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

FORM 10-Q

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

FOR THE QUARTER ENDED DECEMBER 31, 2003.

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

COMMISSION FILE NUMBER: 814-00237

GLADSTONE CAPITAL CORPORATION
(Exact name of registrant as specified in its charter)

MARYLAND	**54-2040781**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1616 ANDERSON ROAD, SUITE 208
MCLEAN, VIRGINIA 22102
(Address of principal executive office)

(703) 286-7000
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12 b-2 of the Exchange Act).
Yes ☒ No ☐.

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. The number of shares of the issuer's Common Stock, $0.001 par value, outstanding as of February 11, 2004 was 10,081,844.

GLADSTONE CAPITAL CORPORATION

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PART I—FINANCIAL INFORMATION

Gladstone Capital Corporation

Consolidated Financial Statements

(Unaudited)

December 31, 2003

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GLADSTONE CAPITAL CORPORATION

CONSOLIDATED BALANCE SHEETS

	(Unaudited) December 31, 2003	(Audited) September 30, 2003
ASSETS		
Investments at fair value (Cost 12/31/2003: $120,663,277; 9/30/2003: $109,529,893)	$ 118,883,375	$ 109,307,553
Cash and cash equivalents	7,252,566	21,143,972
Cash and cash equivalents pledged to creditors	95,001,094	80,022,249
Interest receivable – investments in debt securities	1,043,095	1,041,943
Interest receivable – cash and cash equivalents	1,302	955
Interest receivable – officers	19,543	108,657
Due from custodian	37,500	1,207,000
Prepaid assets	1,473,355	1,479,815
Other assets	499,471	254,519
TOTAL ASSETS	$ 224,211,301	$ 214,566,663
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Accounts payable	$ 91,052	$ 23,247
Dividends payable	—	3,327,009
Accrued expenses and deferred liabilities	2,059,550	1,965,025
Repurchase agreement	93,101,000	78,449,000
Total Liabilities	$ 95,251,602	$ 83,764,281
STOCKHOLDERS' EQUITY		
Common stock, $0.001 par value, 50,000,000 shares authorized and 10,081,844 and 10,071,844 shares issued and outstanding, respectively	$ 10,082	$ 10,082
Capital in excess of par value	140,416,674	140,416,674
Notes receivable – officers	(8,882,688)	(8,985,940)
Net unrealized depreciation on investments	(1,779,902)	(222,340)
Undistributed/(overdistributed) net investment income	(804,467)	(416,094)
Total Stockholders' Equity	$ 128,959,699	$ 130,802,382
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 224,211,301	$ 214,566,663

SEE ACCOMPANYING NOTES.

GLADSTONE CAPITAL CORPORATION
SCHEDULE OF INVESTMENTS
AS OF DECEMBER 31, 2003
(UNAUDITED)

Company (1)	Industry	Investment	Cost	Fair Value
America's Water Heater Rentals, LLC	Water heater rentals and servicing	Senior Term Debt (2)(4)	$ 12,000,000	$ 12,000,000
ARI Holdings, Inc.	Manufacturing-auto parts	Senior Term Debt (2)(3)(4)	3,547,683	3,543,248
		Senior Term Debt (2)(4)	1,425,000	1,423,219
Burt's Bees, Inc.	Personal and household products	Senior Term Debt	1,000,000	1,005,000
Coyne International Enterprises	Industrial services	Senior Term Debt (2)(3)(4)	15,499,837	15,325,464
Finn Corporation	Manufacturing-landscape equipment	Senior Subordinated Term Debt(4)	10,500,000	9,121,875
		Common Stock Warrants for 2% ownership	37,000	435,649
Fugate & Associates, Inc.	Imaging supplies	Senior Term Debt (4)	3,325,000	3,325,000
		Senior Term Debt (4)	1,666,666	1,666,666
GQM Acquisition Corp. d/b/a Gamill, Inc.	Designer and assembler of quilting machines and accessories	Senior Term Debt	7,500,000	7,500,000
		Senior Term Debt	7,000,000	7,000,000
Home Care Supply, Inc.	Medical equipment rental	Senior Term Debt (2)(4)(5)	18,000,000	18,494,100
Inca Metal Products Corp. Kingway Acquisition, Inc. Clymer Acquisition, Inc.	Material handling and storage products	Senior Term Debt (2)(4)	2,500,000	2,246,875
Marcal Paper Mills, Inc.	Manufacturing-paper products	Senior Term Debt (2)(4)	6,975,000	6,155,438
		First Mortgage Debt (3)	9,187,091	9,187,091
Mistras Holdings, Inc.	Nondestructive testing instruments, systems and services	Senior Term Debt(2)(4)	10,000,000	9,987,500
		Senior Term Debt (2)(4)	5,000,000	4,993,750
Wingstop Restaurants International, Inc.	Restaurant – fast food	Senior Term Debt (4)	3,500,000	3,482,500
		Senior Debt (4)	2,000,000	1,990,000
Totals			$ 120,663,277	$ 118,883,375

(1) We do not "Control," and are not an "Affiliate" of, any of our portfolio companies, each as defined in the Investment Company Act of 1940, as amended (the "1940 Act"). In general, under the 1940 Act, we would "Control" a portfolio company if we owned 25% or more of its voting securities and would be an "Affiliate" of a portfolio company if we owned 5% or more of its voting securities.
(2) Last Out Tranche of senior debt, meaning if the company is liquidated then the holder of the Last Out Tranche is paid after the senior debt.
(3) Has some paid in kind (PIK) interest. Refer to Note 2 "Summary of Significant Accounting Policies" of Form 10-K for the fiscal year ended September 30, 2003.
(4) Fair value was based on valuation prepared and provided by Standard & Poor's Loan Evaluation Services.
(5) Includes a success fee with a fair value of $516,600 and no cost basis.
SEE ACCOMPANYING NOTES.

GLADSTONE CAPITAL CORPORATION
SCHEDULE OF INVESTMENTS
AS OF SEPTEMBER 30, 2003

Company (1)	Industry	Investment	Cost	Fair Value
America's Water Heater Rentals, LLC	Water heater rentals and servicing	Senior Term Debt (2)(4)	$ 12,000,000	$ 12,000,000
ARI Holdings, Inc.	Manufacturing-auto parts	Senior Term Debt (2)(3)	3,511,667	3,511,667
		Senior Term Debt (2)	1,500,000	1,500,000
Coyne International Enterprises	Industrial services	Senior Term Debt (2)(3)(4)	15,421,740	15,306,077
Finn Corporation	Manufacturing-landscape equipment	Senior Subordinated Term Debt(4)	10,500,000	10,421,250
		Common Stock Warrants for 2% ownership	37,000	431,111
Fugate & Associates, Inc.	Imaging supplies	Senior Term Debt (4)	3,412,500	3,412,500
		Senior Term Debt (4)	1,833,333	1,833,333
Home Care Supply, Inc.	Medical equipment rental	Senior Term Debt (2)(4)(5)	18,000,000	18,428,400
Inca Metal Products Corp. Kingway Acquisition, Inc. Clymer Acquisition, Inc.	Material handling and storage products	Senior Term Debt (2)(4)	5,775,000	4,995,375

Kozy Shack Enterprises, Inc.	Food production and sales	Senior Term Debt (2)(4)	900,000	909,000
Marcal Paper Mills, Inc.	Manufacturing-paper products	Senior Term Debt (2)(4) First Mortgage Debt (3)	6,975,000 9,163,653	6,922,687 9,163,653
Mistras Holdings, Inc.	Nondestructive testing instruments, systems and services	Senior Term Debt (2) Senior Term Debt (2)	10,000,000 5,000,000	10,000,000 5,000,000
Wingstop Restaurants International, Inc.	Restaurant – fast food	Senior Term Debt (4) Senior Debt (4)	3,500,000 2,000,000	3,482,500 1,990,000
Totals			$ 109,529,893	$ 109,307,553

(1) We do not "Control," and are not an "Affiliate" of, any of our portfolio companies, each as defined in the Investment Company Act of 1940, as amended (the "1940 Act"). In general, under the 1940 Act, we would "Control" a portfolio company if we owned 25% or more of its voting securities and would be an "Affiliate" of a portfolio company if we owned 5% or more of its voting securities.
(2) Last Out Tranche of senior debt, meaning if the company is liquidated then the holder of the Last Out Tranche is paid after the senior debt.
(3) Has some paid in kind (PIK) interest. Refer to Note 2 "Summary of Significant Accounting Policies" of Form 10-K for the fiscal year ended September 30, 2003.
(4) Fair value was based on valuation prepared and provided by Standard & Poor's Loan Evaluation Services.
(5) Includes a success fee with a fair value of $473,400 and no cost basis.

SEE ACCOMPANYING NOTES.

GLADSTONE CAPITAL CORPORATION

CONSOLIDATED STATEMENT OF OPERATIONS

(UNAUDITED)

	Three Months Ended December 31, 2003	Three Months Ended December 31, 2002
INVESTMENT INCOME		
Interest income – investments	$ 3,539,696	$ 2,927,663
Interest income – cash and cash equivalents	48,621	198,166
Interest income – notes receivable from officers	108,632	109,603
Managerial assistance fees	255,000	—
Other income	16,000	—
Total Investment Income	$ 3,967,949	$ 3,235,432
EXPENSES		
Salaries and benefits	$ 390,707	$ 433,240
Rent	37,760	54,620
Professional fees	177,658	114,690
Directors fees	24,333	13,500
Insurance	74,011	71,154
Stockholder related costs	52,660	11,565
Financing fees	144,996	—
General and administrative	127,188	124,509
Total Expenses	$ 1,029,313	$ 823,278
NET INVESTMENT INCOME	$ 2,938,636	$ 2,412,154
Net unrealized depreciation on investments	(1,557,562)	—
NET INCREASE (DECREASE) IN STOCKHOLDERS' EQUITY RESULTING FROM OPERATIONS	$ 1,381,074	$ 2,412,154
NET INCREASE IN STOCKHOLDERS' EQUITY RESULTING FROM OPERATIONS PER COMMON SHARE:		
Basic	$ 0.14	$ 0.24
Diluted	$ 0.13	$ 0.24
WEIGHTED AVERAGE SHARES OF COMMON STOCK OUTSTANDING:		
Basic	10,081,844	10,071,844
Diluted	10,333,529	10,124,197

SEE ACCOMPANYING NOTES.

GLADSTONE CAPITAL CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(UNAUDITED)

	Common Stock Shares	Common Stock Amount	Capital in Excess of Par Value	Notes Receivable From Sale of Common Stock	Under/(Over) Distributed Net Investment Income	Unrealized Appreciation/ (Depreciation) of Investments	Total Stockholders' Equity
Balance at September 30, 2002	10,071,844	$ 10,072	$ 140,266,684	$ (8,983,796)	$ (629,687)	$ —	$ 130,663,273
Net Increase in Stockholders' Equity Resulting from Operations					2,412,154		2,412,154
Distributions Declared ($0.23 per common share)					(2,316,523)	—	(2,316,523)
Balance at December 31, 2002	10,071,844	$ 10,072	$ 140,266,684	$ (8,983,796)	$ (534,056)	$ —	$ 130,758,904
Balance at September 30, 2003	10,081,844	$ 10,082	$ 140,416,674	$ (8,985,940)	$ (416,094)	$ (222,340)	$ 130,802,382
Repayment of Principal on Notes Receivable				103,252			103,252
Net Increase in Stockholders' Equity Resulting from Operations					2,938,636	(1,557,562)	1,381,074
Distributions Declared ($0.33 per common share)					(3,327,009)		(3,327,009)
Balance at December 31, 2003	10,081,844	$ 10,082	$ 140,416,674	$ (8,882,688)	$ (804,467)	$ (1,779,902)	$ 128,959,699

SEE ACCOMPANYING NOTES.

GLADSTONE CAPITAL CORPORATION

CONSOLIDATED STATEMENT OF CASH FLOWS

(UNAUDITED)

	Three Months Ended December 31, 2003	Three Months Ended December 31, 2002
CASH FLOWS FROM OPERATING ACTIVITIES		
Net increase (decrease) in stockholders' equity resulting from operations	$ 1,381,074	$ 2,412,154
Adjustments to reconcile net increase (decrease) in stockholders' equity resulting from operations to net cash provided by (used in) operating activities:		
Depreciation	7,091	6,765
Change in net unrealized depreciation	1,557,562	
Decrease (increase) in interest receivable	87,615	(79,148)
Decrease in funds due from custodian	1,169,500	
Increase in other assets	(250,476)	(64,022)
(Increase) decrease in prepaid assets	(52,204)	2,132
Increase in accounts payable	67,805	—
Increase in accrued expenses and deferred liabilities	94,525	184,737
Increase in investment balance due to payment in kind interest	(137,551)	(208,080)
Net Cash Provided by Operating Activities	$ 3,924,941	$ 2,254,538
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of furniture and equipment, net	$ (1,567)	$ (38,823)
Purchase of investments	(15,500,000)	(4,000,000)
Principal repayments on investments	4,504,167	100,000
Proceeds from repurchase agreements	93,101,000	39,205,697
Repayment of repurchase agreements	(78,449,000)	(39,198,719)
Receipt of principal on notes receivable – officers	103,252	—
Net Cash Provided by (Used in) Investing Activities	$ 3,757,852	$ (3,931,845)
CASH FLOWS FROM FINANCING ACTIVITIES		
Prepaid financing fees	$ 58,664	$ —
Distributions paid	(6,654,018)	(2,115,087)
Net Cash (Used in) Financing Activities	$ (6,595,354)	$ (2,115,087)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	$ 1,087,439	$ (3,792,394)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	$ 101,166,221	$ 91,929,328
CASH AND CASH EQUIVALENTS, END OF PERIOD (Note 8)	$ 102,253,660	$ 88,136,934

SEE ACCOMPANYING NOTES.

GLADSTONE CAPITAL CORPORATION

FINANCIAL HIGHLIGHTS

(UNAUDITED)

	Three Months Ended December 31, 2003		Three Months Ended December 31, 2002	
Per Share Data(1)				
Net asset value at beginning of period	$	12.97	$	12.97
Net investment income		0.29		0.24
Net unrealized loss on investments		(0.15)		—
Distributions from net investment income		(0.33)		(0.23)
Repayment of principal on notes receivable		0.01		—
Net asset value at end of period	$	12.79	$	12.98
Per share market value at beginning of period	$	19.45	$	16.88
Per share market value at end of period		22.35		16.47
Total Return(2)(3)		16.71 %		-1.07 %
Shares outstanding at end of period		10,081,844		10,071,844
Ratios/Supplemental Data				
Net assets at end of period	$	128,959,699	$	130,758,904
Average net assets		129,002,039		131,563,142
Ratio of expenses to average net assets – annualized		3.19 %		0.63 %
Ratio of net investment income to average net assets - annualized		9.11 %		1.83 %

(1) Basic per share data.
(2) Amounts were not annualized for the results of the three-month periods ended December 31, 2003 and December 31, 2002.
(3) Total return equals the increase of the ending market value over the beginning market value plus dividends divided by the beginning market value.

SEE ACCOMPANYING NOTES**.**

GLADSTONE CAPITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2003

(UNAUDITED)

NOTE 1. UNAUDITED INTERIM FINANCIAL STATEMENTS

Interim financial statements of Gladstone Capital Corporation (the “Company”) are prepared in accordance with generally accepted accounting principles (“GAAP”) for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain disclosures accompanying annual financial statements prepared in accordance with GAAP are omitted. In the opinion of management, all adjustments, consisting solely of normal recurring accruals, necessary for the fair statement of financial statements for the interim periods have been included. The current period’s results of operations are not necessarily indicative of results that ultimately may be achieved for the year. The interim financial statements and notes thereto should be read in conjunction with the financial statements and notes thereto included in the Company’s Form 10-K for the fiscal year ended September 30, 2003, as filed with the Securities and Exchange Commission.

NOTE 2. ORGANIZATION

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

Gladstone Capital Advisers, Inc., a wholly-owned subsidiary of the Company, conducts the daily administrative operations of the Company. The financial statements of this subsidiary are consolidated with those of the Company.

Gladstone Business Loan LLC, a wholly-owned subsidiary of the Company, was established on February 3, 2003 for the purpose of owning the Company’s portfolio of loan investments. The financial statements of the subsidiary are consolidated with those of the company.

NOTE 3. STOCK OPTIONS

The following tables set forth the pro-forma effect of fair value option accounting for the three months ended December 31, 2003 and December 31, 2002 in accordance with Statement of Financial Accounting Standards (SFAS) Statement No. 148 “Accounting for Stock-Based Compensation – Transition and Disclosure”.

	Three Months Ended December 31, 2003		Three Months Ended December 31, 2002	
Increase in stockholders’ equity from operations, as reported	$	1,381,074	$	2,412,154
Deduct: total stock-based employee compensation expense determined under fair value method for all awards		(403,619)		(388,775)

Pro-forma increase in stockholders' equity from operations	$	977,455	$	2,023,379
Increase in stockholders' equity from operations per share				
Basic, as reported	$	0.14	$	0.24
Basic, pro-forma	$	0.10	$	0.20
Diluted, as reported	$	0.13	$	0.24
Diluted, pro-forma	$	0.09	$	0.20

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

The following table sets forth the computation of basic and diluted net increase in stockholders' equity resulting from operations per share for the three months ended December 31, 2003 and December 31, 2002:

		Three Months Ended December 31, 2003		Three Months Ended December 31, 2002
Numerator for basic and diluted net increase in stockholders' equity resulting from operations per share	$	1,381,074	$	2,412,154
Denominator for basic weighted average shares		10,081,844		10,071,844
Dilutive potential shares		251,685		52,353
Denominator for diluted weighted average shares		10,333,529		10,124,197
Employee stock options		991,664		811,664
Basic net increase in stockholders' equity resulting from operations per common share		0.14		0.24
Diluted net increase in stockholders' equity resulting from operations per common share		0.13		0.24

NOTE 5. DIVIDENDS

The Company is required to pay out as a dividend 90% of its ordinary income and short-term capital gains for each taxable year in order to maintain its status as a RIC under Subtitle A, Chapter 1 of Subchapter M of the Code. It is the policy of the Company to pay out as a dividend up to 100% of those amounts. The amount to be paid out as a dividend is determined by the Board of Directors each quarter and is based on the annual earnings estimated by the management of the Company. Based on that estimate, a dividend is declared each quarter. At year-end the Company may pay a bonus dividend, in addition to the quarterly dividends, to ensure that it has paid out at least 90% of its ordinary income and short-term capital gains for the year. The Company has a policy of retaining long-term capital gains, if any, and not paying them out as dividends. Effective October 31, 2003, the Company began paying a monthly dividend. The following table illustrates the 2004 fiscal year monthly dividends per share and the 2003 quarterly dividend per share for the three months ended December 31:

Record Date	Payment Date		Dividend per Share	Monthly or Quarterly
Dec. 18, 2003	Dec. 31, 2003	$	0.11	Monthly
Nov. 17, 2003	Nov. 28, 2003	$	0.11	Monthly
Oct. 20, 2003	Oct. 31, 2003	$	0.11	Monthly
Sept. 30, 2003	Oct. 6, 2003	$	0.33	Quarterly
June 30, 2003	July 7, 2003	$	0.29	Quarterly
March 31, 2003	April 7, 2003	$	0.25	Quarterly
Dec. 31, 2002	Jan 7, 2003	$	0.23	Quarterly

NOTE 6. INVESTMENT VALUATION

The Company carries its investments at fair value, as determined by its Board of Directors. Securities that are publicly traded are valued at the closing price on the valuation date. Debt and equity securities that are not publicly traded are valued at fair value as determined in good faith by the Board of Directors. Beginning in March 2003, the Company engaged Standard & Poor's Loan Evaluation Service (S&P) to perform independent valuations of its investments. The Board of Directors uses the recommended valuations as prepared by S&P as a component of the foundation for the final fair value determination. In making such determination, the Board of Directors values non-convertible debt securities at cost plus amortized original issue discount plus PIK interest, if any, unless adverse factors lead to a determination of a lesser valuation. In valuing convertible debt, equity, success fees or other equity like securities, the Board of Directors determines the fair value based on the collateral, the issuer's ability to make payments, the earnings of the issuer, sales to third parties of similar securities, the comparison to publicly traded securities, discounted cash flow and other pertinent factors. Due to the uncertainty inherent in the valuation process, such estimates of fair value may differ significantly from the values that would have resulted had a ready market for the securities existed, and the differences could be material. Additionally, changes in the market environment and other events that may occur over the life of the investments may cause the gains ultimately realized on these investments to be different than the valuation currently assigned. Because there is a lag between when we close a loan and when the loan can be evaluated by S&P, new loans are not valued immediately by S&P; rather, the Board makes its own determination about the value of the loan in accordance with our valuation policy. Because S&P does not provide values for mortgage loans or equity securities, the directors also determine fair value of these.

NOTE 7. LOAN AND MANAGERIAL ASSISTANCE FEES

The 1940 Act requires that a business development company make available managerial assistance to its portfolio companies. The Company provides managerial assistance to its portfolio companies through its wholly-owned subsidiary, Gladstone Advisers, Inc. The Company receives fee income for managerial assistance it renders to portfolio companies in connection with its investments. Such fees are normally paid at the closing of the Company's investments and are generally non-recurring. These managerial assistance services vary by investment, but generally consist of reviewing existing credit facilities, arranging bank financing, arranging equity financing, structuring financing from multiple lenders, structuring financing from equity investors, restructuring existing loans, raising equity and debt capital, and providing general financial advice. For the three months ended December 31, 2003 and December 31, 2002, these fees totaled $255,000 and $0 respectively.

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

NOTE 8. PAYMENT IN KIND INTEREST

The Company has loans in its portfolio, which contain a payment in kind ("PIK") provision. The PIK interest is added to the principal balance of the loan and recorded as income. To maintain the Company's status as a RIC (as discussed in Note 5, above), this non-cash source of income must be paid out to stockholders in the form of dividends, even though the Company has not yet collected the cash. For the three months ended December 31, 2003 and December 31, 2002, the Company recorded PIK income of $138,543 and $211,321 respectively. At December 31, 2003 and September 30, 2003 the Company had accrued on its balance sheet, a total in PIK income of $711,156 and $608,572 respectively. The Company does not have any original issue discount income.

NOTE 9. REPURCHASE AGREEMENT

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

On December 31, 2003, the Company entered into a Repurchase Agreement with UBS Paine Webber for $93,101,000, which agreement was settled on January 2, 2004. The Repurchase Agreement was recorded at cost and was fully collateralized by a United States Treasury Bill with a fair value of $95,005,000 and a carrying value of $95,001,094 that matured on January 2, 2004. The interest rate on the Repurchase Agreement was 0.92%. On September 30, 2003, the Company entered into a Repurchase Agreement with UBS for $78,449,000, which agreement was settled on October 1, 2003. The Repurchase Agreement was recorded at cost and was fully collateralized by a United States Treasury Bill with a fair value of $80,050,000 and a carrying value of $80,022,249 that matured on October 16, 2003. The interest rate on the Repurchase Agreement was 0.80%.

NOTE 10. CONTRACTUAL OBLIGATIONS

The Company occupies its McLean, Virginia office space pursuant to a license agreement scheduled to expire on October 31, 2004. The Company's New York City office facility has a service agreement scheduled to expire August 31, 2004. The future scheduled payments are as follows:

	Payment due by period				
Contractual Obligations	**Total**	**Less than 1 year**	**1-3 years**	**3-5 years**	**More than 5 years**
Office Lease Obligations	$ 163,453	$ 163,453	—	—	—
Total	$ 163,453	$ 163,453	—	—	—

NOTE 11. DEFERRED COMPENSATION PLAN

The company has adopted a deferred compensation plan (the "Plan") effective January 1, 2002. The Plan permits an employee to defer the lesser of 75% of his or her total compensation or the applicable Internal Revenue Service ("IRS") limit. The employees are eligible to participate in the Plan upon completion of 1,000 hours of service within the first six months of employment or after one year of service. The service requirement is waived for those employees who were employed as of January 1, 2002. The Company has funded $23,987 in contributions to the Plan that were accrued in the fiscal year ended September 30,2003. The Company has received a determination letter from the IRS concurring that the deferred compensation plan satisfies the qualification requirements of the Code.

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

All statements contained herein, other than historical facts, may constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements may relate to, among other things, future events or our future performance or financial condition. In some cases, you can identify forward-looking statements by terminology such as "may," "might," "believe," "will," "provided," "anticipate," "future," "could," "growth," "plan," "intend," "expect," "should," "would," "if," "seek," "possible," "potential" or the negative of such terms or comparable terminology. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others: (1) adverse changes in interest rates; (2) our failure or inability to establish or maintain referral arrangements with leveraged buyout funds and venture capital funds to generate loan opportunities; (3) the loss of one or more of our executive officers, in particular David Gladstone, Terry Lee Brubaker or George Stelljes, III; (4) our inability to maintain a credit facility on terms reasonably acceptable to us, if at all; (5) our inability to successfully securitize our loan portfolio on terms reasonably acceptable to us, if at all; (6) the decision of our competitors to aggressively seek to make senior and subordinated loans to small and medium-sized businesses on terms more favorable than we intend to provide; and (7) those factors listed under the caption "Risk Factors" of the Annual Report on Form 10-K as filed with the Securities and Exchange Commission on December 11, 2003. We caution readers not to place undue reliance on any such forward-looking statements, which are made pursuant to the Private Securities Litigation Reform Act of 1995 and, as such, speak only as of the date made. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, after the date of this Form 10-Q.

The following analysis of our financial condition and results of operations should be read in conjunction with our financial statements and the notes thereto contained elsewhere in this report.

OVERVIEW

We were incorporated under the General Corporation Laws of the State of Maryland on May 30, 2001. Our investment objectives are to achieve a high level of current income by investing in debt securities, consisting primarily of senior notes, senior subordinated notes and junior subordinated notes, of established private businesses that are backed by leveraged buyout funds, venture capital funds or others, with a particular emphasis on senior subordinated notes. In addition, we may acquire existing loans, 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 out small and medium-sized businesses that meet certain criteria, including (1) the potential for growth in cash flow, (2) adequate assets for loan collateral, (3) experienced management teams with a significant ownership interest in the borrower, (4) profitable operations based on the borrower's cash flow, (5) reasonable capitalization of the borrower (usually by leveraged buyout funds or venture capital funds) and (6) the potential to realize appreciation and gain liquidity in our equity position, if any. We anticipate that liquidity in our equity position will be achieved through a merger or acquisition of the borrower, a public offering by the borrower or by exercise of our right to require the borrower to buy back its warrants. We lend to borrowers that need funds to finance growth, restructure their balance sheets or effect a change of control.

Our loans typically range from $5 million to $15 million, mature in no more than seven years and accrue interest at a fixed or variable rate that exceeds the prime rate. A number of our loans have a provision that calls for some portion of the interest payments to be deferred and added to the principal balance so that the interest is paid, together with the principal, at maturity. This form of deferred interest is often called "paid-in-kind" or "PIK" interest, and, when earned, we record PIK interest as interest income and add the PIK interest to the principal balance of the loans. The amount of PIK interest accrued and on our books as of December 31, 2003 was approximately $711,000.

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

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

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

Our business plan calls for managerial assistance fee revenue to equal or exceed our operating expenses (excluding interest expense). However, during the quarters ended December 31, 2003, and December 31, 2002, operating expenses (excluding interest expense) exceeded managerial assistance fee revenue by approximately $731,000 and $823,000, respectively. We believe that, as the economic environment improves, we will be able to make sufficient new investments so that over time our managerial assistance fee revenue will equal or exceed our operating expenses (excluding interest expense), although there can be no guarantee that we will be able to do so.

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

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

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

The general economic climate during the quarter ended December 31, 2003 and the previous fiscal year ended September 30, 2003 was unfavorable. Many businesses saw their sales and business prospects decline during the year. Consequently, many of these companies were forced to lay off employees and engage in other cost cutting measures. As a result of the difficult business climate, we determined it prudent to proceed cautiously in making loans during these periods. Since our initial public offering in August 2001, we have made 23 different loans to, or investments in, 14companies for a total of approximately $147.4 million (including the maximum aggregate amount outstanding under an $8 million line of credit in favor of one of our portfolio companies, that has

subsequently been retired). In the fourth quarter of the 2002 fiscal year, one of our investments, including all amounts outstanding under a $7 million senior term loan and an $8 million senior line of credit, was repaid in full. During the quarter ended December 31, 2003, one company paid in full its outstanding loan balance of $900,000 and we entered into new loans with two companies, in the aggregate amount of $15.5 million.

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

Expense Allocation

In July, 2003, we entered into an expense sharing arrangement with Gladstone Management Corporation ("Gladstone Management"), a registered investment adviser that serves as the external adviser to Gladstone Commercial Corporation, a real estate investment trust affiliated with us. Under this expense sharing arrangement, Gladstone Management reimburses Gladstone Capital Advisers, for a portion of our total payroll and benefits expenses (based on the percentage of total hours worked by each employee on Gladstone Commercial matters). Gladstone Management also reimburses Gladstone Capital Advisers for it's pro rata portion of all other general expenses (based on the percentage of total hours worked by all employees on Gladstone Commercial matters). Gladstone Management further passes its share of these expenses along to Gladstone Commercial under a separate advisory agreement. As a result of this expense sharing arrangement, certain of our expenses declined during the quarter ended December 31, 2003 and we expect that they will continue to be somewhat lower in future periods than they have historically been. However, the actual amount by which our expenses decline in future periods will depend upon the relative time that our personnel spend on our and Gladstone Commercial matters.

Moreover, we have presented to our stockholders for their consideration at our 2004 annual meeting of stockholders a proposal to enter into an advisory agreement with Gladstone Management, whereby we would pay Gladstone Management an annual advisory fee of 1.25% of total assets excluding cash and cash equivalents pledged to creditors, payable in quarterly increments of 0.3125%, and an annual administrative fee of 0.75% of total assets excluding cash and cash equivalents pledged to creditors, payable in quarterly increments of 0.1875%. We would continue to pay direct expenses including, but not limited to, directors fees, legal and accounting fees, and stockholder related expenses.

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States 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 this report. We have identified our investment valuation process as our most critical accounting policy.

Investment Valuation

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

We value our investment portfolio each quarter. Members of our portfolio management team prepare the portfolio company valuations using the most recent portfolio company financial statements and forecasts. These individuals also consult with the respective principal who originated the portfolio investment to obtain further updates on the portfolio company's performance, including information such as industry trends, new product development, and other operational issues. As of March 31, 2003, we engaged Standard & Poor's Loan Evaluation Service (S&P) to help evaluate the value of the majority of our loan securities. Since June 30, 2003, our S&P engagement includes evaluations on exit fees (conditional interest included in some loan securities). We and S&P only evaluate the value of an exit fee if the probability of receiving the exit fee on a given loan is above 6-8%, a threshold of significance, in which case a value is assigned. Upon completing the data collection, the valuation data is presented to S&P. S&P makes its independent assessment of the data and assesses its own data to determine market values for the securities. With regard to its work, S&P has issued the following paragraph:

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

With our assessment and S&P value estimates as a backdrop, our Board votes to accept or not accept the analyses and values recommended by management and S&P. At December 31, 2003, the Board elected to accept the valuations recommended by S&P on those loans as denoted on the Schedule of Investments in the Consolidated Financial Statements. Because there is a lag between when we close a loan and when the loan can be evaluated by S&P, new loans are not valued immediately by S&P; rather, the Board makes its own determination about the value of the loan in accordance with our valuation policy. Because S&P does not provide values for mortgage loans or equity securities, the directors also determine fair value of these using the valuation policy:

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

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

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

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

Company's System	**First NRSRO**	**Second NRSRO**	**Gladstone Capital's Description(a)**
>10	Baa2	BBB	Probability of Default (PD during the next ten years is 4% and the Expected Loss (EL) is 1% or less
10	Baa3	BBB-	PD is 5% and the EL is 1% to 2%
9	Ba1	BB+	PD is 10% and the EL is 2% to 3%
8	Ba2	BB	PD is 16% and the EL is 3% to 4%
7	Ba3	BB-	PD is 17.8% and the EL is 4% to 5%
6	B1	B+	PD is 22.0% and the EL is 5% to 6.5%
5	B2	B	PD is 25% and the EL is 6.5% to 8%
4	B3	B-	PD is 27% and the EL is 8% to 10%
3	Caa1	CCC+	PD is 30% and the EL is 10.0% to 13.3%
2	Caa2	CCC	PD is 35% and the EL is 13.3% to 16.7%
1	Caa3	CC	PD is 65% and the EL is 16.7% to 20%
0	N/a	D	PD is 85% or there is a Payment Default: and the EL is greater than 20%

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

At September 30, 2003, the average debt security was risk rated 7.8 for all debt securities and the weighted average risk rating was 7.6 for all the debt securities. At December 31, 2003 the average debt security was risk rated 7.8 for all debt securities and the weighted average risk rating was 7.6 for all debt securities. The highest rated loan was 9.0 and the lowest was 7.0. The above scale gives an indication of the probability of default and the magnitude of the loss if there is a default using the expanded risk rating scale.

Rating	December 31, 2003
Average	7.8
Weighted Average	7.6
Highest	9.0
Lowest	7.0

Our policy is to stop accruing interest on an investment if we determine that interest is no longer collectible. To date we have not placed any investments on non-accrual. At September 30, 2003 no payments were past due on any of our debt securities, however at December 31, 2003 one investment was late in remitting its principal payment and has since remitted the past due amount. We do not risk rate our equity securities.

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

For equity securities, we first determine if there is any market for the equity security. If there is a market, then we determine the value based on the market prices for the security, even if that market is not robust. At December 31, 2003 and September 30, 2003 there was no market for any of the equity securities we owned. If there is no market for the equity securities, then we use the same information we would use for a debt security valuation described above, 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 sales price in the future, the value of the securities based on the recent sale of comparable transactions and a review of similar companies that are publicly traded and the market multiple of their equity securities. At December 31, 2003 we had $37,000 invested, at cost, in equity securities compared to our debt portfolio with a cost basis of $120,626,277.

At December 31, 2003, The Home Care Supply, Inc. senior loan had an appreciation of $494,100 in its value as a result of the value applied to the exit fee. Further, the value of our warrants in Finn Corporation had an appreciation of $398,649 at December 31, 2003. This appreciation plus an increase of $5,000 on the Burt's Bee's investment totals $897,749 and partially offsets depreciation of $2,677,651.

Managerial Assistance Fees

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

RESULTS OF OPERATIONS

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

Investment Income

Investment income for the three months ended December 31, 2003 was approximately $4.0 million as compared to $3.2 million for the three months ended December 31, 2002. This increase was primarily a result of increased interest income from an increased number of investments as compared to the same period of the prior year.

Interest income from our investments in debt securities of private companies was approximately $3.6 million, including $138,000 of PIK interest, for the three months ended December 31, 2003 as compared to $2.9 million , including $211,000 of PIK interest, for the three months ended December 31, 2001. This increase was primarily a result of an increase in investments of $36.8 million at December 31, 2003 as compared to investments at December 31, 2002.

The weighted average yield on our portfolio for the three months ended December 31, 2003 was 12.29% (without giving effect to PIK interest) and 13.12% (after giving effect to PIK interest). The weighted average yield on our portfolio for the three months ended December 31, 2002 was 13.36% (without giving effect to PIK interest) and 14.30% (after giving effect to PIK interest).

Interest income from invested cash and cash equivalents for the three months ended December 31, 2003 was approximately $49,000, as compared to $198,000 for the three months ended December 31, 2002. This decrease was primarily a result of the $58.5 million of new investments made between December 31, 2002 and December 31, 2003.

For the three months ended December 31, 2003 and December 31, 2002, we recorded approximately $109,000 in interest income from loans to our employees in connection with the exercise of employee stock options.

Managerial assistance fees were $255,000 for the three months ended December 31, 2003, as compared to $0 for the three months ended December 31, 2002. This increase was the result of the new GQM Acquisition Corp. investment closing during the quarter with related fees.

Operating Expenses

Operating expenses for the three months ended December 31, 2003 were approximately $1.0 million, as compared to approximately $823,000 for the three months ended December 31, 2002. This increase was primarily a result of an increase in professional fees, directors fees, stockholder related costs and financing fees.

Salaries and benefits for the three months ended December 31, 2003 were approximately $391,000, as compared to approximately $443,000 for the three months ended December 31, 2002. Although employee headcount increased for the quarter ended December 31, 2003 as compared to December 31, 2002, the salaries and benefits expense decreased due to the new expense sharing arrangement with Gladstone Management, which allocates expenses based on each employee's time to Gladstone Commercial Corporation.

Rent expense for the three months ended December 31, 2003 were approximately $38,000, as compared to approximately $55,000 for the three months ended December 31, 2002. The decrease in rent is due to the new expense sharing arrangement with Gladstone Management, which allocates general expenses based on a ratio of all employees' time allocated to Gladstone Commercial Corporation to total time spent.

Professional fees, consisting primarily of legal and audit fees, for the three months ended December 31, 2003 were approximately $178,000, as compared to approximately $115,000 for the three months ended December 31, 2002. The increase is due to a rise in legal fees.

Directors' fees for the three months ended December 31, 2003 were approximately $24,000, as compared to approximately $14,000 for the three months ended December 31, 2002. The increase is due to an increase in the number of directors during the three months ended December 31, 2003 as compared to December 31, 2002.

Insurance expense for the three months ended December 31, 2003 was approximately $74,000, as compared to approximately $71,000 for the three months ended December 31, 2002.

Stockholder related costs for the three months ended December 31, 2003 were approximately $53,000, as compared to approximately $12,000 for the three months ended December 31, 2002. The increase is mainly due to the printing of the 2003 annual report to stockholders.

Financing fees consist of the related service fees associated with the line of credit, backup service and the amortization of deferred financing costs. Financing fees for the three months ended December 31, 2003 were approximately $145,000. There were no financing fees incurred the three months ended December 31, 2002.

General and administrative expenses, consisting primarily of office operations, travel, and data communications expenses for the three months ended December 31, 2003 were approximately $127,000, as compared to approximately $125,000 for the three months ended December 31, 2002. This increase was primarily a result of the related expenses from increased operations during the three months ended December 31, 2003 as compared to the three months ended December 31, 2002. General and administrative expenses are also in accordance with the new expense sharing arrangement with Gladstone Management, which allocates general expenses based on a ratio of all employees' time allocated to Gladstone Commercial Corporation to total time spent.

Net Increase in Stockholders' Equity from Operations

We had a net increase in stockholders' equity resulting from operations of $1,381,074 for the three months ended December 31, 2003. Based on a weighted-average of 10,081,844 (basic) and 10,333,529 (diluted) shares outstanding, our net increase in stockholders' equity from operations per common share for the three months ended December 31, 2003 was $0.14 for basic earnings and $0.13 for diluted earnings.

For the three months ended December 31, 2002, werealized a net increase in stockholders' equity resulting from operations of approximately $2.4 million. Based on a weighted-average of 10,071,844 (basic) and 10,124,197 (diluted) shares outstanding, our net increase in stockholders' equity resulting from operations per common share for the three months ended December 31, 2002 was $0.24 for both basic and diluted.

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2003, we had investments in debt securities of, or loans to, 12 private companies, totaling approximately $117.6 million of total investment assets. This number includes approximately $138,000 in accrued PIK interest, which as described in "Overview," is added to the carrying value of our investments.

In November 2003, we purchased a $1.0 million participation in a $55.0 million senior term loan to Burt's Bees, Inc., a manufacturer of personal and household products.

In December 2003 we closed two loans with GQM Acquisition Corp. totaling $14.5 million and also containing a success fee provision. GQM Acquisition Corp conducts business as Gamill, Inc. and is the designer and assembler of quilting machines and accessories.

In November 2003, Kozy Shack Enterprises repaid $900,000 to fully settle its principal obligation. In December 2003, we sold a $3.2 million principal portion of our Inca Metal Products Corp/Kingway Acquisition Inc./Clymer Acquisition Inc. investment. The remaining portion of this investment currently has a cost basis of $2.5 million.

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

Year	Amount
2004	$ 3,047,870
2005	$ 14,139,932
2006	$ 17,665,455
2007	$ 26,197,753
2008	$ 17,741,667
Thereafter	$ 41,870,600
Total	$ 120,663,277

Cash provided by operating activities for the three months ended December 31, 2003, consisting primarily of the items described in "Results of Operations," was approximately $3.9 million. Net cash provided by investing activities was approximately $3.8 million during the three months ended December 31, 2003. The net cash provided by investing activities was mainly due to the proceeds of $93.1 million from the repurchase agreement and principal repayments of $4.5 million from our portfolio companies, partially offset by new investments of $15.5 million and repayment of repurchase agreement of $78.4 million. Net cash used in financing activities was approximately $6.5 million for the three months ended December 31, 2003 and consisted mainly of the payment of dividends.

During the three months ended December 31, 2003, cash and cash equivalents increased from approximately $101.1 million at the beginning of the period to approximately $102.2 million at the end of the period.

On December 31, 2003, we entered into a repurchase agreement with UBS Paine Webber for approximately $93.1 million. The repurchase agreement was fully collateralized by a United States treasury bill with a fair value of approximately $95.0 million that matured on January 2, 2004. The interest rate on the repurchase agreement was 0.92%. This repurchase agreement was reflected on our balance sheet as of December 31, 2003 as an increase in cash and cash equivalents pledged to creditors of $95.0 million, along with a corresponding liability for approximately the same amount. The repurchase agreement was settled on January 2, 2004. In the future, we plan to use a similar form of repurchase agreement as an investment option or in order to satisfy certain asset diversification requirements and maintain our status as a RIC.

In order to qualify as a regulated investment company and to avoid corporate level tax on the income we distribute to our stockholders, we are required, under Subchapter M of the Code, to distribute at least 90% of our ordinary income and short-term capital gains to our stockholders on an annual basis. In accordance with these requirements, we declared and paid a monthly cash dividend of $0.11 per common share for each month in October, November and December 2003.

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

Revolving Credit Facility

Through our wholly-owned subsidiary, Gladstone Business Loan LLC ("Business Loan"), we have obtained a $100 million revolving credit facility. On May 19, 2003, we executed a Purchase and Sale Agreement pursuant to which we agreed to sell certain loans to Business Loan in consideration of a membership interest therein. Simultaneously, Business Loan executed a Credit Agreement with CIBC World Markets Inc., as administrative agent, and others, pursuant to which Business Loan pledged the loans purchased from us to secure future advances by certain institutional lenders. Interest rates charged on the advances under the facility will be based on LIBOR, the Prime Rate or the Federal Funds Rate, depending on market conditions, and will adjust periodically.

The facility contains covenants that, among other things, require Business Loan to maintain its status as a separate entity; prohibit certain significant corporate transactions (such as mergers, consolidations, liquidations or dissolutions); and restrict material changes to our credit and collection policies. The facility also restricts some of the terms and provisions (including interest rates, terms to maturity and payments schedules) and limits the borrower and industry concentrations of loans that are eligible to secure advances. As of December 31, 2003, Business Loan was in compliance with all of the facility covenants. We currently intend to securitize all of the loans held by Business Loan and will use the proceeds from the securitization to pay down any amounts then outstanding under the revolving credit facility. There are currently no advances outstanding under this facility.

Gladstone Advisers, Inc. ("Advisers"), our servicing subsidiary, will service the loans pledged under the facility. As a condition to this servicing arrangement, we executed a Performance Guaranty pursuant to which we guaranteed that Advisers would comply fully with all of its obligations under the facility. The Performance Guaranty requires us to maintain a minimum net worth of $100 million and to maintain "asset coverage" with respect to "senior securities representing indebtedness" of at least 200%, in accordance with Section 18 of the 1940 Act. As of December 31, 2003, we were in compliance with our covenants under the Performance Guaranty.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

We are subject to financial market risks, including changes in interest rates. We expect that ultimately approximately 50% of the loans in our portfolio will be made at fixed rates, with approximately 50% made at variable rates. Currently our portfolio has approximately 62% of the total loan portfolio value at fixed rates and the remaining 38% of the total loan portfolio value at variable rates.

Pursuant to our line of credit, we have agreed to enter into hedging transactions, such as interest rate swaps, in connection with the borrowings that we make under the line of credit, which we currently expect to begin making in the near future. Such transactions will effectively convert our fixed rate portfolio loans into variable rate loans in an effort to mitigate our exposure to increases in interest rates on our borrowings on the line of credit, which will be at variable rates. Furthermore, 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 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 our portfolio of investments.

ITEM 4. CONTROLS AND PROCEDURES.

As of December 31, 2003, we, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective in timely alerting management, including the Chief Executive Officer and Chief Financial Officer, of material information about us required to be included in periodic Securities and Exchange Commission filings. However, in evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

There have been no changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2003, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II–OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

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

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS.

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

Not applicable.

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

Not applicable.

ITEM 5. OTHER INFORMATION.

On December 9, 2003, John Outland was appointed to the Board of Directors by the existing members of the Board of Directors to fill a newly created seat.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) EXHIBITS

See the exhibit index on page 25.

(b) REPORTS ON FORM 8-K

On December 11, 2003, the Company filed an Item 12 Form 8-K announcing the release of earnings for the quarter ended September 30, 2003.

SIGNATURE

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

GLADSTONE CAPITAL CORPORATION

By: /s/ HARRY BRILL

Harry Brill
Chief Financial Officer and Treasurer

Date: February 17, 2004

EXHIBIT INDEX

Exhibit	Description
3.1	Articles of Amendment and Restatement of the Articles of Incorporation, incorporated by reference to Exhibit a.2 to Pre-Effective Amendment No. 1 to the Registration Statement on Form N-2 (File No. 333-63700), filed July 27, 2001.
3.2	By-laws, incorporated by reference to Exhibit b to Pre-Effective Amendment No. 1 to the Registration Statement on Form N-2 (File No. 333-63700), filed July 27, 2001.
3.3	Amendment to By-laws.
11	Computation of Per Share Earnings (included in the notes to the unaudited financial statements contained in this report).
31.1	Certification of Chief Executive Officer pursuant to section 302 of The Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to section 302 of The Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to section 906 of The Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to section 906 of The Sarbanes-Oxley Act of 2002.

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

Exhibit 3.3

AMENDMENT TO BYLAWS
OF
GLADSTONE CAPITAL CORPORATION

The following Amendment is hereby made to the Bylaws (the "***Bylaws***") of Gladstone Capital Corporation, a Maryland corporation (the "***Company***"), as of December 12, 2003:

1. Article III, Section 15 of the Bylaws is hereby deleted in its entirety and replaced with the following:

"**Section 15**. **Vacancy.** Any vacancy occurring in the Board of Directors for any cause, including by reason of an increase in the number of directors, may be filled by a majority of the remaining members of the Board of Directors, although such majority is less than a quorum. Notwithstanding the foregoing, if the stockholders of any class or series are entitled separately to elect one or more directors, a majority of the remaining directors elected by that class or series or the sole remaining director elected by that class or series may fill any vacancy among the number of directors elected by that class or series. If the Board of Directors is classified, any director elected to fill a vacancy shall hold office for the remainder of the full term of the class of directors in which the vacancy occurred, and until a successor is elected and qualifies."

2. Article IV, Section 27 of the Bylaws is hereby deleted in its entirety and replaced with the following:

"**Section 27**. **Ethics, Nominating and Corporate Governance Committee.** The Board of Directors shall appoint an Ethics, Nominating and Corporate Governance Committee consisting of not fewer than two members, one of whom shall be designated as Chairman of the Ethics, Nominating and Corporate Governance Committee, and all of whom shall be independent, as defined by NASD rules prevailing at the time. The Ethics, Nominating and Corporate Governance Committee shall have and may exercise those rights, powers and authority of the Board of Directors as may from time to time be granted to it by the Board of Directors; provided, however, that in addition to any such rights, powers or authority, the Ethics, Nominating and Corporate Governance Committee shall have the exclusive right to recommend candidates for election as director to the Board of Directors. The Board of Directors shall adopt a formal written charter for the Ethics, Nominating and Corporate Governance Committee that specifies the nominations process and such related matters as may be required under the federal securities laws."

3. Article IV, Section 28 of the Bylaws is hereby deleted in its entirety and replaced with the following:

"**Section 28**. **Compensation Committee.** The Board of Directors may appoint from its membership a Compensation Committee consisting of not fewer than two members, one of whom shall be designated as Chairman of the Compensation Committee, and all of whom shall be independent, as defined by NASD rules prevailing at the time. The Compensation Committee shall have and may exercise those rights, powers and authority of the Board of Directors as may from time to time be granted to it by the Board of Directors.

* * * * *

Exhibit 31.1

CERTIFICATION
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, David Gladstone, certify that:

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

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

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

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

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

b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and

c) disclosed in this report any changes in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect the registrant's internal control over financial reporting.

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

a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial data; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 17, 2004

/s/ DAVID GLADSTONE

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

Exhibit 31.2

CERTIFICATION
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Harry Brill, certify that:

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

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

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

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

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

b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and

c) disclosed in this report any changes in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect the registrant's internal control over financial reporting; and

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

a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial data; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 17, 2004

/s/ HARRY BRILL
Harry Brill
Chief Financial Officer and Treasurer

Exhibit 32.1

CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

The undersigned, the Chief Executive Officer of Gladstone Capital Corporation (the “Company”), hereby certifies on the date hereof, pursuant to 18 U.S.C. §1350(a), as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q for the quarter ended December 31, 2003 (“Form 10-Q”), filed concurrently herewith by the Company, fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended, and that the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: February 17, 2004

/s/ David Gladstone
David Gladstone
Chief Executive Officer

Exhibit 32.2

CERTIFICATION OF THE CHIEF FINANCIAL OFFICER PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

The undersigned, the Chief Financial Officer of Gladstone Capital Corporation (the “Company”), hereby certifies on the date hereof, pursuant to 18 U.S.C. §1350(a), as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q for the quarter ended December 31, 2003 (“Form 10-Q”), filed concurrently herewith by the Company, fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended, and that the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: February 17, 2004

/s/ Harry Brill
Harry Brill
Chief Financial Officer