analysis.

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

49

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

On October 1, 2006, we implemented an amended and restated investment advisory and management agreement with our Adviser. In addition to providing for a base management fee based on our total assets, this agreement contemplates a quarterly incentive fee based on our pre-incentive fee net investment income and an annual incentive fee based on our capital gains, if any. Our Adviser has the ability to issue a full or partial waiver of the incentive fee for current and future periods, however our Adviser is not required to issue this waiver. If our Adviser does not issue this waiver in future quarters, it could negatively impact our earnings and may compromise our ability to maintain our current level of, or increase, distributions to our stockholders, which could have a material adverse impact on our stock price.

50

BUSINESS

Overview

We were incorporated under the General Corporation Laws of the State of Maryland on May 30, 2001. Our investment objectives are to achieve a high level of current

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

Our Investment Strategy

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

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

Our Investment Adviser and Administrator

Our Adviser is our investment adviser and is led by a management team which has extensive experience in our lines of business. All of our directors and executive officers serve as either directors or executive officers, or both, of Gladstone Commercial, a publicly traded real estate investment trust; Gladstone Investment, a publicly traded business development company; our Adviser; and our Administrator. Our Adviser also has a wholly-owned subsidiary, our Administrator, which employs our chief financial officer, chief compliance officer, controller, treasurer and their respective staffs.

Our Adviser and our Administrator also provide investment advisory and administrative services to our affiliates Gladstone Commercial, Gladstone Investment and Gladstone Land Corporation, an agricultural real estate company owned by Mr. Gladstone. In the future, our Adviser may provide investment advisory and administrative services to other funds, both public and private, of which it is the sponsor.

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

Corporate Information

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

Investment Process

Overview of Loan Origination and Approval Process

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

Prospective Portfolio Company Characteristics

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

- *Growth.* In addition to generating sufficient cash flow to service its debt, a potential borrower generally will be required to establish its ability to grow its cash flow. Anticipated growth will be a key factor in determining the value ascribed to any equity position we acquire in connection with our loans.
- *Significant sponsor.* We seek businesses in which leveraged buyout funds or venture capital funds have invested. We believe that a business in which a substantial equity sponsor has made a meaningful investment is more likely to be a good borrowing candidate.
- *Liquidation value of assets.* Although we do not generally intend to operate as an asset-based lender, liquidation value of the assets collateralizing our loans is an important factor in each credit decision. Emphasis is placed both on tangible assets (e.g., inventory, plant, property and equipment) and intangible assets (e.g., accounts receivable, customer lists, networks, databases and recurring revenue streams).
- *Experienced management team.* We generally require that each borrower have a management team that is experienced and properly incentivized through a significant ownership interest in the borrower. We generally will require that a borrower have, at a minimum, a strong chief executive

officer and chief financial officer who have demonstrated the ability to accomplish the borrower's objectives and implement its business plan.

- *Profitable or near-profitable operations.* We focus on borrowers that are profitable or near-profitable at the operating level. We do not typically lend to, or invest in, start-up or other early stage companies, nor do we typically lend to, or invest in, businesses that are experiencing significant operating problems.
- *Exit strategy.* Prior to making a loan for which we receive a warrant to purchase stock of the borrower or other yield enhancement, we analyze the potential for the borrower to experience a liquidity event that will allow us to realize value for our equity position. Liquidity events include, among other things, an initial public

offering, a private sale of our financial interest, a merger or acquisition of the borrower or a purchase of our equity position by the borrower or one of its stockholders.

Extensive Due Diligence

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

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

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

Investment Structure

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

To the extent possible, our loans generally are collateralized by a security interest in the borrower's assets. In senior and subordinated loans, we do not usually have the first claim on these assets. Interest payments on loans we make will generally be made monthly or quarterly (except to the extent of any PIK interest) with amortization of principal generally being deferred for several years. The principal amount of the loans and any accrued but unpaid interest will generally become due at maturity at five to seven years. We seek to make loans that are accompanied by warrants to purchase stock in the borrowers or other yield enhancement features, such as success fees. Any warrants that we receive will typically have an exercise price equal to the fair value of the portfolio company's common stock at the time of the loan and entitle us

to purchase a modest percentage of the borrower's stock. Success fees are conditional interest that is paid if the borrower is successful. The success fee is calculated as additional interest on the loan and is paid upon the occurrence of certain triggering events, such as the sale of the borrower. If the event or events do not occur, no success fee will be paid.

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

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

Temporary Investments

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

Hedging Strategies

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

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

Extensive Loan Referral Network

Our executive officers and our Adviser's managing directors have an extensive referral network of venture capitalists, leveraged buyout funds, investment bankers, attorneys, commercial bankers and business and financial brokers. We believe that this established network, consisting of relationships established over many years by

Messrs. Gladstone, Stelljes, and Brubaker and our Adviser's managing directors will generate opportunities to identify and make senior and subordinated loans to selected businesses that satisfy our investment criteria. We intend to continue to pursue additional informal relationships with other leveraged buyout funds and venture capital funds that we believe may lead to the origination of loans.

Flexible Transaction Structuring

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

Leverage

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

privileges as it deems appropriate, provided that such an issuance adheres to the requirements of the 1940 Act. See "Regulation as a Business Development Company—Asset Coverage" for a discussion of our leveraging constraints.

Securitization

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

Ongoing Relationships with and Monitoring of Portfolio Companies

Monitoring

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

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

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

Managerial Assistance and Services

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

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

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

Valuation Process

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

- Our quarterly valuation process begins with each portfolio company or investment being initially assessed by our Adviser's investment professionals responsible for the investment, using valuation policies and procedures previously established by our Board of Directors.
- For all debt securities other than those that we value using the latest bid and ask price, we will seek an independent opinion of value of such debt securities from SPSE.
- Preliminary valuation conclusions are then discussed with our management, and documented, along with any SPSE opinions of value, for review by our Board of Directors.
- Our Board of Directors reviews this documentation and discusses the input of our Adviser, management, and the opinions of value of SPSE to arrive at a determination for the aggregate fair value of our portfolio of investments.

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

Investment Advisory and Administration Agreements

Since October 1, 2004, we have been externally managed pursuant to a contractual investment advisory arrangement with our Adviser, under which our Adviser has directly employed all of our personnel and paid its payroll, benefits, and general expenses directly. Our initial investment advisory agreement with our Adviser, which we refer to as the Initial Advisory Agreement, was in place from October 1, 2004 through September 30, 2006. On October 1, 2006, we entered into an amended and restated investment advisory agreement with our Adviser, which we refer to as the Amended Advisory Agreement, and an administration agreement with our Administrator, which we refer to as the Administration Agreement. Our Board of Directors proposed the Amended Advisory Agreement to stockholders in order to provide what it considers to be more appropriate incentives to reward fund

management, and our stockholders approved each of these agreements on December 2, 2005. The management services and fees in effect under the Initial and Amended Advisory Agreements are described below. In addition to the fees described below, certain fees received by our Adviser from our portfolio companies were credited against the investment advisory fee under the Initial Advisory Agreement, and will continue to be paid to our Adviser and credited under the Amended Advisory Agreement. In addition, we continue to pay our direct expenses including, but not limited to, directors fees, legal and accounting fees, and stockholder related expenses under the Amended Advisory Agreement.

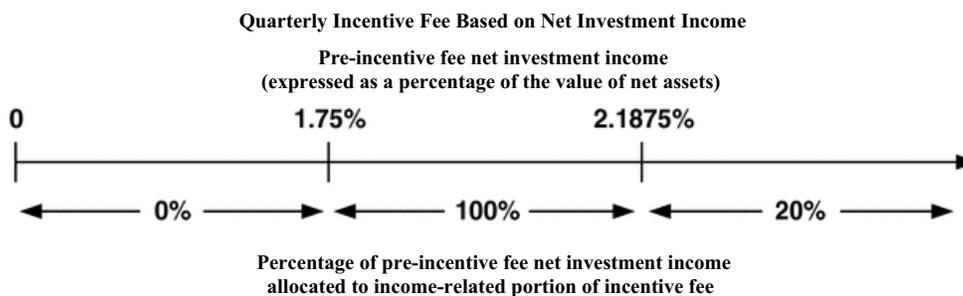
Management services and fees in effect through September 30, 2006

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

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

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

- no incentive fee in any calendar quarter in which our pre-incentive fee net investment income does not exceed the hurdle rate (7% annualized);
- 100% of our pre-incentive fee net investment income with respect to that portion of such pre-incentive fee net investment income, if any, that exceeds the hurdle rate but is less than 2.1875% in any calendar quarter (8.75% annualized); and
- 20% of the amount of our pre-incentive fee net investment income, if any, that exceeds 2.1875% in any calendar quarter (8.75% annualized).



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

Our Adviser's board of directors agreed to waive, for the fiscal quarters ending December 31, 2006 and March 31, 2007, the annual 2.0% base management fee to 0.5%

for senior syndicated loan participations.

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

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

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

License Agreement

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

Code of Ethics

We and our Adviser have each adopted a Code of Ethics and Business Conduct applicable to our officers, directors and all employees of our Adviser and our Administrator that comply with the guidelines set forth in Item 406 of Regulation S-K of the Securities Act. As required by the 1940 Act, this code establishes procedures for personal investments, restricts certain transactions by our personnel and

59

requires the reporting of certain transactions and holdings by our personnel. A copy of this code is available for review, free of charge, at our website at www.gladstonecapital.com. We intend to provide disclosure of any amendments to or waivers of the provisions of this code by posting information regarding any such amendment or waiver to our website within four days of its effectiveness.

Compliance Policies and Procedures

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

Competition

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

Staffing

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

60

As of April 30, 2007, our Adviser and our Administrator had 52 full-time employees. A breakdown of these full-time employees is summarized by functional area in the table below:

Number of Individuals	Functional Area
6	Executive Management
36	Investment Management, Portfolio Management, and Due Diligence

Properties

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

Legal Proceedings

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

61

PORTFOLIO COMPANIES

The following table sets forth certain information as of March 31, 2007, regarding each portfolio company in which we had a debt or equity security as of such date. All such investments have been made in accordance with our investment policies and procedures described in this prospectus.

<u>Company(1)</u>	<u>Industry</u>	<u>Investment(2)</u>	<u>Cost</u>	<u>Fair Value</u>
ActivStyle Acquisition Co. ActivStyle, Inc. 3100 Pacific Street North Minneapolis, MN 55411	Service-medical products distribution	Line of Credit(5)(9) (9.6%, Due 7/2009) Senior Term Debt(5) (9.6%, Due 7/2011) Senior Term Debt(3)(5) (11.9%, Due 7/2011)	\$ 450,000 3,040,000 2,500,000	\$ 448,875 3,040,000 2,500,000
Advanced Homecare Management, Inc. 7502 Greenville Ave., Suite 100 Dallas, TX 75231	Service-home health nursing services	Senior Subordinated Term Debt(5)(6) (11.8%, Due 12/2013)	6,300,000	6,300,000
Allied Extruders, LLC P&O Packaging Acquisition LLC 36-08 Review Avenue Long Island City, NY 11101	Manufacturing-polyethylene film	Senior Real Estate Term Debt (9.8%, Due 3/2011) Senior Term Debt (3)(5)(19) (11.3%, Due 3/2011)	1,000,000 8,000,000	1,000,000 8,170,800
Anitox Acquisition Company Anitox Holding, Inc. Anitox Corporation 1055 Progress Circle Lawrenceville, GA 30043	Manufacturing-preservatives for animal feed	Senior Real Estate Term Debt (8.8%, Due 1/2012) Senior Term Debt(5) (9.6%, Due 1/2012) Senior Term Debt(3)(5) (11.8%, Due 1/2012)	3,415,828 2,750,000 2,750,000	3,360,000 2,750,000 2,750,000
Badanco Acquisition Corp. 994 Riverview Drive Totowa, NJ 07512	Service-luggage design and distribution	Senior Subordinated Term Debt(5) (12.1%, Due 7/2012)	9,750,000	9,762,188
Benetech, Inc. 1851 Albright Rd. Montgomery, IL 60538	Service & Manufacuring-dust management systems for the coal and electric utility industries	Senior Term Debt(5) (10.3%, Due 5/2009) Senior Term Debt(3)(5) (13.3%, Due 5/2009)	1,787,500 2,965,625	1,816,547 3,028,645
Bresnan Communications, LLC One Manhattanville Rd. Purchase, NY 10577-2596	Service-telecommunications	Senior Term Debt(6) (7.1%, Due 9/2013) Senior Subordinated Term Debt(6) (9.9%, Due 3/2014)	1,001,958 1,510,780	1,000,000 1,530,000
CHG Companies, Inc. CHG Medical Staffing, Inc. CHG Healthcare East, Services, Inc. 4021 South 700 Suite 300 Salt Lake City, UT 84107	Service-healthcare staffing	Letter of Credit(5)(6) (7.9%, Due 12/2012) Senior Term Debt(5)(6) (7.9%, Due 12/2012) Senior Subordinated Term Debt(5)(6) (11.3%, Due 12/2012)	400,000 1,596,000 500,000	404,500 1,613,955 507,500
Clinton Holdings, LLC Clinton Aluminum Acquisition, LLC Metal Transportation, LLC Clinton Distribution Center, LLC Clinton Aluminum 6270 Van Buren Road Clinton, OH 44216	Distribution-aluminum sheets and stainless steel	Senior Subordinated Term Debt(5) (12.6%, Due 1/2013) Common Stock Warrants(7)	15,500,000 109,124	15,538,750 109,124
Consolidated Bedding, Inc. 500 S. Falkenburg Road Tampa, FL 33619	Manufacturing-mattresses	Senior Subordinated Term Debt(5) (14.4%, Due 3/2009)	2,340,538	1,858,050

62

Country Road Communications LLC Country Road Management, Inc. 1500 Mt. Kemble Avenue, Suite 203 Morristown, NJ 07960	Service-telecommunications	Senior Subordinated Term Debt (5) (6) (13.2%, Due 7/2013)	5,964,420	6,030,000
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Critical Healthcare Solutions, Inc. Two Tower Building One Fayette Street Suite 150 Conshohocken, PA 19428	Service-home therapy and respiratory therapy	Senior Term Debt(8) (8.6%, Due 1/2012)	1,987,500	1,986,258
Dealer Computer Services, Inc. (d/b/a Reynolds & Reynolds) The Reynolds and Reynolds Company One Reynolds Way Dayton, OH 45430	Manufacturing & Service Systems for automotive retailers	Senior Term Debt(8) (7.4%, Due 10/2012)	947,240	954,936
Defiance Acquisition Corporation 1090 Perry Street Defiance, OH 43512	Manufacturing-trucking parts	Senior Term Debt(3)(5) (13.3%, Due 4/2010)	6,325,000	6,317,094
Doe & Ingalls Management LLC Doe & Ingalls of North Carolina Operating LLC Doe & Ingalls of Florida Operating LLC Doe & Ingalls of Virginia Operating LLC Doe & Ingalls of Maryland Operating LLC 1301 Person Street Durham, NC 27703	Distributor-specialty chemicals	Senior Term Debt(5) (9.8%, Due 11/2010) Senior Term Debt(3)(5) (13.3%, Due 11/2010)	4,300,000 4,477,500	4,310,750 4,483,097
Emdeon Business Services, Inc. 26 Century Blvd. Nashville, TN 37214	Service-healthcare technology solutions	Senior Term Debt(6) (7.6%, Due 11/2013) Senior Subordinated Term Debt(6) (10.4%, Due 5/2014)	2,479,803 2,013,952	2,486,483 2,030,000
Employment Solutions Management, Inc. Employbridge 1040 Crown Pointe Parkway Suite 1040 Atlanta, GA 30338	Service-specialty staffing	Senior Term Debt(8) (8.3%, Due 10/2012) Senior Subordinated Term Debt(8) (12.3%, Due 10/2013)	2,992,989 3,000,495	2,996,241 3,000,000
Express Courier International, Inc. P.O. Box 290279 Nashville, TN 37229-0279	Service-ground delivery and logistics	Line of Credit(10) (9.6%, Due 6/2009) Senior Term Debt(5) (9.6%, Due 6/2011) Senior Term Debt(3)(5) (11.8%, Due 6/2011)	200,000 4,465,000 3,950,000	200,000 4,470,581 3,954,938
Finn Corporation 9281 Lesaint Drive Fairfield, OH 45014	Manufacturing-landscape equipment	Common Stock Warrants	37,000	826,061
FR X Ohmstede Holdings, LLC FR X Ohmstede Acquisitions Co. Ohmstede Ltd. 895 North Main Street P.O. Box 2431 Beaumont, TX 77701	Service & Manufacturing-heat exchangers	Senior Term Debt(6) (7.9%, Due 8/2013) Senior Subordinated Term Debt(6) (12.4%, Due 8/2014)	2,739,130 3,011,583	2,749,402 3,052,500

Generac Acquisition Corp. Hwy. 59 & Hillside Road P.O. Box 8 Waukesha, WI 53187	Manufacturing-standby power products	Senior Term Debt(8) (7.9%, Due 11/2013)	2,356,200	2,375,344
Global Materials Technologies, Inc. 1540 E. Dundee Road Palatine, IL 60067	Manufacturing-steel wool products and metal fibers	Senior Term Debt(3)(5) (14.3%, Due 11/2009)	5,200,000	5,018,000
GTM Holdings, Inc. Gold Toe Investment Corp. 514 West 21st Street P.O. Box 580 Newton, NC 28658	Manufacturing-socks	Senior Term Debt(6) (8.1%, Due 10/2013) Senior Subordinated Term Debt(6) (11.4%, Due 4/2014)	498,750 507,500	501,244 507,500
Greatwide Logistics Services, Inc. 5215 N. O'Connor Boulevard Suite 200 Irving, TX 75039	Service - logistics and transportation	Senior Term Debt(6) (8.6%, Due 12/2013) Senior Subordinated Term Debt(6) (11.9%, Due 6/2014)	3,990,000 4,000,000	4,009,950 3,960,000
Harrington Holdings, Inc. Harrington Acquisition Corp. 1810 Summit Conference Park Twinsburg, OH 44087	Service - healthcare products distribution	Senior Term Debt(6) (7.8%, Due 1/2014) Senior Subordinated Term Debt(6) (11.3%, Due 1/2014)	2,500,000 5,000,000	2,506,250 5,025,000
Hudson Products Holdings, Inc. 1307 Soldiers Field Drive Sugar Land, TX 77479	Manufacturing-heat transfer solutions	Senior Term Debt(8) (8.1%, Due 12/2013)	2,141,257	2,148,664
IPC Information Systems, LLC 88 Pine Street Wall Street Plaza New York, NY 10005	Manufacturing-specialized telephony systems	Senior Term Debt(6) (7.9%, Due 9/2013)	236,810	238,290
It's Just Lunch International, LLC 44-489 Town Center Way Suite 500 Palm Desert, CA 92260	Service-dating service	Line of Credit(5)(11) (9.3%, Due 6/2009)	550,000 3,300,000	545,875 3,275,250

		Senior Term Debt(5) (9.6%, Due 6/2011)		
		Senior Term Debt(3)(5)(11) (11.8%, Due 6/2011)	500,000	496,250
John Henry Holdings, Inc. Multi Packaging Solutions, Inc. 5800 W. Grand River Ave PO Box 17099 Lansing, MI 48901	Manufacturing-packaging products	Senior Subordinated Term Debt(6) (12.3%, Due 6/2011)	8,000,000	8,000,000
Kinetek Acquisition Corp. ArborLake Center, Suite 550 1751 Lake Cook Road Deerfield, IL 60015	Manufacturing-custom engineered motor & controls	Senior Term Debt(6) (7.8%, Due 11/2013)	1,505,605	1,507,157
		Senior Subordinated Term Debt(6) (10.8%, Due 5/2014)	1,509,548	1,515,000
LocalTel, Inc. 210 Bear Hill Rd. Suite 400 Waltham, MA 02451	Service-yellow pages publishing	Line of Credit(5)(12) (9.8%, Due 6/2009)	1,035,000	983,250
		Senior Term Debt(5) (9.8%, Due 6/2011)	2,687,500	2,418,750
		Senior Term Debt(3)(5) (12.3%, Due 6/2011)	2,750,000	2,337,500
MediMedia USA Inc. 26 Main Street, 1st Floor Chatham, NJ 07928	Service-healthcare and pharmaceutical marketing	Senior Term Debt(8) (7.8%, Due 10/2013)	1,074,835	1,075,667

64

Meteor Holding Corporation Metrologic Instruments, Inc. Metrologic Instruments, Inc. 90 Coles Road Blackwood, NJ 08012-4683	Manufacturing-bar code scanning and data capture	Senior Term Debt(6) (8.1%, Due 12/2013)	997,500	1,002,488
		Senior Subordinated Term Debt(6) (11.8%, Due 12/2013)	500,000	505,000
Northern Contours Northern Contours of Kentucky, Inc. Norcon Holding LLC Norcon Lewis LLC 409 South Roberts Street Fergus Falls, MN 56537	Manufacturing-veneer and laminare components	Senior Subordinated Term Debt(5) (12.3%, Due 5/2010)	7,000,000	7,026,250
Pinnacle Treatment Centers, Inc. 59 31st Street Pittsburgh, PA 15201	Service-Addiction treatment centers	Line of Credit(13) (9.6%, Due 12/2009)	—	—
		Senior Term Debt(5) (9.6%, Due 12/2011)	2,500,000	2,500,000
		Senior Term Debt(3)(5) (12.3%, Due 12/2011)	4,500,000	4,500,000
Precision Acquisition Group Holdings, Inc. Precision Asset Acquisition Company, LLC 435 Burt Street Sistersville, WV 26175	Manufacturing-consumable components for the aluminum industry	Equipment Note(14) (9.8%, Due 10/2011)	—	—
		Senior Term Debt(5) (9.8%, Due 10/2010)	5,000,000	5,012,500
		Senior Term Debt(3)(5) (11.8%, Due 10/2010)	4,200,000	4,210,500
PROFITSystems Acquisition Co. PROFITSystems, Inc. 422 E. Vermijo Avenue Suite 100 Colorado Springs, CO 80903	Service-design and develop ERP software	Line of Credit(15) (9.6%, Due 7/2009)	—	—
		Senior Term Debt(5) (9.6%, Due 7/2011)	2,950,000	2,957,375
		Senior Term Debt(3)(5) (11.8%, Due 7/2011)	2,900,000	2,907,250
Puerto Rico Cable Acquisition Company, Inc. 996 Street San Roberto Reparto Loyola, Bo. Monacillos San Juan, PR 00926	Service-telecommunications	Senior Subordinated Term Debt(5) (11.6%, Due 1/2012)	7,805,906	7,794,524
Rally Parts, Inc. Motorsport Aftermarket Group, Inc. 2146 Michelson Drive, Suite B Irvine, CA 92612	Manufacturing-aftermarket motorcycle parts and accessories	Senior Term Debt(8) (7.9%, Due 11/2013)	1,193,021	1,198,153
RCS Management Holding Co. 16535 Southpark Drive Westfield, IN 46074	Service-healthcare supplies	Senior Term Debt(3)(5) (9.8%, Due 1/2011)	3,000,000	2,925,000
		Senior Term Debt(4)(5) (12.3%, Due 1/2011)	3,000,000	2,910,000
RedPrairie Holding, Inc. RedPrairie Corporation Blue Cube Software, Inc. 20700 Swenson Drive Waukesha, WI 53186	Service-design and develop supply chain software	Senior Term Debt(6) (8.4%, Due 7/2012)	4,480,000	4,480,000
		Senior Subordinated Term Debt(6) (11.9%, Due 1/2013)	3,000,000	3,030,000
RiskMetrics Group Holdings, LLC One Chase Manhattan Plaza 44th Floor New York, NY 10005	Service - develop risk and wealth management solutions	Senior Term Debt(6) (7.6%, Due 1/2014)	2,000,000	2,012,500
		Senior Subordinated Term Debt(6) (10.6%, Due 7/2014)	500,000	507,500

65

RMK Acquisition Corporation ARAMARK Corporation 1101 Market Street Philadelphia, PA 19107	Service - vending services	Letter of Credit (8) (7.5%, Due 1/2014) Senior Term Debt(8) (7.5%, Due 1/2014)	65,841 921,289	66,171 925,895
SCPH Holdings, Inc. Sea Con Phoenix, Inc. Phoenix Optix, Inc. 52 Airport Road Westerly, RI 02891	Manufacturing-underwater and harsh environment components	Credit Facility(5)(16) (9.8%, Due 2/2008) Senior Term Debt(5) (10.3%, Due 2/2010) Senior Term Debt(3)(5)(20) (13.3%, Due 2/2010)	500,000 2,275,000 2,812,500	500,000 2,277,844 2,913,750
SCS Acquisition Corp. (d/b/a Specialty Coatings Systems) 7645 Woodland Drive Indianapolis, IN 46278	Service-chemically treated equipment distribution	Senior Term Debt(5)(17) (9.3%, Due 12/2011) Senior Term Debt(3)(5)(17) (11.3%, Due 12/2011)	5,625,000 6,550,000	5,632,031 6,558,188
Thibaut Acquisition Co. 480 Frelinghuysen Avenue Newark, NJ 07114	Service-design and distribute wall covering	Credit Facility(5)(18) (9.8%, Due 1/2011) Senior Term Debt(5) (9.8%, Due 1/2011) Senior Term Debt(3)(5) (12.3%, Due 1/2011)	500,000 3,062,500 3,000,000	500,000 3,066,328 3,003,750
Visual Edge Technology, Inc. Graphic Enterprises, Inc. Copeco, Inc. 3874 Highland Park NW North Canton, OH 44720	Service-office equipment distribution	Senior Subordinated Term Debt(5) (13.3%, Due 8/2011)	5,000,000	3,750,000
Wesco Holdings, Inc.	Service-aerospace parts and distribution	Senior Term Debt(6) (7.6%, Due 9/2013) Senior Subordinated Term Debt(6) (11.1%, Due 3/2014)	2,525,125 2,272,298	2,518,750 2,295,000
Wesco Aircraft Hardware Corp. 27727 Avenue Scott Valencia, CA 91355				
Westlake Hardware, Inc. WHI Holding Corp. 14000 Marshall Dr. Lenexa, KS 66215	Retail-hardware and variety	Senior Subordinated Term Debt(5) (12.6%, Due 1/2011)	15,000,000	14,943,750
Winchester Electronics 62 Barnes Industrial Road North Wallingford, CT 06492	Manufacturing-high bandwidth connectors and cables	Senior Term Debt(3)(5) (12.3%, Due 6/2012)	6,000,000	6,015,000
WP Evenflo Group Holdings Inc. WP Evenflo Acquisition, Inc. 707 Crossroads Court Vandalia, OH 45377	Manufacturing-infant and juvenile products	Senior Term Debt(6) (7.8%, Due 2/2013) Senior Subordinated Term Debt(6) (11.3%, Due 2/2014)	1,995,000 2,000,000	2,004,975 2,010,000
Total:			\$281,525,450	\$280,242,688

(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) Percentage represents interest rates in effect at March 31, 2007 and due date represents the contractual maturity date.

(3) 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.

(4) 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, however the debt is junior to another Last Out Tranche.

(5) Fair value was based on opinions of value submitted by Standard & Poor's Securities Evaluations, Inc.

(6) Marketable securities, such as syndicated loans, are valued based on the indicative bid price, as of March 30, 2007, from the respective originating syndication agent's trading desk.

(7) Investment valued at cost due to recent acquisition.

(8) Investment valued at pending trade amount.

(9) Availability under the credit facility totals \$1,500,000. Borrowings of \$450,000 were outstanding at March 31, 2007.

(10) Availability under the credit facility totals \$1,500,000. Borrowings of \$200,000 were outstanding at March 31, 2007.

(11) Remaining availability under the revolving credit facility totals \$200,000, borrowings of \$550,000 were outstanding at March 31, 2007. The company may borrow an additional \$1,750,000 of the senior term debt facility, subject to certain conditions including Gladstone Capital's approval, borrowings of \$500,000 were outstanding at March 31, 2007.

(12) Availability under the credit facility totals \$2,000,000. Borrowings of \$1,035,000 were outstanding at March 31, 2007.

(13) Availability under the credit facility totals \$500,000. There were no borrowings outstanding at March 31, 2007.

(14) The company may borrow up to \$1,000,000 for purposes of acquiring equipment. There were no borrowings outstanding at March 31, 2007.

(15) Availability under the credit facility totals \$1,250,000. There were no borrowings outstanding at March 31, 2007.

(16) Availability under the credit facility totals \$500,000. Borrowings of \$500,000 were outstanding at March 31, 2007.

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

(18) Availability under the credit facility totals \$1,000,000. Borrowings of \$500,000 were outstanding at March 31, 2007.

(19) Includes a success fee with a \$180,800 fair value and no cost basis.

(20) Includes a success fee with a \$94,219 fair value and no cost basis.

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

Sunshine Media Holdings Corp.

In May 2007, we loaned \$27.8 million to Sunshine Media Holdings Corp. and its subsidiaries, which we refer to collectively as Sunshine. The investment consists of a three-year revolving line of credit with an available capacity of \$3 million; a five-year senior term loan in the amount of \$17 million; and a five-year senior subordinated term loan in the amount of \$10 million. Amounts outstanding on the revolving line of credit are due in full at its maturity, which is May 14, 2010. The senior term loan is to be repaid over the life of the loan through annual payments equal to 50% of Sunshine's excess cash flow (as defined in the note), if any, with the remaining balance due at its maturity, which is May 14, 2012. The senior subordinated term loan is due in full at its maturity, which is May 14, 2012. The interest rate for the revolving line of credit and senior term loan is LIBOR plus 4% with a floor of 9%. The interest rate on the senior subordinated loan is LIBOR plus 6.5% with a floor of 11.5%. The senior subordinated loan also includes a provision for a 2.5% exit fee, which is payable upon repayment of the loan.

Sunshine is a Phoenix-based publisher of regional trade magazine and custom publications. The company publishes 186 regional publications under the *MD News*, *Doctor of Dentistry*, *Builder/Architect*, and *Real Estate Executive* brands. Additionally, the company also produces 135 sponsored, custom publications for the community hospital market.

Because of the relative size of this investment, we are significantly exposed to the risks associated with Sunshine's business. In particular, Sunshine has significant exposure to advertising cyclicality. Advertising spending is a leading indicator of general economic health, and more than half of Sunshine's revenues are advertising-based. Additionally, approximately one-third of Sunshine's publications cover the real estate and construction industry. There is a risk that poor performance of Sunshine's end market could impact

67

spending on advertising and sponsorships, which could have a material adverse impact on Sunshine and the value of our investment in Sunshine.

Sunshine's principal executive offices are located at 8283 N. Hayden Rd., Scottsdale, Arizona 85258.

Subsequent Portfolio Activity

Subsequent to March 31, 2007, we sold either outright or to our affiliate Gladstone Investment approximately \$16.9 million of syndicated loan participations via an independent broker and were repaid in full on one loan origination investment of approximately \$5.6 million and received a success fee of approximately \$195,000. Sales to Gladstone Investment were made in reliance on Rule 17a-7 of the 1940 Act. The proceeds from the sales were used to reduce our borrowings on our line of credit. We also funded approximately \$39.4 million of loan originations, including our investment in Sunshine discussed above, increased our positions in certain syndicate investments by approximately \$4.4 million, and funded approximately \$1.0 million of lines of credit already held in our portfolio, for total aggregate funding of approximately \$44.8 million.

Certain Subsidiaries

We have a wholly-owned small business investment company subsidiary, Gladstone SSBIC Corporation, which we refer to as SSBIC. SSBIC is neither regulated as an investment company or a business development company under the 1940 Act. Currently, less than 1% of our consolidated assets are invested in SSBIC, and SSBIC has not made any investments to date.

68

MANAGEMENT

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

Board of Directors

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

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

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- (1) Interested person as defined in Section 2(a)(19) of the 1940 Act.
 - (2) Member of the executive committee.
 - (3) Member of the audit committee.
 - (4) Member of the ethics, nominating, and corporate governance committee.
 - (5) Member of the compensation committee.

Executive Officers Who Are Not Directors

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

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

Independent Directors (in alphabetical order)

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

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

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

Michela A. English. Ms. English has served as director since June 2002. Ms. English is President and CEO of Fight for Children, a non-profit charitable organization focused on providing high quality education and health care services to underserved youth in Washington, D.C. Ms. English has also been a director of Gladstone Commercial since August 2003, and a director of Gladstone Investment since June 2005. From March 1996 to March 2004, Ms. English held several positions with Discovery Communications, Inc., including president of Discovery Consumer Products, president of Discovery Enterprises Worldwide and president of Discovery.com. From 1991 to 1996, Ms. English served as senior vice president of the National Geographic Society and was a member of the National Geographic Society's

Board of Trustees and Education Foundation Board. Prior to 1991, Ms. English served as vice president, corporate planning and business development for Marriott Corporation and as a senior engagement manager for McKinsey & Company. Ms. English currently serves as director of the Educational Testing Service (ETS), as a director of D.C. Preparatory Academy, and as a member of the Virginia Institute of Marine Science Council. Ms. English is an emeritus member of the board of Sweet Briar College. Ms. English holds a Bachelor of Arts in International Affairs from Sweet Briar College and a Master of Public and Private Management degree from Yale University's School of Management.

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

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

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

Interested Directors

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

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

72

planning manager and marketing manager of white papers at Boise Cascade. Previously, Mr. Brubaker was a senior engagement manager at McKinsey & Company from 1972 to 1976. Mr. Brubaker holds an MBA from the Harvard Business School and a BSE from Princeton University.

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

Executive Officers Who Are Not Directors

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

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

Employment Agreements

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

73

Director Independence

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

Select Market, as in effect from time to time.

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

Committees of Our Board of Directors

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

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

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

74

with our compensation philosophies and the performance of our Adviser, are reasonable in relation to the nature and quality of services performed, and whether the provisions of the Advisory and Administration Agreements are being satisfactorily performed. The compensation committee met four times during the last fiscal year.

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

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

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

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

75

Compensation of Executive Officers and Directors

Executive Compensation

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

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

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

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

76

Compensation of Directors

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

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

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

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

77

Deferred Compensation Plan

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

Certain Transactions

Advisory and Administration Agreements

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

On October 1, 2006 we entered into the Amended Advisory Agreement with our Adviser and the Administration Agreement with our Administrator. The Amended Advisory Agreement provides for an annual base management fee equal to 2% of our assets and an income-based incentive fee which rewards our Adviser if our quarterly net

investment income (before giving effect to the incentive fee) exceeds 1.75% of our net assets (the “hurdle rate”). We will pay our Adviser an income incentive fee with respect to its pre-incentive fee net investment income in each calendar quarter as follows:

- no incentive fee in any calendar quarter in which our pre-incentive fee net investment income does not exceed the hurdle rate (7% annualized);
- 100% of our pre-incentive fee net investment income with respect to that portion of such pre-incentive fee net investment income, if any, that exceeds the hurdle rate but is less than 2.1875% in any calendar quarter (8.75% annualized); and
- 20% of the amount of our pre-incentive fee net investment income, if any, that exceeds 2.1875% in any calendar quarter (8.75% annualized).

The Amended Advisory Agreement also provides for a capital gains-based incentive fee, whereby our Adviser receives a fee equal to 20% of our realized capital gains (net of realized capital losses and unrealized capital depreciation). Under the Administration Agreement, we pay separately for our allocable portion of our Administrator’s overhead expenses in performing its obligations, including, but not limited to, rent, and our allocable portion of the salaries and benefits expenses of our chief financial officer, treasurer, chief compliance officer, controller and their respective staff. Based on an analysis of publicly

available information, the board believes that the terms and the fees payable under both the Amended Advisory Agreement and the Administration Agreement are similar to those of the agreements of other business development companies that do not have equity incentive plans with their external investment advisers.

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

Loans

At March 31, 2007, we had loans outstanding in the principal amount of \$5,900,010 to Mr. Gladstone, \$1,400,010 to Mr. Brubaker and \$150,000 to Mr. Brill, each of whom is an executive officer of ours. These loans were extended in connection with the exercise of stock options by each of the executive officers. Each such loan is evidenced by a full recourse promissory note secured by the shares of common stock purchased upon the exercise of the options. The interest rate on each such loan is 4.9% per annum. Interest is due quarterly and each of the executive officers has made each of his quarterly interest payments to date. The outstanding principal amount of each loan is due and payable in cash on August 23, 2010. The Sarbanes-Oxley Act of 2002 prohibits us from making loans to our executive officers, although certain loans outstanding prior to July 30, 2002, including the promissory notes we have received from Messrs. Gladstone, Brubaker and Brill, were expressly exempted from this prohibition. In addition, these loans meet the requirements set forth in Section 57(j) of the 1940 Act.

Also at March 31, 2007, we had two loans outstanding in the principal amounts of \$275,010 and \$474,990, respectively, to Laura Gladstone, a managing director of ours and the daughter of our chief executive officer, Mr. Gladstone. These loans were extended in connection with the exercise of stock options under the 2001 Plan by Ms. Gladstone, and were made on terms available to all eligible participants of the 2001 Plan. The interest rates on the loans are 4.9% and 8.26%, respectively, and the outstanding principal amounts of each loan are due and payable in cash on August 23, 2010 and July 13, 2015, respectively. Mr. Gladstone has not received, nor will he receive in the future, any direct or indirect benefit from these loans.

Indemnification

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

License Agreement

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

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

CONTROL PERSONS AND PRINCIPAL STOCKHOLDERS

The following table sets forth, as of May 11, 2007 (unless otherwise indicated), the beneficial ownership of each current director, each of the executive officers, the executive officers and directors as a group and each stockholder known to our management to own beneficially more than 5% of the outstanding shares of common stock. Except as otherwise noted, the address of the individuals below is c/o Gladstone Capital Corporation, 1521 Westbranch Drive, Suite 200, McLean, VA 22102.

Name and Address	Number of Shares	Percent of Total	Beneficial Ownership(1) Dollar Range of Equity Securities of the Company Owned by Directors and Executive Officers(2)	Aggregate Dollar Range of Equity Securities of all Funds by Directors and Executive Officers in Family of Investment Companies(2)(3)
Executive Officers and Directors:				

David Gladstone(4)	1,001,493	7.03%	Over \$100,000	Over \$100,000
Terry Lee Brubaker(5)	196,024	1.38%	Over \$100,000	Over \$100,000
George Stelljes III	4,069	*	\$ 50,001 – \$100,000	Over \$100,000
Harry T. Brill, Jr.(6)	10,500	*	Over \$100,000	Over \$100,000
Gary Gerson	0	*	None	\$10,001 – \$50,000
Anthony W. Parker	4,169	*	\$ 50,001 – \$100,000	Over \$100,000
David A.R. Dullum	2,037	*	\$10,001 – \$50,000	Over \$100,000
Michela A. English	2,500	*	\$ 50,001 – \$100,000	Over \$100,000
Paul Adelgren	1,008	*	\$10,001 – \$50,000	\$10,001 – \$50,000
Maurice Coulon	0	*	None	\$10,001 – \$50,000
John H. Outland	1,000	*	\$10,001 – \$50,000	\$ 50,001 – \$100,000
Gerard Mead	817	*	\$10,001 – \$50,000	\$10,001 – \$50,000
All executive officers and directors as a group (12 persons)	1,223,617	8.59%	n/a	n/a

* Less than 1%

- (1) This table is based upon information supplied by officers, directors and principal stockholders. Unless otherwise indicated in the footnotes to this table and subject to community property laws where applicable, we believe that each of the stockholders named in this table has sole voting and sole investment power with respect to the shares indicated as beneficially owned. Applicable percentages are based on 14,249,683 shares outstanding on May 11, 2007.
- (2) Ownership calculated in accordance with Rule 16a-1(a)(2) of the Exchange Act. The dollar range of our equity securities beneficially owned is calculated by multiplying the closing price of Common Stock as reported on The Nasdaq Global Select Market as of May 11, 2007, times the number of shares beneficially owned.
- (3) Each of our directors and executive officers is also a director or executive officer, or both, of Gladstone Investment, our affiliate and a business development company, and Gladstone Commercial, our affiliate and a real estate investment trust, each of which is also externally managed by our Adviser.
- (4) 393,334 of these shares of common stock are pledged to us as security for a promissory note issued in connection with Mr. Gladstone's acquisition of these shares through a stock option exercise on August 23, 2001. Mr. Gladstone retains voting power with respect to these shares.

81

- (5) 177,500 of these shares of common stock are pledged to secure indebtedness incurred for their acquisition, including 93,334 shares that are pledged to us as security for a promissory note issued in connection with Mr. Brubaker's acquisition of these shares through a stock option exercise on August 23, 2001. Mr. Brubaker retains voting power with respect to these shares.
- (6) 10,000 of these shares of common stock are pledged to us as security for a promissory note issued in connection with the acquisition of these shares through a stock option exercise on August 23, 2001. Mr. Brill retains voting power with respect to these shares.

82

DIVIDEND REINVESTMENT PLAN

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

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

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

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

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

83

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

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

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

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

MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS

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

Taxation of the Company

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

- *Income source requirements.* At least 90% of our gross income for each taxable year must be from dividends, interest, payments with respect to securities loans, gains from sales or other dispositions of securities or other income derived with respect to our business of investing in securities, and net income derived from an interest in a qualified publicly traded partnership, and
- *Asset diversification requirements.* As of the close of each quarter of our taxable year: (1) at least 50% of the value of our assets must consist of cash, cash items, U.S. government securities, the securities of other regulated investment companies and other securities to the extent that (a) we do not hold more than 10% of the outstanding voting securities of an issuer of such other securities and (b) such other securities of any one issuer do not represent more than 5% of our total assets, and (2) no more than 25% of the value of our total assets may be invested in the securities of one issuer (other than U.S. government securities or the securities of other regulated investment companies), or of two or more issuers that are controlled by us and are engaged in the same or similar or related trades or businesses or in the securities of one or more qualified publicly traded partnerships.

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

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

If we acquire debt obligations that were originally issued at a discount, which would generally include loans we make that are accompanied by warrants, that bear interest at rates that are not either fixed rates or certain qualified variable rates or that are not unconditionally payable at least annually over the life of the obligation, we will be required to include in taxable income each year a portion of the OID that accrues over the life of the obligation. Such OID will be included in our investment company taxable income even though we receive no cash corresponding to such discount amount. As a result, we may be required to make additional distributions corresponding to such OID amounts in order to satisfy the annual distribution requirement and to continue to qualify as a RIC or to avoid the 4% excise tax. In this event, we may be required to sell temporary investments or other assets to meet the RIC distribution requirements. Through March 31, 2007, we incurred no OID income.

Taxation of Our U.S. Stockholders

Distributions. For any period during which we qualify for treatment as a RIC for federal income tax purposes, distributions to our stockholders attributable to our investment company taxable income generally will be taxable as ordinary income to stockholders to the extent of our current or accumulated earnings and profits. Any

distributions in excess of our earnings and profits will first be treated as a return of capital to the extent of the stockholder's adjusted basis in his or her shares of common stock and thereafter as gain from the sale of shares of our common stock. Distributions of our long-term capital gains, designated by us as such, will be taxable to stockholders as long-term capital gains regardless of the stockholder's holding period for its common stock and whether the distributions are paid in cash or invested in additional common stock. Corporate stockholders are generally eligible for the 70% dividends received deduction with respect to ordinary income, but not with respect to capital gain dividends to the extent such amount designated by us does not exceed the dividends received by us from domestic corporations. Any dividend declared by us in October, November or December of any calendar year, payable to stockholders of record on a specified date in such a month and actually paid during January of

the following year, will be treated as if it were paid by us and received by the stockholders on December 31 of the previous year. In addition, we may elect to relate a dividend back to the prior taxable year if we (1) declare such dividend prior to the due date for filing our return for that taxable year, (2) make the election in that return, and (3) distribute the amount in the 12-month period following the close of the taxable year but not later than the first regular dividend payment following the declaration. Any such election will not alter the general rule that a stockholder will be treated as receiving a dividend in the taxable year in which the distribution is made, subject to the October, November, December rule described above.

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

If a stockholder participates in our dividend reinvestment plan (see "Dividend Reinvestment Plan"), any distributions reinvested under the plan will be taxable to the stockholder to the same extent, and with the same character, as if the stockholder had received the distribution in cash. The stockholder will have an adjusted basis in the additional common shares purchased through the plan equal to the amount of the reinvested distribution. The additional shares will have a new holding period commencing on the day following the day on which the shares are credited to the stockholder's account.

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

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

REGULATION AS A BUSINESS DEVELOPMENT COMPANY

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

We intend to conduct our business so as to retain our status as a business development company. A business development company may use capital provided by public shareholders and from other sources to invest in long-term private investments in businesses. A business development company provides shareholders the ability to retain the liquidity of a publicly traded stock while sharing in the possible benefits, if any, of investing in primarily privately owned companies. In general, a business development company must have been organized and have its principal place of business in the United States and must be operated for the purpose of making investments in the types of securities described in (1) or (2) below.

Qualifying Assets

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

- (1) Securities purchased in transactions not involving any public offering from the issuer of such securities, which issuer is an eligible portfolio company. An eligible portfolio company is generally defined in the 1940 Act as any issuer which:
 - (a) is organized under the laws of, and has its principal place of business in, any State or States in the United States;
 - (b) is not an investment company (other than a small business investment company wholly owned by the business development company); and
 - (c) satisfies one of the following:
 - (i) it does not have any class of securities with respect to which a broker or dealer may extend margin credit;
 - (ii) it is controlled by the business development company and for which an affiliate of the business development company serves as a director; or
 - (iii) it has total assets of not more than \$4 million and capital and surplus of not less than \$2 million.
- (2) Securities received in exchange for or distributed on or with respect to securities described in (1) above, or pursuant to the exercise of options, warrants or rights relating to such securities.
- (3) Cash, cash items, government securities or high quality debt securities maturing in one year or less from the time of investment.

Securities of public companies are generally not qualifying assets unless they were acquired in a distribution or in exchange for, or upon the exercise of, a right relating to securities that were qualifying assets.

Asset Coverage

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

Significant Managerial Assistance

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

Fundamental Investment Policies

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

available to the issuers of these securities), as well as temporary investments, will generally be qualifying assets.

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

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

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

DESCRIPTION OF OUR SECURITIES

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

Common Stock

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

Preferred Stock

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

You should note, however, that any issuance of preferred stock must comply with the requirements of the 1940 Act. The 1940 Act requires, among other things, that (1) immediately after issuance and before any dividend or other distribution is made with respect to our common stock and before any purchase of common stock is made, such preferred stock together with all other senior securities must not exceed an amount equal to 50% of our total assets after deducting the amount of such dividend, distribution or purchase price, as the case may be, and (2) the holders of shares of preferred stock, if any are issued, must be entitled as a class to elect two directors at all times and to elect a majority of the directors if dividends on such preferred stock are in arrears by two years or more. Certain matters under the 1940 Act require the separate vote of the holders of any issued and outstanding preferred stock. For example, holders of preferred stock would vote separately from the holders of common stock on a proposal to cease operations as a business development company. We have no present plans to issue any shares of our preferred stock, but believe that the availability for issuance of preferred stock will provide us with increased flexibility in structuring future financings.

Debt Securities

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

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

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

Classified Board of Directors

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

Number of Directors; Removal; Vacancies

Our articles of incorporation provide that the number of directors will be determined pursuant to our bylaws and our bylaws provide that a majority of our entire Board of Directors may at any time increase or decrease the number of directors. In addition, our bylaws provide that the number of directors shall not be increased by 50% or more in any 12-month period without the approval of at least 66²/₃% of the members of our Board of Directors then in office. Our bylaws provide that any vacancies will be filled by the vote of a majority of the remaining directors, even if less than a quorum, and the directors so appointed shall hold office until the next annual meeting of stockholders and until their successors are elected and qualified. Accordingly, our Board of Directors could temporarily prevent any stockholder from enlarging the Board of Directors and filling the new directorships with such stockholder's own nominees.

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

Stockholder Approval Requirements

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

Advance Notice Provisions for Stockholder Nominations and Stockholder Proposals

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

The stockholder notice procedure provides that (1) only persons who are nominated by, or at the direction of, the Board of Directors, or by a stockholder who has given timely written notice containing specified information to our secretary prior to the meeting at which directors are to be elected, will be eligible for election as directors and

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

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

Amendment of Articles of Incorporation and Bylaws

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

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

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

93

Limitation on Liability of Directors

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

PLAN OF DISTRIBUTION

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

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

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

We may enter into derivative transactions with third parties, or sell securities not covered by this prospectus to third parties in privately negotiated transactions. If the applicable prospectus supplement indicates, in connection with those derivatives, the third parties may sell Securities covered by this prospectus and the applicable prospectus supplement, including in short sale transactions. If so, the third

94

party may use securities pledged by us or borrowed from us or others to settle those sales or to close out any related open borrowings of stock, and may use securities received from us in settlement of those derivatives to close out any related open borrowings of stock. The third parties in such sale transactions will be underwriters and, if not identified in this prospectus, will be identified in the applicable prospectus supplement (or a post-effective amendment).

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

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

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

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

SHARE REPURCHASES

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

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

95

have the effect of increasing our expense ratio. We may borrow money to finance the repurchase of shares subject to the limitations described in this prospectus. Any interest on such borrowing for this purpose would reduce our net income.

CUSTODIAN, TRANSFER AND DIVIDEND PAYING AGENT AND REGISTRAR

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

BROKERAGE ALLOCATION AND OTHER PRACTICES

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

LEGAL MATTERS

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

EXPERTS

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

96

GLADSTONE CAPITAL CORPORATION INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Audited Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm	F-3
Consolidated Statements of Assets and Liabilities as of September 30, 2006 and September 30, 2005	F-5
Consolidated Schedule of Investments as of September 30, 2006	F-6

Consolidated Schedule of Investments as of September 30, 2005	F-9
Consolidated Statements of Operations for the years ended September 30, 2006, September 30, 2005 and September 30, 2004	F-11
Consolidated Statements of Changes in Net Assets for the years ended September 30, 2006, September 30, 2005 and September 30, 2004	F-12
Consolidated Statements of Cash Flows for the years ended September 30, 2006, September 30, 2005 and September 30, 2004	F-13
Financial Highlights for the years ended September 30, 2006, September 30, 2005 and September 30, 2004	F-14
Notes to Consolidated Financial Statements	F-15
Unaudited Consolidated Financial Statements	
Consolidated Statements of Assets and Liabilities as of March 31, 2007 and September 30, 2006	F-35
Consolidated Schedules of Investments as of March 31, 2007 and September 30, 2006	F-36
Consolidated Statements of Operations for the three months ended March 31, 2007 and 2006	F-46
Consolidated Statements of Operations for the six months ended March 31, 2007 and 2006	F-47
Consolidated Statements of Changes in Net Assets for the six months ended March 31, 2007 and 2006	F-48
Consolidated Statements of Cash Flows for the six months ended March 31, 2007 and 2006	F-49
Financial Highlights for the three months ended March 31, 2007 and 2006	F-50
Financial Highlights for the six months ended March 31, 2007 and 2006	F-51
Notes to Consolidated Financial Statements	F-52

F-1

Management's Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and include those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect our transactions and the dispositions of our assets; (2) provide reasonable assurance that our transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with appropriate authorizations; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Under the supervision and with the participation of our management, we assessed the effectiveness of our internal control over financial reporting as of September 30, 2006, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control—Integrated Framework. Based on its assessment, management has concluded that our internal control over financial reporting was effective as of September 30, 2006.

Our management's assessment of the effectiveness of our internal control over financial reporting as of September 30, 2006 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which is included herein.

F-2

Report of Independent Registered Public Accounting Firm

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

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

Consolidated financial statements and financial statement schedules

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

Internal control over financial reporting

Also, in our opinion, management's assessment, included in Management's Annual Report on Internal Control over Financial Reporting appearing on page F-2, that the Company maintained effective internal control over financial reporting as of September 30, 2006 based on criteria established in *Internal Control—Integrated Framework*

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

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for

F-3

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

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

PricewaterhouseCoopers LLP
McLean, Virginia
December 6, 2006

F-4

GLADSTONE CAPITAL CORPORATION
CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES

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

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

GLADSTONE CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS
SEPTEMBER 30, 2006

<u>Company(1)</u>	<u>Industry</u>	<u>Investment(2)</u>	<u>Cost</u>	<u>Fair Value</u>
ActivStyle Acquisition Co. ActivStyle, Inc.	Service—medical products distribution	Line of Credit(16) (9.6%, Due 7/2009) Senior Term Debt(5) (9.6%, Due 7/2011) Senior Term Debt(3)(5) (11.8%, Due 7/2011)	\$ — 3,200,000 2,500,000	\$ — 3,200,000 2,500,000
Advanced Homecare Management, Inc.	Service—home health nursing services	Senior Subordinated Term Debt(5)(6) (11.33%, Due 12/2013)	5,000,000	5,000,000
Allied Extruders, LLC P&O Packaging Acquisition LLC	Manufacturing—polyethylene film	Senior Real Estate Term Debt (9.8%, Due 3/2011) Senior Term Debt(3)(5) (11.3%, Due 3/2011)	1,000,000 8,000,000	1,000,000 8,030,000
Badanco Acquisition Corp.	Manufacturing—luggage	Senior Term Debt(5) (10.8%, Due 2/2010) Senior Term Debt(3)(5) (13.8%, Due 2/2010)	5,145,019 8,585,125	5,157,881 8,628,051
Benetech, Inc.	Service & Manufacturing—dust management systems for the coal and electric utility industries	Senior Term Debt(5) (10.3%, Due 5/2009) Senior Term Debt(3)(5) (13.3%, Due 5/2009)	2,112,500 3,046,875	2,144,187 3,107,813
Bresnan Communications, LLC	Service—telecommunications	Senior Term Debt(6) (7.2%, Due 9/2013) Senior Subordinated Term Debt (9.9%, Due 3/2014)	1,002,115 1,511,554	997,500 1,533,750
Consolidated Bedding, Inc.	Manufacturing—mattresses	Senior Subordinated Term Debt(5) (14.4%, Due 3/2009)	2,438,359	2,306,991
Country Road Communications LLC Country Road Management, Inc.	Service—telecommunications	Senior Subordinated Term Debt(5)(6) (13.3%, Due 7/2013)	5,961,594	6,015,000
Defiance Stamping Company	Manufacturing—trucking parts	Senior Term Debt(3)(5) (13.3%, Due 4/2010)	6,325,000	6,332,906
Doe & Ingalls Management LLC Doe & Ingalls of North Carolina Operating LLC Doe & Ingalls of Florida Operating LLC Doe & Ingalls of Virginia Operating LLC	Distributor—specialty chemicals	Senior Term Debt(5) (9.8%, Due 11/2010) Senior Term Debt(3)(5) (13.3%, Due 11/2010)	4,700,000 4,500,000	4,723,500 4,516,875
Express Courier International, Inc.	Service—ground delivery and logistics	Line of Credit(7) (9.6%, Due 6/2009) Senior Term Debt(5) (9.6%, Due 6/2011) Senior Term Debt(3)(5) (11.8%, Due 6/2011)	— 4,700,000 3,950,000	— 4,700,000 3,950,000
Finn Corporation	Manufacturing—landscape equipment	Common Stock Warrants	37,000	709,431
FR X Ohmstede Holdings, LLC FR X Ohmstede Acquisitions Co.	Service & Manufacturing—heat exchangers	Senior Term Debt(6) (8.5%, Due 8/2013) Senior Subordinated Term Debt(6) (12.5%, Due 8/2014)	3,000,000 3,012,369	3,026,250 3,030,000
Global Materials Technologies, Inc.	Manufacturing—steel wool products and metal fibers	Senior Term Debt(3)(5) (14.3%, Due 11/2009)	\$ 5,300,000	\$ 5,233,750
It's Just Lunch International, LLC	Service—dating service	Line of Credit(12)(5) (9.2%, Due 6/2009) Senior Term Debt(13)(5) (9.6%, Due 6/2011) Senior Term Debt(3)(14) (11.8%, Due 6/2011)	200,000 3,300,000	199,500 3,291,750
John Henry Holdings, Inc. Multi Packaging Solutions, Inc.	Manufacturing—packaging products	Senior Subordinated Term Debt(6) (12.5%, Due 6/2011)	8,000,000	8,000,000

GLADSTONE CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)
SEPTEMBER 30, 2006

LocalTel, Inc.	Service—yellow pages publishing	Line of Credit(5)(15) (9.8%, Due 6/2009) Senior Term Debt(5) (9.8%, Due 6/2011) Senior Term Debt(3)(5) (12.3%, Due 6/2011)	\$ 350,000 2,687,500 2,750,000	\$ 343,000 2,633,750 2,695,000
Mistras Holdings Corp.	Service & Manufacturing—nondestructive testing instruments, systems and services	Senior Term Debt(3)(5) (11.5%, Due 8/2008) Senior Term Debt(4)(5)(18) (12.5%, Due 8/2008)	9,499,999 5,250,001	9,737,499 5,620,124
Network Solutions LLC	Service—internet domain registry and host	Senior Term Debt(6) (10.4%, Due 1/2012)	4,464,358	4,499,747
Northern Contours Northern Contours of Kentucky, Inc. Norcon Holding LLC Norcon Lewis LLC	Manufacturing—veneer and laminate components	Senior Subordinated Term Debt(5) (12.3%, Due 5/2010)	7,000,000	7,017,500
PROFITSystems Acquisition Co. PROFITSystems, Inc.	Service—design and develop ERP software	Line of Credit(17) (9.6%, Due 7/2009) Senior Term Debt(5) (9.6%, Due 7/2011) Senior Term Debt(5) (11.8%, Due 7/2011)(3)	— 3,100,000 2,900,000	— 3,100,000 2,900,000
Puerto Rico Cable	Service—telecommunications	Senior Subordinated Term Debt(5)(6)	7,813,274	7,775,183

Acquisition Company, Inc.		(11.6%, Due 1/2012)		
QCE, LLC (d/b/a Quiznos Corp.)	Service—restaurant franchisor	Senior Term Debt(6) (7.6%, Due 5/2013)	3,010,713	2,977,538
		Senior Term Debt(3)(6) (11.1%, Due 11/2013)	3,045,560	3,033,750
RCS Management Holding Co.	Service—healthcare supplies	Senior Term Debt(3)(5) (9.8%, Due 1/2011)	3,000,000	3,003,750
		Senior Term Debt(4)(5) (12.3%, Due 1/2011)	3,000,000	3,003,750
RedPrairie Holding, Inc. RedPrairie Corporation Blue Cube Software, Inc.	Service—design and develop supply chain software	Senior Term Debt(6) (8.4%, Due 7/2012)	3,990,000	3,990,000
		Senior Subordinated Term Debt(6) (11.9%, Due 1/2013)	2,000,000	2,005,000
SCPH Holdings, Inc. Sea Con Phoenix, Inc. Phoenix Optix, Inc.	Manufacturing—underwater and harsh environment components	Credit Facility(8) (9.8%, Due 2/2007)	—	—
		Senior Term Debt(5) (10.3%, Due 2/2010)	2,625,000	2,631,563
		Senior Term Debt(3)(5) (13.3%, Due 2/2010)	2,887,500	2,898,328
SCS Acquisition Corp.	Service—chemically treated equipment distribution	Senior Term Debt(3)(5)(9) (9.3%, Due 12/2011)	6,250,000	6,257,812
		Senior Term Debt(3)(5)(10) (11.3%, Due 12/2011)	6,568,750	6,576,961
Thibaut Acquisition Co.	Design and Distribution—wall coverings	Credit Facility(11) (9.8%, Due 1/2011)	—	—
		Senior Term Debt(5) (9.8%, Due 1/2011)	3,325,000	3,325,000
		Senior Term Debt(3)(5) (12.3%, Due 1/2011)	3,000,000	3,000,000
Visual Edge Technology, Inc. Graphic Enterprises, Inc. Copeco, Inc.	Service—office supplies distribution	Senior Subordinated Term Debt(5) (13.3%, Due 8/2011)	5,000,000	4,987,500
Westlake Hardware, Inc. WHI Holding Corp.	Retail—hardware and variety	Senior Subordinated Term Debt(5) (12.6%, Due 1/2011)	15,000,000	14,981,250
Winchester Electronics	Manufacturing—high bandwidth connectors and cables	Senior Term Debt(3)(5) (12.3%, Due 6/2012)	6,000,000	6,007,500
Xspedius Communications LLC	Service—telecommunications	Senior Subordinated Term Debt(5) (15.8%, Due 3/2010)	5,157,821	5,306,110
Total:			\$ 216,202,986	\$ 217,642,750

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

F-7

GLADSTONE CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)
SEPTEMBER 30, 2006

- (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) Percentage represents interest rates in effect at September 30, 2006 and due date represents the contractual maturity date.
- (3) 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.
- (4) 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, however the debt is junior to another Last Out Tranche.
- (5) Fair value was based on valuation prepared and provided by SPSE.
- (6) Marketable securities, such as syndicated loans, are valued based on the indicative bid price, as of September 30, 2006 from the respective originating syndication agent's trading desk.
- (7) Availability under the credit facility totals \$1,500,000. There were no borrowings outstanding at September 30, 2006.
- (8) Availability under the credit facility totals \$500,000. There were no borrowings outstanding at September 30, 2006.
- (9) Availability under the debt facility totals \$7,500,000. The outstanding balance of the debt facility was \$6,375,000 at September 30, 2006.
- (10) Availability under the debt facility totals \$7,500,000. The outstanding balance of the debt facility was \$6,587,500 at September 30, 2006.
- (11) Availability under the credit facility totals \$1,000,000. There were no borrowings outstanding at September 30, 2006.
- (12) Availability under the credit facility totals \$750,000. Borrowings of \$200,000 were outstanding at September 30, 2006.
- (13) The company may borrow an additional \$500,000 under the senior term debt facility, subject to certain conditions including Gladstone Capital's approval.
- (14) The company may borrow an additional \$2,250,000 under the senior term debt facility, subject to certain conditions including Gladstone Capital's approval.
- (15) Availability under the credit facility totals \$3,000,000. Borrowings of \$350,000 were outstanding at September 30, 2006.
- (16) Availability under the credit facility totals \$1,500,000. There were no borrowings outstanding at September 30, 2006.
- (17) Availability under the credit facility totals \$1,250,000. There were no borrowings outstanding at September 30, 2006.
- (18) Includes a success fee with a fair value of \$742,000 and no cost basis.

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

F-8

GLADSTONE CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS
SEPTEMBER 30, 2005

Company(1)	Industry	Investment(2)	Cost	Fair Value
Advanced Homecare Management, Inc.	Home health nursing services	Senior Subordinated Term Debt(6) (12.6%, Due 12/2010)	\$ 7,500,000	\$ 7,500,000

Allied Extruders, Inc.	Polyethylene film manufacturer	Senior Term Debt(3) (12.3%, Due 7/2009)	3,950,000	3,964,813
ARI Holdings, Inc.(11)(12)	Manufacturing—auto parts	Senior Term Debt (12.8%, Due 2/2008)	3,933,939	2,880,000
Badanco Acquisition Corp.	Manufacturing—luggage	Senior Term Debt(6) (9.2%, Due 2/2010)	6,615,019	6,615,019
		Senior Term Debt(3)(6) (12.2%, Due 2/2010)	8,650,000	8,650,000
Benetech, Inc.	Dust management systems for the coal and electric utility industries	Senior Term Debt(6) (8.7%, Due 5/2009)	2,762,500	2,783,219
		Senior Term Debt(3)(6) (11.7%, Due 5/2009)	3,209,375	3,249,492
Consolidated Bedding, Inc.	Manufacturing—mattresses	Senior Subordinated Term Debt(6) (13.0%, Due 3/2009)	2,927,382	2,898,968
Country Road Communications LLC	Service—telecommunications	Senior Subordinated Term Debt (11.6%, Due 7/2013)	5,955,942	6,060,000
Country Road Management, Inc.				
Coyne International Enterprises	Industrial services	Senior Term Debt(3)(5)(6) (13.0%, PIK 2%, Due 7/2007)	6,375,052	6,367,083
Defiance Stamping Company	Manufacturing—trucking parts	Senior Term Debt(3) (11.7%, Due 4/2010)	6,325,000	6,332,906
Finn Corporation	Manufacturing—landscape equipment	Senior Subordinated Term Debt(6) (13.0%, Due 2/2006)	10,500,000	7,350,000
		Common Stock Warrants	37,000	682,114
Gammill, Inc.	Designer and assembler of quilting machines and accessories	Senior Term Debt(6) (9.5%, Due 12/2008)	3,771,427	3,771,427
		Senior Term Debt(3)(6) (12.0%, Due 12/2008)	4,690,625	4,667,172
Global Materials Technologies, Inc.	Manufacturing—steel wool products and metal fibers	Senior Term Debt(3)(6) (13.0%, Due 11/2009)	5,500,000	5,486,250
Infor Global Solutions Ltd.	Enterprise application solutions	Senior Subordinated Term Debt(7) (11.0%, Due 4/2012)	6,821,250	7,070,000
John Henry Holdings, Inc.	Manufacturing—packaging products	Senior Subordinated Term Debt(6) (11.0%, Due 6/2011)	7,067,923	7,064,500
Marcal Paper Mills, Inc.(12)	Manufacturing—paper products	Senior Subordinated Term Debt(6) (13.0%, Due 12/2006)	6,275,000	6,149,500
		First Mortgage Loan(5) (16%, PIK 1%, Due 12/2006)	9,277,877	9,277,877
Mistras Holdings Corp.	Nondestructive testing instruments, systems and services	Senior Term Debt(3)(6) (10.5%, Due 8/2008)	9,666,666	9,461,249
		Senior Term Debt(3)(6) (12.5%, Due 8/2008)	4,833,334	4,724,584
		Senior Term Debt(3)(6) (13.5%, Due 8/2008)	1,000,000	982,500
Northern Contours Northern Contours of Kentucky, Inc. Norcon Holding LLC Norcon Lewis LLC	Manufacturing—vener and laminate components	Senior Subordinated Term Debt(8) (10.7%, Due 5/2010)	7,000,000	7,000,000
Penn Engineering & Manufacturing Corp. PN Merger Sub Inc. PEM Holding Co.	Manufacturing—fractional horsepower engines	Senior Subordinated Term Debt(8) (10.0%, Due 5/2012)	5,009,524	5,050,000
Polar Corporation	Manufacturing—trailer parts	Senior Subordinated Term Debt(6) (10.3%, Due 6/2010)	8,609,566	8,627,500
Puerto Rico Cable Acquisition Company, Inc.	Service—telecommunications	Senior Subordinated Term Debt (10.3%, Due 1/2012)	5,050,182	5,075,000
Regency Gas Services LLC	Midstream gas gathering and processing	Senior Subordinated Term Debt(7) (9.9%, Due 12/2010)	5,029,188	5,037,500

F-9

GLADSTONE CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)
SEPTEMBER 30, 2005

Santana Plastics	Manufacturing—polyethylene bathroom partitions	Senior Term Debt(3)(6) (11.7%, Due 11/2009)	\$ 6,000,000	\$ 6,007,500
SCPH Holdings, Inc. Sea Con Phoenix, Inc. Phoenix Optix, Inc.	Manufacturing—underwater and harsh environment components	Senior Term Debt(4)(6) (13.0%, Due 11/2009)	1,950,000	1,952,438
		Credit Facility(9) (8.0%, Due 3/2006)	—	—
		Senior Term Debt(3)(6) (8.7%, Due 2/2010)	3,237,500	3,241,547
		Senior Term Debt(6) (12.0%, Due 2/2010)	3,000,000	3,003,750
Survey Sampling	Service—telecommunications	Senior Subordinated Term Debt(6) (11.0%, Due 5/2012)	4,514,105	4,539,375
Tech Lighting LLC	Manufacturing—low voltage lighting systems	Senior Subordinated Term Debt(6) (10.4%, Due 10/2010)	9,012,452	9,067,500
Visual Edge Technology, Inc. Graphic Enterprises, Inc. Copeco, Inc.	Service—office supplies distribution	Senior Subordinated Term Debt (11.7%, Due 8/2011)	5,000,000	5,000,000
Woven Electronics Corporation	Custom electrical cable assemblies	Senior Term Debt(4)(6)(10) (11.5%, Due 3/2009)	8,344,999	8,776,435
Xspedius Communications LLC	Service—telecommunications	Senior Subordinated Term Debt(6) (14.3%, Due 3/2010)	5,972,727	4,479,545
Total:			\$ 205,375,554	\$ 200,846,763

(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) Percentage represents interest rates in effect at September 30, 2005 and due date represents the contractual maturity date.

(3) 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.

(4) 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, however the debt is junior to another Last Out Tranche.

(5) Has some paid in kind (PIK) interest. Refer to Note 2 "Summary of Significant Accounting Policies."

(6) Fair value was based on valuation prepared and provided by SPSE.

- (7) Marketable securities are valued based on the bid price, as of September 30, 2005, from the respective originating syndication agent's trading desk.
- (8) Investment was valued at cost due to recent acquisition.
- (9) Availability under the credit facility totals \$500,000. There were no borrowings outstanding at September 30, 2005.
- (10) Includes a success fee with a \$347,986 fair value and no cost basis.
- (11) Non-income producing at September 30, 2005.
- (12) Subsequent to September 30, 2005, the entire investment in the portfolio company was sold at the fair value reflected herein.

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

F-10

GLADSTONE CAPITAL CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended September 30.		
	2006	2005	2004
INVESTMENT INCOME			
Interest income—investments	\$ 25,646,746	\$ 22,407,605	\$ 18,176,617
Interest income—cash and cash equivalents	38,381	32,807	84,273
Interest income—notes receivable from employees	441,341	444,170	443,658
Fee income (Refer to Note 10)	—	—	1,118,106
Prepayment fees and other income	773,378	1,065,177	573,314
Total investment income	<u>26,899,846</u>	<u>23,949,759</u>	<u>20,395,968</u>
EXPENSES			
Loan servicing (Refer to Note 12)	2,907,875	2,549,728	501,670
Management fee (Refer to Note 11)	1,266,875	1,359,643	—
Professional fees	548,326	725,336	579,599
Amortization of deferred financing fees	140,143	385,737	1,373,415
Interest expense	3,238,615	1,774,629	741,621
Stockholder related costs	303,709	220,445	140,090
Directors fees	116,212	101,843	112,210
Insurance expense	206,554	178,214	258,358
Salaries and benefits	—	—	2,554,490
Rent	—	—	139,399
Stock option compensation	285,318	—	—
Other expenses	484,722	235,861	702,341
Expenses before credit from Gladstone Management	<u>9,498,349</u>	<u>7,531,436</u>	<u>7,103,193</u>
Credit to management fee for fees collected by Gladstone Management (Refer to Note 11)	<u>(2,051,000)</u>	<u>(1,077,100)</u>	<u>—</u>
Total expenses net of credit to management fee	<u>7,447,349</u>	<u>6,454,336</u>	<u>7,103,193</u>
NET INVESTMENT INCOME BEFORE INCOME TAXES	<u>19,452,497</u>	<u>17,495,423</u>	<u>13,292,775</u>
Income tax expense	101,917	209,278	—
NET INVESTMENT INCOME	<u>19,350,580</u>	<u>17,286,145</u>	<u>13,292,775</u>
REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS:			
Net realized (loss) gain on sale of investments	(903,945)	29,750	12,500
Realized gain on settlement of derivative	15,014	—	—
Unrealized appreciation (depreciation) on derivative	31	(39,488)	(214,259)
Net unrealized appreciation (depreciation) on investments	<u>5,968,555</u>	<u>(1,785,725)</u>	<u>(2,520,726)</u>
Net gain (loss) on investments	<u>5,079,655</u>	<u>(1,795,463)</u>	<u>(2,722,485)</u>
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS	<u>\$ 24,430,235</u>	<u>\$ 15,490,682</u>	<u>\$ 10,570,290</u>
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS PER COMMON SHARE:			
Basic	<u>\$ 2.15</u>	<u>\$ 1.37</u>	<u>\$ 1.05</u>
Diluted	<u>\$ 2.10</u>	<u>\$ 1.33</u>	<u>\$ 1.02</u>
WEIGHTED AVERAGE SHARES OF COMMON STOCK OUTSTANDING:			
Basic	11,381,378	11,292,466	10,101,341
Diluted	11,615,922	11,609,146	10,344,388

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

F-11

GLADSTONE CAPITAL CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS

	Year Ended September.		
	2006	2005	2004
Operations:			
Net investment income	\$ 19,350,580	\$ 17,286,145	\$ 13,292,775
Net realized (loss) gain on sale of investments	(903,945)	29,750	12,500
Realized gain on settlement of derivative	15,014	—	—

Unrealized appreciation (depreciation) on derivative	31	(39,488)	(214,259)
Net unrealized appreciation (depreciation) on investments	5,968,555	(1,785,725)	(2,520,726)
Net increase in net assets from operations	<u>24,430,235</u>	<u>15,490,682</u>	<u>10,570,290</u>
<i>Capital transactions:</i>			
Distributions to stockholders	(18,628,597)	(17,109,668)	(12,578,583)
Tax return of capital to shareholders	—	—	(1,207,143)
Stock option compensation	285,318	—	—
Issuance of common stock under stock option plan	16,375,375	427,350	707,090
Repayment of principal on employee notes	189,943	843,997	103,252
Note receivable issued from sale of common stock	(1,692,470)	(157,100)	(549,990)
Issuance of common stock under shelf offering	—	—	24,855,525
Shelf offering costs	—	(111,233)	(476,168)
(Decrease) increase in net assets from capital share transactions	(3,470,431)	(16,106,654)	10,853,983
Total increase (decrease) in net assets	20,959,804	(615,972)	21,424,273
Net assets at beginning of year	151,610,683	152,226,655	130,802,382
Net assets at end of period	<u>\$ 172,570,487</u>	<u>\$ 151,610,683</u>	<u>\$ 152,226,655</u>

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

F-12

GLADSTONE CAPITAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended September 30,		
	2006	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES			
Net increase in net assets resulting from operations	\$ 24,430,235	\$ 15,490,682	\$ 10,570,290
Adjustments to reconcile net increase in net assets resulting from operations to net cash provided by (used in) operating activities:			
Purchase of investments	(135,954,879)	(143,794,006)	(86,267,500)
Principal repayments on investments	124,009,929	88,019,136	47,158,995
Proceeds from repurchase agreements	—	—	285,099,546
Repayment of repurchase agreements	—	(21,345,997)	(342,202,549)
Depreciation	—	—	24,356
Net amortization of premiums and discounts	(137,239)	(1,635)	2,036
Amortization of deferred financing fees	135,143	385,737	1,303,776
Stock compensation expense	285,318	—	—
Realized loss on investments	1,329,458	—	—
Unrealized (appreciation) depreciation on derivative	(31)	39,488	214,259
Change in net unrealized (appreciation) depreciation on investments	(5,968,555)	1,785,725	2,520,726
Decrease (increase) in interest receivable	941	(482,983)	201,259
(Increase) decrease in funds due from custodian	(963,078)	(1,420,995)	3,921
(Increase) decrease in prepaid assets	(48,897)	13,828	201,275
Decrease (increase) in due from affiliate	—	109,639	(67,508)
Decrease (increase) in other assets	(76,125)	(49,622)	33,188
(Decrease) increase in accounts payable	(17,822)	99,679	82,674
Increase in interest payable	63,823	—	—
Increase (decrease) in accrued expenses and deferred liabilities	370,622	(447,431)	(1,053,418)
(Decrease) increase in fees due to affiliate	(150,959)	277,811	—
Increase in funds held in escrow	2,433	200,760	—
Increase in investment balance due to payment in kind interest	(74,701)	(409,743)	(552,944)
Net cash provided by (used in) operating activities	<u>7,235,616</u>	<u>(61,529,927)</u>	<u>(82,727,618)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Receipt of principal on notes receivable—employees	189,943	843,997	103,252
Sale of furniture & equipment, net	—	—	117,365
Net cash provided by investing activities	<u>189,943</u>	<u>843,997</u>	<u>220,617</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net proceeds from the issuance of common shares	—	—	24,379,357
Borrowings from the lines of credit	146,740,000	155,000,000	114,743,547
Repayments on the lines of credit	(149,781,064)	(142,709,483)	(74,000,000)
Distributions paid	(18,628,598)	(17,109,668)	(17,112,735)
Exercise of employee stock options	14,682,905	270,250	157,100
Deferred financing fees	(210,834)	(105,000)	(567,649)
Purchase of derivative	—	—	(304,000)
Shelf offering costs	—	(111,233)	—
Net cash (used in) provided by financing activities	<u>(7,197,591)</u>	<u>(4,765,134)</u>	<u>47,295,620</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS(1)	<u>227,968</u>	<u>(65,451,064)</u>	<u>(35,211,381)</u>
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	<u>503,776</u>	<u>65,954,840</u>	<u>101,166,221</u>
CASH AND CASH EQUIVALENTS, END OF PERIOD	<u>\$ 731,744</u>	<u>\$ 503,776</u>	<u>\$ 65,954,840</u>
CASH PAID DURING PERIOD FOR INTEREST	<u>\$ 3,174,492</u>	<u>\$ 1,662,309</u>	<u>\$ 672,449</u>
CASH PAID DURING PERIOD FOR INCOME TAXES	<u>\$ —</u>	<u>\$ 138,678</u>	<u>\$ —</u>
NON-CASH FINANCING ACTIVITIES			
Notes receivable issued in exchange for common stock associated with the exercise of employee stock options	<u>\$ 1,692,470</u>	<u>\$ 157,100</u>	<u>\$ 549,990</u>

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

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

F-13

Per Share Data(1)	Year Ended September 30,		
	2006	2005	2004
Net asset value at beginning of period	\$ 13.41	\$ 13.50	\$ 12.97
<i>Income from investment operations:</i>			
Net investment income(2)	1.70	1.53	1.32
Realized loss on sale of investments(2)	(0.08)	—	—
Net unrealized gain (loss) on investments(2)	0.53	(0.16)	(0.25)
Net unrealized loss on derivative(2)	—	—	(0.02)
Total from investment operations	2.15	1.37	1.05
<i>Less distributions:</i>			
Distributions from net investment income	(1.64)	(1.52)	(1.25)
Tax return of capital distribution	—	—	(0.12)
Total distributions	(1.64)	(1.52)	(1.37)
Issuance of common stock under shelf offering	—	—	0.99
Issuance of common stock under stock option plan	1.19	0.02	0.01
Stock compensation expense	0.02	—	—
Repayment of principal on notes receivable	0.02	0.07	0.01
Dilutive effect of share issuance(6)	(1.13)	(0.01)	—
Offering costs	—	(0.02)	(0.16)
Net asset value at end of period	\$ 14.02	\$ 13.41	\$ 13.50
Per share market value at beginning of period	\$ 22.55	\$ 22.71	\$ 19.45
Per share market value at end of period	22.01	22.55	22.71
Total return(3)	5.21 %	5.93 %	24.40 %
Shares outstanding at end of period	12,305,008	11,303,510	11,278,510
<i>Ratios/Supplemental Data</i>			
Net assets at end of period	\$ 172,570,487	\$ 151,610,683	\$ 152,226,655
Average net assets(7)	\$ 155,867,538	\$ 151,897,549	\$ 130,385,129
Ratio of expenses to average net assets(4)	6.16 %	5.10 %	5.45 %
Ratio of net expenses to average net assets(5)	4.84 %	4.39 %	5.45 %
Ratio of net investment income to average net assets	12.42 %	11.38 %	10.20 %
Portfolio turnover rate	9.01 %	31.11 %	19.11 %

(1) Based on actual shares outstanding at the end of the corresponding period.

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

(3) Total return equals the increase of the ending market value over the beginning market value plus monthly dividends divided by the monthly beginning market value, assuming monthly dividend reinvestment.

(4) Ratio of expenses to average net assets is computed using expenses before credit from Gladstone Management and including income tax expense.

(5) Ratio of net expenses to average net assets is computed using total expenses net of credits to management fee and including income tax expense.

(6) Represents the anti-dilutive impact of (i) the other components in the changes in net assets and (ii) the different share amounts used in calculating per share data as a result of calculating certain per share data based upon the weighted average basic shares outstanding during the period and certain per share data based on the shares outstanding as of a period end or transaction date.

(7) Average net assets are computed using the average balance of net assets at the end of each reporting month.

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

F-14

GLADSTONE CAPITAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2006

Note 1. Organization

Gladstone Capital Corporation (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 Business Loan LLC (“Business Loan”), a wholly-owned subsidiary of the Company, was established on February 3, 2003 for the purpose of holding the Company’s portfolio of loan investments. Gladstone Capital Advisers, Inc. is also a wholly-owned subsidiary. The financial statements of the subsidiaries are consolidated with those of the Company.

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

Note 2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

Use of Estimates

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) that require management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates.

Reclassifications

Certain amounts in the prior years’ financial statements have been reclassified to conform to the current year presentation with no effect to net increase in net assets resulting from operations.

Cash and Cash Equivalents

Cash and cash equivalents consist of demand deposits and highly liquid investments with original maturities of three months or less when purchased. Cash and cash equivalents are carried at cost which approximates fair value as of September 30, 2006 and September 30, 2005.

Concentration of Credit Risk

The Company places its cash and cash equivalents with financial institutions and, at times, cash held in checking accounts may exceed the Federal Deposit Insurance Corporation insured limit.

Investment Valuation

The Company carries its investments at fair value, as determined by its Board of Directors. Securities that are publicly traded are valued at the closing price on the valuation date. Securities for which a limited

F-15

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

Interest Income Recognition

Interest income, adjusted for amortization of premiums and accretion of discounts, is recorded on the accrual basis to the extent that such amounts are expected to be collected. The Company stops accruing interest on its investments when it is determined that interest is no longer collectible. Conditional interest or a success fee is recorded when earned upon full repayment of a loan investment.

Paid in Kind Interest

The Company has loans in its portfolio which contain a paid in kind ("PIK") provision. The PIK interest, computed at the contractual rate specified in each loan agreement, is added to the principal balance of the loan and recorded as income. To maintain the Company's status as a RIC, 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 years ended September 30, 2006, September 30, 2005 and September 30, 2004, the Company recorded PIK income of \$63,217, \$394,985, and \$553,409, respectively.

Fee Income

The 1940 Act requires that a business development company make available managerial assistance to its portfolio companies. The 1940 Act defines managerial assistance as the service made available to a portfolio company to provide "significant guidance and counsel concerning the management, operations, or business objectives and policies of a portfolio company." Prior to the start of fiscal year 2005, the

F-16

Company provided managerial assistance and other services to its portfolio companies through its wholly-owned subsidiary, Gladstone Capital Advisers, Inc. and therefore recorded managerial assistance and other fee revenue in connection with these activities. Effective October 1, 2004, the Company offers managerial assistance and other services to its portfolio companies through its external investment adviser, GMC. Neither the Company nor its external investment adviser, GMC, charges a fee for managerial assistance. However, in the past the Company and, since October 1, 2004, GMC, have provided other services to portfolio companies in addition to managerial assistance. These other services include a wide variety of services to the portfolio companies such as investment banking services, arranging bank financing, arranging equity financing, structuring financing from multiple lenders and investors, reviewing existing credit facilities, restructuring existing loans, raising equity and debt capital, turnaround management, merger and acquisition services and recruiting new management personnel. GMC is charging for these services and is crediting the funds received from these other services to the Company as a credit against the investment advisory fee due from the Company under the investment advisory agreement. Such fees are normally paid in part at the time of signing a non-binding letter of intent, with the remainder paid upon completion of the services, and are generally non-recurring.

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

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

Stock Options

In December 2004, the Financial Accounting Standards Board ("FASB") approved the revision of Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation, and issued the revised SFAS Statement No. 123(R), "Share-Based Payment." SFAS No. 123(R) effectively replaces SFAS No. 123, and supersedes Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees" (APB 25)". SFAS 123(R) is effective for awards that are granted, modified, or settled in cash for annual periods beginning after June 15, 2005. The Company adopted SFAS No. 123(R) on October 1, 2005 using the modified prospective approach.

Advisory Agreement with GMC

Since October 1, 2004, the Company has been externally managed pursuant to a contractual investment advisory arrangement with GMC, an unconsolidated affiliate of the Company and a registered investment adviser, under which GMC has directly employed all of the Company's personnel and paid its payroll, benefits, and general expenses directly. The Company's initial advisory agreement with GMC was in place through September 30, 2006 (the "Initial Advisory Agreement"). Pursuant to the Initial Advisory Agreement, the Company paid GMC an annual advisory fee of 1.25% of its total assets (as reduced by cash and cash equivalents pledged to creditors), payable in quarterly increments of 0.3125%, and an annual administrative fee of 0.75% of its total assets (as reduced by cash and cash equivalents pledged to creditors), payable in quarterly increments of 0.1875%. GMC's board of directors agreed to waive, for the quarters ending June 30, 2006 and September 30, 2006, the annual advisory fee of 1.25% to 0.5% for those senior syndicated loans in which the Company already has syndicated second lien participations. On October 1, 2006, the Company entered into an amended and restated investment advisory agreement (the "Amended Advisory Agreement") with GMC and an administration agreement (the "Administration Agreement") with Gladstone Administration. (Please refer to Note 11. Advisory Agreement with GMC.)

F-17

GMC services the loans held by Business Loan, in return for which, GMC receives a 1.5% annual fee based on the monthly aggregate balance of loans held by Business Loan. Since the Company owns these loans, all loan servicing fees paid to GMC are also credited directly against the 2% management fee. These credits reduce the amount of the investment advisory fee. Under the advisory agreement, GMC also provides the managerial assistance and other services that the Company previously made available to its portfolio companies through its wholly-owned subsidiary Gladstone Capital Advisers, Inc. To the extent that GMC receives any fees directly from a portfolio company for such services, GMC credits these fees directly against the 2% management fee. Effective in April 2006, GMC's board of directors voluntarily waived the advisory fee on a temporary basis by reducing the 1.25% annual fee to 0.5% per annum applicable only to the senior syndicated loans in which the Company already has a second lien position. Overall, the management fee due to GMC cannot exceed 2% of total assets (as reduced by cash and cash equivalents pledged to creditors) during any given fiscal year.

In July 2003, the Company entered into an expense sharing arrangement with GMC that serves as the external adviser to Gladstone Commercial Corporation, a real estate investment trust, an affiliate. Under this expense sharing arrangement, GMC reimbursed Gladstone Capital Advisers for a portion of total payroll and benefits expenses (based on the percentage of total hours worked by each of the Company's employees on Gladstone Commercial matters). GMC also reimbursed Gladstone Capital Advisers for its pro rata portion of all other general expenses (based on the percentage of total hours worked by all employees on Gladstone Commercial matters). GMC further passed its share of these expenses along to Gladstone Commercial under a separate advisory agreement. As a result of this expense sharing arrangement, certain expenses, such as rent and insurance, declined during the fiscal year ended September 30, 2004. Following the engagement of GMC on October 1, 2004, the first day of the 2005 fiscal year, GMC now directly employs all personnel and pays the payroll, benefits, and general expenses directly. Thus, the expense sharing arrangement between Gladstone Capital Advisers and GMC terminated upon the externalization of management on October 1, 2004.

The Company was self-managed and therefore did not incur management fees payable to third parties during the fiscal year ended September 30, 2004.

Property and Equipment

Property and equipment were carried at cost and depreciated using the straight-line method over the estimated useful lives of the related assets ranging from three to five years. On July 1, 2004, the Company sold its fixed assets at net book value to GMC.

Federal Income Taxes

The Company intends to continue to qualify for treatment as a RIC under Subchapter M of the Code. As a RIC, the Company is not subject to federal income tax on the portion of its taxable income and gains distributed to stockholders. To qualify as a RIC, the Company is required to distribute to its stockholders at least 90% of investment company taxable income, as defined by the Code.

Dividends

Distributions to stockholders are recorded on the ex-dividend date. The Company is required to pay out at least 90% of its ordinary income and short-term capital gains for each taxable year as a dividend to its stockholders 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 and is paid out monthly over the course of the respective quarter. At

F-18

year-end the Company may pay a bonus dividend, in addition to the monthly dividends, to ensure that it has paid out at least 90% of its ordinary income and 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. If the Company decides to retain long-term capital gains, the portion of the retained capital gains will be subject to 35% tax.

New Accounting Pronouncements

In October 2005, the Financial Accounting Standards Board ("FASB") released FASB Staff Position No. FAS 123(R)-2 ("FSP FAS 123(R)-2"), "Practical Accommodation to the Application of Grant Date as Defined in FASB Statement No. 123(R)." FSP FAS 123(R)-2 provides guidance on the application of grant date as defined in Statement of Financial Accounting Standards ("SFAS") No. 123(R). The FASB addresses the notion of "mutual understanding," specifically that a mutual understanding shall be presumed to exist at the date the award is approved in accordance with the relevant corporate governance requirements if, the award is a unilateral grant and therefore the recipient does not have the ability to negotiate the terms and conditions of the award with the employer and, the key terms and conditions of the award are expected to be communicated to an individual recipient within a relatively short time period for the date of approval. The Company applied FSP FAS 123(R)-2 in conjunction with the adoption of SFAS No. 123(R) on October 1, 2005.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections", a replacement of APB Opinion No. 20, "Accounting Changes", and SFAS No. 3, "Reporting Accounting Changes in Interim Financial Statements" and changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS 154 applies to all voluntary changes in accounting principle and also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. SFAS 154 requires retrospective application to prior periods' financial statements of changes in accounting principle. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Early adoption is permitted for accounting changes and corrections of errors made in fiscal years beginning after the date of issuance. The Company is required to adopt the provisions of SFAS 154, as applicable, beginning in fiscal year 2007. The Company is currently evaluating the effect of this statement.

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

In June 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109," which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes." This Statement shall be effective as of the beginning of an entity's first fiscal year that begins after December 15, 2006. The Company will adopt this Interpretation effective January 1, 2007. The Company does not expect that this pronouncement will have a material impact on its consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with GAAP, and expands disclosures about fair value measurements. SFAS No. 157 applies broadly to

F-19

securities and other types of assets and liabilities. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within that fiscal year. The Company will be required to adopt SFAS No. 157 on October 1, 2008 and does not expect it to have a material impact on its consolidated financial statements since the Company currently values all portfolio investments at fair value.

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

Note 3. Common Stock Transactions

Transactions in common stock were as follows:

	Common Stock	
	Shares	Amount
Balance at September 30, 2003	10,081,844	\$10,082
Issuance of Common Stock Under Shelf Offering	1,150,000	1,150
Issuance of Common Stock Under Stock Option Plan	46,666	47
Balance at September 30, 2004	11,278,510	\$11,279
Issuance of Common Stock Under Stock Option Plan	25,000	\$ 25
Balance at September 30, 2005	11,303,510	\$11,304
Issuance of Common Stock Under Stock Option Plan	1,001,498	1,001
Balance at September 30, 2006	12,305,008	\$12,305

The balance of common stock at September 30, 2006 does not include 5,000 shares resulting from the exercise of stock options on September 29, 2006 that were not issued by the Company's transfer agent until October 1, 2006.

Note 4. Stock Option Plan

Prior to its termination on September 30, 2006, the Company had in place the Amended and Restated 2001 Equity Incentive Plan (the "2001 Plan"). The Company had authorized 2,000,000 shares of capital stock for the issuance of options under the 2001 Plan to employees and directors. Options granted under the 2001 Plan originally may have been exercised during a term not to exceed ten years from the date of grant. Only employees of the Company and its affiliates were eligible to receive incentive stock options and both employees and non-employee directors were eligible to receive nonstatutory stock options under the 2001 Plan.

Options granted under the 2001 Plan were either incentive stock options or nonstatutory stock options. The option exercise price was equal to the market price on the date of the grant. For the options granted during fiscal year 2006, all vested immediately, 2005, 3% vested immediately, 50% vested one year

F-20

after the grant date and 47% vested on the second year anniversary of the grant date. For the options granted during fiscal year 2004, 50% vested after one year after the grant date and the remaining 50% vested on the second year anniversary of the grant date. Prior to the termination of the 2001 Plan, the vesting of all unvested stock options were accelerated on April 11, 2006.

In December 2004, the FASB issued SFAS No. 123 (revised 2004) ("SFAS No. 123(R)") *Share-based Payment*. SFAS No. 123(R) replaces SFAS No. 123, *Accounting for Stock-Based Compensation* and supersedes Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB No. 25"). SFAS No. 123(R) is effective for awards that are granted, modified, or settled in cash for annual periods beginning after June 15, 2005. The Company adopted SFAS No. 123(R) on October 1, 2005 using the modified prospective approach. Under the modified prospective approach, stock-based compensation expense will be recorded for the unvested portion of previously issued awards that remain outstanding at October 1, 2005 using the same estimate of the grant date fair value and the same attribution method used to determine the pro forma disclosure under SFAS No. 123. SFAS No. 123(R) also requires that all share-based payments to employees after October 1, 2005, including employee stock options, be recognized in the financial statements as stock-based compensation expense based on the fair value on the date of grant. Accordingly, prior period amounts have not been restated.

For the fiscal year ended September 30, 2006, the Company recorded stock option compensation expense for the cost of stock options issued under the 2001 Plan of \$285,318. The Company's expensing of stock options decreased both basic and diluted net increase to net assets resulting from operations per share by \$0.03 and \$0.02, respectively, for the fiscal year ended September 30, 2006. Additionally, SFAS No. 123(R) states that any potential tax benefits associated with incentive stock options should be recognized only at the time of settlement if those options settle through a disqualifying disposition. Thus, the related stock-based compensation expense must be treated as a permanent difference until that time which in turn, results in an increase to the Company's effective tax rate. The Company does not record tax benefits associated with the expensing of stock options since the Company intends to qualify as a RIC under Subchapter M of the Code and as such the Company is not subject to federal income tax on the portion of its taxable income and gains distributed to stockholders, provided that at least 90% of the taxable income is distributed.

The Company accounted for the issuance of stock options through the 2001 Plan in accordance with APB 25 during fiscal years 2005 and 2004. In connection with the externalization of the Company's management, all of its officers and employees became direct employees of GMC as of October 1, 2004, the start of fiscal year 2005. However, these individuals continued to be eligible to receive stock options under the 2001 Plan. Effective October 1, 2004, the Company accounted for any options granted to employees of GMC, who qualify as leased employees of the Company under FIN 44, "Accounting for Certain Transactions Involving Stock Compensation, an Interpretation of APB Opinion No. 25."

Under the provisions of APB No. 25, the Company was not required to recognize compensation expense for the cost of stock options issued under the 2001 Plan. The following table illustrates the effect on net increase to net assets resulting from operations and net increase to net assets resulting from operations per share for the fiscal years ended September 30, 2005 and September 30, 2004, as if the Company had applied the fair value recognition provisions of SFAS No. 123, as amended by SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure":

	<u>Year Ended September 30,</u>	
	<u>2005</u>	<u>2004</u>
Net increase in net assets resulting from operations		
As reported:	\$ 15,490,682	\$ 10,570,290
Deduct: Total stock-based compensation expense determined using the fair value based method for all awards	(297,391)	(1,687,199)
Pro forma net increase in net assets resulting from operations per share	<u>\$ 15,193,291</u>	<u>\$ 8,883,091</u>
As reported—basic	<u>\$ 1.37</u>	<u>\$ 1.05</u>
As reported—diluted	<u>\$ 1.33</u>	<u>\$ 1.02</u>
Pro forma—basic	<u>\$ 1.35</u>	<u>\$ 0.88</u>
Pro forma—diluted	<u>\$ 1.31</u>	<u>\$ 0.86</u>

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used for grants in the fiscal years ended September 30, 2006, 2005 and 2004.

<u>Assumptions:</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Risk free interest rate	4.23 %	3.41 %	2.41 %
Expected life	3 years	3 years	3 years
Expected volatility	23.00%	17.67%	16.91%
Expected dividend yield	7.65 %	6.07 %	6.67 %

The weighted average per share fair value based on the Black-Scholes option pricing model of options granted during the fiscal years ended September 30, 2006, 2005 and 2004, were \$1.89, \$1.71, and \$1.24, respectively.

A summary of the status of the Company's 2001 Plan from September 30, 2004 through September 30, 2006 is as follows:

	<u>Shares</u>	<u>Weighted Average Exercise Price</u>
Options outstanding at September 30, 2004, of which		
897,496 shares were exercisable	<u>1,260,498</u>	\$ 17.44
Granted	74,500	\$ 24.05
Exercised	(25,000)	\$ 17.09
Forfeited	(2,000)	\$ 22.55
Options outstanding at September 30, 2005, of which		
1,307,998 shares are exercisable	<u>1,307,998</u>	\$ 17.81
Granted	2,500	\$ 21.17
Exercised	(1,006,498)	\$ 16.27
Forfeited	(304,000)	\$ 22.94
Options outstanding at September 30, 2006	<u>—</u>	

A detailed summary of the stock options outstanding at fiscal years ended September 30, 2006, September 30, 2005 and September 30, 2004 is presented in the following table:

<u>Fiscal Year Ended</u>	<u>Range of Exercise Prices</u>	<u>Stock Options Outstanding</u>	<u>Weighted Average Remaining Contractual Life (Years)</u>
September 30, 2006	—	—	—
September 30, 2005	\$ 15.00 – \$24.39	1,307,998	7.03
September 30, 2004	\$ 15.00 – \$22.84	1,260,498	7.88

During the fiscal year ended September 30, 2006, the Company issued 1,006,498 shares, 823,332 to executives and directors and 183,166 to ten employees pursuant to stock option exercises, in exchange for cash of \$14,682,905 and four full recourse notes receivable of \$1,692,470. During the fiscal year ended September 30, 2005, the Company issued 25,000 shares; 10,000 to a director and 15,000 to two employees pursuant to stock option exercises, in exchange for cash of \$270,250 and one full recourse note receivable of \$157,100. During the fiscal year ended September 30, 2004, the Company issued 46,666 shares of common stock to three employees pursuant to stock option exercises, in exchange for cash of \$157,100 and two full recourse notes receivable of \$549,990. These transactions were effected pursuant to the 2001 Plan, which allowed the Company to lend its employees funds to pay for the exercise of stock options. All loans made under this arrangement are fully secured by the value of the common stock purchased. Interest is charged and paid on such loans at the market rate as determined based on individual financial positions.

On December 2, 2005, the Company held a special meeting of stockholders in which the stockholders voted to approve a proposal to enter into an amended and restated investment advisory agreement (the "Amended Advisory Agreement") with GMC and an administration agreement (the "Administration Agreement") between the Company and Gladstone Administration LLC, a wholly-owned subsidiary of GMC.

The Amended Advisory Agreement includes an incentive advisory fee, and regulations promulgated by the SEC prohibit business development companies from implementing an incentive advisory fee while having in place a stock option plan or any outstanding stock options. Thus, in connection with the approval of the Amended Advisory Agreement, and pursuant to an offer approved by the Board of Directors on April 11, 2006, the Company extended an offer to its then-current stock option holders to amend the terms of all outstanding stock options under the 2001 Plan to accelerate the contractual expiration date of these options to September 30, 2006. The offer was filed with the SEC on April 12, 2006, was conducted in accordance with the federal tender offer rules and regulations, and was conditioned upon the acceptance by 100% of the stock option holders. The Board of Directors also accelerated in full the vesting of all outstanding options other than options held by the non-employee Directors effective April 11, 2006, resulting in accelerated vesting of 34,500 outstanding options. On May 31, 2006, 100% of the stock option holders accepted the tender offer, and on

Note 5. Commitments and Contingencies

At September 30, 2006, the Company was party to a signed and non-binding term sheet for one potential investment for \$9.0 million and \$7.2 million in four syndicate loan participations. The future scheduled contractual payments at September 30, 2006 were as follows:

Contractual Obligations	Total	Payment Due by Period			
		Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Investments	\$ 16,226,000	16,226,000	—	—	—
Total	\$ 16,226,000	\$ 16,226,000	\$ —	\$ —	\$ —

All prospective investments are subject to, among other things, the satisfactory completion of the Company's due diligence investigation of each borrower, acceptance of terms and structure and receipt of necessary consents. With respect to each prospective loan, the Company will only agree to provide the loan if, among other things, the results of its due diligence investigations are satisfactory, the terms and conditions of the loan are acceptable and all necessary consents are received. The Company has initiated its due diligence investigations of the potential borrowers, however there can be no guarantee that facts will not be discovered in the course of completing the due diligence that would render a particular investment imprudent or that any of these investments will actually be made.

At September 30, 2006, the Company had unpaid federal and state withholding taxes of \$1,803,283 related to the exercise of non-qualified stock options during the third and fourth quarters of fiscal 2006. These withholding taxes were unfunded by the optionees at September 30, 2006 and as a result a corresponding receivable is recorded on the consolidated statements of assets and liabilities at September 30, 2006. During the first fiscal quarter of 2007 the Company remitted the entire tax withholding liability to the respective taxing authorities and it has received substantially all of the amounts due from the optionees.

Note 6. Net Increase in Net Assets Resulting from Operations per Share

The following table sets forth the computation of basic and diluted net increase in net assets resulting from operations per share for the fiscal year ended September 2006, September 30, 2005, and September 30, 2004:

	Year ended September 30.		
	2006	2005	2004
Numerator for basic and diluted net increase in net assets resulting from operations per share	\$ 24,430,235	\$ 15,490,682	\$ 10,570,290
Denominator for basic weighted average shares	11,381,378	11,292,466	10,101,341
Dilutive effect of stock options	234,544	316,680	243,047
Denominator for diluted weighted average shares	11,615,922	11,609,146	10,344,388
Basic net increase in net assets resulting from operations per share	\$ 2.15	\$ 1.37	\$ 1.05
Diluted net increase in net assets resulting from operations per share	\$ 2.10	\$ 1.33	\$ 1.02

Note 7. Related Party Transactions

The Company has provided loans to employees for the exercise of options under the 2001 Plan. The loans require the quarterly payment of interest at the market rate of interest in effect at the date of issue, have varying terms not exceeding nine years and have been recorded as a reduction of net assets. The loans are evidenced by full recourse notes that are due upon maturity or 60 days following termination of employment, and the shares of common stock purchased with the proceeds of the loan are posted as

collateral. During the fiscal year ended September 30, 2006, the Company issued four loans to three employees for \$1,692,470 for the exercise of stock options and received the full repayment of one loan that was issued in fiscal year 2002. During the fiscal year ended September 30, 2005, the Company issued a loan to one employee for \$157,100 for exercise of stock options and received the full repayment of three loans that were issued during fiscal years 2001, 2003, and 2004. During the fiscal year ended September 30, 2004, the Company issued \$549,990 in loans to two employees for the exercise of options and received the full repayment of a loan that was issued during fiscal year 2002. The Company recognized interest income from all employee stock option loans of \$441,341, \$444,170, and \$443,658 during the fiscal years ended September 30, 2006, September 30, 2005 and September 30, 2004, respectively. The outstanding principal balances due on all employee stock option loans at September 30, 2006 and September 30, 2005 were \$10,248,308 and \$8,745,781, respectively.

On July 1, 2004, the Company sold its fixed assets at cost, net of accumulated depreciation to GMC.

Note 8. 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.

The Company had no outstanding repurchase agreement at September 30, 2006 or September 30, 2005. On September 29, 2004, the Company entered into a repurchase agreement (the "Repurchase Agreement") with Ferris Baker Watts for \$44,984,950. On September 30, 2004, this amount was reduced to \$21,345,997 with the application of the net proceeds from the public offering of common stock. This remaining balance was settled on October 1, 2004. The Repurchase Agreement was recorded at cost and was fully collateralized by a United States Treasury Bill with a fair value of \$50,000,000, a carrying value of \$49,984,950 that matured on October 7, 2004 and earned interest of \$2,133. The interest rate on the Repurchase Agreement was 4.25% for a cost of \$7,831.

Note 9. Dividends

The following table illustrates the 2006 and 2005 fiscal year monthly dividends per share:

<u>Fiscal Year</u>	<u>Record Date</u>	<u>Payment Date</u>	<u>Dividend per Share</u>
2006	September 21, 2006	September 29, 2006	\$ 0.140
	August 23, 2006	August 31, 2006	\$ 0.140
	July 21, 2006	July 31, 2006	\$ 0.140
	June 22, 2006	June 30, 2006	\$ 0.135
	May 22, 2006	May 31, 2006	\$ 0.135
	April 20, 2006	April 28, 2006	\$ 0.135
	March 23, 2006	March 31, 2006	\$ 0.135
	February 20, 2006	February 28, 2006	\$ 0.135
	January 19, 2006	January 31, 2006	\$ 0.135
	December 21, 2005	December 30, 2005	\$ 0.135
	November 21, 2005	November 30, 2005	\$ 0.135
	October 21, 2005	October 31, 2005	\$ 0.135
		Annual Total:	\$ 1.635
	2005	September 22, 2005	September 30, 2005
August 23, 2005		August 31, 2005	\$ 0.135
July 21, 2005		July 29, 2005	\$ 0.135
June 16, 2005		June 30, 2005	\$ 0.130
May 13, 2005		May 27, 2005	\$ 0.130
April 15, 2005		April 29, 2005	\$ 0.130
March 18, 2005		March 31, 2005	\$ 0.120
February 11, 2005		February 28, 2005	\$ 0.120
January 14, 2005		January 28, 2005	\$ 0.120
December 17, 2004		December 30, 2004	\$ 0.120
November 17, 2004		November 30, 2004	\$ 0.120
October 18, 2004		October 29, 2004	\$ 0.120
		Annual Total:	\$ 1.515

Aggregate dividends declared and paid for the 2006 fiscal year were approximately \$18.6 million which were declared based on an estimate of net investment income for the year. Net investment income, including realized gains exceeded dividends declared by approximately \$0.2 million.

Aggregate dividends declared and paid for the 2005 fiscal year were approximately \$17.1 million which were declared based on an estimate of net investment income for the year. Net investment income, including realized gains exceeded dividends declared by approximately \$0.2 million.

Note 10. Fee Income

The 1940 Act requires that a business development company make available managerial assistance to its portfolio companies. The 1940 Act defines managerial assistance as the service made available to a portfolio company to provide "significant guidance and counsel concerning the management, operations, or business objectives and policies of a portfolio company." Prior to the start of fiscal year 2005, the Company provided managerial assistance and other services to its portfolio companies through its wholly-owned subsidiary, Gladstone Capital Advisers, Inc. and therefore recorded managerial assistance and other fee revenue in connection with these activities. Effective October 1, 2004, the Company offers managerial assistance and other services to its portfolio companies through its external investment adviser, GMC. Neither the Company nor GMC currently charges a fee for managerial assistance. However, in the past the Company and, since October 1, 2004, GMC, have provided other services to portfolio companies in addition to managerial assistance. These other services include a wide variety of services to the portfolio

F-26

companies such as investment banking services, arranging bank financing, arranging equity financing, structuring financing from multiple lenders and investors, reviewing existing credit facilities, restructuring existing loans, raising equity and debt capital, turnaround management, merger and acquisition services and recruiting new management personnel. GMC is charging for these services and is crediting the funds received from these other services to the Company as a credit against the investment advisory fee due from the Company under the investment advisory agreement. Such fees are normally paid in part at the time of signing a non-binding letter of intent, with the remainder paid upon completion of the services, and are generally non-recurring. For the fiscal years ended September 30, 2006 and September 30, 2005, the Company recorded no revenue from fees since, as described above, these fees were remitted by the borrower directly to GMC. For the fiscal year ended September 30, 2004, these fees totaled \$1,118,106.

While GMC began receiving all fees in connection with the Company's investments as of October 1, 2004, such fees received by GMC are credited to the Company as a reduction of the advisory fee payable to GMC under the advisory agreement between the Company and GMC. For the fiscal years ended September 30, 2006 and September 30, 2005, GMC received \$2,051,000 and \$1,077,100, respectively, for fees for services rendered to portfolio companies. None of these fees were for managerial assistance even though GMC provided managerial assistance to many of the Company's portfolio companies. Accordingly, the advisory fee payable by the Company to GMC for the fiscal year ended September 30, 2006 and September 30, 2005 were reduced by \$2,051,000 and \$1,077,100, respectively, in respect of these fees received by GMC.

Note 11. Advisory Agreement with GMC

Since October 1, 2004, the Company has been externally managed pursuant to a contractual investment advisory arrangement with GMC, an unconsolidated affiliate of the Company and a registered investment adviser, under which GMC has directly employed all of the Company's personnel and paid its payroll, benefits, and general expenses directly. The Company's initial advisory agreement with GMC was in place through September 30, 2006 (the "Initial Advisory Agreement"). Pursuant to the Initial Advisory Agreement, the Company paid GMC an annual advisory fee of 1.25% of its total assets (as reduced by cash and cash equivalents pledged to creditors), payable in quarterly increments of 0.3125%, and an annual administrative fee of 0.75% of its total assets (as reduced by cash and cash equivalents pledged to creditors), payable in quarterly increments of 0.1875%. GMC's board of directors agreed to waive, for the quarters ending June 30, 2006 and September 30, 2006, the annual advisory fee of 1.25% to 0.5% for those senior syndicated loans in which the Company already has syndicated second lien participations. Under the Initial Advisory Agreement, the Company paid all of its direct expenses, including, but not limited to, directors' fees, legal and accounting fees, stockholder related expenses, and directors and officers insurance.

GMC services the loans held by Business Loan, in return for which GMC receives a 1.5% annual fee based on the monthly aggregate balance of loans held by Business Loan. Since the Company owns these loans, all loan servicing fees paid to GMC are also credited directly against the 2% management fee. These credits reduce the amount of the investment advisory fee and are shown above the direct credits line item in the table below. Under the advisory agreement, GMC also provides the managerial assistance and other services that the Company previously made available to its portfolio companies through its wholly-owned subsidiary Gladstone Capital Advisers, Inc. To the extent that GMC receives any fees directly from a portfolio company for such services, GMC credits these fees directly against the 2% management fee and these amounts are shown in the table below as a credit to the management fee. Overall, the management fee due to GMC cannot exceed 2% of total assets (as reduced by cash and cash equivalents pledged to creditors) during any given fiscal year. Because the Company was internally managed at all times prior to October 1, 2004, no management fee was recorded prior to that date.

The following tables set forth the quarterly computation of the management fee for the fiscal years ended September 30, 2006 and 2005 based on the quarterly increment of 0.50% (0.3125% quarterly advisory fee and 0.1875% quarterly administrative fee):

	September 30, 2006	June 30, 2006	March 31, 2006	December 31, 2005
Fee:				
Total assets at	\$ 223,979,932(f)	\$ 207,265,095	\$ 217,404,695	\$ 211,823,244
Less: Senior syndicated loans subject to reduced fee	(11,011,616)(a)	(3,018,897)(a)	—	
Less: Borrowings under line of credit at	—	—	—	(15,000,000)(d)
Total assets subject to quarterly fee of 0.50% as of	212,968,316	204,246,198	217,404,695	196,823,244
Quarterly fee rate	0.50%	0.50%	0.50%	0.50%
Management fee before senior syndicated loan advisory fee	1,064,841	1,021,231	1,087,023	984,116
Total senior syndicated loan advisory fee at quarterly rate 0.125%	13,765(b)	3,774(b)	—	—
Gross management fee before loan servicing fee credit	1,078,606	1,025,005	1,087,023	984,116
Less: loan servicing fee from Business Loan	763,851	693,965	734,644	715,415
Management fee before credit:	314,755	331,040	352,379	268,701
Direct Credit to Management Fee:				
Fee revenue recorded by GMC:	289,000	539,000	673,000	550,000
Net management fee for the three months ended(c):	\$ 25,755	\$ (207,960)	\$ (320,621)	\$ (281,299)
	September 30, 2005	June 30, 2005	March 31, 2005	December 31, 2004
Fee:				
Total assets	\$ 205,793,094	\$ 209,320,463	\$ 213,753,998	\$ 194,085,591
Less: Borrowings under line of credit	—	—	(18,644,179)(e)	(22,435,000)(e)
Total assets subject to quarterly fee of 0.50% as of	205,793,094	209,320,463	195,109,819	171,650,591
Quarterly fee rate	0.50%	0.50%	0.50%	0.50%
Gross management fee before loan servicing fee credit	1,028,965	1,046,602	975,549	858,254
Less: loan servicing fee from Business Loan	745,263	687,971	585,542	530,952
Management fee before credit:	283,702	358,631	390,007	327,302
Direct Credit to Management Fee:				
Fee revenue recorded by GMC:	100,000	240,600	450,000	286,500
Net management fee for the three months ended:	\$ 183,702	\$ 118,031	\$ (59,993)	\$ 40,802

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

- (b) This amount represents the reduced quarterly advisory fee applicable only to the senior syndicated loans.
- (c) If the amount presented is in parentheses it denotes the amount is due back to the Company from GMC; if the amount is positive, it indicates that the Company owes GMC the stated amount.
- (d) This amount represents borrowings under one of the Company's lines of credit that were held in cash and cash equivalents as of December 31, 2005. The \$15.0 million was to be used to fund a new loan investment, however the investment did not fund until January 2006. Solely for the purposes of calculating the amount of the management fee due to GMC, the Company treats any such amounts as "cash and cash equivalents pledged to creditors" under the terms of its advisory agreement with GMC. As a result, such amounts are deducted from its total assets for purposes of computing the asset base upon which the management fee is determined.
- (e) This amount represents borrowings under one of the Company's lines of credit that were held in cash and cash equivalents as of March 31, 2005 and December 31, 2004, for the purpose of satisfying its asset diversification requirements under the Code. Solely for the purposes of calculating the amount of the management fee due to GMC, the Company treats any such amounts as "cash and cash equivalents pledged to creditors" under the terms of its advisory agreement with GMC. As a result, such amounts are deducted from the Company's total assets for purposes of computing the asset base upon which the management fee is determined.
- (f) Excludes amounts due from employees in connection with tax withholdings related to the exercise of non-qualified stock options during the third and fourth quarters of fiscal 2006. (See Note 5)

On October 1, 2006, the Company entered into an amended and restated investment advisory agreement (the "Amended Advisory Agreement") with GMC and an administration agreement (the "Administration Agreement") with Gladstone Administration. Under the Amended Advisory Agreement, the Company pays GMC an annual base management fee of 2% of its average gross assets, which is defined as total assets less cash and cash equivalents pledged to creditors calculated as of the end of the two most recently completed fiscal quarters, in addition to a two-part incentive fee. The first part of the incentive fee is an income-based incentive fee which rewards GMC if the Company's quarterly net investment income (before giving effect to any incentive fee) exceeds 1.75% of the Company's net assets (the "hurdle rate"). The Company will pay GMC an income incentive fee with respect to its pre-incentive fee net investment income in each calendar quarter as follows:

- no incentive fee in any calendar quarter in which pre-incentive fee net investment income does not exceed the hurdle rate (7% annualized);
- 100% of pre-incentive fee net investment income with respect to that portion of such pre-incentive fee net investment income, if any, that exceeds the hurdle rate but is

less than 2.1875% in any calendar quarter (8.75% annualized); and

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

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

F-29

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

In addition to the base management and incentive fees under the Amended Advisory Agreement, certain fees received by GMC from the Company's portfolio companies were credited against the investment advisory fee under the Initial Advisory Agreement, and will continue to be paid to GMC and credited under the Amended Advisory Agreement. In addition, the Company will continue to pay its direct expenses including, but not limited to, directors fees, legal and accounting fees, and stockholder related expenses under the Amended Advisory Agreement.

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

Note 12. Lines of Credit

In June 2004, the Company entered into a \$15.0 million line of credit agreement with Branch Banking and Trust Company ("BB&T Agreement"), which originally matured in June 2005 and had been extended through December 31, 2006. On June 22, 2006, the Company terminated the BB&T Agreement due to infrequent borrowings. Interest on outstanding borrowings was based upon the one month London Interbank Offered Rate ("LIBOR") plus 2.5% per annum. The unused portion of the line of credit was subject to a fee of 0.2% per annum during the period in which the BB&T Agreement was outstanding.

Through Business Loan, the Company has a \$150 million revolving credit facility (the "DB Facility") with Deutsche Bank AG, as administrative agent, pursuant to which Business Loan pledged the loans it holds to secure future advances by certain institutional lenders. The interest rate charged on the advances under the DB Facility is based on LIBOR, the Prime Rate or the Federal Funds Rate, depending on market conditions, and adjusts periodically. In May 2006, the Company renewed its line of credit through May 25, 2007. In September 2006, the Company increased its capacity in the DB Facility from \$100 million to \$150 million. As of September 30, 2006, the outstanding principal balance under the DB Facility was approximately \$50.0 million at an interest rate of 5.4%. Available borrowings are subject to various constraints imposed by Deutsche Bank AG, based on the aggregate loan balance pledged by Business Loan, which varies as loans are added and repaid, regardless of whether such repayments are early prepayment or are made as contractually required. At September 30, 2006, the remaining borrowing capacity available under the DB Facility was approximately \$100.0 million.

The DB Facility contains covenants that require Business Loan to maintain its status as a separate entity; prohibit certain significant corporate transactions (such as mergers, consolidations, liquidations or dissolutions); and restrict material changes to the Company's credit and collection policies. The DB Facility also restricts some of the terms and provisions (including interest rates, terms to maturity and payments schedules) and limits the borrower and industry concentrations of loans that are eligible to secure advances. As of September 30, 2006, Business Loan was in compliance with all of the facility covenants.

The administrative agent also requires that any interest or principal payments on pledged loans be remitted directly by the borrower into a lockbox account with the Bank of New York as custodian. Deutsche Bank AG is also the trustee of the account and once a month remits the collected funds to the Company. At September 30, 2006, the amount due from custodian was \$3,587,152 and at September 30, 2005, the amount due from custodian was \$2,624,074.

F-30

Effective July 12, 2004, GMC, the Company's affiliated external adviser also services the loans pledged under the DB Facility. As a condition to this servicing arrangement, the Company executed a performance guaranty pursuant to which it guaranteed that Management would comply fully with all of its obligations under the DB Facility. The performance guaranty requires the Company to maintain a minimum net worth of \$100 million and to maintain "asset coverage" with respect to "senior securities representing indebtedness" of at least 200%, in accordance with Section 18 of the 1940 Act. As of September 30, 2006, the Company was in compliance with all covenants under the performance guaranty. GMC services these loans for an annual fee of 1.5% of the monthly aggregate outstanding loan balance of the loans pledged under the DB Facility. Effective in April 2006, GMC's board of directors voluntarily agreed to waive, on a temporary basis, the annual servicing fee rate for those senior syndicated loans in which the Company already has a second lien position to 0.5%. For the fiscal year ended September 30, 2006, the Company recorded loan servicing fees of \$2,907,875 and owed \$214,608 of unpaid loan servicing fees to GMC, recorded in fees due to affiliate. For the fiscal year ended September 30, 2005, the Company recorded loan servicing fees of \$2,549,728. At September 30, 2005, the Company owed \$207,619 of unpaid loan servicing fees to GMC, which are recorded in fees due to affiliate. For the fiscal year ended September 30, 2004, loan servicing fees were \$501,670, which represented the period July 12, 2004 through September 30, 2004 as prior to July 12, 2004, the loans pledged under the DB Facility were serviced by Gladstone Capital Advisers, Inc., wholly-owned subsidiary of the Company.

Loan servicing fees received by GMC are credited to the Company's advisory fee payable to GMC under the advisory agreement between the Company and GMC. Accordingly, the advisory fee payable by the Company to GMC for the fiscal year ended September 30, 2006 and September 30, 2005 was reduced by \$2,907,875 and \$2,549,728, respectively, in respect of these fees received by GMC.

Note 13. Interest Rate Cap Agreement

Pursuant to the Deutsche Bank AG line of credit, the Company has an interest rate cap agreement that effectively limits the interest rate on a portion of the borrowings under the line of credit.

The use of a cap involves risks that are different from those associated with ordinary portfolio securities transactions. Cap agreements may be considered to be illiquid. Although the Company will not enter into any such agreements unless it believes that the other party to the transaction is creditworthy, the Company does bear the risk of loss of the amount expected to be received under such agreements in the event of default or bankruptcy of the agreement counterparty.

In February 2004, the Company entered into an interest rate cap agreement with a notional amount of \$35.0 million at a cost of \$304,000. The interest rate cap agreement's current notional amount is \$16.4 million with a current fair value of \$50,284 which is recorded in other assets on the Company's consolidated balance sheet at September 30, 2006. At September 30, 2005, the interest rate cap agreement had a fair value of \$50,253. The Company records changes in the fair value of the interest rate cap agreement monthly based on the current market valuation at month end as unrealized depreciation or appreciation on derivative on the Company's consolidated statement of operations. The interest rate cap agreement expires in February 2009. The agreement provides that the Company's floating interest rate or cost of funds on a portion of the

portfolio's borrowings will be capped at 5% when the LIBOR rate is in excess of 5%. During the fiscal year ended September 30, 2006, the Company recorded \$15,014 of income from the interest rate cap agreement recorded as a realized gain on the settlement of derivative on the Company's consolidated statements of operations. The Company did not recognize any income from the interest rate cap agreement during the fiscal years ended September 30, 2005 and September 30, 2004.

Note 14. Federal and State Income Taxes

The Company has historically operated, and intends to continue to operate, in a manner to qualify for treatment as a RIC under Subchapter M of the Code. As a RIC, the Company is not subject to federal or state income tax on the portion of its taxable income and gains distributed to stockholders. To qualify as a RIC, the Company is required to distribute to its stockholders at least 90% of investment company taxable income, as defined by the Code and as such no income tax provisions have been recorded for the individual companies of Gladstone Capital Corporation and Gladstone Business Loan LLC.

During the fiscal year ended September 30, 2006, the Company recorded \$101,917 in tax expense in connection with penalties incurred on misclassified revenue on its fiscal year 2004 corporate tax return.

Gladstone Capital Advisers, Inc., a wholly-owned subsidiary of Gladstone Capital Corporation, is subject to federal and state income taxation on the income it has recorded such as fees received from portfolio companies resulting in aggregate federal and state income taxes of \$209,278 during the fiscal year ended September 30, 2005.

Note 15. Deferred Compensation Plan

The Company adopted a deferred compensation plan (the "401(k) Plan") effective January 1, 2002 which permits an employee to defer the lesser of 75% of his or her total annual compensation or the applicable Internal Revenue Service (IRS) annual limit. As of September 30, 2004, the Company funded \$50,630 in contributions to the 401(k) Plan. For the fiscal year ended September 30, 2004, the Company recorded \$48,502 in expenses related to the 401(k) Plan. Effective October 1, 2004, GMC assumed sponsorship of the 401(k) Plan pursuant to a corporate resolution. There were no expenses incurred for the fiscal year ended September 30, 2006 or September 30, 2005 related to the 401(k) Plan.

Note 16. Subsequent Events

Dividends

On October 10, 2006, the Company's Board of Directors declared the following monthly dividends which it believes were and will be paid, as applicable, from ordinary income:

<u>Declaration Date</u>	<u>Record Date</u>	<u>Pavment Date</u>	<u>Dividend per Share</u>
October 10, 2006	October 23, 2006	October 31, 2006	\$0.14
October 10, 2006	November 21, 2006	November 30, 2006	\$0.14
October 10, 2006	December 20, 2006	December 29, 2006	\$0.14

Amended Advisory Agreement and Administration Agreement

On October 1, 2006, the Company entered into the Amended Advisory Agreement with GMC, and the Administration Agreement with Gladstone Administration.

Under the terms of the Amended Advisory Agreement, GMC will continue to manage the investment and reinvestment of the Company's assets, including identifying, evaluating, and structuring such investments; continuously review, supervise and administer the Company's investment program to determine in its discretion the securities to be purchased or sold and the portion of the Company's assets to be held un-invested; offer to provide significant managerial assistance to the issuers of securities in which the Company is invested as required by the Investment Company Act of 1940, as amended; arrange debt financing for the Company; provide the Company with all required records concerning GMC's efforts on behalf of the Company; and provide regular reports to the Company's Board concerning GMC's activities on behalf of the Company.

The Amended Advisory Agreement provides for an annual base management fee equal to 2% of the Company's assets and an income-based incentive fee which will reward GMC if the Company's quarterly net investment income (before giving effect to the incentive fee) exceeds 1.75% of net assets. The agreement also provides for an annual capital gains-based incentive fee, whereby GMC will receive an annual fee equal to 20% of the Company's realized capital gains (net of realized capital losses and unrealized capital depreciation since inception of the Company). These incentive fees are intended to replace the Company's equity incentive plan and stock options, which have been terminated in connection with the Company's entrance into the Amended Advisory Agreement and Administration Agreement.

Under the terms of the Administration Agreement, Administration will manage the Company's day-to-day operations and administration, record keeping and regulatory compliance functions. The Company will pay separately for administrative services under the Administration Agreement, which payments will be equal to the Company's allocable portion of Administration's overhead expenses in performing its obligations under the Administration Agreement, including rent, and the Company's allocable portion of the salaries and benefits expenses of its chief financial officer, chief compliance officer, controller and their respective staffs.

The Amended Advisory and Administration Agreements were approved by the Company's stockholders at a special meeting on December 2, 2005.

Investment Activity

Subsequent to September 30, 2006, the Company extended \$9.2 million in loans to Precision Inc., an industrial machinery components manufacturer, extended \$975,000 in revolver borrowings to 2 existing portfolio companies and funded additional term loans of \$1.0 million to 2 portfolio companies. The Company also purchased 12 syndicated loan participations for approximately \$25.2 million.

Also subsequent to September 30, 2006, the Company received principal repayments of approximately \$1,682,000 on 8 existing portfolio company loans. In addition, the Company received the full repayment of loans to Mistras Holdings Corp. and Xspedius Communications, LLC in the approximate amounts of \$14.8 million and \$5.2 million, respectively.

Note 17. Selected Quarterly Data (Unaudited)

	<u>Year Ended September 30, 2006</u>			
	<u>Quarter Ended December 31, 2005</u>	<u>Quarter Ended March 31, 2006</u>	<u>Quarter Ended June 30, 2006</u>	<u>Quarter Ended September 30, 2006</u>
Total Investment Income	\$ 6,030,319	\$ 7,000,700	\$ 6,522,816	\$ 7,346,011
Net Investment Income	4,442,414	5,203,816	4,788,082	4,916,268

Net Increase in Net Assets Resulting From Operations	8,233,349	5,590,381	5,543,076	5,063,429
Basic Earnings per Weighted Average Common Share	\$ 0.73	\$ 0.49	\$ 0.49	\$ 0.44
Diluted Earning per Weighted Average Common Share	\$ 0.71	\$ 0.48	\$ 0.48	\$ 0.43

F-33

	Year Ended September 30, 2005			
	Quarter Ended December 31, 2004	Quarter Ended March 31, 2005	Quarter Ended June 30, 2005	Quarter Ended September 30, 2005
Total Investment Income	\$ 6,078,401	\$ 5,886,529	\$ 6,127,226	\$ 5,857,603
Net Investment Income	4,677,404	4,431,258	4,372,426	3,805,057
Net Increase in Net Assets Resulting From Operations	4,944,948	4,275,378	3,934,153	2,336,203
Basic Earnings per Weighted Average Common Share	\$ 0.44	\$ 0.38	\$ 0.35	\$ 0.21
Diluted Earning per Weighted Average Common Share	\$ 0.43	\$ 0.37	\$ 0.34	\$ 0.20

F-34

GLADSTONE CAPITAL CORPORATION
CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES
(Unaudited)

	March 31, 2007	September 30, 2006
ASSETS		
Investments at fair value (Cost 3/31/2007: \$281,525,450; 9/30/2006: \$216,202,986)	\$ 280,242,688	\$ 217,642,750
Cash and cash equivalents	2,973,135	731,744
Interest receivable—investments in debt securities	2,116,813	1,394,942
Interest receivable—employees	45,359	37,396
Due from custodian	4,828,847	3,587,152
Deferred financing fees	50,466	145,691
Prepaid assets	241,088	226,747
Fees due from Adviser (Refer to Notes 4 and 5)	28,768	—
Due from employees	—	1,803,283
Other assets	488,790	213,510
TOTAL ASSETS	<u>\$ 291,015,954</u>	<u>\$ 225,783,215</u>
LIABILITIES		
Accounts payable	\$ 5,005	\$ 4,072
Interest payable	528,736	247,530
Administration fee due to Administrator	168,766	—
Fees due to Adviser (Refer to Notes 4 and 5)	—	240,363
Borrowings under line of credit	120,300,000	49,993,000
Withholding taxes payable	—	1,803,283
Accrued expenses and deferred liabilities	486,330	721,287
Funds held in escrow	203,222	203,193
TOTAL LIABILITIES	<u>121,692,059</u>	<u>53,212,728</u>
NET ASSETS	<u>\$ 169,323,895</u>	<u>\$ 172,570,487</u>
ANALYSIS OF NET ASSETS		
Common stock, \$0.001 par value, 50,000,000 shares authorized and 12,249,683 and 12,305,008 shares issued and outstanding, respectively	\$ 12,250	\$ 12,305
Capital in excess of par value	179,782,427	181,270,565
Notes receivable—employees	(9,947,366)	(10,248,308)
Net unrealized appreciation on investments	(1,282,764)	1,439,764
Unrealized depreciation on derivative	(279,329)	(253,716)
Realized loss on sale of investments	(775,176)	(861,695)
Realized gain on settlement of derivative	37,807	15,014
Accumulated undistributed net investment income	1,776,046	1,196,558
TOTAL NET ASSETS	<u>\$ 169,323,895</u>	<u>\$ 172,570,487</u>
NET ASSETS PER SHARE	<u>\$ 13.82</u>	<u>\$ 14.02</u>

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

F-35

AS OF MARCH 31, 2007

(UNAUDITED)

<u>Company(1)</u>	<u>Industry</u>	<u>Investment(2)</u>	<u>Cost</u>	<u>Fair Value</u>
ActivStyle Acquisition Co. ActivStyle, Inc.	Service-medical products distribution	Line of Credit(5)(9) (9.6%, Due 7/2009) Senior Term Debt(5) (9.6%, Due 7/2011) Senior Term Debt(3)(5) (11.9%, Due 7/2011)	\$ 450,000 3,040,000 2,500,000	\$ 448,875 3,040,000 2,500,000
Advanced Homecare Management, Inc.	Service-home health nursing services	Senior Subordinated Term Debt(5) (6) (11.8%, Due 12/2013)	6,300,000	6,300,000
Allied Extruders, LLC P&O Packaging Acquisition LLC	Manufacturing-polyethylene film	Senior Real Estate Term Debt (9.8%, Due 3/2011) Senior Term Debt(3)(5)(19) (11.3%, Due 3/2011)	1,000,000 8,000,000	1,000,000 8,170,800
Anitox Acquisition Company Anitox Holding, Inc.	Manufacturing-preservatives for animal feed	Senior Real Estate Term Debt (8.8%, Due 1/2012) Senior Term Debt(5) (9.6%, Due 1/2012) Senior Term Debt(3)(5) (11.8%, Due 1/2012)	3,415,828 2,750,000 2,750,000	3,360,000 2,750,000 2,750,000
Badanco Acquisition Corp.	Service-luggage design and distribution	Senior Subordinated Term Debt(5) (12.1%, Due 7/2012)	9,750,000	9,762,188
Benetech, Inc.	Service & Manufacturing- dust management systems for the coal and electric utility industries	Senior Term Debt(5) (10.3%, Due 5/2009) Senior Term Debt(3)(5) (13.3%, Due 5/2009)	1,787,500 2,965,625	1,816,547 3,028,645
Bresnan Communications, LLC	Service-telecommunications	Senior Term Debt(6) (7.1%, Due 9/2013) Senior Subordinated Term Debt(6) (9.9%, Due 3/2014)	1,001,958 1,510,780	1,000,000 1,530,000
CHG Companies, Inc. CHG Medical Staffing, Inc.	Service-healthcare staffing	Letter of Credit(5)(6) (7.9%, Due 12/2012) Senior Term Debt(5)(6) (7.9%, Due 12/2012) Senior Subordinated Term Debt(5) (6) (11.3%, Due 12/2012)	400,000 1,596,000 500,000	404,500 1,613,955 507,500
Clinton Holdings, LLC	Distribution-aluminum sheets and stainless steel	Senior Subordinated Term Debt(5) (12.6%, Due 1/2013)	15,500,000	15,538,750
Clinton Aluminum Acquisition, LLC Metal Transportation, LLC Clinton Distribution Center, LLC		Common Stock Warrants(7)	109,124	109,124

F-36

GLADSTONE CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)
AS OF MARCH 31, 2007
(UNAUDITED)

<u>Company(1)</u>	<u>Industry</u>	<u>Investment(2)</u>	<u>Cost</u>	<u>Fair Value</u>
Consolidated Bedding, Inc.	Manufacturing-mattresses	Senior Subordinated Term Debt(5) (14.4%, Due 3/2009)	\$2,340,538	\$1,858,050
Country Road Communications LLC Country Road Management, Inc.	Service-telecommunications	Senior Subordinated Term Debt(5) (6) (13.2%, Due 7/2013)	5,964,420	6,030,000
Critical Healthcare Solutions, Inc.	Service-home therapy and respiratory therapy	Senior Term Debt(8) (8.6%, Due 1/2012)	1,987,500	1,986,258
Dealer Computer Services, Inc. (d/b/a Reynolds & Reynolds)	Manufacturing & Service- Systems for automotive retailers	Senior Term Debt(8) (7.4%, Due 10/2012)	947,240	954,936
Defiance Acquisition Corporation	Manufacturing-trucking parts	Senior Term Debt(3)(5) (13.3%, Due 4/2010)	6,325,000	6,317,094
Doe & Ingalls Management LLC	Distributor-specialty chemicals	Senior Term Debt(5) (9.8%, Due 11/2010)	4,300,000	4,310,750
Doe & Ingalls of North Carolina Operating LLC Doe & Ingalls of Florida Operating LLC Doe & Ingalls of Virginia Operating LLC Doe & Ingalls of Maryland Operating LLC		Senior Term Debt(3)(5) (13.3%, Due 11/2010)	4,477,500	4,483,097

Emdeon Business Services, Inc.	Service-healthcare technology	Senior Term Debt(6)	2,479,803	2,486,483
	solutions	(7.6%, Due 11/2013) Senior Subordinated Term Debt(6) (10.4%, Due 5/2014)	2,013,952	2,030,000
Employment Solutions Management, Inc. Employbridge	Service-specialty staffing	Senior Term Debt(8)	2,992,989	2,996,241
		Senior Subordinated Term Debt(8) (12.3%, Due 10/2013)	3,000,495	3,000,000
Express Courier International, Inc.	Service-ground delivery and logistics	Line of Credit(10) (9.6%, Due 6/2009)	200,000	200,000
		Senior Term Debt(5) (9.6%, Due 6/2011)	4,465,000	4,470,581
		Senior Term Debt(3)(5) (11.8%, Due 6/2011)	3,950,000	3,954,938
Finn Corporation	Manufacturing-landscape equipment	Common Stock Warrants	37,000	826,061
FR X Ohmstede Holdings, LLC	Service & Manufacturing-heat exchangers	Senior Term Debt(6)	2,739,130	2,749,402
FR X Ohmstede Acquisitions Co.		(7.9%, Due 8/2013) Senior Subordinated Term Debt(6) (12.4%, Due 8/2014)	3,011,583	3,052,500
Generac Acquisition Corp.	Manufacturing-standby power products	Senior Term Debt(8) (7.9%, Due 11/2013)	\$2,356,200	\$2,375,344
Global Materials Technologies, Inc.	Manufacturing-steel wool products and metal fibers	Senior Term Debt(3)(5) (14.3%, Due 11/2009)	5,200,000	5,018,000

F-37

GLADSTONE CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)
AS OF MARCH 31, 2007
(UNAUDITED)

<u>Company(1)</u>	<u>Industry</u>	<u>Investment(2)</u>	<u>Cost</u>	<u>Fair Value</u>
GTM Holdings, Inc. Gold Toe Investment Corp.	Manufacturing-socks	Senior Term Debt(6) (8.1%, Due 10/2013)	498,750	501,244
		Senior Subordinated Term Debt(6) (11.4%, Due 4/2014)	500,000	507,500
Greatwide Logistics Services, Inc.	Service—logistics and transportation	Senior Term Debt(6) (8.6%, Due 12/2013)	3,990,000	4,009,950
		Senior Subordinated Term Debt(6) (11.9%, Due 6/2014)	4,000,000	3,960,000
Harrington Holdings, Inc. Harrington Acquisition Corp.	Service—healthcare products distribution	Senior Term Debt(6) (7.8%, Due 1/2014)	2,500,000	2,506,250
		Senior Subordinated Term Debt(6) (11.3%, Due 1/2014)	5,000,000	5,025,000
Hudson Products Holdings, Inc.	Manufacturing-heat transfer solutions	Senior Term Debt(8) (8.1%, Due 12/2013)	2,141,257	2,148,664
IPC Information Systems, LLC	Manufacturing-specialized telephony systems	Senior Term Debt(6) (7.9%, Due 9/2013)	236,810	238,290
It's Just Lunch International, LLC	Service-dating service	Line of Credit(5)(11) (9.3%, Due 6/2009)	550,000	545,875
		Senior Term Debt(5) (9.6%, Due 6/2011)	3,300,000	3,275,250
		Senior Term Debt(3)(5)(11) (11.8%, Due 6/2011)	500,000	496,250
John Henry Holdings, Inc.	Manufacturing-packaging products	Senior Subordinated Term Debt(6) (12.3%, Due 6/2011)	8,000,000	8,000,000
Multi Packaging Solutions, Inc.		Senior Term Debt(6) (7.8%, Due 11/2013)	1,505,605	1,507,157
Kinetek Acquisition Corp.	Manufacturing-custom engineered motors & controls	Senior Subordinated Term Debt(6) (10.8%, Due 5/2014)	1,509,548	1,515,000
LocalTel, Inc.	Service-yellow pages publishing	Line of Credit(5)(12) (9.8%, Due 6/2009)	1,035,000	983,250
		Senior Term Debt(5) (9.8%, Due 6/2011)	2,687,500	2,418,750
		Senior Term Debt(3)(5) (12.3%, Due 6/2011)	2,750,000	2,337,500
MediMedia USA Inc.	Service-healthcare and pharmaceutical marketing	Senior Term Debt(8) (7.8%, Due 10/2013)	\$1,074,835	\$1,075,667
Meteor Holding Corporation Metrologic Instruments, Inc.	Manufacturing-bar code scanning and data capture	Senior Term Debt(6) (8.1%, Due 12/2013)	997,500	1,002,488
		Senior Subordinated Term Debt(6) (11.8%, Due 12/2013)	500,000	505,000

Northern Contours	Manufacturing-veneer and	Senior Subordinated Term Debt(5)	7,000,000	7,026,250
Northern Contours of Kentucky, Inc. Norcon Holding LLC Norcon Lewis LLC	laminare components	(12.3%, Due 5/2010)		

F-38

GLADSTONE CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)
AS OF MARCH 31, 2007
(UNAUDITED)

<u>Company(1)</u>	<u>Industry</u>	<u>Investment(2)</u>	<u>Cost</u>	<u>Fair Value</u>
Pinnacle Treatment Centers, Inc.	Service-Addiction treatment centers	Line of Credit(13) (9.6%, Due 12/2009) Senior Term Debt(5) (9.6%, Due 12/2011) Senior Term Debt(3)(5) (12.3%, Due 12/2011)	— 2,500,000 4,500,000	— 2,500,000 4,500,000
Precision Acquisition Group Holdings, Inc.	Manufacturing-consumable components for the aluminum industry	Equipment Note(14) (9.8%, Due 10/2011)	—	—
Precision Asset Acquisition Company, LLC		Senior Term Debt(5) (9.8%, Due 10/2010) Senior Term Debt(3)(5) (11.8%, Due 10/2010)	5,000,000 4,200,000	5,012,500 4,210,500
PROFITSystems Acquisition Co. PROFITSystems, Inc.	Service-design and develop ERP software	Line of Credit(15) (9.6%, Due 7/2009) Senior Term Debt(5) (9.6%, Due 7/2011) Senior Term Debt(3)(5) (11.8%, Due 7/2011)	— 2,950,000 2,900,000	— 2,957,375 2,907,250
Puerto Rico Cable Acquisition Company, Inc.	Service-telecommunications	Senior Subordinated Term Debt(5) (6) (11.6%, Due 1/2012)	7,805,906	7,794,524
Rally Parts, Inc. Motorsport Aftermarket Group, Inc.	Manufacturing-aftermarket motorcycle parts and accessories	Senior Term Debt(8) (7.9%, Due 11/2013)	1,193,021	1,198,153
RCS Management Holding Co.	Service-healthcare supplies	Senior Term Debt(3)(5) (9.8%, Due 1/2011) Senior Term Debt(4)(5) (12.3%, Due 1/2011)	3,000,000 3,000,000	2,925,000 2,910,000
RedPrairie Holding, Inc. RedPrairie Corporation Blue Cube Software, Inc.	Service-design and develop supply chain software	Senior Term Debt(6) (8.4%, Due 7/2012) Senior Subordinated Term Debt(6) (11.9%, Due 1/2013)	\$4,480,000 3,000,000	\$4,480,000 3,030,000
RiskMetrics Group Holdings, LLC	Service—develop risk and wealth management solutions	Senior Term Debt(6) (7.6%, Due 1/2014) Senior Subordinated Term Debt(6) (10.6%, Due 7/2014)	2,000,000 500,000	2,012,500 507,500
RMK Acquisition Corporation ARAMARK Corporation	Service—vending services	Letter of Credit(8) (7.5%, Due 1/2014) Senior Term Debt(8) (7.5%, Due 1/2014)	65,841 921,289	66,171 925,895
SCPH Holdings, Inc. Sea Con Phoenix, Inc. Phoenix Optix, Inc.	Manufacturing-underwater and harsh environment components	Credit Facility(5)(16) (9.8%, Due 2/2008) Senior Term Debt(5) (10.3%, Due 2/2010) Senior Term Debt(3)(5)(20) (13.3%, Due 2/2010)	500,000 2,275,000 2,812,500	500,000 2,277,844 2,913,750

F-39

GLADSTONE CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)
AS OF MARCH 31, 2007
(UNAUDITED)

<u>Company(1)</u>	<u>Industry</u>	<u>Investment(2)</u>	<u>Cost</u>	<u>Fair Value</u>
SCS Acquisition Corp. (d/b/a Specialty Coatings Systems)	Service-chemically treated equipment distribution	Senior Term Debt(5)(17) (9.3%, Due 12/2011) Senior Term Debt(3)(5)(17)	5,625,000 6,550,000	5,632,031 6,558,188

		(11.3%, Due 12/2011)		
Thibaut Acquisition Co.	Service-design and disribute wall covering	Credit Facility(5)(18) (9.8%, Due 1/2011)	500,000	500,000
		Senior Term Debt(5) (9.8%, Due 1/2011)	3,062,500	3,066,328
		Senior Term Debt(3)(5) (12.3%, Due 1/2011)	3,000,000	3,003,750
Visual Edge Technology, Inc. Graphic Enterprises, Inc. Copeco, Inc.	Service-office equipment distribution	Senior Subordinated Term Debt(5) (13.3%, Due 8/2011)	5,000,000	3,750,000
Wesco Holdings, Inc. Wesco Aircraft Hardware Corp.	Service-aerospace parts and distribution	Senior Term Debt(6) (7.6%, Due 9/2013)	2,525,125	2,518,750
		Senior Subordinated Term Debt(6) (11.1%, Due 3/2014)	2,272,298	2,295,000
Westlake Hardware, Inc.	Retail-hardware and variety	Senior Subordinated Term Debt(5) (12.6%, Due 1/2011)	15,000,000	14,943,750
WHI Holding Corp.				
Winchester Electronics	Manufacturing-high bandwidth connectors and cables	Senior Term Debt(3)(5) (12.3%, Due 6/2012)	6,000,000	6,015,000
WP Evenflo Group Holdings Inc. WP Evenflo Acquisition, Inc.	Manufacturing-infant and juvenile products	Senior Term Debt(6) (7.8%, Due 2/2013)	1,995,000	2,004,975
		Senior Subordinated Term Debt(6) (11.3%, Due 2/2014)	2,000,000	2,010,000
Total:			\$281,525,450	\$280,242,688

(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) Percentage represents interest rates in effect at March 31, 2007 and due date represents the contractual maturity date.

(3) 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.

(4) 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, however the debt is junior to another Last Out Tranche.

(5) Fair value was based on opinions of value submitted by Standard & Poor's Securities Evaluations, Inc.

(6) Marketable securities, such as syndicated loans, are valued based on the indicative bid price, as of March 30, 2007, from the respective originating syndication agent's trading desk.

(7) Investment valued at cost due to recent acquisition.

(8) Investment valued at pending trade amount.

(9) Availability under the credit facility totals \$1,500,000. Borrowings of \$450,000 were outstanding at March 31, 2007.

(10) Availability under the credit facility totals \$1,500,000. Borrowings of \$200,000 were outstanding at March 31, 2007.

(11) Remaining availability under the revolving credit facility totals \$200,000, borrowings of \$550,000 were outstanding at March 31, 2007. The company may borrow an additional \$1,750,000 of the senior term debt facility, subject to certain conditions including Gladstone Capital's approval, borrowings of \$500,000 were outstanding at March 31, 2007.

F-40

GLADSTONE CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)
AS OF MARCH 31, 2007
(UNAUDITED)

(12) Availability under the credit facility totals \$2,000,000. Borrowings of \$1,035,000 were outstanding at March 31, 2007.

(13) Availability under the credit facility totals \$500,000. There were no borrowings outstanding at March 31, 2007.

(14) The company may borrow up to \$1,000,000 for purposes of acquiring equipment. There were no borrowings outstanding at March 31, 2007.

(15) Availability under the credit facility totals \$1,250,000. There were no borrowings outstanding at March 31, 2007.

(16) Availability under the credit facility totals \$500,000. Borrowings of \$500,000 were outstanding at March 31, 2007.

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

(18) Availability under the credit facility totals \$1,000,000. Borrowings of \$500,000 were outstanding at March 31, 2007.

(19) Includes a success fee with a \$180,800 fair value and no cost basis.

(20) Includes a success fee with a \$94,219 fair value and no cost basis.

F-41

GLADSTONE CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)
AS OF SEPTEMBER 30, 2006

Company(1)	Industry	Investment(2)	Cost	Fair Value
ActivStyle Acquisition Co. ActivStyle, Inc.	Service-medical products distribution	Line of Credit(16) (9.6%, Due 7/2009)	\$ —	\$ —
		Senior Term Debt(5) (9.6%, Due 7/2011)	3,200,000	3,200,000
		Senior Term Debt(3)(5) (11.8%, Due 7/2011)	2,500,000	2,500,000

Advanced Homecare Management, Inc.	Service-home health nursing services	Senior Subordinated Term Debt(5)(6) (11.33%, Due 12/2013)	5,000,000	5,000,000
Allied Extruders, LLC P&O Packaging Acquisition LLC	Manufacturing-polyethylene film	Senior Real Estate Term Debt (9.8%, Due 3/2011) Senior Term Debt(3)(5) (11.3%, Due 3/2011)	1,000,000 8,000,000	1,000,000 8,030,000
Badanco Acquisition Corp.	Manufacturing-luggage	Senior Term Debt(5) (10.8%, Due 2/2010) Senior Term Debt(3)(5) (13.8%, Due 2/2010)	5,145,019 8,585,125	5,157,881 8,628,051
Benetech, Inc.	Service & Manufacturing-dust management systems for the coal and electric utility industries	Senior Term Debt(5) (10.3%, Due 5/2009) Senior Term Debt(3)(5) (13.3%, Due 5/2009)	2,112,500 3,046,875	2,144,187 3,107,813
Bresnan Communications, LLC	Service-telecommunications	Senior Term Debt(6) (7.2%, Due 9/2013) Senior Subordinated Term Debt (9.9%, Due 3/2014)	1,002,115 1,511,554	997,500 1,533,750
Consolidated Bedding, Inc.	Manufacturing-mattresses	Senior Subordinated Term Debt(5) (14.4%, Due 3/2009)	2,438,359	2,306,991
Country Road Communications LLC	Service-telecommunications	Senior Subordinated Term Debt(5)(6) (13.3%, Due 7/2013)	5,961,594	6,015,000
Country Road Management, Inc.				
Defiance Stamping Company	Manufacturing-trucking parts	Senior Term Debt(3)(5) (13.3%, Due 4/2010)	6,325,000	6,332,906
Doe & Ingalls Management LLC Doe & Ingalls of North Carolina Operating LLC Doe & Ingalls of Florida Operating LLC Doe & Ingalls of Virginia Operating LLC	Distributor-specialty chemicals	Senior Term Debt(5) (9.8%, Due 11/2010) Senior Term Debt(3)(5) (13.3%, Due 11/2010)	4,700,000 4,500,000	4,723,500 4,516,875
Express Courier International, Inc.	Service-ground delivery and logistics	Line of Credit(7) (9.6%, Due 6/2009) Senior Term Debt(5) (9.6%, Due 6/2011) Senior Term Debt(3)(5) (11.8%, Due 6/2011)	— 4,700,000 3,950,000	— 4,700,000 3,950,000
Finn Corporation	Manufacturing-landscape equipment	Common Stock Warrants	37,000	709,431

F-42

GLADSTONE CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)
AS OF SEPTEMBER 30, 2006

FR X Ohmstede Holdings, LLC FR X Ohmstede Acquisitions Co.	Service & Manufacturing-heat exchangers	Senior Term Debt(6) (8.5%, Due 8/2013) Senior Subordinated Term Debt(6) (12.5%, Due 8/2014)	\$3,000,000 3,012,369	\$3,026,250 3,030,000
Global Materials Technologies, Inc.	Manufacturing-steel wool products and metal fibers	Senior Term Debt(3)(5) (14.3%, Due 11/2009)	5,300,000	5,233,750
It's Just Lunch International, LLC	Service-dating service	Line of Credit(12)(5) (9.2%, Due 6/2009) Senior Term Debt(13)(5) (9.6%, Due 6/2011) Senior Term Debt(3)(14) (11.8%, Due 6/2011)	200,000 3,300,000 —	199,500 3,291,750 —
John Henry Holdings, Inc. Multi Packaging Solutions, Inc.	Manufacturing-packaging products	Senior Subordinated Term Debt(6) (12.5%, Due 6/2011)	8,000,000	8,000,000
LocalTel, Inc.	Service-yellow pages publishing	Line of Credit(5)(15) (9.8%, Due 6/2009) Senior Term Debt(5) (9.8%, Due 6/2011) Senior Term Debt(3)(5) (12.3%, Due 6/2011)	350,000 2,687,500 2,750,000	343,000 2,633,750 2,695,000
Mistras Holdings Corp.	Service & Manufacturing-nondestructive testing instruments, systems and services	Senior Term Debt(3)(5) (11.5%, Due 8/2008) Senior Term Debt(4)(5)(18) (12.5%, Due 8/2008)	9,499,999 5,250,001	9,737,499 5,620,124
Network Solutions LLC	Service-internet domain registry and host	Senior Term Debt(6) (10.4%, Due 1/2012)	4,464,358	4,499,747
Northern Contours Northern Contours of Kentucky, Inc. Norcon Holding LLC Norcon Lewis LLC	Manufacturing-veneer and laminate components	Senior Subordinated Term Debt(5) (12.3%, Due 5/2010)	7,000,000	7,017,500

PROFITSystems Acquisition Co.	Service-design and develop	Line of Credit(17)	—	—
PROFITSystems, Inc.	ERP software	(9.6%, Due 7/2009) Senior Term Debt(5)	3,100,000	3,100,000
		(9.6%, Due 7/2011) Senior Term Debt(5)	2,900,000	2,900,000
		(11.8%, Due 7/201)(3)		
Puerto Rico Cable Acquisition Company, Inc.	Service-telecommunications	Senior Subordinated Term Debt(5) (6)	7,813,274	7,775,183
		(11.6%, Due 1/2012)		
QCE, LLC (d/b/a Quiznos Corp.)	Service-restaurant franchisor	Senior Term Debt(6)	3,010,713	2,977,538
		(7.6%, Due 5/2013) Senior Term Debt(3)(6)	3,045,560	3,033,750
		(11.1%, Due 11/2013)		
RCS Management Holding Co.	Service-healthcare supplies	Senior Term Debt(3)(5)	\$3,000,000	\$3,003,750
		(9.8%, Due 1/2011) Senior Term Debt(4)(5)	3,000,000	3,003,750
		(12.3%, Due 1/2011)		

F-43

GLADSTONE CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)
AS OF SEPTEMBER 30, 2006

RedPrairie Holding, Inc. RedPrairie Corporation Blue Cube Software, Inc.	Service-design and develop supply chain software	Senior Term Debt(6)	3,990,000	3,990,000
		(8.4%, Due 7/2012) Senior Subordinated Term Debt(6)	2,000,000	2,005,000
		(11.9%, Due 1/2013)		
SCPH Holdings, Inc. Sea Con Phoenix, Inc. Phoenix Optix, Inc.	Manufacturing-underwater and harsh environment components	Credit Facility(8)	—	—
		(9.8%, Due 2/2007) Senior Term Debt(5)	2,625,000	2,631,563
		(10.3%, Due 2/2010) Senior Term Debt(3)(5)	2,887,500	2,898,328
		(13.3%, Due 2/2010)		
SCS Acquisition Corp.	Service-chemically treated equipment distribution	Senior Term Debt(3)(5)(9)	6,250,000	6,257,812
		(9.3%, Due 12/2011) Senior Term Debt(3)(5)(10)	6,568,750	6,576,961
		(11.3%, Due 12/2011)		
Thibaut Acquisition Co.	Design and Disbtribution- wall coverings	Credit Facility(11)	—	—
		(9.8%, Due 1/2011) Senior Term Debt(5)	3,325,000	3,325,000
		(9.8%, Due 1/2011) Senior Term Debt(3)(5)	3,000,000	3,000,000
		(12.3%, Due 1/2011)		
Visual Edge Technology, Inc. Graphic Enterprises, Inc. Copeco, Inc.	Service-office equipment distribution	Senior Subordinated Term Debt(5)	5,000,000	4,987,500
		(13.3%, Due 8/2011)		
Westlake Hardware, Inc. WHI Holding Corp.	Retail-hardware and variety	Senior Subordinated Term Debt(5)	15,000,000	14,981,250
		(12.6%, Due 1/2011)		
Winchester Electronics	Manufacturing-high bandwidth connectors and cables	Senior Term Debt(3)(5)	6,000,000	6,007,500
		(12.3%, Due 6/2012)		
Xspedius Communications LLC	Service-telecommunications	Senior Subordinated Term Debt(5)	5,157,821	5,306,110
		(15.8%, Due 3/2010)		
Total:			\$216,202,986	\$217,642,750

(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) Percentage represents interest rates in effect at September 30, 2006 and due date represents the contractual maturity date.

(3) 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.

(4) 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, however the debt is junior to another Last Out Tranche.

(5) Fair value was based on opinions of value submitted by Standard & Poor's Securities Evaluations, Inc.

(6) Marketable securities, such as syndicated loans, are valued based on the indicative bid price, as of September 30, 2006 from the respective originating syndication agent's trading desk.

(7) Availability under the credit facility totals \$1,500,000. There were no borrowings outstanding at September 30, 2006.

F-44

GLADSTONE CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)
AS OF SEPTEMBER 30, 2006

- (8) Availability under the credit facility totals \$500,000. There were no borrowings outstanding at September 30, 2006.
- (9) Availability under the debt facility totals \$7,500,000. The outstanding balance of the debt facility was \$6,250,000 at September 30, 2006.
- (10) Availability under the debt facility totals \$7,500,000. The outstanding balance of the debt facility was \$6,568,750 at September 30, 2006.
- (11) Availability under the credit facility totals \$1,000,000. There were no borrowings outstanding at September 30, 2006.
- (12) Availability under the credit facility totals \$750,000. Borrowings of \$200,000 were outstanding at September 30, 2006.
- (13) The company may borrow an additional \$500,000 under the senior term debt facility, subject to certain conditions including Gladstone Capital's approval.
- (14) The company may borrow an additional \$2,250,000 under the senior term debt facility, subject to certain conditions including Gladstone Capital's approval.
- (15) Availability under the credit facility totals \$3,000,000. Borrowings of \$350,000 were outstanding at September 30, 2006.
- (16) Availability under the credit facility totals \$1,500,000. There were no borrowings outstanding at September 30, 2006.
- (17) Availability under the credit facility totals \$1,250,000. There were no borrowings outstanding at September 30, 2006.
- (18) Includes a success fee with a fair value of \$742,000 and no cost basis.

F-45

GLADSTONE CAPITAL CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended March 31,	
	2007	2006
INVESTMENT INCOME		
Interest income—investments	\$ 8,254,459	\$ 6,875,264
Interest income—cash and cash equivalents	31,645	4,624
Interest income—notes receivable from employees	132,931	107,033
Prepayment fees and other income	224,743	13,779
Total investment income	<u>8,643,778</u>	<u>7,000,700</u>
EXPENSES		
Interest expense	1,811,019	948,166
Loan servicing (Refer to Notes 4 and 5)	760,623	734,644
Base management fee (Refer to Note 4)	450,484	352,379
Incentive fee (Refer to Note 4)	1,158,995	—
Administration fee (Refer to Note 4)	168,766	—
Professional fees	109,081	110,887
Amortization of deferred financing fees	68,200	32,286
Stockholder related costs	87,288	115,864
Directors fees	56,970	30,212
Insurance expense	62,398	50,590
Stock option compensation	—	34,065
Other expenses	48,975	60,791
Expenses before credit from Adviser	4,782,799	2,469,884
Credit to base management and incentive fees from Adviser (Refer to Note 4)	<u>(1,863,378)</u>	<u>(673,000)</u>
Total expenses net of credits to base management and incentive fees	<u>2,919,421</u>	<u>1,796,884</u>
NET INVESTMENT INCOME BEFORE INCOME TAXES	<u>5,724,357</u>	<u>5,203,816</u>
Income tax expense	—	—
NET INVESTMENT INCOME	<u>5,724,357</u>	<u>5,203,816</u>
REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS:		
Realized gain on sale of investments	84,205	377,500
Realized gain on settlement of derivative	10,239	—
Unrealized (depreciation) appreciation on derivative	(15,801)	24,658
Net unrealized depreciation on investments	<u>(1,718,149)</u>	<u>(15,593)</u>
Net (loss) gain on investments	<u>(1,639,506)</u>	<u>386,565</u>
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS	<u>\$ 4,084,851</u>	<u>\$ 5,590,381</u>
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS PER COMMON SHARE:		
Basic	<u>\$ 0.33</u>	<u>\$ 0.49</u>
Diluted	<u>\$ 0.33</u>	<u>\$ 0.48</u>
WEIGHTED AVERAGE SHARES OF COMMON STOCK OUTSTANDING:		
Basic	12,249,683	11,308,510
Diluted	12,249,683	11,536,360

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

F-46

GLADSTONE CAPITAL CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Six Months Ended March 31,	
	2007	2006
INVESTMENT INCOME		
Interest income—investments	\$ 16,153,059	\$ 12,722,371
Interest income—cash and cash equivalents	68,914	13,536
Interest income—notes receivable from employees	271,122	214,126
Prepayment fees and other income	384,401	80,986
Total investment income	<u>16,877,496</u>	<u>13,031,019</u>
EXPENSES		
Interest expense	2,931,276	1,600,244
Loan servicing (Refer to Notes 4 and 5)	1,479,775	1,450,059
Base management fee (Refer to Note 4)	848,916	621,080
Incentive fee (Refer to Note 4)	2,307,478	—
Administration fee (Refer to Note 4)	294,851	—
Professional fees	220,001	233,353
Amortization of deferred financing fees	126,500	58,536
Stockholder related costs	151,016	244,799
Directors fees	111,220	54,212
Insurance expense	125,092	101,367
Stock option compensation	—	77,322
General and administrative expenses	<u>137,460</u>	<u>116,580</u>
Expenses before credit from Adviser	8,733,585	4,557,552
Credit to base management and incentive fees from Adviser (Refer to Note 4)	<u>(2,743,372)</u>	<u>(1,223,000)</u>
Total expenses net of credits to base management and incentive fees	<u>5,990,213</u>	<u>3,334,552</u>
NET INVESTMENT INCOME BEFORE INCOME TAXES	<u>10,887,283</u>	<u>9,696,467</u>
Income tax expense	—	50,237
NET INVESTMENT INCOME	<u>10,887,283</u>	<u>9,646,230</u>
REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS:		
Net realized gain (loss) on sale of investments	86,519	(803,095)
Realized gain on settlement of derivative	22,793	—
Unrealized (depreciation) appreciation on derivative	(25,613)	23,766
Net unrealized (depreciation) appreciation on investments	<u>(2,722,528)</u>	<u>4,956,829</u>
Net (loss) gain on investments	<u>(2,638,829)</u>	<u>4,177,500</u>
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS	<u>\$ 8,248,454</u>	<u>\$ 13,823,730</u>
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS PER COMMON SHARE:		
Basic	<u>\$ 0.67</u>	<u>\$ 1.22</u>
Diluted	<u>\$ 0.67</u>	<u>\$ 1.20</u>
WEIGHTED AVERAGE SHARES OF COMMON STOCK OUTSTANDING:		
Basic	12,272,012	11,307,510
Diluted	12,272,012	11,555,479

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

F-47

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

	Six Months Ended March 31,	
	2007	2006
Operations:		
Net investment income	\$ 10,887,283	\$ 9,646,230
Net realized gain (loss) on sale of investments	86,519	(803,095)
Realized gain on settlement of derivative	22,793	—
Unrealized (depreciation) appreciation on derivatives	(25,613)	23,766
Net unrealized (depreciation) appreciation on investments	<u>(2,722,528)</u>	<u>4,956,829</u>
Net increase in net assets from operations	<u>8,248,454</u>	<u>13,823,730</u>
Capital transactions:		
Distributions to stockholders	(10,307,794)	(9,159,218)
Repayment of principal on employee notes	300,941	23,094
Stock option compensation	—	77,322
Issuance of common stock under stock option plan	—	85,900
Stock surrendered in settlement of withholding tax	<u>(1,488,193)</u>	<u>—</u>
Decrease in net assets from capital share transactions	<u>(11,495,046)</u>	<u>(8,972,902)</u>
Total (decrease) increase in net assets	<u>(3,246,592)</u>	<u>4,850,828</u>
Net assets at beginning of year	<u>172,570,487</u>	<u>151,610,683</u>
Net assets at end of period	<u>\$ 169,323,895</u>	<u>\$ 156,461,511</u>

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

GLADSTONE CAPITAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	<u>Six Months Ended March 31,</u>	
	<u>2007</u>	<u>2006</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net increase in net assets resulting from operations	\$ 8,248,454	\$ 13,823,730
Adjustments to reconcile net increase in net assets resulting from operations to net cash (used in) provided by operating activities:		
Purchase of investments	(127,641,175)	(65,159,566)
Principal repayments on investments	62,230,246	63,517,133
Net amortization of premiums and discounts	19,351	(121,151)
Amortization of deferred financing fees	126,500	58,536
Stock compensation expense	—	77,322
Realized loss on investments	69,114	1,180,595
Unrealized depreciation (appreciation) on derivative	25,613	(23,766)
Change in net unrealized depreciation (appreciation) on investments	2,722,528	(4,956,829)
(Increase) decrease in interest receivable	(729,834)	356,566
Increase in funds due from custodian	(1,241,695)	(6,627,901)
(Increase) decrease in prepaid assets	(14,343)	32,812
Increase in due from affiliate	(28,768)	(320,621)
(Increase) decrease in other assets	(300,893)	26,054
Increase (decrease) in accounts payable	933	(17,304)
Increase in interest payable	281,206	95,244
Decrease in accrued expenses and deferred liabilities	(234,957)	(101,379)
Decrease in fees due to affiliate	(240,363)	(161,140)
Increase in administration fee due to Gladstone Administration	168,766	—
Increase in funds held in escrow	29	40
Increase in investment balance due to payment in kind interest	—	(74,701)
Net cash (used in) provided by operating activities	<u>(56,539,288)</u>	<u>1,603,674</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Receipt of principal on notes receivable—employees	300,941	23,094
Net cash provided by investing activities	<u>300,941</u>	<u>23,094</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Borrowings from the lines of credit	146,900,000	69,780,000
Repayments on the lines of credit	(76,593,000)	(62,514,064)
Distributions paid	(10,307,794)	(9,159,218)
Exercise of employee stock options	—	85,900
Deferred financing fees	(31,275)	(12,072)
Stock surrendered to settle withholding tax obligation	(1,488,193)	—
Net cash provided by (used in) financing activities	<u>58,479,738</u>	<u>(1,819,454)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS(1)	<u>2,241,391</u>	<u>(192,686)</u>
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	<u>731,744</u>	<u>503,776</u>
CASH AND CASH EQUIVALENTS, END OF PERIOD	<u>\$ 2,973,135</u>	<u>\$ 311,090</u>
CASH PAID DURING PERIOD FOR INTEREST	<u>\$ 2,650,071</u>	<u>\$ 1,505,000</u>

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

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

GLADSTONE CAPITAL CORPORATION
FINANCIAL HIGHLIGHTS
(UNAUDITED)

	<u>Three Months Ended March 31,</u>	
	<u>2007</u>	<u>2006</u>
Per Share Data(1)		
Net asset value at beginning of period	\$ 13.88	\$ 13.74
<i>Income from investment operations:</i>		
Net investment income(2)	0.47	0.46
Realized gain on sale of investments(2)	—	0.03
Net unrealized loss on investments(2)	(0.14)	—
Total from investment operations	<u>0.33</u>	<u>0.49</u>
Less distributions:		
Distributions from net investment income	(0.42)	(0.41)
Total distributions	<u>(0.42)</u>	<u>(0.41)</u>
Repayment of principal on notes receivable	0.02	—
Effect of antidilution(3)	—	0.02
Net asset value at end of period	<u>\$ 13.82</u>	<u>\$ 13.84</u>
Per share market value at beginning of period	\$ 23.86	\$ 21.38
Per share market value at end of period	23.68	21.55

Total return(4)(5)	1.08%	2.78%
Shares outstanding at end of period	12,249,683	11,308,510
Ratios/Supplemental Data		
Net assets at end of period	\$ 169,323,895	\$ 156,461,511
Average net assets(6)	\$ 169,055,526	\$ 154,397,504
Ratio of expenses to average net assets—annualized(7)	11.32%	6.40%
Ratio of net expenses to average net assets—annualized(8)	6.91%	4.66%
Ratio of expenses net of voluntary waiver to average net assets—annualized(9)	8.74%	n/a
Ratio of net investment income to average net assets—annualized	13.54%	13.48%

- (1) Based on actual shares outstanding at the end of the corresponding period.
- (2) Based on weighted average basic per share data.
- (3) This represents the antidilutive impact of other components in changes in net assets and the different share amounts used in calculating per share data as a result of calculating certain per share data based upon the weighted average basic shares outstanding during the period and certain per share data based on the shares outstanding as of a period end.
- (4) Total return equals the increase of the ending market value over the beginning market value plus monthly dividends divided by the monthly beginning market value, assuming monthly dividend reinvestment.
- (5) Amounts were not annualized.
- (6) Average net assets are computed using the average of the balance of net assets at the end of each month of the reporting period.
- (7) Ratio of expenses to average net assets is computed using expenses before credits from Adviser to the base management and incentive fees and including income tax expense.
- (8) Ratio of net expenses to average net assets is computed using total expenses net of credits from Adviser to the base management and incentive fees and including income tax expense.
- (9) Ratio of expenses net of voluntary waiver to average net assets is computed using expenses before credits from Adviser and including income tax expense then deducting only the amount of the credit applicable to the waiver for the incentive fee.

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

F-50

GLADSTONE CAPITAL CORPORATION
FINANCIAL HIGHLIGHTS
(UNAUDITED)

	<u>Six Months Ended March 31,</u>	
	<u>2007</u>	<u>2006</u>
Per Share Data(1)		
Net asset value at beginning of period	\$ 14.02	\$ 13.41
<i>Income from investment operations:</i>		
Net investment income(2)	0.89	0.85
Realized loss on sale of investments(2)	—	(0.07)
Net unrealized (loss) gain on investments(2)	(0.22)	0.44
Total from investment operations	0.67	1.22
<i>Less distributions:</i>		
Distributions from net investment income	(0.84)	(0.81)
Total distributions	(0.84)	(0.81)
Issuance of common stock under stock option plan	—	0.01
Repayment of principal on notes receivable	0.02	—
Stock surrendered to settle withholding tax obligation	(0.06)	—
Effect of antidilution(3)	—	0.01
Net asset value at end of period	\$ 13.82	\$ 13.84
Per share market value at beginning of period	\$ 22.01	\$ 22.55
Per share market value at end of period	23.68	21.55
Total return(4)(5)	11.50%	-0.75%
Shares outstanding at end of period	12,249,683	11,308,510
Ratios/Supplemental Data		
Net assets at end of period	\$ 169,323,895	\$ 156,461,511
Average net assets(6)	\$ 169,693,656	\$ 152,679,547
Ratio of expenses to average net assets—annualized(7)	10.29%	6.04%
Ratio of net expenses to average net assets—annualized(8)	7.06%	4.43%
Ratio of expenses net of voluntary waiver to average net assets—annualized(9)	8.34%	n/a
Ratio of net investment income to average net assets—annualized	12.83%	12.64%

- (1) Based on actual shares outstanding at the end of the corresponding period.
- (2) Based on weighted average basic per share data.
- (3) This represents the antidilutive impact of other components in changes in net assets and the different share amounts used in calculating per share data as a result of calculating certain per share data based upon the weighted average basic shares outstanding during the period and certain per share data based on the shares outstanding as of a period end.
- (4) Total return equals the increase of the ending market value over the beginning market value plus monthly dividends divided by the monthly beginning market value, assuming monthly dividend reinvestment.
- (5) Amounts were not annualized.
- (6) Average net assets are computed using the average of the balance of net assets at the end of each month of the reporting period.
- (7) Ratio of expenses to average net assets is computed using expenses before credits from Adviser to the base management and incentive fees and including income tax expense.

- (8) Ratio of net expenses to average net assets is computed using total expenses net of credits from Adviser to the base management and incentive fees and including income tax expense.
- (9) Ratio of expenses net of voluntary waiver to average net assets is computed using expenses before credits from Adviser and including income tax expense then deducting only the amount of the credit applicable to the waiver for the incentive fee.

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

F-51

GLADSTONE CAPITAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2007
(UNAUDITED)

NOTE 1. ORGANIZATION

Gladstone Capital Corporation (the "Company") was incorporated under the General Corporation Laws of the State of Maryland on May 30, 2001. The Company is a closed-end, non-diversified management investment company that 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 ("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 Business Loan LLC ("Business Loan"), a wholly-owned subsidiary of the Company, was established on February 3, 2003 for the purpose of holding the Company's portfolio of loan investments. Gladstone Capital Advisers, Inc. is also a wholly-owned subsidiary. The financial statements of the subsidiaries are consolidated with those of the Company.

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

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Unaudited Interim Financial Statements

Interim financial statements of the Company are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain disclosures accompanying annual financial statements prepared in accordance with GAAP are omitted. In the opinion of management, all adjustments, consisting solely of normal recurring accruals, necessary for the fair statement of financial statements for the interim periods have been included. The current period's results of operations are not necessarily indicative of results that ultimately may be achieved for the year. The interim financial statements and notes thereto should be read in conjunction with the financial statements and notes thereto included in the Company's Form 10-K for the fiscal year ended September 30, 2006, as filed with the Securities and Exchange Commission (the "SEC") on December 6, 2006.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Investment Valuation

The Company carries its investments at fair value, as determined by its Board of Directors. Securities that are publicly traded are valued at the closing price on the valuation date. Securities for which a limited market exists, such as participations in syndicated loans, are valued at the indicative bid price on the valuation date from the respective originating syndication agent's trading desk. Debt and equity securities

F-52

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

Interest Income Recognition

Interest income, adjusted for amortization of premiums and accretion of discounts, is recorded on the accrual basis to the extent that such amounts are expected to be collected. The Company stops accruing interest on its investments when it is determined that interest is no longer collectible. There were no uncollectible accounts at March 31, 2007. Conditional interest or a success fee is recorded when earned upon full repayment of a loan investment.

The Company seeks to avoid PIK interest, however the Company had one loan in its portfolio during the three and six months ended March 31, 2006 that contained a PIK provision. A PIK provision requires the borrower to accrue a payment to the Company but the borrower does not have to pay that interest until the loan is paid in full. The PIK interest is added to the principal balance of the loan and recorded as income to the Company even though the cash has not been received. To maintain the Company's status as a RIC (as discussed in Note 10), this non-cash source of income must be paid out to stockholders in the form of cash dividends, even though the Company has not yet collected the cash. The Company recorded

no PIK interest income for the three and six months ended March 31, 2007 and \$30,707 and \$63,217, respectively, for the three and six months ended March 31, 2006.

Services Provided to Portfolio Companies

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

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

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

While the Adviser receives all fees in connection with the Company's investments, such fees received by the Adviser, with the exception of monitoring and review fees, are entirely credited to the Company as a reduction of the advisory fee payable under the advisory agreement between the Company and the Adviser. For the three and six months ended March 31, 2007, the Adviser received \$775,000 and \$1,086,000, respectively, of such fees, as compared to \$673,000 and \$1,223,000, respectively, for the three and six months ended March 31, 2006 and the advisory fee payable by the Company to the Adviser was reduced by these amounts. None of these fees were for managerial assistance even though the Adviser provided managerial assistance to many of the Company's portfolio companies.

Cash and Cash Equivalents

Cash and cash equivalents consist of demand deposits and highly liquid investments with original maturities of three months or less when purchased. Cash and cash equivalents are carried at cost which approximates fair value as of March 31, 2007 and September 30, 2006.

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

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

Federal and State Income Taxes

The Company intends to continue to qualify for treatment as a RIC under Subchapter M of the Code. As a RIC, the Company is not subject to federal or state income tax on the portion of its taxable income and gains distributed to stockholders. To qualify as a RIC, the Company is required to distribute to its

stockholders at least 90% of investment company taxable income, as defined by the Code and, as such, no income tax provisions have been recorded for the individual companies of Gladstone Capital Corporation and Gladstone Business Loan LLC.

During the six months ended March 31, 2006, Gladstone Capital Corporation recorded approximately \$50,000 in connection with penalties incurred on misclassified revenue on its fiscal year 2004 corporate tax return.

Recent Accounting Pronouncements

In May 2005, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 154, "*Accounting Changes and Error Corrections*," a replacement of APB Opinion No. 20, "*Accounting Changes*," and SFAS No. 3, "*Reporting Accounting Changes in Interim Financial Statements*" and changed the requirements for the accounting for and reporting of a change in accounting principle. SFAS No. 154 applies to all voluntary changes in accounting principle and also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. SFAS No. 154 requires retrospective application to prior periods' financial statements of changes in accounting principle. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company adopted the provisions of SFAS No. 154, as applicable, on October 1, 2006.

In February 2006, the FASB issued SFAS No. 155, "*Accounting for Certain Hybrid Financial Instruments, an amendment of FASB statements No. 133 and 140*" ("SFAS No. 155"). SFAS No. 155 allows financial instruments that have embedded derivatives to be accounted for as a whole (eliminating the need to bifurcate the derivative from its host) as long as the entire instrument is valued on a fair value basis. The statement also resolves and clarifies other specific SFAS No. 133 and SFAS No. 140 related issues. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company adopted SFAS No. 155 on October 1, 2006 and has not realized a material impact of the financial statements since all investments are valued on a fair value basis.

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

In September 2006, the FASB issued SFAS No. 157, "*Fair Value Measurements*" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with GAAP, and expands disclosures about fair value measurements. SFAS No. 157 applies broadly to securities and other types of assets and liabilities. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within that fiscal year. The Company will be required to adopt SFAS No. 157 on October 1, 2008 and is currently evaluating the impact of this pronouncement on its consolidated financial statements.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108 (“SAB 108”). SAB 108 addresses how the effects of prior year uncorrected misstatements should be considered when quantifying misstatements in current year financial statements and requires registrants to consider the effect of all carry over and reversing effects of prior year misstatements when quantifying errors in current year financial statements. SAB 108 does not change the SEC’s previous guidance in SAB No. 99, “Materiality,”

F-55

on evaluating the materiality of misstatements. A registrant applying the new guidance for the first time that identifies material errors in existence at the beginning of the first fiscal year ending after November 15, 2006, may correct those errors through a one-time cumulative effect adjustment to beginning-of-year retained earnings. The cumulative effect alternative is available only if the application of the new guidance results in a conclusion that a material error exists as of the beginning of the first fiscal year ending after November 15, 2006, and those misstatements were determined to be immaterial based on a proper application of the registrant’s previous method for quantifying misstatements. The adoption of SAB 108 did not have an impact on the Company’s consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, “*The Fair Value Option for Financial Assets and Financial Liabilities — Including an Amendment of FASB Statement No. 115*” which is effective for fiscal years beginning after November 15, 2007. This pronouncement permits an entity to choose to measure many financial instruments and certain other items at fair value at specified election dates. Subsequent unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. The Company is currently evaluating the potential impact of this pronouncement on its consolidated financial statements.

F-56

NOTE 3. INVESTMENTS

Investments at fair value consisted of the following industry classifications as of March 31, 2007 and September 30, 2006:

Industry Classification	March 31, 2007			September 30, 2006		
	Fair Value	% of Total Investments	% of Net Assets	Fair Value	% of Total Investments	% of Net Assets
Aerospace & Defense	\$ 10,505,344	3.7%	6.2%	\$ 5,529,891	2.5%	3.2%
Automobile	7,515,247	2.7%	4.4%	6,332,906	2.9%	3.7%
Cargo Transport	16,595,469	5.9%	9.8%	8,650,000	4.0%	5.0%
Chemicals, Plastics & Rubber	30,154,866	10.8%	17.8%	31,105,148	14.3%	18.0%
Diversified/Conglomerate						
Manufacturing	4,014,975	1.4%	2.4%	—	0.0%	0.0%
Diversified/Conglomerate Service	992,066	0.4%	0.6%	—	0.0%	0.0%
Electronics	24,874,206	8.9%	14.7%	33,360,123	15.4%	19.3%
Entertainment	—	0.0%	0.0%	3,491,250	1.6%	2.0%
Farming & Agriculture	9,686,061	3.5%	5.7%	709,431	0.3%	0.4%
Finance	2,520,000	0.9%	1.5%	—	0.0%	0.0%
Healthcare, Education & Childcare	41,683,822	15.0%	24.6%	16,707,500	7.7%	9.7%
Home & Office Furnishings	19,204,379	6.9%	11.3%	20,636,991	9.5%	12.0%
Leisure, Amusement & Movies	4,317,375	1.5%	2.5%	—	0.0%	0.0%
Machinery	11,598,344	4.1%	6.8%	—	0.0%	0.0%
Mining, Steel, Iron & Non-precious						
Metals	20,665,874	7.4%	12.2%	5,233,750	2.4%	3.0%
Oil & Gas	7,950,566	2.8%	4.7%	6,056,250	2.8%	3.5%
Personal, Food and Miscellaneous						
Services	5,996,241	2.1%	3.5%	6,011,288	2.8%	3.5%
Printing, Publishing & Broadcasting	31,169,691	11.1%	18.4%	16,203,000	7.4%	9.4%
Retail Stores	14,943,750	5.3%	8.8%	14,981,250	6.9%	8.7%
Telecommunications	238,290	0.1%	0.1%	23,596,040	10.8%	13.7%
Textiles & Leather	10,770,931	3.8%	6.4%	13,785,932	6.3%	8.0%
Utilities	4,845,191	1.7%	2.9%	5,252,000	2.4%	3.0%
Total	\$ 280,242,688	100.0%		\$ 217,642,750	100.0%	

F-57

The investments at fair value consisted of the following geographic regions of the United States at March 31, 2007 and September 30, 2006:

Geographic Region	March 31, 2007		September 30, 2006	
	Fair Value	% of Total Investments	Fair Value	% of Total Investments
Midwest	\$ 147,240,494	52.5%	\$ 99,413,970	45.7%
Mid-Atlantic	49,382,834	17.6%	53,044,805	24.4%
Southeast	39,658,884	14.2%	24,697,113	11.3%
West	18,719,858	6.7%	15,502,538	7.1%
Northeast	17,446,094	6.2%	17,209,141	7.9%
US Territory	7,794,524	2.8%	7,775,183	3.6%
	\$ 280,242,688		\$ 217,642,750	

The geographic region depicts the location of the headquarters for the Company’s portfolio companies. A portfolio company may have a number of other locations in other geographic regions.

NOTE 4. RELATED PARTY TRANSACTIONS

Loans to Employees

The Company provided loans to employees of the Adviser for the exercise of options under the Amended and Restated 2001 Equity Incentive Plan (the “2001 Plan”), which has since been terminated and is no longer in operation. The loans require the quarterly payment of interest at the market rate in effect at the date of issue, have varying

terms not exceeding ten years and have been recorded as a reduction of net assets. The loans are evidenced by full recourse notes that are due upon maturity or 60 days following termination of employment, and the shares of common stock purchased with the proceeds of the loan are posted as collateral. No new loans were issued during the three and six months ended March 31, 2007 and the Company received \$300,789 and \$300,941, respectively, of principal repayments. During the six months ended March 31, 2006, the Company received principal repayments of \$23,094 in connection with the full repayment of one loan and a partial repayment of another loan. The Company recognized interest income from all employee stock option loans of \$132,931 and \$271,122 for the three and six months ended March 31, 2007, as compared to \$107,033 and \$214,126, respectively, for the three and six months ended March 31, 2006.

Investment Advisory and Management and Administration Agreements

The Company is externally managed by the Adviser, which is controlled by our chairman and chief executive officer, under a contractual investment advisory agreement. On October 1, 2006, the Company entered into an amended and restated investment advisory agreement (the "Amended Advisory Agreement"). Prior to October 1, 2006, the relationship was governed by the initial advisory agreement (the "Initial Advisory Agreement").

Terms of the Amended Advisory Agreement

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

The first part of the incentive fee is an income-based incentive fee which rewards the Adviser if the Company's quarterly net investment income (before giving effect to any incentive fee) exceeds 1.75% of

F-58

the Company's net assets (the "hurdle rate"). The Company pays the Adviser an income incentive fee with respect to its pre-incentive fee net investment income in each calendar quarter as follows:

- no incentive fee in any calendar quarter in which pre-incentive fee net investment income does not exceed the hurdle rate (7% annualized);
- 100% of pre-incentive fee net investment income with respect to that portion of such pre-incentive fee net investment income, if any, that exceeds the hurdle rate but is less than 2.1875% in any calendar quarter (8.75% annualized); and
- 20% of the amount of pre-incentive fee net investment income, if any, that exceeds 2.1875% in any calendar quarter (8.75% annualized).

The second part of the incentive fee is a capital gains incentive fee that is determined and payable in arrears as of the end of each fiscal year (or upon termination of the Amended Advisory Agreement, as of the termination date) and equals 20% of the Company's realized capital gains as of the end of the fiscal year. In determining the capital gains incentive fee payable to the Adviser, the Company calculates the cumulative aggregate realized capital gains and cumulative aggregate realized capital losses since its inception, and the aggregate unrealized capital depreciation as of the date of the calculation, as applicable, with respect to each of the investments in its portfolio.

The Adviser's board of directors voluntarily waived, for the fiscal quarter ended March 31, 2007, the annual 2.0% base management fee to 0.5% for senior syndicated loan participations and also waived a portion of the incentive fee due.

In addition to the base management and incentive fees under the Amended Advisory Agreement, certain fees received by the Adviser from the Company's portfolio companies were credited against the investment advisory fee under the Initial Advisory Agreement, and will continue to be paid to the Adviser and credited under the Amended Advisory Agreement. In addition, the Company will continue to pay its direct expenses including, but not limited to, directors' fees, legal and accounting fees, stockholder related expenses, and directors and officers insurance under the Amended Advisory Agreement.

For the three months ended March 31, 2007, the Company recorded a gross base management fee of \$450,484, less a credit of \$775,000 for fees received by the Adviser, for a net base management fee credit of \$324,516 as compared to a gross base management fee of \$352,379, less a credit of \$673,000 for fees received by the Adviser, for a net base management fee credit of \$320,621 for the three months ended March 31, 2006. For the six months ended March 31, 2007, the Company recorded a gross base management fee of \$848,916, less a credit of \$1,086,000 for fees received by the Adviser, for a net base management fee credit of \$237,084 as compared to a gross base management fee of \$621,080, less a credit of \$1,223,000 for fees received by the Adviser, for a net base management fee credit of \$601,920 for the six months ended March 31, 2006. The Company also recorded a gross incentive fee of \$1,158,995 and \$2,307,478, for the three and six months ended March 31, 2007, respectively, offset by a credit from a voluntary waiver issued by the Adviser's board of directors of \$1,088,378 and \$1,657,372, for the three and six months ended March 31, 2007, respectively, for a net incentive fee of \$70,617 and \$650,106, respectively, for the three and six months ended March 31, 2007. There was no incentive fee in effect at March 31, 2006. As of March 31, 2007, the Company was owed \$324,516 of unpaid base management fee credit due from the Adviser and owed \$70,617 of unpaid incentive fees to the Adviser, presented in the net fees due from Adviser in the accompanying consolidated statements of assets and liabilities.

Terms of the Initial Advisory Agreement

As compensation for its services, the Company paid the Adviser an annual advisory fee of 1.25% of total assets (as reduced by cash and cash equivalents pledged to creditors), payable in quarterly computed increments of 0.3125%, and an annual administrative fee of 0.75% of total assets (as reduced by cash and

F-59

cash equivalents pledged to creditors), payable in quarterly computed increments of 0.1875%, for a total annual management fee of 2.0% (0.50% quarterly) of total assets (as reduced by cash and cash equivalents pledged to creditors). The Company also paid all of its direct expenses including, but not limited to, directors' fees, legal and accounting fees, stockholder related expenses, and directors and officers insurance.

Loan Servicing and Portfolio Company Fees

The Adviser also services the loans held by Business Loan, in return for which it receives a 1.5% annual fee based on the monthly aggregate outstanding balance of the loans pledged under the Company's line of credit. Since the Company owns these loans, all loan servicing fees paid to the Adviser are also treated as reductions directly against the 2% management fee, under both the Initial and Amended Advisory Agreements. Effective in April 2006, the Adviser's board of directors voluntarily agreed to waive, on a temporary basis, and reduce the annual servicing fee rate for senior syndicated loans to 0.5%. For the three and six months ended March 31, 2007, these loan servicing fees totaled \$760,623 and \$1,479,775, respectively, as compared to the loan servicing fees for the three and six months ended March 31, 2006 of \$734,644 and \$1,450,059, respectively, all of which were deducted against the 2% base management fee in order to derive the base management fee which is presented as the line item base management fee in the consolidated statements of operations. At March 31, 2007, the Company owed \$217,631 of unpaid loan servicing fees to the Adviser, which are netted and recorded in fees due from Adviser. At September 30, 2006, the Company owed \$214,608 in loan servicing fees to the Adviser, recorded in fees due to Adviser in the consolidated statements of assets and liabilities. Under the Initial and Amended Advisory Agreements, the Adviser also provides managerial assistance and other services to the Company's portfolio companies and may receive fees for services other than managerial assistance services. To the extent that the Adviser receives any fees directly from a portfolio company for such services, it credits these fees directly against the 2% base management fee. For the three and six months ended March 31, 2007, the Adviser

recorded \$775,000 and \$1,086,000, respectively of such fees and credited this amount against the 2% base management fee received from the Company, as compared to such fees for the three and six months ended March 31, 2006 of \$673,000 and \$1,223,000, respectively, these credits are reflected on the consolidated statement of operations as credits to base management and incentive fees. Overall, the base management fee due to the Adviser cannot exceed 2% of total assets (as reduced by cash and cash equivalents pledged to creditors) during any given fiscal year.

Administration Agreement

On October 1, 2006, the Company entered into an administration agreement (the “Administration Agreement”) with Gladstone Administration, LLC (the “Administrator”), a wholly-owned subsidiary of the Adviser. Under the Administration Agreement, the Company pays separately for administrative services. The Administration Agreement provides for payments equal to the Company’s allocable portion of the Administrator’s overhead expenses in performing its obligations under the Administration Agreement, including, but not limited to, rent for employees of the Administrator, and the allocable portion of salaries and benefits expenses of the Company’s chief financial officer, controller, chief compliance officer, treasurer and their respective staffs. The Company recorded an administration fee of \$168,766 and \$294,851, respectively, for the three and six months ended March 31, 2007. The administration fee was not in effect during the three and six months ended March 31, 2006.

Sale of Investments to Affiliate

During the three months ended March 31, 2007, the Company sold to its affiliate, Gladstone Investment Corporation (“Gladstone Investment”), certain of its investments in syndicated loan participations totaling \$12,215,594. An independent broker was engaged to execute these transactions

between the Company and Gladstone Investment. The independent broker accepted the quotes from the respective agent bank for each syndicated loan and then executed these transactions between the Company and Gladstone Investment. The cumulative effect of these transactions, net of any unamortized premiums or discounts associated with the loans, resulted in a realized net gain of \$56,218.

NOTE 5. LINE OF CREDIT

Through Business Loan, the Company has a \$170 million revolving credit facility (the “DB Facility”) with Deutsche Bank AG, as administrative agent, pursuant to which Business Loan pledges the loans it holds to secure future advances by certain institutional lenders. The interest rate charged on the advances under the DB Facility is based on the London Interbank Offered Rate (“LIBOR”), the Prime Rate or the Federal Funds Rate, depending on market conditions, and adjusts periodically. The DB Facility is in effect through May 25, 2007. As of March 31, 2007, the outstanding principal balance under the DB Facility was approximately \$120.3 million at an interest rate of approximately 5.3%. Available borrowings are subject to various constraints imposed under the credit agreement, based on the aggregate loan balance pledged by Business Loan, which varies as loans are added and repaid, regardless of whether such repayments are early prepayment or are made as contractually required. At March 31, 2007, the remaining borrowing capacity available under the DB Facility was approximately \$49.7 million.

The DB Facility contains covenants that require Business Loan to maintain its status as a separate entity; prohibit certain significant corporate transactions (such as mergers, consolidations, liquidations or dissolutions); and restrict material changes to the Company’s credit and collection policies. The DB Facility also restricts some of the terms and provisions (including interest rates, terms to maturity and payments schedules) and limits the borrower and industry concentrations of loans that are eligible to secure advances. As of March 31, 2007, Business Loan was in compliance with all of the facility covenants.

The administrative agent also requires that any interest or principal payments on pledged loans be remitted directly by the borrower into a lockbox account with the Bank of New York as custodian. Deutsche Bank AG is also the trustee of the account and once a month remits the collected funds to the Company. At March 31, 2007, the amount due from custodian was \$4,828,847 and at September 30, 2006, the amount due from custodian was \$3,587,152.

The Adviser also services the loans pledged under the DB Facility. As a condition to this servicing arrangement, the Company executed a performance guaranty pursuant to which it guaranteed that the Adviser would comply fully with all of its obligations under the DB Facility. The performance guaranty requires that the Company maintain a minimum net worth of \$100 million and maintain “asset coverage” with respect to “senior securities representing indebtedness” of at least 200%, in accordance with Section 18 of the 1940 Act. As of March 31, 2007, the Company was in compliance with all covenants under the performance guaranty.

NOTE 6. INTEREST RATE CAP AGREEMENT

Pursuant to the DB Facility, the Company has an interest rate cap agreement that effectively limits the interest rate on a portion of the borrowings under the line of credit.

The use of a cap involves risks that are different from those associated with ordinary portfolio securities transactions. Cap agreements may be considered to be illiquid. Although the Company will not enter into any such agreements unless it believes that the other party to the transaction is creditworthy, the Company does bear the risk of loss of the amount expected to be received under such agreements in the event of default or bankruptcy of the agreement counterparty.

In February 2004, the Company entered into an interest rate cap agreement with a notional amount of \$35.0 million at a cost of \$304,000. The interest rate cap agreement’s current notional amount is \$10.9

million and it has a current fair value of approximately \$24,671 which is recorded in other assets on the Company’s consolidated balance sheet at March 31, 2007. At September 30, 2006, the interest rate cap agreement had a fair market value of \$50,284. The Company records changes in the fair market value of the interest rate cap agreement monthly based on the current market valuation at month end as unrealized depreciation or appreciation on derivative on the Company’s consolidated statement of operations. The interest rate cap agreement expires in February 2009. The agreement provides that the Company’s floating interest rate or cost of funds on a portion of the portfolio’s borrowings will be capped at 5% when the LIBOR rate is in excess of 5%. During the three and six months ended March 31, 2007, the Company recorded \$10,239 and \$22,793, respectively, of income from the interest rate cap agreement recorded as a realized gain on the settlement of derivative on the Company’s consolidated statements of operations. The Company did not recognize any income from the interest rate cap agreement during the three and six months ended March 31, 2006.

NOTE 7. COMMON STOCK TRANSACTIONS

As of March 31, 2006 and March 31, 2007, 50,000,000 shares of \$0.001 par value common stock were authorized and 11,308,510 and 12,249,683 shares were outstanding, respectively.

Transactions in common stock were as follows:

	<u>Common Stock</u>	
	<u>Shares</u>	<u>Amount</u>
Balance at September 30, 2005	11,303,510	\$11,304
Issuance of Common Stock Under Stock Option Plan	5,000	5

Balance at March 31, 2006	<u>11,308,510</u>	<u>\$ 11,309</u>
Balance at September 30, 2006	12,305,008	\$ 12,305
Issuance of Common Stock Under Stock Option Plan	5,000	5
Shares surrendered for settlement of withholding tax	(60,325)	(60)
Balance at March 31, 2007	<u>12,249,683</u>	<u>\$ 12,250</u>

In October 2006, 5,000 shares of common stock were issued as a result of an option exercise which took place on the last business day of the prior fiscal year. These shares were issued by the transfer agent at the start of the current fiscal year. Also during the six months ended March 31, 2007, 60,325 shares of stock were surrendered to the Company from certain optionees who exercised non-qualified stock options during the third and fourth quarters of fiscal year 2006 in order to satisfy settlement of withholding taxes that were paid by the Company with respect to the shares underlying the exercise of such options.

NOTE 8. STOCK OPTIONS

There were no stock options outstanding at March 31, 2007. Prior to its termination on September 30, 2006, the Company had in place the 2001 Plan. The Company had authorized 2,000,000 shares of capital stock for the issuance of options under the 2001 Plan to employees and directors. Options granted under the 2001 Plan originally could have been exercised during a term not to exceed ten years from the date of grant. Only employees of the Company and its affiliates were eligible to receive incentive stock options and both employees and non-employee directors were eligible to receive nonstatutory stock options under the 2001 Plan. Options granted under the 2001 Plan were either incentive stock options or nonstatutory stock options. The option exercise price was equal to the market price on the date of the grant. In connection with the externalization of the Company's management, all of the Company's officers and employees became direct employees of the Adviser, as of October 1, 2004. However, these individuals continued to be eligible to receive stock options under the 2001 Plan. Effective October 1, 2004, the Company accounted for any options granted to employees of the Adviser, who qualify as leased employees of the Company

F-62

under FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation, an Interpretation of APB Opinion No. 25."

On October 1, 2005, the Company adopted SFAS No. 123 (revised 2004) "Share-based Payment" ("SFAS No. 123(R)") using the modified prospective approach. Under the modified prospective approach, stock-based compensation expense was recorded for the invested portion of previously issued awards that remained outstanding at October 1, 2005 using the same estimate of the grant date fair value and the same attribution method previously used to determine the pro forma disclosure under SFAS No. 123. SFAS No. 123(R) also requires that all share-based payments to employees after October 1, 2005, including employee stock options, be recognized in the financial statements as stock-based compensation expense based on the fair value on the date of grant.

For the three and six months ended March 31, 2006, the Company recorded stock option compensation expense for the cost of stock options issued under the 2001 Plan of \$34,065 and \$77,322, respectively. The Company's expensing of stock options decreased both basic and diluted net increase to net assets resulting from operations per share by \$0.003 and \$0.01 for the three and six months ended March 31, 2006, respectively. Additionally, SFAS No. 123(R) states that any potential tax benefits associated with incentive stock options should be recognized only at the time of settlement if those options settle through a disqualifying disposition. Thus, the related stock-based compensation expense must be treated as a permanent difference until that time which, in turn, results in an increase to the Company's effective tax rate. The Company does not record tax benefits associated with the expensing of stock options since the Company intends to qualify as a RIC under Subchapter M of the Code and as such the Company is not subject to federal income tax on the portion of its taxable income and gains distributed to stockholders, provided that at least 90% of the taxable income is distributed.

NOTE 9. INCREASE IN NET ASSETS PER SHARE RESULTING FROM OPERATIONS

The following table sets forth the computation of basic and diluted net increase in net assets per share resulting from operations for the three and six months ended March 31, 2007 and March 31, 2006:

	<u>Three Months Ended March 31,</u>		<u>Six Months Ended March 31,</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Numerator for basic and diluted net increase in net assets resulting from operations per share	\$ 4,084,851	\$ 5,590,381	\$ 8,248,454	\$ 13,823,730
Denominator for basic weighted average shares	12,249,683	11,308,510	12,272,012	11,307,510
Dilutive effect of stock options	—	227,850	—	247,969
Denominator for diluted weighted average shares	12,249,683	11,536,360	12,272,012	11,555,479
Basic net increase in net assets resulting from operations per share	<u>\$ 0.33</u>	<u>\$ 0.49</u>	<u>\$ 0.67</u>	<u>\$ 1.22</u>
Diluted net increase in net assets resulting from operations per share	<u>\$ 0.33</u>	<u>\$ 0.48</u>	<u>\$ 0.67</u>	<u>\$ 1.20</u>

There were 1,300,498 options outstanding to purchase common stock at March 31, 2006. Of these, 338,500 and 336,000 options were not included in the computation of diluted earnings per share for the three and six months ended March 31, 2006, respectively, because the options' exercise prices were greater than the average market price of the common shares for the period and, therefore, were anti-dilutive. There were no stock options outstanding at March 31, 2007.

F-63

NOTE 10. 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, three monthly dividends are declared each quarter. At year-end the Company may pay a bonus dividend, in addition to the monthly dividends, to ensure that it has paid out at least 90% of its ordinary income and realized net short-term capital gains for the year. Long-term capital gains are composed of success fees, prepayment fees and gains from the sale of securities held for one year or more. The Company intends to retain long-term capital gains from the sale of securities, if any, and not pay them out as dividends, however, the Board of Directors may decide to declare and pay out capital gains during any fiscal year. If the Company decides to retain long-term capital gains, the portion of the retained capital gains will be subject to 35% tax. The tax characteristics of all dividends will be reported to stockholders on Form 1099 at the end of each calendar year. The following table lists the per share dividends paid for the six months ended March 31, 2007 and 2006:

<u>Fiscal Year</u>	<u>Record Date</u>	<u>Payment Date</u>	<u>Dividend per Share</u>
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2007	March 22, 2007	March 30, 2007	\$ 0.14
	February 20, 2007	February 28, 2007	\$ 0.14
	January 23, 2007	January 31, 2007	\$ 0.14
	December 20, 2006	December 29, 2006	\$ 0.14
	November 21, 2006	November 30, 2006	\$ 0.14
	October 23, 2006	October 31, 2006	\$ 0.14
		Total	<u>\$ 0.84</u>
2006	March 23, 2006	March 31, 2006	\$ 0.135
	February 20, 2006	February 28, 2006	\$ 0.135
	January 19, 2006	January 31, 2006	\$ 0.135
	December 21, 2005	December 30, 2005	\$ 0.135
	November 21, 2005	November 30, 2005	\$ 0.135
	October 21, 2005	October 31, 2005	\$ 0.135
		Total	<u>\$ 0.810</u>

NOTE 11. CONTRACTUAL OBLIGATIONS

As of March 31, 2007, the Company was a party to signed and non-binding term sheets for two loan originations for \$14.0 million. The Company expects to fund these potential investments as follows:

Contractual Obligations	Total	Payment Due by Period			
		Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Investments	14,000,000	14,000,000	—	—	—
Total	\$ 14,000,000	\$ 14,000,000	\$ —	\$ —	\$ —

All prospective investments are subject to, among other things, the satisfactory completion of the Company's due diligence investigation of each borrower, acceptance of terms and structure and receipt of necessary consents. With respect to each prospective loan, the Company will only agree to provide the loan if, among other things, the results of its due diligence investigations are satisfactory, the terms and conditions of the loan are acceptable and all necessary consents are received. The Company has initiated its due diligence investigations of the potential borrowers, however there can be no guarantee that facts

F-64

will not be discovered in the course of completing the due diligence that would render a particular investment imprudent or that any of these investments will actually be made.

NOTE 12. SUBSEQUENT EVENTS

In April 2007, the Company sold either outright or to Gladstone Investment at market value via an independent broker approximately \$16.9 million of syndicated loan participations and the Company was repaid in full on one loan origination investment of approximately \$5.6 million and received a success fee of approximately \$195,000.

In April 2007, the Company's Board of Directors declared the following monthly cash dividends:

Fiscal Year	Record Date	Payment Date	Dividend per Share
2007	April 20, 2007	April 30, 2007	\$0.14
	May 22, 2007	May 31, 2007	\$0.14
	June 21, 2007	June 29, 2007	\$0.14

On May 2, 2007, the Company completed a public offering of 2,000,000 shares of its common stock, at a price of \$24.25 per share, under a shelf registration statement on Form N-2 (File No. 333-100385), and pursuant to the terms set forth in a prospectus dated April 16, 2007, as supplemented by a final prospectus dated April 27, 2007. Net proceeds of the offering, after underwriting discounts and offering expenses, were approximately \$45,625,000 and were used to repay outstanding borrowings under the Company's line of credit.

F-65

PART C OTHER INFORMATION

Item 25. Financial Statements and Exhibits

1. Financial Statements

The following financial statements of Gladstone Capital Corporation (the "Company" or the "Registrant") are included in the Registration Statement in "Part A: Information Required in a Prospectus:"

GLADSTONE CAPITAL CORPORATION INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Audited Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm	F-3
Consolidated Statements of Assets and Liabilities as of September 30, 2006 and September 30, 2005	F-5
Consolidated Schedule of Investments as of September 30, 2006	F-6
Consolidated Schedule of Investments as of September 30, 2005	F-9
Consolidated Statements of Operations for the years ended September 30, 2006, September 30, 2005 and September 30, 2004	F-11

Consolidated Statements of Changes in Net Assets for the years ended September 30, 2006, September 30, 2005 and September 30, 2004	F-12
Consolidated Statements of Cash Flows for the years ended September 30, 2006, September 30, 2005 and September 30, 2004	F-13
Financial Highlights for the years ended September 30, 2006, September 30, 2005 and September 30, 2004	F-14
Notes to Consolidated Financial Statements	F-15
Unaudited Consolidated Financial Statements	
Consolidated Statements of Assets and Liabilities as of March 31, 2007 and September 30, 2006	F-35
Consolidated Schedules of Investments as of March 31, 2007 and September 30, 2006	F-36
Consolidated Statements of Operations for the three months ended March 31, 2007 and 2006	F-46
Consolidated Statements of Operations for the six months ended March 31, 2007 and 2006	F-47
Consolidated Statements of Changes in Net Assets for the six months ended March 31, 2007 and 2006	F-48
Consolidated Statements of Cash Flows for the six months ended March 31, 2007 and 2006	F-49
Financial Highlights for the three months ended March 31, 2007 and 2006	F-50
Financial Highlights for the six months ended March 31, 2007 and 2006	F-51
Notes to Consolidated Financial Statements	F-52

C-1

2. Exhibits

<u>Exhibit Number</u>	<u>Description</u>
2.a.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.
2.b.1	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.
2.b.2	Amendment to By-laws, incorporated by reference to Exhibit 3.3 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2003 (File No. 814-00237), filed February 17, 2004.
2.c	Not applicable.
2.d.1	Form of Direct Registration Transaction Advice for the Registrant's common stock, par value \$0.001 per share, incorporated by reference to Exhibit d to Pre-Effective Amendment No. 1 to the Registration Statement on Form N-2 (File No. 333-63700), filed July 27, 2001.
2.d.2	Specimen Stock Certificate, incorporated by reference to Exhibit d.2 to Pre-Effective Amendment No. 3 to the Registration Statement on Form N-2 (File No. 333-63700), filed August 23, 2001.
2.d.3	Form of Senior indenture.
2.d.4	Form of Subordinated indenture.
2.e.1	Dividend Reinvestment Plan, incorporated by reference to Exhibit e to Pre-Effective Amendment No. 1 to the Registration Statement on Form N-2 (File No. 333-63700), filed July 27, 2001.
2.f	Not applicable.
2.g.1	Amended and Restated Investment Advisory and Management Agreement between Gladstone Capital Corporation and Gladstone Management Corporation, dated as of October 1, 2006 incorporated by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed October 5, 2006.
2.h	Not applicable.
2.i.1	Joint Directors Nonqualified Excess Plan of Gladstone Commercial Corporation, Gladstone Capital Corporation and Gladstone Investment Corporations, dated as of July 11, 2006, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed July 12, 2006.
2.j.1	Custodian Agreement between Gladstone Capital Corporation and The Bank of New York, dated as of May 5, 2006, incorporated by reference to Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2006 (File No. 814-00237), filed August 1, 2006.
2.k.1	Promissory Note of David Gladstone in favor of the Company, dated August 23, 2001, incorporated by reference to Exhibit 10.4 to the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2001, filed October 4, 2001.

C-2

2.k.2	Promissory Note of Terry Brubaker in favor of the Company, dated August 23, 2001, incorporated by reference to Exhibit 10.5 to the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2001, filed October 4, 2001.
2.k.3	Promissory Note of Harry Brill in favor of the Company, dated August 23, 2001, incorporated by reference to Exhibit 10.6 to the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2001, filed October 4, 2001.
2.k.4	Trademark License Agreement between Gladstone Management Corporation and Gladstone Capital Corporation, incorporated by reference to Exhibit 10.29 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2004 (File No. 814-00237), filed February 9, 2005.
2.k.5	Amended and Restated Credit Agreement by and among Gladstone Business Loan, LLC, Deutsche Bank AG, and certain other parties, dated as of May 26, 2006, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed May 30, 2006.
2.k.6	Amendment No. 1 to Amended and Restated Credit Agreement by and among Gladstone Business Loan, LLC, Deutsche Bank AG, and certain other parties, dated as of September 22, 2006, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed September 22, 2006.

- 2.k.7 Administration Agreement between Gladstone Capital Corporation and Gladstone Administration, LLC, dated as of October 1, 2006 incorporated by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed October 5, 2006.
- 2.k.8 Amendment No. 2 to Amended and Restated Credit Agreement by and among Gladstone Business Loan, LLC, Deutsche Bank AG, and certain other parties, dated as of February 9, 2007, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed February 12, 2007.
- 2.l Opinion of Cooley Godward Kronish LLP.
- 2.m Not applicable.
- 2.n.1 Consent of Independent Registered Public Accounting Firm.
- 2.n.2 Consent of Cooley Godward Kronish LLP (included in Exhibit 2.l).
- 2.o Not applicable.
- 2.p Subscription Agreement dated May 30, 2001, incorporated by reference to incorporated by reference to Exhibit p to the Registration Statement on Form N-2 (File No. 333-63700), filed June 22, 2001.
- 2.q Not applicable.
- 2.r Code of Ethics and Business Conduct, incorporated by reference to Exhibit 14.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed October 12, 2005.
- 2.s Power of Attorney (included on signature page hereto).

C-3

Item 26. Marketing Arrangements

The information contained under the heading "Plan of Distribution" on page 94 of the prospectus is incorporated herein by reference, and any information concerning any underwriters will be contained in the accompanying prospectus supplement, if any.

Item 27. Other Expenses of Issuance and Distribution

Commission registration fee	\$ 9,210
NASD	*
Nasdaq Global Select Market Additional Listing Fee	*
Accounting fees and expenses	*
Legal fees and expenses	*
Printing and engraving	*
Miscellaneous fees and expenses	*
Total	*

* To be filed by amendment.

All of the expenses set forth above shall be borne by the Company.

Item 28. Persons Controlled By or Under Common Control

Gladstone Investment Advisers, Inc., a Delaware corporation and wholly-owned subsidiary of Gladstone Investment Corporation.

Noble Logistics, an affiliated investment with 12.7% ownership by Gladstone Investment Corporation.

Gladstone Acquisition-4 Corporation, a Delaware corporation and wholly-owned subsidiary of Gladstone Investment Corporation.

Hailey Transport Corp., a Delaware corporation and wholly-owned subsidiary of Gladstone Investment Corporation.

Quench Holdings Corp., a Delaware corporation and wholly-owned subsidiary of Gladstone Investment Corporation.

Chase II Holding Corp., a Delaware corporation controlled by Gladstone Investment Corporation through 59% ownership.

A. Stucki Company, a Delaware corporation controlled by Gladstone Investment Corporation through 55% ownership.

ACME Cryogenics, Inc., a Pennsylvania corporation controlled by Gladstone Investment Corporation.

Gladstone Business Investment, LLC, a Delaware limited liability company and wholly-owned subsidiary of Gladstone Investment Corporation.

Gladstone Investment Corporation, a Delaware corporation controlled by the Registrant's officers and directors.

Gladstone Capital Advisers, Inc., a Delaware corporation and wholly-owned subsidiary of the Registrant.

Gladstone Business Loan, LLC, a Delaware limited liability company and wholly-owned subsidiary of the Registrant.

Gladstone SSBIC Corporation, a Delaware corporation and wholly-owned subsidiary of the Registrant.

C-4

Gladstone Commercial Corporation, a Maryland corporation controlled by the Registrant's officers and directors.

GCLP Business Trust I, a Massachusetts business trust controlled by Gladstone Commercial Corporation.

Gladstone Commercial Partners, LLC, a Delaware limited liability company and wholly-owned subsidiary of Gladstone Commercial Corporation.

GCLP Business Trust II, a Massachusetts business trust controlled by Gladstone Commercial Partners, LLC.

Gladstone Commercial Advisers, Inc., a Delaware corporation and wholly-owned subsidiary of Gladstone Commercial Corporation.

GCC Coco, Inc., a Delaware corporation and wholly-owned subsidiary of Gladstone Commercial Corporation.
First Park Ten COCO San Antonio GP LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
First Park Ten COCO San Antonio LP, a Delaware limited partnership controlled by its general partner, First Park Ten COCO San Antonio GP LLC.
COCO04 Austin TX GP LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
COCO04 Austin TX LP, a Delaware limited partnership controlled by its general partner, COCO04 Austin TX GP LLC.
Pocono PA GCC, LP, a Delaware limited partnership controlled by its general partner, GCC Coco, Inc.
Gladstone Commercial Limited Partnership, a Delaware limited partnership controlled by its general partner GCLP Business Trust II.
GCC Acquisition Holdings LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
SLEE Grand Prairie LP, a Delaware limited partnership controlled by its general partner, GCC Acquisition Holdings, Inc.
EE 208 South Rogers Lane, Raleigh, NC LLC, Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
Gladstone Lending LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
260 Springside Drive Akron OH LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
Little Arch04 Charlotte NC Member LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
Little Arch Charlotte NC LLC, a Delaware limited liability company controlled by its sole member, Little Arch04 Charlotte NC Member LLC.
CMI04 Canton NC LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
OB Midway NC Gladstone Commercial LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

C-5

GCC Granby LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
Granby Property Trust, a Delaware statutory trust controlled by its grantor, GCC Granby LLC.
GCC Dorval LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
Dorval Property Trust, a Delaware statutory trust controlled by its grantor, GCC Dorval LLC.
3094174 Nova Scotia Company, a Nova Scotia corporation controlled by its sole stockholder, Gladstone Commercial Limited Partnership.
3094175 Nova Scotia Company, a Nova Scotia corporation controlled by its sole stockholder, Gladstone Commercial Limited Partnership.
GCC Norfolk LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
WMI05 Columbus OH LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
2525 N Woodlawn Vstrm Wichita KS LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
Coming Big Flats LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
OB Crenshaw SPE GP LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
OB Crenshaw GCC LP, a Delaware limited partnership controlled by its general partner, OB Crenshaw SPE GP LLC.
HMBF05 Newburyport MA LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
YorkTC05 Eatontown NJ LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
STI05 Franklin NJ LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
AFL05 Duncan SC Member LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
AFL05 Duncan SC LLC, a Delaware limited liability company controlled by its sole member, AFL05 Duncan SC Member LLC.
MSI05-3 LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
WMI05 Hazelwood MO LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
CI05 Clintonville WI LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
PZ05 Maple Heights OH LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

C-6

YCC06 South Hadley MA LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
NW05 Richmond VA LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
SVMMC05 Toledo OH LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
ACI06 Champaign IL LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
UC06 Roseville MN LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
TCI06 Burnsville MN LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
RC06 Menomonee Falls WI LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
SJM06 Baytown TX GP LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
SJM06 Baytown TX LP, a Delaware limited partnership controlled by its general partner, SJM06 Baytown TX GP LLC.
NJT06 Sterling Heights MI LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

CMS06-3 LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.
 MPI06 Mason OH LLC, a Delaware limited liability company, controlled by its manager, Gladstone Commercial Limited Partnership.
 EE07 Raleigh NC GP LLC, a Delaware limited liability company, controlled by its manager, Gladstone Commercial Limited Partnership.
 EE07 Raleigh NC, L.P., a Delaware limited partnership, controlled by its General Partner, EE07 Raleigh NC LP LLC.
 APMLO7 Hialeah FL LLC, controlled by its manager, Gladstone Commercial Limited Partnership.
 WPI07 Tulsa OK LLC, a Delaware limited liability company, controlled by its manager, Gladstone Commercial Limited Partnership.
 E107 Tewksbury MA LLC, controlled by its manager, Gladstone Commercial Limited Partnership.
 AC07 Lawrenceville GA LLC, a Delaware limited liability company, controller by its manager, Gladstone Commercial Limited Partnership.
 GB107 Syracuse NY LLC, controlled by its manager, Gladstone Commercial Limited Partnership.
 Gladstone Land Corporation, a Delaware corporation controlled by David Gladstone through indirect 100% stock ownership.
 Gladstone Land Partners, LLC, a Delaware limited liability company controlled by its manager, Gladstone Land Corporation.

C-7

SC Land, Inc., a California corporation and wholly-owned subsidiary of Gladstone Land Limited Partnership.
 Gladstone Land Limited Partnership, a Delaware limited partnership controlled by its general partner, Gladstone Land Partners, LLC.
 San Andreas Road Watsonville LLC, a California limited liability company controlled by its manager, Gladstone Land Limited Partnership.
 West Gonzales Road Oxnard LLC, a California limited liability company controlled by its manager, Gladstone Land Limited Partnership.
 Coastal Farming Corporation, a California corporation controlled by David Gladstone through 100% indirect stock ownership.
 Gladstone Management Corporation, a Delaware corporation controlled by David Gladstone through 100% indirect stock ownership.
 Gladstone Administration, LLC, a Delaware limited liability company and wholly-owned subsidiary of Gladstone Management Corporation.
 Gladstone General Partner, LLC, a Delaware limited liability company controlled by its manager, Gladstone Management Corporation.
 Gladstone Participation Fund LLC, a Delaware limited liability company controlled by Gladstone General Partner, LLC.
 Gladstone Partners Fund, LP, a Delaware limited partnership controlled by its General Partner, Gladstone Management Corporation

C-8

Item 29. Number of Holders of Securities

The following table sets forth the approximate number of record holders of the Company's common stock at May 11, 2007.

Title of Class	Number of Record Holders
Common stock, par value \$0.001 per share	81

Item 30. Indemnification

Subject to the Investment Company Act of 1940, as amended (the "1940 Act") or any valid rule, regulation or order of the Securities and Exchange Commission ("SEC") thereunder, our articles of incorporation and bylaws provide that we will indemnify any person who was or is a party or is threatened to be made a party to any threatened action, suit or proceeding whether civil, criminal, administrative or investigative, by reason of the fact that he is or was our director or officer, or is or was serving at our request as a director, officer, partner or trustee of another corporation, real estate investment trust, partnership, joint venture, trust, employee benefit plan or other enterprise to the maximum extent permitted by Section 2-418 of the Annotated Code of Maryland, Corporations and Associations (the "Maryland Law"). The 1940 Act provides that a company may not indemnify any director or officer against liability to it or its security holders to which he or she might otherwise be subject by reason of his or her willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his or her office unless a determination is made by final decision of a court, by vote of a majority of a quorum of directors who are disinterested, non-party directors or by independent legal counsel that the liability for which indemnification is sought did not arise out of the foregoing conduct. In addition to any indemnification to which our directors and officers are entitled pursuant to our articles of incorporation and bylaws and Maryland Law, our articles of incorporation and bylaws permit us to indemnify our other employees and agents to the fullest extent permitted by Maryland Law, whether such employees or agents are serving us or, at our request, any other entity.

In addition, the investment advisory and management agreement between us and our investment adviser, Gladstone Management Corporation (the "Adviser"), as well as the administration agreement between us and our administrator Gladstone Administration, LLC (the "Administrator"), each provide that, absent willful misfeasance, bad faith, or gross negligence in the performance of their respective duties or by reason of the reckless disregard of their respective duties and obligations, our Adviser or our Administrator, as applicable, and their respective officers, managers, partners, agents, employees, controlling persons, members, and any other person or entity affiliated with it are entitled to indemnification from us for any damages, liabilities, costs, and expenses (including reasonable attorneys' fees and amounts reasonably paid in settlement) arising from the rendering of our Adviser's services under the investment advisory and management agreement or otherwise as our investment adviser, or the rendering of our Administrator's services under the administration agreement, as applicable.

Item 31. Business and Other Connections of Investment Adviser

A description of any other business, profession, vocation or employment of a substantial nature in which our Adviser, and each director or executive officer of our Adviser, is or has been during the past two fiscal years, engaged in for his or her own account or in the capacity of director, officer, employee, partner or trustee, is set forth in Part A of this Registration Statement in the section entitled "Management." Additional information regarding our Adviser and its officers and directors is set forth in its Form ADV, as filed with the SEC, and is incorporated herein by reference.

C-9

Item 32. Location of Accounts and Records

All accounts, books or other documents required to be maintained by Section 31(a) of the 1940 Act and the rules thereunder are maintained at the offices of:

- (1) the Registrant, Gladstone Capital Corporation, 1521 Westbranch Drive, Suite 200, McLean, VA 22102;
- (2) the Transfer Agent, the Bank of New York, 101 Barclay Street, New York, NY 10286; and
- (3) our Adviser, Gladstone Management Corporation, 1521 Westbranch Drive, Suite 200, McLean, VA 22102.

Item 33. Management Services

Not applicable.

Item 34. Undertakings

1. We hereby undertake to suspend the offering of shares until the prospectus is amended if subsequent to the effective date of this registration statement, our net asset value declines more than ten percent from our net asset value as of the effective date of this registration statement.
2. We hereby undertake:
 - (a) to file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement:
 - (i) to include any prospectus required by Section 10(a) (3) of the Securities Act of 1933, as amended (the "Securities Act");
 - (ii) to reflect in the prospectus any facts or events arising after the effective date of this registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement; and
 - (iii) to include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement.
 - (b) that, for the purpose of determining any liability under the Securities Act, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of those securities at that time shall be deemed to be the initial bona fide offering thereof;
 - (c) to remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering; and
 - (d) that, for the purpose of determining liability under the Securities Act to any purchaser, if the Registrant is subject to Rule 430C: Each prospectus filed pursuant to Rule 497(b), (c), (d) or (e) under the Securities Act as part of a registration statement relating to an offering, other than prospectuses filed in reliance on Rule 430A under the Securities Act, shall be deemed to be part of and included in the registration statement as of the date it is first used after effectiveness. Provided, however, that no statement made in a registration statement or prospectus that is part of the registration statement or made in a document incorporated or deemed incorporated by reference into the registration statement or prospectus that is part of the registration statement will, as to a purchaser with a time of contract of sale prior to such first use, supersede or modify any statement

C-10

that was made in the registration statement or prospectus that was part of the registration statement or made in any such document immediately prior to such date of first use;

(e) that for the purpose of determining liability of the Registrant under the Securities Act to any purchaser in the initial distribution of securities: The undersigned Registrant undertakes that in a primary offering of securities of the undersigned Registrant pursuant to this registration statement, regardless of the underwriting method used to sell the securities to the purchaser, if the securities are offered or sold to such purchaser by means of any of the following communications, the undersigned Registrant will be a seller to the purchaser and will be considered to offer or sell such securities to the purchaser:

- (i) any preliminary prospectus or prospectus of the undersigned Registrant relating to the offering required to be filed pursuant to Rule 497 under the Securities Act;
 - (ii) the portion of any advertisement pursuant to Rule 482 under the Securities Act relating to the offering containing material information about the undersigned Registrant or its securities provided by or on behalf of the undersigned Registrant; and
 - (iii) any other communication that is an offer in the offering made by the undersigned Registrant to the purchaser.
3. We hereby undertake that:
 - (a) for the purpose of determining any liability under the Securities Act, the information omitted from the form of prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in a form of prospectus filed by us under Rule 497(h) under the Securities Act shall be deemed to be part of this registration statement as of the time it was declared effective; and
 - (b) for the purpose of determining any liability under the Securities Act, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of the securities at that time shall be deemed to be the initial bona fide offering thereof.

C-11

SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, as amended, and the Investment Company Act of 1940, as amended, the Registrant has duly caused this Registration Statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of McLean and Commonwealth of Virginia, on the 14th day of May, 2007.

GLADSTONE CAPITAL CORPORATION

By: /s/ DAVID GLADSTONE
David Gladstone

Chairman of the Board and Chief Executive Officer

KNOW ALL MEN BY THESE PRESENT, each person whose signature appears below hereby constitutes and appoints David Gladstone and Terry L. Brubaker and each of them, his or her true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him or her and in his or her name, place, and stead, in any and all capacities, to sign any and all amendments to this Registration Statement and any registration statement filed pursuant to Rule 462(b) under the Securities Act of 1933, as amended, and to file the same, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises, as fully to all intents and purposes as he or she might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or their substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Act of 1933, as amended, this Registration Statement has been signed below by the following persons in the capacities and on the dates indicated:

Date: May 14, 2007	By: <u>/s/ DAVID GLADSTONE</u> David Gladstone Chief Executive Officer and Chairman of the Board of Directors (principal executive officer)
Date: May 14, 2007	By: <u>/s/ TERRY L. BRUBAKER</u> Terry L. Brubaker Vice Chairman, Chief Operating Officer, Secretary and Director
Date: May 14, 2007	By: <u>/s/ HARRY T. BRILL, JR.</u> Harry T. Brill, Jr. Chief Financial Officer (principal financial and accounting officer)
Date: May 14, 2007	By: <u>/s/ GEORGE STELLJES III</u> George Stelljes III President, Chief Investment Officer and Director
Date: May 14, 2007	By: <u>/s/ DAVID A. R. DULLUM</u> David A.R. Dullum Director
Date: May 14, 2007	By: <u>/s/ ANTHONY W. PARKER</u> Anthony W. Parker Director

C-12

Date: May 14, 2007	By: <u>/s/ MICHELA A. ENGLISH</u> Michela A. English Director
Date: May 13, 2007	By: <u>/s/ PAUL W. ADELGREN</u> Paul W. Adलगren Director
Date: May 14, 2007	By: <u>/s/ MAURICE W. COULON</u> Maurice W. Coulon Director
Date: May 14, 2007	By: <u>/s/ JOHN H. OUTLAND</u> John H. Outland Director
Date: May 14, 2007	By: <u>/s/ GERARD MEAD</u> Gerard Mead Director

C-13

Exhibit List

Exhibit Number	Description
2.a.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.
2.b.1	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.
2.b.2	Amendment to By-laws, incorporated by reference to Exhibit 3.3 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2003 (File No. 814-00237), filed February 17, 2004.
2.c	Not applicable.
2.d.1	Form of Direct Registration Transaction Advice for the Registrant's common stock, par value \$0.001 per share, incorporated by reference to Exhibit d to Pre-Effective Amendment No. 1 to the Registration Statement on Form N-2 (File No. 333-63700), filed July 27, 2001.
2.d.2	Specimen Stock Certificate, incorporated by reference to Exhibit d.2 to Pre-Effective Amendment No. 3 to the Registration Statement on Form N-2 (File No. 333-63700), filed August 23, 2001.

- 2.d.3 Form of Senior indenture.
 - 2.d.4 Form of Subordinated indenture.
 - 2.e.1 Dividend Reinvestment Plan, incorporated by reference to Exhibit e to Pre-Effective Amendment No. 1 to the Registration Statement on Form N-2 (File No. 333-63700), filed July 27, 2001.
 - 2.f Not applicable.
 - 2.g.1 Amended and Restated Investment Advisory and Management Agreement between Gladstone Capital Corporation and Gladstone Management Corporation, dated as of October 1, 2006 incorporated by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed October 5, 2006.
 - 2.h Not applicable.
 - 2.i.1 Joint Directors Nonqualified Excess Plan of Gladstone Commercial Corporation, Gladstone Capital Corporation and Gladstone Investment Corporations, dated as of July 11, 2006, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed July 12, 2006.
 - 2.j.1 Custodian Agreement between Gladstone Capital Corporation and The Bank of New York, dated as of May 5, 2006, incorporated by reference to Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2006 (File No. 814-00237), filed August 1, 2006.
 - 2.k.1 Promissory Note of David Gladstone in favor of the Company, dated August 23, 2001, incorporated by reference to Exhibit 10.4 to the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2001, filed October 4, 2001.
 - 2.k.2 Promissory Note of Terry Brubaker in favor of the Company, dated August 23, 2001, incorporated by reference to Exhibit 10.5 to the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2001, filed October 4, 2001.
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- 2.k.3 Promissory Note of Harry Brill in favor of the Company, dated August 23, 2001, incorporated by reference to Exhibit 10.6 to the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2001, filed October 4, 2001.
 - 2.k.4 Trademark License Agreement between Gladstone Management Corporation and Gladstone Capital Corporation, incorporated by reference to Exhibit 10.29 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2004 (File No. 814-00237), filed February 9, 2005.
 - 2.k.5 Amended and Restated Credit Agreement by and among Gladstone Business Loan, LLC, Deutsche Bank AG, and certain other parties, dated as of May 26, 2006, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed May 30, 2006.
 - 2.k.6 Amendment No. 1 to Amended and Restated Credit Agreement by and among Gladstone Business Loan, LLC, Deutsche Bank AG, and certain other parties, dated as of September 22, 2006, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed September 22, 2006.
 - 2.k.7 Administration Agreement between Gladstone Capital Corporation and Gladstone Administration, LLC, dated as of October 1, 2006 incorporated by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed October 5, 2006.
 - 2.k.8 Amendment No. 2 to Amended and Restated Credit Agreement by and among Gladstone Business Loan, LLC, Deutsche Bank AG, and certain other parties, dated as of February 9, 2007, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed February 12, 2007.
 - 2.l Opinion of Cooley Godward Kronish LLP
 - 2.m Not applicable.
 - 2.n.1 Consent of Independent Registered Public Accounting Firm.
 - 2.n.2 Consent of Cooley Godward Kronish LLP (included in Exhibit 2.l).
 - 2.o Not applicable.
 - 2.p Subscription Agreement dated May 30, 2001, incorporated by reference to incorporated by reference to Exhibit p to the Registration Statement on Form N-2 (File No. 333-63700), filed June 22, 2001.
 - 2.q Not applicable.
 - 2.r Code of Ethics and Business Conduct, incorporated by reference to Exhibit 14.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed October 12, 2005.
 - 2.s Power of Attorney (included on signature page hereto).
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**GLADSTONE CAPITAL CORPORATION,
Issuer**

AND

**[TRUSTEE],
Trustee**

INDENTURE

Dated as of [____], 20__

Senior Debt Securities

TABLE OF CONTENTS

		<u>Page</u>
ARTICLE 1	DEFINITIONS	1
Section 1.01	Definitions of Terms	1
ARTICLE 2	ISSUE, DESCRIPTION, TERMS, EXECUTION, REGISTRATION AND EXCHANGE OF SECURITIES	5
Section 2.01	Designation and Terms of Securities	5
Section 2.02	Form of Securities and Trustee's Certificate	7
Section 2.03	Denominations: Provisions for Payment	7
Section 2.04	Execution and Authentications	9
Section 2.05	Registration of Transfer and Exchange	10
Section 2.06	Temporary Securities	11
Section 2.07	Mutilated, Destroyed, Lost or Stolen Securities	11
Section 2.08	Cancellation	12
Section 2.09	Benefits of Indenture	12
Section 2.10	Authenticating Agent	12
Section 2.11	Global Securities	13
ARTICLE 3	REDEMPTION OF SECURITIES AND SINKING FUND PROVISIONS	14
Section 3.01	Redemption	14
Section 3.02	Notice of Redemption	14
Section 3.03	Payment Upon Redemption	15
Section 3.04	Sinking Fund	16
Section 3.05	Satisfaction of Sinking Fund Payments with Securities	16
Section 3.06	Redemption of Securities for Sinking Fund	16
ARTICLE 4	COVENANTS	17
Section 4.01	Payment of Principal, Premium and Interest	17
Section 4.02	Maintenance of Office or Agency	17
Section 4.03	Paying Agents	17
Section 4.04	Appointment to Fill Vacancy in Office of Trustee	19
Section 4.05	Compliance with Consolidation Provisions	19

ARTICLE 5	SECURITYHOLDERS' LISTS AND REPORTS BY THE COMPANY AND THE TRUSTEE	19
Section 5.01	Company to Furnish Trustee Names and Addresses of Securityholders	19
Section 5.02	Preservation Of Information; Communications With Securityholders	19
Section 5.03	Reports by the Company	20
Section 5.04	Reports by the Trustee	20
ARTICLE 6	REMEDIES OF THE TRUSTEE AND SECURITYHOLDERS ON EVENT OF DEFAULT	20
Section 6.01	Events of Default	20
Section 6.02	Collection of Indebtedness and Suits for Enforcement by Trustee	22
Section 6.03	Application of Moneys Collected	23
Section 6.04	Limitation on Suits	24
Section 6.05	Rights and Remedies Cumulative; Delay or Omission Not Waiver	25

Section 6.06	Control by Securityholders	25
Section 6.07	Undertaking to Pay Costs	26
ARTICLE 7	CONCERNING THE TRUSTEE	26
Section 7.01	Certain Duties and Responsibilities of Trustee	26
Section 7.02	Certain Rights of Trustee	27
Section 7.03	Trustee Not Responsible for Recitals or Issuance or Securities	28
Section 7.04	May Hold Securities	29
Section 7.05	Moneys Held in Trust	29
Section 7.06	Compensation and Reimbursement	29
Section 7.07	Reliance on Officers' Certificate	30
Section 7.08	Disqualification; Conflicting Interests	30
Section 7.09	Corporate Trustee Required; Eligibility	30
Section 7.10	Resignation and Removal; Appointment of Successor	30
Section 7.11	Acceptance of Appointment By Successor	32
Section 7.12	Merger, Conversion, Consolidation or Succession to Business	33
Section 7.13	Preferential Collection of Claims Against the Company	33
Section 7.14	Notice of Default	33

ARTICLE 8	CONCERNING THE SECURITYHOLDERS	34
Section 8.01	Evidence of Action by Securityholders	34
Section 8.02	Proof of Execution by Securityholders	34
Section 8.03	Who May be Deemed Owners	35
Section 8.04	Certain Securities Owned by Company Disregarded	35
Section 8.05	Actions Binding on Future Securityholders	35
ARTICLE 9	SUPPLEMENTAL INDENTURES	36
Section 9.01	Supplemental Indentures Without the Consent of Securityholders	36
Section 9.02	Supplemental Indentures With Consent of Securityholders	37
Section 9.03	Effect of Supplemental Indentures	37
Section 9.04	Securities Affected by Supplemental Indentures	38
Section 9.05	Execution of Supplemental Indentures	38
ARTICLE 10	SUCCESSOR ENTITY	38
Section 10.01	Company May Consolidate, Etc.	38
Section 10.02	Successor Entity Substituted	39
Section 10.03	Evidence of Consolidation, Etc. to Trustee	39
ARTICLE 11	SATISFACTION AND DISCHARGE	40
Section 11.01	Satisfaction and Discharge of Indenture	40
Section 11.02	Discharge of Obligations	40
Section 11.03	Deposited Moneys to be Held in Trust	41
Section 11.04	Payment of Moneys Held by Paying Agents	41
Section 11.05	Repayment to Company	41
ARTICLE 12	IMMUNITY OF INCORPORATORS, STOCKHOLDERS, OFFICERS AND DIRECTORS	41
Section 12.01	No Recourse	41
ARTICLE 13	MISCELLANEOUS PROVISIONS	42
Section 13.01	Effect on Successors and Assigns	42
Section 13.02	Actions by Successor	42
Section 13.03	Surrender of Company Powers	42
Section 13.04	Notices	42

Section 13.05	Governing Law	43
Section 13.06	Treatment of Securities as Debt	43
Section 13.07	Certificates and Opinions as to Conditions Precedent	43
Section 13.08	Payments on Business Days	43
Section 13.09	Conflict with Trust Indenture Act	44
Section 13.10	Counterparts	44
Section 13.11	Separability	44
Section 13.12	Compliance Certificates	44

(1) This Table of Contents does not constitute part of the Indenture and shall not have any bearing on the interpretation of any of its terms or provisions.

INDENTURE

INDENTURE, dated as of [_____], 20__, among GLADSTONE CAPITAL CORPORATION, a Maryland corporation (the “Company”), and [TRUSTEE], as trustee (the “Trustee”):

WHEREAS, for its lawful corporate purposes, the Company has duly authorized the execution and delivery of this Indenture to provide for the issuance of debt securities (hereinafter referred to as the “Securities”), in an unlimited aggregate principal amount to be issued from time to time in one or more series as in this Indenture provided, as registered Securities without coupons, to be authenticated by the certificate of the Trustee;

WHEREAS, to provide the terms and conditions upon which the Securities are to be authenticated, issued and delivered, the Company has duly authorized the execution of this Indenture; and

WHEREAS, all things necessary to make this Indenture a valid agreement of the Company, in accordance with its terms, have been done.

NOW, THEREFORE, in consideration of the premises and the purchase of the Securities by the holders thereof, it is mutually covenanted and agreed as follows for the equal and ratable benefit of the holders of Securities:

ARTICLE 1

DEFINITIONS

Section 1.01 Definitions of Terms.

The terms defined in this Section (except as in this Indenture or any indenture supplemental hereto otherwise expressly provided or unless the context otherwise requires) for all purposes of this Indenture and of any indenture supplemental hereto shall have the respective meanings specified in this Section and shall include the plural as well as the singular. All other terms used in this Indenture that are defined in the Trust Indenture Act of 1939, as amended, or that are by reference in such Act defined in the Securities Act of 1933, as amended (except as herein or any indenture supplemental hereto otherwise expressly provided or unless the context otherwise requires), shall have the meanings assigned to such terms in said Trust Indenture Act and in said Securities Act as in force at the date of the execution of this instrument.

“*Authenticating Agent*” means an authenticating agent with respect to all or any of the series of Securities appointed by the Trustee pursuant to Section 2.10.

“*Bankruptcy Law*” means Title 11, U.S. Code, or any similar federal or state law for the relief of debtors.

“*Board of Directors*” means the Board of Directors of the Company or any duly authorized committee of such Board.

1

“*Board Resolution*” means a copy of a resolution certified by the Secretary or an Assistant Secretary of the Company to have been duly adopted by the Board of Directors and to be in full force and effect on the date of such certification.

“*Business Day*” means, with respect to any series of Securities, any day other than a day on which federal or state banking institutions in the Borough of Manhattan, the City of New York, or in the city of the Corporate Trust Office of the Trustee, are authorized or obligated by law, executive order or regulation to close.

“*Company*” means Gladstone Capital Corporation, a corporation duly organized and existing under the laws of the State of Maryland, and, subject to the provisions of Article Ten, shall also include its successors and assigns.

“*Corporate Trust Office*” means the office of the Trustee at which, at any particular time, its corporate trust business shall be principally administered, which office at the date hereof is located at

“*Custodian*” means any receiver, trustee, assignee, liquidator or similar official under any Bankruptcy Law.

“*Default*” means any event, act or condition that with notice or lapse of time, or both, would constitute an Event of Default.

“*Defaulted Interest*” shall have the meaning as set forth in Section 2.03.

“*Depository*” means, with respect to Securities of any series for which the Company shall determine that such Securities will be issued as a Global Security, The Depository Trust Company, New York, New York, another clearing agency, or any successor registered as a clearing agency under the Securities and Exchange Act of 1934, as amended (the “Exchange Act”), or other applicable statute or regulation, which, in each case, shall be designated by the Company pursuant to either Section 2.01 or 2.11.

“*Event of Default*” means, with respect to Securities of a particular series, any event specified in Section 6.01, continued for the period of time, if any, therein designated.

“*Global Security*” means, with respect to any series of Securities, a Security executed by the Company and delivered by the Trustee to the Depository or pursuant to the Depository’s instruction, all in accordance with the Indenture, which shall be registered in the name of the Depository or its nominee.

“*Governmental Obligations*” means securities that are (a) direct obligations of the United States of America for the payment of which its full faith and credit is pledged or (b) obligations of a Person controlled or supervised by and acting as an agency or instrumentality of the United States of America, the payment of which is unconditionally guaranteed as a full faith and credit obligation by the United States of America that, in either case, are not callable or redeemable at the option of the issuer thereof at any time prior to the stated maturity of the Securities, and shall also include a depository receipt issued by a bank or trust company as custodian with respect to

2

any such Governmental Obligation or a specific payment of principal of or interest on any such Governmental Obligation held by such custodian for the account of the holder of such depository receipt; provided, however, that (except as required by law) such custodian is not authorized to make any deduction from the amount payable to the holder of such depository receipt from any amount received by the custodian in respect of the Governmental Obligation or the specific payment of principal of or interest on the

Governmental Obligation evidenced by such depositary receipt.

“*herein*”, “*hereof*” and “*hereunder*”, and other words of similar import, refer to this Indenture as a whole and not to any particular Article, Section or other subdivision.

“*Indenture*” means this instrument as originally executed or as it may from time to time be supplemented or amended by one or more indentures supplemental hereto entered into in accordance with the terms hereof.

“*Interest Payment Date*”, when used with respect to any installment of interest on a Security of a particular series, means the date specified in such Security or in a Board Resolution or in an indenture supplemental hereto with respect to such series as the fixed date on which an installment of interest with respect to Securities of that series is due and payable.

“*Officer*” means, with respect to the Company, the chairman of the Board of Directors, a chief executive officer, a president, a chief financial officer, a chief operating officer, any executive vice president, any senior vice president, any vice president, the treasurer or any assistant treasurer, the controller or any assistant controller or the secretary or any assistant secretary.

“*Officers’ Certificate*” means a certificate signed by any two Officers. Each such certificate shall include the statements provided for in Section 13.07, if and to the extent required by the provisions thereof.

“*Opinion of Counsel*” means an opinion in writing subject to customary exceptions of legal counsel, who may be an employee of or counsel for the Company, that is delivered to the Trustee in accordance with the terms hereof. Each such opinion shall include the statements provided for in Section 13.07, if and to the extent required by the provisions thereof.

“*Outstanding*”, when used with reference to Securities of any series, means, subject to the provisions of Section 8.04, as of any particular time, all Securities of that series theretofore authenticated and delivered by the Trustee under this Indenture, except (a) Securities theretofore canceled by the Trustee or any paying agent, or delivered to the Trustee or any paying agent for cancellation or that have previously been canceled; (b) Securities or portions thereof for the payment or redemption of which moneys or Governmental Obligations in the necessary amount shall have been deposited in trust with the Trustee or with any paying agent (other than the Company) or shall have been set aside and segregated in trust by the Company (if the Company shall act as its own paying agent); provided, however, that if such Securities or portions of such Securities are to be redeemed prior to the maturity thereof, notice of such redemption shall have been given as in Article Three provided, or provision satisfactory to the Trustee shall have been made for giving such notice; and (c) Securities in lieu of or in substitution for which other Securities shall have been authenticated and delivered pursuant to the terms of Section 2.07.

3

“*Person*” means any individual, corporation, partnership, joint venture, joint-stock company, limited liability company, association, trust, unincorporated organization, any other entity or organization, including a government or political subdivision or an agency or instrumentality thereof.

“*Predecessor Security*” of any particular Security means every previous Security evidencing all or a portion of the same debt as that evidenced by such particular Security; and, for the purposes of this definition, any Security authenticated and delivered under Section 2.07 in lieu of a lost, destroyed or stolen Security shall be deemed to evidence the same debt as the lost, destroyed or stolen Security.

“*Responsible Officer*” when used with respect to the Trustee means the chairman of its board of directors, the chief executive officer, the president, any vice president, the secretary, the treasurer, any trust officer, any corporate trust officer or any other officer or assistant officer of the Trustee customarily performing functions similar to those performed by the Persons who at the time shall be such officers, respectively, or to whom any corporate trust matter is referred because of his or her knowledge of and familiarity with the particular subject.

“*Securities*” means the debt Securities authenticated and delivered under this Indenture.

“*Securityholder*”, “holder of Securities”, “registered holder”, or other similar term, means the Person or Persons in whose name or names a particular Security shall be registered on the books of the Company kept for that purpose in accordance with the terms of this Indenture.

“*Security Register*” and “*Security Registrar*” shall have the meanings as set forth in Section 2.05.

“*Subsidiary*” means, with respect to any Person, (i) any corporation at least a majority of whose outstanding Voting Stock shall at the time be owned, directly or indirectly, by such Person or by one or more of its Subsidiaries or by such Person and one or more of its Subsidiaries, (ii) any general partnership, joint venture or similar entity, at least a majority of whose outstanding partnership or similar interests shall at the time be owned by such Person, or by one or more of its Subsidiaries, or by such Person and one or more of its Subsidiaries and (iii) any limited partnership of which such Person or any of its Subsidiaries is a general partner.

“*Trustee*” means _____, and, subject to the provisions of Article Seven, shall also include its successors and assigns, and, if at any time there is more than one Person acting in such capacity hereunder, “Trustee” shall mean each such Person. The term “Trustee” as used with respect to a particular series of the Securities shall mean the trustee with respect to that series.

“*Trust Indenture Act*” means the Trust Indenture Act of 1939, as amended.

4

“*Voting Stock*”, as applied to stock of any Person, means shares, interests, participations or other equivalents in the equity interest (however designated) in such Person having ordinary voting power for the election of a majority of the directors (or the equivalent) of such Person, other than shares, interests, participations or other equivalents having such power only by reason of the occurrence of a contingency.

ARTICLE 2

ISSUE, DESCRIPTION, TERMS, EXECUTION, REGISTRATION AND EXCHANGE OF SECURITIES

Section 2.01 Designation and Terms of Securities.

(a) The aggregate principal amount of Securities that may be authenticated and delivered under this Indenture is unlimited. The Securities may be issued in one or more series up to the aggregate principal amount of Securities of that series from time to time authorized by or pursuant to a Board Resolution or pursuant to one or more indentures supplemental hereto. Prior to the initial issuance of Securities of any series, there shall be established in or pursuant to a Board Resolution, and set forth in an Officers' Certificate, or established in one or more indentures supplemental hereto:

- (1) the title of the Securities of the series (which shall distinguish the Securities of that series from all other Securities);
- (2) any limit upon the aggregate principal amount of the Securities of that series that may be authenticated and delivered under this Indenture (except for Securities authenticated and delivered upon registration of transfer of, or in exchange for, or in lieu of, other Securities of that series);
- (3) the date or dates on which the principal of the Securities of the series is payable, any original issue discount that may apply to the Securities of that series upon their issuance, the principal amount due at maturity, and the place(s) of payment;
- (4) the rate or rates at which the Securities of the series shall bear interest or the manner of calculation of such rate or rates, if any;
- (5) the date or dates from which such interest shall accrue, the Interest Payment Dates on which such interest will be payable or the manner of determination of such Interest Payment Dates, the place(s) of payment, and the record date for the determination of holders to whom interest is payable on any such Interest Payment Dates or the manner of determination of such record dates;
- (6) the right, if any, to extend the interest payment periods and the duration of such extension;

5

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- (7) the period or periods within which, the price or prices at which and the terms and conditions upon which Securities of the series may be redeemed, in whole or in part, at the option of the Company;
 - (8) the obligation, if any, of the Company to redeem or purchase Securities of the series pursuant to any sinking fund, mandatory redemption, or analogous provisions (including payments made in cash in satisfaction of future sinking fund obligations) or at the option of a holder thereof and the period or periods within which, the price or prices at which, and the terms and conditions upon which, Securities of the series shall be redeemed or purchased, in whole or in part, pursuant to such obligation;
 - (9) the form of the Securities of the series including the form of the certificate of Authentication for such series;
 - (10) if other than denominations of one thousand U.S. dollars (\$1,000) or any integral multiple thereof, the denominations in which the Securities of the series shall be issuable;
 - (11) any and all other terms (including terms, to the extent applicable, relating to any auction or remarketing of the Securities of that series and any security for the obligations of the Company with respect to such Securities) with respect to such series (which terms shall not be inconsistent with the terms of this Indenture, as amended by any supplemental indenture) including any terms which may be required by or advisable under United States laws or regulations or advisable in connection with the marketing of Securities of that series;
 - (12) whether the Securities are issuable as a Global Security and, in such case, the terms and the identity of the Depository for such series;
 - (13) whether the Securities will be convertible into or exchangeable for shares of common stock or other securities of the Company or any other Person and, if so, the terms and conditions upon which such Securities will be so convertible or exchangeable, including the conversion or exchange price, as applicable, or how it will be calculated and may be adjusted, any mandatory or optional (at the Company's option or the holders' option) conversion or exchange features, and the applicable conversion or exchange period;
 - (14) if other than the principal amount thereof, the portion of the principal amount of Securities of the series which shall be payable upon declaration of acceleration of the maturity thereof pursuant to Section 6.01;
 - (15) any additional or different Events of Default or restrictive covenants (which may include, among other restrictions, restrictions on the Company's ability or the ability of the Company's Subsidiaries to: incur additional indebtedness; issue additional securities; create liens; pay dividends or make distributions in respect of their capital stock; redeem capital stock; place restrictions on such Subsidiaries placing restrictions on their ability to pay dividends, make distributions or transfer assets; make investments or other restricted payments; sell or otherwise dispose of assets; enter into sale-leaseback transactions; engage in transactions with stockholders and affiliates; issue or sell stock of their Subsidiaries; or effect a

6

consolidation or merger) or financial covenants (which may include, among other financial covenants, financial covenants that require the Company and its Subsidiaries to maintain specified interest coverage, fixed charge, cash flow-based or asset-based ratios) provided for with respect to the Securities of the series;

- (16) if other than dollars, the coin or currency in which the Securities of the series are denominated (including, but not limited to, foreign currency);
- (17) the terms and conditions, if any, upon which the Company shall pay amounts in addition to the stated interest, premium, if any and principal amounts of the Securities of the series to any Securityholder that is not a "United States person" for federal tax purposes; and
- (18) any restrictions on transfer, sale or assignment of the Securities of the series.

All Securities of any one series shall be substantially identical except as to denomination and except as may otherwise be provided in or pursuant to any such Board Resolution or in any indentures supplemental hereto.

If any of the terms of the series are established by action taken pursuant to a Board Resolution of the Company, a copy of an appropriate record of such action shall be certified by the secretary or an assistant secretary of the Company and delivered to the Trustee at or prior to the delivery of the Officers' Certificate of the Company setting forth the terms of the series.

Securities of any particular series may be issued at various times, with different dates on which the principal or any installment of principal is payable, with different rates of interest, if any, or different methods by which rates of interest may be determined, with different dates on which such interest may be payable and with different redemption dates.

Section 2.02 Form of Securities and Trustee's Certificate

The Securities of any series and the Trustee's certificate of authentication to be borne by such Securities shall be substantially of the tenor and purport as set forth in one or more indentures supplemental hereto or as provided in a Board Resolution, and set forth in an Officers' Certificate, and they may have such letters, numbers or other marks of identification or designation and such legends or endorsements printed, lithographed or engraved thereon as the Company may deem appropriate and as are not inconsistent with the provisions of this Indenture, or as may be required to comply with any law or with any rule or regulation made pursuant thereto or with any rule or regulation of any securities exchange on which Securities of that series may be listed, or to conform to usage.

Section 2.03 Denominations: Provisions for Payment

The Securities shall be issuable as registered Securities and in the denominations of one thousand U.S. dollars (\$1,000) or any integral multiple thereof, subject to Section 2.01(a)(10). The Securities of a particular series shall bear interest payable on the dates and at the rate

7

specified with respect to that series. Subject to Section 2.01(a)(16), the principal of and the interest on the Securities of any series, as well as any premium thereon in case of redemption thereof prior to maturity, shall be payable in the coin or currency of the United States of America that at the time is legal tender for public and private debt, at the office or agency of the Company maintained for that purpose in the Borough of Manhattan, the City and State of New York. Each Security shall be dated the date of its authentication. Interest on the Securities shall be computed on the basis of a 360-day year composed of twelve 30-day months.

The interest installment on any Security that is payable, and is punctually paid or duly provided for, on any Interest Payment Date for Securities of that series shall be paid to the Person in whose name said Security (or one or more Predecessor Securities) is registered at the close of business on the regular record date for such interest installment. In the event that any Security of a particular series or portion thereof is called for redemption and the redemption date is subsequent to a regular record date with respect to any Interest Payment Date and prior to such Interest Payment Date, interest on such Security will be paid upon presentation and surrender of such Security as provided in Section 3.03.

Any interest on any Security that is payable, but is not punctually paid or duly provided for, on any Interest Payment Date for Securities of the same series (herein called "**Defaulted Interest**") shall forthwith cease to be payable to the registered holder on the relevant regular record date by virtue of having been such holder; and such Defaulted Interest shall be paid by the Company, at its election, as provided in clause (1) or clause (2) below:

(1) The Company may make payment of any Defaulted Interest on Securities to the Persons in whose names such Securities (or their respective Predecessor Securities) are registered at the close of business on a special record date for the payment of such Defaulted Interest, which shall be fixed in the following manner: the Company shall notify the Trustee in writing of the amount of Defaulted Interest proposed to be paid on each such Security and the date of the proposed payment, and at the same time the Company shall deposit with the Trustee an amount of money equal to the aggregate amount proposed to be paid in respect of such Defaulted Interest or shall make arrangements satisfactory to the Trustee for such deposit prior to the date of the proposed payment, such money when deposited to be held in trust for the benefit of the Persons entitled to such Defaulted Interest as in this clause provided. Thereupon the Trustee shall fix a special record date for the payment of such Defaulted Interest which shall not be more than 15 nor less than 10 days prior to the date of the proposed payment and not less than 10 days after the receipt by the Trustee of the notice of the proposed payment. The Trustee shall promptly notify the Company of such special record date and, in the name and at the expense of the Company, shall cause notice of the proposed payment of such Defaulted Interest and the special record date therefor to be mailed, first class postage prepaid, to each Securityholder at his or her address as it appears in the Security Register (as hereinafter defined), not less than 10 days prior to such special record date. Notice of the proposed payment of such Defaulted Interest and the special record date therefor having been mailed as aforesaid, such Defaulted Interest shall be paid to the Persons in whose names such Securities (or their respective Predecessor Securities) are registered on such special record date.

(2) The Company may make payment of any Defaulted Interest on any Securities in any other lawful manner not inconsistent with the requirements of any securities

8

exchange on which such Securities may be listed, and upon such notice as may be required by such exchange, if, after notice given by the Company to the Trustee of the proposed payment pursuant to this clause, such manner of payment shall be deemed practicable by the Trustee.

Unless otherwise set forth in a Board Resolution or one or more indentures supplemental hereto establishing the terms of any series of Securities pursuant to Section 2.01 hereof, the term "regular record date" as used in this Section with respect to a series of Securities and any Interest Payment Date for such series shall mean either the fifteenth day of the month immediately preceding the month in which an Interest Payment Date established for such series pursuant to Section 2.01 hereof shall occur, if such Interest Payment Date is the first day of a month, or the first day of the month in which an Interest Payment Date established for such series pursuant to Section 2.01 hereof shall occur, if such Interest Payment Date is the fifteenth day of a month, whether or not such date is a Business Day.

Subject to the foregoing provisions of this Section, each Security of a series delivered under this Indenture upon transfer of or in exchange for or in lieu of any other Security of such series shall carry the rights to interest accrued and unpaid, and to accrue, that were carried by such other Security.

Section 2.04 Execution and Authentications.

The Securities shall be signed on behalf of the Company by one of its Officers. Signatures may be in the form of a manual or facsimile signature.

The Company may use the facsimile signature of any Person who shall have been an Officer, notwithstanding the fact that at the time the Securities shall be authenticated and delivered or disposed of such Person shall have ceased to be such an officer of the Company. The Securities may contain such notations, legends or endorsements required by law, stock exchange rule or usage. Each Security shall be dated the date of its authentication by the Trustee.

A Security shall not be valid until authenticated manually by an authorized signatory of the Trustee, or by an Authenticating Agent. Such signature shall be conclusive evidence that the Security so authenticated has been duly authenticated and delivered hereunder and that the holder is entitled to the benefits of this Indenture. At any time and from time to time after the execution and delivery of this Indenture, the Company may deliver Securities of any series executed by the Company to the Trustee for authentication, together with a written order of the Company for the authentication and delivery of such Securities, signed by an Officer, and the Trustee in accordance

with such written order shall authenticate and deliver such Securities.

In authenticating such Securities and accepting the additional responsibilities under this Indenture in relation to such Securities, the Trustee shall be entitled to receive, and (subject to Section 7.01) shall be fully protected in relying upon, an Opinion of Counsel stating that the form and terms thereof have been established in conformity with the provisions of this Indenture.

The Trustee shall not be required to authenticate such Securities if the issue of such Securities pursuant to this Indenture will affect the Trustee's own rights, duties or immunities under the Securities and this Indenture or otherwise in a manner that is not reasonably acceptable to the Trustee.

9

Section 2.05 Registration of Transfer and Exchange.

(a) Securities of any series may be exchanged upon presentation thereof at the office or agency of the Company designated for such purpose in the Borough of Manhattan, the City and State of New York, for other Securities of such series of authorized denominations, and for a like aggregate principal amount, upon payment of a sum sufficient to cover any tax or other governmental charge in relation thereto, all as provided in this Section. In respect of any Securities so surrendered for exchange, the Company shall execute, the Trustee shall authenticate and such office or agency shall deliver in exchange therefor the Security or Securities of the same series that the Securityholder making the exchange shall be entitled to receive, bearing numbers not contemporaneously outstanding.

(b) The Company shall keep, or cause to be kept, at its office or agency designated for such purpose in the Borough of Manhattan, the City and State of New York, or such other location designated by the Company, a register or registers (herein referred to as the "*Security Register*") in which, subject to such reasonable regulations as it may prescribe, the Company shall register the Securities and the transfers of Securities as in this Article provided and which at all reasonable times shall be open for inspection by the Trustee. The registrar for the purpose of registering Securities and transfer of Securities as herein provided shall be appointed as authorized by Board Resolution (the "*Security Registrar*").

Upon surrender for transfer of any Security at the office or agency of the Company designated for such purpose, the Company shall execute, the Trustee shall authenticate and such office or agency shall deliver in the name of the transferee or transferees a new Security or Securities of the same series as the Security presented for a like aggregate principal amount.

All Securities presented or surrendered for exchange or registration of transfer, as provided in this Section, shall be accompanied (if so required by the Company or the Security Registrar) by a written instrument or instruments of transfer, in form satisfactory to the Company or the Security Registrar, duly executed by the registered holder or by such holder's duly authorized attorney in writing.

(c) Except as provided pursuant to Section 2.01 pursuant to a Board Resolution, and set forth in an Officers' Certificate, or established in one or more indentures supplemental to this Indenture, no service charge shall be made for any exchange or registration of transfer of Securities, or issue of new Securities in case of partial redemption of any series, but the Company may require payment of a sum sufficient to cover any tax or other governmental charge in relation thereto, other than exchanges pursuant to Section 2.06, Section 3.03(b) and Section 9.04 not involving any transfer.

(d) The Company shall not be required (i) to issue, exchange or register the transfer of any Securities during a period beginning at the opening of business 15 days before the day of the mailing of a notice of redemption of less than all the Outstanding Securities of the same series and ending at the close of business on the day of such mailing, nor (ii) to register the

10

transfer of or exchange any Securities of any series or portions thereof called for redemption, other than the unredeemed portion of any such Securities being redeemed in part. The provisions of this Section 2.05 are, with respect to any Global Security, subject to Section 2.11 hereof.

Section 2.06 Temporary Securities.

Pending the preparation of definitive Securities of any series, the Company may execute, and the Trustee shall authenticate and deliver, temporary Securities (printed, lithographed or typewritten) of any authorized denomination. Such temporary Securities shall be substantially in the form of the definitive Securities in lieu of which they are issued, but with such omissions, insertions and variations as may be appropriate for temporary Securities, all as may be determined by the Company. Every temporary Security of any series shall be executed by the Company and be authenticated by the Trustee upon the same conditions and in substantially the same manner, and with like effect, as the definitive Securities of such series. Without unnecessary delay the Company will execute and will furnish definitive Securities of such series and thereupon any or all temporary Securities of such series may be surrendered in exchange therefor (without charge to the holders), at the office or agency of the Company designated for the purpose in the Borough of Manhattan, the City and State of New York, and the Trustee shall authenticate and such office or agency shall deliver in exchange for such temporary Securities an equal aggregate principal amount of definitive Securities of such series, unless the Company advises the Trustee to the effect that definitive Securities need not be executed and furnished until further notice from the Company. Until so exchanged, the temporary Securities of such series shall be entitled to the same benefits under this Indenture as definitive Securities of such series authenticated and delivered hereunder.

Section 2.07 Mutilated, Destroyed, Lost or Stolen Securities.

In case any temporary or definitive Security shall become mutilated or be destroyed, lost or stolen, the Company (subject to the next succeeding sentence) shall execute, and upon the Company's request the Trustee (subject as aforesaid) shall authenticate and deliver, a new Security of the same series, bearing a number not contemporaneously outstanding, in exchange and substitution for the mutilated Security, or in lieu of and in substitution for the Security so destroyed, lost or stolen. In every case the applicant for a substituted Security shall furnish to the Company and the Trustee such security or indemnity as may be required by them to save each of them harmless, and, in every case of destruction, loss or theft, the applicant shall also furnish to the Company and the Trustee evidence to their satisfaction of the destruction, loss or theft of the applicant's Security and of the ownership thereof. The Trustee may authenticate any such substituted Security and deliver the same upon the written request or authorization of any officer of the Company. Upon the issuance of any substituted Security, the Company may require the payment of a sum sufficient to cover any tax or other governmental charge that may be imposed in relation thereto and any other expenses (including the fees and expenses of the Trustee) connected therewith.

In case any Security that has matured or is about to mature shall become mutilated or be destroyed, lost or stolen, the Company may, instead of issuing a substitute Security, pay or authorize the payment of the same (without surrender thereof except in the case of a mutilated Security) if the applicant for such payment shall furnish to the Company and the Trustee such

security or indemnity as they may require to save them harmless, and, in case of destruction, loss or theft, evidence to the satisfaction of the Company and the Trustee of the destruction, loss or theft of such Security and of the ownership thereof.

Every replacement Security issued pursuant to the provisions of this Section shall constitute an additional contractual obligation of the Company whether or not the mutilated, destroyed, lost or stolen Security shall be found at any time, or be enforceable by anyone, and shall be entitled to all the benefits of this Indenture equally and proportionately with any and all other Securities of the same series duly issued hereunder. All Securities shall be held and owned upon the express condition that the foregoing provisions are exclusive with respect to the replacement or payment of mutilated, destroyed, lost or stolen Securities, and shall preclude (to the extent lawful) any and all other rights or remedies, notwithstanding any law or statute existing or hereafter enacted to the contrary with respect to the replacement or payment of negotiable instruments or other securities without their surrender.

Section 2.08 Cancellation.

All Securities surrendered for the purpose of payment, redemption, exchange or registration of transfer shall, if surrendered to the Company or any paying agent, be delivered to the Trustee for cancellation, or, if surrendered to the Trustee, shall be cancelled by it, and no Securities shall be issued in lieu thereof except as expressly required or permitted by any of the provisions of this Indenture. On request of the Company at the time of such surrender, the Trustee shall deliver to the Company canceled Securities held by the Trustee. In the absence of such request the Trustee may dispose of canceled Securities in accordance with its standard procedures and deliver a certificate of disposition to the Company. If the Company shall otherwise acquire any of the Securities, however, such acquisition shall not operate as a redemption or satisfaction of the indebtedness represented by such Securities unless and until the same are delivered to the Trustee for cancellation.

Section 2.09 Benefits of Indenture.

Nothing in this Indenture or in the Securities, express or implied, shall give or be construed to give to any Person, other than the parties hereto and the holders of the Securities any legal or equitable right, remedy or claim under or in respect of this Indenture, or under any covenant, condition or provision herein contained; all such covenants, conditions and provisions being for the sole benefit of the parties hereto and of the holders of the Securities.

Section 2.10 Authenticating Agent

So long as any of the Securities of any series remain Outstanding there may be an Authenticating Agent for any or all such series of Securities which the Trustee shall have the right to appoint. Said Authenticating Agent shall be authorized to act on behalf of the Trustee to authenticate Securities of such series issued upon exchange, transfer or partial redemption thereof, and Securities so authenticated shall be entitled to the benefits of this Indenture and shall be valid and obligatory for all purposes as if authenticated by the Trustee hereunder. All references in this Indenture to the authentication of Securities by the Trustee shall be deemed to include authentication by an Authenticating Agent for such series. Each Authenticating Agent

shall be acceptable to the Company and shall be a corporation that has a combined capital and surplus, as most recently reported or determined by it, sufficient under the laws of any jurisdiction under which it is organized or in which it is doing business to conduct a trust business, and that is otherwise authorized under such laws to conduct such business and is subject to supervision or examination by federal or state authorities. If at any time any Authenticating Agent shall cease to be eligible in accordance with these provisions, it shall resign immediately.

Any Authenticating Agent may at any time resign by giving written notice of resignation to the Trustee and to the Company. The Trustee may at any time (and upon request by the Company shall) terminate the agency of any Authenticating Agent by giving written notice of termination to such Authenticating Agent and to the Company. Upon resignation, termination or cessation of eligibility of any Authenticating Agent, the Trustee may appoint an eligible successor Authenticating Agent acceptable to the Company. Any successor Authenticating Agent, upon acceptance of its appointment hereunder, shall become vested with all the rights, powers and duties of its predecessor hereunder as if originally named as an Authenticating Agent pursuant hereto.

Section 2.11 Global Securities.

(a) If the Company shall establish pursuant to Section 2.01 that the Securities of a particular series are to be issued as a Global Security, then the Company shall execute and the Trustee shall, in accordance with Section 2.04, authenticate and deliver, a Global Security that (i) shall represent, and shall be denominated in an amount equal to the aggregate principal amount of, all of the Outstanding Securities of such series, (ii) shall be registered in the name of the Depository or its nominee, (iii) shall be delivered by the Trustee to the Depository or pursuant to the Depository's instruction and (iv) shall bear a legend substantially to the following effect: "Except as otherwise provided in Section 2.11 of the Indenture, this Security may be transferred, in whole but not in part, only to another nominee of the Depository or to a successor Depository or to a nominee of such successor Depository."

(b) Notwithstanding the provisions of Section 2.05, the Global Security of a series may be transferred, in whole but not in part and in the manner provided in Section 2.05, only to another nominee of the Depository for such series, or to a successor Depository for such series selected or approved by the Company or to a nominee of such successor Depository.

(c) If at any time the Depository for a series of the Securities notifies the Company that it is unwilling or unable to continue as Depository for such series or if at any time the Depository for such series shall no longer be registered or in good standing under the Exchange Act, or other applicable statute or regulation, and a successor Depository for such series is not appointed by the Company within 90 days after the Company receives such notice or becomes aware of such condition, as the case may be, or if an Event of Default has occurred and is continuing and the Company has received a request from the Depository, this Section 2.11 shall no longer be applicable to the Securities of such series and the Company will execute, and subject to Section 2.04, the Trustee will authenticate and deliver the Securities of such series in definitive registered form without coupons, in authorized denominations, and in an aggregate principal amount equal to the principal amount of the Global Security of such series in exchange

for such Global Security. In addition, the Company may at any time determine that the Securities of any series shall no longer be represented by a Global Security and that the provisions of this Section 2.11 shall no longer apply to the Securities of such series. In such event the Company will execute and, subject to Section 2.04, the Trustee, upon

receipt of an Officers' Certificate evidencing such determination by the Company, will authenticate and deliver the Securities of such series in definitive registered form without coupons, in authorized denominations, and in an aggregate principal amount equal to the principal amount of the Global Security of such series in exchange for such Global Security. Upon the exchange of the Global Security for such Securities in definitive registered form without coupons, in authorized denominations, the Global Security shall be canceled by the Trustee. Such Securities in definitive registered form issued in exchange for the Global Security pursuant to this Section 2.11(c) shall be registered in such names and in such authorized denominations as the Depository, pursuant to instructions from its direct or indirect participants or otherwise, shall instruct the Trustee. The Trustee shall deliver such Securities to the Depository for delivery to the Persons in whose names such Securities are so registered.

ARTICLE 3

REDEMPTION OF SECURITIES AND SINKING FUND PROVISIONS

Section 3.01 Redemption.

The Company may redeem the Securities of any series issued hereunder on and after the dates and in accordance with the terms established for such series pursuant to Section 2.01 hereof.

Section 3.02 Notice of Redemption.

(a) In case the Company shall desire to exercise such right to redeem all or, as the case may be, a portion of the Securities of any series in accordance with any right the Company reserved for itself to do so pursuant to Section 2.01 hereof, the Company shall, or shall cause the Trustee to, give notice of such redemption to holders of the Securities of such series to be redeemed by mailing, first class postage prepaid, a notice of such redemption not less than 30 days and not more than 90 days before the date fixed for redemption of that series to such holders at their last addresses as they shall appear upon the Security Register, unless a shorter period is specified in the Securities to be redeemed. Any notice that is mailed in the manner herein provided shall be conclusively presumed to have been duly given, whether or not the registered holder receives the notice. In any case, failure duly to give such notice to the holder of any Security of any series designated for redemption in whole or in part, or any defect in the notice, shall not affect the validity of the proceedings for the redemption of any other Securities of such series or any other series. In the case of any redemption of Securities prior to the expiration of any restriction on such redemption provided in the terms of such Securities or elsewhere in this Indenture, the Company shall furnish the Trustee with an Officers' Certificate evidencing compliance with any such restriction.

Each such notice of redemption shall specify the date fixed for redemption and the redemption price at which Securities of that series are to be redeemed, and shall state that

14

payment of the redemption price of such Securities to be redeemed will be made at the office or agency of the Company in the Borough of Manhattan, the City and State of New York, upon presentation and surrender of such Securities, that interest accrued to the date fixed for redemption will be paid as specified in said notice, that from and after said date interest will cease to accrue and that the redemption is for a sinking fund, if such is the case. If less than all the Securities of a series are to be redeemed, the notice to the holders of Securities of that series to be redeemed in part shall specify the particular Securities to be so redeemed.

In case any Security is to be redeemed in part only, the notice that relates to such Security shall state the portion of the principal amount thereof to be redeemed, and shall state that on and after the redemption date, upon surrender of such Security, a new Security or Securities of such series in principal amount equal to the unredeemed portion thereof will be issued.

(b) If less than all the Securities of a series are to be redeemed, the Company shall give the Trustee at least 45 days' notice (unless a shorter notice shall be satisfactory to the Trustee) in advance of the date fixed for redemption as to the aggregate principal amount of Securities of the series to be redeemed, and thereupon the Trustee shall select, by lot or in such other manner as it shall deem appropriate and fair in its discretion and that may provide for the selection of a portion or portions (equal to one thousand U.S. dollars (\$1,000) or any integral multiple thereof) of the principal amount of such Securities of a denomination larger than \$1,000, the Securities to be redeemed and shall thereafter promptly notify the Company in writing of the numbers of the Securities to be redeemed, in whole or in part. The Company may, if and whenever it shall so elect, by delivery of instructions signed on its behalf by an Officer, instruct the Trustee or any paying agent to call all or any part of the Securities of a particular series for redemption and to give notice of redemption in the manner set forth in this Section, such notice to be in the name of the Company or its own name as the Trustee or such paying agent may deem advisable. In any case in which notice of redemption is to be given by the Trustee or any such paying agent, the Company shall deliver or cause to be delivered to, or permit to remain with, the Trustee or such paying agent, as the case may be, such Security Register, transfer books or other records, or suitable copies or extracts therefrom, sufficient to enable the Trustee or such paying agent to give any notice by mail that may be required under the provisions of this Section.

Section 3.03 Payment Upon Redemption.

(a) If the giving of notice of redemption shall have been completed as above provided, the Securities or portions of Securities of the series to be redeemed specified in such notice shall become due and payable on the date and at the place stated in such notice at the applicable redemption price, together with interest accrued to the date fixed for redemption and interest on such Securities or portions of Securities shall cease to accrue on and after the date fixed for redemption, unless the Company shall default in the payment of such redemption price and accrued interest with respect to any such Security or portion thereof. On presentation and surrender of such Securities on or after the date fixed for redemption at the place of payment specified in the notice, said Securities shall be paid and redeemed at the applicable redemption price for such series, together with interest accrued thereon to the date fixed for redemption (but if the date fixed for redemption is an interest payment date, the interest installment payable on such date shall be payable to the registered holder at the close of business on the applicable record date pursuant to Section 2.03).

15

(b) Upon presentation of any Security of such series that is to be redeemed in part only, the Company shall execute and the Trustee shall authenticate and the office or agency where the Security is presented shall deliver to the holder thereof, at the expense of the Company, a new Security of the same series of authorized denominations in principal amount equal to the unredeemed portion of the Security so presented.

Section 3.04 Sinking Fund.

The provisions of Sections 3.04, 3.05 and 3.06 shall be applicable to any sinking fund for the retirement of Securities of a series, except as otherwise specified as contemplated by Section 2.01 for Securities of such series.

The minimum amount of any sinking fund payment provided for by the terms of Securities of any series is herein referred to as a “mandatory sinking fund payment,” and any payment in excess of such minimum amount provided for by the terms of Securities of any series is herein referred to as an “optional sinking fund payment”. If provided for by the terms of Securities of any series, the cash amount of any sinking fund payment may be subject to reduction as provided in Section 3.05. Each sinking fund payment shall be applied to the redemption of Securities of any series as provided for by the terms of Securities of such series.

Section 3.05 Satisfaction of Sinking Fund Payments with Securities.

The Company (i) may deliver Outstanding Securities of a series and (ii) may apply as a credit Securities of a series that have been redeemed either at the election of the Company pursuant to the terms of such Securities or through the application of permitted optional sinking fund payments pursuant to the terms of such Securities, in each case in satisfaction of all or any part of any sinking fund payment with respect to the Securities of such series required to be made pursuant to the terms of such Securities as provided for by the terms of such series, provided that such Securities have not been previously so credited. Such Securities shall be received and credited for such purpose by the Trustee at the redemption price specified in such Securities for redemption through operation of the sinking fund and the amount of such sinking fund payment shall be reduced accordingly.

Section 3.06 Redemption of Securities for Sinking Fund.

Not less than 45 days prior to each sinking fund payment date for any series of Securities (unless a shorter period shall be satisfactory to the Trustee), the Company will deliver to the Trustee an Officers’ Certificate specifying the amount of the next ensuing sinking fund payment for that series pursuant to the terms of the series, the portion thereof, if any, that is to be satisfied by delivering and crediting Securities of that series pursuant to Section 3.05 and the basis for such credit and will, together with such Officers’ Certificate, deliver to the Trustee any Securities to be so delivered. Not less than 30 days before each such sinking fund payment date the Trustee shall select the Securities to be redeemed upon such sinking fund payment date in the manner specified in Section 3.02 and cause notice of the redemption thereof to be given in the name of and at the expense of the Company in the manner provided in Section 3.02. Such notice having been duly given, the redemption of such Securities shall be made upon the terms and in the manner stated in Section 3.03.

16

ARTICLE 4

COVENANTS

Section 4.01 Payment of Principal, Premium and Interest

The Company will duly and punctually pay or cause to be paid the principal of (and premium, if any) and interest on the Securities of that series at the time and place and in the manner provided herein and established with respect to such Securities. Payments of principal on the Securities may be made at the time provided herein and established with respect to such Securities by U.S. dollar check drawn on and mailed to the address of the Securityholder entitled thereto as such address shall appear in the Security Register, or U.S. dollar wire transfer to, a U.S. dollar account (such wire transfer to be made only to a Securityholder of an aggregate principal amount of Securities of the applicable series in excess of U.S. \$2,000,000 and only if such Securityholder shall have furnished wire instructions to the Trustee no later than 15 days prior to the relevant payment date). Payments of interest on the Securities may be made at the time provided herein and established with respect to such Securities by U.S. dollar check mailed to the address of the Securityholder entitled thereto as such address shall appear in the Security Register, or U.S. dollar wire transfer to, a U.S. dollar account (such a wire transfer to be made only to a Securityholder of an aggregate principal amount of Securities of the applicable series in excess of U.S. \$2,000,000 and only if such Securityholder shall have furnished wire instructions in writing to the Security Registrar and the Trustee no later than 15 days prior to the relevant payment date.

Section 4.02 Maintenance of Office or Agency.

So long as any series of the Securities remain Outstanding, the Company agrees to maintain an office or agency in the Borough of Manhattan, the City and State of New York, with respect to each such series and at such other location or locations as may be designated as provided in this Section 4.02, where (i) Securities of that series may be presented for payment, (ii) Securities of that series may be presented as herein above authorized for registration of transfer and exchange, and (iii) notices and demands to or upon the Company in respect of the Securities of that series and this Indenture may be given or served, such designation to continue with respect to such office or agency until the Company shall, by written notice signed by any officer authorized to sign an Officers’ Certificate and delivered to the Trustee, designate some other office or agency for such purposes or any of them. If at any time the Company shall fail to maintain any such required office or agency or shall fail to furnish the Trustee with the address thereof, such presentations, notices and demands may be made or served at the Corporate Trust Office of the Trustee, and the Company hereby appoints the Trustee as its agent to receive all such presentations, notices and demands. The Company initially appoints the Corporate Trust Office of the Trustee located in the Borough of Manhattan, the City of New York as its paying agent with respect to the Securities.

Section 4.03 Paying Agents.

(a) If the Company shall appoint one or more paying agents for all or any series of the Securities, other than the Trustee, the Company will cause each such paying agent to execute

17

and deliver to the Trustee an instrument in which such agent shall agree with the Trustee, subject to the provisions of this Section:

(1) that it will hold all sums held by it as such agent for the payment of the principal of (and premium, if any) or interest on the Securities of that series (whether such sums have been paid to it by the Company or by any other obligor of such Securities) in trust for the benefit of the Persons entitled thereto;

(2) that it will give the Trustee notice of any failure by the Company (or by any other obligor of such Securities) to make any payment of the principal of (and premium, if any) or interest on the Securities of that series when the same shall be due and payable;

(3) that it will, at any time during the continuance of any failure referred to in the preceding paragraph (a)(2) above, upon the written request of the Trustee, forthwith pay to the Trustee all sums so held in trust by such paying agent; and

(4) that it will perform all other duties of paying agent as set forth in this Indenture.

(b) If the Company shall act as its own paying agent with respect to any series of the Securities, it will on or before each due date of the principal of (and premium, if any) or interest on Securities of that series, set aside, segregate and hold in trust for the benefit of the Persons entitled thereto a sum sufficient to pay such

principal (and premium, if any) or interest so becoming due on Securities of that series until such sums shall be paid to such Persons or otherwise disposed of as herein provided and will promptly notify the Trustee of such action, or any failure (by it or any other obligor on such Securities) to take such action. Whenever the Company shall have one or more paying agents for any series of Securities, it will, prior to each due date of the principal of (and premium, if any) or interest on any Securities of that series, deposit with the paying agent a sum sufficient to pay the principal (and premium, if any) or interest so becoming due, such sum to be held in trust for the benefit of the Persons entitled to such principal, premium or interest, and (unless such paying agent is the Trustee) the Company will promptly notify the Trustee of this action or failure so to act.

(c) Notwithstanding anything in this Section to the contrary, (i) the agreement to hold sums in trust as provided in this Section is subject to the provisions of Section 11.05, and (ii) the Company may at any time, for the purpose of obtaining the satisfaction and discharge of this Indenture or for any other purpose, pay, or direct any paying agent to pay, to the Trustee all sums held in trust by the Company or such paying agent, such sums to be held by the Trustee upon the same terms and conditions as those upon which such sums were held by the Company or such paying agent; and, upon such payment by the Company or any paying agent to the Trustee, the Company or such paying agent shall be released from all further liability with respect to such money.

18

Section 4.04 Appointment to Fill Vacancy in Office of Trustee.

The Company, whenever necessary to avoid or fill a vacancy in the office of Trustee, will appoint, in the manner provided in Section 7.10, a Trustee, so that there shall at all times be a Trustee hereunder.

Section 4.05 Compliance with Consolidation Provisions.

The Company will not, while any of the Securities remain Outstanding, consolidate with or merge into any other Person, in either case where the Company is not the survivor of such transaction, or sell or convey all or substantially all of its property to any other Person unless the provisions of Article Ten hereof are complied with.

ARTICLE 5

SECURITYHOLDERS' LISTS AND REPORTS BY THE COMPANY AND THE TRUSTEE

Section 5.01 Company to Furnish Trustee Names and Addresses of Securityholders

The Company will furnish or cause to be furnished to the Trustee (a) within 15 days after each regular record date (as defined in Section 2.03) a list, in such form as the Trustee may reasonably require, of the names and addresses of the holders of each series of Securities as of such regular record date, provided that the Company shall not be obligated to furnish or cause to furnish such list at any time that the list shall not differ in any respect from the most recent list furnished to the Trustee by the Company and (b) at such other times as the Trustee may request in writing within 30 days after the receipt by the Company of any such request, a list of similar form and content as of a date not more than 15 days prior to the time such list is furnished; provided, however, that, in either case, no such list need be furnished for any series for which the Trustee shall be the Security Registrar.

Section 5.02 Preservation Of Information; Communications With Securityholders

(a) The Trustee shall preserve, in as current a form as is reasonably practicable, all information as to the names and addresses of the holders of Securities contained in the most recent list furnished to it as provided in Section 5.01 and as to the names and addresses of holders of Securities received by the Trustee in its capacity as Security Registrar (if acting in such capacity).

(b) The Trustee may destroy any list furnished to it as provided in Section 5.01 upon receipt of a new list so furnished.

(c) Securityholders may communicate as provided in Section 312(b) of the Trust Indenture Act with other Securityholders with respect to their rights under this Indenture or under the Securities, and, in connection with any such communications, the Trustee shall satisfy

19

its obligations under Section 312(b) of the Trust Indenture Act in accordance with the provisions of Section 312(b) of the Trust Indenture Act.

Section 5.03 Reports by the Company.

The Company covenants and agrees to provide a copy to the Trustee, after the Company files the same with the Securities and Exchange Commission, copies of the annual reports and of the information, documents and other reports (or copies of such portions of any of the foregoing as the Securities and Exchange Commission may from time to time by rules and regulations prescribe) that the Company files with the Securities and Exchange Commission pursuant to Section 13 or Section 15(d) of the Exchange Act; provided, however, the Company shall not be required to deliver to the Trustee any materials for which the Company has sought and received confidential treatment by the SEC.

Section 5.04 Reports by the Trustee.

(a) If required by Section 313(a) of the Trust Indenture Act, the Trustee, within sixty (60) days after each May 1, shall transmit by mail, first class postage prepaid, to the Securityholders, as their names and addresses appear upon the Security Register, a brief report dated as of such May 1, which complies with Section 313(a) of the Trust Indenture Act.

(b) The Trustee shall comply with Section 313(b) and 313(c) of the Trust Indenture Act.

(c) A copy of each such report shall, at the time of such transmission to Securityholders, be filed by the Trustee with the Company, with each securities exchange upon which any Securities are listed (if so listed) and also with the Securities and Exchange Commission. The Company agrees to notify the Trustee when any Securities become listed on any securities exchange.

ARTICLE 6

REMEDIES OF THE TRUSTEE AND SECURITYHOLDERS ON EVENT OF DEFAULT

Section 6.01 Events of Default.

(a) Whenever used herein with respect to Securities of a particular series, “*Event of Default*” means any one or more of the following events that has occurred and is continuing:

(1) the Company defaults in the payment of any installment of interest upon any of the Securities of that series, as and when the same shall become due and payable, and such default continues for a period of 90 days; provided, however, that a valid extension of an interest payment period by the Company in accordance with the terms of any indenture supplemental hereto shall not constitute a default in the payment of interest for this purpose;

20

(2) the Company defaults in the payment of the principal of (or premium, if any, on) any of the Securities of that series as and when the same shall become due and payable whether at maturity, upon redemption, by declaration or otherwise, or in any payment required by any sinking or analogous fund established with respect to that series; provided, however, that a valid extension of the maturity of such Securities in accordance with the terms of any indenture supplemental hereto shall not constitute a default in the payment of principal or premium, if any;

(3) the Company fails to observe or perform any other of its covenants or agreements with respect to that series contained in this Indenture or otherwise established with respect to that series of Securities pursuant to Section 2.01 hereof (other than a covenant or agreement that has been expressly included in this Indenture solely for the benefit of one or more series of Securities other than such series) for a period of 90 days after the date on which written notice of such failure, requiring the same to be remedied and stating that such notice is a “*Notice of Default*” hereunder, shall have been given to the Company by the Trustee, by registered or certified mail, or to the Company and the Trustee by the holders of at least 25% in principal amount of the Securities of that series at the time Outstanding;

(4) the Company pursuant to or within the meaning of any Bankruptcy Law (i) commences a voluntary case, (ii) consents to the entry of an order for relief against it in an involuntary case, (iii) consents to the appointment of a Custodian of it or for all or substantially all of its property or (iv) makes a general assignment for the benefit of its creditors; or

(5) a court of competent jurisdiction enters an order under any Bankruptcy Law that (i) is for relief against the Company in an involuntary case, (ii) appoints a Custodian of the Company for all or substantially all of its property or (iii) orders the liquidation of the Company, and the order or decree remains unstayed and in effect for 90 days.

(b) In each and every such case (other than an Event of Default specified in clause (4) or clause (5) above), unless the principal of all the Securities of that series shall have already become due and payable, either the Trustee or the holders of not less than 25% in aggregate principal amount of the Securities of that series then Outstanding hereunder, by notice in writing to the Company (and to the Trustee if given by such Securityholders), may declare the principal of (and premium, if any, on) and accrued and unpaid interest on all the Securities of that series to be due and payable immediately, and upon any such declaration the same shall become and shall be immediately due and payable. If an Event of Default specified in clause (4) or clause (5) above occurs, the principal of and accrued and unpaid interest on all the Securities of that series shall automatically be immediately due and payable without any declaration or other act on the part of the Trustee or the holders of the Securities.

(c) At any time after the principal of (and premium, if any, on) and accrued and unpaid interest on the Securities of that series shall have been so declared due and payable, and before any judgment or decree for the payment of the moneys due shall have been obtained or entered as hereinafter provided, the holders of a majority in aggregate principal amount of the Securities of that series then Outstanding hereunder, by written notice to the Company and the Trustee, may rescind and annul such declaration and its consequences if: (i) the Company has

21

paid or deposited with the Trustee a sum sufficient to pay all matured installments of interest upon all the Securities of that series and the principal of (and premium, if any, on) any and all Securities of that series that shall have become due otherwise than by acceleration (with interest upon such principal and premium, if any, and, to the extent that such payment is enforceable under applicable law, upon overdue installments of interest, at the rate per annum expressed in the Securities of that series to the date of such payment or deposit) and the amount payable to the Trustee under Section 7.06, and (ii) any and all Events of Default under the Indenture with respect to such series, other than the nonpayment of principal on (and premium, if any, on) and accrued and unpaid interest on Securities of that series that shall not have become due by their terms, shall have been remedied or waived as provided in Section 6.06.

No such rescission and annulment shall extend to or shall affect any subsequent default or impair any right consequent thereon.

(d) In case the Trustee shall have proceeded to enforce any right with respect to Securities of that series under this Indenture and such proceedings shall have been discontinued or abandoned because of such rescission or annulment or for any other reason or shall have been determined adversely to the Trustee, then and in every such case, subject to any determination in such proceedings, the Company and the Trustee shall be restored respectively to their former positions and rights hereunder, and all rights, remedies and powers of the Company and the Trustee shall continue as though no such proceedings had been taken.

Section 6.02 Collection of Indebtedness and Suits for Enforcement by Trustee

(a) The Company covenants that (i) in case it shall default in the payment of any installment of interest on any of the Securities of a series, or in any payment required by any sinking or analogous fund established with respect to that series as and when the same shall have become due and payable, and such default shall have continued for a period of 90 Business Days, or (ii) in case it shall default in the payment of the principal of (or premium, if any, on) any of the Securities of a series when the same shall have become due and payable, whether upon maturity of the Securities of a series or upon redemption or upon declaration or otherwise then, upon demand of the Trustee, the Company will pay to the Trustee, for the benefit of the holders of the Securities of that series, the whole amount that then shall have become due and payable on all such Securities for principal (and premium, if any) or interest, or both, as the case may be, with interest upon the overdue principal (and premium, if any) and (to the extent that payment of such interest is enforceable under applicable law) upon overdue installments of interest at the rate per annum expressed in the Securities of that series; and, in addition thereto, such further amount as shall be sufficient to cover the costs and expenses of collection, and the amount payable to the Trustee under Section 7.06.

(b) If the Company shall fail to pay such amounts forthwith upon such demand, the Trustee, in its own name and as trustee of an express trust, shall be entitled and empowered to institute any action or proceedings at law or in equity for the collection of the sums so due and unpaid, and may prosecute any such action or proceeding to judgment or final decree, and may enforce any such judgment or final decree against the Company or other obligor upon the Securities of that series and collect the moneys adjudged or decreed to be payable in the

manner provided by law or equity out of the property of the Company or other obligor upon the Securities of that series, wherever situated.

(c) In case of any receivership, insolvency, liquidation, bankruptcy, reorganization, readjustment, arrangement, composition or judicial proceedings affecting the Company, or its creditors or property, the Trustee shall have power to intervene in such proceedings and take any action therein that may be permitted by the court and shall (except as may be otherwise provided by law) be entitled to file such proofs of claim and other papers and documents as may be necessary or advisable in order to have the claims of the Trustee and of the holders of Securities of such series allowed for the entire amount due and payable by the Company under the Indenture at the date of institution of such proceedings and for any additional amount that may become due and payable by the Company after such date, and to collect and receive any moneys or other property payable or deliverable on any such claim, and to distribute the same after the deduction of the amount payable to the Trustee under Section 7.06; and any receiver, assignee or trustee in bankruptcy or reorganization is hereby authorized by each of the holders of Securities of such series to make such payments to the Trustee, and, in the event that the Trustee shall consent to the making of such payments directly to such Securityholders, to pay to the Trustee any amount due it under Section 7.06.

(d) All rights of action and of asserting claims under this Indenture, or under any of the terms established with respect to Securities of that series, may be enforced by the Trustee without the possession of any such Securities, or the production thereof at any trial or other proceeding relative thereto, and any such suit or proceeding instituted by the Trustee shall be brought in its own name as trustee of an express trust, and any recovery of judgment shall, after provision for payment to the Trustee of any amounts due under Section 7.06, be for the ratable benefit of the holders of the Securities of such series.

In case of an Event of Default hereunder, the Trustee may in its discretion proceed to protect and enforce the rights vested in it by this Indenture by such appropriate judicial proceedings as the Trustee shall deem most effectual to protect and enforce any of such rights, either at law or in equity or in bankruptcy or otherwise, whether for the specific enforcement of any covenant or agreement contained in the Indenture or in aid of the exercise of any power granted in this Indenture, or to enforce any other legal or equitable right vested in the Trustee by this Indenture or by law.

Nothing contained herein shall be deemed to authorize the Trustee to authorize or consent to or accept or adopt on behalf of any Securityholder any plan of reorganization, arrangement, adjustment or composition affecting the Securities of that series or the rights of any holder thereof or to authorize the Trustee to vote in respect of the claim of any Securityholder in any such proceeding.

Section 6.03 Application of Moneys Collected.

Any moneys collected by the Trustee pursuant to this Article with respect to a particular series of Securities shall be applied in the following order, at the date or dates fixed by the Trustee and, in case of the distribution of such moneys on account of principal (or premium, if

any) or interest, upon presentation of the Securities of that series, and notation thereon of the payment, if only partially paid, and upon surrender thereof if fully paid:

FIRST: To the payment of reasonable costs and expenses of collection and of all amounts payable to the Trustee under Section 7.06;

SECOND: To the payment of the amounts then due and unpaid upon Securities of such series for principal (and premium, if any) and interest, in respect of which or for the benefit of which such money has been collected, ratably, without preference or priority of any kind, according to the amounts due and payable on such Securities for principal (and premium, if any) and interest, respectively; and

THIRD: To the payment of the remainder, if any, to the Company or any other Person lawfully entitled thereto.

Section 6.04 Limitation on Suits

No holder of any Security of any series shall have any right by virtue or by availing of any provision of this Indenture to institute any suit, action or proceeding in equity or at law upon or under or with respect to this Indenture or for the appointment of a receiver or trustee, or for any other remedy hereunder, unless (i) such holder previously shall have given to the Trustee written notice of an Event of Default and of the continuance thereof with respect to the Securities of such series specifying such Event of Default, as hereinbefore provided; (ii) the holders of not less than 25% in aggregate principal amount of the Securities of such series then Outstanding shall have made written request upon the Trustee to institute such action, suit or proceeding in its own name as Trustee hereunder; (iii) such holder or holders shall have offered to the Trustee such reasonable indemnity as it may require against the costs, expenses and liabilities to be incurred therein or thereby; (iv) the Trustee for 90 days after its receipt of such notice, request and offer of indemnity, shall have failed to institute any such action, suit or proceeding and (v) during such 90 day period, the holders of a majority in principal amount of the Securities of that series do not give the Trustee a direction inconsistent with the request.

Notwithstanding anything contained herein to the contrary or any other provisions of this Indenture, the right of any holder of any Security to receive payment of the principal of (and premium, if any) and interest on such Security, as therein provided, on or after the respective due dates expressed in such Security (or in the case of redemption, on the redemption date), or to institute suit for the enforcement of any such payment on or after such respective dates or redemption date, shall not be impaired or affected without the consent of such holder and by accepting a Security hereunder it is expressly understood, intended and covenanted by the taker and holder of every Security of such series with every other such taker and holder and the Trustee, that no one or more holders of Securities of such series shall have any right in any manner whatsoever by virtue or by availing of any provision of this Indenture to affect, disturb or prejudice the rights of the holders of any other of such Securities, or to obtain or seek to obtain priority over or preference to any other such holder, or to enforce any right under this Indenture, except in the manner herein provided and for the equal, ratable and common benefit of all holders of Securities of such series. For the protection and enforcement of the provisions of this

Section, each and every Securityholder and the Trustee shall be entitled to such relief as can be given either at law or in equity.

Section 6.05 Rights and Remedies Cumulative; Delay or Omission Not Waiver

(a) Except as otherwise provided in Section 2.07, all powers and remedies given by this Article to the Trustee or to the Securityholders shall, to the extent permitted by law, be deemed cumulative and not exclusive of any other powers and remedies available to the Trustee or the holders of the Securities, by judicial proceedings or otherwise, to enforce the performance or observance of the covenants and agreements contained in this Indenture or otherwise established with respect to such

(b) No delay or omission of the Trustee or of any holder of any of the Securities to exercise any right or power accruing upon any Event of Default occurring and continuing as aforesaid shall impair any such right or power, or shall be construed to be a waiver of any such default or an acquiescence therein; and, subject to the provisions of Section 6.04, every power and remedy given by this Article or by law to the Trustee or the Securityholders may be exercised from time to time, and as often as shall be deemed expedient, by the Trustee or by the Securityholders.

Section 6.06 Control by Securityholders

The holders of a majority in aggregate principal amount of the Securities of any series at the time Outstanding, determined in accordance with Section 8.04, shall have the right to direct the time, method and place of conducting any proceeding for any remedy available to the Trustee, or exercising any trust or power conferred on the Trustee with respect to such series; provided, however, that such direction shall not be in conflict with any rule of law or with this Indenture. Subject to the provisions of Section 7.01, the Trustee shall have the right to decline to follow any such direction if the Trustee in good faith shall, by a Responsible Officer or officers of the Trustee, determine that the proceeding so directed, subject to the Trustee's duties under the Trust Indenture Act, would involve the Trustee in personal liability or might be unduly prejudicial to the Securityholders not involved in the proceeding. The holders of a majority in aggregate principal amount of the Securities of any series at the time Outstanding affected thereby, determined in accordance with Section 8.04, may on behalf of the holders of all of the Securities of such series waive any past default in the performance of any of the covenants contained herein or established pursuant to Section 2.01 with respect to such series and its consequences, except a default in the payment of the principal of, or premium, if any, or interest on, any of the Securities of that series as and when the same shall become due by the terms of such Securities otherwise than by acceleration (unless such default has been cured and a sum sufficient to pay all matured installments of interest and principal and any premium has been deposited with the Trustee (in accordance with Section 6.01(c)). Upon any such waiver, the default covered thereby shall be deemed to be cured for all purposes of this Indenture and the Company, the Trustee and the holders of the Securities of such series shall be restored to their former positions and rights hereunder, respectively; but no such waiver shall extend to any subsequent or other default or impair any right consequent thereon.

Section 6.07 Undertaking to Pay Costs.

All parties to this Indenture agree, and each holder of any Securities by such holder's acceptance thereof shall be deemed to have agreed, that any court may in its discretion require, in any suit for the enforcement of any right or remedy under this Indenture, or in any suit against the Trustee for any action taken or omitted by it as Trustee, the filing by any party litigant in such suit of an undertaking to pay the costs of such suit, and that such court may in its discretion assess reasonable costs, including reasonable attorneys' fees, against any party litigant in such suit, having due regard to the merits and good faith of the claims or defenses made by such party litigant; but the provisions of this Section shall not apply to any suit instituted by the Trustee, to any suit instituted by any Securityholder, or group of Securityholders, holding more than 10% in aggregate principal amount of the Outstanding Securities of any series, or to any suit instituted by any Securityholder for the enforcement of the payment of the principal of (or premium, if any) or interest on any Security of such series, on or after the respective due dates expressed in such Security or established pursuant to this Indenture.

ARTICLE 7

CONCERNING THE TRUSTEE

Section 7.01 Certain Duties and Responsibilities of Trustee.

(a) The Trustee, prior to the occurrence of an Event of Default with respect to the Securities of a series and after the curing of all Events of Default with respect to the Securities of that series that may have occurred, shall undertake to perform with respect to the Securities of such series such duties and only such duties as are specifically set forth in this Indenture, and no implied covenants shall be read into this Indenture against the Trustee. In case an Event of Default with respect to the Securities of a series has occurred (that has not been cured or waived), the Trustee shall exercise with respect to Securities of that series such of the rights and powers vested in it by this Indenture, and use the same degree of care and skill in their exercise, as a prudent man would exercise or use under the circumstances in the conduct of his own affairs.

(b) No provision of this Indenture shall be construed to relieve the Trustee from liability for its own negligent action, its own negligent failure to act, or its own willful misconduct, except that:

(i) prior to the occurrence of an Event of Default with respect to the Securities of a series and after the curing or waiving of all such Events of Default with respect to that series that may have occurred:

(A) the duties and obligations of the Trustee shall with respect to the Securities of such series be determined solely by the express provisions of this Indenture, and the Trustee shall not be liable with respect to the Securities of such series except for the performance of such duties and obligations as are specifically set forth in this Indenture, and no implied covenants or obligations shall be read into this Indenture against the Trustee; and

(B) in the absence of bad faith on the part of the Trustee, the Trustee may with respect to the Securities of such series conclusively rely, as to the truth of the statements and the correctness of the opinions expressed therein, upon any certificates or opinions furnished to the Trustee and conforming to the requirements of this Indenture; but in the case of any such certificates or opinions that by any provision hereof are specifically required to be furnished to the Trustee, the Trustee shall be under a duty to examine the same to determine whether or not they conform to the requirement of this Indenture;

(ii) the Trustee shall not be liable for any error of judgment made in good faith by a Responsible Officer or Responsible Officers of the Trustee, unless it shall be proved that the Trustee was negligent in ascertaining the pertinent facts;

(iii) the Trustee shall not be liable with respect to any action taken or omitted to be taken by it in good faith in accordance with the direction of the holders of not less than a majority in principal amount of the Securities of any series at the time Outstanding relating to the time, method and place of conducting any proceeding for any remedy available to the Trustee, or exercising any trust or power conferred upon the Trustee under this Indenture with respect to the Securities of that series; and

(iv) None of the provisions contained in this Indenture shall require the Trustee to expend or risk its own funds or otherwise incur personal financial

liability in the performance of any of its duties or in the exercise of any of its rights or powers if there is reasonable ground for believing that the repayment of such funds or liability is not reasonably assured to it under the terms of this Indenture or adequate indemnity against such risk is not reasonably assured to it.

Section 7.02 Certain Rights of Trustee.

Except as otherwise provided in Section 7.01:

- (a) The Trustee may rely and shall be protected in acting or refraining from acting upon any resolution, certificate, statement, instrument, opinion, report, notice, request, consent, order, approval, bond, security or other paper or document believed by it to be genuine and to have been signed or presented by the proper party or parties;
- (b) Any request, direction, order or demand of the Company mentioned herein shall be sufficiently evidenced by a Board Resolution or an instrument signed in the name of the Company by any authorized officer of the Company (unless other evidence in respect thereof is specifically prescribed herein);
- (c) The Trustee may consult with counsel and the written advice of such counsel or any Opinion of Counsel shall be full and complete authorization and protection in respect of any action taken or suffered or omitted hereunder in good faith and in reliance thereon;
- (d) The Trustee shall be under no obligation to exercise any of the rights or powers vested in it by this Indenture at the request, order or direction of any of the Securityholders pursuant to the provisions of this Indenture, unless such Securityholders shall have offered to the Trustee reasonable security or indemnity against the costs, expenses and

27

liabilities that may be incurred therein or thereby; nothing contained herein shall, however, relieve the Trustee of the obligation, upon the occurrence of an Event of Default with respect to a series of the Securities (that has not been cured or waived), to exercise with respect to Securities of that series such of the rights and powers vested in it by this Indenture, and to use the same degree of care and skill in their exercise, as a prudent man would exercise or use under the circumstances in the conduct of his own affairs;

- (e) The Trustee shall not be liable for any action taken or omitted to be taken by it in good faith and believed by it to be authorized or within the discretion or rights or powers conferred upon it by this Indenture;
- (f) The Trustee shall not be bound to make any investigation into the facts or matters stated in any resolution, certificate, statement, instrument, opinion, report, notice, request, consent, order, approval, bond, security, or other papers or documents, unless requested in writing so to do by the holders of not less than a majority in principal amount of the Outstanding Securities of the particular series affected thereby (determined as provided in Section 8.04); provided, however, that if the payment within a reasonable time to the Trustee of the costs, expenses or liabilities likely to be incurred by it in the making of such investigation is, in the opinion of the Trustee, not reasonably assured to the Trustee by the security afforded to it by the terms of this Indenture, the Trustee may require reasonable indemnity against such costs, expenses or liabilities as a condition to so proceeding. The reasonable expense of every such examination shall be paid by the Company or, if paid by the Trustee, shall be repaid by the Company upon demand; and
- (g) The Trustee may execute any of the trusts or powers hereunder or perform any duties hereunder either directly or by or through agents or attorneys and the Trustee shall not be responsible for any misconduct or negligence on the part of any agent or attorney appointed with due care by it hereunder.

In addition, the Trustee shall not be deemed to have knowledge of any Default or Event of Default except (1) any Event of Default occurring pursuant to Sections 6.01(a)(1), 6.01(a)(2) and 4.01 hereof or (2) any Default or Event of Default of which the Trustee shall have received written notification in the manner set forth in this Indenture or a Responsible Officer of the Trustee shall have obtained actual knowledge. Delivery of reports, information and documents to the Trustee under Section 5.03 is for informational purposes only and the information and the Trustee's receipt of the foregoing shall not constitute constructive notice of any information contained therein, or determinable from information contained therein including the Company's compliance with any of their covenants thereunder (as to which the Trustee is entitled to rely exclusively on an Officers' Certificate).

Section 7.03 Trustee Not Responsible for Recitals or Issuance of Securities

- (a) The recitals contained herein and in the Securities shall be taken as the statements of the Company, and the Trustee assumes no responsibility for the correctness of the same.

28

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- (b) The Trustee makes no representations as to the validity or sufficiency of this Indenture or of the Securities.

- (c) The Trustee shall not be accountable for the use or application by the Company of any of the Securities or of the proceeds of such Securities, or for the use or application of any moneys paid over by the Trustee in accordance with any provision of this Indenture or established pursuant to Section 2.01, or for the use or application of any moneys received by any paying agent other than the Trustee.

Section 7.04 May Hold Securities

The Trustee or any paying agent or Security Registrar, in its individual or any other capacity, may become the owner or pledgee of Securities with the same rights it would have if it were not Trustee, paying agent or Security Registrar.

Section 7.05 Moneys Held in Trust

Subject to the provisions of Section 11.05, all moneys received by the Trustee shall, until used or applied as herein provided, be held in trust for the purposes for which they were received, but need not be segregated from other funds except to the extent required by law. The Trustee shall be under no liability for interest on any moneys received by it hereunder except such as it may agree with the Company to pay thereon.

Section 7.06 Compensation and Reimbursement

- (a) The Company covenants and agrees to pay to the Trustee, and the Trustee shall be entitled to, such reasonable compensation (which shall not be limited by any provision of law in regard to the compensation of a trustee of an express trust) as the Company and the Trustee may from time to time agree in writing, for all

services rendered by it in the execution of the trusts hereby created and in the exercise and performance of any of the powers and duties hereunder of the Trustee, and, except as otherwise expressly provided herein, the Company will pay or reimburse the Trustee upon its request for all reasonable expenses, disbursements and advances incurred or made by the Trustee in accordance with any of the provisions of this Indenture (including the reasonable compensation and the expenses and disbursements of its counsel and of all Persons not regularly in its employ), except any such expense, disbursement or advance as may arise from its negligence or bad faith and except as the Company and Trustee may from time to time agree in writing. The Company also covenants to indemnify the Trustee (and its officers, agents, directors and employees) for, and to hold it harmless against, any loss, liability or expense incurred without negligence or bad faith on the part of the Trustee and arising out of or in connection with the acceptance or administration of this trust, including the reasonable costs and expenses of defending itself against any claim of liability in the premises.

(b) The obligations of the Company under this Section to compensate and indemnify the Trustee and to pay or reimburse the Trustee for reasonable expenses, disbursements and advances shall constitute additional indebtedness hereunder. Such additional indebtedness shall be secured by a lien prior to that of the Securities upon all property and funds

held or collected by the Trustee as such, except funds held in trust for the benefit of the holders of particular Securities.

Section 7.07 Reliance on Officers' Certificate.

Except as otherwise provided in Section 7.01, whenever in the administration of the provisions of this Indenture the Trustee shall deem it reasonably necessary or desirable that a matter be proved or established prior to taking or suffering or omitting to take any action hereunder, such matter (unless other evidence in respect thereof be herein specifically prescribed) may, in the absence of negligence or bad faith on the part of the Trustee, be deemed to be conclusively proved and established by an Officers' Certificate delivered to the Trustee and such certificate, in the absence of negligence or bad faith on the part of the Trustee, shall be full warrant to the Trustee for any action taken, suffered or omitted to be taken by it under the provisions of this Indenture upon the faith thereof.

Section 7.08 Disqualification; Conflicting Interests

If the Trustee has or shall acquire any "conflicting interest" within the meaning of Section 310(b) of the Trust Indenture Act, the Trustee and the Company shall in all respects comply with the provisions of Section 310(b) of the Trust Indenture Act.

Section 7.09 Corporate Trustee Required; Eligibility.

There shall at all times be a Trustee with respect to the Securities issued hereunder which shall at all times be a corporation organized and doing business under the laws of the United States of America or any state or territory thereof or of the District of Columbia, or a corporation or other Person permitted to act as trustee by the Securities and Exchange Commission, authorized under such laws to exercise corporate trust powers, having a combined capital and surplus of at least fifty million U.S. dollars (\$50,000,000), and subject to supervision or examination by federal, state, territorial, or District of Columbia authority.

If such corporation or other Person publishes reports of condition at least annually, pursuant to law or to the requirements of the aforesaid supervising or examining authority, then for the purposes of this Section, the combined capital and surplus of such corporation or other Person shall be deemed to be its combined capital and surplus as set forth in its most recent report of condition so published. The Company may not, nor may any Person directly or indirectly controlling, controlled by, or under common control with the Company, serve as Trustee. In case at any time the Trustee shall cease to be eligible in accordance with the provisions of this Section, the Trustee shall resign immediately in the manner and with the effect specified in Section 7.10.

Section 7.10 Resignation and Removal; Appointment of Successor.

(a) The Trustee or any successor hereafter appointed may at any time resign with respect to the Securities of one or more series by giving written notice thereof to the Company and by transmitting notice of resignation by mail, first class postage prepaid, to the Securityholders of such series, as their names and addresses appear upon the Security Register.

Upon receiving such notice of resignation, the Company shall promptly appoint a successor trustee with respect to Securities of such series by written instrument, in duplicate, executed by order of the Board of Directors, one copy of which instrument shall be delivered to the resigning Trustee and one copy to the successor trustee. If no successor trustee shall have been so appointed and have accepted appointment within 30 days after the mailing of such notice of resignation, the resigning Trustee may petition any court of competent jurisdiction for the appointment of a successor trustee with respect to Securities of such series, or any Securityholder of that series who has been a bona fide holder of a Security or Securities for at least six months may on behalf of himself and all others similarly situated, petition any such court for the appointment of a successor trustee. Such court may thereupon after such notice, if any, as it may deem proper and prescribe, appoint a successor trustee.

(b) In case at any time any one of the following shall occur:

(i) the Trustee shall fail to comply with the provisions of Section 7.08 after written request therefor by the Company or by any Securityholder who has been a bona fide holder of a Security or Securities for at least six months; or

(ii) the Trustee shall cease to be eligible in accordance with the provisions of Section 7.09 and shall fail to resign after written request therefor by the Company or by any such Securityholder; or

(iii) the Trustee shall become incapable of acting, or shall be adjudged a bankrupt or insolvent, or commence a voluntary bankruptcy proceeding, or a receiver of the Trustee or of its property shall be appointed or consented to, or any public officer shall take charge or control of the Trustee or of its property or affairs for the purpose of rehabilitation, conservation or liquidation;

then, in any such case, the Company may remove the Trustee with respect to all Securities and appoint a successor trustee by written instrument, in duplicate, executed by order of the Board of Directors, one copy of which instrument shall be delivered to the Trustee so removed and one copy to the successor trustee, or any Securityholder who has been a bona fide holder of a Security or Securities for at least six months may, on behalf of that holder and all others similarly situated, petition any court of competent jurisdiction for the removal of the Trustee and the appointment of a successor trustee. Such court may thereupon after such notice, if any, as it may deem proper and prescribe, remove the Trustee and appoint a successor trustee.

(c) The holders of a majority in aggregate principal amount of the Securities of any series at the time Outstanding may at any time remove the Trustee

with respect to such series by so notifying the Trustee and the Company and may appoint a successor Trustee for such series with the consent of the Company.

(d) Any resignation or removal of the Trustee and appointment of a successor trustee with respect to the Securities of a series pursuant to any of the provisions of this Section shall become effective upon acceptance of appointment by the successor trustee as provided in Section 7.11.

31

(e) Any successor trustee appointed pursuant to this Section may be appointed with respect to the Securities of one or more series or all of such series, and at any time there shall be only one Trustee with respect to the Securities of any particular series.

Section 7.11 Acceptance of Appointment By Successor

(a) In case of the appointment hereunder of a successor trustee with respect to all Securities, every such successor trustee so appointed shall execute, acknowledge and deliver to the Company and to the retiring Trustee an instrument accepting such appointment, and thereupon the resignation or removal of the retiring Trustee shall become effective and such successor trustee, without any further act, deed or conveyance, shall become vested with all the rights, powers, trusts and duties of the retiring Trustee; but, on the request of the Company or the successor trustee, such retiring Trustee shall, upon payment of its charges, execute and deliver an instrument transferring to such successor trustee all the rights, powers, and trusts of the retiring Trustee and shall duly assign, transfer and deliver to such successor trustee all property and money held by such retiring Trustee hereunder.

(b) In case of the appointment hereunder of a successor trustee with respect to the Securities of one or more (but not all) series, the Company, the retiring Trustee and each successor trustee with respect to the Securities of one or more series shall execute and deliver an indenture supplemental hereto wherein each successor trustee shall accept such appointment and which (i) shall contain such provisions as shall be necessary or desirable to transfer and confirm to, and to vest in, each successor trustee all the rights, powers, trusts and duties of the retiring Trustee with respect to the Securities of that or those series to which the appointment of such successor trustee relates, (ii) shall contain such provisions as shall be deemed necessary or desirable to confirm that all the rights, powers, trusts and duties of the retiring Trustee with respect to the Securities of that or those series as to which the retiring Trustee is not retiring shall continue to be vested in the retiring Trustee, and (iii) shall add to or change any of the provisions of this Indenture as shall be necessary to provide for or facilitate the administration of the trusts hereunder by more than one Trustee, it being understood that nothing herein or in such supplemental indenture shall constitute such Trustees co-trustees of the same trust, that each such Trustee shall be trustee of a trust or trusts hereunder separate and apart from any trust or trusts hereunder administered by any other such Trustee and that no Trustee shall be responsible for any act or failure to act on the part of any other Trustee hereunder; and upon the execution and delivery of such supplemental indenture the resignation or removal of the retiring Trustee shall become effective to the extent provided therein, such retiring Trustee shall with respect to the Securities of that or those series to which the appointment of such successor trustee relates have no further responsibility for the exercise of rights and powers or for the performance of the duties and obligations vested in the Trustee under this Indenture, and each such successor trustee, without any further act, deed or conveyance, shall become vested with all the rights, powers, trusts and duties of the retiring Trustee with respect to the Securities of that or those series to which the appointment of such successor trustee relates; but, on request of the Company or any successor trustee, such retiring Trustee shall duly assign, transfer and deliver to such successor trustee, to the extent contemplated by such supplemental indenture, the property and money held by such retiring Trustee hereunder with respect to the Securities of that or those series to which the appointment of such successor trustee relates.

32

(c) Upon request of any such successor trustee, the Company shall execute any and all instruments for more fully and certainly vesting in and confirming to such successor trustee all such rights, powers and trusts referred to in paragraph (a) or (b) of this Section, as the case may be.

(d) No successor trustee shall accept its appointment unless at the time of such acceptance such successor trustee shall be qualified and eligible under this Article.

(e) Upon acceptance of appointment by a successor trustee as provided in this Section, the Company shall transmit notice of the succession of such trustee hereunder by mail, first class postage prepaid, to the Securityholders, as their names and addresses appear upon the Security Register. If the Company fails to transmit such notice within ten days after acceptance of appointment by the successor trustee, the successor trustee shall cause such notice to be transmitted at the expense of the Company.

Section 7.12 Merger, Conversion, Consolidation or Succession to Business

Any corporation into which the Trustee may be merged or converted or with which it may be consolidated, or any corporation resulting from any merger, conversion or consolidation to which the Trustee shall be a party, or any corporation succeeding to the corporate trust business of the Trustee, including the administration of the trust created by this Indenture, shall be the successor of the Trustee hereunder, provided that such corporation shall be qualified under the provisions of Section 7.08 and eligible under the provisions of Section 7.09, without the execution or filing of any paper or any further act on the part of any of the parties hereto, anything herein to the contrary notwithstanding. In case any Securities shall have been authenticated, but not delivered, by the Trustee then in office, any successor by merger, conversion or consolidation to such authenticating Trustee may adopt such authentication and deliver the Securities so authenticated with the same effect as if such successor Trustee had itself authenticated such Securities.

Section 7.13 Preferential Collection of Claims Against the Company

The Trustee shall comply with Section 311(a) of the Trust Indenture Act, excluding any creditor relationship described in Section 311(b) of the Trust Indenture Act. A Trustee who has resigned or been removed shall be subject to Section 311(a) of the Trust Indenture Act to the extent included therein.

Section 7.14 Notice of Default

If any Default or any Event of Default occurs and is continuing and if such Default or Event of Default is known to a Responsible Officer of the Trustee, the Trustee shall mail to each Securityholder in the manner and to the extent provided in Section 313(c) of the Trust Indenture Act notice of the Default or Event of Default within 45 days after it occurs, unless such Default or Event of Default has been cured; *provided, however*, that, except in the case of a default in the payment of the principal of (or premium, if any) or interest on any Security, the Trustee shall be protected in withholding such notice if and so long as the board of directors, the executive

33

committee or a trust committee of directors and/or Responsible Officers of the Trustee in good faith determine that the withholding of such notice is in the interest of the Securityholders.

ARTICLE 8

CONCERNING THE SECURITYHOLDERS

Section 8.01 Evidence of Action by Securityholders.

Whenever in this Indenture it is provided that the holders of a majority or specified percentage in aggregate principal amount of the Securities of a particular series may take any action (including the making of any demand or request, the giving of any notice, consent or waiver or the taking of any other action), the fact that at the time of taking any such action the holders of such majority or specified percentage of that series have joined therein may be evidenced by any instrument or any number of instruments of similar tenor executed by such holders of Securities of that series in person or by agent or proxy appointed in writing.

If the Company shall solicit from the Securityholders of any series any request, demand, authorization, direction, notice, consent, waiver or other action, the Company may, at its option, as evidenced by an Officers' Certificate, fix in advance a record date for such series for the determination of Securityholders entitled to give such request, demand, authorization, direction, notice, consent, waiver or other action, but the Company shall have no obligation to do so. If such a record date is fixed, such request, demand, authorization, direction, notice, consent, waiver or other action may be given before or after the record date, but only the Securityholders of record at the close of business on the record date shall be deemed to be Securityholders for the purposes of determining whether Securityholders of the requisite proportion of Outstanding Securities of that series have authorized or agreed or consented to such request, demand, authorization, direction, notice, consent, waiver or other action, and for that purpose the Outstanding Securities of that series shall be computed as of the record date; provided, however, that no such authorization, agreement or consent by such Securityholders on the record date shall be deemed effective unless it shall become effective pursuant to the provisions of this Indenture not later than six months after the record date.

Section 8.02 Proof of Execution by Securityholders.

Subject to the provisions of Section 7.01, proof of the execution of any instrument by a Securityholder (such proof will not require notarization) or his agent or proxy and proof of the holding by any Person of any of the Securities shall be sufficient if made in the following manner:

- (a) The fact and date of the execution by any such Person of any instrument may be proved in any reasonable manner acceptable to the Trustee.
- (b) The ownership of Securities shall be proved by the Security Register of such Securities or by a certificate of the Security Registrar thereof.

34

The Trustee may require such additional proof of any matter referred to in this Section as it shall deem necessary.

Section 8.03 Who May be Deemed Owners

Prior to the due presentment for registration of transfer of any Security, the Company, the Trustee, any paying agent and any Security Registrar may deem and treat the Person in whose name such Security shall be registered upon the books of the Company as the absolute owner of such Security (whether or not such Security shall be overdue and notwithstanding any notice of ownership or writing thereon made by anyone other than the Security Registrar) for the purpose of receiving payment of or on account of the principal of, premium, if any, and (subject to Section 2.03) interest on such Security and for all other purposes; and neither the Company nor the Trustee nor any paying agent nor any Security Registrar shall be affected by any notice to the contrary.

Section 8.04 Certain Securities Owned by Company Disregarded.

In determining whether the holders of the requisite aggregate principal amount of Securities of a particular series have concurred in any direction, consent or waiver under this Indenture, the Securities of that series that are owned by the Company or any other obligor on the Securities of that series or by any Person directly or indirectly controlling or controlled by or under common control with the Company or any other obligor on the Securities of that series shall be disregarded and deemed not to be Outstanding for the purpose of any such determination, except that for the purpose of determining whether the Trustee shall be protected in relying on any such direction, consent or waiver, only Securities of such series that the Trustee actually knows are so owned shall be so disregarded. The Securities so owned that have been pledged in good faith may be regarded as Outstanding for the purposes of this Section, if the pledgee shall establish to the satisfaction of the Trustee the pledgee's right so to act with respect to such Securities and that the pledgee is not a Person directly or indirectly controlling or controlled by or under direct or indirect common control with the Company or any such other obligor. In case of a dispute as to such right, any decision by the Trustee taken upon the advice of counsel shall be full protection to the Trustee.

Section 8.05 Actions Binding on Future Securityholders

At any time prior to (but not after) the evidencing to the Trustee, as provided in Section 8.01, of the taking of any action by the holders of the majority or percentage in aggregate principal amount of the Securities of a particular series specified in this Indenture in connection with such action, any holder of a Security of that series that is shown by the evidence to be included in the Securities the holders of which have consented to such action may, by filing written notice with the Trustee, and upon proof of holding as provided in Section 8.02, revoke such action so far as concerns such Security. Except as aforesaid any such action taken by the holder of any Security shall be conclusive and binding upon such holder and upon all future holders and owners of such Security, and of any Security issued in exchange therefor, on registration of transfer thereof or in place thereof, irrespective of whether or not any notation in regard thereto is made upon such Security. Any action taken by the holders of the majority or percentage in aggregate principal amount of the Securities of a particular series specified in this Indenture in connection with such action shall be conclusively binding upon the Company, the Trustee and the holders of all the Securities of that series.

35

ARTICLE 9

SUPPLEMENTAL INDENTURES

Section 9.01 Supplemental Indentures Without the Consent of Securityholders

In addition to any supplemental indenture otherwise authorized by this Indenture, the Company and the Trustee may from time to time and at any time enter into an indenture or indentures supplemental hereto (which shall conform to the provisions of the Trust Indenture Act as then in effect), without the consent of the Securityholders, for one or more of the following purposes:

- (a) to cure any ambiguity, defect, or inconsistency herein or in the Securities of any series;
- (b) to comply with Article Ten;
- (c) to provide for uncertificated Securities in addition to or in place of certificated Securities;
- (d) to add to the covenants, restrictions, conditions or provisions relating to the Company for the benefit of the holders of all or any series of Securities (and if such covenants, restrictions, conditions or provisions are to be for the benefit of less than all series of Securities, stating that such covenants, restrictions, conditions or provisions are expressly being included solely for the benefit of such series), to make the occurrence, or the occurrence and the continuance, of a default in any such additional covenants, restrictions, conditions or provisions an Event of Default, or to surrender any right or power herein conferred upon the Company;
- (e) to add to, delete from, or revise the conditions, limitations, and restrictions on the authorized amount, terms, or purposes of issue, authentication, and delivery of Securities, as herein set forth;
- (f) to make any change that does not adversely affect the rights of any Securityholder in any material respect;
- (g) to provide for the issuance of and establish the form and terms and conditions of the Securities of any series as provided in Section 2.01, to establish the form of any certifications required to be furnished pursuant to the terms of this Indenture or any series of Securities, or to add to the rights of the holders of any series of Securities;
- (h) to evidence and provide for the acceptance of appointment hereunder by a successor trustee; or

36

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- (i) to comply with any requirements of the Securities and Exchange Commission or any successor in connection with the qualification of this Indenture under the Trust Indenture Act.

The Trustee is hereby authorized to join with the Company in the execution of any such supplemental indenture, and to make any further appropriate agreements and stipulations that may be therein contained, but the Trustee shall not be obligated to enter into any such supplemental indenture that affects the Trustee's own rights, duties or immunities under this Indenture or otherwise.

Any supplemental indenture authorized by the provisions of this Section may be executed by the Company and the Trustee without the consent of the holders of any of the Securities at the time Outstanding, notwithstanding any of the provisions of Section 9.02.

Section 9.02 Supplemental Indentures With Consent of Securityholders

With the consent (evidenced as provided in Section 8.01) of the holders of not less than a majority in aggregate principal amount of the Securities of each series affected by such supplemental indenture or indentures at the time Outstanding, the Company, when authorized by a Board Resolution, and the Trustee may from time to time and at any time enter into an indenture or indentures supplemental hereto (which shall conform to the provisions of the Trust Indenture Act as then in effect) for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions of this Indenture or of any supplemental indenture or of modifying in any manner not covered by Section 9.01 the rights of the holders of the Securities of such series under this Indenture; provided, however, that no such supplemental indenture shall, without the consent of the holders of each Security then Outstanding and affected thereby, (a) extend the fixed maturity of any Securities of any series, or reduce the principal amount thereof, or reduce the rate or extend the time of payment of interest thereon, or reduce any premium payable upon the redemption thereof or (b) reduce the aforesaid percentage of Securities, the holders of which are required to consent to any such supplemental indenture.

It shall not be necessary for the consent of the Securityholders of any series affected thereby under this Section to approve the particular form of any proposed supplemental indenture, but it shall be sufficient if such consent shall approve the substance thereof.

Section 9.03 Effect of Supplemental Indentures.

Upon the execution of any supplemental indenture pursuant to the provisions of this Article or of Section 10.01, this Indenture shall, with respect to such series, be and be deemed to be modified and amended in accordance therewith and the respective rights, limitations of rights, obligations, duties and immunities under this Indenture of the Trustee, the Company and the holders of Securities of the series affected thereby shall thereafter be determined, exercised and enforced hereunder subject in all respects to such modifications and amendments, and all the terms and conditions of any such supplemental indenture shall be and be deemed to be part of the terms and conditions of this Indenture for any and all purposes.

37

Section 9.04 Securities Affected by Supplemental Indentures.

Securities of any series affected by a supplemental indenture, authenticated and delivered after the execution of such supplemental indenture pursuant to the provisions of this Article or of Section 10.01, may bear a notation in form approved by the Company, provided such form meets the requirements of any securities exchange upon which such series may be listed, as to any matter provided for in such supplemental indenture. If the Company shall so determine, new Securities of that series so modified as to conform, in the opinion of the Board of Directors, to any modification of this Indenture contained in any such supplemental indenture may be prepared by the Company, authenticated by the Trustee and delivered in exchange for the Securities of that series then Outstanding.

Section 9.05 Execution of Supplemental Indentures.

Upon the request of the Company, accompanied by its Board Resolutions authorizing the execution of any such supplemental indenture, and upon the filing with the Trustee of evidence of the consent of Securityholders required to consent thereto as aforesaid, the Trustee shall join with the Company in the execution of such supplemental

indenture unless such supplemental indenture affects the Trustee's own rights, duties or immunities under this Indenture or otherwise, in which case the Trustee may in its discretion but shall not be obligated to enter into such supplemental indenture. The Trustee, subject to the provisions of Section 7.01, may receive an Officers' Certificate or an Opinion of Counsel as conclusive evidence that any supplemental indenture executed pursuant to this Article is authorized or permitted by, and conforms to, the terms of this Article and that it is proper for the Trustee under the provisions of this Article to join in the execution thereof; provided, however, that such Officers' Certificate or Opinion of Counsel need not be provided in connection with the execution of a supplemental indenture that establishes the terms of a series of Securities pursuant to Section 2.01 hereof.

Promptly after the execution by the Company and the Trustee of any supplemental indenture pursuant to the provisions of this Section, the Trustee shall transmit by mail, first class postage prepaid, a notice, setting forth in general terms the substance of such supplemental indenture, to the Securityholders of all series affected thereby as their names and addresses appear upon the Security Register. Any failure of the Trustee to mail such notice, or any defect therein, shall not, however, in any way impair or affect the validity of any such supplemental indenture.

ARTICLE 10 SUCCESSOR ENTITY

Section 10.01 Company May Consolidate, Etc.

Except as provided pursuant to Section 2.01 pursuant to a Board Resolution, and set forth in an Officers' Certificate, or established in one or more indentures supplemental to this Indenture, nothing contained in this Indenture shall prevent any consolidation or merger of the Company with or into any other Person (whether or not affiliated with the Company) or successive consolidations or mergers in which the Company or its successor or successors shall

38

be a party or parties, or shall prevent any sale, conveyance, transfer or other disposition of the property of the Company or its successor or successors as an entirety, or substantially as an entirety, to any other corporation (whether or not affiliated with the Company or its successor or successors) authorized to acquire and operate the same; provided, however, (a) the Company hereby covenants and agrees that, upon any such consolidation or merger (in each case, if the Company is not the survivor of such transaction), sale, conveyance, transfer or other disposition, the due and punctual payment of the principal of (premium, if any) and interest on all of the Securities of all series in accordance with the terms of each series, according to their tenor, and the due and punctual performance and observance of all the covenants and conditions of this Indenture with respect to each series or established with respect to such series pursuant to Section 2.01 to be kept or performed by the Company shall be expressly assumed, by supplemental indenture (which shall conform to the provisions of the Trust Indenture Act, as then in effect) reasonably satisfactory in form to the Trustee executed and delivered to the Trustee by the entity formed by such consolidation, or into which the Company shall have been merged, or by the entity which shall have acquired such property and (b) in the event that the Securities of any series then Outstanding are convertible into or exchangeable for shares of common stock or other securities of the Company, such entity shall, by such supplemental indenture, make provision so that the Securityholders of Securities of that series shall thereafter be entitled to receive upon conversion or exchange of such Securities the number of securities or property to which a holder of the number of shares of common stock or other securities of the Company deliverable upon conversion or exchange of those Securities would have been entitled had such conversion or exchange occurred immediately prior to such consolidation, merger, sale, conveyance, transfer or other disposition.

Section 10.02 Successor Entity Substituted.

(a) In case of any such consolidation, merger, sale, conveyance, transfer or other disposition and upon the assumption by the successor entity by supplemental indenture, executed and delivered to the Trustee and satisfactory in form to the Trustee, of the obligations set forth under Section 10.01 on all of the Securities of all series Outstanding, such successor entity shall succeed to and be substituted for the Company with the same effect as if it had been named as the Company herein, and thereupon the predecessor corporation shall be relieved of all obligations and covenants under this Indenture and the Securities.

(b) In case of any such consolidation, merger, sale, conveyance, transfer or other disposition, such changes in phraseology and form (but not in substance) may be made in the Securities thereafter to be issued as may be appropriate.

(c) Nothing contained in this Article shall require any action by the Company in the case of a consolidation or merger of any Person into the Company where the Company is the survivor of such transaction, or the acquisition by the Company, by purchase or otherwise, of all or any part of the property of any other Person (whether or not affiliated with the Company).

Section 10.03 Evidence of Consolidation, Etc. to Trustee.

The Trustee, subject to the provisions of Section 7.01, may receive an Officers' Certificate or an Opinion of Counsel as conclusive evidence that any such consolidation, merger, sale, conveyance, transfer or other disposition, and any such assumption, comply with the provisions of this Article.

39

ARTICLE 11 SATISFACTION AND DISCHARGE

Section 11.01 Satisfaction and Discharge of Indenture.

If at any time: (a) the Company shall have delivered to the Trustee for cancellation all Securities of a series theretofore authenticated and not delivered to the Trustee for cancellation (other than any Securities that shall have been destroyed, lost or stolen and that shall have been replaced or paid as provided in Section 2.07 and Securities for whose payment money or Governmental Obligations have theretofore been deposited in trust or segregated and held in trust by the Company and thereupon repaid to the Company or discharged from such trust, as provided in Section 11.05); or (b) all such Securities of a particular series not theretofore delivered to the Trustee for cancellation shall have become due and payable, or are by their terms to become due and payable within one year or are to be called for redemption within one year under arrangements satisfactory to the Trustee for the giving of notice of redemption, and the Company shall deposit or cause to be deposited with the Trustee as trust funds the entire amount in moneys or Governmental Obligations or a combination thereof, sufficient in the opinion of a nationally recognized firm of independent public accountants expressed in a written certification thereof delivered to the Trustee, to pay at maturity or upon redemption all Securities of that series not theretofore delivered to the Trustee for cancellation, including principal (and premium, if any) and interest due or to become due to such date of maturity or date fixed for redemption, as the case may be, and if the Company shall also pay or cause to be paid all other sums payable hereunder with respect to such series by the Company then this Indenture shall thereupon cease to be of further effect with respect to such series except for the provisions of Sections 2.03, 2.05, 2.07, 4.01, 4.02, 4.03 and 7.10, that shall survive until the date of maturity or redemption date, as the

case may be, and Sections 7.06 and 11.05, that shall survive to such date and thereafter, and the Trustee, on demand of the Company and at the cost and expense of the Company shall execute proper instruments acknowledging satisfaction of and discharging this Indenture with respect to such series.

Section 11.02 Discharge of Obligations.

If at any time all such Securities of a particular series not heretofore delivered to the Trustee for cancellation or that have not become due and payable as described in Section 11.01 shall have been paid by the Company by depositing irrevocably with the Trustee as trust funds moneys or an amount of Governmental Obligations sufficient to pay at maturity or upon redemption all such Securities of that series not theretofore delivered to the Trustee for cancellation, including principal (and premium, if any) and interest due or to become due to such date of maturity or date fixed for redemption, as the case may be, and if the Company shall also pay or cause to be paid all other sums payable hereunder by the Company with respect to such series, then after the date such moneys or Governmental Obligations, as the case may be, are deposited with the Trustee the obligations of the Company under this Indenture with respect to such series shall cease to be of further effect except for the provisions of Sections 2.03, 2.05,

40

2.07, 4.01, 4.02, 4.03, 7.06, 7.10 and 11.05 hereof that shall survive until such Securities shall mature and be paid.

Thereafter, Sections 7.06 and 11.05 shall survive.

Section 11.03 Deposited Moneys to be Held in Trust

All moneys or Governmental Obligations deposited with the Trustee pursuant to Sections 11.01 or 11.02 shall be held in trust and shall be available for payment as due, either directly or through any paying agent (including the Company acting as its own paying agent), to the holders of the particular series of Securities for the payment or redemption of which such moneys or Governmental Obligations have been deposited with the Trustee.

Section 11.04 Payment of Moneys Held by Paying Agents

In connection with the satisfaction and discharge of this Indenture all moneys or Governmental Obligations then held by any paying agent under the provisions of this Indenture shall, upon demand of the Company, be paid to the Trustee and thereupon such paying agent shall be released from all further liability with respect to such moneys or Governmental Obligations.

Section 11.05 Repayment to Company.

Any moneys or Governmental Obligations deposited with any paying agent or the Trustee, or then held by the Company, in trust for payment of principal of or premium, if any, or interest on the Securities of a particular series that are not applied but remain unclaimed by the holders of such Securities for at least two years after the date upon which the principal of (and premium, if any) or interest on such Securities shall have respectively become due and payable, or such other shorter period set forth in applicable escheat or abandoned or unclaimed property law, shall be repaid to the Company on May 31 of each year or upon the Company's request or (if then held by the Company) shall be discharged from such trust; and thereupon the paying agent and the Trustee shall be released from all further liability with respect to such moneys or Governmental Obligations, and the holder of any of the Securities entitled to receive such payment shall thereafter, as a general creditor, look only to the Company for the payment thereof.

ARTICLE 12

IMMUNITY OF INCORPORATORS, STOCKHOLDERS, OFFICERS AND DIRECTORS

Section 12.01 No Recourse.

No recourse under or upon any obligation, covenant or agreement of this Indenture, or of any Security, or for any claim based thereon or otherwise in respect thereof, shall be had against any incorporator, stockholder, officer or director, past, present or future as such, of the Company or of any predecessor or successor corporation, either directly or through the Company or any such predecessor or successor corporation, whether by virtue of any constitution, statute or rule

41

of law, or by the enforcement of any assessment or penalty or otherwise; it being expressly understood that this Indenture and the obligations issued hereunder are solely corporate obligations, and that no such personal liability whatever shall attach to, or is or shall be incurred by, the incorporators, stockholders, officers or directors as such, of the Company or of any predecessor or successor corporation, or any of them, because of the creation of the indebtedness hereby authorized, or under or by reason of the obligations, covenants or agreements contained in this Indenture or in any of the Securities or implied therefrom; and that any and all such personal liability of every name and nature, either at common law or in equity or by constitution or statute, of, and any and all such rights and claims against, every such incorporator, stockholder, officer or director as such, because of the creation of the indebtedness hereby authorized, or under or by reason of the obligations, covenants or agreements contained in this Indenture or in any of the Securities or implied therefrom, are hereby expressly waived and released as a condition of, and as a consideration for, the execution of this Indenture and the issuance of such Securities.

ARTICLE 13

MISCELLANEOUS PROVISIONS

Section 13.01 Effect on Successors and Assigns.

All the covenants, stipulations, promises and agreements in this Indenture made by or on behalf of the Company shall bind its successors and assigns, whether so expressed or not.

Section 13.02 Actions by Successor.

Any act or proceeding by any provision of this Indenture authorized or required to be done or performed by any board, committee or officer of the Company shall and may be done and performed with like force and effect by the corresponding board, committee or officer of any corporation that shall at the time be the lawful successor of the Company.

Section 13.03 Surrender of Company Powers.

The Company by instrument in writing executed by authority of its Board of Directors and delivered to the Trustee may surrender any of the powers reserved to the Company, and thereupon such power so surrendered shall terminate both as to the Company and as to any successor corporation.

Section 13.04 Notices.

Except as otherwise expressly provided herein, any notice, request or demand that by any provision of this Indenture is required or permitted to be given, made or served by the Trustee or by the holders of Securities or by any other Person pursuant to this Indenture to or on the Company may be given or served by being deposited in first class mail, postage prepaid, addressed (until another address is filed in writing by the Company with the Trustee), as follows: .. Any notice, election, request or demand by the Company or any Securityholder or by any other Person pursuant to this Indenture to or upon the Trustee shall be deemed to have been sufficiently given or made, for all purposes, if given or made in writing at the Corporate Trust Office of the Trustee.

42

Section 13.05 Governing Law.

This Indenture and each Security shall be deemed to be a contract made under the internal laws of the State of New York, and for all purposes shall be construed in accordance with the laws of said State, except to the extent that the Trust Indenture Act is applicable.

Section 13.06 Treatment of Securities as Debt.

It is intended that the Securities will be treated as indebtedness and not as equity for federal income tax purposes. The provisions of this Indenture shall be interpreted to further this intention.

Section 13.07 Certificates and Opinions as to Conditions Precedent.

(a) Upon any application or demand by the Company to the Trustee to take any action under any of the provisions of this Indenture, the Company shall furnish to the Trustee an Officers' Certificate stating that all conditions precedent provided for in this Indenture (other than the certificate to be delivered pursuant to Section 13.12) relating to the proposed action have been complied with and an Opinion of Counsel stating that in the opinion of such counsel all such conditions precedent have been complied with, except that in the case of any such application or demand as to which the furnishing of such documents is specifically required by any provision of this Indenture relating to such particular application or demand, no additional certificate or opinion need be furnished.

(b) Each certificate or opinion provided for in this Indenture and delivered to the Trustee with respect to compliance with a condition or covenant in this Indenture shall include (i) a statement that the Person making such certificate or opinion has read such covenant or condition; (ii) a brief statement as to the nature and scope of the examination or investigation upon which the statements or opinions contained in such certificate or opinion are based; (iii) a statement that, in the opinion of such Person, he has made such examination or investigation as is reasonably necessary to enable him to express an informed opinion as to whether or not such covenant or condition has been complied with; and (iv) a statement as to whether or not, in the opinion of such Person, such condition or covenant has been complied with.

Section 13.08 Payments on Business Days.

Except as provided pursuant to Section 2.01 pursuant to a Board Resolution, and set forth in an Officers' Certificate, or established in one or more indentures supplemental to this Indenture, in any case where the date of maturity of interest or principal of any Security or the date of redemption of any Security shall not be a Business Day, then payment of interest or principal (and premium, if any) may be made on the next succeeding Business Day with the same force and effect as if made on the nominal date of maturity or redemption, and no interest shall accrue for the period after such nominal date.

43

Section 13.09 Conflict with Trust Indenture Act.

If and to the extent that any provision of this Indenture limits, qualifies or conflicts with the duties imposed by Sections 310 to 317, inclusive, of the Trust Indenture Act, such imposed duties shall control.

Section 13.10 Counterparts.

This Indenture may be executed in any number of counterparts, each of which shall be an original, but such counterparts shall together constitute but one and the same instrument.

Section 13.11 Separability.

In case any one or more of the provisions contained in this Indenture or in the Securities of any series shall for any reason be held to be invalid, illegal or unenforceable in any respect, such invalidity, illegality or unenforceability shall not affect any other provisions of this Indenture or of such Securities, but this Indenture and such Securities shall be construed as if such invalid or illegal or unenforceable provision had never been contained herein or therein.

Section 13.12 Compliance Certificates.

The Company shall deliver to the Trustee, within 120 days after the end of each fiscal year during which any Securities of any series were outstanding, an officer's certificate stating whether or not the signers know of any Default or Event of Default that occurred during such fiscal year. Such certificate shall contain a certification from the principal executive officer, principal financial officer or principal accounting officer of the Company that a review has been conducted of the activities of the Company and the Company's performance under this Indenture and that the Company has complied with all conditions and covenants under this Indenture. For purposes of this Section 13.12, such compliance shall be determined without regard to any period of grace or requirement of notice provided under this Indenture. If the officer of the Company signing such certificate has knowledge of such a Default or Event of Default, the certificate shall describe any such Default or Event of Default and its status.

IN WITNESS WHEREOF, the parties hereto have caused this Indenture to be duly executed all as of the day and year first above written.

GLADSTONE CAPITAL CORPORATION

By: _____

Name: _____

Title: _____

[TRUSTEE], as Trustee

By: _____

Name: _____

Title: _____

CROSS-REFERENCE TABLE (1)

<u>Section of Trust Indenture Act Of 1939, as Amended</u>	<u>Section of Indenture</u>
310(a)	7.09
310(b)	7.08
	7.10
310(c)	Inapplicable
311(a)	7.13
311(b)	7.13
311(c)	Inapplicable
312(a)	5.01
	5.02(a)
312(b)	5.02(c)
312(c)	5.02(c)
313(a)	5.04(a)
313(b)	5.04(b)
313(c)	5.04(a)
	5.04(b)
313(d)	5.04(c)
314(a)	5.03
	13.12
314(b)	Inapplicable
314(c)	13.07(a)
314(d)	Inapplicable
314(e)	13.07(b)
314(f)	Inapplicable
315(a)	7.01(a)
	7.01(b)
315(b)	7.14
315(c)	7.01
315(d)	7.01(b)
315(e)	6.07
316(a)	6.06
	8.04
316(b)	6.04
316(c)	8.01
317(a)	6.02
317(b)	4.03
318(a)	13.09

(1) This Cross-Reference Table does not constitute part of the Indenture and shall not have any bearing on the interpretation of any of its terms or provisions.

**GLADSTONE CAPITAL CORPORATION,
Issuer**

AND

**[TRUSTEE],
Trustee**

INDENTURE

Dated as of _____, 20__

Subordinated Debt Securities

TABLE OF CONTENTS

		<u>Page</u>
ARTICLE 1	DEFINITIONS	1
Section 1.01	Definitions of Terms	1
ARTICLE 2	ISSUE, DESCRIPTION, TERMS, EXECUTION, REGISTRATION AND EXCHANGE OF SECURITIES	5
Section 2.01	Designation and Terms of Securities	5
Section 2.02	Form of Securities and Trustee's Certificate	7
Section 2.03	Denominations: Provisions for Payment	7
Section 2.04	Execution and Authentications	9
Section 2.05	Registration of Transfer and Exchange	10
Section 2.06	Temporary Securities	11
Section 2.07	Mutilated, Destroyed, Lost or Stolen Securities	11
Section 2.08	Cancellation	12
Section 2.09	Benefits of Indenture	12
Section 2.10	Authenticating Agent	12
Section 2.11	Global Securities	13
ARTICLE 3	REDEMPTION OF SECURITIES AND SINKING FUND PROVISIONS	14
Section 3.01	Redemption	14
Section 3.02	Notice of Redemption	14
Section 3.03	Payment Upon Redemption	15
Section 3.04	Sinking Fund	16
Section 3.05	Satisfaction of Sinking Fund Payments with Securities	16
Section 3.06	Redemption of Securities for Sinking Fund	16
ARTICLE 4	COVENANTS	17
Section 4.01	Payment of Principal, Premium and Interest	17
Section 4.02	Maintenance of Office or Agency	17
Section 4.03	Paying Agents	17
Section 4.04	Appointment to Fill Vacancy in Office of Trustee	19
Section 4.05	Compliance with Consolidation Provisions	19

ARTICLE 5	SECURITYHOLDERS' LISTS AND REPORTS BY THE COMPANY AND THE TRUSTEE	19
Section 5.01	Company to Furnish Trustee Names and Addresses of Securityholders	19
Section 5.02	Preservation Of Information; Communications With Securityholders	19
Section 5.03	Reports by the Company	20
Section 5.04	Reports by the Trustee	20
ARTICLE 6	REMEDIES OF THE TRUSTEE AND SECURITYHOLDERS ON EVENT OF DEFAULT	21
Section 6.01	Events of Default	21
Section 6.02	Collection of Indebtedness and Suits for Enforcement by Trustee	22
Section 6.03	Application of Moneys Collected	23

Section 6.04	Limitation on Suits	24
Section 6.05	Rights and Remedies Cumulative; Delay or Omission Not Waiver	25
Section 6.06	Control by Securityholders	25
Section 6.07	Undertaking to Pay Costs	26
ARTICLE 7	CONCERNING THE TRUSTEE	26
Section 7.01	Certain Duties and Responsibilities of Trustee	26
Section 7.02	Certain Rights of Trustee	27
Section 7.03	Trustee Not Responsible for Recitals or Issuance of Securities	28
Section 7.04	May Hold Securities	29
Section 7.05	Moneys Held in Trust	29
Section 7.06	Compensation and Reimbursement	29
Section 7.07	Reliance on Officers' Certificate	30
Section 7.08	Disqualification; Conflicting Interests	30
Section 7.09	Corporate Trustee Required; Eligibility	30
Section 7.10	Resignation and Removal; Appointment of Successor	30
Section 7.11	Acceptance of Appointment By Successor	32
Section 7.12	Merger, Conversion, Consolidation or Succession to Business	33
Section 7.13	Preferential Collection of Claims Against the Company	33
Section 7.14	Notice of Default	33

ARTICLE 8	CONCERNING THE SECURITYHOLDERS	34
Section 8.01	Evidence of Action by Securityholders	34
Section 8.02	Proof of Execution by Securityholders	34
Section 8.03	Who May be Deemed Owners	35
Section 8.04	Certain Securities Owned by Company Disregarded	35
Section 8.05	Actions Binding on Future Securityholders	35
ARTICLE 9	SUPPLEMENTAL INDENTURES	36
Section 9.01	Supplemental Indentures Without the Consent of Securityholders	36
Section 9.02	Supplemental Indentures With Consent of Securityholders	37
Section 9.03	Effect of Supplemental Indentures	37
Section 9.04	Securities Affected by Supplemental Indentures	38
Section 9.05	Execution of Supplemental Indentures	38
ARTICLE 10	SUCCESSOR ENTITY	38
Section 10.01	Company May Consolidate, Etc.	38
Section 10.02	Successor Entity Substituted	39
Section 10.03	Evidence of Consolidation, Etc. to Trustee	39
ARTICLE 11	SATISFACTION AND DISCHARGE	40
Section 11.01	Satisfaction and Discharge of Indenture	40
Section 11.02	Discharge of Obligations	40
Section 11.03	Deposited Moneys to be Held in Trust	41
Section 11.04	Payment of Moneys Held by Paying Agents	41
Section 11.05	Repayment to Company	41
ARTICLE 12	IMMUNITY OF INCORPORATORS, STOCKHOLDERS, OFFICERS AND DIRECTORS	41
Section 12.01	No Recourse	41
ARTICLE 13	MISCELLANEOUS PROVISIONS	42
Section 13.01	Effect on Successors and Assigns	42
Section 13.02	Actions by Successor	42
Section 13.03	Surrender of Company Powers	42
Section 13.04	Notices	42

Section 13.05	Governing Law	43
Section 13.06	Treatment of Securities as Debt	43
Section 13.07	Certificates and Opinions as to Conditions Precedent	43
Section 13.08	Payments on Business Days	43
Section 13.09	Conflict with Trust Indenture Act	44
Section 13.10	Counterparts	44
Section 13.11	Separability	44
Section 13.12	Compliance Certificates	44
ARTICLE 14	SUBORDINATION OF SECURITIES	44
Section 14.01	Subordination Terms	44

(1) This Table of Contents does not constitute part of the Indenture and shall not have any bearing on the interpretation of any of its terms or provisions.

INDENTURE

INDENTURE, dated as of [_____], 20__, among GLADSTONE CAPITAL CORPORATION, a Maryland corporation (the “Company”), and [TRUSTEE], as trustee (the “Trustee”):

WHEREAS, for its lawful corporate purposes, the Company has duly authorized the execution and delivery of this Indenture to provide for the issuance of subordinated debt securities (hereinafter referred to as the “Securities”), in an unlimited aggregate principal amount to be issued from time to time in one or more series as in this Indenture provided, as registered Securities without coupons, to be authenticated by the certificate of the Trustee;

WHEREAS, to provide the terms and conditions upon which the Securities are to be authenticated, issued and delivered, the Company has duly authorized the execution of this Indenture; and

WHEREAS, all things necessary to make this Indenture a valid agreement of the Company, in accordance with its terms, have been done.

NOW, THEREFORE, in consideration of the premises and the purchase of the Securities by the holders thereof, it is mutually covenanted and agreed as follows for the equal and ratable benefit of the holders of Securities:

ARTICLE 1

DEFINITIONS

Section 1.01 Definitions of Terms.

The terms defined in this Section (except as in this Indenture or any indenture supplemental hereto otherwise expressly provided or unless the context otherwise requires) for all purposes of this Indenture and of any indenture supplemental hereto shall have the respective meanings specified in this Section and shall include the plural as well as the singular. All other terms used in this Indenture that are defined in the Trust Indenture Act of 1939, as amended, or that are by reference in such Act defined in the Securities Act of 1933, as amended (except as herein or any indenture supplemental hereto otherwise expressly provided or unless the context otherwise requires), shall have the meanings assigned to such terms in said Trust Indenture Act and in said Securities Act as in force at the date of the execution of this instrument.

“*Authenticating Agent*” means an authenticating agent with respect to all or any of the series of Securities appointed by the Trustee pursuant to Section 2.10.

“*Bankruptcy Law*” means Title 11, U.S. Code, or any similar federal or state law for the relief of debtors.

“*Board of Directors*” means the Board of Directors of the Company or any duly authorized committee of such Board.

1

“*Board Resolution*” means a copy of a resolution certified by the Secretary or an Assistant Secretary of the Company to have been duly adopted by the Board of Directors and to be in full force and effect on the date of such certification.

“*Business Day*” means, with respect to any series of Securities, any day other than a day on which federal or state banking institutions in the Borough of Manhattan, the City of New York, or in the city of the Corporate Trust Office of the Trustee, are authorized or obligated by law, executive order or regulation to close.

“*Company*” means Gladstone Capital Corporation, a corporation duly organized and existing under the laws of the State of Maryland, and, subject to the provisions of Article Ten, shall also include its successors and assigns.

“*Corporate Trust Office*” means the office of the Trustee at which, at any particular time, its corporate trust business shall be principally administered, which office at the date hereof is located at _____.

“*Custodian*” means any receiver, trustee, assignee, liquidator or similar official under any Bankruptcy Law.

“*Default*” means any event, act or condition that with notice or lapse of time, or both, would constitute an Event of Default.

“*Defaulted Interest*” shall have the meaning as set forth in Section 2.03.

“*Depository*” means, with respect to Securities of any series for which the Company shall determine that such Securities will be issued as a Global Security, The Depository Trust Company, New York, New York, another clearing agency, or any successor registered as a clearing agency under the Securities and Exchange Act of 1934, as amended (the “Exchange Act”), or other applicable statute or regulation, which, in each case, shall be designated by the Company pursuant to either Section 2.01 or 2.11.

“*Event of Default*” means, with respect to Securities of a particular series, any event specified in Section 6.01, continued for the period of time, if any, therein designated.

“*Global Security*” means, with respect to any series of Securities, a Security executed by the Company and delivered by the Trustee to the Depository or pursuant to the Depository’s instruction, all in accordance with the Indenture, which shall be registered in the name of the Depository or its nominee.

“*Governmental Obligations*” means securities that are (a) direct obligations of the United States of America for the payment of which its full faith and credit is pledged or (b) obligations of a Person controlled or supervised by and acting as an agency or instrumentality of the United States of America, the payment of which is unconditionally guaranteed as a full faith and credit obligation by the United States of America that, in either case, are not callable or redeemable at the option of the issuer thereof at any time prior to the stated maturity of the Securities, and shall also include a depositary receipt issued by a bank or trust company as custodian with respect to

2

any such Governmental Obligation or a specific payment of principal of or interest on any such Governmental Obligation held by such custodian for the account of the holder

of such depositary receipt; provided, however, that (except as required by law) such custodian is not authorized to make any deduction from the amount payable to the holder of such depositary receipt from any amount received by the custodian in respect of the Governmental Obligation or the specific payment of principal of or interest on the Governmental Obligation evidenced by such depositary receipt.

“*herein*”, “*hereof*” and “*hereunder*”, and other words of similar import, refer to this Indenture as a whole and not to any particular Article, Section or other subdivision.

“*Indenture*” means this instrument as originally executed or as it may from time to time be supplemented or amended by one or more indentures supplemental hereto entered into in accordance with the terms hereof.

“*Interest Payment Date*”, when used with respect to any installment of interest on a Security of a particular series, means the date specified in such Security or in a Board Resolution or in an indenture supplemental hereto with respect to such series as the fixed date on which an installment of interest with respect to Securities of that series is due and payable.

“*Officer*” means, with respect to the Company, the chairman of the Board of Directors, a chief executive officer, a president, a chief financial officer, a chief operating officer, any executive vice president, any senior vice president, any vice president, the treasurer or any assistant treasurer, the controller or any assistant controller or the secretary or any assistant secretary.

“*Officers’ Certificate*” means a certificate signed by any two Officers. Each such certificate shall include the statements provided for in Section 13.07, if and to the extent required by the provisions thereof.

“*Opinion of Counsel*” means an opinion in writing subject to customary exceptions of legal counsel, who may be an employee of or counsel for the Company, that is delivered to the Trustee in accordance with the terms hereof. Each such opinion shall include the statements provided for in Section 13.07, if and to the extent required by the provisions thereof.

“*Outstanding*”, when used with reference to Securities of any series, means, subject to the provisions of Section 8.04, as of any particular time, all Securities of that series theretofore authenticated and delivered by the Trustee under this Indenture, except (a) Securities theretofore canceled by the Trustee or any paying agent, or delivered to the Trustee or any paying agent for cancellation or that have previously been canceled; (b) Securities or portions thereof for the payment or redemption of which moneys or Governmental Obligations in the necessary amount shall have been deposited in trust with the Trustee or with any paying agent (other than the Company) or shall have been set aside and segregated in trust by the Company (if the Company shall act as its own paying agent); provided, however, that if such Securities or portions of such Securities are to be redeemed prior to the maturity thereof, notice of such redemption shall have been given as in Article Three provided, or provision satisfactory to the Trustee shall have been

3

made for giving such notice; and (c) Securities in lieu of or in substitution for which other Securities shall have been authenticated and delivered pursuant to the terms of Section 2.07.

“*Person*” means any individual, corporation, partnership, joint venture, joint-stock company, limited liability company, association, trust, unincorporated organization, any other entity or organization, including a government or political subdivision or an agency or instrumentality thereof.

“*Predecessor Security*” of any particular Security means every previous Security evidencing all or a portion of the same debt as that evidenced by such particular Security; and, for the purposes of this definition, any Security authenticated and delivered under Section 2.07 in lieu of a lost, destroyed or stolen Security shall be deemed to evidence the same debt as the lost, destroyed or stolen Security.

“*Responsible Officer*” when used with respect to the Trustee means the chairman of its board of directors, the chief executive officer, the president, any vice president, the secretary, the treasurer, any trust officer, any corporate trust officer or any other officer or assistant officer of the Trustee customarily performing functions similar to those performed by the Persons who at the time shall be such officers, respectively, or to whom any corporate trust matter is referred because of his or her knowledge of and familiarity with the particular subject.

“*Securities*” means the debt Securities authenticated and delivered under this Indenture.

“*Securityholder*”, “holder of Securities”, “registered holder”, or other similar term, means the Person or Persons in whose name or names a particular Security shall be registered on the books of the Company kept for that purpose in accordance with the terms of this Indenture.

“*Security Register*” and “*Security Registrar*” shall have the meanings as set forth in Section 2.05.

“*Subsidiary*” means, with respect to any Person, (i) any corporation at least a majority of whose outstanding Voting Stock shall at the time be owned, directly or indirectly, by such Person or by one or more of its Subsidiaries or by such Person and one or more of its Subsidiaries, (ii) any general partnership, joint venture or similar entity, at least a majority of whose outstanding partnership or similar interests shall at the time be owned by such Person, or by one or more of its Subsidiaries, or by such Person and one or more of its Subsidiaries and (iii) any limited partnership of which such Person or any of its Subsidiaries is a general partner.

“*Trustee*” means _____, and, subject to the provisions of Article Seven, shall also include its successors and assigns, and, if at any time there is more than one Person acting in such capacity hereunder, “Trustee” shall mean each such Person. The term “Trustee” as used with respect to a particular series of the Securities shall mean the trustee with respect to that series.

“*Trust Indenture Act*” means the Trust Indenture Act of 1939, as amended.

4

“*Voting Stock*”, as applied to stock of any Person, means shares, interests, participations or other equivalents in the equity interest (however designated) in such Person having ordinary voting power for the election of a majority of the directors (or the equivalent) of such Person, other than shares, interests, participations or other equivalents having such power only by reason of the occurrence of a contingency.

ISSUE, DESCRIPTION, TERMS, EXECUTION, REGISTRATION AND EXCHANGE OF SECURITIES

Section 2.01 Designation and Terms of Securities.

(a) The aggregate principal amount of Securities that may be authenticated and delivered under this Indenture is unlimited. The Securities may be issued in one or more series up to the aggregate principal amount of Securities of that series from time to time authorized by or pursuant to a Board Resolution or pursuant to one or more indentures supplemental hereto. Prior to the initial issuance of Securities of any series, there shall be established in or pursuant to a Board Resolution, and set forth in an Officers' Certificate, or established in one or more indentures supplemental hereto:

- (1) the title of the Securities of the series (which shall distinguish the Securities of that series from all other Securities);
- (2) any limit upon the aggregate principal amount of the Securities of that series that may be authenticated and delivered under this Indenture (except for Securities authenticated and delivered upon registration of transfer of, or in exchange for, or in lieu of, other Securities of that series);
- (3) the date or dates on which the principal of the Securities of the series is payable, any original issue discount that may apply to the Securities of that series upon their issuance, the principal amount due at maturity, and the place(s) of payment;
- (4) the rate or rates at which the Securities of the series shall bear interest or the manner of calculation of such rate or rates, if any;
- (5) the date or dates from which such interest shall accrue, the Interest Payment Dates on which such interest will be payable or the manner of determination of such Interest Payment Dates, the place(s) of payment, and the record date for the determination of holders to whom interest is payable on any such Interest Payment Dates or the manner of determination of such record dates;
- (6) the right, if any, to extend the interest payment periods and the duration of such extension;

5

(7) the period or periods within which, the price or prices at which and the terms and conditions upon which Securities of the series may be redeemed, in whole or in part, at the option of the Company;

(8) the obligation, if any, of the Company to redeem or purchase Securities of the series pursuant to any sinking fund, mandatory redemption, or analogous provisions (including payments made in cash in satisfaction of future sinking fund obligations) or at the option of a holder thereof and the period or periods within which, the price or prices at which, and the terms and conditions upon which, Securities of the series shall be redeemed or purchased, in whole or in part, pursuant to such obligation;

(9) the form of the Securities of the series including the form of the certificate of Authentication for such series;

(10) if other than denominations of one thousand U.S. dollars (\$1,000) or any integral multiple thereof, the denominations in which the Securities of the series shall be issuable;

(11) any and all other terms (including terms, to the extent applicable, relating to any auction or remarketing of the Securities of that series and any security for the obligations of the Company with respect to such Securities) with respect to such series (which terms shall not be inconsistent with the terms of this Indenture, as amended by any supplemental indenture) including any terms which may be required by or advisable under United States laws or regulations or advisable in connection with the marketing of Securities of that series;

(12) whether the Securities are issuable as a Global Security and, in such case, the terms and the identity of the Depository for such series;

(13) whether the Securities will be convertible into or exchangeable for shares of common stock or other securities of the Company or any other Person and, if so, the terms and conditions upon which such Securities will be so convertible or exchangeable, including the conversion or exchange price, as applicable, or how it will be calculated and may be adjusted, any mandatory or optional (at the Company's option or the holders' option) conversion or exchange features, and the applicable conversion or exchange period;

(14) if other than the principal amount thereof, the portion of the principal amount of Securities of the series which shall be payable upon declaration of acceleration of the maturity thereof pursuant to Section 6.01;

(15) any additional or different Events of Default or restrictive covenants (which may include, among other restrictions, restrictions on the Company's ability or the ability of the Company's Subsidiaries to: incur additional indebtedness; issue additional securities; create liens; pay dividends or make distributions in respect of their capital stock; redeem capital stock; place restrictions on such Subsidiaries placing restrictions on their ability to pay dividends, make distributions or transfer assets; make investments or other restricted payments; sell or otherwise dispose of assets; enter into sale-leaseback transactions; engage in transactions with stockholders and affiliates; issue or sell stock of their Subsidiaries; or effect a

6

consolidation or merger) or financial covenants (which may include, among other financial covenants, financial covenants that require the Company and its Subsidiaries to maintain specified interest coverage, fixed charge, cash flow-based or asset-based ratios) provided for with respect to the Securities of the series;

(16) if other than dollars, the coin or currency in which the Securities of the series are denominated (including, but not limited to, foreign currency);

(17) the terms and conditions, if any, upon which the Company shall pay amounts in addition to the stated interest, premium, if any and principal amounts of the Securities of the series to any Securityholder that is not a "United States person" for federal tax purposes;

(18) any restrictions on transfer, sale or assignment of the Securities of the series; and

(19) the subordination terms of the Securities of the series.

All Securities of any one series shall be substantially identical except as to denomination and except as may otherwise be provided in or pursuant to any such Board Resolution or in any indentures supplemental hereto.

If any of the terms of the series are established by action taken pursuant to a Board Resolution of the Company, a copy of an appropriate record of such action shall be certified by the secretary or an assistant secretary of the Company and delivered to the Trustee at or prior to the delivery of the Officers' Certificate of the Company setting forth the terms of the series.

Securities of any particular series may be issued at various times, with different dates on which the principal or any installment of principal is payable, with different rates of interest, if any, or different methods by which rates of interest may be determined, with different dates on which such interest may be payable and with different redemption dates.

Section 2.02 Form of Securities and Trustee's Certificate

The Securities of any series and the Trustee's certificate of authentication to be borne by such Securities shall be substantially of the tenor and purport as set forth in one or more indentures supplemental hereto or as provided in a Board Resolution, and set forth in an Officers' Certificate, and they may have such letters, numbers or other marks of identification or designation and such legends or endorsements printed, lithographed or engraved thereon as the Company may deem appropriate and as are not inconsistent with the provisions of this Indenture, or as may be required to comply with any law or with any rule or regulation made pursuant thereto or with any rule or regulation of any securities exchange on which Securities of that series may be listed, or to conform to usage.

7

Section 2.03 Denominations: Provisions for Payment.

The Securities shall be issuable as registered Securities and in the denominations of one thousand U.S. dollars (\$1,000) or any integral multiple thereof, subject to Section 2.01(a)(10). The Securities of a particular series shall bear interest payable on the dates and at the rate specified with respect to that series. Subject to Section 2.01(a)(16), the principal of and the interest on the Securities of any series, as well as any premium thereon in case of redemption thereof prior to maturity, shall be payable in the coin or currency of the United States of America that at the time is legal tender for public and private debt, at the office or agency of the Company maintained for that purpose in the Borough of Manhattan, the City and State of New York. Each Security shall be dated the date of its authentication. Interest on the Securities shall be computed on the basis of a 360-day year composed of twelve 30-day months.

The interest installment on any Security that is payable, and is punctually paid or duly provided for, on any Interest Payment Date for Securities of that series shall be paid to the Person in whose name said Security (or one or more Predecessor Securities) is registered at the close of business on the regular record date for such interest installment. In the event that any Security of a particular series or portion thereof is called for redemption and the redemption date is subsequent to a regular record date with respect to any Interest Payment Date and prior to such Interest Payment Date, interest on such Security will be paid upon presentation and surrender of such Security as provided in Section 3.03.

Any interest on any Security that is payable, but is not punctually paid or duly provided for, on any Interest Payment Date for Securities of the same series (herein called "**Defaulted Interest**") shall forthwith cease to be payable to the registered holder on the relevant regular record date by virtue of having been such holder; and such Defaulted Interest shall be paid by the Company, at its election, as provided in clause (1) or clause (2) below:

(1) The Company may make payment of any Defaulted Interest on Securities to the Persons in whose names such Securities (or their respective Predecessor Securities) are registered at the close of business on a special record date for the payment of such Defaulted Interest, which shall be fixed in the following manner: the Company shall notify the Trustee in writing of the amount of Defaulted Interest proposed to be paid on each such Security and the date of the proposed payment, and at the same time the Company shall deposit with the Trustee an amount of money equal to the aggregate amount proposed to be paid in respect of such Defaulted Interest or shall make arrangements satisfactory to the Trustee for such deposit prior to the date of the proposed payment, such money when deposited to be held in trust for the benefit of the Persons entitled to such Defaulted Interest as in this clause provided. Thereupon the Trustee shall fix a special record date for the payment of such Defaulted Interest which shall not be more than 15 nor less than 10 days prior to the date of the proposed payment and not less than 10 days after the receipt by the Trustee of the notice of the proposed payment. The Trustee shall promptly notify the Company of such special record date and, in the name and at the expense of the Company, shall cause notice of the proposed payment of such Defaulted Interest and the special record date therefor to be mailed, first class postage prepaid, to each Securityholder at his or her address as it appears in the Security Register (as hereinafter defined), not less than 10 days prior to such special record date. Notice of the proposed payment of such Defaulted Interest and the special record date therefor having been mailed as aforesaid, such

8

Defaulted Interest shall be paid to the Persons in whose names such Securities (or their respective Predecessor Securities) are registered on such special record date.

(2) The Company may make payment of any Defaulted Interest on any Securities in any other lawful manner not inconsistent with the requirements of any securities exchange on which such Securities may be listed, and upon such notice as may be required by such exchange, if, after notice given by the Company to the Trustee of the proposed payment pursuant to this clause, such manner of payment shall be deemed practicable by the Trustee.

Unless otherwise set forth in a Board Resolution or one or more indentures supplemental hereto establishing the terms of any series of Securities pursuant to Section 2.01 hereof, the term "regular record date" as used in this Section with respect to a series of Securities and any Interest Payment Date for such series shall mean either the fifteenth day of the month immediately preceding the month in which an Interest Payment Date established for such series pursuant to Section 2.01 hereof shall occur, if such Interest Payment Date is the first day of a month, or the first day of the month in which an Interest Payment Date established for such series pursuant to Section 2.01 hereof shall occur, if such Interest Payment Date is the fifteenth day of a month, whether or not such date is a Business Day.

Subject to the foregoing provisions of this Section, each Security of a series delivered under this Indenture upon transfer of or in exchange for or in lieu of any other Security of such series shall carry the rights to interest accrued and unpaid, and to accrue, that were carried by such other Security.

Section 2.04 Execution and Authentications.

The Securities shall be signed on behalf of the Company by one of its Officers. Signatures may be in the form of a manual or facsimile signature.

The Company may use the facsimile signature of any Person who shall have been an Officer, notwithstanding the fact that at the time the Securities shall be authenticated and delivered or disposed of such Person shall have ceased to be such an officer of the Company. The Securities may contain such notations, legends or endorsements required by law, stock exchange rule or usage. Each Security shall be dated the date of its authentication by the Trustee.

A Security shall not be valid until authenticated manually by an authorized signatory of the Trustee, or by an Authenticating Agent. Such signature shall be conclusive evidence that the Security so authenticated has been duly authenticated and delivered hereunder and that the holder is entitled to the benefits of this Indenture. At any time and from time to time after the execution and delivery of this Indenture, the Company may deliver Securities of any series executed by the Company to the Trustee for authentication, together with a written order of the Company for the authentication and delivery of such Securities, signed by an Officer, and the Trustee in accordance with such written order shall authenticate and deliver such Securities.

In authenticating such Securities and accepting the additional responsibilities under this Indenture in relation to such Securities, the Trustee shall be entitled to receive, and (subject to

Section 7.01) shall be fully protected in relying upon, an Opinion of Counsel stating that the form and terms thereof have been established in conformity with the provisions of this Indenture.

The Trustee shall not be required to authenticate such Securities if the issue of such Securities pursuant to this Indenture will affect the Trustee's own rights, duties or immunities under the Securities and this Indenture or otherwise in a manner that is not reasonably acceptable to the Trustee.

Section 2.05 Registration of Transfer and Exchange.

(a) Securities of any series may be exchanged upon presentation thereof at the office or agency of the Company designated for such purpose in the Borough of Manhattan, the City and State of New York, for other Securities of such series of authorized denominations, and for a like aggregate principal amount, upon payment of a sum sufficient to cover any tax or other governmental charge in relation thereto, all as provided in this Section. In respect of any Securities so surrendered for exchange, the Company shall execute, the Trustee shall authenticate and such office or agency shall deliver in exchange therefor the Security or Securities of the same series that the Securityholder making the exchange shall be entitled to receive, bearing numbers not contemporaneously outstanding.

(b) The Company shall keep, or cause to be kept, at its office or agency designated for such purpose in the Borough of Manhattan, the City and State of New York, or such other location designated by the Company, a register or registers (herein referred to as the "*Security Register*") in which, subject to such reasonable regulations as it may prescribe, the Company shall register the Securities and the transfers of Securities as in this Article provided and which at all reasonable times shall be open for inspection by the Trustee. The registrar for the purpose of registering Securities and transfer of Securities as herein provided shall be appointed as authorized by Board Resolution (the "*Security Registrar*").

Upon surrender for transfer of any Security at the office or agency of the Company designated for such purpose, the Company shall execute, the Trustee shall authenticate and such office or agency shall deliver in the name of the transferee or transferees a new Security or Securities of the same series as the Security presented for a like aggregate principal amount.

All Securities presented or surrendered for exchange or registration of transfer, as provided in this Section, shall be accompanied (if so required by the Company or the Security Registrar) by a written instrument or instruments of transfer, in form satisfactory to the Company or the Security Registrar, duly executed by the registered holder or by such holder's duly authorized attorney in writing.

(c) Except as provided pursuant to Section 2.01 pursuant to a Board Resolution, and set forth in an Officers' Certificate, or established in one or more indentures supplemental to this Indenture, no service charge shall be made for any exchange or registration of transfer of Securities, or issue of new Securities in case of partial redemption of any series, but the Company may require payment of a sum sufficient to cover any tax or other governmental charge in relation thereto, other than exchanges pursuant to Section 2.06, Section 3.03(b) and Section 9.04 not involving any transfer.

(d) The Company shall not be required (i) to issue, exchange or register the transfer of any Securities during a period beginning at the opening of business 15 days before the day of the mailing of a notice of redemption of less than all the Outstanding Securities of the same series and ending at the close of business on the day of such mailing, nor (ii) to register the transfer of or exchange any Securities of any series or portions thereof called for redemption, other than the unredeemed portion of any such Securities being redeemed in part. The provisions of this Section 2.05 are, with respect to any Global Security, subject to Section 2.11 hereof.

Section 2.06 Temporary Securities.

Pending the preparation of definitive Securities of any series, the Company may execute, and the Trustee shall authenticate and deliver, temporary Securities (printed, lithographed or typewritten) of any authorized denomination. Such temporary Securities shall be substantially in the form of the definitive Securities in lieu of which they are issued, but with such omissions, insertions and variations as may be appropriate for temporary Securities, all as may be determined by the Company. Every temporary Security of any series shall be executed by the Company and be authenticated by the Trustee upon the same conditions and in substantially the same manner, and with like effect, as the definitive Securities of such series. Without unnecessary delay the Company will execute and will furnish definitive Securities of such series and thereupon any or all temporary Securities of such series may be surrendered in exchange therefor (without charge to the holders), at the office or agency of the Company designated for the purpose in the Borough of Manhattan, the City and State of New York, and the Trustee shall authenticate and such office or agency shall deliver in exchange for such temporary Securities an equal aggregate principal amount of definitive Securities of such series, unless the Company advises the Trustee to the effect that definitive Securities need not be executed and furnished until further notice from the Company. Until so exchanged, the temporary Securities of such series shall be entitled to the same benefits under this Indenture as definitive Securities of such series authenticated and delivered hereunder.

Section 2.07 Mutilated, Destroyed, Lost or Stolen Securities.

In case any temporary or definitive Security shall become mutilated or be destroyed, lost or stolen, the Company (subject to the next succeeding sentence) shall execute, and upon the Company's request the Trustee (subject as aforesaid) shall authenticate and deliver, a new Security of the same series, bearing a number not contemporaneously outstanding, in exchange and substitution for the mutilated Security, or in lieu of and in substitution for the Security so destroyed, lost or stolen. In every case the applicant for a substituted Security shall furnish to the Company and the Trustee such security or indemnity as may be required by them to save each of them harmless, and, in every case of destruction, loss or theft, the applicant shall also furnish to the Company and the Trustee evidence to their satisfaction of the destruction, loss or theft of the applicant's Security and of the ownership thereof. The Trustee may authenticate any such substituted Security and deliver the same upon the written request or authorization of any officer of the Company. Upon the issuance of any substituted Security, the Company may require the payment of a sum sufficient to cover any tax or other governmental charge that may be imposed in relation thereto and any other expenses (including the fees and expenses of the Trustee) connected therewith.

In case any Security that has matured or is about to mature shall become mutilated or be destroyed, lost or stolen, the Company may, instead of issuing a substitute Security, pay or authorize the payment of the same (without surrender thereof except in the case of a mutilated Security) if the applicant for such payment shall furnish to the Company and the Trustee such security or indemnity as they may require to save them harmless, and, in case of destruction, loss or theft, evidence to the satisfaction of the Company and the Trustee of the destruction, loss or theft of such Security and of the ownership thereof.

Every replacement Security issued pursuant to the provisions of this Section shall constitute an additional contractual obligation of the Company whether or not the mutilated, destroyed, lost or stolen Security shall be found at any time, or be enforceable by anyone, and shall be entitled to all the benefits of this Indenture equally and proportionately with any and all other Securities of the same series duly issued hereunder. All Securities shall be held and owned upon the express condition that the foregoing provisions are exclusive with respect to the replacement or payment of mutilated, destroyed, lost or stolen Securities, and shall preclude (to the extent lawful) any and all other rights or remedies, notwithstanding any law or statute existing or hereafter enacted to the contrary with respect to the replacement or payment of negotiable instruments or other securities without their surrender.

Section 2.08 Cancellation.

All Securities surrendered for the purpose of payment, redemption, exchange or registration of transfer shall, if surrendered to the Company or any paying agent, be delivered to the Trustee for cancellation, or, if surrendered to the Trustee, shall be cancelled by it, and no Securities shall be issued in lieu thereof except as expressly required or permitted by any of the provisions of this Indenture. On request of the Company at the time of such surrender, the Trustee shall deliver to the Company canceled Securities held by the Trustee. In the absence of such request the Trustee may dispose of canceled Securities in accordance with its standard procedures and deliver a certificate of disposition to the Company. If the Company shall otherwise acquire any of the Securities, however, such acquisition shall not operate as a redemption or satisfaction of the indebtedness represented by such Securities unless and until the same are delivered to the Trustee for cancellation.

Section 2.09 Benefits of Indenture.

Nothing in this Indenture or in the Securities, express or implied, shall give or be construed to give to any Person, other than the parties hereto and the holders of the Securities (and, with respect to the provisions of Article Fourteen, the holders of any indebtedness of the Company to which the Securities of any series are subordinated) any legal or equitable right, remedy or claim under or in respect of this Indenture, or under any covenant, condition or provision herein contained; all such covenants, conditions and provisions being for the sole benefit of the parties hereto and of the holders of the Securities (and, with respect to the provisions of Article Fourteen, the holders of any indebtedness of the Company to which the Securities of any series are subordinated).

Section 2.10 Authenticating Agent.

So long as any of the Securities of any series remain Outstanding there may be an Authenticating Agent for any or all such series of Securities which the Trustee shall have the right to appoint. Said Authenticating Agent shall be authorized to act on behalf of the Trustee to authenticate Securities of such series issued upon exchange, transfer or partial redemption thereof, and Securities so authenticated shall be entitled to the benefits of this Indenture and shall be valid and obligatory for all purposes as if authenticated by the Trustee hereunder. All references in this Indenture to the authentication of Securities by the Trustee shall be deemed to include authentication by an Authenticating Agent for such series. Each Authenticating Agent shall be acceptable to the Company and shall be a corporation that has a combined capital and surplus, as most recently reported or determined by it, sufficient under the laws of any jurisdiction under which it is organized or in which it is doing business to conduct a trust business, and that is otherwise authorized under such laws to conduct such business and is subject to supervision or examination by federal or state authorities. If at any time any Authenticating Agent shall cease to be eligible in accordance with these provisions, it shall resign immediately.

Any Authenticating Agent may at any time resign by giving written notice of resignation to the Trustee and to the Company. The Trustee may at any time (and upon request by the Company shall) terminate the agency of any Authenticating Agent by giving written notice of termination to such Authenticating Agent and to the Company. Upon resignation, termination or cessation of eligibility of any Authenticating Agent, the Trustee may appoint an eligible successor Authenticating Agent acceptable to the Company. Any successor Authenticating Agent, upon acceptance of its appointment hereunder, shall become vested with all the rights, powers and duties of its predecessor hereunder as if originally named as an Authenticating Agent pursuant hereto.

Section 2.11 Global Securities.

(a) If the Company shall establish pursuant to Section 2.01 that the Securities of a particular series are to be issued as a Global Security, then the Company shall execute and the Trustee shall, in accordance with Section 2.04, authenticate and deliver, a Global Security that (i) shall represent, and shall be denominated in an amount equal to the aggregate principal amount of, all of the Outstanding Securities of such series, (ii) shall be registered in the name of the Depository or its nominee, (iii) shall be delivered by the Trustee to the Depository or pursuant to the Depository's instruction and (iv) shall bear a legend substantially to the following effect: "Except as otherwise provided in Section 2.11 of the Indenture, this Security may be transferred, in whole but not in part, only to another nominee of the Depository or to a successor Depository or to a nominee of such successor Depository."

(b) Notwithstanding the provisions of Section 2.05, the Global Security of a series may be transferred, in whole but not in part and in the manner provided in Section 2.05, only to another nominee of the Depository for such series, or to a successor Depository for such series selected or approved by the Company or to a nominee of such successor Depository.

(c) If at any time the Depository for a series of the Securities notifies the Company that it is unwilling or unable to continue as Depository for such series or if at any time the Depository for such series shall no longer be registered or in good standing under the Exchange Act, or other applicable statute or regulation, and a successor Depository for such series is not appointed by the Company within 90 days after the Company receives such notice or becomes aware of such condition, as the case may be, or if an Event of Default has occurred and is continuing and the Company has received a request from the Depository, this Section 2.11 shall no longer be applicable to the Securities of such series and the Company will execute, and subject to Section 2.04, the Trustee will authenticate and deliver the Securities of such series in definitive registered form without coupons, in authorized denominations, and in an aggregate principal amount equal to the principal amount of the Global Security of such series in exchange for such Global Security. In addition, the Company may at any time determine that the Securities of any series shall no longer be represented by a Global Security and that the provisions of this Section 2.11 shall no longer apply to the Securities of such series. In such event the Company will execute and, subject to Section 2.04, the

Trustee, upon receipt of an Officers' Certificate evidencing such determination by the Company, will authenticate and deliver the Securities of such series in definitive registered form without coupons, in authorized denominations, and in an aggregate principal amount equal to the principal amount of the Global Security of such series in exchange for such Global Security. Upon the exchange of the Global Security for such Securities in definitive registered form without coupons, in authorized denominations, the Global Security shall be canceled by the Trustee. Such Securities in definitive registered form issued in exchange for the Global Security pursuant to this Section 2.11(c) shall be registered in such names and in such authorized denominations as the Depository, pursuant to instructions from its direct or indirect participants or otherwise, shall instruct the Trustee. The Trustee shall deliver such Securities to the Depository for delivery to the Persons in whose names such Securities are so registered.

ARTICLE 3

REDEMPTION OF SECURITIES AND SINKING FUND PROVISIONS

Section 3.01 Redemption.

The Company may redeem the Securities of any series issued hereunder on and after the dates and in accordance with the terms established for such series pursuant to Section 2.01 hereof.

Section 3.02 Notice of Redemption.

(a) In case the Company shall desire to exercise such right to redeem all or, as the case may be, a portion of the Securities of any series in accordance with any right the Company reserved for itself to do so pursuant to Section 2.01 hereof, the Company shall, or shall cause the Trustee to, give notice of such redemption to holders of the Securities of such series to be redeemed by mailing, first class postage prepaid, a notice of such redemption not less than 30 days and not more than 90 days before the date fixed for redemption of that series to such holders at their last addresses as they shall appear upon the Security Register, unless a shorter period is specified in the Securities to be redeemed. Any notice that is mailed in the manner herein

14

provided shall be conclusively presumed to have been duly given, whether or not the registered holder receives the notice. In any case, failure duly to give such notice to the holder of any Security of any series designated for redemption in whole or in part, or any defect in the notice, shall not affect the validity of the proceedings for the redemption of any other Securities of such series or any other series. In the case of any redemption of Securities prior to the expiration of any restriction on such redemption provided in the terms of such Securities or elsewhere in this Indenture, the Company shall furnish the Trustee with an Officers' Certificate evidencing compliance with any such restriction.

Each such notice of redemption shall specify the date fixed for redemption and the redemption price at which Securities of that series are to be redeemed, and shall state that payment of the redemption price of such Securities to be redeemed will be made at the office or agency of the Company in the Borough of Manhattan, the City and State of New York, upon presentation and surrender of such Securities, that interest accrued to the date fixed for redemption will be paid as specified in said notice, that from and after said date interest will cease to accrue and that the redemption is for a sinking fund, if such is the case. If less than all the Securities of a series are to be redeemed, the notice to the holders of Securities of that series to be redeemed in part shall specify the particular Securities to be so redeemed.

In case any Security is to be redeemed in part only, the notice that relates to such Security shall state the portion of the principal amount thereof to be redeemed, and shall state that on and after the redemption date, upon surrender of such Security, a new Security or Securities of such series in principal amount equal to the unredeemed portion thereof will be issued.

(b) If less than all the Securities of a series are to be redeemed, the Company shall give the Trustee at least 45 days' notice (unless a shorter notice shall be satisfactory to the Trustee) in advance of the date fixed for redemption as to the aggregate principal amount of Securities of the series to be redeemed, and thereupon the Trustee shall select, by lot or in such other manner as it shall deem appropriate and fair in its discretion and that may provide for the selection of a portion or portions (equal to one thousand U.S. dollars (\$1,000) or any integral multiple thereof) of the principal amount of such Securities of a denomination larger than \$1,000, the Securities to be redeemed and shall thereafter promptly notify the Company in writing of the numbers of the Securities to be redeemed, in whole or in part. The Company may, if and whenever it shall so elect, by delivery of instructions signed on its behalf by an Officer, instruct the Trustee or any paying agent to call all or any part of the Securities of a particular series for redemption and to give notice of redemption in the manner set forth in this Section, such notice to be in the name of the Company or its own name as the Trustee or such paying agent may deem advisable. In any case in which notice of redemption is to be given by the Trustee or any such paying agent, the Company shall deliver or cause to be delivered to, or permit to remain with, the Trustee or such paying agent, as the case may be, such Security Register, transfer books or other records, or suitable copies or extracts therefrom, sufficient to enable the Trustee or such paying agent to give any notice by mail that may be required under the provisions of this Section.

Section 3.03 Payment Upon Redemption.

(a) If the giving of notice of redemption shall have been completed as above provided, the Securities or portions of Securities of the series to be redeemed specified in such

15

notice shall become due and payable on the date and at the place stated in such notice at the applicable redemption price, together with interest accrued to the date fixed for redemption and interest on such Securities or portions of Securities shall cease to accrue on and after the date fixed for redemption, unless the Company shall default in the payment of such redemption price and accrued interest with respect to any such Security or portion thereof. On presentation and surrender of such Securities on or after the date fixed for redemption at the place of payment specified in the notice, said Securities shall be paid and redeemed at the applicable redemption price for such series, together with interest accrued thereon to the date fixed for redemption (but if the date fixed for redemption is an interest payment date, the interest installment payable on such date shall be payable to the registered holder at the close of business on the applicable record date pursuant to Section 2.03).

(b) Upon presentation of any Security of such series that is to be redeemed in part only, the Company shall execute and the Trustee shall authenticate and the office or agency where the Security is presented shall deliver to the holder thereof, at the expense of the Company, a new Security of the same series of authorized denominations in principal amount equal to the unredeemed portion of the Security so presented.

Section 3.04 Sinking Fund.

The provisions of Sections 3.04, 3.05 and 3.06 shall be applicable to any sinking fund for the retirement of Securities of a series, except as otherwise specified as contemplated by Section 2.01 for Securities of such series.

The minimum amount of any sinking fund payment provided for by the terms of Securities of any series is herein referred to as a “mandatory sinking fund payment,” and any payment in excess of such minimum amount provided for by the terms of Securities of any series is herein referred to as an “optional sinking fund payment”. If provided for by the terms of Securities of any series, the cash amount of any sinking fund payment may be subject to reduction as provided in Section 3.05. Each sinking fund payment shall be applied to the redemption of Securities of any series as provided for by the terms of Securities of such series.

Section 3.05 Satisfaction of Sinking Fund Payments with Securities.

The Company (i) may deliver Outstanding Securities of a series and (ii) may apply as a credit Securities of a series that have been redeemed either at the election of the Company pursuant to the terms of such Securities or through the application of permitted optional sinking fund payments pursuant to the terms of such Securities, in each case in satisfaction of all or any part of any sinking fund payment with respect to the Securities of such series required to be made pursuant to the terms of such Securities as provided for by the terms of such series, provided that such Securities have not been previously so credited. Such Securities shall be received and credited for such purpose by the Trustee at the redemption price specified in such Securities for redemption through operation of the sinking fund and the amount of such sinking fund payment shall be reduced accordingly.

16

Section 3.06 Redemption of Securities for Sinking Fund.

Not less than 45 days prior to each sinking fund payment date for any series of Securities (unless a shorter period shall be satisfactory to the Trustee), the Company will deliver to the Trustee an Officers' Certificate specifying the amount of the next ensuing sinking fund payment for that series pursuant to the terms of the series, the portion thereof, if any, that is to be satisfied by delivering and crediting Securities of that series pursuant to Section 3.05 and the basis for such credit and will, together with such Officers' Certificate, deliver to the Trustee any Securities to be so delivered. Not less than 30 days before each such sinking fund payment date the Trustee shall select the Securities to be redeemed upon such sinking fund payment date in the manner specified in Section 3.02 and cause notice of the redemption thereof to be given in the name of and at the expense of the Company in the manner provided in Section 3.02. Such notice having been duly given, the redemption of such Securities shall be made upon the terms and in the manner stated in Section 3.03.

ARTICLE 4

COVENANTS

Section 4.01 Payment of Principal, Premium and Interest

The Company will duly and punctually pay or cause to be paid the principal of (and premium, if any) and interest on the Securities of that series at the time and place and in the manner provided herein and established with respect to such Securities. Payments of principal on the Securities may be made at the time provided herein and established with respect to such Securities by U.S. dollar check drawn on and mailed to the address of the Securityholder entitled thereto as such address shall appear in the Security Register, or U.S. dollar wire transfer to, a U.S. dollar account (such wire transfer to be made only to a Securityholder of an aggregate principal amount of Securities of the applicable series in excess of U.S. \$2,000,000 and only if such Securityholder shall have furnished wire instructions to the Trustee no later than 15 days prior to the relevant payment date). Payments of interest on the Securities may be made at the time provided herein and established with respect to such Securities by U.S. dollar check mailed to the address of the Securityholder entitled thereto as such address shall appear in the Security Register, or U.S. dollar wire transfer to, a U.S. dollar account (such a wire transfer to be made only to a Securityholder of an aggregate principal amount of Securities of the applicable series in excess of U.S. \$2,000,000 and only if such Securityholder shall have furnished wire instructions in writing to the Security Registrar and the Trustee no later than 15 days prior to the relevant payment date).

Section 4.02 Maintenance of Office or Agency.

So long as any series of the Securities remain Outstanding, the Company agrees to maintain an office or agency in the Borough of Manhattan, the City and State of New York, with respect to each such series and at such other location or locations as may be designated as provided in this Section 4.02, where (i) Securities of that series may be presented for payment, (ii) Securities of that series may be presented as herein above authorized for registration of transfer and exchange, and (iii) notices and demands to or upon the Company in respect of the

17

Securities of that series and this Indenture may be given or served, such designation to continue with respect to such office or agency until the Company shall, by written notice signed by any officer authorized to sign an Officers' Certificate and delivered to the Trustee, designate some other office or agency for such purposes or any of them. If at any time the Company shall fail to maintain any such required office or agency or shall fail to furnish the Trustee with the address thereof, such presentations, notices and demands may be made or served at the Corporate Trust Office of the Trustee, and the Company hereby appoints the Trustee as its agent to receive all such presentations, notices and demands. The Company initially appoints the Corporate Trust Office of the Trustee located in the Borough of Manhattan, the City of New York as its paying agent with respect to the Securities.

Section 4.03 Paying Agents.

(a) If the Company shall appoint one or more paying agents for all or any series of the Securities, other than the Trustee, the Company will cause each such paying agent to execute and deliver to the Trustee an instrument in which such agent shall agree with the Trustee, subject to the provisions of this Section:

- (1) that it will hold all sums held by it as such agent for the payment of the principal of (and premium, if any) or interest on the Securities of that series (whether such sums have been paid to it by the Company or by any other obligor of such Securities) in trust for the benefit of the Persons entitled thereto;
- (2) that it will give the Trustee notice of any failure by the Company (or by any other obligor of such Securities) to make any payment of the principal of (and premium, if any) or interest on the Securities of that series when the same shall be due and payable;
- (3) that it will, at any time during the continuance of any failure referred to in the preceding paragraph (a)(2) above, upon the written request of the Trustee, forthwith pay to the Trustee all sums so held in trust by such paying agent; and
- (4) that it will perform all other duties of paying agent as set forth in this Indenture.

(b) If the Company shall act as its own paying agent with respect to any series of the Securities, it will on or before each due date of the principal of (and premium, if any) or interest on Securities of that series, set aside, segregate and hold in trust for the benefit of the Persons entitled thereto a sum sufficient to pay such

principal (and premium, if any) or interest so becoming due on Securities of that series until such sums shall be paid to such Persons or otherwise disposed of as herein provided and will promptly notify the Trustee of such action, or any failure (by it or any other obligor on such Securities) to take such action. Whenever the Company shall have one or more paying agents for any series of Securities, it will, prior to each due date of the principal of (and premium, if any) or interest on any Securities of that series, deposit with the paying agent a sum sufficient to pay the principal (and premium, if any) or interest so becoming due, such sum to be held in trust for the benefit of the Persons entitled to

such principal, premium or interest, and (unless such paying agent is the Trustee) the Company will promptly notify the Trustee of this action or failure so to act.

(c) Notwithstanding anything in this Section to the contrary, (i) the agreement to hold sums in trust as provided in this Section is subject to the provisions of Section 11.05, and (ii) the Company may at any time, for the purpose of obtaining the satisfaction and discharge of this Indenture or for any other purpose, pay, or direct any paying agent to pay, to the Trustee all sums held in trust by the Company or such paying agent, such sums to be held by the Trustee upon the same terms and conditions as those upon which such sums were held by the Company or such paying agent; and, upon such payment by the Company or any paying agent to the Trustee, the Company or such paying agent shall be released from all further liability with respect to such money.

Section 4.04 Appointment to Fill Vacancy in Office of Trustee.

The Company, whenever necessary to avoid or fill a vacancy in the office of Trustee, will appoint, in the manner provided in Section 7.10, a Trustee, so that there shall at all times be a Trustee hereunder.

Section 4.05 Compliance with Consolidation Provisions

The Company will not, while any of the Securities remain Outstanding, consolidate with or merge into any other Person, in either case where the Company is not the survivor of such transaction, or sell or convey all or substantially all of its property to any other Person unless the provisions of Article Ten hereof are complied with.

ARTICLE 5

SECURITYHOLDERS' LISTS AND REPORTS BY THE COMPANY AND THE TRUSTEE

Section 5.01 Company to Furnish Trustee Names and Addresses of Securityholders

The Company will furnish or cause to be furnished to the Trustee (a) within 15 days after each regular record date (as defined in Section 2.03) a list, in such form as the Trustee may reasonably require, of the names and addresses of the holders of each series of Securities as of such regular record date, provided that the Company shall not be obligated to furnish or cause to furnish such list at any time that the list shall not differ in any respect from the most recent list furnished to the Trustee by the Company and (b) at such other times as the Trustee may request in writing within 30 days after the receipt by the Company of any such request, a list of similar form and content as of a date not more than 15 days prior to the time such list is furnished; provided, however, that, in either case, no such list need be furnished for any series for which the Trustee shall be the Security Registrar.

Section 5.02 Preservation Of Information; Communications With Securityholders

(a) The Trustee shall preserve, in as current a form as is reasonably practicable, all information as to the names and addresses of the holders of Securities contained in the most recent list furnished to it as provided in Section 5.01 and as to the names and addresses of holders of Securities received by the Trustee in its capacity as Security Registrar (if acting in such capacity).

(b) The Trustee may destroy any list furnished to it as provided in Section 5.01 upon receipt of a new list so furnished.

(c) Securityholders may communicate as provided in Section 312(b) of the Trust Indenture Act with other Securityholders with respect to their rights under this Indenture or under the Securities, and, in connection with any such communications, the Trustee shall satisfy its obligations under Section 312(b) of the Trust Indenture Act in accordance with the provisions of Section 312(b) of the Trust Indenture Act.

Section 5.03 Reports by the Company.

The Company covenants and agrees to provide a copy to the Trustee, after the Company files the same with the Securities and Exchange Commission, copies of the annual reports and of the information, documents and other reports (or copies of such portions of any of the foregoing as the Securities and Exchange Commission may from time to time by rules and regulations prescribe) that the Company files with the Securities and Exchange Commission pursuant to Section 13 or Section 15(d) of the Exchange Act; provided, however, the Company shall not be required to deliver to the Trustee any materials for which the Company has sought and received confidential treatment by the SEC.

Section 5.04 Reports by the Trustee.

(a) If required by Section 313(a) of the Trust Indenture Act, the Trustee, within sixty (60) days after each May 1, shall transmit by mail, first class postage prepaid, to the Securityholders, as their names and addresses appear upon the Security Register, a brief report dated as of such May 1, which complies with Section 313(a) of the Trust Indenture Act.

(b) The Trustee shall comply with Section 313(b) and 313(c) of the Trust Indenture Act.

(c) A copy of each such report shall, at the time of such transmission to Securityholders, be filed by the Trustee with the Company, with each securities exchange upon which any Securities are listed (if so listed) and also with the Securities and Exchange Commission. The Company agrees to notify the Trustee when any Securities become listed on any securities exchange.

ARTICLE 6
REMEDIES OF THE TRUSTEE AND SECURITYHOLDERS ON EVENT OF DEFAULT
Section 6.01 Events of Default.

(a) Whenever used herein with respect to Securities of a particular series, “*Event of Default*” means any one or more of the following events that has occurred and is continuing:

(1) the Company defaults in the payment of any installment of interest upon any of the Securities of that series, as and when the same shall become due and payable, and such default continues for a period of 90 days; provided, however, that a valid extension of an interest payment period by the Company in accordance with the terms of any indenture supplemental hereto shall not constitute a default in the payment of interest for this purpose;

(2) the Company defaults in the payment of the principal of (or premium, if any, on) any of the Securities of that series as and when the same shall become due and payable whether at maturity, upon redemption, by declaration or otherwise, or in any payment required by any sinking or analogous fund established with respect to that series; provided, however, that a valid extension of the maturity of such Securities in accordance with the terms of any indenture supplemental hereto shall not constitute a default in the payment of principal or premium, if any;

(3) the Company fails to observe or perform any other of its covenants or agreements with respect to that series contained in this Indenture or otherwise established with respect to that series of Securities pursuant to Section 2.01 hereof (other than a covenant or agreement that has been expressly included in this Indenture solely for the benefit of one or more series of Securities other than such series) for a period of 90 days after the date on which written notice of such failure, requiring the same to be remedied and stating that such notice is a “Notice of Default” hereunder, shall have been given to the Company by the Trustee, by registered or certified mail, or to the Company and the Trustee by the holders of at least 25% in principal amount of the Securities of that series at the time Outstanding;

(4) the Company pursuant to or within the meaning of any Bankruptcy Law (i) commences a voluntary case, (ii) consents to the entry of an order for relief against it in an involuntary case, (iii) consents to the appointment of a Custodian of it or for all or substantially all of its property or (iv) makes a general assignment for the benefit of its creditors; or

(5) a court of competent jurisdiction enters an order under any Bankruptcy Law that (i) is for relief against the Company in an involuntary case, (ii) appoints a Custodian of the Company for all or substantially all of its property or (iii) orders the liquidation of the Company, and the order or decree remains unstayed and in effect for 90 days.

(b) In each and every such case (other than an Event of Default specified in clause (4) or clause (5) above), unless the principal of all the Securities of that series shall have already become due and payable, either the Trustee or the holders of not less than 25% in

aggregate principal amount of the Securities of that series then Outstanding hereunder, by notice in writing to the Company (and to the Trustee if given by such Securityholders), may declare the principal of (and premium, if any, on) and accrued and unpaid interest on all the Securities of that series to be due and payable immediately, and upon any such declaration the same shall become and shall be immediately due and payable. If an Event of Default specified in clause (4) or clause (5) above occurs, the principal of and accrued and unpaid interest on all the Securities of that series shall automatically be immediately due and payable without any declaration or other act on the part of the Trustee or the holders of the Securities.

(c) At any time after the principal of (and premium, if any, on) and accrued and unpaid interest on the Securities of that series shall have been so declared due and payable, and before any judgment or decree for the payment of the moneys due shall have been obtained or entered as hereinafter provided, the holders of a majority in aggregate principal amount of the Securities of that series then Outstanding hereunder, by written notice to the Company and the Trustee, may rescind and annul such declaration and its consequences if: (i) the Company has paid or deposited with the Trustee a sum sufficient to pay all matured installments of interest upon all the Securities of that series and the principal of (and premium, if any, on) any and all Securities of that series that shall have become due otherwise than by acceleration (with interest upon such principal and premium, if any, and, to the extent that such payment is enforceable under applicable law, upon overdue installments of interest, at the rate per annum expressed in the Securities of that series to the date of such payment or deposit) and the amount payable to the Trustee under Section 7.06, and (ii) any and all Events of Default under the Indenture with respect to such series, other than the nonpayment of principal on (and premium, if any, on) and accrued and unpaid interest on Securities of that series that shall not have become due by their terms, shall have been remedied or waived as provided in Section 6.06.

No such rescission and annulment shall extend to or shall affect any subsequent default or impair any right consequent thereon.

(d) In case the Trustee shall have proceeded to enforce any right with respect to Securities of that series under this Indenture and such proceedings shall have been discontinued or abandoned because of such rescission or annulment or for any other reason or shall have been determined adversely to the Trustee, then and in every such case, subject to any determination in such proceedings, the Company and the Trustee shall be restored respectively to their former positions and rights hereunder, and all rights, remedies and powers of the Company and the Trustee shall continue as though no such proceedings had been taken.

Section 6.02 Collection of Indebtedness and Suits for Enforcement by Trustee

(a) The Company covenants that (i) in case it shall default in the payment of any installment of interest on any of the Securities of a series, or in any payment required by any sinking or analogous fund established with respect to that series as and when the same shall have become due and payable, and such default shall have continued for a period of 90 Business Days, or (ii) in case it shall default in the payment of the principal of (or premium, if any, on) any of the Securities of a series when the same shall have become due and payable, whether upon maturity of the Securities of a series or upon redemption or upon declaration or otherwise then, upon demand of the Trustee, the Company will pay to the Trustee, for the benefit of the holders of the

Securities of that series, the whole amount that then shall have been become due and payable on all such Securities for principal (and premium, if any) or interest, or both, as the case may be, with interest upon the overdue principal (and premium, if any) and (to the extent that payment of such interest is enforceable under applicable law) upon overdue installments of interest at the rate per annum expressed in the Securities of that series; and, in addition thereto, such further amount as shall be sufficient to cover the costs and expenses of collection, and the amount payable to the Trustee under Section 7.06.

(b) If the Company shall fail to pay such amounts forthwith upon such demand, the Trustee, in its own name and as trustee of an express trust, shall be entitled and empowered to institute any action or proceedings at law or in equity for the collection of the sums so due and unpaid, and may prosecute any such action or proceeding to judgment or final decree, and may enforce any such judgment or final decree against the Company or other obligor upon the Securities of that series and collect the moneys adjudged or decreed to be payable in the manner provided by law or equity out of the property of the Company or other obligor upon the Securities of that series, wherever situated.

(c) In case of any receivership, insolvency, liquidation, bankruptcy, reorganization, readjustment, arrangement, composition or judicial proceedings affecting the Company, or its creditors or property, the Trustee shall have power to intervene in such proceedings and take any action therein that may be permitted by the court and shall (except as may be otherwise provided by law) be entitled to file such proofs of claim and other papers and documents as may be necessary or advisable in order to have the claims of the Trustee and of the holders of Securities of such series allowed for the entire amount due and payable by the Company under the Indenture at the date of institution of such proceedings and for any additional amount that may become due and payable by the Company after such date, and to collect and receive any moneys or other property payable or deliverable on any such claim, and to distribute the same after the deduction of the amount payable to the Trustee under Section 7.06; and any receiver, assignee or trustee in bankruptcy or reorganization is hereby authorized by each of the holders of Securities of such series to make such payments to the Trustee, and, in the event that the Trustee shall consent to the making of such payments directly to such Securityholders, to pay to the Trustee any amount due it under Section 7.06.

(d) All rights of action and of asserting claims under this Indenture, or under any of the terms established with respect to Securities of that series, may be enforced by the Trustee without the possession of any of such Securities, or the production thereof at any trial or other proceeding relative thereto, and any such suit or proceeding instituted by the Trustee shall be brought in its own name as trustee of an express trust, and any recovery of judgment shall, after provision for payment to the Trustee of any amounts due under Section 7.06, be for the ratable benefit of the holders of the Securities of such series.

In case of an Event of Default hereunder, the Trustee may in its discretion proceed to protect and enforce the rights vested in it by this Indenture by such appropriate judicial proceedings as the Trustee shall deem most effectual to protect and enforce any of such rights, either at law or in equity or in bankruptcy or otherwise, whether for the specific enforcement of any covenant or agreement contained in the Indenture or in aid of the exercise of any power

granted in this Indenture, or to enforce any other legal or equitable right vested in the Trustee by this Indenture or by law.

Nothing contained herein shall be deemed to authorize the Trustee to authorize or consent to or accept or adopt on behalf of any Securityholder any plan of reorganization, arrangement, adjustment or composition affecting the Securities of that series or the rights of any holder thereof or to authorize the Trustee to vote in respect of the claim of any Securityholder in any such proceeding.

Section 6.03 Application of Moneys Collected.

Any moneys collected by the Trustee pursuant to this Article with respect to a particular series of Securities shall be applied in the following order, at the date or dates fixed by the Trustee and, in case of the distribution of such moneys on account of principal (or premium, if any) or interest, upon presentation of the Securities of that series, and notation thereon of the payment, if only partially paid, and upon surrender thereof if fully paid:

FIRST: To the payment of all indebtedness of the Company to which such series of Securities is subordinated to the extent required by Section 7.06 and Article Fourteen;

SECOND: To the payment of reasonable costs and expenses of collection and of all amounts payable to the Trustee under Section 7.06;

THIRD: To the payment of the amounts then due and unpaid upon Securities of such series for principal (and premium, if any) and interest, in respect of which or for the benefit of which such money has been collected, ratably, without preference or priority of any kind, according to the amounts due and payable on such Securities for principal (and premium, if any) and interest, respectively; and

FOURTH: To the payment of the remainder, if any, to the Company or any other Person lawfully entitled thereto.

Section 6.04 Limitation on Suits

No holder of any Security of any series shall have any right by virtue or by availing of any provision of this Indenture to institute any suit, action or proceeding in equity or at law upon or under or with respect to this Indenture or for the appointment of a receiver or trustee, or for any other remedy hereunder, unless (i) such holder previously shall have given to the Trustee written notice of an Event of Default and of the continuance thereof with respect to the Securities of such series specifying such Event of Default, as hereinbefore provided; (ii) the holders of not less than 25% in aggregate principal amount of the Securities of such series then Outstanding shall have made written request upon the Trustee to institute such action, suit or proceeding in its own name as Trustee hereunder; (iii) such holder or holders shall have offered to the Trustee such reasonable indemnity as it may require against the costs, expenses and liabilities to be incurred therein or thereby; (iv) the Trustee for 90 days after its receipt of such notice, request and offer of indemnity, shall have failed to institute any such action, suit or proceeding and (v) during such 90

day period, the holders of a majority in principal amount of the Securities of that series do not give the Trustee a direction inconsistent with the request.

Notwithstanding anything contained herein to the contrary or any other provisions of this Indenture, the right of any holder of any Security to receive payment of the principal of (and premium, if any) and interest on such Security, as therein provided, on or after the respective due dates expressed in such Security (or in the case of redemption, on the redemption date), or to institute suit for the enforcement of any such payment on or after such respective dates or redemption date, shall not be impaired or affected without the consent of such holder and by accepting a Security hereunder it is expressly understood, intended and covenanted by the taker and holder of every Security of such series with every other such taker and holder and the Trustee, that no one or more holders of Securities of such series shall have any right in any manner whatsoever by virtue or by availing of any provision of this Indenture to affect, disturb or prejudice the rights of the holders of any other of such Securities, or to obtain or seek to obtain priority over or preference to any other such holder, or to enforce any right under this Indenture, except in the manner herein provided and for the equal, ratable

and common benefit of all holders of Securities of such series. For the protection and enforcement of the provisions of this Section, each and every Securityholder and the Trustee shall be entitled to such relief as can be given either at law or in equity.

Section 6.05 Rights and Remedies Cumulative; Delay or Omission Not Waiver

(a) Except as otherwise provided in Section 2.07, all powers and remedies given by this Article to the Trustee or to the Securityholders shall, to the extent permitted by law, be deemed cumulative and not exclusive of any other powers and remedies available to the Trustee or the holders of the Securities, by judicial proceedings or otherwise, to enforce the performance or observance of the covenants and agreements contained in this Indenture or otherwise established with respect to such Securities.

(b) No delay or omission of the Trustee or of any holder of any of the Securities to exercise any right or power accruing upon any Event of Default occurring and continuing as aforesaid shall impair any such right or power, or shall be construed to be a waiver of any such default or an acquiescence therein; and, subject to the provisions of Section 6.04, every power and remedy given by this Article or by law to the Trustee or the Securityholders may be exercised from time to time, and as often as shall be deemed expedient, by the Trustee or by the Securityholders.

Section 6.06 Control by Securityholders

The holders of a majority in aggregate principal amount of the Securities of any series at the time Outstanding, determined in accordance with Section 8.04, shall have the right to direct the time, method and place of conducting any proceeding for any remedy available to the Trustee, or exercising any trust or power conferred on the Trustee with respect to such series; provided, however, that such direction shall not be in conflict with any rule of law or with this Indenture. Subject to the provisions of Section 7.01, the Trustee shall have the right to decline to follow any such direction if the Trustee in good faith shall, by a Responsible Officer or officers of the Trustee, determine that the proceeding so directed, subject to the Trustee's duties under the Trust

25

Indenture Act, would involve the Trustee in personal liability or might be unduly prejudicial to the Securityholders not involved in the proceeding. The holders of a majority in aggregate principal amount of the Securities of any series at the time Outstanding affected thereby, determined in accordance with Section 8.04, may on behalf of the holders of all of the Securities of such series waive any past default in the performance of any of the covenants contained herein or established pursuant to Section 2.01 with respect to such series and its consequences, except a default in the payment of the principal of, or premium, if any, or interest on, any of the Securities of that series as and when the same shall become due by the terms of such Securities otherwise than by acceleration (unless such default has been cured and a sum sufficient to pay all matured installments of interest and principal and any premium has been deposited with the Trustee (in accordance with Section 6.01(c)). Upon any such waiver, the default covered thereby shall be deemed to be cured for all purposes of this Indenture and the Company, the Trustee and the holders of the Securities of such series shall be restored to their former positions and rights hereunder, respectively; but no such waiver shall extend to any subsequent or other default or impair any right consequent thereon.

Section 6.07 Undertaking to Pay Costs.

All parties to this Indenture agree, and each holder of any Securities by such holder's acceptance thereof shall be deemed to have agreed, that any court may in its discretion require, in any suit for the enforcement of any right or remedy under this Indenture, or in any suit against the Trustee for any action taken or omitted by it as Trustee, the filing by any party litigant in such suit of an undertaking to pay the costs of such suit, and that such court may in its discretion assess reasonable costs, including reasonable attorneys' fees, against any party litigant in such suit, having due regard to the merits and good faith of the claims or defenses made by such party litigant; but the provisions of this Section shall not apply to any suit instituted by the Trustee, to any suit instituted by any Securityholder, or group of Securityholders, holding more than 10% in aggregate principal amount of the Outstanding Securities of any series, or to any suit instituted by any Securityholder for the enforcement of the payment of the principal of (or premium, if any) or interest on any Security of such series, on or after the respective due dates expressed in such Security or established pursuant to this Indenture.

ARTICLE 7

CONCERNING THE TRUSTEE

Section 7.01 Certain Duties and Responsibilities of Trustee.

(a) The Trustee, prior to the occurrence of an Event of Default with respect to the Securities of a series and after the curing of all Events of Default with respect to the Securities of that series that may have occurred, shall undertake to perform with respect to the Securities of such series such duties and only such duties as are specifically set forth in this Indenture, and no implied covenants shall be read into this Indenture against the Trustee. In case an Event of Default with respect to the Securities of a series has occurred (that has not been cured or waived), the Trustee shall exercise with respect to Securities of that series such of the rights and powers vested in it by this Indenture, and use the same degree of care and skill in their

26

exercise, as a prudent man would exercise or use under the circumstances in the conduct of his own affairs.

(b) No provision of this Indenture shall be construed to relieve the Trustee from liability for its own negligent action, its own negligent failure to act, or its own willful misconduct, except that:

(i) prior to the occurrence of an Event of Default with respect to the Securities of a series and after the curing or waiving of all such Events of Default with respect to that series that may have occurred:

(A) the duties and obligations of the Trustee shall with respect to the Securities of such series be determined solely by the express provisions of this Indenture, and the Trustee shall not be liable with respect to the Securities of such series except for the performance of such duties and obligations as are specifically set forth in this Indenture, and no implied covenants or obligations shall be read into this Indenture against the Trustee; and

(B) in the absence of bad faith on the part of the Trustee, the Trustee may with respect to the Securities of such series conclusively rely, as to the truth of the statements and the correctness of the opinions expressed therein, upon any certificates or opinions furnished to the Trustee and conforming to the requirements of this Indenture; but in the case of any such certificates or opinions that by any provision hereof are specifically required to be furnished to the Trustee, the Trustee shall be under a duty to examine the same to determine whether or not they conform to the requirement of this Indenture;

(ii) the Trustee shall not be liable for any error of judgment made in good faith by a Responsible Officer or Responsible Officers of the Trustee,

unless it shall be proved that the Trustee was negligent in ascertaining the pertinent facts;

(iii) the Trustee shall not be liable with respect to any action taken or omitted to be taken by it in good faith in accordance with the direction of the holders of not less than a majority in principal amount of the Securities of any series at the time Outstanding relating to the time, method and place of conducting any proceeding for any remedy available to the Trustee, or exercising any trust or power conferred upon the Trustee under this Indenture with respect to the Securities of that series; and

(iv) None of the provisions contained in this Indenture shall require the Trustee to expend or risk its own funds or otherwise incur personal financial liability in the performance of any of its duties or in the exercise of any of its rights or powers if there is reasonable ground for believing that the repayment of such funds or liability is not reasonably assured to it under the terms of this Indenture or adequate indemnity against such risk is not reasonably assured to it.

27

Section 7.02 Certain Rights of Trustee.

Except as otherwise provided in Section 7.01:

(a) The Trustee may rely and shall be protected in acting or refraining from acting upon any resolution, certificate, statement, instrument, opinion, report, notice, request, consent, order, approval, bond, security or other paper or document believed by it to be genuine and to have been signed or presented by the proper party or parties;

(b) Any request, direction, order or demand of the Company mentioned herein shall be sufficiently evidenced by a Board Resolution or an instrument signed in the name of the Company by any authorized officer of the Company (unless other evidence in respect thereof is specifically prescribed herein);

(c) The Trustee may consult with counsel and the written advice of such counsel or any Opinion of Counsel shall be full and complete authorization and protection in respect of any action taken or suffered or omitted hereunder in good faith and in reliance thereon;

(d) The Trustee shall be under no obligation to exercise any of the rights or powers vested in it by this Indenture at the request, order or direction of any of the Securityholders pursuant to the provisions of this Indenture, unless such Securityholders shall have offered to the Trustee reasonable security or indemnity against the costs, expenses and liabilities that may be incurred therein or thereby; nothing contained herein shall, however, relieve the Trustee of the obligation, upon the occurrence of an Event of Default with respect to a series of the Securities (that has not been cured or waived), to exercise with respect to Securities of that series such of the rights and powers vested in it by this Indenture, and to use the same degree of care and skill in their exercise, as a prudent man would exercise or use under the circumstances in the conduct of his own affairs;

(e) The Trustee shall not be liable for any action taken or omitted to be taken by it in good faith and believed by it to be authorized or within the discretion or rights or powers conferred upon it by this Indenture;

(f) The Trustee shall not be bound to make any investigation into the facts or matters stated in any resolution, certificate, statement, instrument, opinion, report, notice, request, consent, order, approval, bond, security, or other papers or documents, unless requested in writing so to do by the holders of not less than a majority in principal amount of the Outstanding Securities of the particular series affected thereby (determined as provided in Section 8.04); provided, however, that if the payment within a reasonable time to the Trustee of the costs, expenses or liabilities likely to be incurred by it in the making of such investigation is, in the opinion of the Trustee, not reasonably assured to the Trustee by the security afforded to it by the terms of this Indenture, the Trustee may require reasonable indemnity against such costs, expenses or liabilities as a condition to so proceeding. The reasonable expense of every such examination shall be paid by the Company or, if paid by the Trustee, shall be repaid by the Company upon demand; and

28

(g) The Trustee may execute any of the trusts or powers hereunder or perform any duties hereunder either directly or by or through agents or attorneys and the Trustee shall not be responsible for any misconduct or negligence on the part of any agent or attorney appointed with due care by it hereunder.

In addition, the Trustee shall not be deemed to have knowledge of any Default or Event of Default except (1) any Event of Default occurring pursuant to Sections 6.01(a)(1), 6.01(a)(2) and 4.01 hereof or (2) any Default or Event of Default of which the Trustee shall have received written notification in the manner set forth in this Indenture or a Responsible Officer of the Trustee shall have obtained actual knowledge. Delivery of reports, information and documents to the Trustee under Section 5.03 is for informational purposes only and the information and the Trustee's receipt of the foregoing shall not constitute constructive notice of any information contained therein, or determinable from information contained therein including the Company's compliance with any of their covenants thereunder (as to which the Trustee is entitled to rely exclusively on an Officers' Certificate).

Section 7.03 Trustee Not Responsible for Recitals or Issuance or Securities

(a) The recitals contained herein and in the Securities shall be taken as the statements of the Company, and the Trustee assumes no responsibility for the correctness of the same.

(b) The Trustee makes no representations as to the validity or sufficiency of this Indenture or of the Securities.

(c) The Trustee shall not be accountable for the use or application by the Company of any of the Securities or of the proceeds of such Securities, or for the use or application of any moneys paid over by the Trustee in accordance with any provision of this Indenture or established pursuant to Section 2.01, or for the use or application of any moneys received by any paying agent other than the Trustee.

Section 7.04 May Hold Securities

The Trustee or any paying agent or Security Registrar, in its individual or any other capacity, may become the owner or pledgee of Securities with the same rights it would have if it were not Trustee, paying agent or Security Registrar.

Section 7.05 Moneys Held in Trust

Subject to the provisions of Section 11.05, all moneys received by the Trustee shall, until used or applied as herein provided, be held in trust for the purposes for

which they were received, but need not be segregated from other funds except to the extent required by law. The Trustee shall be under no liability for interest on any moneys received by it hereunder except such as it may agree with the Company to pay thereon.

Section 7.06 Compensation and Reimbursement.

(a) The Company covenants and agrees to pay to the Trustee, and the Trustee shall be entitled to, such reasonable compensation (which shall not be limited by any provision of law in regard to the compensation of a trustee of an express trust) as the Company and the Trustee may from time to time agree in writing, for all services rendered by it in the execution of the trusts hereby created and in the exercise and performance of any of the powers and duties hereunder of the Trustee, and, except as otherwise expressly provided herein, the Company will pay or reimburse the Trustee upon its request for all reasonable expenses, disbursements and advances incurred or made by the Trustee in accordance with any of the provisions of this Indenture (including the reasonable compensation and the expenses and disbursements of its counsel and of all Persons not regularly in its employ), except any such expense, disbursement or advance as may arise from its negligence or bad faith and except as the Company and Trustee may from time to time agree in writing. The Company also covenants to indemnify the Trustee (and its officers, agents, directors and employees) for, and to hold it harmless against, any loss, liability or expense incurred without negligence or bad faith on the part of the Trustee and arising out of or in connection with the acceptance or administration of this trust, including the reasonable costs and expenses of defending itself against any claim of liability in the premises.

(b) The obligations of the Company under this Section to compensate and indemnify the Trustee and to pay or reimburse the Trustee for reasonable expenses, disbursements and advances shall constitute indebtedness of the Company to which the Securities are subordinated. Such additional indebtedness shall be secured by a lien prior to that of the Securities upon all property and funds held or collected by the Trustee as such, except funds held in trust for the benefit of the holders of particular Securities.

Section 7.07 Reliance on Officers' Certificate.

Except as otherwise provided in Section 7.01, whenever in the administration of the provisions of this Indenture the Trustee shall deem it reasonably necessary or desirable that a matter be proved or established prior to taking or suffering or omitting to take any action hereunder, such matter (unless other evidence in respect thereof be herein specifically prescribed) may, in the absence of negligence or bad faith on the part of the Trustee, be deemed to be conclusively proved and established by an Officers' Certificate delivered to the Trustee and such certificate, in the absence of negligence or bad faith on the part of the Trustee, shall be full warrant to the Trustee for any action taken, suffered or omitted to be taken by it under the provisions of this Indenture upon the faith thereof.

Section 7.08 Disqualification; Conflicting Interests

If the Trustee has or shall acquire any "conflicting interest" within the meaning of Section 310(b) of the Trust Indenture Act, the Trustee and the Company shall in all respects comply with the provisions of Section 310(b) of the Trust Indenture Act.

Section 7.09 Corporate Trustee Required; Eligibility.

There shall at all times be a Trustee with respect to the Securities issued hereunder which shall at all times be a corporation organized and doing business under the laws of the United States of America or any state or territory thereof or of the District of Columbia, or a corporation or other Person permitted to act as trustee by the Securities and Exchange Commission, authorized under such laws to exercise corporate trust powers, having a combined capital and surplus of at least fifty million U.S. dollars (\$50,000,000), and subject to supervision or examination by federal, state, territorial, or District of Columbia authority.

If such corporation or other Person publishes reports of condition at least annually, pursuant to law or to the requirements of the aforesaid supervising or examining authority, then for the purposes of this Section, the combined capital and surplus of such corporation or other Person shall be deemed to be its combined capital and surplus as set forth in its most recent report of condition so published. The Company may not, nor may any Person directly or indirectly controlling, controlled by, or under common control with the Company, serve as Trustee. In case at any time the Trustee shall cease to be eligible in accordance with the provisions of this Section, the Trustee shall resign immediately in the manner and with the effect specified in Section 7.10.

Section 7.10 Resignation and Removal; Appointment of Successor.

(a) The Trustee or any successor hereafter appointed may at any time resign with respect to the Securities of one or more series by giving written notice thereof to the Company and by transmitting notice of resignation by mail, first class postage prepaid, to the Securityholders of such series, as their names and addresses appear upon the Security Register. Upon receiving such notice of resignation, the Company shall promptly appoint a successor trustee with respect to Securities of such series by written instrument, in duplicate, executed by order of the Board of Directors, one copy of which instrument shall be delivered to the resigning Trustee and one copy to the successor trustee. If no successor trustee shall have been so appointed and have accepted appointment within 30 days after the mailing of such notice of resignation, the resigning Trustee may petition any court of competent jurisdiction for the appointment of a successor trustee with respect to Securities of such series, or any Securityholder of that series who has been a bona fide holder of a Security or Securities for at least six months may on behalf of himself and all others similarly situated, petition any such court for the appointment of a successor trustee. Such court may thereupon after such notice, if any, as it may deem proper and prescribe, appoint a successor trustee.

(b) In case at any time any one of the following shall occur:

(i) the Trustee shall fail to comply with the provisions of Section 7.08 after written request therefor by the Company or by any Securityholder who has been a bona fide holder of a Security or Securities for at least six months; or

(ii) the Trustee shall cease to be eligible in accordance with the provisions of Section 7.09 and shall fail to resign after written request therefor by the Company or by any such Securityholder; or

(iii) the Trustee shall become incapable of acting, or shall be adjudged a bankrupt or insolvent, or commence a voluntary bankruptcy proceeding, or a receiver of the Trustee or of its property shall be appointed or consented to, or any public officer shall take charge or control of the Trustee or of its property or affairs for the purpose of rehabilitation, conservation or liquidation;

then, in any such case, the Company may remove the Trustee with respect to all Securities and appoint a successor trustee by written instrument, in duplicate, executed by order of the Board of Directors, one copy of which instrument shall be delivered to the Trustee so removed and one copy to the successor trustee, or any Securityholder who has been a bona fide holder of a Security or Securities for at least six months may, on behalf of that holder and all others similarly situated, petition any court of competent jurisdiction for the removal of the Trustee and the appointment of a successor trustee. Such court may thereupon after such notice, if any, as it may deem proper and prescribe, remove the Trustee and appoint a successor trustee.

(c) The holders of a majority in aggregate principal amount of the Securities of any series at the time Outstanding may at any time remove the Trustee with respect to such series by so notifying the Trustee and the Company and may appoint a successor Trustee for such series with the consent of the Company.

(d) Any resignation or removal of the Trustee and appointment of a successor trustee with respect to the Securities of a series pursuant to any of the provisions of this Section shall become effective upon acceptance of appointment by the successor trustee as provided in Section 7.11.

(e) Any successor trustee appointed pursuant to this Section may be appointed with respect to the Securities of one or more series or all of such series, and at any time there shall be only one Trustee with respect to the Securities of any particular series.

Section 7.11 Acceptance of Appointment By Successor.

(a) In case of the appointment hereunder of a successor trustee with respect to all Securities, every such successor trustee so appointed shall execute, acknowledge and deliver to the Company and to the retiring Trustee an instrument accepting such appointment, and thereupon the resignation or removal of the retiring Trustee shall become effective and such successor trustee, without any further act, deed or conveyance, shall become vested with all the rights, powers, trusts and duties of the retiring Trustee; but, on the request of the Company or the successor trustee, such retiring Trustee shall, upon payment of its charges, execute and deliver an instrument transferring to such successor trustee all the rights, powers, and trusts of the retiring Trustee and shall duly assign, transfer and deliver to such successor trustee all property and money held by such retiring Trustee hereunder.

(b) In case of the appointment hereunder of a successor trustee with respect to the Securities of one or more (but not all) series, the Company, the retiring Trustee and each successor trustee with respect to the Securities of one or more series shall execute and deliver an indenture supplemental hereto wherein each successor trustee shall accept such appointment and which (i) shall contain such provisions as shall be necessary or desirable to transfer and confirm

32

to, and to vest in, each successor trustee all the rights, powers, trusts and duties of the retiring Trustee with respect to the Securities of that or those series to which the appointment of such successor trustee relates, (ii) shall contain such provisions as shall be deemed necessary or desirable to confirm that all the rights, powers, trusts and duties of the retiring Trustee with respect to the Securities of that or those series as to which the retiring Trustee is not retiring shall continue to be vested in the retiring Trustee, and (iii) shall add to or change any of the provisions of this Indenture as shall be necessary to provide for or facilitate the administration of the trusts hereunder by more than one Trustee, it being understood that nothing herein or in such supplemental indenture shall constitute such Trustees co-trustees of the same trust, that each such Trustee shall be trustee of a trust or trusts hereunder separate and apart from any trust or trusts hereunder administered by any other such Trustee and that no Trustee shall be responsible for any act or failure to act on the part of any other Trustee hereunder; and upon the execution and delivery of such supplemental indenture the resignation or removal of the retiring Trustee shall become effective to the extent provided therein, such retiring Trustee shall with respect to the Securities of that or those series to which the appointment of such successor trustee relates have no further responsibility for the exercise of rights and powers or for the performance of the duties and obligations vested in the Trustee under this Indenture, and each such successor trustee, without any further act, deed or conveyance, shall become vested with all the rights, powers, trusts and duties of the retiring Trustee with respect to the Securities of that or those series to which the appointment of such successor trustee relates; but, on request of the Company or any successor trustee, such retiring Trustee shall duly assign, transfer and deliver to such successor trustee, to the extent contemplated by such supplemental indenture, the property and money held by such retiring Trustee hereunder with respect to the Securities of that or those series to which the appointment of such successor trustee relates.

(c) Upon request of any such successor trustee, the Company shall execute any and all instruments for more fully and certainly vesting in and confirming to such successor trustee all such rights, powers and trusts referred to in paragraph (a) or (b) of this Section, as the case may be.

(d) No successor trustee shall accept its appointment unless at the time of such acceptance such successor trustee shall be qualified and eligible under this Article.

(e) Upon acceptance of appointment by a successor trustee as provided in this Section, the Company shall transmit notice of the succession of such trustee hereunder by mail, first class postage prepaid, to the Securityholders, as their names and addresses appear upon the Security Register. If the Company fails to transmit such notice within ten days after acceptance of appointment by the successor trustee, the successor trustee shall cause such notice to be transmitted at the expense of the Company.

Section 7.12 Merger, Conversion, Consolidation or Succession to Business

Any corporation into which the Trustee may be merged or converted or with which it may be consolidated, or any corporation resulting from any merger, conversion or consolidation to which the Trustee shall be a party, or any corporation succeeding to the corporate trust business of the Trustee, including the administration of the trust created by this Indenture, shall be the successor of the Trustee hereunder, provided that such corporation shall be qualified under the

33

provisions of Section 7.08 and eligible under the provisions of Section 7.09, without the execution or filing of any paper or any further act on the part of any of the parties hereto, anything herein to the contrary notwithstanding. In case any Securities shall have been authenticated, but not delivered, by the Trustee then in office, any successor by merger, conversion or consolidation to such authenticating Trustee may adopt such authentication and deliver the Securities so authenticated with the same effect as if such successor Trustee had itself authenticated such Securities.

Section 7.13 Preferential Collection of Claims Against the Company

The Trustee shall comply with Section 311(a) of the Trust Indenture Act, excluding any creditor relationship described in Section 311(b) of the Trust Indenture Act.

A Trustee who has resigned or been removed shall be subject to Section 311(a) of the Trust Indenture Act to the extent included therein.

Section 7.14 Notice of Default

If any Default or any Event of Default occurs and is continuing and if such Default or Event of Default is known to a Responsible Officer of the Trustee, the Trustee shall mail to each Securityholder in the manner and to the extent provided in Section 313(c) of the Trust Indenture Act notice of the Default or Event of Default within 45 days after it occurs, unless such Default or Event of Default has been cured; *provided, however*, that, except in the case of a default in the payment of the principal of (or premium, if any) or interest on any Security, the Trustee shall be protected in withholding such notice if and so long as the board of directors, the executive committee or a trust committee of directors and/or Responsible Officers of the Trustee in good faith determine that the withholding of such notice is in the interest of the Securityholders.

ARTICLE 8

CONCERNING THE SECURITYHOLDERS

Section 8.01 Evidence of Action by Securityholders.

Whenever in this Indenture it is provided that the holders of a majority or specified percentage in aggregate principal amount of the Securities of a particular series may take any action (including the making of any demand or request, the giving of any notice, consent or waiver or the taking of any other action), the fact that at the time of taking any such action the holders of such majority or specified percentage of that series have joined therein may be evidenced by any instrument or any number of instruments of similar tenor executed by such holders of Securities of that series in person or by agent or proxy appointed in writing.

If the Company shall solicit from the Securityholders of any series any request, demand, authorization, direction, notice, consent, waiver or other action, the Company may, at its option, as evidenced by an Officers' Certificate, fix in advance a record date for such series for the determination of Securityholders entitled to give such request, demand, authorization, direction, notice, consent, waiver or other action, but the Company shall have no obligation to do so. If such a record date is fixed, such request, demand, authorization, direction, notice, consent,

34

waiver or other action may be given before or after the record date, but only the Securityholders of record at the close of business on the record date shall be deemed to be Securityholders for the purposes of determining whether Securityholders of the requisite proportion of Outstanding Securities of that series have authorized or agreed or consented to such request, demand, authorization, direction, notice, consent, waiver or other action, and for that purpose the Outstanding Securities of that series shall be computed as of the record date; provided, however, that no such authorization, agreement or consent by such Securityholders on the record date shall be deemed effective unless it shall become effective pursuant to the provisions of this Indenture not later than six months after the record date.

Section 8.02 Proof of Execution by Securityholders.

Subject to the provisions of Section 7.01, proof of the execution of any instrument by a Securityholder (such proof will not require notarization) or his agent or proxy and proof of the holding by any Person of any of the Securities shall be sufficient if made in the following manner:

- (a) The fact and date of the execution by any such Person of any instrument may be proved in any reasonable manner acceptable to the Trustee.
- (b) The ownership of Securities shall be proved by the Security Register of such Securities or by a certificate of the Security Registrar thereof.

The Trustee may require such additional proof of any matter referred to in this Section as it shall deem necessary.

Section 8.03 Who May be Deemed Owners

Prior to the due presentment for registration of transfer of any Security, the Company, the Trustee, any paying agent and any Security Registrar may deem and treat the Person in whose name such Security shall be registered upon the books of the Company as the absolute owner of such Security (whether or not such Security shall be overdue and notwithstanding any notice of ownership or writing thereon made by anyone other than the Security Registrar) for the purpose of receiving payment of or on account of the principal of, premium, if any, and (subject to Section 2.03) interest on such Security and for all other purposes; and neither the Company nor the Trustee nor any paying agent nor any Security Registrar shall be affected by any notice to the contrary.

Section 8.04 Certain Securities Owned by Company Disregarded.

In determining whether the holders of the requisite aggregate principal amount of Securities of a particular series have concurred in any direction, consent or waiver under this Indenture, the Securities of that series that are owned by the Company or any other obligor on the Securities of that series or by any Person directly or indirectly controlling or controlled by or under common control with the Company or any other obligor on the Securities of that series shall be disregarded and deemed not to be Outstanding for the purpose of any such determination, except that for the purpose of determining whether the Trustee shall be protected

35

in relying on any such direction, consent or waiver, only Securities of such series that the Trustee actually knows are so owned shall be so disregarded. The Securities so owned that have been pledged in good faith may be regarded as Outstanding for the purposes of this Section, if the pledgee shall establish to the satisfaction of the Trustee the pledgee's right so to act with respect to such Securities and that the pledgee is not a Person directly or indirectly controlling or controlled by or under direct or indirect common control with the Company or any such other obligor. In case of a dispute as to such right, any decision by the Trustee taken upon the advice of counsel shall be full protection to the Trustee.

Section 8.05 Actions Binding on Future Securityholders

At any time prior to (but not after) the evidencing to the Trustee, as provided in Section 8.01, of the taking of any action by the holders of the majority or percentage in aggregate principal amount of the Securities of a particular series specified in this Indenture in connection with such action, any holder of a Security of that series that is shown by the evidence to be included in the Securities the holders of which have consented to such action may, by filing written notice with the Trustee, and upon proof of holding as provided in Section 8.02, revoke such action so far as concerns such Security. Except as aforesaid any such action taken by the holder of any Security shall be conclusive and binding upon such holder and upon all future holders and owners of such Security, and of any Security issued in exchange therefor, on registration of transfer thereof or in place thereof, irrespective of whether or not any notation in regard thereto is made upon such Security. Any action taken by the holders of the majority or

percentage in aggregate principal amount of the Securities of a particular series specified in this Indenture in connection with such action shall be conclusively binding upon the Company, the Trustee and the holders of all the Securities of that series.

ARTICLE 9

SUPPLEMENTAL INDENTURES

Section 9.01 Supplemental Indentures Without the Consent of Securityholders

In addition to any supplemental indenture otherwise authorized by this Indenture, the Company and the Trustee may from time to time and at any time enter into an indenture or indentures supplemental hereto (which shall conform to the provisions of the Trust Indenture Act as then in effect), without the consent of the Securityholders, for one or more of the following purposes:

- (a) to cure any ambiguity, defect, or inconsistency herein or in the Securities of any series;
- (b) to comply with Article Ten;
- (c) to provide for uncertificated Securities in addition to or in place of certificated Securities;

36

(d) to add to the covenants, restrictions, conditions or provisions relating to the Company for the benefit of the holders of all or any series of Securities (and if such covenants, restrictions, conditions or provisions are to be for the benefit of less than all series of Securities, stating that such covenants, restrictions, conditions or provisions are expressly being included solely for the benefit of such series), to make the occurrence, or the occurrence and the continuance, of a default in any such additional covenants, restrictions, conditions or provisions an Event of Default, or to surrender any right or power herein conferred upon the Company;

(e) to add to, delete from, or revise the conditions, limitations, and restrictions on the authorized amount, terms, or purposes of issue, authentication, and delivery of Securities, as herein set forth;

(f) to make any change that does not adversely affect the rights of any Securityholder in any material respect;

(g) to provide for the issuance of and establish the form and terms and conditions of the Securities of any series as provided in Section 2.01, to establish the form of any certifications required to be furnished pursuant to the terms of this Indenture or any series of Securities, or to add to the rights of the holders of any series of Securities;

(h) to evidence and provide for the acceptance of appointment hereunder by a successor trustee; or

(i) to comply with any requirements of the Securities and Exchange Commission or any successor in connection with the qualification of this Indenture under the Trust Indenture Act.

The Trustee is hereby authorized to join with the Company in the execution of any such supplemental indenture, and to make any further appropriate agreements and stipulations that may be therein contained, but the Trustee shall not be obligated to enter into any such supplemental indenture that affects the Trustee's own rights, duties or immunities under this Indenture or otherwise.

Any supplemental indenture authorized by the provisions of this Section may be executed by the Company and the Trustee without the consent of the holders of any of the Securities at the time Outstanding, notwithstanding any of the provisions of Section 9.02.

Section 9.02 Supplemental Indentures With Consent of Securityholders

With the consent (evidenced as provided in Section 8.01) of the holders of not less than a majority in aggregate principal amount of the Securities of each series affected by such supplemental indenture or indentures at the time Outstanding, the Company, when authorized by a Board Resolution, and the Trustee may from time to time and at any time enter into an indenture or indentures supplemental hereto (which shall conform to the provisions of the Trust Indenture Act as then in effect) for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions of this Indenture or of any supplemental indenture or of modifying in any manner not covered by Section 9.01 the rights of the holders of the

37

Securities of such series under this Indenture; provided, however, that no such supplemental indenture shall, without the consent of the holders of each Security then Outstanding and affected thereby, (a) extend the fixed maturity of any Securities of any series, or reduce the principal amount thereof, or reduce the rate or extend the time of payment of interest thereon, or reduce any premium payable upon the redemption thereof or (b) reduce the aforesaid percentage of Securities, the holders of which are required to consent to any such supplemental indenture.

It shall not be necessary for the consent of the Securityholders of any series affected thereby under this Section to approve the particular form of any proposed supplemental indenture, but it shall be sufficient if such consent shall approve the substance thereof.

Section 9.03 Effect of Supplemental Indentures.

Upon the execution of any supplemental indenture pursuant to the provisions of this Article or of Section 10.01, this Indenture shall, with respect to such series, be and be deemed to be modified and amended in accordance therewith and the respective rights, limitations of rights, obligations, duties and immunities under this Indenture of the Trustee, the Company and the holders of Securities of the series affected thereby shall thereafter be determined, exercised and enforced hereunder subject in all respects to such modifications and amendments, and all the terms and conditions of any such supplemental indenture shall be and be deemed to be part of the terms and conditions of this Indenture for any and all purposes.

Section 9.04 Securities Affected by Supplemental Indentures.

Securities of any series affected by a supplemental indenture, authenticated and delivered after the execution of such supplemental indenture pursuant to the provisions of this Article or of Section 10.01, may bear a notation in form approved by the Company, provided such form meets the requirements of any securities exchange upon which such series may be listed, as to any matter provided for in such supplemental indenture. If the Company shall so determine, new Securities of that series so modified as to conform, in the opinion of the Board of Directors, to any modification of this Indenture contained in any such supplemental indenture may be prepared by the Company, authenticated by the Trustee and delivered in exchange for the Securities of that series then Outstanding.

Section 9.05 Execution of Supplemental Indentures.

Upon the request of the Company, accompanied by its Board Resolutions authorizing the execution of any such supplemental indenture, and upon the filing with the Trustee of evidence of the consent of Securityholders required to consent thereto as aforesaid, the Trustee shall join with the Company in the execution of such supplemental indenture unless such supplemental indenture affects the Trustee's own rights, duties or immunities under this Indenture or otherwise, in which case the Trustee may in its discretion but shall not be obligated to enter into such supplemental indenture. The Trustee, subject to the provisions of Section 7.01, may receive an Officers' Certificate or an Opinion of Counsel as conclusive evidence that any supplemental indenture executed pursuant to this Article is authorized or permitted by, and conforms to, the terms of this Article and that it is proper for the Trustee under the provisions of this Article to join in the execution thereof; provided, however, that such Officers' Certificate or Opinion of

38

Counsel need not be provided in connection with the execution of a supplemental indenture that establishes the terms of a series of Securities pursuant to Section 2.01 hereof.

Promptly after the execution by the Company and the Trustee of any supplemental indenture pursuant to the provisions of this Section, the Trustee shall transmit by mail, first class postage prepaid, a notice, setting forth in general terms the substance of such supplemental indenture, to the Securityholders of all series affected thereby as their names and addresses appear upon the Security Register. Any failure of the Trustee to mail such notice, or any defect therein, shall not, however, in any way impair or affect the validity of any such supplemental indenture.

**ARTICLE 10
SUCCESSOR ENTITY**

Section 10.01 Company May Consolidate, Etc.

Except as provided pursuant to Section 2.01 pursuant to a Board Resolution, and set forth in an Officers' Certificate, or established in one or more indentures supplemental to this Indenture, nothing contained in this Indenture shall prevent any consolidation or merger of the Company with or into any other Person (whether or not affiliated with the Company) or successive consolidations or mergers in which the Company or its successor or successors shall be a party or parties, or shall prevent any sale, conveyance, transfer or other disposition of the property of the Company or its successor or successors as an entirety, or substantially as an entirety, to any other corporation (whether or not affiliated with the Company or its successor or successors) authorized to acquire and operate the same; provided, however, (a) the Company hereby covenants and agrees that, upon any such consolidation or merger (in each case, if the Company is not the survivor of such transaction), sale, conveyance, transfer or other disposition, the due and punctual payment of the principal of (premium, if any) and interest on all of the Securities of all series in accordance with the terms of each series, according to their tenor, and the due and punctual performance and observance of all the covenants and conditions of this Indenture with respect to each series or established with respect to such series pursuant to Section 2.01 to be kept or performed by the Company shall be expressly assumed, by supplemental indenture (which shall conform to the provisions of the Trust Indenture Act, as then in effect) reasonably satisfactory in form to the Trustee executed and delivered to the Trustee by the entity formed by such consolidation, or into which the Company shall have been merged, or by the entity which shall have acquired such property and (b) in the event that the Securities of any series then Outstanding are convertible into or exchangeable for shares of common stock or other securities of the Company, such entity shall, by such supplemental indenture, make provision so that the Securityholders of Securities of that series shall thereafter be entitled to receive upon conversion or exchange of such Securities the number of securities or property to which a holder of the number of shares of common stock or other securities of the Company deliverable upon conversion or exchange of those Securities would have been entitled had such conversion or exchange occurred immediately prior to such consolidation, merger, sale, conveyance, transfer or other disposition.

39

Section 10.02 Successor Entity Substituted.

(a) In case of any such consolidation, merger, sale, conveyance, transfer or other disposition and upon the assumption by the successor entity by supplemental indenture, executed and delivered to the Trustee and satisfactory in form to the Trustee, of the obligations set forth under Section 10.01 on all of the Securities of all series Outstanding, such successor entity shall succeed to and be substituted for the Company with the same effect as if it had been named as the Company herein, and thereupon the predecessor corporation shall be relieved of all obligations and covenants under this Indenture and the Securities.

(b) In case of any such consolidation, merger, sale, conveyance, transfer or other disposition, such changes in phraseology and form (but not in substance) may be made in the Securities thereafter to be issued as may be appropriate.

(c) Nothing contained in this Article shall require any action by the Company in the case of a consolidation or merger of any Person into the Company where the Company is the survivor of such transaction, or the acquisition by the Company, by purchase or otherwise, of all or any part of the property of any other Person (whether or not affiliated with the Company).

Section 10.03 Evidence of Consolidation, Etc. to Trustee.

The Trustee, subject to the provisions of Section 7.01, may receive an Officers' Certificate or an Opinion of Counsel as conclusive evidence that any such consolidation, merger, sale, conveyance, transfer or other disposition, and any such assumption, comply with the provisions of this Article.

**ARTICLE 11
SATISFACTION AND DISCHARGE**

Section 11.01 Satisfaction and Discharge of Indenture.

If at any time: (a) the Company shall have delivered to the Trustee for cancellation all Securities of a series theretofore authenticated and not delivered to the Trustee for cancellation (other than any Securities that shall have been destroyed, lost or stolen and that shall have been replaced or paid as provided in Section 2.07 and Securities for whose payment money or Governmental Obligations have theretofore been deposited in trust or segregated and held in trust by the Company and thereupon repaid to the Company or discharged from such trust, as provided in Section 11.05); or (b) all such Securities of a particular series not theretofore delivered to the Trustee for cancellation shall have become due and payable, or are by their terms to become due and payable within one year or are to be called for redemption within one year under arrangements satisfactory to the Trustee for the giving of notice of redemption, and the Company shall deposit or cause to be deposited with the Trustee as trust funds the entire amount in moneys or Governmental Obligations or a combination thereof, sufficient in the opinion of a nationally recognized firm of independent public accountants expressed in a written certification thereof delivered to the Trustee, to pay at maturity or upon redemption all Securities of that series not theretofore delivered to the Trustee for cancellation, including principal (and premium, if any)

and interest due or to become due to such date of maturity or date fixed for redemption, as the case may be, and if the Company shall also pay or cause to be paid all other sums payable hereunder with respect to such series by the Company then this Indenture shall thereupon cease to be of further effect with respect to such series except for the provisions of Sections 2.03, 2.05, 2.07, 4.01, 4.02, 4.03 and 7.10, that shall survive until the date of maturity or redemption date, as the case may be, and Sections 7.06 and 11.05, that shall survive to such date and thereafter, and the Trustee, on demand of the Company and at the cost and expense of the Company shall execute proper instruments acknowledging satisfaction of and discharging this Indenture with respect to such series.

Section 11.02 Discharge of Obligations.

If at any time all such Securities of a particular series not heretofore delivered to the Trustee for cancellation or that have not become due and payable as described in Section 11.01 shall have been paid by the Company by depositing irrevocably with the Trustee as trust funds moneys or an amount of Governmental Obligations sufficient to pay at maturity or upon redemption all such Securities of that series not theretofore delivered to the Trustee for cancellation, including principal (and premium, if any) and interest due or to become due to such date of maturity or date fixed for redemption, as the case may be, and if the Company shall also pay or cause to be paid all other sums payable hereunder by the Company with respect to such series, then after the date such moneys or Governmental Obligations, as the case may be, are deposited with the Trustee the obligations of the Company under this Indenture with respect to such series shall cease to be of further effect except for the provisions of Sections 2.03, 2.05, 2.07, 4.01, 4.02, 4.03, 7.06, 7.10 and 11.05 hereof that shall survive until such Securities shall mature and be paid.

Thereafter, Sections 7.06 and 11.05 shall survive.

Section 11.03 Deposited Moneys to be Held in Trust

All moneys or Governmental Obligations deposited with the Trustee pursuant to Sections 11.01 or 11.02 shall be held in trust and shall be available for payment as due, either directly or through any paying agent (including the Company acting as its own paying agent), to the holders of the particular series of Securities for the payment or redemption of which such moneys or Governmental Obligations have been deposited with the Trustee.

Section 11.04 Payment of Moneys Held by Paying Agents

In connection with the satisfaction and discharge of this Indenture all moneys or Governmental Obligations then held by any paying agent under the provisions of this Indenture shall, upon demand of the Company, be paid to the Trustee and thereupon such paying agent shall be released from all further liability with respect to such moneys or Governmental Obligations.

Section 11.05 Repayment to Company.

Any moneys or Governmental Obligations deposited with any paying agent or the Trustee, or then held by the Company, in trust for payment of principal of or premium, if any, or interest on the Securities of a particular series that are not applied but remain unclaimed by the holders of such Securities for at least two years after the date upon which the principal of (and premium, if any) or interest on such Securities shall have respectively become due and payable, or such other shorter period set forth in applicable escheat or abandoned or unclaimed property law, shall be repaid to the Company on May 31 of each year or upon the Company's request or (if then held by the Company) shall be discharged from such trust; and thereupon the paying agent and the Trustee shall be released from all further liability with respect to such moneys or Governmental Obligations, and the holder of any of the Securities entitled to receive such payment shall thereafter, as a general creditor, look only to the Company for the payment thereof.

ARTICLE 12

IMMUNITY OF INCORPORATORS, STOCKHOLDERS, OFFICERS AND DIRECTORS

Section 12.01 No Recourse.

No recourse under or upon any obligation, covenant or agreement of this Indenture, or of any Security, or for any claim based thereon or otherwise in respect thereof, shall be had against any incorporator, stockholder, officer or director, past, present or future as such, of the Company or of any predecessor or successor corporation, either directly or through the Company or any such predecessor or successor corporation, whether by virtue of any constitution, statute or rule of law, or by the enforcement of any assessment or penalty or otherwise; it being expressly understood that this Indenture and the obligations issued hereunder are solely corporate obligations, and that no such personal liability whatever shall attach to, or is or shall be incurred by, the incorporators, stockholders, officers or directors as such, of the Company or of any predecessor or successor corporation, or any of them, because of the creation of the indebtedness hereby authorized, or under or by reason of the obligations, covenants or agreements contained in this Indenture or in any of the Securities or implied therefrom; and that any and all such personal liability of every name and nature, either at common law or in equity or by constitution or statute, of, and any and all such rights and claims against, every such incorporator, stockholder, officer or director as such, because of the creation of the indebtedness hereby authorized, or under or by reason of the obligations, covenants or agreements contained in this Indenture or in any of the Securities or implied therefrom, are hereby expressly waived and released as a condition of, and as a consideration for, the execution of this Indenture and the issuance of such Securities.

ARTICLE 13

MISCELLANEOUS PROVISIONS

Section 13.01 Effect on Successors and Assigns.

All the covenants, stipulations, promises and agreements in this Indenture made by or on behalf of the Company shall bind its successors and assigns, whether so expressed or not.

Section 13.02 Actions by Successor.

Any act or proceeding by any provision of this Indenture authorized or required to be done or performed by any board, committee or officer of the Company shall and may be done and performed with like force and effect by the corresponding board, committee or officer of any corporation that shall at the time be the lawful successor of the Company.

Section 13.03 Surrender of Company Powers.

The Company by instrument in writing executed by authority of its Board of Directors and delivered to the Trustee may surrender any of the powers reserved to the Company, and thereupon such power so surrendered shall terminate both as to the Company and as to any successor corporation.

Section 13.04 Notices.

Except as otherwise expressly provided herein, any notice, request or demand that by any provision of this Indenture is required or permitted to be given, made or served by the Trustee or by the holders of Securities or by any other Person pursuant to this Indenture to or on the Company may be given or served by being deposited in first class mail, postage prepaid, addressed (until another address is filed in writing by the Company with the Trustee), as follows:
Any notice, election, request or demand by the Company or any Securityholder or by any other Person pursuant to this Indenture to or upon the Trustee shall be deemed to have been sufficiently given or made, for all purposes, if given or made in writing at the Corporate Trust Office of the Trustee.

Section 13.05 Governing Law.

This Indenture and each Security shall be deemed to be a contract made under the internal laws of the State of New York, and for all purposes shall be construed in accordance with the laws of said State, except to the extent that the Trust Indenture Act is applicable.

Section 13.06 Treatment of Securities as Debt.

It is intended that the Securities will be treated as indebtedness and not as equity for federal income tax purposes. The provisions of this Indenture shall be interpreted to further this intention.

43

Section 13.07 Certificates and Opinions as to Conditions Precedent.

(a) Upon any application or demand by the Company to the Trustee to take any action under any of the provisions of this Indenture, the Company shall furnish to the Trustee an Officers' Certificate stating that all conditions precedent provided for in this Indenture (other than the certificate to be delivered pursuant to Section 13.12) relating to the proposed action have been complied with and an Opinion of Counsel stating that in the opinion of such counsel all such conditions precedent have been complied with, except that in the case of any such application or demand as to which the furnishing of such documents is specifically required by any provision of this Indenture relating to such particular application or demand, no additional certificate or opinion need be furnished.

(b) Each certificate or opinion provided for in this Indenture and delivered to the Trustee with respect to compliance with a condition or covenant in this Indenture shall include (i) a statement that the Person making such certificate or opinion has read such covenant or condition; (ii) a brief statement as to the nature and scope of the examination or investigation upon which the statements or opinions contained in such certificate or opinion are based; (iii) a statement that, in the opinion of such Person, he has made such examination or investigation as is reasonably necessary to enable him to express an informed opinion as to whether or not such covenant or condition has been complied with; and (iv) a statement as to whether or not, in the opinion of such Person, such condition or covenant has been complied with.

Section 13.08 Payments on Business Days.

Except as provided pursuant to Section 2.01 pursuant to a Board Resolution, and set forth in an Officers' Certificate, or established in one or more indentures supplemental to this Indenture, in any case where the date of maturity of interest or principal of any Security or the date of redemption of any Security shall not be a Business Day, then payment of interest or principal (and premium, if any) may be made on the next succeeding Business Day with the same force and effect as if made on the nominal date of maturity or redemption, and no interest shall accrue for the period after such nominal date.

Section 13.09 Conflict with Trust Indenture Act.

If and to the extent that any provision of this Indenture limits, qualifies or conflicts with the duties imposed by Sections 310 to 317, inclusive, of the Trust Indenture Act, such imposed duties shall control.

Section 13.10 Counterparts.

This Indenture may be executed in any number of counterparts, each of which shall be an original, but such counterparts shall together constitute but one and the same instrument.

Section 13.11 Separability.

In case any one or more of the provisions contained in this Indenture or in the Securities of any series shall for any reason be held to be invalid, illegal or unenforceable in any respect,

44

such invalidity, illegality or unenforceability shall not affect any other provisions of this Indenture or of such Securities, but this Indenture and such Securities shall be construed as if such invalid or illegal or unenforceable provision had never been contained herein or therein.

Section 13.12 Compliance Certificates.

The Company shall deliver to the Trustee, within 120 days after the end of each fiscal year during which any Securities of any series were outstanding, an officer's certificate stating whether or not the signers know of any Default or Event of Default that occurred during such fiscal year. Such certificate shall contain a certification from the principal executive officer, principal financial officer or principal accounting officer of the Company that a review has been conducted of the activities of the Company and the Company's performance under this Indenture and that the Company has complied with all conditions and covenants under this Indenture. For purposes of this Section 13.12, such compliance shall be determined without regard to any period of grace or requirement of notice provided under this Indenture. If the officer of the Company signing such certificate has knowledge of such a Default or Event of Default, the certificate shall describe any such Default or Event of Default and its status.

ARTICLE 14

SUBORDINATION OF SECURITIES

Section 14.01 Subordination Terms.

The payment by the Company of the principal of, premium, if any, and interest on any series of securities issued hereunder shall be subordinated to the extent set forth in an indenture supplemental hereto relating to such Securities.

IN WITNESS WHEREOF, the parties hereto have caused this Indenture to be duly executed all as of the day and year first above written.

GLADSTONE CAPITAL CORPORATION

By: _____

Name: _____

Title: _____

[TRUSTEE], as Trustee

By: _____

Name: _____

Title: _____

CROSS-REFERENCE TABLE (1)

<u>Section of Trust Indenture Act Of 1939, as Amended</u>	<u>Section of Indenture</u>
310(a)	7.09
310(b)	7.08
	7.10
310(c)	Inapplicable
311(a)	7.13
311(b)	7.13
311(c)	Inapplicable
312(a)	5.01
	5.02(a)
312(b)	5.02(c)
312(c)	5.02(c)
313(a)	5.04(a)
313(b)	5.04(b)
313(c)	5.04(a)
	5.04(b)
313(d)	5.04(c)
314(a)	5.03
	13.12
314(b)	Inapplicable
314(c)	13.07(a)
314(d)	Inapplicable
314(e)	13.07(b)
314(f)	Inapplicable
315(a)	7.01(a)
	7.01(b)
315(b)	7.14

315(c)	7.01
315(d)	7.01(b)
315(e)	6.07
316(a)	6.06
	8.04
316(b)	6.04
316(c)	8.01
317(a)	6.02
317(b)	4.03
318(a)	13.09

(1) This Cross-Reference Table does not constitute part of the Indenture and shall not have any bearing on the interpretation of any of its terms or provisions.

May 16, 2007

Gladstone Capital Corporation
1521 Westbranch Drive
Suite 200
McLean, VA 22102

Ladies and Gentlemen:

We have acted as counsel to Gladstone Capital Corporation, a Maryland corporation (the "**Company**"), in connection with the Registration Statement on Form N-2 (the "**Registration Statement**") to be filed by the Company under the Securities Act of 1933, as amended (the "**Securities Act**"). The Company has provided us with a prospectus (the "**Prospectus**"), which forms part of the Registration Statement. The Prospectus may be amended from time to time in connection with one or more post-effective amendments to the Registration Statement, and the Prospectus provides that it will be supplemented in the future by one or more prospectus supplements (each, a "**Prospectus Supplement**"). The Registration Statement, as amended from time to time, including the Prospectus as supplemented from time to time by one or more Prospectus Supplements, will provide for the registration by the Company of:

- shares of common stock, \$0.001 par value per share, of the Company (the "**Common Stock**");

- senior debt securities, in one or more series (the "**Senior Debt Securities**"), which may be issued pursuant to an indenture to be dated on or about the date of the first issuance of Senior Debt Securities thereunder, by and between a trustee to be selected by the Company (together with any other trustee selected by the Company with respect to the Subordinated Debt Securities, a "**Trustee**") and the Company, in the form filed as Exhibit 2.d.3 to the Registration Statement, as such indenture may be supplemented from time to time (the "**Senior Indenture**"); and

- subordinated debt securities, in one or more series (the "**Subordinated Debt Securities**" and, together with the Senior Debt Securities, the "**Debt Securities**"), which may be issued pursuant to an indenture to be dated on or about the date of the first issuance of Subordinated Debt Securities thereunder, by and between the Trustee and the Company, in the form filed as Exhibit 2.d.4 to the Registration Statement, as such indenture may be supplemented from time to time (the "**Subordinated Indenture**").

The Common Stock and the Debt Securities are collectively referred to herein as the "**Securities**." The Securities are being registered for offering and sale from time to time pursuant to Rule 415 under the Securities Act. The aggregate public offering price of the Securities being registered will be \$300,000,000.

In connection with this opinion, we have examined and relied upon the originals, or copies certified to our satisfaction, of such records, documents, certificates, opinions, memoranda and other instruments as in our judgment are necessary or appropriate to enable us to render the opinion expressed below. As to certain factual matters, we have relied upon certificates of the officers of the Company and have not independently sought to verify such matters.

In rendering this opinion, we have assumed the genuineness and authenticity of all signatures on original documents; the authenticity of all documents submitted to us as originals; the conformity to originals of all documents submitted to us as copies; the accuracy, completeness and authenticity of certificates of public officials; and the due authorization, execution and delivery of all documents where authorization, execution and delivery are prerequisites to the effectiveness of such documents. With respect to our opinion as to the Common Stock, we have assumed that, at the time of issuance and sale, a sufficient number of shares of Common Stock are authorized and available for issuance and that the consideration for the issuance and sale of the Common Stock (or Debt Securities convertible into Common Stock) is in an amount that is not less than the par value of the Common Stock. We have also

assumed that with respect to any Common Stock being issued upon conversion of any convertible Debt Securities, the applicable convertible Debt Securities will be valid and legally binding obligations of the Company, enforceable against the Company in accordance with their terms, except as enforcement may be limited by applicable bankruptcy, insolvency, reorganization, arrangement, moratorium or other similar laws affecting creditors' rights, and subject to general equity principles and to limitations on availability of equitable relief, including specific performance.

Our opinion herein is expressed solely with respect to the federal laws of the United States, the Maryland General Corporation Law and, as to the Debt Securities constituting valid and legally binding obligations of the Company, solely with respect to the laws of the State of New York. Our opinion is based on these laws as in effect on the date hereof. We express no opinion as to whether the laws of any jurisdiction are applicable to the subject matter hereof. We are not rendering any opinion as to compliance with any federal or state law, rule or regulation relating to securities, or to the sale or issuance thereof.

On the basis of the foregoing and in reliance thereon, and subject to the qualifications herein stated, we are of the opinion that:

1. With respect to the Common Stock offered under the Registration Statement, provided that (i) the Registration Statement and any required post-effective amendment thereto have all become effective under the Securities Act and the Prospectus and any and all Prospectus Supplement(s) required by applicable laws have been delivered and filed as required by such laws; (ii) the issuance of the Common Stock has been duly authorized by all necessary corporate action on the part of the Company; (iii) the issuance and sale of the Common Stock do not violate any applicable law, are in conformity with the Company's then operative Articles of Incorporation (the "**Articles of Incorporation**") and Bylaws (the "**Bylaws**"), do not result in a default under or breach of any agreement or instrument binding upon the Company and comply with any applicable requirement or restriction imposed by any court or governmental body having jurisdiction over the Company; and (iv) the certificates for the Common Stock have been duly executed by the Company, countersigned by the transfer agent therefor and duly delivered to the purchasers thereof against payment therefor, then the Common Stock, when issued and sold as contemplated in the Registration Statement, the Prospectus and the related Prospectus Supplement(s) and in accordance with any applicable duly authorized, executed and delivered purchase, underwriting or similar agreement, or upon conversion of any convertible Debt Securities in accordance with their terms will be duly authorized, validly issued, fully paid and nonassessable.

2. With respect to any series of the Debt Securities issued under the Senior Indenture or the Subordinated Indenture, as applicable, and offered under the Registration Statement, provided that (i) the Registration Statement and any required post-effective amendment thereto have all become effective under the Securities Act and the Prospectus and any and all Prospectus Supplement(s) required by applicable laws have been delivered and filed as required by such laws; (ii) the Senior Indenture or the Subordinated Indenture, as applicable, has been duly authorized by the Company and the Trustee by all necessary corporate action; (iii) the Senior Indenture or the Subordinated Indenture, as applicable, in substantially the form filed as an exhibit to the Registration Statement, has been duly executed and delivered by the Company and the Trustee; (iv) the issuance and terms of the Debt Securities have been duly authorized by the Company by all necessary corporate action; (v) the terms of the Debt Securities and of their issuance and sale have been duly established in conformity with the Senior Indenture or the Subordinated Indenture, as applicable, so as not to violate any applicable law or result in a default under or breach of any agreement or instrument binding upon the Company, so as to be in conformity with the Articles of Incorporation and Bylaws, and so as to comply with any requirement or restriction imposed by any court or governmental body having jurisdiction over the Company; and (vi) the Debt Securities have been duly executed and delivered by the Company and authenticated by the Trustee pursuant to the Senior Indenture or the Subordinated Indenture, as applicable, and delivered against payment therefor, then the Debt Securities, when issued and sold in accordance with the Senior Indenture or the Subordinated Indenture, as applicable, and a duly authorized, executed and delivered purchase, underwriting or similar agreement will be valid and legally binding obligations of the Company, enforceable against the Company in accordance with their terms, except as enforcement thereof may be limited by applicable bankruptcy, insolvency, reorganization,

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the use in this Registration Statement on Form N-2 of our report dated December 6, 2006 relating to the financial statements and management's assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial reporting of Gladstone Capital Corporation, which appear in such Registration Statement. We also consent to the references to us under the headings "Experts" in such Registration Statement.

/s/ PricewaterhouseCoopers LLP
PricewaterhouseCoopers LLP
McLean, Virginia
May 16, 2007
