

GLADSTONE INVESTMENT CORPORATION\DE
Form 10-Q
October 31, 2007

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**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 SEPTEMBER 30, 2007

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

COMMISSION FILE NUMBER: 000-51233

GLADSTONE INVESTMENT CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE

(State or other jurisdiction of incorporation or organization)

83-0423116

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

**1521 WESTBRANCH DRIVE, SUITE 200
MCLEAN, VIRGINIA 22102**

(Address of principal executive office)

(703) 287-5800

(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 a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (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 October 29, 2007 was 16,560,100.

GLADSTONE INVESTMENT CORPORATION

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GLADSTONE INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES
(UNAUDITED)

| | <u>September 30,</u> <u>2007</u> | <u>March 31,</u> <u>2007</u> |
|---|-------------------------------------|---------------------------------|
| ASSETS | | |
| Non-Control/Non-Affiliate investments (Cost 9/30/07: \$209,086,763; 3/31/07: \$138,567,741) | \$ 200,851,289 | \$ 138,168,612 |
| Control investments (Cost 9/30/07: \$116,604,804; 3/31/07: \$116,302,372) | 118,772,882 | 113,016,491 |
| Affiliate investments (Cost 9/30/07: \$18,327,058; 3/31/07: \$19,750,000) | 18,793,931 | 19,762,500 |
| Total investments at fair value (Cost 9/30/07: \$344,018,625; 3/31/07: \$274,620,113) | 338,418,102 | 270,947,603 |
| Cash and cash equivalents | 23,189,457 | 37,788,941 |
| Interest receivable | 2,001,035 | 1,306,090 |
| Prepaid insurance | 164,724 | 83,819 |
| Deferred finance costs | 224,042 | 627,960 |
| Due from custodian | 2,436,682 | 12,694,985 |
| Due from Adviser (Refer to Note 4) | | 20,383 |
| Other assets | 398,972 | 120,434 |
| TOTAL ASSETS | \$ 366,833,014 | \$ 323,590,215 |
| LIABILITIES | | |
| Due to Administrator (Refer to Note 4) | \$ 227,767 | \$ 162,244 |
| Due to Adviser (Refer to Note 4) | 227,687 | |
| Borrowings under line of credit | 146,050,000 | 100,000,000 |
| Accrued expenses | 1,019,264 | 523,698 |
| Other liabilities | 69,949 | 85,764 |
| Total Liabilities | 147,594,667 | 100,771,706 |
| NET ASSETS | \$ 219,238,347 | \$ 222,818,509 |
| ANALYSIS OF NET ASSETS: | | |
| Common stock, \$0.001 par value, 100,000,000 shares authorized and 16,560,100 shares issued and outstanding | \$ 16,560 | \$ 16,560 |
| Capital in excess of par value | 230,065,064 | 230,096,572 |
| Net unrealized depreciation of investment portfolio | (5,600,523) | (3,672,510) |
| Distributions in excess of net investment income | (5,242,754) | (3,622,113) |
| Total Net Assets | \$ 219,238,347 | \$ 222,818,509 |
| Net assets per share | \$ 13.24 | \$ 13.46 |

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

GLADSTONE INVESTMENT CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS
SEPTEMBER 30, 2007
(UNAUDITED)

| Company(1) | Industry | Investment(2) | Cost | Fair Value |
|--|--|---|--------------|--------------|
| NON-CONTROL/NON-AFFILIATE INVESTMENTS | | | | |
| <i>Syndicated Loans:</i> | | | | |
| ACS Media, LLC | Service directory advertising | Senior Term Debt (7.6%, Due 11/2013)(3) | \$ 4,821,654 | \$ 4,579,408 |
| Activant Solutions, Inc. | Service enterprise software and services | Senior Term Debt (7.5%, Due 5/2013)(3) | 3,743,695 | 3,574,646 |
| Advanced Homecare Holdings, Inc. | Service home health nursing services | Senior Term Debt (9.1%, Due 8/2014)(3) | 2,992,500 | 2,947,612 |
| Aeroflex, Inc. | Service provider of highly specialized electronic equipment | Senior Term Debt (8.9%, Due 8/2014)(3) | 1,901,196 | 1,955,000 |
| American Safety Razor Company Inc. | Manufacturing razors and blades | Senior Term Debt (7.7%, Due 7/2013)(3) | 1,483,464 | 1,444,219 |
| Aspect Software, Inc. | Service call center software | Senior Term Debt (8.3%, Due 7/2011)(3) | 2,980,718 | 2,828,625 |
| Brock Holdings II, Inc. | Service industrial specialty maintenance | Senior Term Debt (7.1%, Due 8/2013)(3)(5) | 2,987,113 | 2,865,600 |
| Compsych Investments Corp. | Service employee assistance programs | Senior Term Debt (8.0%, Due 2/2012)(3)(5) | 3,589,734 | 3,424,095 |
| CRC Health Group, Inc. | Service substance abuse treatment | Senior Term Debt (7.4%, Due 2/2012)(3) | 9,945,603 | 9,599,783 |
| Critical Homecare Solutions, Inc. | Service home therapy and respiratory treatment | Senior Term Debt (8.6%, Due 1/2012)(3)(5) | 4,567,171 | 4,519,350 |
| CST Industries Acquisition, Inc. | Manufacturing metal storage units | Senior Term Debt (8.1%, Due 8/2013)(3) | 991,793 | 975,150 |
| Dealer Computer Services, Inc. | Manufacturing & Service systems for automotive retailers | Senior Term Debt (7.2%, Due 9/2013)(3) | 1,914,187 | 1,849,624 |
| Generac Acquisition Corp. | Manufacturing standby power products | Senior Term Debt (9.3%, Due 11/2013)(3)(5) | 6,944,172 | 6,220,250 |
| Graham Packaging Holdings Company | Manufacturing plastic containers | Senior Term Debt (7.6%, Due 10/2011)(3) | 10,447,500 | 10,290,787 |
| Hargray Communications Group, Inc. | Service triple-play (cable, phone, internet) provider | Senior Term Debt (7.4%, Due 6/2014)(3) | 999,448 | 975,056 |
| HMTBP Acquisition II Corp. | Service aboveground storage tanks | Senior Term Debt (7.4%, Due 5/2014)(3)(5) | 3,980,736 | 3,900,400 |
| Hudson Products Holdings, Inc. | Manufacturing heat transfer solutions | Senior Term Debt (7.9%, Due 12/2013)(3) | 6,052,182 | 5,957,958 |
| Huish Detergents, Inc. | Manufacturing household cleaning products | Senior Term Debt (7.2%, Due 4/2014)(3) | 1,996,173 | 1,875,300 |
| Hyland Software, Inc. | Service provider of enterprise content management software | Senior Term Debt (7.9%, Due 7/2013)(3) | 3,961,116 | 3,880,000 |
| Interstate Fibernet, Inc. | Service provider of voice and data telecommunications services | Senior Term Debt (9.2%, Due 7/2013)(3) | 9,951,400 | 9,900,000 |
| J. Crew Operating Corp. | Retail apparel | Senior Term Debt (7.1%, Due 5/2013)(3) | 879,473 | 859,649 |
| KIK Custom Products, Inc. | Manufacturing consumer products | Senior Term Debt (7.5%, Due 5/2014)(3) | 4,000,967 | 3,780,000 |
| Kronos, Inc. | Service workforce management solutions | Senior Term Debt (7.5%, Due 6/2014)(3) | 1,995,000 | 1,905,225 |
| Lexicon Marketing USA, Inc. | Service marketing to Hispanic community | Senior Term Debt (8.4%, Due 5/2012)(3)(5) | 2,947,630 | 1,826,226 |
| Local TV Finance, LLC | Service television station operator | Senior Term Debt (7.3%, Due 5/2013)(3) | 1,000,276 | 950,119 |
| LVI Services, Inc. | Service asbestos and mold remediation | Senior Term Debt (10.0%, Due 11/2010)(3)(5) | 6,404,834 | 6,098,869 |
| MedAssets, Inc. | Service pharmaceuticals and healthcare GPO | Senior Term Debt (7.6%, Due 10/2013)(3)(5) | 6,468,324 | 6,272,245 |
| MediMedia USA, LLC | Service healthcare and pharmaceutical marketing | | 2,247,425 | 2,143,800 |

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| Company(1) | Industry | Investment(2) | Cost | Fair Value |
|--------------------------------|--|---|-----------|------------|
| | | Senior Term Debt (7.5%, Due 10/2013)(3) | | |
| Mitchell International, Inc. | Service automobile insurance claims processing | Senior Term Debt (7.4%, Due 3/2014)(3)(5) | 997,648 | 935,300 |
| National Mentor Holdings, Inc. | Service home health care | Senior Term Debt (7.2%, Due 6/2013)(3) | 1,977,482 | 1,857,793 |
| Network Solutions, LLC | Service internet domain solutions | Senior Term Debt (7.7%, Due 3/2014)(3) | 9,718,581 | 9,231,075 |
| NPC International Inc. | Service Pizza Hut franchisee | Senior Term Debt (7.1%, Due 5/2013)(3) | 2,896,150 | 2,709,793 |
| Open Solutions, Inc. | Service software outsourcing for financial institutions | Senior Term Debt (7.6%, Due 1/2014)(3) | 2,692,663 | 2,555,301 |
| Ozburn-Hessey Holding Co. LLC | Service third party logistics | Senior Term Debt (8.5%, Due 8/2012)(3) | 7,692,673 | 7,340,487 |
| Pinnacle Foods Finance, LLC | Manufacturing branded food products | Senior Term Debt (8.0%, Due 4/2014)(3) | 3,991,269 | 3,860,325 |
| PTS Acquisition Corp. | Manufacturing drug delivery and packaging technologies | Senior Term Debt (7.5%, Due 4/2014)(3) | 6,982,500 | 6,668,288 |
| QTC Acquisition, Inc. | Service outsourced disability evaluations | Senior Term Debt (7.4%, Due 11/2012)(3) | 1,997,974 | 1,905,225 |
| Radio Systems Corporation | Service design electronic pet containment products | Senior Term Debt (8.4%, Due 9/2013)(3) | 1,979,503 | 1,960,200 |
| Rally Parts, Inc. | Manufacturing aftermarket motorcycle parts and accessories | Senior Term Debt (7.7%, Due 11/2013)(3) | 2,499,566 | 2,388,203 |

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NON-CONTROL/NON-AFFILIATE INVESTMENTS (Continued)

| | | | | | |
|--|--------------------------|--|--|-----------------------|-----------------------|
| RPG Holdings, Inc. | Manufacturing and design | greeting cards | Senior Term Debt (9.1%, Due 12/2011)(3) | \$ 4,553,068 | \$ 4,278,958 |
| SafeNet, Inc. | Service | chip encryption products | Senior Term Debt (7.9%, Due 4/2014)(3) | 3,002,375 | 2,745,000 |
| SGS International, Inc. | Service | digital imaging and graphics | Senior Term Debt (7.9%, Due 12/2011)(3) | 1,603,034 | 1,572,616 |
| Specialized Technology Resources, Inc. | Service & Manufacturing | consumer product quality assurance | Senior Term Debt (7.6%, Due 6/2014)(3)(5) | 1,497,325 | 1,443,881 |
| Stolle Machinery Company | Manufacturing | can-making equipment and parts | Senior Term Debt (7.5%, Due 9/2012)(3) | 496,783 | 486,337 |
| Survey Sampling, LLC | Service | telecommunications-based sampling | Senior Term Debt (7.7%, Due 5/2011)(3)(5) | 3,140,946 | 2,954,119 |
| Synagro Technologies, Inc. | Service | waste treatment and recycling | Senior Term Debt (7.5%, Due 3/2014)(3) | 502,262 | 485,000 |
| Triad Laboratory Alliance, LLC | Service | regional medical laboratories | Senior Term Debt (8.8%, Due 12/2011)(3)(5) | 4,926,833 | 4,716,000 |
| United Surgical Partners International, Inc. | Service | outpatient surgical provider | Senior Term Debt (7.4%, Due 4/2014)(3) | 1,326,290 | 1,279,870 |
| US Silica Company | Service | miner, processor and seller of industrial silica | Senior Term Debt (9.2%, Due 8/2013)(3) | 4,950,701 | 4,950,000 |
| Wastequip, Inc. | Service | process and transport waste materials | Senior Term Debt (7.5%, Due 2/2013)(3) | 2,936,556 | 2,819,094 |
| WaveDivision Holdings, LLC | Service | cable | Senior Term Debt (7.8%, Due 6/2014)(3)(5) | 1,925,086 | 1,862,400 |
| West Corporation | Service | business process outsourcing | Senior Term Debt (7.6%, Due 10/2013)(3) | 11,406,011 | 11,173,783 |
| Subtotal Syndicated Loans | | | | \$ 197,888,763 | \$ 189,578,044 |
| Non-syndicated Loans | | | | | |
| B-Dry, LLC | Service | basement waterproofer | Senior Term Debt (10.6%, Due 11/2007) | 125,000 | 125,000 |
| | | | Senior Term Debt (10.6%, Due 5/2014) | 10,773,000 | 10,773,000 |
| | | | Common Stock Warrants(4) | 300,000 | 375,245 |
| | | | | 11,198,000 | 11,273,245 |
| Total Non-Control/Non-Affiliate Investments | | | | \$ 209,086,763 | \$ 200,851,289 |

CONTROL INVESTMENTS

| | | | | | |
|-------------------------|---------------|-------------------------------|--|---------------|---------------|
| A. Stucki Holding Corp. | Manufacturing | railroad freight car products | Senior Term Debt (10.3% Due 3/2012) | \$ 14,463,750 | \$ 14,463,750 |
| | | | Senior Term Debt (12.5% Due 3/2012)(6) | 11,000,000 | 11,000,000 |
| | | | Senior Subordinated Term Debt (13% Due 3/2014) | 5,485,760 | 5,485,760 |
| | | | Preferred Stock(4) | 4,386,686 | 4,572,249 |
| | | | Common Stock(4) | 129,956 | 5,272,696 |
| | | | | 35,466,152 | 40,794,455 |

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| | | | | |
|-----------------------|---|--|-------------------|-------------------|
| Acme Cryogenics, Inc. | Manufacturing manifolds and pipes for industrial gasses | Senior Subordinated Term Debt (11.5% Due 3/2013) | 14,500,000 | 14,500,000 |
| | | Redeemable Preferred Stock(4) | 6,983,785 | 7,400,647 |
| | | Common Stock(4) | 1,045,181 | 4,397,616 |
| | | Common Stock Warrants(4) | 24,686 | 177,816 |
| | | | <u>22,553,652</u> | <u>26,476,079</u> |

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CONTROL INVESTMENTS (Continued)

| | | | | |
|------------------------------------|--|---|-----------------------|-----------------------|
| Chase II Holdings Corp. | Manufacturing traffic doors | Revolving Credit Facility (9.8% Due 3/2008)(7) | \$ 2,780,000 | \$ 2,780,000 |
| | | Senior Term Debt (10.3%, Due 3/2011) | 10,450,000 | 10,450,000 |
| | | Senior Term Debt (12.0% Due 3/2011)(6) | 7,920,000 | 7,920,000 |
| | | Subordinated Term Debt (13.0% Due 3/2013) | 6,167,810 | 6,167,810 |
| | | Redeemable Preferred Stock(4) | 6,960,806 | 6,822,047 |
| | | Common Stock(4) | 61,384 | |
| | | | 34,340,000 | 34,139,857 |
| Hailey Transport Corporation | Retail and Service school buses and parts | Senior Subordinated Term Debt (12.0%, Due 1/2012) | 4,628,682 | |
| | | Preferred Stock(4) | 2,500,000 | |
| | | | 7,128,682 | |
| Quench Holdings Corp. | Service sales, installation and service of water coolers | Revolving Credit Facility (9.8%, Due 3/2009)(8) | 1,450,000 | 1,450,000 |
| | | Senior Term Debt (9.8%, Due 3/2011) | 4,500,000 | 4,500,000 |
| | | Subordinated Term Debt (11.5%, Due 3/2011) | 7,910,000 | 7,910,000 |
| | | Common Stock(4) | 3,256,318 | 3,502,491 |
| | | | 17,116,318 | 17,362,491 |
| Total Control Investments | | | \$ 116,604,804 | \$ 118,772,882 |
| AFFILIATE INVESTMENTS | | | | |
| Noble Logistics, Inc. | Service aftermarket auto parts delivery | Revolving Credit Facility (9.7%, Due 12/2009)(9) | \$ 1,650,000 | \$ 1,650,000 |
| | | Senior Term Debt (9.7%, Due 12/2011) | 6,427,058 | 6,427,058 |
| | | Senior Term Debt (11.7% Due 3/2011)(6) | 7,000,000 | 7,000,000 |
| | | Preferred Stock(4) | 1,750,000 | 1,963,596 |
| | | Common Stock(4) | 1,500,000 | 1,753,277 |
| | | | 18,327,058 | 18,793,931 |
| Total Affiliate Investments | | | \$ 18,327,058 | \$ 18,793,931 |
| Total Investments | | | \$ 344,018,625 | \$ 338,418,102 |

- (1) Certain of the listed securities are issued by affiliate(s) of the indicated portfolio company.
- (2) Percentage represents the weighted average interest rates in effect at September 30, 2007 and due date represents the contractual maturity date.
- (3) Marketable securities are valued based on the indicative bid price, as of September 30, 2007, from the respective originating syndication agent's trading desk.

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- (4) Security is non-income producing.
- (5) Valued using Standard & Poor's Securities Evaluations, Inc. opinions of value at September 30, 2007.
- (6) Last out tranche of senior debt, meaning if the portfolio company is liquidated then the holder of the last out tranche is paid after the senior debt.
- (7) Total available under the revolving credit facility is \$3,500,000, of which \$720,000 remains undrawn at September 30, 2007.
- (8) Total available under the revolving credit facility is \$1,500,000, of which \$50,000 remains undrawn at September 30, 2007.
- (9) Total available under the revolving credit facility is \$2,000,000, of which \$350,000 remains undrawn at September 30, 2007.

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

GLADSTONE INVESTMENT CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS
March 31, 2007
(UNAUDITED)

| Company(1) | Industry | Investment(2) | Cost | Fair Value |
|--|--|---|--------------|--------------|
| NON-CONTROL/NON-AFFILIATE INVESTMENTS | | | | |
| ACS Media, LLC | Service directory advertising | Senior Term Debt (7.9%, Due 11/2013)(3) | \$ 4,857,421 | \$ 4,857,822 |
| Activant | Service enterprise software and services | Senior Term Debt (7.4%, Due 5/2013)(3) | 3,745,496 | 3,714,281 |
| American Safety Razor Company Inc. | Manufacturing razors and blades | Senior Term Debt (7.9%, Due 7/2013)(3) | 1,491,154 | 1,492,472 |
| Aramark Corp. | Service vending services | Senior Term Debt (7.5%, Due 1/2014)(10) | 921,289 | 925,895 |
| | | Letter of Credit (5.3%, Due 1/2014)(10) | 65,841 | 66,170 |
| Aspect Software, Inc. | Service call center software | Senior Term Debt (8.4%, Due 7/2011)(3) | 2,988,647 | 2,999,925 |
| Brock Holdings II, Inc. | Service industrial specialty maintenance | Senior Term Debt (7.3%, Due 8/2013)(3)(5) | 3,000,000 | 3,003,750 |
| Compsych Investments Corp. | Service independent employee assistance programs | Senior Term Debt (8.1%, Due 2/2012)(3)(5) | 3,875,254 | 3,879,300 |
| CRC Health Group, Inc. | Service substance abuse treatment | Senior Term Debt (7.9%, Due 2/2012)(3) | 9,993,754 | 10,010,307 |
| Critical Homecare Solutions, Inc. | Service home therapy and respiratory treatment | Senior Term Debt (8.6%, Due 1/2012)(3)(5) | 2,000,000 | 2,000,000 |
| CST Industries Acquisition, Inc. | Manufacturing metal storage units | Senior Term Debt (8.5%, Due 8/2013)(3) | 996,946 | 999,975 |
| Dealer Computer Services, Inc. | Manufacturing & Service systems for automotive retailers | Senior Term Debt (7.4%, Due 9/2013)(3) | 1,042,760 | 1,044,063 |
| Dresser Holdings, Inc. | Manufacturing oilfield & energy products | Senior Term Debt (8.1%, Due 10/2013)(3) | 3,868,905 | 3,851,943 |
| Generac Acquisition Corp. | Manufacturing standby power products | Senior Term Debt (7.9%, Due 11/2013)(5) | 2,593,800 | 2,611,957 |
| Hudson Products Holdings, Inc. | Manufacturing heat transfer solutions | Senior Term Debt (8.1%, Due 12/2013)(3) | 2,358,550 | 2,363,866 |
| IPC Information Systems, LLC | Manufacturing specialized telephony systems | Senior Term Debt (7.9%, Due 9/2013)(3) | 263,045 | 262,319 |
| J. Crew Operating Corp. | Retail apparel | Senior Term Debt (7.2%, Due 5/2013)(3) | 1,405,990 | 1,407,018 |
| Latham Manufacturing Corp. | Manufacturing swimming pool components accessories | Senior Term Debt (8.5%, Due 6/2012)(3) | 2,427,162 | 2,375,520 |
| Lexicon Marketing USA, Inc. | Service marketing to Hispanic community | Senior Term Debt (7.8%, Due 5/2012)(3)(5) | 2,971,543 | 3,006,325 |
| LVI Services, Inc. | Service asbestos and mold remediation | Senior Term Debt (10.3%, Due 11/2010)(3)(5) | 6,440,352 | 6,330,492 |
| Madison River Capital LLC | Service communications and information | Senior Term Debt (7.6%, Due 7/2012)(3) | 5,727,708 | 5,702,357 |
| Maidenform, Inc. | Manufacturing intimate apparel | Senior Term Debt (7.1%, Due 5/2010)(3) | 2,569,252 | 2,573,084 |
| MedAssets, Inc. | Service pharmaceuticals and healthcare GPO | Senior Term Debt (7.8%, Due 10/2013)(3)(5) | 3,493,734 | 3,504,342 |
| MediMedia USA, LLC | Service healthcare and pharmaceutical marketing | Senior Term Debt (7.9%, Due 10/2013)(3) | 1,185,613 | 1,180,462 |
| National Mentor Holdings, Inc. | Service home health care | Senior Term Debt (7.4%, Due 6/2013)(3) | 1,987,027 | 1,985,825 |
| NPC International Inc. | Service Pizza Hut franchisee | Senior Term Debt (7.1%, Due 5/2013)(3) | 3,017,479 | 2,995,367 |
| Nutro Products, Inc. | Manufacturing pet food | Senior Term Debt (7.4%, Due 4/2012)(3) | 2,442,961 | 2,421,809 |
| Open Solutions, Inc. | Service software outsourcing for financial institutions | Senior Term Debt (7.5%, Due 1/2014)(3) | 2,518,294 | 2,506,250 |

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| Company(1) | Industry | Investment(2) | Cost | Fair Value |
|------------|----------|---------------|------|------------|
| 6 | | | | |

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NON-CONTROL/NON-AFFILIATE INVESTMENTS (Continued)

| | | | | | |
|--|--------------------------|--|--|-----------------------|-----------------------|
| Ozburn-Hessey Holding Co. LLC | Service | third party logistics | Senior Term Debt (8.6%, Due 8/2012)(3) | \$ 7,764,943 | \$ 7,711,178 |
| Patriot Media & Communications CNJ, LLC | Service | telecommunications | Senior Term Debt (7.4%, Due 3/2013)(3) | 4,147,228 | 4,105,476 |
| QTC Acquisition, Inc. | Service | outsourced disability evaluations | Senior Term Debt (8.1%, Due 11/2012)(3) | 1,996,592 | 1,997,199 |
| Radio Systems Corporation | Service | design electronic pet containment products | Senior Term Debt (8.1%, Due 9/2013)(3) | 1,989,421 | 1,999,950 |
| Rally Parts, Inc. | Manufacturing | aftermarket motorcycle parts and accessories | Senior Term Debt (7.9%, Due 11/2013)(3) | 1,313,285 | 1,319,792 |
| RPG Holdings, Inc. | Manufacturing and design | greeting cards | Senior Term Debt (8.9%, Due 12/2011)(3) | 5,001,100 | 4,900,000 |
| SGS International, Inc. | Service | digital imaging and graphics | Senior Term Debt (7.9%, Due 12/2011)(3) | 1,611,921 | 1,616,724 |
| Stolle Machinery Company | Manufacturing | can-making equipment and parts | Senior Term Debt (7.9%, Due 9/2012)(3) | 500,100 | 502,491 |
| Survey Sampling, LLC | Service | telecommunications-based sampling | Senior Term Debt (7.9%, Due 5/2011)(3) | 3,309,714 | 3,282,178 |
| Triad Laboratory Alliance, LLC | Service | regional medical laboratories | Senior Term Debt (8.6%, Due 12/2011)(3)(5) | 4,953,549 | 4,912,813 |
| US Investigative Services, Inc. | Service | background investigations | Senior Term Debt (7.9%, Due 9/2012)(3) | 10,923,253 | 10,910,191 |
| Wastequip, Inc. | Service | process and transport waste materials | Senior Term Debt (7.6%, Due 2/2013)(3) | 2,066,465 | 2,081,963 |
| WaveDivision Holdings, LLC | Service | cable | Senior Term Debt (7.8%, Due 6/2014)(3) | 1,925,440 | 1,929,600 |
| West Corporation | Service | business process outsourcing | Senior Term Debt (7.8%, Due 10/2013)(3) | 10,814,753 | 10,826,161 |
| Total Non-Control/Non-Affiliate Investments | | | | \$ 138,567,741 | \$ 138,168,612 |

CONTROL INVESTMENTS

| | | | | | |
|-------------------------|---------------|---|--|-------------------|-------------------|
| A. Stucki Company | Manufacturing | railroad cars and accessories | Senior Term Debt (9.8% Due 3/2012)(6) | 15,000,000 | 15,000,000 |
| | | | Senior Term Debt (12.1% Due 3/2012)(6)(11) | 11,000,000 | 11,000,000 |
| | | | Senior Subordinated Term Debt (13% Due 3/2014)(6) | 5,485,760 | 5,485,760 |
| | | | Preferred Stock(4)(6) | 4,386,686 | 4,386,686 |
| | | | Common Stock(4)(6) | 129,956 | 129,956 |
| | | | | 36,002,402 | 36,002,402 |
| Acme Cryogenics, Inc. | Manufacturing | manifolds and pipes for industrial gasses | Senior Subordinated Term Debt (11.5% Due 3/2013)(5)(6) | \$ 14,500,000 | \$ 14,481,875 |
| | | | Redeemable Preferred Stock(4)(6) | 6,983,785 | 6,983,785 |
| | | | Common Stock(4)(6) | 1,045,181 | 1,045,181 |
| | | | Common Stock | 24,686 | 24,686 |
| | | | Warrants(4)(6) | | |
| | | | | 22,553,652 | 22,535,527 |
| Chase II Holdings Corp. | Manufacturing | traffic doors | Revolving Credit Facility (9.8% Due 3/2008)(7) | 1,900,000 | 1,900,000 |
| | | | Senior Term Debt (9.8%, Due 3/2011)(5) | 11,000,000 | 11,000,000 |
| | | | Senior Term Debt (12.0% Due 3/2011)(5)(11) | 8,000,000 | 8,000,000 |
| | | | Subordinated Term Debt (13% Due 3/2013)(5) | 6,167,810 | 6,167,810 |
| | | | | 6,960,806 | 3,120,070 |

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| | | | | |
|----------------------------------|--|--|-----------------------|-----------------------|
| | | Redeemable Preferred Stock(4) | | |
| | | Common Stock(4) | 61,384 | |
| | | | <u>34,090,000</u> | <u>30,187,880</u> |
| Hailey Transport Corporation | Retail and Service school buses and parts | Senior Subordinated Term Debt (12.0%, Due 1/2012)(5) | 4,000,000 | 4,000,000 |
| | | Preferred Stock(4) | 2,500,000 | 3,184,874 |
| | | | <u>6,500,000</u> | <u>7,184,874</u> |
| Quench Holdings Corp. | Service sales, installation and service of water coolers | Revolving Credit Facility (9.3%, Due 3/2009)(5)(8) | 1,900,000 | 1,900,000 |
| | | Senior Term Debt (9.3%, Due 3/2011)(5) | 4,000,000 | 4,000,000 |
| | | Subordinated Term Debt (11.5%, Due 3/2011)(5) | 8,000,000 | 8,000,000 |
| | | Common Stock(4) | 3,256,318 | 3,205,808 |
| | | | <u>17,156,318</u> | <u>17,105,808</u> |
| Total Control Investments | | | \$ 116,302,372 | \$ 113,016,491 |

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AFFILIATE INVESTMENTS

| | | | | |
|------------------------------------|---|--|-----------------------|-----------------------|
| Noble Logistics, Inc. | Service aftermarket auto parts delivery | Revolving Credit Facility (9.3%, Due 12/2009)(5)(9) | \$ 2,000,000 | \$ 1,995,000 |
| | | Senior Term Debt (9.3%, Due 12/2011)(5)(6) | 7,000,000 | 7,008,750 |
| | | Senior Term Debt (11.3% Due 3/2011)(5)(6)(11) | 7,000,000 | 7,008,750 |
| | | Senior Subordinated Term Debt (12.3% Due 8/2007)(5)(6) | 500,000 | 500,000 |
| | | Preferred Stock(4)(6) | 1,750,000 | 1,750,000 |
| | | Common Stock(4)(6) | 1,500,000 | 1,500,000 |
| | | | 19,750,000 | 19,762,500 |
| Total Affiliate Investments | | | \$ 19,750,000 | \$ 19,762,500 |
| Total Investments | | | \$ 274,620,113 | \$ 270,947,603 |

- (1) Certain of the listed securities are issued by affiliate(s) of the indicated portfolio company.
- (2) Percentage represents the weighted average interest rates in effect at March 31, 2007 and due date represents the contractual maturity date.
- (3) Marketable securities are valued based on the indicative bid price, as of March 31, 2007, from the respective originating syndication agent's trading desk.
- (4) Security is non-income producing.
- (5) Valued using Standard & Poor's Securities Evaluations, Inc. opinions of value at March 31, 2007.
- (6) Fair value is equal to cost due to recent acquisition.
- (7) Total available under the revolving credit facility is \$3,500,000 of which \$1,600,000 remains undrawn as of March 31, 2007.
- (8) Total available under the revolving credit facility is \$2,000,000, of which \$100,000 remains undrawn at March 31, 2007.
- (9) Total available under the revolving credit facility is \$2,000,000, which was fully drawn at March 31, 2007.
- (10) Subsequent to March 31, 2007, the investment in the portfolio company was sold at the fair value reflected herein.
- (11) Last out tranche of senior debt, meaning if the portfolio company is liquidated then the holder of the last out tranche is paid after the senior debt.

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

GLADSTONE INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

| | Three months ended September 30, 2007 | Three months ended September 30, 2006 |
|--|--|--|
| INVESTMENT INCOME | | |
| Interest income | | |
| Non-Control/Non-Affiliate investments | \$ 4,079,994 | \$ 2,387,375 |
| Control investments | 2,612,412 | 1,256,303 |
| Affiliate investments | 374,887 | |
| Cash and cash equivalents | 60,419 | 569,580 |
| | <u>7,127,712</u> | <u>4,213,258</u> |
| Other income | 28,457 | 670 |
| | <u>7,156,169</u> | <u>4,213,928</u> |
| EXPENSES | | |
| Base management fee (Refer to Note 4) | 452,630 | 861,893 |
| Loan servicing fee (Refer to Note 4) | 1,259,651 | |
| Administration fee (Refer to Note 4) | 227,767 | 124,861 |
| Interest expense | 2,023,075 | |
| Amortization of deferred finance costs | 216,363 | |
| Stockholder related costs | 157,340 | 65,100 |
| Professional fees | 110,255 | 88,040 |
| Insurance expense | 73,129 | 67,626 |
| Directors fees | 67,472 | 56,250 |
| Taxes and licenses | 41,325 | 41,337 |
| General and administrative expenses | 35,343 | 24,935 |
| | <u>4,664,350</u> | <u>1,330,042</u> |
| Expenses before credit from Adviser | 4,664,350 | 1,330,042 |
| | <u>(502,719)</u> | <u></u> |
| Credits to base management fee (Refer to Note 4) | (502,719) | |
| | <u>4,161,631</u> | <u>1,330,042</u> |
| | <u>4,161,631</u> | <u>1,330,042</u> |
| NET INVESTMENT INCOME | <u>2,994,538</u> | <u>2,883,886</u> |
| REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS | | |
| Realized loss on sale of Non-Control/Non-Affiliate investments | (3,431) | (1,934) |
| Net unrealized (depreciation) appreciation of Non-Control/Non-Affiliate investments | (7,307,700) | 2,927 |
| Net unrealized appreciation (depreciation) of Control investments | 180,090 | (36,835) |
| Net unrealized depreciation of Affiliate investments | (230,572) | |
| | <u>(7,361,613)</u> | <u>(35,842)</u> |
| Net loss on investments | (7,361,613) | (35,842) |
| NET (DECREASE) INCREASE IN NET ASSETS RESULTING FROM OPERATIONS | <u>\$ (4,367,075)</u> | <u>\$ 2,848,044</u> |

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| | Three months ended September 30, 2007 | Three months ended September 30, 2006 |
|--|--|--|
| NET (DECREASE) INCREASE IN NET ASSETS RESULTING FROM OPERATIONS PER COMMON SHARE: | | |
| Basic and Diluted | \$ (0.26) | \$ 0.17 |
| SHARES OF COMMON STOCK OUTSTANDING: | | |
| Basic and diluted weighted average shares | 16,560,100 | 16,560,100 |

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

GLADSTONE INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

| | <u>Six months ended September 30, 2007</u> | <u>Six months ended September 30, 2006</u> |
|---|--|--|
| INVESTMENT INCOME | | |
| Interest income | | |
| Non-Control/Non-Affiliate investments | \$ 7,328,549 | \$ 4,351,855 |
| Control investments | 5,177,404 | 2,446,605 |
| Affiliate investments | 801,450 | |
| Cash and cash equivalents | 114,111 | 1,277,920 |
| | <u>13,421,514</u> | <u>8,076,380</u> |
| Other income | 34,584 | 986 |
| | <u>13,456,098</u> | <u>8,077,366</u> |
| EXPENSES | | |
| Base management fee (Refer to Note 4) | 812,319 | 1,663,202 |
| Loan servicing fee (Refer to Note 4) | 2,454,069 | |
| Administration fee (Refer to Note 4) | 435,581 | 240,250 |
| Interest expense | 3,437,337 | |
| Amortization of deferred finance costs | 426,203 | |
| Professional fees | 265,921 | 167,788 |
| Stockholder related costs | 195,229 | 158,866 |
| Insurance expense | 136,070 | 140,237 |
| Directors fees | 122,272 | 99,500 |
| Taxes and licenses | 83,132 | 98,444 |
| General and administrative expenses | 91,477 | 44,029 |
| | <u>8,459,610</u> | <u>2,612,316</u> |
| Expenses before credit from Adviser | 8,459,610 | 2,612,316 |
| | <u>(886,594)</u> | <u></u> |
| Credits to base management fee (Refer to Note 4) | (886,594) | |
| | <u>7,573,016</u> | <u>2,612,316</u> |
| | <u>7,573,016</u> | <u>2,612,316</u> |
| NET INVESTMENT INCOME | <u>5,883,082</u> | <u>5,465,050</u> |
| REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS | | |
| Realized (loss) gain on sale of Non-Control/Non-Affiliate investments | (51,678) | 1,339 |
| Net unrealized depreciation of Non-Control/Non-Affiliate investments | (7,836,345) | (1,136,784) |
| Net unrealized appreciation (depreciation) of Control investments | 5,453,959 | (204,513) |
| Net unrealized appreciation of Affiliate investments | 454,373 | |
| | <u>(1,979,691)</u> | <u>(1,339,958)</u> |
| Net loss on investments | (1,979,691) | (1,339,958) |
| | <u>\$ 3,903,391</u> | <u>\$ 4,125,092</u> |
| NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS | <u>\$ 3,903,391</u> | <u>\$ 4,125,092</u> |

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Six months ended
September 30, 2007

Six months ended
September 30, 2006

NET INCREASE IN NET ASSETS RESULTING FROM
OPERATIONS PER COMMON SHARE:

| | | | | |
|-------------------|----|------|----|------|
| Basic and Diluted | \$ | 0.24 | \$ | 0.25 |
|-------------------|----|------|----|------|

SHARES OF COMMON STOCK OUTSTANDING:

| | | |
|---|------------|------------|
| Basic and diluted weighted average shares | 16,560,100 | 16,560,100 |
|---|------------|------------|

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

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

| | <u>Six months ended September 30, 2007</u> | <u>Six months ended September 30, 2006</u> |
|---|--|--|
| <i>Operations:</i> | | |
| Net investment income | \$ 5,883,082 | \$ 5,465,050 |
| Realized (loss) gain on sale of investments | (51,678) | 1,339 |
| Unrealized depreciation of portfolio | (1,928,013) | (1,341,297) |
| Net increase in net assets from operations | 3,903,391 | 4,125,092 |
| <i>Capital transactions:</i> | | |
| Shelf offering registration costs | (31,508) | (33,128) |
| Dividends | (7,452,045) | (6,955,245) |
| Total decrease in net assets from capital transactions | (7,483,553) | (6,988,373) |
| Total decrease in net assets | (3,580,162) | (2,863,281) |
| Net Assets | | |
| Beginning of period | 222,818,509 | 229,841,697 |
| End of period | \$ 219,238,347 | \$ 226,978,416 |

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

GLADSTONE INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

| | <u>Six months ended September 30, 2007</u> | <u>Six months ended September 30, 2006</u> |
|---|--|--|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net increase in net assets resulting from operations | \$ 3,903,391 | \$ 4,125,092 |
| Adjustments to reconcile net increase in net assets resulting from operations to net cash used in operating activities: | | |
| Purchase of investments | (113,784,083) | (49,477,779) |
| Principal repayments of investments | 38,306,176 | 6,838,467 |
| Proceeds from the sale of investments | 5,809,471 | 16,549,229 |
| Net unrealized depreciation of investment portfolio | 1,928,013 | 1,341,297 |
| Net realized loss (gain) on sales of investments | 51,678 | (1,339) |
| Net amortization of premiums and discounts | 218,246 | 85,348 |
| Amortization of deferred finance costs | 426,203 | |
| Increase in interest receivable | (694,945) | (532,967) |
| Decrease in due from custodian | 10,258,303 | |
| Increase in prepaid assets | (163,979) | (176,467) |
| (Increase) decrease in other assets | (195,464) | 101,333 |
| (Decrease) increase in other liabilities | (15,815) | 11,615 |
| Increase in administration fee payable to Administrator (See Note 4) | 65,523 | 14,859 |
| Increase in base management fee payable to Adviser (See Note 4) | 253,591 | 1,096,444 |
| Decrease in loan servicing fee payable to Adviser (See Note 4) | (5,521) | |
| Increase (decrease) in accrued expenses | 495,566 | (212,746) |
| Net cash used in operating activities | <u>(53,143,646)</u> | <u>(20,237,614)</u> |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Borrowings from line of credit | 147,100,000 | |
| Repayments of line of credit | (101,050,000) | |
| Deferred finance costs | (22,285) | |
| Shelf offering registration costs | (31,508) | (33,128) |
| Distributions paid | (7,452,045) | (6,955,245) |
| Net cash provided by (used in) financing activities | <u>38,544,162</u> | <u>(6,988,373)</u> |
| NET DECREASE IN CASH AND CASH EQUIVALENTS(1) | <u>(14,599,484)</u> | <u>(27,225,987)</u> |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | <u>37,788,941</u> | <u>75,672,605</u> |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | <u>\$ 23,189,457</u> | <u>\$ 48,446,618</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 INVESTMENT CORPORATION
FINANCIAL HIGHLIGHTS
(UNAUDITED)

| | <u>Three months ended</u> <u>September 30, 2007</u> | <u>Three months ended</u> <u>September 30, 2006</u> |
|---|--|--|
| <i>Per Share Data(1)</i> | | |
| Balance at beginning of period | \$ 13.73 | \$ 13.75 |
| <i>Income from investment operations:</i> | | |
| Net investment income(2) | 0.18 | 0.17 |
| Realized loss on sale of investments(2) | | |
| Net unrealized depreciation of investments(2) | (0.44) | |
| Total from investment operations | (0.26) | 0.17 |
| Distributions | (0.23) | (0.21) |
| Net asset value at end of period | \$ 13.24 | \$ 13.71 |
| Per share market value at beginning of period | \$ 14.21 | \$ 14.82 |
| Per share market value at end of period | 12.84 | 14.60 |
| Total Return(3) | (8.04)% | (0.04)% |
| Shares outstanding at end of period | 16,560,100 | 16,560,100 |
| <i>Ratios/Supplemental Data</i> | | |
| Net assets at end of period | \$ 219,238,347 | \$ 226,978,416 |
| Average net assets(4) | \$ 223,254,321 | \$ 226,140,157 |
| Ratio of expenses to average net assets(5)(6) | 8.36% | 2.35% |
| Ratio of net expenses to average net assets(5)(7) | 7.46% | 2.35% |
| Ratio of net investment income to average net assets(5) | 5.37% | 5.10% |

(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 change in the market value of the Company's common stock from the beginning of the period taking into account dividends reinvested in accordance with the terms of our dividend reinvestment plan. Total return does not take into account dividends that may be characterized as a return of capital. For further information on estimated character of our dividends please refer to Note 8.

(4) Calculated using the average of the ending monthly net assets for the respective periods.

(5)

Amounts are annualized.

- (6) Ratio of expenses to average net assets is computed using expenses before credit from the Adviser.
- (7) Ratio of net expenses to average net assets is computed using total expenses net of credits to the management fee.

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

GLADSTONE INVESTMENT CORPORATION
FINANCIAL HIGHLIGHTS
(UNAUDITED)

| | <u>Six months ended September 30, 2007</u> | <u>Six months ended September 30, 2006</u> |
|---|--|--|
| <i>Per Share Data(1)</i> | | |
| Balance at beginning of period | \$ 13.46 | \$ 13.88 |
| <i>Income from investment operations:</i> | | |
| Net investment income(2) | 0.35 | 0.33 |
| Realized (loss) gain on sale of investments(2) | | |
| Net unrealized depreciation of investments(2) | (0.12) | (0.08) |
| Total from investment operations | 0.23 | 0.25 |
| Distributions | (0.45) | (0.42) |
| Net asset value at end of period | \$ 13.24 | \$ 13.71 |
| Per share market value at beginning of period | \$ 14.87 | \$ 14.90 |
| Per share market value at end of period | 12.84 | 14.60 |
| Total Return(3) | (10.73)% | 0.87% |
| Shares outstanding at end of period | 16,560,100 | 16,560,100 |
| <i>Ratios/Supplemental Data</i> | | |
| Net assets at end of period | \$ 219,238,347 | \$ 226,978,416 |
| Average net assets(4) | \$ 223,091,437 | \$ 226,929,612 |
| Ratio of expenses to average net assets(5)(6) | 7.58% | 2.30% |
| Ratio of net expenses to average net assets(5)(7) | 6.79% | 2.30% |
| Ratio of net investment income to average net assets(5) | 5.27% | 4.82% |

(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 change in the market value of the Company's common stock from the beginning of the period taking into account dividends reinvested in accordance with the terms of our dividend reinvestment plan. Total return does not take into account dividends that may be characterized as a return of capital. For further information on estimated character of our dividends please refer to Note 8.

(4) Calculated using the average of the ending monthly net assets for the respective periods.

(5)

Amounts are annualized.

- (6) Ratio of expenses to average net assets is computed using expenses before credit from the Adviser.
- (7) Ratio of net expenses to average net assets is computed using total expenses net of credits to the management fee.

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

GLADSTONE INVESTMENT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2007

(UNAUDITED)

NOTE 1. ORGANIZATION

Gladstone Investment Corporation (the "Company") was incorporated under the General Corporation Laws of the State of Delaware on February 18, 2005 and completed an initial public offering on June 22, 2005. The Company is a closed-end, non-diversified management investment company that 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 ("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 and capital gains by investing in debt and equity securities of established private businesses.

Gladstone Business Investment, LLC ("Business Investment"), a wholly-owned subsidiary of the Company, was established on August 11, 2006 for the sole purpose of owning the Company's portfolio of investments in connection with the establishment of its line of credit facility with Deutsche Bank AG. The financial statements of Business Investment are consolidated with those of the Company.

The Company is externally managed by Gladstone Management Corporation ("GMC" or 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 March 31, 2007, as filed with the Securities and Exchange Commission ("SEC") on May 31, 2007.

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.

Consolidation

Under Article 6 of Regulation S-X under the Securities Act of 1933, as amended, and the authoritative accounting guidance provided by the AICPA Audit and Accounting Guide for Investment Companies, the Company is not permitted to consolidate any subsidiary or other entity that is not an investment company.

Use of Estimates

The consolidated financial statements have been prepared in accordance with 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.

Cash and Cash Equivalents

The Company considers all short-term, highly liquid investments that are both readily convertible to cash and have a maturity of three months or less at the time of purchase to be cash equivalents. Items classified as cash equivalents include temporary investments in U.S. Treasury bills and can also include commercial paper and money-market funds. All of the Company's cash at September 30, 2007 was deposited with two financial institutions, and the Company's balances exceed federally insurable limits. The Company seeks to mitigate this risk by depositing funds with major financial institutions.

Classification of Investments

The 1940 Act requires classification of the Company's investments by its respective level of control. As defined in the 1940 Act, "Control investments" are investments in those portfolio companies that the Company is deemed to "Control." "Affiliate investments" are investments in those portfolio companies that are "Affiliated companies" of the Company, as defined in the 1940 Act, other than Control investments. "Non-Control/Non-Affiliate investments" are those that are neither Control investments nor Affiliate investments. In general, the 1940 Act prescribes that the Company has control over a portfolio company if it owns greater than 25% of the voting securities of the portfolio company. The Company is deemed to be an affiliate of a portfolio company if it owns between 5% and 25% of the voting securities of such portfolio company or has one or more seats on the affiliated company's board of directors. However, if the Company holds 50% or more contractual representation on a portfolio company's board of directors, the Company will be deemed to have control over the portfolio company.

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 certain participations in syndicated loans, are valued at the indicative bid price on or near the valuation date from the respective originating syndication agent's trading desk. Debt and equity securities that are not publicly traded, or for which a limited market does not exist, are valued at fair value based on the Company's valuation policy. 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.

The procedures for the determination of the fair value of the Company's debt securities that are not publicly traded and that are issued by portfolio companies where the Company has no equity, or equity-like securities, rely on the opinions of value submitted to it by Standard & Poor's Securities Evaluations, Inc. ("SPSE"). The Company may also submit paid in kind ("PIK") interest to SPSE for valuation when it is determined the PIK interest is likely to be received. 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. Lastly, the Company adds any amortized original issue discount ("OID") interest to the fair value, 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, recent sales to third parties of similar securities, the comparison to publicly traded securities, discounted cash flow or other pertinent factors. In gathering the sales to third parties of similar securities, the Company may reference industry statistics and use outside experts.

Debt securities that are issued by portfolio companies where the Company has equity, or equity-like securities are valued at cost, if there is adequate total enterprise value determined when valuing the Company's equity securities of the portfolio company. Fair values are discounted for any shortfall of total enterprise value over the total debt outstanding for the borrower.

The Board of Directors then reviews whether the Adviser has followed its established procedures for determinations of fair value, and votes whether or not to accept the recommended valuation of the Company's investment portfolio.

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, if any, 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 and Dividend Income Recognition

Interest income, adjusted for amortization of premiums and acquisition costs and for the 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. At September 30, 2007, one Non-Control/Non-Affiliate investment was on

non-accrual with a cost basis of approximately \$2.9 million at September 30, 2007, or less than 1% of the cost basis of all loans in the Company's portfolio. Conditional interest, or a success fee, is recorded upon full repayment of a loan investment. Dividend income on preferred equity securities is accrued to the extent that such amounts are expected to be collected and that the Company has the option to collect such amounts in cash. To date, the Company has not accrued any dividend income.

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 portfolio companies through its Adviser. Currently, neither the Company nor the Adviser receives fees in connection with managerial assistance.

The Adviser receives fees for other services it provides to the Company's 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 investments, raising equity and debt capital, turnaround management, merger and acquisition services and recruiting new management personnel. When the Adviser receives fees for these services, 50% of certain of those fees are credited against the base management fee and the loan servicing fee that the Company pays to its Adviser. 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 fee.

The Company may receive fees for the origination and closing services it provides to portfolio companies through its Adviser. These fees are paid directly to the Company and are recognized as revenue upon closing of the originated investment and are reported as fee income in the consolidated statements of operations.

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.

Deferred Finance Costs

Costs associated with the Company's line of credit facility with Deutsche Bank AG are deferred and amortized over the life of the credit facility, generally for a period of one year.

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 will not be 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 at least 90% of its investment company taxable income, as defined by the Code. The Company intends to distribute at least 90% of its ordinary income, and as a result, no income tax provisions have been recorded. The Company may, but does not intend to, pay out a return of capital.

In June 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109*, ("FIN 48"), 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." FIN 48 is effective as of the beginning of an entity's first fiscal year that begins after December 15, 2006. The Company adopted this Interpretation on April 1, 2007. The adoption of FIN 48 did not have an impact on the Company's consolidated financial statements.

Recent Accounting Pronouncements

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ("SFAS 159"). SFAS 159 allows entities to measure at fair value many financial instruments and certain other assets and liabilities that are not otherwise required to be measured at fair value. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of this pronouncement on its consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in GAAP and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is required to adopt the provisions of SFAS 157 beginning with the fiscal year ended March 31, 2009. The Company 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," 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 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 April 1, 2007 and the adoption did not have an impact on the Company's consolidated financial statements.

NOTE 3. INVESTMENTS

Non-Control/Non-Affiliate Investments

At September 30, 2007 and March 31, 2007, the Company held investments in Non-Control/Non-Affiliates of approximately \$209.1 million and \$138.6 million, at cost, respectively. These investments are comprised primarily of syndicated loan participations of senior notes of both public and private companies and also non-syndicated loan investments where the Company does not have a significant ownership interest in the portfolio company. At September 30, 2007 and March 31, 2007, the Company's investments, at cost, in Non-Control/Non-Affiliates represented approximately 95% and 62%, respectively, of the Company's net assets.

Control and Affiliate Investments

At September 30, 2007, the Company had investments of approximately \$106.3 million, at cost, in revolving credit facilities, senior debt and subordinated debt of six portfolio companies. In addition, at September 30, 2007, the Company had invested approximately \$28.6 million in preferred and common equity of those companies.

At September 30, 2007 and March 31, 2007, the Company's investments in Control investments, at cost, represented approximately 53% and 52%, respectively, of the Company's net assets. Also at September 30, 2007 and March 31, 2007, the Company's investments, at cost, in Affiliate investments represented approximately 8% and 9%, respectively, of the Company's net assets.

Investment Concentrations

Approximately 79% of the aggregate fair value of the Company's investment portfolio at September 30, 2007 consisted of senior debt, approximately 6% was senior subordinated debt,

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approximately 4% was subordinated debt and approximately 11% was preferred and common equity securities. At September 30, 2007, the Company had approximately \$344 million invested in 59 portfolio companies. The following table outlines the Company's investments by type at September 30, 2007 and March 31, 2007:

| | September 30, 2007 | | March 31, 2007 | |
|--------------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | Cost | Fair Value | Cost | Fair Value |
| Senior Term Debt | \$ 276,427,571 | \$ 268,116,852 | \$ 207,367,741 | \$ 206,981,112 |
| Senior Subordinated Term Debt | 24,614,442 | 19,985,760 | 24,485,760 | 24,467,635 |
| Subordinated Term Debt | 14,077,810 | 14,077,810 | 14,167,810 | 14,167,810 |
| Preferred & Common Equity Securities | 28,898,802 | 36,237,680 | 28,598,802 | 25,331,046 |
| Total Investments | \$ 344,018,625 | \$ 338,418,102 | \$ 274,620,113 | \$ 270,947,603 |

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

| | September 30, 2007 | | | March 31, 2007 | | |
|--|-----------------------|-------------------|------------|-----------------------|-------------------|------------|
| | Percentage of | | | Percentage of | | |
| | Fair Value | Total Investments | Net Assets | Fair Value | Total Investments | Net Assets |
| Automobile | \$ 2,388,203 | 0.7% | 1.1% | \$ 8,504,666 | 3.1% | 3.8% |
| Beverage, Food & Tobacco | 3,860,325 | 1.1% | 1.8% | 3,413,874 | 1.3% | 1.5% |
| Broadcasting & Entertainment | 975,056 | 0.3% | 0.4% | | | |
| Buildings & Real Estate | 14,138,845 | 4.2% | 6.4% | 3,003,750 | 1.1% | 1.3% |
| Cargo Transport | 21,613,024 | 6.4% | 9.9% | 21,844,463 | 8.1% | 9.8% |
| Chemicals, Plastics & Rubber | 26,476,079 | 7.8% | 12.1% | 22,535,527 | 8.3% | 10.1% |
| Containers, Packaging and Glass | 11,265,938 | 3.3% | 5.1% | 999,975 | 0.4% | 0.4% |
| Diversified/Conglomerate | | | | | | |
| Manufacturing | 34,139,858 | 10.1% | 15.6% | 32,563,400 | 12.0% | 14.6% |
| Diversified/Conglomerate Service | 44,179,915 | 13.1% | 20.2% | 27,374,081 | 10.1% | 12.3% |
| Ecological | 485,000 | 0.1% | 0.2% | | | |
| Electronics | 14,924,996 | 4.4% | 6.8% | 6,758,294 | 2.5% | 3.0% |
| Healthcare, Education and Childcare | 45,016,486 | 13.3% | 20.5% | 31,296,111 | 11.6% | 14.0% |
| Home & Office Furnishings | 17,362,491 | 5.1% | 7.9% | 17,105,808 | 6.3% | 7.7% |
| Machinery | 54,902,881 | 16.2% | 25.0% | 41,480,716 | 15.3% | 18.6% |
| Mining, Steel, Iron and Precious Metals | 4,950,000 | 1.5% | 2.3% | | | |
| Oil & Gas | | | | 3,851,943 | 1.4% | 1.7% |
| Personal, Non-durable Consumer Products | 7,099,519 | 2.1% | 3.2% | 1,492,472 | 0.6% | 0.7% |
| Personal, Food, & Miscellaneous Services | 5,538,418 | 1.6% | 2.5% | 16,905,483 | 6.2% | 7.6% |
| Printing, Publishing, Broadcasting | 15,387,301 | 4.5% | 7.0% | 18,590,084 | 6.9% | 8.3% |
| Retail Stores | 859,649 | 0.3% | 0.4% | 1,407,018 | 0.5% | 0.6% |
| Telecommunications | 12,854,119 | 3.7% | 5.9% | 9,246,854 | 3.4% | 4.1% |
| Textiles & Leather | | | | 2,573,084 | 0.9% | 1.2% |
| Total Investments | \$ 338,418,102 | 100% | | \$ 270,947,603 | 100% | |

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

| | September 30, 2007 | | | March 31, 2007 | | |
|--------------------------|-----------------------|-------------------|------------|-----------------------|-------------------|------------|
| | Fair Value | Percentage of | | Fair Value | Percentage of | |
| | | Total Investments | Net Assets | | Total Investments | Net Assets |
| Mid-Atlantic | \$ 145,722,631 | 43.1% | 66.5% | \$ 94,257,169 | 34.8% | 42.3% |
| Midwest | 107,700,975 | 31.8% | 49.1% | 88,508,725 | 32.7% | 39.7% |
| Northeast | 13,544,944 | 4.0% | 6.2% | 14,879,654 | 5.5% | 6.7% |
| Southeast | 38,636,723 | 11.4% | 17.6% | 36,357,555 | 13.4% | 16.3% |
| West | 29,032,829 | 8.6% | 13.2% | 36,944,500 | 13.6% | 16.6% |
| Canada | 3,780,000 | 1.1% | 1.7% | | | |
| Total Investments | \$ 338,418,102 | 100.0% | | \$ 270,947,603 | 100.0% | |

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.

Investment Principal Amortization

The following table summarizes the contractual principal amortization and maturity of the Company's investment portfolio by fiscal year, assuming no voluntary prepayments:

| Fiscal Year Ended March 31, | Amount |
|---|-----------------------|
| 2008 | \$ 7,302,577 |
| 2009 | 10,098,966 |
| 2010 | 9,597,716 |
| 2011 | 50,578,462 |
| 2012 | 46,511,482 |
| Thereafter | 190,829,882 |
| Total contractual repayments | \$ 314,919,085 |
| Investments in equity securities | \$ 28,898,802 |
| Unamortized premiums on debt securities | 200,738 |
| Total | \$ 344,018,625 |

NOTE 4. RELATED PARTY TRANSACTIONS

Investment Advisory and Management Agreement

The Company has entered into an investment advisory and management agreement with the Adviser (the "Advisory Agreement"), which is controlled by the Company's chairman and chief executive officer. In accordance with the Advisory Agreement, the Company pays the Adviser fees, as compensation for its services, consisting of a base management fee and an incentive fee.

The base management fee is computed and payable quarterly and is assessed at an annual rate of 2.0%. The base management fee was initially computed on the basis of the average value of the Company's gross invested assets at the end of the two most recently completed quarters, which were total assets less the cash proceeds and cash and cash equivalents from the proceeds of the Company's initial public offering that were not invested in debt and equity securities of portfolio companies. Beginning on January 1, 2007, the base management fee is computed on the basis of the value of the Company's average gross assets at the end of the two most recently completed quarters, which are total assets,

including investments made with proceeds of borrowings, less any uninvested cash or cash

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equivalents resulting from borrowings. This new calculation was originally scheduled to begin in periods after March 31, 2006; however, the Company's Board of Directors accepted voluntary waivers from the Adviser that allowed the initial calculation of the base management fee to be effective through December 31, 2006.

On April 11, 2007, the Company's Board of Directors accepted a voluntary waiver from the Adviser to reduce the annual 2.0% base management fee on senior syndicated loan participations to 0.5% to the extent that proceeds resulting from borrowings were used to purchase such syndicated loan participations. This waiver remains in effect and was applied during the three and six months ended September 30, 2007.

When the Adviser receives fees from portfolio companies, as discussed in Note 2 under "Services Provided to Portfolio Companies," 50% of certain of these fees are credited against the base management fee that the Company would otherwise be required to pay to the Adviser.

For the three months ended September 30, 2007 and 2006, the Company incurred base management fees to the Adviser of \$452,630 (after reductions for loan servicing fees received by the Adviser) and \$861,893, respectively. For the six months ended September 30, 2007 and 2006, the Company incurred base management fees to the Adviser of \$812,319 (after reductions for loan servicing fees) and \$1,663,202, respectively. For the three months ended September 30, 2007, the Company recognized aggregate credits against the base management fee of \$502,719, which is comprised of \$441,469 resulting from reduced fees on syndicated loan participations and \$61,250 resulting from investment banking fees paid to the Adviser during the period. For the six months ended September 30, 2007, the Company recognized aggregate credits against the base management fee of \$886,594, which is comprised of \$734,469 resulting from reduced fees on syndicated loan participations and \$152,125 resulting from investment banking fees paid to the Adviser during the period. As of September 30, 2007, a resulting base management fee credit of \$50,089 was unpaid and is included as a reduction in fees due to Adviser in the accompanying consolidated statements of assets and liabilities. The amount due to Adviser of \$227,687 also includes loan servicing fees due to the Adviser of \$277,776 as discussed below. At March 31, 2007, a base management fee credit of \$303,679 was unpaid and included in fees due from Adviser in the accompanying consolidated statements of assets and liabilities which was offset by loan servicing fees due to the Adviser of \$283,296, resulting in \$20,383 due from the Adviser as discussed below.

In addition, the Adviser services the loans held by Business Investment, in return for which the Adviser receives a 2.0% annual fee based on the monthly aggregate balance of loans held by Business Investment. Since the Company owns these loans, all loan servicing fees paid to the Adviser are treated as reductions against the 2.0% base management fee payable to the Adviser. Overall, the base management fee due to the Adviser cannot exceed 2.0% of total assets (as reduced by cash and cash equivalents pledged to creditors) during any given fiscal year.

For the three and six months ended September 30, 2007, the Company recorded loan servicing fees to the Adviser of \$1,259,651 and \$2,454,069, respectively, of which \$277,776 was unpaid at September 30, 2007. At March 31, 2007 there were \$283,296 of loan servicing fees due to the adviser that were included as a credit in fees due from the Adviser in the accompanying consolidated statements of assets and liabilities, offsetting the base management fee credit due to the Company from the Adviser at that date.

The incentive fee consists of two parts: an income-based incentive fee and a capital gains incentive fee. The income-based incentive fee rewards the Adviser if the Company's quarterly net investment income (before giving effect to any incentive fee) exceeds 1.75% of our net assets (the "hurdle rate").

The Company will pay the Adviser an income incentive fee with respect to the Company's pre-incentive fee net investment income in each calendar quarter as follows:

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

100% of the Company's 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 the Company's 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 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 will calculate the cumulative aggregate realized capital gains and cumulative aggregate realized capital losses since the Company's inception, and the aggregate unrealized capital depreciation as of the date of the calculation, as applicable, with respect to each of the investments in the Company's portfolio.

Because pre-incentive fee net investment income was below the hurdle rate of 1.75% of net assets, no income-based incentive fee was recorded for any of the three or six months ended September 30, 2007 or September 30, 2006.

Administration Agreement

The Company has entered into an administration agreement (the "Administration Agreement") with Gladstone Administration, LLC ("Gladstone Administration" or 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 fees to the Administrator on the consolidated statements of operations of \$227,767 and \$124,861 for the three months ended September 30, 2007 and 2006, respectively. The Company recorded fees to the Administrator on the consolidated statements of operations of \$435,581 and \$240,250 for the six months ended September 30, 2007 and 2006, respectively. As of September 30, 2007 and March 31, 2007, \$227,767 and \$162,244, respectively, was unpaid and included in the administration fee payable to the Administrator in the accompanying consolidated statements of assets and liabilities.

Purchase of Investments from Affiliate

During April 2007, the Company purchased from its affiliate, Gladstone Capital Corporation ("Gladstone Capital"), certain of its investments in syndicated loan participations at market value for approximately \$9.7 million. These purchases reflect the settlement of transactions initiated in March 2007. An independent broker was engaged to execute these transactions between the Company and Gladstone Capital. 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 Capital.

NOTE 5. LINE OF CREDIT

Through the Company's wholly-owned subsidiary, Business Investment, the Company has obtained a \$200 million revolving credit facility (the "Credit Facility"). On October 19, 2006, the Company executed a Purchase and Sale Agreement pursuant to which it agreed to sell certain loans to Business Investment in consideration of a membership interest therein. Simultaneously, Business Investment executed a Credit Agreement (the "Credit Agreement") with Deutsche Bank AG, New York Branch ("Deutsche Bank"), as administrative agent, pursuant to which Business Investment pledged the loans purchased from the Company to secure future advances by certain institutional lenders. On March 29, 2007, the Company increased its capacity under the Credit Facility from \$100 million to \$200 million. Availability under the Credit Facility was originally scheduled to terminate on October 18, 2007, however, on that date the Company amended and extended the Credit Facility such that availability under the Credit facility will terminate on October 16, 2008, unless extended in the discretion of the lenders at the request of Business Investment. Interest is payable monthly during the term of the Credit Facility and principal is payable out of collections on loans purchased from the Company during the period following the date of which availability for advances has terminated through maturity. The Credit Facility will mature two years following the date on which availability for advances has terminated and on such date, all principal, interest and other amounts owing under the Credit Facility will be due and payable. Interest rates charged on the advances under the facility are based on the rate paid by the lenders on commercial paper notes issued by such lenders to fund some or all of the advances, the London Interbank Offered Rate ("LIBOR"), the Prime Rate or the Federal Funds Rate, depending on market conditions, and adjust periodically. Available borrowings are subject to various constraints imposed under the Credit Agreement, based on the aggregate loan balance pledged by Business Investment, which varies as loans are added and repaid, regardless of whether such repayments are early prepayment or are made as contractually required.

The Credit Facility contains covenants that require Business Investment 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 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, 2007, Business Investment was in compliance with all of the facility covenants. As of September 30, 2007 there were \$146.1 million of borrowings outstanding under the Credit Facility at an interest rate of approximately 5.71% and the remaining borrowing capacity under the Credit Facility was approximately \$54 million.

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 is also the trustee of the account and once a month remits the collected funds to the Company. At September 30, 2007, the amount due from the custodian was \$2.4 million.

The Adviser services the loans pledged under the Credit 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 Credit 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, 2007, the Company was in compliance with the covenants under the performance guaranty.

NOTE 6. COMMON STOCK

As of September 30, 2007 and March 31, 2007, 100,000,000 shares of \$0.001 par value common stock were authorized and 16,560,100 shares were outstanding.

NOTE 7. 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:

| | Three months ended September 30, 2007 | Three months ended September 30, 2006 | Six months ended September 30, 2007 | Six months ended September 30, 2006 |
|---|--|--|--|--|
| Numerator for basic and diluted net (decrease) increase in net assets resulting from operations per share | \$ (4,367,075) | \$ 2,848,044 | \$ 3,903,391 | \$ 4,125,092 |
| Denominator for basic and diluted shares | 16,560,100 | 16,560,100 | 16,560,100 | 16,560,100 |
| Basic and diluted net (decrease) increase in net assets per share resulting from operations | \$ (0.26) | \$ 0.17 | \$ 0.24 | \$ 0.25 |

NOTE 8. DIVIDENDS

The Company is required to pay out as a dividend 90% of its ordinary income and realized net short-term capital gains in excess of realized net short-term capital losses, if any, 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 monthly 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 Company currently pays a monthly dividend. The tax characteristics of all dividends will be reported to stockholders on Form 1099 at the end of each calendar year. The Company's Board of Directors declared the following monthly dividends for the six months ended September 30, 2007 and 2006:

Fiscal Year 2008

| Declaration Date | Record Date | Payment Date | Dividend per Share |
|-------------------------|--------------------|---------------------|-------------------------------|
| July 10, 2007 | September 20, 2007 | September 28, 2007 | \$ 0.075 |
| July 10, 2007 | August 23, 2007 | August 31, 2007 | \$ 0.075 |
| July 10, 2007 | July 23, 2007 | July 31, 2007 | \$ 0.075 |
| April 11, 2007 | June 21, 2007 | June 29, 2007 | \$ 0.075 |
| April 11, 2007 | May 22, 2007 | May 31, 2007 | \$ 0.075 |
| April 11, 2007 | April 20, 2007 | April 30, 2007 | \$ 0.075 |

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Fiscal Year 2007

| Declaration Date | Record Date | Payment Date | Dividend per Share |
|------------------|--------------------|--------------------|--------------------|
| July 11, 2006 | September 21, 2006 | September 29, 2006 | \$ 0.07 |
| July 11, 2006 | August 21, 2006 | August 31, 2006 | \$ 0.07 |
| July 11, 2006 | July 19, 2006 | July 31, 2006 | \$ 0.07 |
| April 11, 2006 | June 22, 2006 | June 30, 2006 | \$ 0.07 |
| April 11, 2006 | May 22, 2006 | May 31, 2006 | \$ 0.07 |
| April 11, 2006 | April 20, 2006 | April 28, 2006 | \$ 0.07 |

The Company's Board of Directors estimates the source of the distributions listed above at the time of their declaration as required by Section 19(a) of the 1940 Act. The following estimates were made by the Board of Directors during the quarter ended September 30, 2007:

| Month Ended | Ordinary Income | Return of Capital | Total Dividend |
|--------------------|-----------------|-------------------|----------------|
| September 30, 2007 | \$ 0.070 | \$ 0.005 | \$ 0.075 |
| August 31, 2007 | 0.075 | | 0.075 |
| July 31, 2007 | 0.069 | 0.006 | 0.075 |

For dividends declared subsequent to quarter end, the following estimates have been made pursuant to Section 19(a) of the 1940 Act:

| Month Ended | Ordinary Income | Return of Capital | Total Dividend |
|-------------------|-----------------|-------------------|----------------|
| December 31, 2007 | \$ 0.080 | \$ | \$ 0.080 |
| November 30, 2007 | 0.080 | | 0.080 |
| October 31, 2007 | 0.080 | | 0.080 |

Because the Board of Directors declares dividends at the beginning of a quarter, it is difficult to estimate how much of the Company's monthly dividends and distributions will come from ordinary income, capital gains, and returns of capital. Subsequent to quarter end, the following corrections were made to the above listed estimates:

| Month Ended | Ordinary Income | Return of Capital | Total Dividend |
|--------------------|-----------------|-------------------|----------------|
| September 30, 2007 | \$ 0.054 | \$ 0.021 | \$ 0.075 |
| August 31, 2007 | 0.056 | 0.019 | 0.075 |
| July 31, 2007 | 0.072 | 0.003 | 0.075 |

On a monthly basis, if required under Section 19(a), the Company posts a Section 19(a) notice through the Depository Trust Company's Legal Notice System (LENS) and also sends out to its registered shareholders a written Section 19(a) notice along with the payment of dividends for any payment which includes a dividend estimated to be paid from any other source other than net investment income. The estimates of the source of the distribution provided above and in the Company's 19(a) notices are interim estimates based on GAAP that are subject to revision, and the exact character of the distributions for tax purposes year cannot be determined until the final books and records of the Company are finalized for the calendar year. These estimates are made solely in order to comply with the requirements of Section 19(a) of 1940 Act and should not be relied upon for tax reporting or any other purposes. Following the calendar year end, after definitive information has been determined by the Company, if the Company has made distributions of taxable income (or return

of capital), the Company will deliver a Form 1099-DIV to its stockholders specifying such amount and the tax characterization of such amount.

NOTE 9. CONTRACTUAL OBLIGATIONS

As of September 30, 2007, the Company was a party to signed and non-binding term sheets for two buyout investments totaling approximately \$39.9 million. The future scheduled contractual payments at September 30, 2007 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 | 39,850,000 | 39,850,000 | | | |
| Total | \$ 39,850,000 | \$ 39,850,000 | \$ | \$ | \$ |

In October 2007, all of the investment purchase obligations summarized above were funded. (Refer to Note 10 below for more information).

NOTE 10. SUBSEQUENT EVENTS

Investments

On October 16, 2007, the Company invested approximately \$17.1 million in Danco Machine DPMS, Inc. ("Danco"). The investment consisted of approximately \$2.5 million in preferred stock and warrants to purchase common stock of Danco and approximately \$14.6 million of senior and subordinated notes from Danco. Founded in 1979, Danco provides machining and sheet metal work for short-run prototype and R&D work, as well as long-run production.

Also on October 16, 2007, the Company extended a revolving credit facility to B-Dry, LLC, an existing portfolio company, with a total borrowing capacity of \$750,000. As of October 29, 2007, there was \$481,000 drawn on the facility leaving \$269,000 available for future borrowings.

On October 23, 2007, the Company extended an equipment note to Quench USA, LLC, a subsidiary of Quench Holdings Corp., for approximately \$370,000 that will allow Quench USA, LLC to acquire equipment for use in its operating activities.

On October 24, 2007, the Company invested approximately \$20.4 million in Cavert Wire Company, Inc. ("Cavert"). The investment consisted of approximately \$4.2 million in common and preferred stock and approximately \$16.2 million of senior and subordinated notes, including a revolving credit facility. Cavert is a manufacturer and distributor of bailing wire and is the largest supplier of non-galvanized bailing wire in the United States.

In October 2007, the Company received the full repayment of two syndicated loan investments of approximately \$9.8 million. The Company also sold two syndicated loan participations for aggregate proceeds of approximately \$9.9 million and recognized a net loss on the transactions of approximately \$0.1 million.

Shelf Registration Statement

On October 2, 2007, the SEC declared effective the Company's shelf registration statement on Form N-2 (File No. 333-138008) (the "Registration Statement.") The Registration Statement would

permit the Company to issue, through one or more transactions, up to an aggregate of \$300 million in securities, which may consist of common stock, preferred stock and/or debt securities.

Line of Credit

On October 18, 2007, the Company, through its wholly-owned subsidiary, Business Investment, amended and extended its credit agreement which was originally established on October 19, 2006. In conjunction with this amendment and extension, Business Investment, the Adviser and Deutsche Bank AG entered into Amendment No. 3 to the Credit Agreement, dated October 18, 2007 (the "Amendment"). The Amendment, among other things, extended the maturity of the credit agreement to October 16, 2008 and modified certain existing definitions to the credit agreement. In connection with this amendment, Business Investment paid a \$400,000 amendment fee.

Interest Rate Cap Agreement

In October 2007, the Company entered into an interest rate cap agreement that will effectively limit the interest rate on a portion of the borrowings under the line of credit pursuant to the terms of the Credit Facility. The interest rate cap has a notional amount of \$20 million at a cost of \$15,000. The interest rate cap agreement expires in October 2008. 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 9% when the LIBOR rate is in excess of 9%.

Dividends

On October 9, 2007, the Company's Board of Directors declared the following monthly dividends:

| Declaration Date | Record Date | Payment Date | Dividend per Share |
|-------------------------|--------------------|---------------------|---------------------------|
| October 9, 2007 | October 23, 2007 | October 31, 2007 | \$ 0.08 |
| October 9, 2007 | November 21, 2007 | November 30, 2007 | \$ 0.08 |
| October 9, 2007 | December 20, 2007 | December 31, 2007 | \$ 0.08 |

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." 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) our future operating results as we are a company with a limited operating history; (2) the loss of one or more of our executive officers, in particular, David Gladstone, George Stelljes III, or Terry Lee Brubaker; (3) the impact of the investments that we make and the ability of these investments to achieve their objectives; (4) our contractual relationships with third parties; (5) the adequacy of our cash resources and working capital; (6) our ability to obtain future financing, if at all; and (7) those factors listed under the caption "Risk Factors" of this Quarterly Report on Form 10-Q. We caution readers not to place undue reliance on any such forward-looking statements, which 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 consolidated financial statements and the notes thereto contained elsewhere in this report and our annual report on Form 10-K for the fiscal year ended March 31, 2007.

OVERVIEW

We were incorporated under the General Corporation Laws of the State of Delaware on February 18, 2005. On June 22, 2005 we completed an initial public offering and commenced operations. We were primarily established for the purpose of investing in subordinated loans, mezzanine debt, preferred stock and warrants to purchase common stock of small and medium-sized companies in connection with buyouts and other recapitalizations. We also invest in senior secured loans and common stock and senior and subordinated syndicated loans. Our investment objective is to generate both current income and capital gains through these debt and equity instruments. We operate as a closed-end, non-diversified management investment company and have elected to be treated as a business development company ("BDC") under the Investment Company Act of 1940, as amended (the "1940 Act").

Our Investment Strategy

We seek to achieve returns from current income from senior, subordinated and mezzanine debt, and capital gains from preferred stock and warrants to purchase common stock that we purchase in connection with buyouts and recapitalizations of small and mid-sized companies with established management teams. Our investments generally range between \$10 million and \$30 million each, although this investment size may vary proportionately as the size of our capital base changes. We intend to invest either by ourselves or jointly with other buyout funds and/or management of the portfolio company, depending on the opportunity. If we are participating in an investment with one or more co-investors, then our investment is likely to be smaller than if we were investing alone.

We expect that our target portfolio over time will include mostly subordinated loans, mezzanine debt, preferred stock, and warrants to buy common stock. Structurally, subordinated loans and

mezzanine loans usually rank lower in priority of payment to senior debt, such as senior bank debt, and may be unsecured. However, subordinated debt and mezzanine loans rank senior to common and preferred equity in a borrower's capital structure. Typically, subordinated debt and mezzanine loans have elements of both debt and equity instruments, offering returns in the form of interest payments associated with senior debt, while providing lenders an opportunity to participate in the capital appreciation of a borrower, if any, through an equity position. Due to its higher risk profile and often less restrictive covenants as compared to senior debt, mezzanine debt generally earns a higher return than senior secured debt. Any warrants associated with mezzanine loans are typically detachable, which allows lenders to receive repayment of their principal on an agreed amortization schedule while retaining their equity interest in the borrower. Mezzanine debt also may include a "put" feature, which permits the holder to sell its equity interest back to the borrower at a price determined through a pre-determined formula.

Non-Control/Non-Affiliate Investments

We invested a substantial portion of the proceeds of our initial public offering in senior secured syndicated loans, since these investments typically may be originated more quickly than investments in companies undergoing a buyout or recapitalization. We employed this strategy in order to quickly invest our initial capital to generate current income, and have continued this strategy in order to build a portfolio that may be securitized in the future to obtain financing to pay down borrowings and invest in additional buyout and recapitalization investments. At September 30, 2007, we had investments in 52 such syndicated loans. There can be no guarantee that we will be able to successfully securitize any loans in our portfolio.

Senior secured syndicated loans typically involve a number of banks or other financial institutions and are generally more marketable than loans that are not syndicated. In order to invest in certain senior secured syndicated loans, we may purchase these investments at a premium or discount. We amortize premiums and discounts over the contractual life of the investment. In the event that an investment is sold prior to its contractual maturity date, we recognize a loss on any unamortized premium or a gain on any unamortized discount.

At September 30, 2007 and March 31, 2007, we held investments in Non-Control/Non-Affiliates of approximately \$209.1 million and \$138.6 million, at cost, respectively. These investments were comprised primarily of syndicated loan participations of senior notes of both public and private companies and also non-syndicated loan investments where we do not have a significant ownership interest in the portfolio company. We expect to continue purchasing syndicated loans using borrowings from our credit facility.

Control and Affiliate Investments

At September 30, 2007, we had investments of approximately \$106.3 million, at cost, in revolving credit facilities, senior debt and subordinated debt of six portfolio companies. In addition, at September 30, 2007, we had invested approximately \$28.6 million in preferred and common equity of those companies. These investments are the result of buyout and recapitalization transactions and represent our primary investment focus.

Investment Concentrations

Approximately 79% of the aggregate fair value of our investment portfolio at September 30, 2007 was comprised of senior debt, approximately 6% was senior subordinated debt, approximately 4% was subordinated debt and approximately 11% was preferred and common equity securities. At

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September 30, 2007, we had approximately \$344 million invested in 59 portfolio companies. The following table outlines our investments by type at September 30, 2007 and March 31, 2007:

| | September 30, 2007 | | March 31, 2007 | |
|--------------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | Cost | Fair Value | Cost | Fair Value |
| Senior Term Debt | \$ 276,427,571 | \$ 268,116,852 | \$ 207,367,741 | \$ 206,981,112 |
| Senior Subordinated Term Debt | 24,614,442 | 19,985,760 | 24,485,760 | 24,467,635 |
| Subordinated Term Debt | 14,077,810 | 14,077,810 | 14,167,810 | 14,167,810 |
| Preferred & Common Equity Securities | 28,898,802 | 36,237,680 | 28,598,802 | 25,331,046 |
| Total Investments | \$ 344,018,625 | \$ 338,418,102 | \$ 274,620,113 | \$ 270,947,603 |

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

| | September 30, 2007 | | | March 31, 2007 | | |
|--|-----------------------|---------------|-------------------|-----------------------|---------------|-------|
| | Fair Value | Percentage of | | Fair Value | Percentage of | |
| Total Investments | | Net Assets | Total Investments | | Net Assets | |
| Automobile | \$ 2,388,203 | 0.7% | 1.1% | \$ 8,504,666 | 3.1% | 3.8% |
| Beverage, Food & Tobacco | 3,860,325 | 1.1% | 1.8% | 3,413,874 | 1.3% | 1.5% |
| Broadcasting & Entertainment | 975,056 | 0.3% | 0.4% | | | |
| Buildings & Real Estate | 14,138,845 | 4.2% | 6.4% | 3,003,750 | 1.1% | 1.3% |
| Cargo Transport | 21,613,024 | 6.4% | 9.9% | 21,844,463 | 8.1% | 9.8% |
| Chemicals, Plastics & Rubber | 26,476,079 | 7.8% | 12.1% | 22,535,527 | 8.3% | 10.1% |
| Containers, Packaging and Glass | 11,265,938 | 3.3% | 5.1% | 999,975 | 0.4% | 0.4% |
| Diversified/Conglomerate Manufacturing | 34,139,858 | 10.1% | 15.6% | 32,563,400 | 12.0% | 14.6% |
| Diversified/Conglomerate Service | 44,179,915 | 13.1% | 20.2% | 27,374,081 | 10.1% | 12.3% |
| Ecological | 485,000 | 0.1% | 0.2% | | | |
| Electronics | 14,924,996 | 4.4% | 6.8% | 6,758,294 | 2.5% | 3.0% |
| Healthcare, Education and Childcare | 45,016,486 | 13.3% | 20.5% | 31,296,111 | 11.6% | 14.0% |
| Home & Office Furnishings | 17,362,491 | 5.1% | 7.9% | 17,105,808 | 6.3% | 7.7% |
| Machinery | 54,902,881 | 16.2% | 25.0% | 41,480,716 | 15.3% | 18.6% |
| Mining, Steel, Iron and Precious Metals | 4,950,000 | 1.5% | 2.3% | | | |
| Oil & Gas | | | | 3,851,943 | 1.4% | 1.7% |
| Personal, Non-durable Consumer Products | 7,099,519 | 2.1% | 3.2% | 1,492,472 | 0.6% | 0.7% |
| Personal, Food, & Miscellaneous Services | 5,538,418 | 1.6% | 2.5% | 16,905,483 | 6.2% | 7.6% |
| Printing, Publishing, Broadcasting | 15,387,301 | 4.5% | 7.0% | 18,590,084 | 6.9% | 8.3% |
| Retail Stores | 859,649 | 0.3% | 0.4% | 1,407,018 | 0.5% | 0.6% |
| Telecommunications | 12,854,119 | 3.7% | 5.9% | 9,246,854 | 3.4% | 4.1% |
| Textiles & Leather | | | | 2,573,084 | 0.9% | 1.2% |
| Total Investments | \$ 338,418,102 | 100% | | \$ 270,947,603 | 100% | |

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

| | September 30, 2007 | | | March 31, 2007 | | |
|--------------------------|-----------------------|-------------------|------------|-----------------------|-------------------|------------|
| | Fair Value | Percentage of | | Fair Value | Percentage of | |
| | | Total Investments | Net Assets | | Total Investments | Net Assets |
| Mid-Atlantic | \$ 145,722,631 | 43.1% | 66.5% | \$ 94,257,169 | 34.8% | 42.3% |
| Midwest | 107,700,975 | 31.8% | 49.1% | 88,508,725 | 32.7% | 39.7% |
| Northeast | 13,544,944 | 4.0% | 6.2% | 14,879,654 | 5.5% | 6.7% |
| Southeast | 38,636,723 | 11.4% | 17.6% | 36,357,555 | 13.4% | 16.3% |
| West | 29,032,829 | 8.6% | 13.2% | 36,944,500 | 13.6% | 16.6% |
| Canada | 3,780,000 | 1.1% | 1.7% | | | |
| Total Investments | \$ 338,418,102 | 100.0% | | \$ 270,947,603 | 100.0% | |

The geographic region depicts the location of the headquarters for the Company's portfolio companies. A portfolio company may have a number of other business locations in other geographic regions.

Our Adviser and Administrator

Our Adviser is led by a management team which has extensive experience in our lines of business. Our Adviser also has a wholly-owned subsidiary, Gladstone Administration, LLC (the "Administrator"), which employs our chief financial officer, chief compliance officer, controller, treasurer and their respective staffs. All of our executive officers are officers or directors, or both, of our Adviser and our Administrator.

Our Adviser also provides investment advisory and administrative services to our affiliates Gladstone Commercial Corporation, a publicly traded real estate investment trust; Gladstone Capital Corporation, a publicly traded registered investment 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 Corporation and Gladstone Capital Corporation. 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 (the "Advisory Agreement") since our inception. 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 1940 Act. Our Adviser is headquartered in McLean, Virginia, a suburb of Washington, D.C., and also has offices in the states of New York, Illinois, Pennsylvania, New Jersey, Texas and Washington.

Investment Advisory and Management Agreement

Pursuant to the Advisory Agreement we pay our Adviser fees, as compensation for its services, consisting of a base management fee and an incentive fee.

The base management fee is computed and payable quarterly and is assessed at an annual rate of 2.0%. The base management fee was initially computed on the basis of the average value of our gross invested assets at the end of the two most recently completed quarters, which were total assets less the cash proceeds and cash and cash equivalent investments from the proceeds of our initial public offering that were not invested in debt and equity securities of portfolio companies. Beginning on January 1, 2007, the base management fee is assessed at an annual rate of 2.0% computed on the basis of the average value of our gross assets at the end of the two most recently completed quarters, which are total assets, including investments made with proceeds of borrowings, less any uninvested cash or cash

equivalents resulting from borrowings. This new calculation was originally scheduled to begin in periods after March 31, 2006; however, our Board of Directors accepted voluntary waivers from our Adviser that allowed the initial calculation of the base management fee to be effective through December 31, 2006.

On April 11, 2007, our Board of Directors accepted a voluntary waiver from the Adviser to reduce the annual 2.0% base management fee on senior syndicated loan participations to 0.5% to the extent that proceeds resulting from borrowings were used to purchase such syndicated loan participations. This waiver remains in effect and was applied during the three and six months ended September 30, 2007.

When our Adviser receives fees from our portfolio companies, such as investment banking fees, structuring fees or executive recruiting services fees, 50% of certain of these fees will be credited against the base management fee that we would otherwise be required to pay to our Adviser.

In addition, our Adviser services the loans held by Gladstone Business Investment, LLC ("Business Investment"), in return for which the Adviser receives a 2.0% annual fee based on the monthly aggregate balance of loans held by Business Investment. Since we own these loans, all loan servicing fees paid to our Adviser are treated as reductions against the 2.0% base management fee. Overall, the base management fee due to our Adviser cannot exceed 2.0% of total assets (as reduced by cash and cash equivalents pledged to creditors) during any given fiscal year.

The incentive fee consists of two parts: an income-based incentive fee and a capital gains incentive fee. The income-based incentive fee 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 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 is determined and payable in arrears as of the end of each fiscal year (or upon termination of the Advisory Agreement, as of the termination date), and equals 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 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.

Administration Agreement

We have entered into an administration agreement with our Administrator (the "Administration Agreement") whereby 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.

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States ("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 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.

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 organization ("NRSRO"), (such as certain participations in syndicated loans) are valued at the indicative bid price offered by the respective originating syndication agent's desk on or near 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 original issue discount ("OID") and paid in kind ("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 September 30, 2007, we engaged Standard and Poor's Securities Evaluations, Inc. ("SPSE") to submit opinions of value for our debt securities that are issued to portfolio companies where we have no equity, or equity-like 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. We may also submit PIK interest to SPSE for valuation when it is determined the PIK interest is likely to be received. SPSE

will only evaluate the debt portion of our investments for which we specifically request evaluation, and may decline to make requested evaluations for any reason at its sole discretion. We also add any amortized OID interest to the fair value, unless adverse factors lead to a determination of a lesser valuation. 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 to SPSE for review and analysis. SPSE makes its independent assessment of the data that we have assembled and assesses its independent data to form an opinion as to what they consider to be the market values for the securities. With regard to its work, SPSE has issued the following paragraph:

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

SPSE opinions of value of our debt securities that are issued by portfolio companies where we have no equity, or equity-like securities are submitted to our Board of Directors along with our Adviser's supplemental assessment and recommendation regarding valuation of each of these investments. Our Adviser generally accepts the opinion of value given by SPSE, however, in certain limited circumstances, such as when our Adviser may learn new information regarding an investment between the time of submission to SPSE and the date of the Board assessment, our Adviser's conclusions as to value may differ from the opinion of value delivered by SPSE. Our Board of Directors then reviews whether our Adviser has followed its established procedures for determinations of fair value, and votes to accept or reject the recommended valuation of our investment portfolio. Our Adviser and our management recommended, and the Board of Directors voted to accept, the opinions of value delivered by SPSE on the loans in our portfolio as denoted on the Consolidated Schedule of Investments as of September 30, 2007 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 our equity securities, our Adviser determines the recommended 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. We and our Adviser participate in the periodic board meetings of our portfolio companies in which we hold control and affiliate investments and also require them to provide annual audited and monthly unaudited financial statements. Using these statements and board discussions, our Adviser calculates and evaluates 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 Investment'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 10.0 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 forth are for a ten year term debt security. If a 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. At September 30, 2007, one investment was on non-accrual and at March 31, 2007 there were no investments on non-accrual. Additionally, we do not risk rate our equity securities.

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The following table lists the risk ratings for all non-syndicated loans in our portfolio at September 30, 2007 and March 31, 2007, representing approximately 37% and 44%, respectively, of all loans in our portfolio:

| Rating | September 30, 2007 | March 31, 2007 |
|------------------|-------------------------------|---------------------------|
| Highest | 7.0 | 8.0 |
| Average | 5.9 | 5.7 |
| Weighted Average | 5.2 | 5.0 |
| Lowest | 2.0 | 2.0 |

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

| Rating | September 30, 2007 | March 31, 2007 |
|------------------|-------------------------------|---------------------------|
| Highest | 9.0 | 8.0 |
| Average | 7.5 | 7.2 |
| Weighted Average | 7.6 | 7.3 |
| Lowest | 6.0 | 6.0 |

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 September 30, 2007 and March 31, 2007, representing approximately 46% and 42%, respectively, of all loans in our portfolio:

| Rating | September 30, 2007 | March 31, 2007 |
|------------------|-------------------------------|---------------------------|
| Highest | BB/Ba2 | BB-/Ba2 |
| Average | B+/B1 | B+/B1 |
| Weighted Average | B+/B1 | B+/B1 |
| Lowest | CCC+/B2 | B/B2 |

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 certain participations in syndicated loans, at the indicative bid price offered by the respective originating syndication agent's trading desk on or near the valuation date. At September 30, 2007, none of the debt securities in our portfolio were publicly traded and there was a limited market for 52 debt securities in our portfolio. At March 31, 2007, none of the debt securities in our portfolio were publicly traded and there was a limited market for 42 debt securities in our portfolio.

Debt securities that are issued by portfolio companies where we have an equity, or equity-like interest that are not publicly traded, for which there is no market, or for which there is a market but the securities have not been rated by a NRSRO, are valued at cost, if there is adequate total enterprise value determined when valuing our equity holdings in the borrower. Fair values are discounted for any shortfall of total enterprise value over the total debt outstanding for the borrower.

Debt securities that are not publicly traded and that are issued by portfolio companies where we have no equity, or equity-like securities, for which there is no market, or for which there is a market but the securities 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 intended currently to sell the security and consider some or all of the following factors:

the cost basis and the type of the security;

the nature and realizable value of the collateral;

the portfolio company's ability to make payments and discounted cash flow;

reports from portfolio company senior management and board meetings;

reported values of similar securities of the portfolio company or comparable companies; and

changes in the economy affecting the portfolio company.

We value convertible debt, equity, success or exit 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 September 30, 2007 and March 31, 2007, there was no market for any of the equity securities we owned. To value convertible debt, equity, success or exit fees or other equity-like 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 also include discounted cash flow of the expected sale price in the future, valuation of the securities based on recent sales to third parties in comparable transactions, or a review of similar companies that are publicly traded and the market multiple of their equity securities. In gathering the sales to third parties of similar securities, we may reference industry statistics and use outside experts. At September 30, 2007 we had \$28.9 million invested, at cost, in equity securities compared to our debt portfolio with a cost basis of \$315.1 million. At March 31, 2007, we had \$28.6 million invested, at cost, in equity securities compared to our debt portfolio with a cost basis of \$246.0 million.

At September 30, 2007, we had total unrealized depreciation of approximately \$5.6 million, which was primarily comprised of approximately \$8.3 million of net unrealized depreciation of our syndicated loan investments, offset by approximately \$2.7 million of net appreciation in our Control and Affiliate investments. The syndicated loan market was extremely volatile during the quarter ended September 30, 2007 and as a result, certain of our syndicated loan investments experienced significant declines in fair market value. At March 31, 2007, we had total unrealized depreciation of approximately \$3.7 million, which was primarily comprised of net unrealized depreciation of our preferred and common stock in Chase II Holdings Corp.

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 Internal Revenue Code of 1986, as amended (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 our investment company taxable income, as defined by the Code. It is our policy to pay out as a dividend up to 100% of those amounts.

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 to 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 and Dividend 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 when it is determined that interest is no longer collectible. At September 30, 2007, one Non-Control/Non-Affiliate investment was on non-accrual with a cost basis of approximately \$2.9 million at September 30, 2007, or less than 1% of the cost basis of all loans in our portfolio. There were no accounts on non-accrual at March 31, 2007. Conditional interest, or a success fee, is recorded when earned upon full repayment of a loan investment. To date we have not recorded any conditional interest. Dividend income on preferred equity securities is accrued to the extent that such amounts are expected to be collected and that we have the option to collect such amounts in cash. To date, we have not accrued any dividend income.

Services Provided to Portfolio Companies

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

Our Adviser receives fees for the other services it provides to our 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 the closing of the investment. The services our Adviser provides to our 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 investments, raising equity and debt capital, turnaround management, merger and acquisition services and recruiting new management personnel. When our Adviser receives fees for these services, 50% of certain of those fees are credited against the base management fee that 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 fee.

We may receive fees for the origination and closing services we provide to portfolio companies through our Adviser. These fees are paid directly to us and are recognized as revenue upon closing of the originated investment and are reported as fee income in the consolidated statements of operations.

RESULTS OF OPERATIONS

Three months ended September 30, 2007 compared to the three months ended September 30, 2006

Investment Income

Investment income for the three months ended September 30, 2007 increased \$2,942,241 to \$7,156,169 compared to investment income of \$4,213,928 for the three months ended September 30, 2006.

Interest income from Non-Control/Non-Affiliate investments increased \$1,692,619 to \$4,079,994 for the three months ended September 30, 2007 compared to \$2,387,375 for the three months ended September 30, 2006. This increase was mainly the result of approximately \$86 million of additional Non-Control/Non-Affiliate investments at September 30, 2007 compared to the prior year period.

Interest income from Control investments was \$2,612,412 for the three months ended September 30, 2007 representing interest on our loan investments to our Control affiliates compared to interest income of \$1,256,303 for the three months ended September 30, 2006. The increase of \$1,356,109 is directly attributable to the addition of two Control investments compared to the prior year period.

Interest income from Affiliate investments was \$374,887 for the three months ended September 30, 2007 representing interest on our loan investments to our Non-Control affiliate. At September 30, 2006, we had not yet invested in any Affiliate investments.

Interest income from cash and equivalents decreased \$509,161 to \$60,419 for the three months ended September 30, 2007 from \$569,580 for the three months ended September 30, 2006. This decrease was the result of the complete investment of the proceeds of our initial public offering in Control, Affiliate and Non-Control/Non-Affiliate investments. At September 30, 2006 we had approximately \$30 million of cash equivalents invested in treasury securities and at September 30, 2007 we had no investments in treasury securities as all of the proceeds from our initial public offering had been invested.

Other income for the three months ended September 30, 2007 was \$28,457 compared to \$670 for the three months ended September 30, 2006. Other income is primarily comprised of loan amendment fees that are received from portfolio companies and are amortized over the remaining life of the respective loans. The increase of \$27,787 from the prior year quarter is primarily due to the repayment of two loans which resulted in the full recognition of the unamortized fees and the receipt of additional amendment fees in the current year period.

The weighted average yield on our portfolio of investments, excluding cash and cash equivalents, was 9.08% for the three months ended September 30, 2007 and 8.72% for the three months ended September 30, 2006. This increase is largely the result of rising interest rates and the increase in our investments in non-syndicated loans that typically bear higher interest rates than those of syndicated loans.

Operating Expenses

Operating expenses for the three months ended September 30, 2007 were \$4,161,631 compared to \$1,330,042 for the three months ended September 30, 2006, representing an overall increase of \$2,831,589.

For the three months ended September 30, 2007, we incurred a base management fee of \$452,630 after reductions for loan servicing fees received by our Adviser of \$1,259,651. We also received credits against our base management fee of \$502,719, which is comprised of \$441,469 resulting from reduced fees on syndicated loan participations and \$61,250 resulting from investment banking fees paid to the

Adviser during the period, resulting in a net management fee credit of \$50,089 for the three months ended September 30, 2007. For the three months ended September 30, 2006, we incurred a base management fee of \$861,893. The gross base management fees, before any reductions for loan servicing fees of \$1,712,281 increased in the current period due to the growth of the investment portfolio as compared to the same period of the prior year, however, the increase was partially offset by credits against the management fee of \$502,719 in the current fiscal quarter of which there were none in the prior year quarter. The base management fee is currently computed quarterly as described under "Investment Advisory and Management Agreement."

Loan servicing fees of \$1,259,651 were incurred for the three months ended September 30, 2007. These fees were incurred in connection with a loan servicing agreement between Business Investment and our Adviser in connection with our credit facility established in October 2006, which is based on the size of the aggregate outstanding loan portfolio. These fees reduced the amount of the management fee due to our Adviser as noted above.

The administration fee payable to our Administrator was \$227,767 for the three months ended September 30, 2007 compared to \$124,861 for the three months ended September 30, 2006. This fee consists of our allocable portion of our Administrator's rent and other overhead expenses, and our allocable portion of the salaries and benefits of our chief financial officer, chief compliance officer, treasurer, controller and their respective staffs. Our allocable portion of expenses is derived by multiplying the percentage of our average assets (the assets at the beginning and ending of each quarter) in comparison to the average assets of all companies managed by our Adviser. The increase was mainly attributable to the personnel growth of our Administrator.

Directors' fees for the three months ended September 30, 2007 and 2006 were \$67,472 and \$56,250, respectively. Directors' fees consist of the amortization of the directors' annual stipend and individual meeting fees. The increase is due to fewer committee meetings held in the prior year quarter.

Insurance expense for the three months ended September 30, 2007 was \$73,129 compared to \$67,626 for the three months ended September 30, 2006. Insurance expense consists of the amortization of the directors and officers insurance policy and professional liability policy premiums.

Professional fees for the three months ended September 30, 2007 were \$110,255, an increase of \$22,215 over the professional fees for the three months ended September 30, 2006 of \$88,040. Professional fees primarily consist of legal fees and audit and accounting fees. The increase is mainly due to an increase in audit fees related to our compliance with Sarbanes-Oxley regulations, tax fees for our prior period tax returns and direct consulting and legal fees incurred on potential investments that were not executed.

Stockholder related costs increased \$92,240 for the three months ended September 30, 2007 to \$157,340 from \$65,100 in the three months ended September 30, 2006. Stockholder related costs consist of the amortization of annual Nasdaq listing fees, transfer agent fees, annual report printing fees, Securities and Exchange Commission ("SEC") filing fees and press release costs. The increase is primarily attributed to additional expenses incurred related to the solicitation of stockholder proxy votes for our annual meeting of stockholders in August 2007.

Interest expense for the three months ended September 30, 2007 was \$2,023,075 and resulted from borrowings on our credit facility during the quarter, which were used to finance our investment purchases during the period. There were no outstanding borrowings for the same period in the prior year.

Deferred finance cost amortization for the three months ended September 30, 2007 was \$216,363 and is directly attributable to the amortization of the capitalized finance costs associated with our credit facility that was established in October 2006.

Taxes and licenses expense for the three months ended September 30, 2007 was \$41,325 and was primarily comprised of franchise taxes due to the state of Delaware and other fees surrounding state and regulatory licensing, registration and other corporate filing fees.

General and administrative expenses for the three months ended September 30, 2007 were \$35,343 compared to \$24,935 for the three months ended September 30, 2006. General and administrative expenses consist primarily of direct expenses such as travel related specifically to our portfolio companies, loan evaluation services for our portfolio companies and backup servicer expenses. The overall increase of \$10,408 is mainly due to the increase in direct expenses as the overall size of our investment portfolio grew from the prior year period.

Realized and Unrealized Loss on Investments

For the three months ended September 30, 2007, we recognized a net loss of \$3,431 resulting from additional legal expenses incurred in connection with the sale of one of our syndicated loans during the three months ended June 30, 2007. We recorded net unrealized depreciation of investments in the aggregate amount of \$7,358,182. The net unrealized depreciation of our investments for the three months ended September 30, 2007 was primarily related to the decline in market value of our syndicated loan portfolio of approximately \$7.3 million as the result of extreme market volatility during the quarter.

Net Decrease in Net Assets from Operations

Overall, we realized a net decrease in net assets resulting from operations of \$4,367,075 for the three months ended September 30, 2007 as a result of the factors discussed above. Our net decrease in net assets from operations per basic and diluted weighted average common share for the three months ended September 30, 2007 was (\$0.26) compared to a net increase in net assets resulting from operations per share of \$0.17 for the three months ended September 30, 2006.

We will continue to incur base management fees which are likely to increase as our investment portfolio grows, and we may begin to incur incentive fees. Our administrative expenses payable to our Administrator are also likely to grow during future periods as our average assets increase and as the expenses incurred by our Administrator to support our operations grow.

Six months ended September 30, 2007 compared to the six months ended September 30, 2006

Investment Income

Investment income for the six months ended September 30, 2007 increased \$5,378,732 to \$13,456,098 compared to investment income of \$8,077,366 for the six months ended September 30, 2006.

Interest income from Non-Control/Non-Affiliate investments increased \$2,976,694 to \$7,328,549 for the six months ended September 30, 2007 compared to \$4,351,855 for the six months ended September 30, 2006. This increase was mainly the result of approximately \$86 million of additional Non-Control/Non-Affiliate investments at September 30, 2007 compared to the prior year period.

Interest income from Control investments was \$5,177,404 for the six months ended September 30, 2007, representing interest on our loan investments to our Control affiliates, compared to interest income of \$2,446,605 for the six months ended September 30, 2006. The increase of \$2,730,799 is directly attributable to the addition of two Control investments compared to the prior year period.

Interest income from Affiliate investments was \$801,450 for the six months ended September 30, 2007 representing interest on our loan investments to our Non-Control affiliate. At September 30, 2006, we had not yet invested in any Affiliate investments.

Interest income from cash and equivalents decreased \$1,163,809 to \$114,111 for the six months ended September 30, 2007 from \$1,277,920 for the six months ended September 30, 2006. This decrease was the result of the complete investment of the proceeds of our initial public offering in Control, Affiliate and Non-Control/Non-Affiliate investments. At September 30, 2006 we had approximately \$30 million of cash equivalents invested in treasury securities and at September 30, 2007 we had no investments in treasury securities as all of the proceeds from our initial public offering had been invested.

Other income for the six months ended September 30, 2007 was \$34,584 compared to \$986 for the three months ended September 30, 2006. Other income is primarily comprised of loan amendment fees that are received from portfolio companies and are amortized over the remaining life of the respective loans. The increase of \$33,598 from the prior year period is primarily due to the repayment of two loans which resulted in the full recognition of the unamortized fees and the receipt of additional amendment fees during the period.

The weighted average yield on our portfolio of investments, excluding cash and cash equivalents, was 9.12% for the six months ended September 30, 2007 and 8.44% for the six months ended September 30, 2006. This increase is largely the result of rising interest rates and the increase in our investments in non-syndicated loans that typically bear higher interest rates than those of syndicated loans.

Operating Expenses

Operating expenses for the six months ended September 30, 2007 were \$7,573,016 compared to \$2,612,316 for the six months ended September 30, 2006, representing an overall increase of \$4,960,700.

For the six months ended September 30, 2007, we incurred a base management fee of \$812,319 after reductions for loan servicing fees received by our Adviser of \$2,454,069. We also received credits against our base management fee of \$886,594 which were comprised of \$734,469 resulting from reduced fees on syndicated loan participations and \$152,125 resulting from investment banking fees paid to the Adviser during the period, resulting in a net management fee credit of \$74,275 for the six months ended September 30, 2007. For the six months ended September 30, 2006, we incurred a base management fee of \$1,663,202. The gross base management fees, before any reductions for loan servicing fees, of \$3,266,388 increased in the current period due to the growth of the investment portfolio and the full investment of the proceeds from our initial public offering as compared to the same period of the prior year, however, the increase was partially offset by credits against the management fee of \$886,594 in the current period of which there were none in the prior year period. The base management fee is currently computed quarterly as described under "Investment Advisory and Management Agreement."

Loan servicing fees of \$2,454,069 were incurred for the six months ended September 30, 2007. These fees were incurred in connection with a loan servicing agreement between Business Investment and our Adviser in connection with our credit facility established in October 2006, which is based on the size of the aggregate outstanding loan portfolio. These fees reduced the amount of the management fee due to our Adviser as noted above.

The administration fee payable to our Administrator was \$435,581 for the six months ended September 30, 2007 compared to \$240,250 for the six months ended September 30, 2006. This fee consists of our allocable portion of our Administrator's rent and other overhead expenses, and our allocable portion of the salaries and benefits of our chief financial officer, chief compliance officer, treasurer, controller and their respective staffs. Our allocable portion of expenses is derived by multiplying the percentage of our average assets (the assets at the beginning and ending of each quarter) in comparison to the average assets of all companies managed by our Adviser that are under

similar administration agreements with our Administrator. The increase was mainly attributable to the personnel growth of our Administrator.

Directors' fees for the six months ended September 30, 2007 and 2006 were \$122,272 and \$99,500, respectively. Directors' fees consist of the amortization of the directors' annual stipend and individual meeting fees. The increase is due to fewer committee meetings held in the prior year period.

Insurance expense for the six months ended September 30, 2007 was \$136,070 compared to \$140,237 for the six months ended September 30, 2006. Insurance expense consists of the amortization of the directors and officers insurance policy and professional liability policy premiums.

Professional fees for the six months ended September 30, 2007 were \$265,921, an increase of \$98,133 over the professional fees for the six months ended September 30, 2006 of \$167,788. Professional fees primarily consist of legal fees and audit and accounting fees. The increase is mainly due to an increase in audit fees related to our compliance with Sarbanes-Oxley regulations, tax fees for our prior period tax returns and direct consulting and legal fees incurred on potential investments that were not executed.

Stockholder related costs increased \$36,363 for the six months ended September 30, 2007 to \$195,229 from \$158,866 in the six months ended September 30, 2006. Stockholder related costs consist of the amortization of annual Nasdaq listing fees, transfer agent fees, annual report printing fees, SEC filing fees and press release costs. The increase is primarily attributed to additional expenses incurred related to the solicitation of stockholder proxy votes for our annual meeting of stockholders in August 2007.

Interest expense for the six months ended was \$3,437,337 and resulted from borrowings on our credit facility during the six months ended September 30, 2007, which were used to finance our investment purchases during the period.

Deferred finance cost amortization for the six months ended September 30, 2007 was \$426,203 and was directly attributable to the amortization of the capitalized finance costs associated with our credit facility that was established in October 2006.

Taxes and licenses expense for the six months ended September 30, 2007 was \$83,132 and was primarily comprised of franchise taxes due to the state of Delaware and other fees surrounding state and regulatory licensing, registration and other corporate filing fees. The decrease of \$15,312 compared to the prior year period was the result of the timing of the accruals of the franchise tax to the state of Delaware in the prior year. The maximum franchise tax to be paid to the state of Delaware is \$165,000 in a calendar year.

General and administrative expenses for the six months ended September 30, 2007 were \$91,477 compared to \$44,029 for the six months ended September 30, 2006. General and administrative expenses consist primarily of direct expenses such as travel related specifically to our portfolio companies, loan evaluation services for our portfolio companies and backup servicer expenses. The overall increase of \$47,448 is mainly due to the increase in direct expenses as the overall size of our investment portfolio grew from the prior year period.

Realized and Unrealized Loss on Investments

For the six months ended September 30, 2007, we recognized a net loss on the sale of four syndicated loan participations aggregating \$51,678 and we recorded net unrealized depreciation of investments in the aggregate amount of \$1,928,013. The net unrealized depreciation of our investments for the six months ended September 30, 2007 was primarily related to a decrease in the fair market value of our syndicated loan portfolio during the period compared to their fair market value at March 31, 2007.

Net Increase in Net Assets from Operations

Overall, we realized a net increase in net assets resulting from operations of \$3,903,391 for the six months ended September 30, 2007 as a result of the factors discussed above. Our net increase in net assets from operations per basic and diluted weighted average common share for the six months ended September 30, 2007 was \$0.24 compared to \$0.25 for the six months ended September 30, 2006.

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We will continue to incur base management fees which are likely to increase as our investment portfolio grows, and we may begin to incur incentive fees. Our administrative expenses payable to our Administrator are also likely to grow during future periods as our average assets increase and as the expenses incurred by our Administrator to support our operations grow.

LIQUIDITY AND CAPITAL RESOURCES

Operating Activities

Net cash used in operating activities for the six months ended September 30, 2007 was approximately \$53.1 million and consisted primarily of the purchase of investments and the net unrealized depreciation of our investments, offset by repayments and sales of existing portfolio investments and an increase in amounts due from custodian.

A summary of our investment activity for the six months ended September 30, 2007 and September 30, 2006 is as follows:

| Quarter Ended | New Investments | Principal Repayments | Investments Sold | Loss on Disposal |
|--------------------|-----------------------|----------------------|---------------------|--------------------|
| June 30, 2007 | \$ 72,601,227 | \$ 21,358,187 | \$ 5,809,471 | \$ (48,247) |
| September 30, 2007 | 41,182,856 | 16,947,989 | | (3,431) |
| Total | \$ 113,784,083 | \$ 38,306,176 | \$ 5,809,471 | \$ (51,678) |

| Quarter Ended | New Investments | Principal Repayments | Investments Sold | Gain on Disposal |
|--------------------|----------------------|----------------------|----------------------|------------------|
| June 30, 2006 | \$ 33,665,549 | \$ 874,222 | \$ 15,551,727 | \$ 3,273 |
| September 30, 2006 | 15,812,230 | 5,964,245 | 997,502 | (1,934) |
| Total | \$ 49,477,779 | \$ 6,838,467 | \$ 16,549,229 | \$ 1,339 |

The following table summarizes the contractual principal amortization and maturity of our investment portfolio by fiscal year, assuming no voluntary prepayments:

| Fiscal Year Ended March 31, | Amount |
|---|-----------------------|
| 2008 | \$ 7,302,577 |
| 2009 | 10,098,966 |
| 2010 | 9,597,716 |
| 2011 | 50,578,462 |
| 2012 | 46,511,482 |
| Thereafter | 190,829,882 |
| Total contractual repayments | \$ 314,919,085 |
| Investments in equity securities | \$ 28,898,802 |
| Unamortized premiums on debt securities | 200,738 |
| Total | \$ 344,018,625 |

Financing Activities

During the six months ended September 30, 2007, we recorded net borrowings under our credit facility of \$46.1 million which were used to purchase new investments.

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For the six months ended September 30, 2007, our dividends paid of \$7,452,045 exceeded our net investment income (including net realized losses) by \$1,620,641. As a result, we estimate that \$5,831,404, or \$0.35 per share, of our dividends declared and paid to stockholders during the period

were paid from ordinary income and \$1,620,641, or \$0.10 per share, of these dividends represented a return of capital to stockholders. We declared these dividends based on our estimates of net investment income for the fiscal year. Our investment pace continues to be slower than expected in our second year of operations and, consequently, our net investment income was lower than our original estimates.

We anticipate continuing to borrow funds and, from time to time, issuing securities to obtain additional capital in the future. The terms of the future equity issuances cannot be determined and there can be no assurances that the equity markets will be available to us on terms we deem favorable, if at all. To this end, we have an effective registration statement on file with the SEC that permits us to issue, through one or more transactions, up to an aggregate of \$300 million in securities, which may consist of common stock, preferred stock and/or debt securities. To date we have incurred approximately \$194,000 of costs in connection with this registration statement.

Revolving Credit Facility

On October 19, 2006, through our wholly-owned subsidiary, Business Investment, we initially obtained a \$100 million revolving credit facility (the "Credit Facility"). On October 19, 2006, we executed a purchase and sale agreement pursuant to which we agreed to sell certain loans to Business Investment in consideration for a membership interest therein. Simultaneously, Business Investment executed a credit agreement (the "Credit Agreement") with Deutsche Bank AG, New York Branch ("Deutsche Bank"), as administrative agent, and others, pursuant to which Business Investment pledged the loans purchased from us to secure future advances by certain institutional lenders. Availability under the Credit Facility was originally scheduled to terminate on October 18, 2007, however, on that date we amended and extended the Credit Facility such that availability under the Credit Facility will terminate on October 16, 2008, unless extended in the discretion of the lenders at the request of Business Investment. Interest is payable monthly during the term of the Credit Facility and principal is payable out of collections on loans purchased from us during the period following the date of which availability for advances has terminated through maturity. The Credit Facility will mature two years following the date on which availability for advances has terminated and on such date, all principal, interest and other amounts owing under the Credit Facility will be due and payable. Interest rates charged on the advances under the facility are based on the rate paid by the lenders on commercial paper notes issued by such lenders to fund some or all of the advances, the London Interbank Offered Rate ("LIBOR"), the Prime Rate or the Federal Funds Rate, depending on market conditions, and adjusts periodically. On March 29, 2007, we increased our borrowing capacity under the Credit Facility from \$100 million to \$200 million. As of September 30, 2007, there was an outstanding principal balance of \$146.1 million under the Credit Facility at an interest rate of approximately 5.71%. Available borrowings are subject to various constraints imposed under the Credit Agreement, based on the aggregate loan balance pledged by Business Investment, 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, 2007, the remaining borrowing capacity available under the Credit Facility was approximately \$54 million.

The Credit Facility contains covenants that require Business Investment 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 September 30, 2007, Business Investment was in compliance with all of the facility covenants. We currently intend to securitize some or all of the loans held by Business Investment and if we are able to do so, we will use the proceeds from the securitization to pay down any amounts then outstanding under the revolving credit facility.

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The administrative agent also requires that any interest or principal payments on pledged loans be remitted directly by the borrower into lockbox accounts controlled by Deutsche Bank. Once a month, Deutsche Bank remits the collected funds to the Company after payment of any interest and expenses provided for under the Credit Agreement.

Our Adviser services the loans pledged under the Credit 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 Credit 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 September 30, 2007, we were in compliance with our covenants under the performance guaranty.

Dividends

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 realized net short-term capital gains to our stockholders on an annual basis. In accordance with these requirements, we declared the following dividends:

| Declaration Date | Record Date | Payment Date | Dividend per Share |
|------------------|--------------------|--------------------|--------------------|
| October 9, 2007 | December 20, 2007 | December 31, 2007 | \$ 0.08 |
| October 9, 2007 | November 21, 2007 | November 30, 2007 | \$ 0.08 |
| October 9, 2007 | October 23, 2007 | October 31, 2007 | \$ 0.08 |
| July 10, 2007 | September 20, 2007 | September 28, 2007 | \$ 0.075 |
| July 10, 2007 | August 23, 2007 | August 31, 2007 | \$ 0.075 |
| July 10, 2007 | July 23, 2007 | July 31, 2007 | \$ 0.075 |
| April 11, 2007 | June 21, 2007 | June 29, 2007 | \$ 0.075 |
| April 11, 2007 | May 22, 2007 | May 31, 2007 | \$ 0.075 |
| April 11, 2007 | April 20, 2007 | April 30, 2007 | \$ 0.075 |
| January 10, 2007 | March 22, 2007 | March 30, 2007 | \$ 0.075 |
| January 10, 2007 | February 20, 2007 | February 28, 2007 | \$ 0.075 |
| January 10, 2007 | January 23, 2007 | January 31, 2007 | \$ 0.075 |
| October 10, 2006 | December 20, 2006 | December 29, 2006 | \$ 0.07 |
| October 10, 2006 | November 21, 2006 | November 30, 2006 | \$ 0.07 |
| October 10, 2006 | October 23, 2006 | October 31, 2006 | \$ 0.07 |
| July 11, 2006 | September 21, 2006 | September 29, 2006 | \$ 0.07 |
| July 11, 2006 | August 21, 2006 | August 31, 2006 | \$ 0.07 |
| July 11, 2006 | July 19, 2006 | July 31, 2006 | \$ 0.07 |
| April 11, 2006 | June 22, 2006 | June 30, 2006 | \$ 0.07 |
| April 11, 2006 | May 22, 2006 | May 31, 2006 | \$ 0.07 |
| April 11, 2006 | April 20, 2006 | April 28, 2006 | \$ 0.07 |

Contractual Obligations and Off-Balance Sheet Arrangements

As of September 30, 2007, we were a party to signed and non-binding term sheets for two buyout investments for an aggregate of approximately \$39.9 million. The future scheduled contractual payments at September 30, 2007 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 | 39,850,000 | 39,850,000 | \$ | \$ | \$ |
| Total | \$ 39,850,000 | \$ 39,850,000 | \$ | \$ | \$ |

In October 2007, all of the investment purchase obligations summarized above were funded. See Note 10 "Subsequent Events" in our unaudited consolidated financial statements for further information.

We did not have any significant off-balance sheet arrangements as defined in Item 303(a)(4)(ii) of SEC Regulation S-K as of September 30, 2007.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

We are subject to financial market risks, including changes in interest rates. General interest rate fluctuations may have a substantial negative impact on our investments and investment opportunities and, accordingly have a material adverse effect on our investment objectives and our rate of return on invested capital. Currently, approximately 67% of our investment portfolio, at cost, is comprised of loans at variable rates and approximately 11% of our investment portfolio, at cost, is in loans at variable rates with a floor. In addition, an increase in interest rates would make it more expensive to use debt for our financing needs, if any.

We expect to continue to borrow funds to finance future lending activities as we have fully invested the proceeds of our initial public offering. These future borrowings may be at fixed or variable rates. For example, interest rates charged on the advances under our credit facility are based on the rate paid by the lenders on commercial paper notes issued by such lenders to fund some or all of the advances, LIBOR, the Prime Rate or the Federal Funds Rate, depending on market conditions, and adjust periodically. As of September 30, 2007, there was an outstanding principal balance of \$146.1 million under the credit facility.

In October 2007, 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 \$20 million (which will be amortized quarterly) for a one-time, up-front payment of \$15,000. 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 9%. The cap expires in October 2008. 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 9%. This mitigates our exposure to increases in interest rates on our borrowings on our line of credit, which are at variable rates.

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 1.0% would increase our net increase in net assets resulting from operations by approximately \$1.2 million, or 17.2%, over the next twelve months, compared to the net increase in net

assets resulting from operations for twelve months ended September 30, 2007. A hypothetical decrease in the one month LIBOR by 1.0% would decrease our net increase in net assets resulting from operations by approximately \$1.2 million, or 16.6%, over the next twelve months, compared to the net increase in net assets from operations for the twelve months ended September 30, 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 investment portfolio and other business developments that could affect net increase in net assets resulting from operations. Accordingly, no assurances can be given that actual results would not differ materially from the results under this hypothetical analysis.

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

We may also experience risk associated with investing in securities of companies with foreign operations. At September 30, 2007, we had approximately \$4.0 million invested in a syndicated loan participation of a portfolio company headquartered in Ontario, Canada. Although we currently do not anticipate additional investments in debt or equity of foreign companies, 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.

ITEM 4. CONTROLS AND PROCEDURES.

As of September 30, 2007, 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 September 30, 2007 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 we, nor any of our subsidiaries are currently subject to any material legal proceeding, nor, to our knowledge, is any material legal proceeding threatened against us or any of our subsidiaries.

ITEM 1A. RISK FACTORS.

Our business is subject to certain risks and events that, if they occur, could adversely affect our financial condition and results of operations and the trading price of our common stock. 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.

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, president and chief investment officer, chief operating 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.

The 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 Advisory Agreement with our Adviser, see "Management's Discussion and Analysis of Financial Condition and Results of Operations Overview Investment Advisory and Management Agreement."

Our Adviser's failure to identify and invest in securities that meet our investment criteria or perform its responsibilities under the investment 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 investment 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 are a relatively new company with limited operating history.

We were incorporated in Delaware on February 18, 2005. We are subject to all of the business risks and uncertainties associated with any new business, including the risk that we will not achieve our investment objectives and that the value of your investment could decline substantially.

We operate in a highly competitive market for investment opportunities.

A number of entities compete with us for investments in small and mid-sized companies. We will compete with public and private buyout funds, commercial and investment banks, commercial financing companies, and, to the extent they provide an alternative form of financing, hedge funds. 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, some of our competitors may have higher risk tolerances or different risk assessments, which would allow them to consider a wider variety of investments and establish more relationships than us. Furthermore, many of our competitors are not subject to the regulatory restrictions that the 1940 Act imposes on us as a business development company. The competitive pressures we face could 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 we can offer no assurance that we will be able to identify and make investments that are consistent with our investment objective. We do not seek to compete primarily based on the interest rates we offer, and we believe that some of our competitors may make loans with interest rates that will be comparable to or lower than the rates we offer. We may lose investment opportunities if we do not match our competitors' pricing, terms, and structure. However, if we match our competitors' pricing, terms, and structure, we may experience decreased net interest income and increased risk of credit loss.

Our investments in small and medium-sized portfolio companies are extremely risky and you could lose all or a part of your investment.

Investments in small and medium-sized portfolio companies 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 portfolio companies 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 portfolio companies 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. A 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 portfolio companies 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 invest in privately owned businesses, there is generally little or no publicly available operating and financial information about our potential portfolio companies. As a result, we rely on our officers, our Adviser and its employees and consultants to perform due diligence investigations of these portfolio companies, 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 portfolio companies 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 portfolio companies 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 portfolio companies 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. Portfolio companies 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.

When we invest in mezzanine or senior secured loans, we may acquire warrants or other equity securities as well. In addition we may invest in preferred and common stock. Our goal is ultimately to dispose of such equity interests and realize gains upon our disposition of such interests. However, the equity interests we receive may not appreciate in value and, in fact, may decline in value. Accordingly,

we may not be able to realize gains from our equity interests, and any gains that we do realize on the disposition of any equity interests may not be sufficient to offset any other losses we experience.

Because the loans we make and equity securities we receive 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 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.

A portion of our assets are, and will continue to be, comprised 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. For more information concerning our investment valuation procedures, see "Management's Discussion and Analysis of Financial Condition and Results of Operations Overview Critical Accounting Policies Investment Valuation."

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

We will generally make investments in private companies whose securities are not traded in any public market. Substantially all of these securities will be subject to legal and other restrictions on resale and will otherwise be less liquid than publicly traded securities. The illiquidity of our investments may make it difficult for us to sell such investments if the need arises. In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may realize substantial book losses upon liquidation. 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.

We typically invest in transactions involving acquisitions, buyouts and recapitalizations of companies, which will subject us to the risks associated with change in control transactions.

Our strategy includes making debt and equity investments in companies in connection with acquisitions, buyouts and recapitalizations, which subjects us to the risks associated with change in control transactions. Change in control transactions often present a number of uncertainties. Companies undergoing change in control transactions often face challenges retaining key employees, maintaining relationships with customers and suppliers. While we hope to avoid many of these difficulties by participating in transactions where the management team is retained and by conducting thorough due diligence in advance of our decision to invest, if our portfolio companies experience one or more of these problems, we may not realize the value that we expect in connection with our investments which would likely harm our operating results and financial condition.

Our portfolio companies are likely to have debt that ranks equally with, or senior to, our investments in such companies.

We invest primarily in subordinated debt, mezzanine debt and preferred and common equity securities issued by our portfolio companies in connection with buyouts or recapitalizations of these companies. Portfolio companies undergoing these types of transactions usually will have other debt that ranks equally with, or senior to, the debt securities in which we invest. By their terms, such debt instruments may provide that the holders are entitled to receive payment of interest or principal on or before the dates on which we are entitled to receive payments in respect of the debt securities in which we invest. Also, in the event of insolvency, liquidation, dissolution, reorganization, or bankruptcy of a portfolio company, holders of debt instruments ranking senior to our investment in that portfolio company would typically be entitled to receive payment in full before we receive any distribution with respect to our investment. After repaying its senior creditors, our portfolio company may not have any remaining assets to use for repaying its obligation to us. In the case of debt ranking equally with debt securities in which we invest, we would have to share on an equal basis any distributions with other creditors holding such debt in the event of an insolvency, liquidation, dissolution, reorganization, or bankruptcy of the relevant portfolio company. In addition, we may not be in a position to control any portfolio company by investing in its debt securities. Therefore, we are subject to the risk that a portfolio company in which we invest may make business decisions with which we disagree, and the management of such company, as representatives of the holders of their equity securities, may take risks or otherwise act in ways that do not serve our interests as debt investors.

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.

We are exposed to risks associated with changes in interest rates, and our hedging strategies may expose us to additional risks.

We anticipate using a combination of equity and long-term and short-term borrowings to finance our investment 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, such as under our credit facility. 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 September 30, 2007, our portfolio had approximately 74% of the total of the loan cost value at variable rates, approximately 12% of the total loan cost value at variable rates with a floor and approximately 15% of the total loan portfolio cost basis at a fixed rate.

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, through our wholly-owned subsidiary, 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 \$200 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, if any. The line of credit facility will permit us to fund additional loans and investments as long as we are within the conditions set out in the credit agreement.

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

Any inability to renew our credit facility on terms favorable to us, if at all, could adversely impact our liquidity and ability to fund new investments.

Availability under our credit facility will terminate on October 16, 2008, unless extended in the discretion of the lenders, and the credit facility will mature two years following this date, at which time all principal, interest and other amounts owing under the credit facility will be due and payable. There can be no guarantee that we will be able to renew the credit facility on terms that are favorable to us,

if at all. In the event that we are not able to renew or refinance the credit facility, this could have a material adverse effect on our liquidity and ability to fund new investments.

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

Since we generally make five to seven year term loans and hold our loans and related warrants or other equity positions 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 equity positions 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 of our loans by our portfolio companies could adversely impact our results of operations and reduce our return on our investment.

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 credit facility. 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 and/or equity 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.

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

In certain circumstances, we may make investments in a portfolio company in which one of our affiliates has or will have an investment, subject to satisfaction of any regulatory restrictions and, where required, to the prior approval of our Board of Directors. As of September 30, 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 Capital 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 stockholders of the portfolio company, which duties may from time to time conflict with the interests of our stockholders.

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

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

We and our portfolio companies are subject to regulation by laws at the local, state and federal levels. These laws and regulations, as well as their interpretation, may be changed from time to time.

Accordingly, any change in these laws or regulations, or their interpretation, or any failure by us or our portfolio companies to comply with these laws or regulations may adversely affect our business.

We may experience fluctuations in our quarterly results.

We could experience fluctuations in our quarterly operating results due to a number of factors, including the interest rates payable on the debt securities we acquire, the default rates on such securities, the level of our expenses, variations in and the timing of the recognition of realized and unrealized gains or losses, 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. For additional information concerning the fluctuations in our operating results, see "Management's Discussion and Analysis of Financial Condition and Results of Operations."

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 by paying monthly dividends. 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.

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 BDC 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. As with any stock, the price of our shares will fluctuate with market conditions and other factors. If shares are sold, the price received may be more or less than the original investment. Whether investors will realize gains or losses upon the sale of our shares will not depend directly upon our net asset value, but will depend upon the market price of the shares at the time of sale. Since the market price of our shares will be affected by such factors as the relative demand for and supply of the shares in the market, general market and economic conditions and other factors beyond our control, we cannot predict whether the shares will trade at, below or above our net asset value. In addition, if our common stock trades below its net asset value, we will generally not be able to issue additional shares of our common stock to purchasers other than our existing stockholders at its market price without first obtaining the approval of our stockholders and our independent directors.

Provisions of the Delaware General Corporation Law and of our certificate of incorporation and bylaws could restrict a change in control and have an adverse impact on the price of our common stock.

We are subject to provisions of the Delaware General Corporation Law that, in general, prohibit any business combination with a beneficial owner of 15% or more of our common stock for three years unless the holder's acquisition of our stock was either approved in advance by our Board of Directors or ratified by the Board of Directors and stockholders owning two-thirds of our outstanding stock not owned by the acquiring holder. Although we believe these provisions collectively provide for an opportunity to receive higher bids by requiring potential acquirers to negotiate with our Board of Directors, they would apply even if the offer may be considered beneficial by some stockholders.

We have also adopted other measures that may make it difficult for a third party to obtain control of us, including provisions of our certificate of incorporation classifying our Board of Directors in three classes serving staggered three-year terms, and provisions of our certificate of incorporation authorizing our Board of Directors to induce the issuance of additional shares of our stock. These provisions, as well as other provisions of our certificate of incorporation and bylaws, may delay, defer, or prevent a transaction or a change in control that might otherwise be in the best interests of our stockholders.

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.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

Not applicable.

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

The 2007 Annual Meeting of Stockholders was held on August 8, 2007. The stockholders voted and approved the following matters:

The election of three directors to hold office until the 2010 Annual Meeting of Stockholders.

| Nominee | Shares Voted For | Authority Withheld |
|------------------------|---------------------|-----------------------|
| David Gladstone (2010) | 11,554,815 | 548,014 |
| Paul Adelgren (2010) | 11,537,851 | 564,978 |
| John Outland (2010) | 11,546,901 | 555,928 |

To approve a series of amendments to our fundamental policies to repeal such policies as follows:

| | Number of Shares | | | Broker Non-Votes |
|--|---------------------|------------------|-----------|---------------------|
| | Shares Voted For | Voted Against | Abstained | |
| A. To repeal the policy which relates to our ability to invest in securities of a particular issuer. | 8,444,448 | 291,659 | 215,782 | 3,150,940 |
| B. To repeal the policy which relates to our underwriting activities. | 8,396,637 | 332,504 | 222,748 | 3,150,940 |
| C. To repeal the policy which relates to our ability to purchase or sell real estate or interests in real estate or real estate investment trusts. | 8,455,466 | 285,070 | 211,353 | 3,150,940 |
| D. To repeal the policy which relates to our ability to sell securities short. | 8,289,627 | 450,031 | 212,231 | 3,150,940 |
| E. To repeal the policy which relates to our ability to purchase securities on margin. | 8,278,668 | 456,787 | 216,434 | 3,150,940 |
| F. To repeal the policy which relates to our ability to write or by put or call options. | 8,339,663 | 388,525 | 223,701 | 3,150,940 |
| G. To repeal the policy which relates to our ability to engage in the purchase or sale of commodities or commodity contracts, including futures contracts. | 8,309,813 | 386,753 | 255,323 | 3,150,940 |
| H. To repeal the policy which relates to our ability to acquire voting stock of, or investing in, any securities issued by any other investment company. | 8,451,484 | 283,359 | 217,046 | 3,150,940 |

ITEM 5. OTHER INFORMATION.

Not applicable

ITEM 6. EXHIBITS

See the exhibit index.

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 INVESTMENT CORPORATION

By: */s/ HARRY BRILL*

Harry Brill
Chief Financial Officer

Date: October 31, 2007

EXHIBIT INDEX

| Exhibit | Description |
|---------|---|
| 3.1 | Amended and Restated Certificate 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. 333-123699), filed May 13, 2005. |
| 3.2 | Amended and Restated Bylaws, incorporated by reference to Exhibit b.2 to Pre-Effective Amendment No. 3 to the Registration Statement on Form N-2 (File No. 333-123699), filed June 21, 2005. |
| 3.3 | First Amendment to Amended and Restated Bylaws, incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K (File No. 814-00704), filed on July 10, 2007. |
| 4.1 | Specimen Stock Certificate, incorporated by reference to Exhibit 99.d to Pre-Effective Amendment No. 3 to the Registration Statement on Form N-2 (File No. 333-123699), filed June 21, 2005. |
| 10.1 | Amendment No. 2 to the Credit Agreement by and among Gladstone Business Investment, LLC and Deutsche Bank AG, dated as of July 25, 2007. |
| 10.2 | Amendment No. 3 to the Credit Agreement by and among Gladstone Business Investment, LLC and Deutsche Bank AG, dated as of October 18, 2007, incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K (File No. 814-00704), filed on October 22, 2007 |
| 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.