

GLADSTONE INVESTMENT CORPORATION\DE

Form N-2/A

August 24, 2010

**Table of Contents**

**As filed with the Securities and Exchange Commission on August 24, 2010**

**1933 Act File No. 333-160720**

**SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**Form N-2  
REGISTRATION STATEMENT  
UNDER  
THE SECURITIES ACT OF 1933**

**o PRE-EFFECTIVE AMENDMENT NO.  
p POST-EFFECTIVE AMENDMENT NO. 1**

**GLADSTONE INVESTMENT CORPORATION**  
*(Exact name of registrant as specified in charter)*

**1521 Westbranch Drive, Suite 200  
McLean, VA 22102**  
*(Address of principal executive offices)*

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

**David Gladstone  
Chairman and Chief Executive Officer  
Gladstone Investment Corporation  
1521 Westbranch Drive, Suite 200  
McLean, Virginia 22102**  
*(Name and address of agent for service)*

**COPIES TO:**

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(703) 456-8100 (facsimile)

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

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

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

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**Table of Contents**

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

**SUBJECT TO COMPLETION, DATED AUGUST 24, 2010**

**PROSPECTUS**

**\$300,000,000**

**COMMON STOCK  
PREFERRED STOCK  
SUBSCRIPTION RIGHTS  
WARRANTS  
DEBT SECURITIES**

We may offer, from time to time, up to \$300,000,000 aggregate initial offering price of our common stock, \$0.001 par value per share, preferred stock, \$0.001 par value per share, subscription rights, warrants representing rights to purchase shares of our common stock, or debt securities, or a combination of these securities, which we refer to in this prospectus collectively as our Securities, in one or more offerings. The Securities may be offered at prices and on terms to be disclosed in one or more supplements to this prospectus. In the case of our common stock and warrants or rights to acquire such common stock hereunder, the offering price per share of our common stock by us, less any underwriting commissions or discounts, will not be less than the net asset value per share of our common stock at the time of the offering except (i) in connection with a rights offering to our existing stockholders, (ii) with the consent of the majority of our common stockholders, or (iii) under such other circumstances as the Securities and Exchange Commission may permit. You should read this prospectus and the applicable prospectus supplement carefully before you invest in our Securities.

Our Securities may be offered directly to one or more purchasers, including existing stockholders in a rights offering, through agents designated from time to time by us, or to or through underwriters or dealers. The prospectus supplement relating to the offering will identify any agents or underwriters involved in the sale of our Securities, and will disclose any applicable purchase price, fee, commission or discount arrangement between us and our agents or underwriters or among our underwriters or the basis upon which such amount may be calculated. See Plan of Distribution. We may not sell any of our Securities through agents, underwriters or dealers without delivery of a prospectus supplement describing the method and terms of the offering of such Securities. Our common stock is traded on The Nasdaq Global Select Market under the symbol GAIN. As of August 20, 2010, the last reported sales price for our common stock was \$5.75.

This prospectus contains information you should know before investing, including information about risks. Please read it before you invest and keep it for future reference. Additional information about us, including our annual, quarterly and current reports, has been filed with the Securities and Exchange Commission. This information is available free of charge on our corporate website located at <http://www.gladstoneinvestment.com>. See Additional Information. This prospectus may not be used to consummate sales of securities unless accompanied by a prospectus supplement.

**An investment in our Securities involves certain risks, including, among other things, risks relating to investments in securities of small, private and developing businesses. We describe some of these risks in the section entitled Risk Factors, which begins on page 8. Shares of closed-end investment companies frequently trade at a discount to their net asset value and this may increase the risk of loss of purchasers of our Securities. You should carefully consider these risks together with all of the other information contained in this prospectus and any prospectus supplement before making a decision to purchase our Securities.**

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

, 2010

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## TABLE OF CONTENTS

	<b>Page</b>
<u>Prospectus Summary</u>	1
<u>Additional Information</u>	6
<u>Risk Factors</u>	8
<u>Special Note Regarding Forward-Looking Statements</u>	24
<u>Use of Proceeds</u>	25
<u>Price Range of Common Stock and Distributions</u>	25
<u>Consolidated Selected Financial Data</u>	27
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	29
<u>Sales of Common Stock Below Net Asset Value</u>	65
<u>Business</u>	70
<u>Portfolio Companies</u>	81
<u>Management</u>	87
<u>Control Persons and Principal Stockholders</u>	99
<u>Dividend Reinvestment Plan</u>	100
<u>Material U.S. Federal Income Tax Considerations</u>	101
<u>Regulation as a Business Development Company</u>	104
<u>Description of Our Securities</u>	106
<u>Certain Provisions of Delaware Law and of Our Certificate of Incorporation and Bylaws</u>	110
<u>Share Repurchases</u>	113
<u>Plan of Distribution</u>	113
<u>Custodian, Transfer and Dividend Paying Agent and Registrar</u>	114
<u>Brokerage Allocation and Other Practices</u>	115
<u>Legal Matters</u>	115
<u>Experts</u>	115
<u>Financial Statements</u>	F-1
<u>Exhibit 2.N.2</u>	

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

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**Table of Contents**

**PROSPECTUS SUMMARY**

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

**GLADSTONE INVESTMENT CORPORATION**

**General**

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, 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, or BDC, under the Investment Company Act of 1940, as amended, which we refer to as the 1940 Act.

**Our Investment Adviser and Administrator**

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

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

We have been externally managed by our Adviser pursuant to an investment advisory and management agreement since 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 Investment Advisers Act of 1940, as amended. Our Adviser is headquartered in McLean, Virginia, a suburb of Washington D.C., and also has offices in New York, New Jersey, Illinois, Texas, Connecticut and Georgia.

**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 acquire in connection with buyouts and recapitalizations of small and mid-sized companies with established management teams. We seek to make investments that generally range between \$10 million and \$40 million each, although this investment size may vary proportionately as the size of our capital base changes. We 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



## **Table of Contents**

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.

## **THE OFFERING**

We may offer, from time to time, up to \$300,000,000 of our Securities, on terms to be determined at the time of the offering. Our Securities may be offered at prices and on terms to be disclosed in one or more prospectus supplements. In the case of offering of our common stock and warrants or rights to acquire such common stock hereunder in any offering, the offering price per share, less any underwriting commissions or discounts, will not be less than the net asset value per share of our common stock at the time of the offering except (i) in connection with a rights offering to our existing stockholders, (ii) with the consent of the majority of our common stockholders, or (iii) under such other circumstances as the Securities and Exchange Commission may permit. If we were to sell shares of our common stock below our then current net asset value per share, such sales would result in an immediate dilution to the net asset value per share. This dilution would occur as a result of the sale of shares at a price below the then current net asset value per share of our common stock and a proportionately greater decrease in a stockholder's interest in our earnings and assets and voting interest in us than the increase in our assets resulting from such issuance.

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

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

The Nasdaq Global Select Market Symbol GAIN

Use of Proceeds

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

Dividends and Distributions

We have paid monthly dividends to the holders of our common stock and generally intend to continue to do so. The amount of the monthly dividend is determined by our Board of Directors on a quarterly basis and is based on our estimate of our annual investment company taxable income and net short-term taxable capital gains, if any. See

**Table of Contents**

Price Range of Common Stock and Distributions. Certain additional amounts may be deemed as distributed to stockholders for income tax purposes. Other types of securities will likely pay distributions in accordance with their terms.

**Taxation**

We intend to continue to elect to be treated for federal income tax purposes as a regulated investment company, which we refer to as a RIC. So long as we continue to qualify, we generally will pay no corporate-level federal income taxes on any ordinary income or capital gains that we distribute to our stockholders. To maintain our RIC status, we must meet specified source-of-income and asset diversification requirements and distribute annually at least 90% of our taxable ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, out of assets legally available for distribution. Due to the current economic environment, there is a risk that in future quarters we may be unable to satisfy one or more of these requirements. See Material U.S. Federal Income Tax Considerations.

**Trading at a Discount**

Shares of closed-end investment companies frequently trade at a discount to their net asset value. The possibility that our shares may trade at a discount to our net asset value is separate and distinct from the risk that our net asset value per share may decline. We cannot predict whether our shares will trade above, at or below net asset value, although during the past two years, our common stock has traded consistently, and at times significantly, below net asset value.

**Certain Anti-Takeover Provisions**

Our Board of Directors is divided into three classes of directors serving staggered three-year terms. This structure is intended to provide us with a greater likelihood of continuity of management, which may be necessary for us to realize the full value of our investments. A staggered board of directors also may serve to deter hostile takeovers or proxy contests, as may certain provisions of Delaware law and other measures we have adopted. See Certain Provisions of Delaware Law and of Our Certificate of Incorporation and Bylaws.

**Dividend Reinvestment Plan**

We have a dividend reinvestment plan for our stockholders. This is an opt in dividend reinvestment plan, meaning that stockholders may elect to have their cash dividends automatically reinvested in additional shares of our common stock. Stockholders who do not so elect will receive their dividends in cash. Stockholders who receive distributions in the form of stock will be subject to the same federal, state and local tax consequences as stockholders who elect to receive their distributions in cash. See Dividend Reinvestment Plan.

**Management Arrangements**

Gladstone Management Corporation serves as our investment adviser, and Gladstone Administration, LLC serves serve as our administrator. For a description of our Adviser, our Administrator, the Gladstone Companies and our contractual arrangements with these companies, see Management Certain Transactions Investment Advisory and Management Agreement,

Management Certain Transactions Administration Agreement and  
Management Certain Transactions Loan Servicing Agreement.

**Table of Contents**

Risks of Losing Tax Status and External Financing Constraints	Currently, we do not meet the 50% threshold of the asset diversification test applicable to RICs under the Internal Revenue Code of 1986, as amended, or the Code. In addition, committed funding under our credit facility has been significantly reduced over the past two years. As a result, we have very limited ability to fund new investments and may become subject to corporate-level taxation. See Risk Factors We currently do not meet the 50% threshold of the asset diversification test applicable to RICs under the Code. If we make any additional investment in the future, including advances under outstanding lines of credit to our portfolio companies, and remain below this threshold as of September 30, 2010, or any subsequent quarter end, we would lose our RIC status unless we are able to cure such failure within 30 days of the quarter end. and Risk Factors Committed funding under our credit facility has been reduced from \$125.0 million to \$50.0 million. Any inability to expand the credit facility could adversely impact our liquidity and ability to find new investments or maintain distributions to our stockholders.
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**FEES AND EXPENSES**

The following table is intended to assist you in understanding the costs and expenses that an investor in this offering will bear directly or indirectly. We caution you that some of the percentages indicated in the table below are estimates and may vary. Except where the context suggests otherwise, whenever this prospectus contains a reference to fees or expenses paid by us or Gladstone Investment, or that we will pay fees or expenses, stockholders will indirectly bear such fees or expenses as investors in Gladstone Investment. The following percentages were calculated based on actual expenses incurred in the quarter ended June 30, 2010 and net assets as of June 30, 2010.

**Stockholder Transaction Expenses:**

Sales load (as a percentage of offering price)	%
Dividend reinvestment plan expenses(1)	None
<b>Estimated annual expenses (as a percentage of net assets attributable to common stock):</b>	
Management fees(2)	1.85%
Incentive fees payable under investment advisory and management agreement (20% of realized capital gains and 20% of pre-incentive fee net investment income)(3)	0.54%
Interest payments on borrowed funds(4)	0.90%
Other expenses(5)	1.32%
Total annual expenses (estimated)(2)(5)	4.60%

**Example**

The following example demonstrates the projected dollar amount of total cumulative expenses that would be incurred over various periods with respect to a hypothetical investment in our Securities. In calculating the following expense amounts, we have assumed that our annual operating expenses would remain at the levels set forth in the table above. In the event that securities to which this prospectus related are sold to or through underwriters, a corresponding prospectus supplement will restate this example to reflect the applicable sales load.

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

\$ 48    \$ 145    \$ 242    \$ 487

While the example assumes, as required by the Securities and Exchange Commission, which we refer to as the SEC, a 5% annual return, our performance will vary and may result in a return greater or less than 5%. Additionally, we have assumed that the entire amount of such 5% annual return would constitute ordinary income as we have not

## **Table of Contents**

historically realized positive capital gains (computed net of all realized capital losses) on our investments. Because the assumed 5% annual return is significantly below the hurdle rate of 7% (annualized) that we must achieve under the investment advisory and management agreement to trigger the payment of an income-based incentive fee, we have assumed, for purposes of the above example, that no income-based incentive fee would be payable if we realized a 5% annual return on our investments. Additionally, because the capital gains-based incentive fee is calculated on a cumulative basis (computed net of all realized capital losses and unrealized capital depreciation) and because of the significant capital losses realized to date, we have assumed that we will not trigger the payment of any capital gains-based incentive fee in any of the indicated time periods. If we achieve sufficient returns on our investments, including through the realization of capital gains, to trigger an incentive fee of a material amount, our expenses, and returns to our investors after such expenses, would be higher than reflected in the example. In addition, while the example assumes reinvestment of all dividends and distributions at net asset value, participants in our dividend reinvestment plan will receive a number of shares of our common stock, determined by dividing the total dollar amount of the dividend payable to a participant by the market price per share of our common stock at the close of trading on the valuation date for the dividend. See [Dividend Reinvestment Plan](#) for additional information regarding our dividend reinvestment plan.

This example and the expenses in the table above should not be considered a representation of our future expenses, and actual expenses (including the cost of debt, incentive fees, if any, and other expenses) may be greater or less than those shown.

- (1) The expenses of the reinvestment plan are included in stock record expenses, a component of [Other expenses](#). We do not have a cash purchase plan. The participants in the dividend reinvestment plan will bear a pro rata share of brokerage commissions incurred with respect to open market purchases, if any. See [Dividend Reinvestment Plan](#) for information on the dividend reinvestment plan.
- (2) Our annual base management fee is 2% (0.5% quarterly) of our average gross assets, which are defined as total assets of Gladstone Investment, including investments made with proceeds of borrowings, less any uninvested cash or cash equivalents resulting from borrowings. For the three months ended June 30, 2010, our Adviser voluntarily agreed to waive the annual base management fee of 2% to 0.5% for those senior syndicated loans that we purchase using borrowings from our credit facility. Although there can be no guarantee that our Adviser will continue to waive any portion of the management fee, on an annual basis after giving effect to this waiver, the estimated management fees as a percentage of net assets attributable to common stock were 1.85% and the total estimated annual expenses as a percentage of net assets attributable to common stock were 1.88%. See [Management Certain Transactions Investment Advisory and Management Agreement](#) and footnote 3 below.
- (3) The incentive fee consists of two parts: an income-based fee and a capital gains-based fee. The income-based fee is payable quarterly in arrears, and equals 20% of the excess, if any, of our pre-incentive fee net investment income that exceeds a 1.75% quarterly (7% annualized) hurdle rate of our net assets, subject to a catch-up provision measured as of the end of each calendar quarter. The catch-up provision requires us to pay 100% of our pre-incentive fee net investment income with respect to that portion of such income, if any, that exceeds the hurdle rate but is less than 125% of the quarterly hurdle rate (or 2.1875%) in any calendar quarter (8.75% annualized). The catch-up provision is meant to provide our Adviser with 20% of our pre-incentive fee net investment income as if a hurdle rate did not apply when our pre-incentive fee net investment income exceeds 125% of the quarterly hurdle rate in any calendar quarter (8.75% annualized). The income-based incentive fee is computed and paid on income that may include interest that is accrued but not yet received in cash. Our pre-incentive fee net investment income used to calculate this part of the income-based incentive fee is also included in the amount of our gross assets used to calculate the 2% base management fee (see footnote 2 above). The capital gains-based incentive fee equals 20% of our net realized capital gains since our inception, if any,

computed net of all realized capital losses and unrealized capital depreciation since our inception, less any prior payments, and is payable at the end of each fiscal year.



**Table of Contents**

Examples of how the incentive fee would be calculated are as follows:

Assuming pre-incentive fee net investment income of 0.55%, there would be no income-based incentive fee because such income would not exceed the hurdle rate of 1.75%.

Assuming pre-incentive fee net investment income of 2.00%, the income-based incentive fee would be as follows:

$$= 100\% \times (2.00\% - 1.75\%)$$

$$= 0.25\%$$

Assuming pre-incentive fee net investment income of 2.30%, the income-based incentive fee would be as follows:

$$= (100\% \times (\text{catch-up} : 2.1875\% - 1.75\%)) + (20\% \times (2.30\% - 2.1875\%))$$

$$= (100\% \times 0.4375\%) + (20\% \times 0.1125\%)$$

$$= 0.4375\% + 0.0225\%$$

$$= 0.46\%$$

Assuming net realized capital gains of 6% and realized capital losses and unrealized capital depreciation of 1%, the capital gains-based incentive fee would be as follows:

$$= 20\% \times (6\% - 1\%)$$

$$= 20\% \times 5\%$$

$$= 1\%$$

For a more detailed discussion of the calculation of the two-part incentive fee, see Management Certain Transactions Investment Advisory and Management Agreement.

- (4) Includes deferred financing costs. We entered into a revolving credit facility, effective April 13, 2010, under which our borrowing capacity is \$50 million. We have drawn down on this credit facility and we expect to borrow additional funds in the future up to an amount so that our asset coverage, as defined in the 1940 Act, is at least 200% after each issuance of our senior securities. Assuming that we borrowed \$50 million at an interest rate of 2% plus an additional fee related to borrowings of 4.5%, for an aggregate rate of 6.5%, interest payments and amortization of deferred financing costs on borrowed funds would have been 1.87% of our net assets as of June 30, 2010.
- (5) Includes our overhead expenses, including payments under the administration agreement based on our projected allocable portion of overhead and other expenses incurred by our Administrator in performing its obligations under the administration agreement. See Management Certain Transactions Administration Agreement.

**ADDITIONAL INFORMATION**

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

We also file reports, proxy statements and other information with the SEC under the Securities Exchange Act of 1934, as amended, which we refer to as the Exchange Act. Such reports, proxy statements and other information,

**Table of Contents**

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

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

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

**Table of Contents**

**RISK FACTORS**

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

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

**Risks Related to the Economy**

*The current state of the economy and the capital markets increases the possibility of adverse effects on our financial position and results of operations. Continued economic adversity could impair our portfolio companies financial positions and operating results and affect the industries in which we invest, which could, in turn, harm our operating results. Continued adversity in the capital markets could impact our ability to raise capital and reduce our volume of new investments.*

The United States is beginning to recover from the recession that largely began in late 2007. Despite signs of economic improvement and stabilization in both the equity and debt markets, however, conditions within the global credit markets generally continue to experience dislocation and stress. As a result, we do not know if adverse conditions will again intensify, and we are unable to gauge the full extent to which the disruptions will affect us. The longer these uncertain conditions persist, the greater the probability that these factors could continue to increase our costs of, and significantly limit our access to, debt and equity capital and, thus, have an adverse effect on our operations and financial results. Many of the companies in which we have made or will make investments are also susceptible to these unstable economic conditions, which may affect the ability of one or more of our portfolio companies to repay our loans or engage in a liquidity event, such as a sale, recapitalization or initial public offering. These unstable economic conditions could also disproportionately impact some of the industries in which we invest, causing us to be more vulnerable to losses in our portfolio, which could cause the number of our non-performing assets to increase and the fair market value of our portfolio to decrease. The unstable economic conditions may also decrease the value of collateral securing some of our loans as well as the value of our equity investments which would decrease our ability to borrow under our line of credit or raise equity capital, thereby further reducing our ability to make new investments.

The unstable economic conditions have affected the availability of credit generally and we have seen a reduction in committed funding under our line of credit from \$125.0 million to \$50.0 million and the withdrawal of Deutsche Bank AG as a committed lender. Moreover, during the first quarter of fiscal year 2010, we were forced to sell 29 of the 32 senior syndicated loans that were held in our portfolio of investments at March 31, 2009 in order to repay amounts outstanding under our prior credit facility. The loans, in aggregate, had a cost value of approximately \$104.2 million, or 29.9% of the cost value of our total investments, and an aggregate fair market value of approximately \$69.8 million, or 22.2% of the fair market value of our total investments, at March 31, 2009. As a result of these sales, we received approximately \$69.2 million in net cash proceeds and recorded a realized loss of approximately \$34.6 million. Our current line of credit limits our distributions to stockholders, and, as a result, beginning in fiscal year 2010, we decreased our monthly cash distribution rate by 50% as compared to the prior year period in an effort to more closely align our distributions to our net investment income. We do not know when market conditions will fully stabilize, if adverse conditions will intensify or the full extent to which the disruptions will continue to affect us. Also,

it is possible that persistent instability of the financial markets could have other unforeseen material effects on our business.

*We may experience fluctuations in our quarterly and annual results based on the impact of inflation in the United States.*

The majority of our portfolio companies are in industries that are directly impacted by inflation, such as manufacturing and consumer goods and services. Our portfolio companies may not be able to pass on to customers increases in their costs of production which could greatly affect their operating results, impacting their ability to

## **Table of Contents**

repay our loans. In addition, any projected future decreases in our portfolio companies' operating results due to inflation could adversely impact the fair value of those investments. Any decreases in the fair value of our investments could result in future unrealized losses and therefore reduce our net assets resulting from operations.

### **Risks Related to Our External Management**

*We are dependent upon our key management personnel and the key management personnel of our Adviser, particularly David Gladstone, George Stelljes III, Terry Lee Brubaker and David Dullum, 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, Terry Lee Brubaker and David Dullum 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 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.

*Our incentive fee may induce our Adviser to make certain investments, including speculative investments.*

The management compensation structure that has been implemented under the Advisory Agreement may cause our Adviser to invest in high risk investments or take other risks. In addition to its management fee, our Adviser is entitled under the Advisory Agreement to receive incentive compensation based in part upon our achievement of specified levels of income. In evaluating investments and other management strategies, the opportunity to earn incentive compensation based on net income may lead our Adviser to place undue emphasis on the maximization of net income at the expense of other criteria, such as preservation of capital, maintaining sufficient liquidity, or management of credit risk or market risk, in order to achieve higher incentive compensation. Investments with higher yield potential are generally riskier or more speculative. This could result in increased risk to the value of our investment portfolio.

*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. When calculating our incentive compensation, our pre-incentive fee net investment income 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 Business 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 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 Advisory Agreement. In order to grow, our Adviser will need to hire, train supervise and manage new employees successfully. Any failure to manage our

**Table of Contents**

future growth effectively could have a material adverse effect on our business, financial condition and results of operations.

*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, 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. For example, Mr. Gladstone, our chairman and chief executive officer, is the chairman of the board and chief executive officer of our Adviser, Gladstone Capital and Gladstone Commercial and the sole stockholder of Gladstone Land. In addition, Mr. Brubaker, our co-vice chairman, chief operating officer and secretary is the vice chairman, chief operating officer and secretary of our Adviser, Gladstone Capital and Gladstone Commercial. Mr. Stelljes, our co-vice chairman and chief investment officer, is also the president and chief investment officer of our Adviser, Gladstone Capital and Gladstone Commercial. Mr. Dullum, our president and a director, is a senior managing director of our Adviser and a director of Gladstone Capital and Gladstone Commercial. Moreover, our Adviser may establish or sponsor other investment vehicles which from time to time may have potentially overlapping investment objectives with those of ours and accordingly may invest in, whether principally or secondarily, asset classes similar to those we target. For example, our Adviser recently filed registration statements with the Securities and Exchange Commission for proposed initial public offerings of common stock of Gladstone Lending Corporation, a proposed fund that would primarily invest in first and second lien term loans, and Gladstone Land Corporation, a fund that invests in farmland. While our Adviser generally has broad authority to make investments on behalf of the investment vehicles that it advises, our Adviser has adopted investment allocation procedures to address these potential conflicts and intends to direct investment opportunities to the Gladstone affiliate with the investment strategy that most closely fits the investment opportunity. Nevertheless, the management of our Adviser may face conflicts in the allocation of investment opportunities to other entities managed by our Adviser. As a result, it is possible that we may not be given the opportunity to participate in certain investments made by other members of our Adviser and its affiliated companies or investment funds managed by investment managers affiliated with our Adviser.

In certain circumstances, we may make investments in a portfolio company in which one of our affiliates has or will have an investment, subject to satisfaction of any regulatory restrictions and, where required, to the prior approval of our Board of Directors. As of June 30, 2010, 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.

Additionally, pursuant to an exemptive order granted by the Securities and Exchange Commission, our Adviser may sponsor a private investment fund to co-invest with us and Gladstone Capital in accordance with the terms and conditions of the order.



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 our Adviser and will reimburse our Administrator for certain expenses it incurs. As a result, investors in our common stock will invest on

## **Table of Contents**

a gross basis and receive distributions on a net basis after expenses, resulting in, among other things, a lower rate of return than one might achieve through our investors themselves making direct investments. As a result of this arrangement, there may be times when the management team of our Adviser has interests that differ from those of our stockholders, giving rise to a conflict.

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

The Advisory Agreement provides for a base management fee based on our gross assets. Since our 2008 fiscal year, our Board of Directors has accepted on a quarterly basis voluntary, unconditional and irrevocable waivers to reduce the annual 2% 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, and any waived fees may not be recouped by our Adviser in the future. However, our Adviser is not required to issue these or other waivers of fees under the Advisory Agreement, and to the extent our investment portfolio grows in the future, we expect these fees will increase. If our Adviser does not issue these waivers in future quarters, it could negatively impact our earnings and may compromise our ability to maintain our current level of distributions to our stockholders, which could have a material adverse impact on our stock price.

***Our business model is dependent upon developing and sustaining strong referral relationships with investment bankers, business brokers and other intermediaries.***

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

## **Risks Related to Our External Financing**

***In recent years, creditors have significantly curtailed their lending to business development companies, including us. Because of the limited amount of committed funding under our line of credit, we will have limited ability fund new investments if we are unable to expand the facility.***

On April 13, 2010, through our wholly-owned subsidiary Gladstone Business Investment, LLC, we entered into a third amended and restated credit agreement providing for a \$50.0 million revolving line of credit, which we refer to as the Credit Facility, arranged by Branch Banking and Trust Company, or BB&T, as administrative agent. Key Equipment Finance Company Inc. also joined the Credit Facility as a committed lender. Committed funding under the Credit Facility was reduced from the \$125.0 million under our prior credit facility and Deutsche Bank AG, which was a committed lender under the prior credit facility, elected not to participate in the Credit Facility and withdrew its commitment. The Credit Facility may be expanded up to \$125.0 million through the addition of other committed lenders to the facility. However, if additional lenders are unwilling to join the facility on its terms, we will be unable to expand the facility and thus will continue to have limited availability to finance new investments under our line of credit. The Credit Facility matures on April 13, 2012, and if the facility is not renewed or extended by this date, all principal and interest will be due and payable within one year of maturity. Between the maturity date and April 13, 2013, our lenders have the right to apply all interest income to amounts outstanding under the Credit Facility. As of August 20, 2010 we had \$30.7 million of borrowing capacity under the Credit Facility. There can be no guarantee that we will be able to renew, extend or replace the Credit Facility upon its maturity in 2012 on terms that are favorable to us, if at all. Our ability to expand the Credit Facility, and to obtain replacement financing at the time of its maturity, will be constrained by then-current economic conditions affecting the credit markets. In the event that we are not able to expand the Credit Facility, or to renew, extend or refinance the Credit Facility at the time of its maturity, this could

have a material adverse effect on our liquidity and ability to fund new investments, our ability to make distributions to our stockholders and our ability to qualify as a RIC under the Code.

**Table of Contents**

***Our business plan is dependent upon external financing, which is constrained by the limitations of the 1940 Act.***

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 may 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, which we refer to 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 distributions 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, to the extent possible given the limited market for many of our investments, 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 senior securities convertible into or exchangeable for our common stock, the percentage ownership of our stockholders at the time of the issuance would decrease and our common stock 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. In addition, under the 1940 Act, we will generally not be able to issue additional shares of our common stock at a price below net asset value per share to purchasers, other than to our existing stockholders, through a rights offering without first obtaining the approval of our stockholders and our independent directors. If we were to sell shares of our common stock below our then current net asset value per share, such sales would result in an immediate dilution to the net asset value per share. This dilution would occur as a result of the sale of shares at a price below the then current net asset value per share of our common stock and a proportionately greater decrease in a stockholder's interest in our earnings and assets and voting interest in us than the increase in our assets resulting from such issuance. For example, if we sell an additional 10% of our common stock at a 5% discount from net asset value, a stockholder who does not participate in that offering for its proportionate interest will suffer net asset value dilution of up to 0.5% or \$5 per \$1,000 of net asset value. This imposes constraints on our ability to raise capital when our common stock is trading at below net asset value, as it has for the last year.

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

We anticipate using a combination of equity and long-term and short-term borrowings to finance our 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. Higher interest rates on our borrowings will decrease the overall return on our portfolio.

Ultimately, we expect approximately 80% of the loans in our portfolio to be at variable rates determined on the basis of a LIBOR rate and approximately 20% to be at fixed rates. As of August 20, 2010, our portfolio had approximately

3% of the total of the loan cost value at variable rates, approximately 55.8% of the total loan cost value at variable rates with floors and approximately 41.2% of the total loan portfolio cost basis at fixed rates.

**Table of Contents**

To date, we hold two interest rate cap agreements. 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 any future hedging transactions could have a material adverse effect on our business, financial condition and results of operations. Our ability to receive payments pursuant to our interest rate cap agreement is linked to the ability of the counter-party to that agreement to make the required payments. To the extent that the counter-party to the agreement is unable to pay pursuant to the terms of the agreement, we may lose the hedging protection of the interest rate cap agreement.

***In addition to regulatory limitations on our ability to raise capital, our line of credit contains various covenants, which, if not complied with, could accelerate our repayment obligations under the facility, thereby materially and adversely affecting our liquidity, financial condition, results of operations and ability to pay distributions.***

We will have a continuing need for capital to finance our loans. In order to maintain RIC status, we will be required to distribute to our stockholders at least 90% of our ordinary income and short-term capital gains on an annual basis. Accordingly, such earnings will not be available to fund additional loans. Therefore, we are party to the Credit Facility, which provides us with a revolving credit line facility of \$50.0 million, of which \$30.7 million was available for borrowings as of August 20, 2010. The Credit Facility permits us to fund additional loans and investments as long as we are within the conditions set out in the credit agreement. Current market conditions have forced us to write down the value of a portion of our assets as required by the 1940 Act and fair value accounting rules. These are not realized losses, but constitute adjustment in asset values for purposes of financial reporting and for collateral value for the Credit Facility. As assets are marked down in value, the amount we can borrow on the Credit Facility decreases.

As a result of the 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, dividend payout, payment frequency and status, and average life. The credit agreement also requires us to comply with other financial and operational covenants, which require us to, among other things, maintain certain financial ratios, including asset and interest coverage and a minimum net worth. As of June 30, 2010, we were in compliance with these covenants; however, our continued compliance with these covenants depends on many factors, some of which are beyond our control. In particular, depreciation in the valuation of our assets, which valuation is subject to changing market conditions that remain very volatile, affects our ability to comply with these covenants.

During the year ended March 31, 2010, net unrealized appreciation on our investments was \$14.3 million, which reflected the reversal of \$35.7 million in unrealized depreciation resulting from our realized losses. Excluding reversals, we had \$21.4 million in unrealized depreciation for the year ended March 31, 2010. During the year ended March 31, 2009, net unrealized depreciation on our investments was \$19.8 million. Given the continued instability in the capital markets, the cumulative unrealized depreciation in our portfolio may increase in future periods and threaten our ability to comply with the covenants under the Credit Facility. Accordingly, there are no assurances that we will continue to comply with these covenants. Under the Credit Facility, we are also required to maintain our status as a BDC under the 1940 Act and as a RIC under the Code. Because of recent changes in our asset portfolio, due to significant sales of Non-Control/Non-Affiliate investments, there is a significant possibility that we may not meet the asset diversification threshold under the Code's rules applicable to a RIC as of our next quarterly testing date, September 30, 2010. Although this failure alone, in our current situation, will not cause us to lose our RIC status, our RIC status will be jeopardized if we make any new investments, including additional investments in our portfolio companies (such as advances under our outstanding lines of credit). For more information on our current RIC status, see Material U.S. Federal Income Tax Considerations Regulated Investment Company Status. Our failure to satisfy these covenants could result in foreclosure by our lenders, which would accelerate our repayment obligations under the facility and thereby have a material adverse effect on our business, liquidity, financial condition, results of operations and ability to pay distributions to our stockholders.



## **Table of Contents**

### **Risks Related to Our Investments**

#### ***We operate in a highly competitive market for investment opportunities.***

A large number of entities compete with us and make the types of investments that we seek to make in small and mid-sized companies. We 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 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 could cause you to 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 are likely to have greater exposure to economic downturns than larger businesses.* Our portfolio companies may have fewer resources than larger businesses, and thus the current recession, and any further economic downturns or recessions are more likely to have a material adverse effect on them. If one of our portfolio companies is adversely impacted by a recession, its ability to repay our loan or engage in a liquidity event, such as a sale, recapitalization or initial public offering would be diminished. Moreover, in light of our current near-term strategy of preserving capital, our inability to make additional investments in our portfolio companies at a time when they need capital may increase their exposure to the risks of the current recession and future economic downturns.

*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 a 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.

**Table of Contents**

*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 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.

***Because the loans we make and equity securities we receive when we make loans are not publicly traded, there is uncertainty regarding the value of our privately held securities that could adversely affect our determination of our net asset value.***

Our portfolio investments are, and we expect 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 an investment valuation policy and consistently applied valuation procedures used to determine the fair value of these securities quarterly. These procedures for the determination of value of many of our debt securities rely on the opinions of value submitted to us by Standard and Poor's Securities Evaluations, Inc., or SPSE, or the use of internally developed discounted cash flow, or DCF, methodologies or indicative bid price, or IBP, offered by the respective originating syndication agent's trading desk, or secondary desk, specifically for our syndicated loans, or internal methodologies based on the total enterprise value, or TEV, of the issuer used for certain of our equity investments. 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 use of these fair value methods is inherently subjective and is based on estimates and assumptions of each security. In the event that we are required to sell a security, we may ultimately sell for an amount materially less than the estimated fair value calculated by SPSE, or utilizing the TEV, IBP or the DCF methodology. During April and

May of 2009, we completed the sale of 29 of the 32 senior syndicated loans that were held in our portfolio of investments at March 31, 2009 to various investors in the syndicated loan market, which we refer to as the Syndicated Loan Sales. As a result of these sales, we received approximately \$69.2 million in net cash proceeds, which was approximately \$34.6 million less than the cost value of such investments recorded as of December 31, 2008.

Our procedures also include provisions whereby our Adviser will establish the fair value of any equity securities we may hold where SPSE or third-party agent banks are unable to provide evaluations. The types of

**Table of Contents**

factors that may be considered in determining the fair value of our debt and equity securities 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;

the comparison to publicly traded companies; and

discounted cash flow and other relevant factors.

Because such valuations, particularly valuations of private securities and private companies, are not susceptible to precise determination, may fluctuate over short periods of time, and may be based on estimates, our determinations of fair value may differ from the values that might have actually resulted had a readily available market for these securities been available.

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.

***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 the investments we presently hold and the investments we expect to acquire in the future are, and 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 quickly obtain cash equal to the value at which we record our investments if the need arises. This could cause us to miss important investment opportunities. In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may record substantial realized 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.

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

***Our financial results could be negatively affected if a significant portfolio investment fails to perform as expected.***

Our total investment in companies may be significant individually or in the aggregate. As a result, if a significant investment in one or more companies fails to perform as expected, our financial results could be more negatively affected and the magnitude of the loss could be more significant than if we had made smaller investments in more

companies. This risk is heightened as a result of our sale of the majority of senior syndicated loans in the quarter ended June 30, 2009. As a result of these sales and other exits, the total number of portfolio companies in which we hold investments decreased from 46 at March 31, 2009 to 15 at June 30, 2010. Our five largest investments represent 51.8% of the fair value of our total portfolio at June 30, 2010, compared to 61.9% at June 30, 2009. Additionally, they represent 71% of our total revenues for the quarter ended June 30, 2010, compared to 49.9% for the quarter ended June 30, 2009. Any disposition of a significant investment in one or more companies may negatively impact our net investment income and limit our ability to pay distributions.

**Table of Contents**

***We may not be able to replace lost income due to the reduction in the size of our portfolio and as a result, we may have to reduce our distributions to stockholders.***

Since March 31, 2009, the cost basis of our portfolio has experienced a net decrease of 47%. The decrease in the size of our portfolio was driven predominantly by the Syndicated Loan Sales, which had a cost basis of \$104.2 million, during the quarter ended June 30, 2009 and by the sale of A. Stucki Holding Corp., which had a cost basis of \$33.0 million, during June 2010. The decrease in our portfolio has resulted in a reduction of income-producing assets which has reduced our income and may result in reduced income in future periods if we are unable to reinvest our cash in comparable income producing assets. Even though this lost income is partially offset by a reduction in interest expense due to reduced borrowings outstanding under our Credit Facility and, to a lesser extent, reduced operating expenses, we still have experienced a net decrease in our net investment income as a result of these sales. While we intend to reinvest our cash as quickly as possible into income and capital gain-generating assets, there is no guarantee that that we will be able to do so or that we will be able to do so at yields comparable to the assets that we have recently sold. If we are unable to reinvest our cash and replace our lost income, we may need to reduce our distributions to stockholders.

***When we are a debt or minority equity investor in a portfolio company, which we expect will generally be the case, we may not be in a position to control the entity, and its management may make decisions that could decrease the value of our investment.***

We anticipate that most of our investments will continue to be either debt or minority equity investments in our portfolio companies. Therefore, we are and will remain subject to risk that a portfolio company may make business decisions with which we disagree, and the shareholders and management of such company may take risks or otherwise act in ways that do not serve our best interests. As a result, a portfolio company may make decisions that could decrease the value of our portfolio holdings. In addition, we will generally not be in a position to control any portfolio company by investing in its debt securities.

***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 and 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.

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

In addition to risks associated with delays in investing our capital, we are also subject to the risk that investments that we make in our portfolio companies may be repaid prior to maturity. We will first use any proceeds from prepayments to repay any borrowings outstanding on our line of credit. In the event that funds remain after repayment of our outstanding borrowings, then we will generally reinvest these proceeds in government securities, pending their future investment in new debt 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.

**Table of Contents**

***Higher taxation of our portfolio companies may impact our quarterly and annual operating results.***

The adverse effect of current unstable economic conditions on federal, state, and municipality revenues may induce these government entities to raise various taxes to make up for lost revenues. Additional taxation may have an adverse affect on our portfolio companies' earnings and reduce their ability to repay our loans to them, thus affecting our quarterly and annual operating results.

***Our portfolio is concentrated in a limited number of companies and industries, which subjects us to an increased risk of significant loss if any one of these companies does not repay us or if the industries experience downturns.***

As of June 30, 2010, we had investments in 15 portfolio companies, of which there were three investments, Chase II Holdings Corp., Galaxy Tool Holding Corp. and Cavert II Holdings Corp., that comprised approximately \$62.8 million or 42.3% of our total investment portfolio, at fair value. A consequence of a limited number of investments is that the aggregate returns we realize may be substantially adversely affected by the unfavorable performance of a small number of such loans or a substantial write-down of any one investment. Beyond our regulatory and income tax diversification requirements, we do not have fixed guidelines for industry concentration and our investments could potentially be concentrated in relatively few industries. In addition, while we do not intend to invest 25% or more of our total assets in a particular industry or group of industries at the time of investment, it is possible that as the values of our portfolio companies change, one industry or a group of industries may comprise in excess of 25% of the value of our total assets. As of June 30, 2010, 28.8% of our total assets were invested in diversified conglomerate manufacturing companies. As a result, a downturn in an industry in which we have invested a significant portion of our total assets could have a materially adverse effect on us.

***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.

***The disposition of our investments may result in contingent liabilities.***

Currently, all of our investments involve private securities. In connection with the disposition of an investment in private securities, we may be required to make representations about the business and financial affairs of the underlying portfolio company typical of those made in connection with the sale of a business. We may also be required to indemnify the purchasers of such investment to the extent that any such representations turn out to be inaccurate or with respect to certain potential liabilities. These arrangements may result in contingent liabilities that ultimately yield funding obligations that must be satisfied through our return of certain distributions previously made to us.

***There may be circumstances where our debt investments could be subordinated to claims of other creditors or we could be subject to lender liability claims.***

Even though we have structured some of our investments as senior loans, if one of our portfolio companies were to go bankrupt, depending on the facts and circumstances, including the extent to which we actually provided managerial assistance to that portfolio company, a bankruptcy court might re-characterize our debt investments and subordinate all, or a portion, of our claims to that of other creditors. Holders of debt instruments ranking senior to our investments typically would be entitled to receive payment in full before we receive any distributions. After repaying such senior creditors, such portfolio company may not have any remaining assets to use to repay its obligation to us. We may also



be subject to lender liability claims for actions taken by us with respect to a borrower's business or in instances in which we exercised control over the borrower. It is possible that we could become subject to a lender's liability claim, including as a result of actions taken in rendering significant managerial assistance.

## **Table of Contents**

### ***Portfolio company litigation could result in additional costs and the diversion of management time and resources.***

In the course of providing significant managerial assistance to certain of our portfolio companies, we sometimes serve as directors on the boards of such companies. To the extent that litigation arises out of our investments in these companies, we may be named as a defendant in such litigation, which could result in additional costs and the diversion of management time and resources.

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

When we make a subordinated loan, we may receive warrants to purchase stock issued by the borrower or other yield enhancements, such as success fees. Our goal is to ultimately dispose of these equity interests and realize gains upon our disposition of such interests. We expect that, over time, the gains we realize on these warrants and other yield enhancements will offset any losses we experience on loan defaults. However, any warrants we receive may not appreciate in value and, in fact, may decline in value and any other yield enhancements, such as success fees, may not be realized. Accordingly, we may not be able to realize gains from our equity interests or other yield enhancements and any gains we may recognize might not be sufficient to offset losses we experience on our loan portfolio.

### ***Any unrealized depreciation we experience on our investment portfolio may be an indication of future realized losses, which could reduce our income available for distribution.***

As a business development company we are required to carry our investments at market value or, if no market value is ascertainable, at fair value as determined in good faith by or under the direction of our Board of Directors. Decreases in the market values or fair values of our investments will be recorded as unrealized depreciation. Since our inception, we have, at times, incurred a cumulative net unrealized depreciation of our portfolio. Any unrealized depreciation in our investment portfolio could result in realized losses in the future and ultimately in reductions of our income available for distribution to stockholders in future periods.

## **Risks Related to Our Regulation and Structure**

### ***We currently do not meet the 50% threshold of the asset diversification test applicable to RICs under the Code. If we make any additional investment in the future, including advances under outstanding lines of credit to our portfolio companies, and remain below this threshold as of September 30, 2010, or any subsequent quarter end, we would lose our RIC status unless we are able to cure such failure within 30 days of the quarter end.***

In order to maintain RIC status under the Code, in addition to other requirements, as of the close of each quarter of our taxable year, we must meet the asset diversification test, which requires that at least 50% of the value of our assets consist of cash, cash items, U.S. government securities, the securities of other RICs and other securities to the extent such other securities of any one issuer do not represent more than 5% of our total assets or more than 10% of the voting securities of such issuer. As a result of changes in the value of our assets during April and May 2009, due to the Syndicated Loan Sales, we fell below the 50% threshold. At June 30, 2010, the fifth quarterly measurement date following the Syndicated Loan Sales, we satisfied the 50% threshold through the purchase of short-term qualified securities, which was funded primarily through a short-term loan agreement. Subsequent to the June 30, 2010 measurement date, the short-term qualified securities matured, and we repaid the short-term loan, at which time we again fell below the 50% threshold. Until the composition of our assets is above the required 50% threshold, we will continue to seek to deploy similar purchases of qualified securities using short-term loans that would allow us to satisfy the asset diversification test, thereby allowing us to make new or additional investments. There can be no assurance, however, that we will be able to enter into such a transaction on reasonable terms, if at all. Failure to meet this threshold alone does not result in loss of our RIC status in our current situation. In circumstances where the failure

to meet the 50% threshold as of a quarterly measurement date is the result of fluctuations in the value of assets, including in our case as a result of the sale of assets, we are still deemed under the rules to have satisfied the asset diversification test and, therefore, maintain our RIC status, as long as we have not made any new investments, including additional investments in our portfolio companies (such as advances under outstanding lines of credit),

**Table of Contents**

since the time that we fell below the 50% threshold. Thus, while we currently qualify as a RIC despite our current inability to meet the 50% threshold and potential inability to do so in the future, if we make any new or additional investments before regaining compliance with the asset diversification test, our RIC status will be threatened. Because, in most circumstances, we are contractually required to advance funds on outstanding lines of credit upon the request of our portfolio companies, we may have a limited ability to avoid adding to existing investments in a manner that would cause us to fail the asset diversification test as of September 30, 2010 or as of subsequent quarterly measurement dates.

If we were to make a new or additional investment before regaining compliance with the 50% threshold, and we did not regain compliance prior to the next quarterly measurement date following such investment, we would have thirty days to cure our failure to meet the 50% threshold to avoid our loss of RIC status. Potential cures for failure of the asset diversification test include raising additional equity or debt capital as we have done, or changing the composition of our assets, which could include full or partial divestitures of investments, such that we would once again meet or exceed the 50% threshold. Our ability to implement any of these cures would be subject to market conditions and a number of risks and uncertainties that would be, in part, beyond our control. Accordingly, we can not guarantee you that we would be successful in curing any failure of the asset diversification test, which would subject us to corporate level tax. For additional information about the consequences of failing to satisfy the RIC qualification, see We will be subject to corporate level tax if we are unable to satisfy Internal Revenue Code requirements for RIC qualification.

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

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

From time to time, some of our debt investments may include success fees that would generate payments to us if the business is ultimately sold. Because the satisfaction of these success fees, and the ultimate payment of these fees, is uncertain, to date we have not recognized any of these success fees as income, either for financial accounting or tax purposes, until the time that the success fees have actually been paid. We have recently sought a determination from the Internal Revenue Service, or IRS, that it agrees with our tax treatment. If the IRS were to disagree with this approach, we would be required to accrue these amounts as investment company taxable income, including an immediate accrual of amounts related to success fees that were not accrued in prior periods. As a result, we would be required to distribute such amounts to our stockholders in order to maintain RIC status.

## **Table of Contents**

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

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

***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.

### **Risks Related to an Investment in Our Common Stock**

***We may experience fluctuations in our quarterly and annual operating results.***

We may experience fluctuations in our quarterly and annual operating results due to a number of factors, including, among others, variations in our investment income, 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 level of our expenses, the degree to which we encounter competition in our markets, and general economic conditions, including the impacts of inflation. The majority of our portfolio companies are in industries that are directly impacted by inflation, such as manufacturing and consumer goods and services. Our portfolio companies may not be able to pass on to customers increases in their costs of production which could greatly affect their operating results, impacting their ability to repay our loans. In addition, any projected future decreases in our portfolio companies' operating results due to inflation could adversely impact the fair value of those investments. Any decreases in the fair value of our investments could result in future realized and unrealized losses and therefore reduce our net assets resulting from operations. As a result of these factors, results for any period should not be relied upon as being indicative of performance in future periods.

***There is a risk that you may not receive distributions.***

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 distributions. 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. In addition, our line of credit restricts the amount of distributions we are permitted to make. 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.

**Table of Contents**

***Distributions by us have and may in the future include a return of capital.***

Our Board of Directors declares monthly distributions based on estimates of net investment income for each fiscal year, which may differ, and in the past have differed, from actual results. Because our distributions are based on estimates of net investment income that may differ from actual results, future distributions payable to our stockholders may also include a return of capital. Moreover, to the extent that we distribute amounts that exceed our accumulated earnings and profits, these distributions constitute a return of capital. A return of capital represents a return of a stockholder's original investment in shares of our stock and should not be confused with a distribution from earnings and profits. Although return of capital distributions may not be taxable, such distributions may increase an investor's tax liability for capital gains upon the sale of our shares by reducing the investor's tax basis for such shares. Such returns of capital reduce our asset base and also adversely impact our ability to raise debt capital as a result of the leverage restrictions under the 1940 Act, which could have a material adverse impact on our ability to make new investments.

***The market price of our shares may fluctuate significantly.***

The trading price of our common stock may fluctuate substantially. Due to the extreme volatility and disruption that have affected the capital and credit markets for over a year, we have experienced greater than usual stock price volatility.

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, but are not limited to, the following:

general economic trends and other external factors;

price and volume fluctuations in the stock market from time to time, which are often unrelated to the operating performance of particular companies;

significant volatility in the market price and trading volume of shares of RICs, business development companies or other companies in our sector, which is not necessarily related to the operating performance of these companies;

changes in regulatory policies or tax guidelines, particularly with respect to RICs or business development companies;

loss of business development company status;

loss of RIC status;

changes in our earnings or variations in our operating results;

changes in the value of our portfolio of investments;

any shortfall in our revenue or net income or any increase in losses from levels expected by securities analysts;

departure of key personnel;

operating performance of companies comparable to us;

short-selling pressure with respect to our shares or business development companies generally;

the announcement of proposed, or completed, offerings of our securities, including a rights offering; 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.



**Table of Contents**

***The issuance of subscription rights to our existing stockholders may dilute the ownership and voting powers by existing stockholders in our common stock, dilute the net asset value of their shares and have a material adverse effect on the trading price of our common stock.***

In April 2008 we completed an offering of transferable rights to subscribe for additional shares of our common stock, or subscription rights. We determined to raise equity in this manner primarily because of the capital raising constraints applicable to us under the 1940 Act when our stock is trading below its net asset value per share, as it was at the time of the offering. In the event that we again issue subscription rights to our existing stockholders, there is a significant possibility that the rights offering will dilute the ownership interest and voting power of stockholders who do not fully exercise their subscription rights. Stockholders who do not fully exercise their subscription rights should expect that they will, upon completion of the rights offering, own a smaller proportional interest in the Company than would otherwise be the case if they fully exercised their subscription rights. In addition, because the subscription price of the rights offering is likely to be less than our most recently determined net asset value per share, our stockholders are likely to experience an immediate dilution of the per share net asset value of their shares as a result of the offer. As a result of these factors, any future rights offerings of our common stock, or our announcement of our intention to conduct a rights offering, could have a material adverse impact on the trading price of our common stock.

***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. Since our inception, our common stock has at times traded above net asset value, and at times traded below net asset value. During the past year, our common stock has traded consistently, and at times significantly, below net asset value. Subsequent to June 30, 2010, our stock has traded at discounts of up to 35.1% of our net asset value as of June 30, 2010. 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. Under the 1940 Act, we are generally not able to issue additional shares of our common stock at a price below net asset value per share to purchasers other than our existing stockholders through a rights offering without first obtaining the approval of our stockholders and our independent directors. Additionally, at times when our stock is trading below its net asset value per share, our dividend yield may exceed the weighted average returns that we would expect to realize on new investments that would be made with the proceeds from the sale of such stock, making it unlikely that we would determine to issue additional shares in such circumstances. Thus, for as long as our common stock trades below net asset value we will be subject to significant constraints on our ability to raise capital through the issuance of common stock. Additionally, an extended period of time in which we are unable to raise capital may restrict our ability to grow and adversely impact our ability to increase or maintain our distributions.

***Stockholders may incur dilution if we sell shares of our common stock in one or more offerings at prices below the then current net asset value per share of our common stock.***

At our annual meeting of stockholders held on August 5, 2010, our stockholders approved a proposal designed to allow us to access the capital markets in a way that, absent stockholder approval, we are generally unable to due to restrictions applicable to business development companies under the 1940 Act. Specifically, our stockholders approved a proposal that authorizes us to sell shares of our common stock below the then current net asset value per share of our common stock in one or more offerings for a period of one year. During the past two years, our common stock has traded consistently, and at times significantly, below net asset value. Any decision to sell shares of our

common stock below the then current net asset value per share of our common stock would be subject to the determination by our Board of Directors that such issuance is in our and our stockholders' best interests.

## **Table of Contents**

If we were to sell shares of our common stock below net asset value per share, such sales would result in an immediate dilution to the net asset value per share. This dilution would occur as a result of the sale of shares at a price below the then current net asset value per share of our common stock and a proportionately greater decrease in a stockholder's interest in our earnings and assets and voting interest in us than the increase in our assets resulting from such issuance. The greater the difference between the sale price and the net asset value per share at the time of the offering, the more significant the dilutive impact would be. Because the number of shares of common stock that could be so issued and the timing of any issuance is not currently known, the actual dilutive effect, if any, cannot be currently predicted. However, if, for example, we sold an additional 10% of our common stock at a 5% discount from net asset value, a stockholder who did not participate in that offering for its proportionate interest would suffer net asset value dilution of up to 0.5% or \$5 per \$1,000 of net asset value.

## **Other Risks**

***We could face losses and potential liability if intrusion, viruses or similar disruptions to our technology jeopardize our confidential information, whether through breach of our network security or otherwise.***

Maintaining our network security is of critical importance because our systems store highly confidential financial models and portfolio company information. 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.

***Terrorist attacks, acts of war, or national disasters may affect any market for our common stock, impact the businesses in which we invest, and harm our business, operating results, and financial conditions.***

Terrorist acts, acts of war, or national disasters have created, and continue to create, economic and political uncertainties and have contributed to global economic instability. Future terrorist activities, military or security operations, or national disasters could further weaken the domestic/global economies and create additional uncertainties, which may negatively impact the businesses in which we invest directly or indirectly and, in turn, could have a material adverse impact on our business, operating results, and financial condition. Losses from terrorist attacks and national disasters are generally uninsurable.

## **SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

All statements contained or incorporated by reference in this prospectus or any accompanying prospectus supplement, 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, grow, expect, should, would, if, seek, possible, potential, likely or the negative of such terms or comparable to. 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) further adverse changes in the economy and the capital markets; (2) risks associated with negotiation and consummation of pending and future transactions; (3) the loss of one or more of our executive officers, in particular David Gladstone, Terry Lee Brubaker, George Stelljes III or David Dullum; (4) changes in our business strategy; (5) availability, terms and deployment of capital; (6) changes in our industry, interest rates, exchange rates or the general economy; (7) the degree and nature of our competition; and (8) those factors described in the Risk Factors section of this prospectus. We caution readers not to place undue reliance on any such

forward-looking statements, which speak only as of the date made. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, after the date of this prospectus.

**Table of Contents**

**USE OF PROCEEDS**

Unless otherwise specified in any prospectus supplement accompanying this prospectus, we intend to use the net proceeds from the sale of the Securities for general corporate purposes. We expect the proceeds to be used first to pay down existing short-term debt, then to make investments in small and mid-sized businesses in accordance with our investment objectives, with any remaining proceeds to be used for other general corporate purposes. Indebtedness under our credit line facility currently accrues interest at the rate of approximately 6.5% and matures on April 13, 2012. We anticipate that substantially all of the net proceeds of any offering of Securities will be utilized in the manner described above within three months of the completion of such offering. Pending such utilization, we intend to invest the net proceeds of any offering of Securities primarily in cash, cash equivalents, U.S. government securities, and other high-quality debt investments that mature in one year or less from the date of investment, consistent with the requirements for continued qualification as a RIC for federal income tax purposes.

**PRICE RANGE OF COMMON STOCK AND DISTRIBUTIONS**

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

Our common stock is quoted on The Nasdaq Global Select Market under the symbol GAIN. We completed the initial public offering of our common stock in June 2005 at a price of \$15.00 per share. Prior to such date there was no public market for our common stock. Our common stock has historically traded at prices both above and below its net asset value. There can be no assurance, however, that any premium to net asset value will be attained or maintained. As of August 20, 2010, we had 33 stockholders of record.

**Table of Contents**

The following table sets forth the range of high and low closing sales prices of our common stock as reported on the Nasdaq Global Select Market and the dividends declared by us for the last two completed fiscal years and the current fiscal year through August 20, 2010.

**SHARE PRICE DATA**

	<b>Net Asset Value per Share(1)</b>	<b>High</b>	<b>Low</b>	<b>Dividend Declared</b>	<b>Premium (Discount) of Low Sales Price to Net Asset Value(2)</b>	<b>Premium (Discount) of High Sales Price to Net Asset Value(2)</b>
<b>FY 2009</b>						
First Quarter	\$ 10.77	\$ 9.78	\$ 6.31	\$ 0.24	(41.41)%	(9.19)%
Second Quarter	\$ 10.57	\$ 8.08	\$ 6.00	\$ 0.24	(43.24)%	(23.56)%
Third Quarter	\$ 10.15	\$ 6.83	\$ 3.09	\$ 0.24	(69.56)%	(32.71)%
Fourth Quarter	\$ 9.73	\$ 5.85	\$ 2.40	\$ 0.24	(75.33)%	(39.88)%
<b>FY 2010</b>						
First Quarter	\$ 9.19	\$ 5.38	\$ 3.52	\$ 0.12	(61.70)%	(41.46)%
Second Quarter	\$ 8.24	\$ 5.37	\$ 4.02	\$ 0.12	(51.21)%	(34.83)%
Third Quarter	\$ 7.93	\$ 5.11	\$ 4.41	\$ 0.12	(44.39)%	(35.56)%
Fourth Quarter	\$ 8.74	\$ 6.23	\$ 4.61	\$ 0.12	(47.25)%	(28.72)%
<b>FY 2011</b>						
First Quarter	\$ 8.86	\$ 6.89	\$ 5.13	\$ 0.12	(42.16)%	(22.32)%
Second Quarter (through August 20, 2010)	\$ *	\$ 6.60	\$ 5.75	\$ 0.12	*%	*%

(1) Net asset value per share is determined as of the last day in the relevant quarter and therefore may not reflect the net asset value per share on the date of the high and low sale price. The net asset values shown are based on outstanding shares at the end of each period.

(2) The premiums set forth in these columns represent the high or low, as applicable, closing price per share for the relevant quarter minus the net asset value per share as of the end of such quarter, and therefore may not reflect the premium to net asset value per share on the date of the high and low closing prices.

\* Not yet available, as the net asset value per share as of the end of this quarter has not yet been determined.

**Table of Contents****CONSOLIDATED SELECTED FINANCIAL DATA**

The following table summarizes our consolidated selected financial data. The consolidated selected financial data as of March 31, 2010 and 2009 and for the fiscal years ended March 31, 2010, 2009 and 2008 is derived from our audited consolidated financial statements included in this prospectus. The consolidated selected financial data as of and for the three months ended June 30, 2010 and 2009 is derived from our unaudited consolidated financial statements included in this prospectus. The consolidated selected financial data as of March 31, 2008, 2007 and 2006 and for the year ended March 31, 2007 and the period from June 22, 2005 (commencement of operations) to March 31, 2006 is derived from our audited consolidated financial statements that are not included in this prospectus. You should read this data together with our consolidated financial statements and notes thereto presented elsewhere in this prospectus and the information under Management's Discussion and Analysis of Financial Condition and Results of Operations for more information.

	Quarter Ended June 30,		Year Ended March 31,				Period June 22, 2005 (Commence of Operation through March 31, 2006
	2010	2009	2010	2009	2008	2007	
	(Dollar amounts in thousands, except per share and per unit data)						
ment of tions data:							
ment							
ne	\$ 7,248	\$ 5,169	\$ 20,785	\$ 25,812	\$ 27,894	\$ 17,262	\$ 7,3
expenses							
credits							
Adviser	3,041	2,724	10,187	12,424	14,842	6,114	1,4
vestment							
ne	4,207	2,445	10,598	13,388	13,052	11,148	5,8
ain (loss)							
estments	1,161	(11,635)	(21,669)	(24,837)	(13,993)	(3,879)	1
crease (decrease) in sets							
ing from tions	\$ 5,368	\$ (9,190)	\$ (11,071)	\$ (11,449)	\$ (941)	\$ 7,269	\$ 6,0





ge size of lio any ment at							
pal nt of new ments eds from	<b>1,354</b>	650	4,788	53,002	175,255	182,953	160,0
ments and ments	<b>61,059</b>	75,947	90,240	49,785	96,437	61,167	7,3
nted ge yield							
ments(5):	<b>10.31%</b>	10.01%	11.02%	8.22%	8.91%	8.72%	7
return(6)	<b>(0.99)</b>	35.24	79.80	(51.65)	(31.54)	4.36	3

(1) Per share data for net increase (decrease) in net assets resulting from operations is based on the weighted common stock outstanding for both basic and diluted.

**Table of Contents**

- (2) See Management's Discussion and Analysis of Financial Condition and Results of Operations for more information regarding our level of indebtedness.
- (3) As a business development company, we are generally required to maintain an asset coverage ratio of 200% of total consolidated assets, less all liabilities and indebtedness not represented by senior securities, to total borrowings and guaranty commitments.
- (4) Asset coverage per unit is the asset coverage ratio expressed in terms of dollar amounts per one thousand of indebtedness.
- (5) Weighted average yield on investments equals interest income on investments divided by the annualized weighted average investment balance throughout the year.
- (6) Total return equals the (decrease) increase of the ending market value over the beginning market value plus monthly distributions divided by the monthly beginning market value.

**Table of Contents**

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

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 herein.

**OVERVIEW**

*General*

We were incorporated under the General Corporation Laws of the State of Delaware on February 18, 2005. 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, common stock and, to a much lesser extent, 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 BDC under the 1940 Act. In addition, for tax purposes, we have elected to be treated as a RIC under the Code.

*Business Environment*

While economic conditions generally appear to be improving, we remain cautious about a long-term economic recovery. The recent recession in general, and the disruptions in the capital markets in particular, have impacted our liquidity options and increased the cost of debt and equity capital. Many of our portfolio companies, or those that we evaluate for investment, are impacted by these economic conditions, and if these conditions persist, it may affect their ability to repay our loans or engage in a liquidity event, such as a sale, recapitalization or initial public offering. While these conditions are challenging, we are finding an increase in the number of opportunities for new investments consistent with our investing strategy of providing subordinated debt with equity enhancement features and direct equity in support of management and sponsor led buyouts of small and medium-sized companies.

At the end of the quarter ended June 30, 2010, we achieved a significant amount of liquidity with the sale of our equity investment and the receipt of full repayment of our debt investment in A. Stucki Holding Corp., or A. Stucki, in connection with the sale of 100% of the outstanding capital stock of A. Stucki. The net cash proceeds to us from the sale of our equity in A. Stucki were \$21.7 million, resulting in a realized gain of \$17.0 million. In connection with the equity sale, we accrued and received dividend cash proceeds of \$0.2 million from our preferred stock investment in A. Stucki. At the same time, we received \$30.6 million in payment of our principal, accrued interest and success fees on the loans to A. Stucki. Additionally, immediately prior to the sale of A. Stucki, we received a special distribution of property with a fair value of \$0.5 million, which was recorded as dividend income and is reflected as a new control investment, Gladstone Neville Corp., on our condensed consolidated schedule of investments as of June 30, 2010.

The A. Stucki sale was the first of our management supported buyout liquidity events and an equity investment success, which highlights our investment strategy of striving to achieve returns through current income from debt investments and capital gains from equity investments. Due to previous realized losses during the fiscal year ended March 31, 2010, in connection with the Syndicated Loan Sales as described further below, we are not required to distribute the realized gains to stockholders. We expect this liquidity, along with the availability under our line of credit, will be utilized in making new investments to increase our net investment income and potential for capital gains to enhance our ability to pay dividends to our stockholders.

The A. Stucki sale partially offset the realized losses incurred during the fiscal year ended March 31, 2010. The unstable economic conditions have affected the general availability of credit and, as a result, during the quarter ended June 30, 2009, we sold 29 senior syndicated loans that were held in our portfolio of investments at March 31, 2009 to various investors in the syndicated loan market, which we refer to as the Syndicated Loan Sales, to repay amounts outstanding under our prior line of credit with Deutsche Bank AG, or the Prior Credit Facility, which matured in April 2009 and was not extended. These loans, in aggregate, had a cost value of approximately \$104.2 million, or 29.9% of the cost of our total investments, and an aggregate fair market value of approximately

## **Table of Contents**

\$69.8 million, or 22.2% of the fair market value of our total investments, at March 31, 2009. As a result of the settlement of the Syndicated Loan Sales and other exits, at June 30, 2010, we had one remaining senior syndicated loan. We plan to exit the remaining senior syndicated loan when appropriate. Collectively, these sales have changed our asset composition in a manner that has affected our ability to satisfy certain elements of the Code's rules for maintenance of our RIC status. In order to maintain our status as a RIC, in addition to other requirements, as of the close of each quarter of our taxable year, we must meet the asset diversification test, which requires that at least 50% of the value of our assets consist of cash, cash items, U.S. government securities or certain other qualified securities, which we refer to as the 50% threshold. During the quarter ended June 30, 2010, we again fell below the required 50% threshold.

Failure to meet the 50% threshold alone will not result in our loss of RIC status. In circumstances where the failure to meet the 50% threshold is the result of fluctuations in the value of assets, including as a result of the sale of assets, we will still be deemed to have satisfied the 50% threshold and, therefore, maintain our RIC status, as long as we have not made any new investments, including additional investments in our existing portfolio companies (such as advances under outstanding lines of credit), since the time that we fell below the 50% threshold. At June 30, 2010, the fifth quarterly measurement date following the Syndicated Loan Sales, we satisfied the 50% threshold through the purchase of short-term qualified securities, which was funded primarily through a short-term loan agreement. Subsequent to the June 30, 2010 measurement date, the short-term qualified securities matured and we repaid the short-term loan. See

Recent Developments Short-Term Loan for more information regarding this transaction. Due to the A. Stucki sale, which effectively transformed \$50.4 million in non-qualified securities under the Code into qualified securities, we are above the 50% threshold as of the date of this filing. However, the composition of our assets and investments could change in the future and may put us below the 50% threshold as of the end of the quarter when the measurement occurs.

Thus, while we currently qualify as a RIC despite our recent inability to meet the 50% threshold and potential inability to do so in the future, if we make any new or additional investments before regaining compliance with the asset diversification test, our RIC status will be threatened. If we make a new or additional investment and fail to regain compliance with the 50% threshold on the next quarterly measurement date following such investment, we will be in non-compliance with the RIC rules and will have thirty days to cure our failure to meet the 50% threshold to avoid the loss of our RIC status. Potential cures for failure of the asset diversification test include raising additional equity or debt capital, or changing the composition of our assets, which could include full or partial divestitures of investments, such that we would once again exceed the 50% threshold on a consistent basis.

Until the composition of our assets is above the required 50% threshold on a consistent basis, we will continue to seek to deploy similar purchases of qualified securities using short-term loans that would allow us to satisfy the 50% threshold, thereby allowing us to make additional investments. There can be no assurance, however, that we will be able to enter into such a transaction on reasonable terms, if at all. We also continue to explore a number of other strategies, including changing the composition of our assets, which could include full or partial divestitures of investments, and raising additional equity or debt capital, such that we would once again exceed the 50% threshold on a consistent basis. Our ability to implement any of these strategies will be subject to market conditions and a number of risks and uncertainties that are, in part, beyond our control.

The Syndicated Loan Sales significantly changed the overall composition and reduced the total size of our portfolio. Because the Syndicated Loan Sales were from our Non-Control/Non-Affiliate investment category, the fair value of our Non-Control/Non-Affiliate investments decreased from 30.2% to 9.5% of our total portfolio as of March 31, 2009 and June 30, 2010, respectively. In addition, the size of our portfolio decreased because we exited \$188.0 million in investments, at cost, partially offset by \$4.7 million in disbursements to existing portfolio companies, from March 31, 2009 to June 30, 2010. We expect the overall composition of our investment portfolio to continue to consist of primarily Control and Affiliate investments.

On April 13, 2010, through Business Investment, we entered into the Credit Facility. The Credit Facility's maturity date is April 13, 2012, and if it is not renewed or extended by then, all principal and interest will be due and payable one year later, on or before April 13, 2013. Advances under the Credit Facility were modified to generally bear interest at the 30-day London Interbank Offered Rate, or LIBOR, (subject to a minimum rate of 2%), plus 4.5% per annum, with a commitment fee of 0.50% per annum on undrawn amounts when advances outstanding are above

## **Table of Contents**

50% of the commitment and 1% on undrawn amounts if the advances outstanding are below 50% of the commitment. In connection with the Credit Facility renewal, we paid an upfront fee of 1%. The Credit Facility limits payments on distributions to the aggregate net investment income for each of the twelve months ending March 31, 2011 and 2012. Other significant changes to the Credit facility include a reduced minimum net worth covenant, which was modified to \$155.0 million plus 50% of all equity and subordinated debt raised after April 13, 2010 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 July 30, 2010, there was no balance outstanding under the Credit Facility, and \$30.8 million was available for borrowing due to certain limitations on our borrowing base.

Challenges in the current market are intensified for us by certain regulatory limitations under the Code and the 1940 Act, as well as contractual restrictions under the agreement governing the Credit Facility that further constrain our ability to access the capital markets. To maintain our qualification as a RIC, we must satisfy, among other requirements, an annual distribution requirement to pay out at least 90% of our ordinary income and short-term capital gains to our stockholders on an annual basis. Because we are required to distribute our income in this manner, and because the illiquidity of many of our investments makes it difficult for us to finance new investments through the sale of current investments, our ability to make new investments is highly dependent upon external financing. Our external financing sources include the issuance of equity securities, debt securities or other leverage such as borrowings under our line of credit. Our ability to seek external debt financing, to the extent that it is available under current market conditions, is further subject to the asset coverage limitations of the 1940 Act, which require us to have at least a 200% asset coverage ratio, meaning, generally, that for every dollar of debt that we have outstanding, we must have two dollars of assets.

Market conditions have also affected the trading price of our common stock and thus our ability to finance new investments through the issuance of equity. On July 30, 2010, the closing market price of our common stock was \$6.60, which represented a 25.5% discount to our June 30, 2010 net asset value, or NAV, per share. When our stock is trading below NAV, as it has consistently traded since September 30, 2008, our ability to issue equity is constrained by provisions of the 1940 Act, which generally prohibits the issuance and sale of our common stock below NAV per share without stockholder approval other than through sales to our then-existing stockholders pursuant to a rights offering. At our annual meeting of stockholders held on August 5, 2010, our stockholders approved a proposal which authorizes us to sell shares of our common stock at a price below our then current NAV per share for a period of one year from the date of approval, provided that our Board of Directors makes certain determinations prior to any such sale.

Unstable economic conditions may also continue to decrease the value of collateral securing some of our loans to portfolio companies, as well as the value of our equity investments, which has impacted and may continue to impact our ability to borrow under the Credit Facility. Additionally, our Credit Facility contains covenants regarding the maintenance of certain minimum loan concentrations and net worth covenants which are affected by the decrease in value of our portfolio. Failure to meet these requirements would result in a default which, if we are unable to obtain a waiver from our lenders, would result in the acceleration of our repayment obligations under our Credit Facility. As of June 30, 2010, we were in compliance with all of the Credit Facility's covenants.

We expect that, given these regulatory and contractual constraints in combination with current market conditions, debt and equity capital may be costly or difficult for us to access in the near term. However, in light of the A. Stucki sale and resulting liquidity, the stabilization of our portfolio valuations over the past two quarters and the increased investing opportunities that we see in our target markets, we are cautiously optimistic about the long term prospects for the U.S. economy and will shift our near-term strategy to include making conservative investments in businesses that we believe will weather the current economic conditions and that we believe are likely to produce attractive long-term returns for our stockholders. We will also, where prudent and possible, consider the sale of lower-yielding investments. If implemented, this should result in increased investment activity from our activity over the past year,

but our access to capital may be limited or challenged and other events beyond our control may still encumber our ability to make new investments in the future.



## **Table of Contents**

### ***Investment Highlights***

As previously discussed, we sold our equity investment and received full repayment of our debt investment in A. Stucki in June 2010. During the quarter ended June 30, 2010, we extended approximately \$0.8 million of investments to existing portfolio companies through revolver draws or additions to term notes. From the time of our initial public offering in June 2005 through June 30, 2010, we have made 145 investments in 88 companies for a total of approximately \$584.2 million, before giving effect to principal repayments on investments and divestitures.

During the fiscal year ended March 31, 2010, we extended approximately \$4.8 million of investments to existing portfolio companies through revolver draws or additions to term notes. Also, during the fiscal year ended March 31, 2010, we sold 30 syndicated loans for aggregate proceeds of approximately \$74.7 million, and we received scheduled and unscheduled contractual principal repayments of approximately \$15.5 million, for total principal repayments of approximately \$90.2 million.

### ***Recent Developments***

#### ***Renewal of Credit Facility with Branch Bank and Trust Company***

On April 13, 2010, we renewed the Credit Facility through Business Investment by entering into a third amended and restated credit agreement providing for a \$50.0 million, two year revolving line of credit. The Credit Facility's maturity date is April 13, 2012, and if it is not renewed or extended by then, all unpaid principal and interest will be due and payable one year later, on or before April 13, 2013. Advances under the Credit Facility were modified to generally bear interest at the 30-day LIBOR (subject to a minimum rate of 2%), plus 4.5% per annum, with a commitment fee of 0.50% per annum on undrawn amounts when advances outstanding are above 50% of the commitment and 1% on undrawn amounts if the advances outstanding are below 50% of the commitment. Other significant changes to the Credit facility include a reduced minimum net worth covenant, which was modified to \$155.0 million plus 50% of all equity and subordinated debt raised after April 13, 2010 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.

#### ***Short-Term Loan***

Similar to previous quarter ends, we purchased \$85.0 million of short-term United States Treasury securities through Jefferies & Company, Inc., or Jefferies, on June 28, 2010. The securities were purchased with \$10.0 million in funds drawn on the Credit Facility and the proceeds from a \$75.0 million short-term loan from Jefferies, with an effective annual interest rate of approximately 0.71%. On July 1, 2010, when the securities matured, we repaid the \$75.0 million loan from Jefferies in full, and, on July 2, 2010, repaid the \$10.0 million drawn on the Credit Facility for the transaction.

#### ***Investment Activity***

During the three months ended June 30, 2010, we executed the following transactions with certain of our portfolio companies:

As discussed previously, in June 2010, we sold our equity investment and received full repayment of our debt investment in A. Stucki in connection with the sale of 100% of the outstanding capital stock of A. Stucki. The net cash proceeds to us from the sale of our equity in A. Stucki were \$21.7 million, resulting in a realized gain of \$17.0 million. In connection with the equity sale, we accrued and received dividend cash proceeds of \$0.2 million from our preferred stock investment in A. Stucki. At the same time, we received \$30.6 million in

payment of our principal, accrued interest and success fees on the loans to A. Stucki. Additionally, immediately prior to the sale of A. Stucki, we received a special distribution of property with a fair value of \$0.5 million, which was recorded as dividend income and is reflected as a new control investment, Gladstone Neville Corp., on our condensed consolidated schedule of investments as of June 30, 2010.

In June 2010, we disbursed \$59 to Tread Corporation, or Tread, in the form of preferred and common equity. Our investment in Tread was reclassified from an Affiliate to a Control investment during the quarter ended June 30, 2010.

## **Table of Contents**

In June 2010, we entered into agreements with Noble Logistics, Inc., or Noble, to extend the maturity date of its revolving line of credit to December 2010, and restructured the senior LOT note. These were non-cash transactions.

In May 2010, we increased our senior subordinated term note to Galaxy Tool Holding Corp., or Galaxy, by \$270.

In May 2010, we invested \$415 in Acme Cryogenics, Inc., or Acme, in the form of senior subordinated term debt.

In May 2010, Cavert II Holding Corp., made full repayment of its senior term A debt owed to us resulting in the receipt of approximately \$2.9 million in cash proceeds.

In April 2010, Interstate FiberNet, Inc. made full repayment of its senior term debt owed to us resulting in the receipt of approximately \$6.7 million in cash proceeds. The remaining non-proprietary loans in our investment portfolio had a fair value of approximately \$4.3 million, or 2.9% of our total investments at June 30, 2010.

## ***Investment Strategy***

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.

Our primary investment focuses are situations involving buyouts and recapitalizations of small and mid-sized companies with established management teams. We expect that our investments will generally range between \$10 million and \$40 million each, although this investment size may vary proportionately as the size of our capital base changes. Typically, our investments mature in no more than seven years and accrue interest at fixed or variable rates. 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.

Certain loan investments may have a form of interest that is not paid currently but is accrued and added to the loan balance and paid at the end of the term. This interest is called paid in kind, or PIK, interest. We generally seek investments that do not generate PIK interest as we have to pay out this accrued interest as distributions to our stockholders and we may have to borrow money or raise additional capital in order to meet the tax test for RICs by having to pay out at least 90% of our income. As of June 30, 2010, none of our investments bore PIK interest.

Because the majority of our portfolio loans consist of term debt of private companies who typically cannot or will not expend the resources to have their debt securities rated by a credit rating agency, we expect that several of the debt

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

To the extent possible, our loans generally are collateralized by a security interest in the borrower's assets. Interest payments are generally made monthly or quarterly with amortization of principal generally being deferred for several years. The principal amount of the loans and any accrued but unpaid interest generally become due at maturity, generally at five to seven years. When we receive a warrant to purchase stock in a borrower in connection

## **Table of Contents**

with a loan, the warrant will typically have an exercise price equal to the fair value of the portfolio company's common stock at the time of the loan and entitle us to purchase a modest percentage of the borrower's stock.

Original issue discount, or OID, arises when we extend a loan and receive an equity interest in the borrower at the same time. To the extent that the price paid for the equity is not at market value, we must allocate part of the price paid for the loan to the value of the equity. Then the amount allocated to the equity, the OID, must be amortized over the life of the loan. As with PIK interest, the amortization of OID also produces income that must be recognized for purposes of satisfying the distribution requirements for a RIC under Subchapter M of the Code, whereas the cash is received, if at all, when the equity instrument is sold. We seek to avoid OID with all potential investments under review, and as of June 30, 2010, we did not hold any investments with OID income.

In addition, as a business development company under the 1940 Act, we are required to make available significant managerial assistance to our portfolio companies. Our Adviser 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 other services it provides to our portfolio companies. These other fees are recognized as revenue when earned and are generally paid directly to our Adviser by the borrower or potential borrower upon closing of the investment. The services our Adviser provides to portfolio companies vary by investment, but generally include a broad array of services, such as investment banking services, arranging bank and equity financing, structuring financing from multiple lenders and investors, reviewing existing credit facilities, restructuring existing investments, raising equity and debt capital from other investors, 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 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 provides 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.

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

In the event that we expend significant effort in considering and negotiating a potential investment that ultimately is not consummated, we generally will seek reimbursement from the proposed borrower for our reasonable expenses incurred in connection with the transaction, including legal fees. Any amounts collected for expenses incurred by our Adviser in connection with unconsummated investments will be reimbursed to our Adviser. Amounts collected for these expenses incurred by us will be reimbursed to us and will be recognized in the period in which such

reimbursement is received, but there can be no guarantee that we will be successful in collecting any such reimbursements.

***Our Adviser and Administrator***

Our Adviser is led by a management team which has extensive experience in our lines of business. Our Adviser is controlled by David Gladstone, our chairman and chief executive officer. Mr. Gladstone is also the chairman and

## **Table of Contents**

chief executive officer of our Adviser. David Dullum is our president and has extensive experience in private equity investing in middle market companies. Terry Lee Brubaker is our co-vice chairman and has substantial experience in acquisitions and operations of companies. George Stelljes III is our co-vice chairman and chief investment officer and has extensive experience in leveraged finance. One affiliate of our Adviser is our Administrator, which employs our chief financial officer, chief compliance officer, treasurer, internal counsel and their respective staffs.

Our Adviser and Administrator also provide investment advisory and administrative services, respectively, to our affiliates, Gladstone Commercial, a publicly traded real estate investment trust; Gladstone Capital, a publicly traded BDC and RIC; Gladstone Lending, a public non-traded BDC and RIC; Gladstone Partners Fund, L.P., a private partnership fund formed primarily to co-invest with us and Gladstone Capital; and Gladstone Land, a private agricultural real estate company. The majority of our executive officers serve as either directors or executive officers, or both, of our Adviser, our Administrator, Gladstone Commercial, Gladstone Capital and Gladstone Lending. In the future, our Adviser and Administrator may provide investment advisory and administrative services, respectively, to other funds, both public and private.

### ***Investment Advisory and Management Agreement***

Under the amended and restated investment advisory and management agreement with our Adviser, or the Advisory Agreement, we pay our Adviser an annual base management fee of 2% of our average gross assets, which is defined as total assets, including investments made with proceeds of borrowings, less any uninvested cash or cash equivalents resulting from borrowings, valued at the end of the two most recently completed quarters and appropriately adjusted for any share issuances or repurchases during the current quarter.

We also pay our Adviser a two-part incentive fee under the Advisory Agreement. The first part of the incentive fee is an income-based incentive fee which rewards our Adviser if our quarterly net investment income (before giving effect to any incentive fee) exceeds 1.75% of our net assets, which we refer to as the hurdle rate. The second part of the incentive fee is a capital gains-based 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-based incentive fee payable to our Adviser, we will calculate the cumulative aggregate realized capital gains and cumulative aggregate realized capital losses since our inception, and the aggregate unrealized capital depreciation as of the date of the calculation, as applicable, with respect to each of the investments in our portfolio. The Adviser did not earn the capital gains portion of the incentive fee for the fiscal year ended March 31, 2010.

We pay our direct expenses including, but not limited to, directors' fees, legal and accounting fees, stockholder related expenses, and directors and officers insurance under the Advisory Agreement.

Since April 2006, our Board of Directors has accepted from our Adviser, unconditional and irrevocable voluntarily waivers on a quarterly basis to reduce the annual 2% base management fee on senior syndicated loans to 0.5% to the extent that proceeds resulting from borrowings were used to purchase such syndicated loan participations. In addition to the base management and incentive fees under the Advisory Agreement, 50% of certain fees received by the Adviser from our portfolio companies are credited against the investment advisory fee and paid to the Adviser.

The Adviser services our loan portfolio pursuant to a loan servicing agreement with Business Investment in return for a 2% annual fee, based on the monthly aggregate outstanding loan balance of the loans pledged under our line of credit.

On July 7, 2010, our Board of Directors approved the renewal of the Advisory Agreement with our Adviser through August 31, 2011. We expect that the Board of Directors will approve a further one year renewal in July 2011.

***Administration Agreement***

We have entered into an administration agreement with our Administrator, which we refer to as 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



## **Table of Contents**

obligations under the Administration Agreement including, but not limited to, rent for employees of our Administrator, and our allocable portion of the salaries and benefits expenses of our chief financial officer, chief compliance officer, internal counsel, treasurer and their respective staffs. Our allocable portion of expenses is derived by multiplying our Administrator's total expenses by the percentage of our average assets (the total assets at the beginning of each quarter) in comparison to the average total assets of all companies managed by our Adviser under similar agreements. On July 7, 2010, our Board of Directors approved the renewal of this Administration Agreement with our Administrator through August 31, 2011. We expect that the Board of Directors will approve a further one year renewal in July 2011.

### ***Critical Accounting Policies***

The preparation of financial statements and related disclosures in conformity with GAAP requires management to make estimates and assumptions that affect the reported consolidated amounts of assets and liabilities, including 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. We have identified our investment valuation process, which was modified during the quarter ended March 31, 2010, as our most critical accounting policy.

### ***Investment Valuation***

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

*General Valuation Policy:* We value our investments in accordance with the requirements of the 1940 Act. As discussed more fully below, we value securities for which market quotations are readily available and reliable at their market value. We value all other securities and assets at fair value, as determined in good faith by our Board of Directors.

We adopted Financial Accounting Standards Board, or FASB, Accounting Standards Codification, or ASC, 820 on April 1, 2008. In part, ASC 820 defines fair value, establishes a framework for measuring fair value and expands disclosures about assets and liabilities measured at fair value. ASC 820 provides a consistent definition of fair value that focuses on exit price in the principal, or most advantageous, market and prioritizes, within a measurement of fair value, the use of market-based inputs over entity-specific inputs. ASC 820 also establishes the following three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date.

Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets;

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. Level 2 inputs are in those markets for which there are few transactions, the prices are not current, little public information exists or instances where prices vary substantially over time or among brokered market makers; and

Level 3 inputs to the valuation methodology are unobservable and significant to the fair value measurement. Unobservable inputs are those inputs that reflect our own assumptions that market participants would use to price the asset or liability based upon the best available information.

See Note 3, *Investments* in the accompanying notes to our condensed consolidated financial statements included elsewhere in this prospectus for additional information regarding fair value measurements and our adoption of ASC 820.

We use generally accepted valuation techniques to value our portfolio unless we have specific information about the value of an investment to determine otherwise. From time to time we may accept an appraisal of a business in which we hold securities. These appraisals are expensive and occur infrequently but provide a third-party

## **Table of Contents**

valuation opinion that may differ in results, techniques and scopes used to value our investments. When these specific third-party appraisals are engaged or accepted, we would use estimates of value provided by such appraisals and our own assumptions, including estimated remaining life, current market yield and interest rate spreads of similar securities, as of the measurement date, to value the investment we have in that business.

In determining the value of our investments, our Adviser has established an investment valuation policy, which we refer to as the Policy. The Policy has been approved by our Board of Directors, and each quarter our Board of Directors reviews whether our Adviser has applied the Policy consistently and votes whether or not to accept the recommended valuation of our investment portfolio.

The Policy, which is summarized below, applies to the following categories of securities:

Publicly-traded securities;

Securities for which a limited market exists; and

Securities for which no market exists.

### *Valuation Methods:*

*Publicly-traded securities:* We determine the value of publicly-traded securities based on the closing price for the security on the exchange or securities market on which it is listed and primarily traded on the valuation date. To the extent that we own restricted securities that are not freely tradable, but for which a public market otherwise exists, we will use the market value of that security adjusted for any decrease in value resulting from the restrictive feature.

*Securities for which a limited market exists:* We value securities that are not traded on an established secondary securities market, but for which a limited market for the security exists, such as certain participations in, or assignments of, syndicated loans, at the quoted bid price. In valuing these assets, we assess trading activity in an asset class, evaluate variances in prices and other market insights to determine if any available quote prices are reliable. If we conclude that quotes based on active markets or trading activity may be relied upon, firm bid prices are requested; however, if a firm bid price is unavailable, we base the value of the security upon the indicative bid price, or IBP, offered by the respective originating syndication agent's trading desk, or secondary desk, on or near the valuation date. To the extent that we use the IBP as a basis for valuing the security, our Adviser may take further steps to consider additional information to validate that price in accordance with the Policy.

In the event these limited markets become illiquid such that market prices are no longer readily available, we will value our syndicated loans using alternative methods, such as estimated net present values of the future cash flows or discounted cash flows, or DCF. The use of a DCF methodology follows that prescribed by ASC 820, which provides guidance on the use of a reporting entity's own assumptions about future cash flows and risk-adjusted discount rates when relevant observable inputs, such as quotes in active markets, are not available. When relevant observable market data does not exist, the alternative outlined in ASC 820 is the use of valuing investments based on DCF. For the purposes of using DCF to provide fair value estimates, we consider multiple inputs such as a risk-adjusted discount rate that incorporates adjustments that market participants would make both for nonperformance and liquidity risks. As such, we developed a modified discount rate approach that incorporates risk premiums including, among others, increased probability of default, or higher loss given default, or increased liquidity risk. The DCF valuations applied to the syndicated loans provide an estimate of what we believe a market participant would pay to purchase a syndicated loan in an active market, thereby establishing a fair value. We apply the DCF methodology in illiquid markets until quoted prices are available or are deemed reliable based on trading activity.

As of June 30, 2010, we assessed trading activity in syndicated loan assets and determined that there continued to be market liquidity and a secondary market for these assets. Thus, firm bid prices or IBPs were used to fair value our remaining unsold syndicated loans at June 30, 2010.

*Securities for which no market exists:* The valuation methodology for securities for which no market exists falls into three categories: (1) portfolio investments comprised solely of debt securities; (2) portfolio investments in controlled companies comprised of a bundle of securities, which can include debt and equity securities; and

**Table of Contents**

(3) portfolio investments in non-controlled companies comprised of a bundle of investments, which can include debt and equity securities.

(1) *Portfolio investments comprised solely of debt securities:* Debt securities that are not publicly traded on an established securities market, or for which a limited market does not exist, which we refer to as Non-Public Debt Securities, and that are issued by portfolio companies where we have no equity, or equity-like securities, are fair valued in accordance with the terms of the policy, which utilizes opinions of value submitted to us by SPSE. We may also submit PIK interest to SPSE for their evaluation when it is determined that PIK interest is likely to be received.

In the case of Non-Public Debt Securities, we have engaged SPSE to submit opinions of value for our debt securities that are issued by portfolio companies in which we own no equity, or equity-like securities. SPSE's opinions of value are based on the valuations prepared by our portfolio management team, as described below. We request that SPSE also evaluate and assign values to success fees when we determine that there is a reasonable probability of receiving a success fee on a given loan. 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. Upon completing our collection of data with respect to the investments (which may include the information described below under Credit Information, the risk ratings of the loans described below under Loan Grading and Risk Rating and the factors described hereunder), 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 the value of our debt securities that are issued by portfolio companies in which we do not own 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 our Board of Directors 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 our Board of Directors voted to accept, the opinions of value delivered by SPSE on the loans in our portfolio as denoted on the Schedule of Investments included in our accompanying condensed 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 using the methods described herein.

(2) *Portfolio investments in controlled companies comprised of a bundle of investments, which can include debt and equity securities:* The fair value of these investments is determined based on the total enterprise value, or TEV, of the portfolio company, or issuer, utilizing a liquidity waterfall approach under ASC 820. For Non-Public Debt Securities

and equity or equity-like securities (e.g. preferred equity, equity, or other equity-like securities) that are purchased together as part of a package, where we have control or could gain control through an option or warrant security, both the debt and equity securities of the portfolio investment would exit in the mergers and acquisitions market as the principal market, generally through a sale or recapitalization of the portfolio company. In accordance with ASC 820, we apply the in-use premise of value which assumes the debt and equity securities are sold together. Under this liquidity waterfall approach, we continue to use the enterprise value methodology utilizing

**Table of Contents**

a liquidity waterfall approach to determine the fair value of these investments under ASC 820 if we have the ability to initiate a sale of a portfolio company as of the measurement date. Under this approach, we first calculate the TEV of the issuer by incorporating some or all of the following factors:

- 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; and
- DCF or other pertinent factors.

In gathering the sales to third parties of similar securities, we may gather and analyze industry statistics and use outside experts. Once we have estimated the TEV of the issuer, we subtract the value of all the debt securities of the issuer, which are valued at the contractual principal balance. Fair values of these debt securities are discounted for any shortfall of TEV over the total debt outstanding for the issuer. Once the values for all outstanding senior securities (which include the debt securities) have been subtracted from the TEV of the issuer, the remaining amount, if any, is used to determine the value of the issuer's equity or equity like securities. If, in our Adviser's judgment, the liquidity waterfall approach does not accurately reflect the value of the debt component, our Adviser may recommend that we use a valuation by SPSE, or if that is unavailable, a DCF valuation technique.

*(3) Portfolio investments in non-controlled companies comprised of a bundle of investments, which can include debt and equity securities:* We value Non-Public Debt Securities that are purchased together with equity or equity-like securities from the same portfolio company, or issuer, for which we do not control or cannot gain control as of the measurement date, using a hypothetical secondary market as our principal market. In accordance with ASC 820, we determine the fair value of these debt securities of non-control investments assuming the sale of an individual debt security using the in-exchange premise of value (as defined in ASC 820). As such, we estimate the fair value of the debt component using estimates of value provided by SPSE and our own assumptions in the absence of observable market data, including synthetic credit ratings, estimated remaining life, current market yield and interest rate spreads of similar securities as of the measurement date. Subsequent to June 30, 2009, for equity or equity-like securities of investments for which we do not control or cannot gain control as of the measurement date, we estimate the fair value of the equity using the in-exchange premise of value based on factors such as the overall value of the issuer, the relative fair value of other units of account, including debt, or other relative value approaches. Consideration also is given to capital structure and other contractual obligations that may impact the fair value of the equity. Further, we may utilize comparable values of similar companies, recent investments and indices with similar structures and risk characteristics or our own assumptions in the absence of other observable market data, and may also employ DCF valuation techniques.

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 in an arms-length transaction in the security's principal market.

*Valuation Considerations:* From time to time, depending on certain circumstances, the Adviser may use the following valuation considerations, including but not limited to:

the nature and realizable value of the 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;



**Table of Contents**

the comparison to publicly traded companies; and

DCF and other relevant factors.

Because such valuations, particularly valuations of private securities and private companies, are not susceptible to precise determination, may fluctuate over short periods of time, and may be based on estimates, our determinations of fair value may differ from the values that might have actually resulted had a readily available market for these securities been available.

*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 or comparable information and board discussions, our Adviser calculates and evaluates the credit statistics.

*Loan Grading and Risk Rating:* As part of our valuation procedures above, we risk rate all of our investments in debt securities. For syndicated loans that have been rated by an 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. During the three months ended March 31, 2010, we modified our risk rating model to incorporate additional factors in our qualitative and quantitative analysis. While the overall process did not change, we believe the additional factors enhance the quality of the risk ratings of our investments. No adjustments were made to prior periods as a result of this modification.

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 an 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 an 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 an 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 an NRSRO, however, no assurance can be given that a 10 on our scale is equal to a BBB on an NRSRO scale.

**Table of Contents**

<b>Company s System</b>	<b>First NRSRO</b>	<b>Second NRSRO</b>	<b>Gladstone Investment s Description<sup>(a)</sup></b>
<b>&gt;10</b>	Baa2	BBB	Probability of Default (PD) during the next ten years is 4% and the Expected Loss (EL) is 1% or less
<b>10</b>	Baa3	BBB-	PD is 5% and the EL is 1% to 2%
<b>9</b>	Ba1	BB+	PD is 10% and the EL is 2% to 3%
<b>8</b>	Ba2	BB	PD is 16% and the EL is 3% to 4%
<b>7</b>	Ba3	BB-	PD is 17.8% and the EL is 4% to 5%
<b>6</b>	B1	B+	PD is 22% and the EL is 5% to 6.5%
<b>5</b>	B2	B	PD is 25% and the EL is 6.5% to 8%
<b>4</b>	B3	B-	PD is 27% and the EL is 8% to 10%
<b>3</b>	Caa1	CCC+	PD is 30% and the EL is 10% to 13.3%
<b>2</b>	Caa2	CCC	PD is 35% and the EL is 13.3% to 16.7%
<b>1</b>	Caa3	CC	PD is 65% and the EL is 16.7% to 20%
<b>0</b>	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. As of June 30, 2010 and March 31, 2010, one Control investment, ASH, was on non-accrual with a fair value of approximately \$2.1 million and \$2.2 million, respectively, which represented 1.4% and 1% of the fair value of all loans held in our portfolio at June 30, 2010 and March 31, 2010, respectively. Additionally, we do not risk rate our equity securities.

The following table lists the risk ratings for all proprietary loans in our portfolio as of June 30, 2010, March 31, 2010 and March 31, 2009, representing approximately 96.6%, 93.5% and 59% respectively, of all loans in our portfolio at fair value at the end of each period:

<b>Rating</b>	<b>As of June 30, 2010</b>	<b>As of March 31, 2010</b>	<b>As of March 31, 2009</b>
Highest	10.0	9.0	7.0
Average	5.4	5.3	5.5
Weighted Average	6.0	5.9	5.1
Lowest	2.0	2.0	2.0

The risk rating for the syndicated loan in our portfolio that was not rated by an NRSRO was 9.0 as of June 30, 2010, March 31, 2010 and March 31, 2009, representing approximately 1.1%, 0.7% and 12%, respectively, of all loans in our portfolio at fair value at the end of each period. For 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 an NRSRO. The weighted average risk ratings for all syndicated loans in our portfolio that were rated by an NRSRO were BBB/Ba3, B/B2 and B/B2 as of June 30, 2010, March 31, 2010 and March 31, 2009, respectively, representing

approximately 2.3%, 5.8% and 29%, respectively, of all loans in our portfolio at fair value at the end of each period.

***Tax Status***

*Federal Income Taxes*

We intend to continue to qualify for treatment as a RIC under Subtitle A, Chapter 1 of Subchapter M of the Code. As a RIC, we are not subject to federal income tax on the portion of our taxable income and gains distributed to stockholders. To qualify as a RIC, we must meet certain source-of-income, asset diversification and annual

## **Table of Contents**

distribution requirements. Under the annual distribution requirements, we are required to distribute to stockholders at least 90% of our investment company taxable income, as defined by the Code. Our policy is to pay out as distributions up to 100% of that amount.

In an effort to avoid certain excise taxes to which RICs are subject, 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 from preceding years that were not distributed during such years.

### ***Revenue Recognition***

#### ***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. Generally, when a loan becomes 90 days or more past due, or if our qualitative assessment indicates that the debtor is unable to service its debt or other obligations, we will place the loan on non-accrual status and cease recognizing interest income on that loan until the borrower has demonstrated the ability and intent to pay contractual amounts due. However, we remain contractually entitled to this interest. Interest payments received on non-accrual loans may be recognized as income or applied to principal, depending upon management's judgment. Non-accrual loans are restored to accrual status when past due principal and interest is paid and, in management's judgment, are likely to remain current, or as a result of a restructuring such that the interest income is deemed to be collectible. At June 30, 2010, one Control investment, ASH, was on non-accrual with a fair value of approximately \$2.1 million, or 1.4% of the fair value of all loans held in our portfolio at June 30, 2010. At March 31, 2010, ASH was on non-accrual with a fair value of approximately \$2.2 million, or 1% of the fair value of all loans held in our portfolio at March 31, 2010. At March 31, 2009, one Control investment was on non-accrual with a fair value of approximately \$2.6 million, or 0.8% of the aggregate fair value of all loans held in our portfolio at March 31, 2009. Currently, we do not have investments that have PIK interest.

Success fees are recorded upon receipt and are contractually due upon a change of control in a portfolio company. The success fees earned during the quarter ended June 30, 2010 included in other income were \$1,957, which resulted from the payoff of A. Stucki. Previously, we had not recorded any success fees. 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. During the quarter ended June 30, 2010, we recorded and collected approximately \$230 of dividends on preferred shares of A. Stucki and accrued and received a special dividend of property valued at \$515 in connection with the A. Stucki sale. No dividend income was recorded during the quarter ended June 30, 2009.

## **RESULTS OF OPERATIONS (dollar amounts in thousands, except per share amounts or unless otherwise indicated)**

### ***Comparison of the Three Months Ended June 30, 2010 to the Three Months Ended June 30, 2009***

#### ***Investment Income***

Total net investment income increased by 72.1% for the three months ended June 30, 2010 as compared to the three months ended June 30, 2009. This increase was due mainly to success fee and dividend income resulting from our exit in A. Stucki, partially offset by a decrease in the size of our loan portfolio, specifically the senior syndicated loans, as compared to the three months ended June 30, 2009.

Interest income from our investments in debt securities decreased for the three months ended June 30, 2010 as compared to the three months ended June 30, 2009 for several reasons. The level of interest income from investments is directly related to the balance, at cost, of the interest-bearing investment portfolio outstanding during the period multiplied by the weighted average yield. The weighted average yield varies from period to period based on the current stated interest rate on interest-bearing investments and the amounts of loans for which interest is not accruing. The weighted average cost basis of our interest-bearing investment portfolio during the quarter ended

**Table of Contents**

June 30, 2010 was approximately \$165.2 million, compared to approximately \$197.8 million for the prior year quarter, due primarily to the aggregate senior syndicated loan sales that occurred during the fiscal year ended March 31, 2010. As of June 30, 2010 and 2009, one loan, ASH Holdings Corp., or ASH, was on non-accrual, with a weighted average cost basis of \$7.8 and \$6.5 million, respectively.

Other income increased significantly due to our sale of A. Stucki. We received \$1,957 in success fee income resulting from our sale of A. Stucki in June 2010. In addition, we recorded and collected approximately \$230 of cash dividends on preferred shares of A. Stucki and we accrued and received a special dividend of property valued at \$515 in connection with the A. Stucki sale. In total, we recorded \$2,702 in other income resulting from the sale of A. Stucki. This is the first time we have recorded success fee income since our inception. No dividend income was recorded during the quarter ended June 30, 2009.

The following table lists the income from investments for our five largest portfolio company investments at fair value during the respective periods:

Company	As of June 30, 2010		Three Months Ended June 30, 2010	
	Fair Value	% of Portfolio	Revenues	% of Total Revenues
A. Stucki Holding Corp.(1)	\$	%	\$ 3,287	45.3%
Chase II Holdings Corp.	29,073	19.6	596	8.2
Galaxy Tool Holding Corp.	17,213	11.6	592	8.2
Cavert II Holding Corp.	16,501	11.1	245	3.4
Acme Cryogenics, Inc.	14,020	9.5	428	5.9
<b>Subtotal five largest investments</b>	<b>76,807</b>	<b>51.8</b>	<b>5,148</b>	<b>71.0</b>
Other portfolio companies	71,522	48.2	2,100	29.0
<b>Total investment portfolio</b>	<b>\$ 148,329</b>	<b>100.0%</b>	<b>\$ 7,248</b>	<b>100.0%</b>

(1) A. Stucki was sold on June 29, 2010.

Company	As of June 30, 2009		Three Months Ended June 30, 2009	
	Fair Value	% of Portfolio	Revenues	% of Total Revenues
A. Stucki Holding Corp.	\$ 43,191	19.0%	\$ 577	11.2%
Chase II Holdings Corp.	38,346	16.9	663	12.8
Acme Cryogenics, Inc.	22,241	9.8	421	8.2
Galaxy Tool Holding Corp.	18,851	8.3	589	11.4

Cavert II Holding Corp.	17,899	7.9	327	6.3
<b>Subtotal five largest investments</b>	<b>140,528</b>	<b>61.9</b>	<b>2,577</b>	<b>49.9</b>
Other portfolio companies	86,481	38.1	2,592	50.1
<b>Total investment portfolio</b>	<b>\$ 227,009</b>	<b>100.0%</b>	<b>\$ 5,169</b>	<b>100.0%</b>

The annualized weighted average yield on our portfolio, excluding cash and cash equivalents, for the three months ended June 30, 2010 was 10.31%, compared to 10.01% for the prior year period. The weighted average yield varies from period to period based on the current stated interest rate on interest-bearing investments and the amounts of loans for which interest is not accruing. The increase in the weighted average yield for the quarter ended June 30, 2010 resulted primarily from our sales of lower interest-bearing senior syndicated loans subsequent to March 31, 2009. The composition of our investment portfolio was primarily Control and Affiliate investments as of June 30, 2010. Due to the sale of A. Stucki and other exits from our portfolio, there has been a significant reduction in our income and capital gain generating assets. While we intend to reinvest our cash as quickly as possible into income and capital gain generating assets, but there is no guarantee that that we will be able to do so.

**Table of Contents***Operating Expenses*

Total operating expenses, excluding any voluntary and irrevocable credits to the base management and incentive fees, increased for the three months ended June 30, 2010, primarily due to the accrual of an incentive fee, partially offset by a reduction in interest expense and deferred financing fees associated with the Credit Facility and a reduction in loan servicing and base management fees, as compared to the prior year period.

Loan servicing fees decreased for the three months ended June 30, 2010, as compared to the prior year period. These fees were incurred in connection with a loan servicing agreement between Business Investment and our Adviser, which is based on the value of the aggregate outstanding balance of eligible loans in our portfolio and were directly credited against the amount of the base management fee due to our Adviser. The decrease in fees is a result of the reduced size of our pledged loan portfolio, caused primarily by the Syndicated Loan Sales.

The base management fee decreased for the three months ended June 30, 2010, as compared to the prior year period, which is reflective of fewer total assets held during the quarter ended June 30, 2010 when compared to the prior year period. Likewise, due to the liquidation of the majority of our syndicated loans, the credit received against the gross base management fee for investments in syndicated loans has also been reduced. An incentive fee was earned by the Adviser during the quarter ended June 30, 2010, due in part to Other income recorded in connection with the A. Stucki sale. The base management and incentive fee is computed quarterly, as described under *Investment Advisory and Management Agreement* in Note 4 of the notes to the accompanying condensed consolidated financial statements and is summarized in the table below:

	<b>Three Months Ended June 30,</b>	
	<b>2010</b>	<b>2009</b>
<b>Average total assets subject to base management fee(1)</b>	\$ 204,800	\$ 276,200
Multiplied by pro-rated annual base management fee of 2%	0.5%	0.5%
<b>Unadjusted base management fee</b>	1,024	1,381
Reduction for loan servicing fees(2)	(824)	(1,068)
<b>Base management fee(2)</b>	\$ 200	\$ 313
<i>Credits to base management fee from Adviser:</i>		
Fee reduction for the waiver of 2% fee on senior syndicated loans to 0.5%	(15)	(183)
Credit for fees received by Adviser from the portfolio companies	(104)	(118)
<b>Credit to base management fee from Adviser</b>	(119)	(301)
<b>Net base management fee</b>	\$ 81	\$ 12
<b>Incentive fee(2)</b>	\$ 1,052	\$

(1)



Average total assets subject to the base management fee is defined as total assets, including investments made with proceeds of borrowings, less any uninvested cash or cash equivalents resulting from borrowings, valued at the end of the four most recently completed quarters and appropriately adjusted for any share issuances or repurchases during the current year.

- (2) Reflected as a line item on the condensed consolidated statement of operations located elsewhere in this prospectus.

Interest expense decreased for the quarter ended June 30, 2010, as compared to the prior year period primarily due to decreased borrowings under the Credit Facility, partially offset by increased borrowing costs, during the quarter ended June 30, 2010. The weighted average balance outstanding on our line of credit during the quarter ended June 30, 2010 was approximately \$11.0 million, as compared to \$41.9 million in the prior year period, a decrease of 73.7%. The effective interest rate, excluding the impact of deferred financing fees, charged on our borrowings increased under our Credit Facility during the quarter ended June 30, 2010 to 9.83%, up from 6.70% under our Prior Credit Facility utilized during the prior year period.

**Table of Contents**

We incurred significant one-time costs related to the termination of our prior credit facility and transition to our Credit Facility, resulting in increased amortization of deferred financing fees during the quarter ended June 30, 2009 when compared to the quarter ended June 30, 2010.

*Realized and Unrealized Gain (Loss) on Investments****Realized Gains (Losses)***

During the three months ended June 30, 2010, we exited our largest portfolio investment, A. Stucki, for \$52.3 million in total proceeds and a realized gain of \$17.0 million. During the three months ended June 30, 2009, we exited 29 of the 32 senior syndicated loans for aggregate proceeds of approximately \$69.2 million in cash and recorded a realized loss of approximately \$34.6 million. The realized losses are attributable to liquidity needs from the Syndicated Loan Sales associated with the repayment of amounts outstanding under our prior credit facility with Deutsche Bank, which matured in April 2009.

***Unrealized (Depreciation) Appreciation***

Net unrealized (depreciation) appreciation of investments is the net change in the fair value of our investment portfolio during the reporting period, including the reversal of previously-recorded unrealized appreciation or depreciation when gains and losses are actually realized. During the quarter ended June 30, 2010, we recorded net unrealized depreciation of investments in the aggregate amount of \$15.8 million, which included the reversal of \$17.4 million in unrealized appreciation related to the A. Stucki sale during the quarter. Excluding reversals, we had \$1.6 million in net unrealized appreciation for the quarter ended June 30, 2010. During the prior year period, we had net unrealized appreciation of investments in the aggregate amount of \$23.0 million, which included the reversal of \$34.4 million in unrealized depreciation related to the Syndicated Loan Sales during the quarter. Excluding reversals, we had \$11.4 million in net unrealized depreciation for the quarter ended June 30, 2009. The unrealized appreciation (depreciation) across our investments for the three months ended June 30, 2010 was as follows:

<b>Three Months Ended June 30, 2010</b>		
<b>Portfolio Company</b>	<b>Investment Classification</b>	<b>Net Unrealized Appreciation (Depreciation)</b>
Cavert II Holdings Corp.	Control	645
Survey Sampling, LLC	Non-Control / Non-Affiliate	367
Chase II Holdings Corp.	Control	287
Quench Holdings Corp.	Affiliate	276
Galaxy Tool Holding Corp.	Control	(156)
A. Stucki Holding Corp.	Control	(17,405)(1)
Other (<\$100)		188
<b>Total:</b>		<b>\$ (15,798)</b>

(1) Reflects the reversal of the unrealized appreciation in connection with the \$17.0 million realized gain on the sale of A. Stucki.

The primary changes in our net unrealized depreciation for the quarter ended June 30, 2010 was the reversal of previously-recorded unrealized appreciation on our A. Stucki sale. Noteworthy appreciation was experienced in our equity holdings of Cavert II Holdings Corp., Quench Holdings Corp. and Chase II Holdings Corp., as well as in our debt position of Survey Sampling, LLC. Certain depreciation occurred in our debt holdings, most notably in Galaxy. Excluding reversals, the unrealized appreciation recognized on our portfolio investments was primarily due to an increase in certain comparable multiples and, to a lesser extent, the performance of some of our portfolio companies used to estimate the fair value of our investments.

**Table of Contents**

The unrealized appreciation (depreciation) across our investments for the three months ended June 30, 2009 was as follows:

<b>Three Months Ended June 30, 2009</b>		
<b>Portfolio Company</b>	<b>Investment Classification</b>	<b>Net Unrealized Appreciation (Depreciation)</b>
Aggregate Non-Proprietary Investments	Non-Control / Non-Affiliate	\$ 36,591(1)
Acme Cryogenics, Inc.	Control	820
ASH Holdings Corp.	Control	443
Cavert II Holdings Corp.	Control	330
B-Dry, LLC	Non-Control / Non-Affiliate	138
Tread Corp.	Affiliate	(220)
Mathey Investments, Inc.	Affiliate	(631)(2)
Quench Holdings Corp.	Affiliate	(651)
Danco Acquisition Corp.	Affiliate	(841)
Chase II Holdings Corp.	Control	(2,219)
A. Stucki Holding Corp.	Control	(3,546)
Galaxy Tool Holding Corp.	Control	(3,586)
Country Club Enterprises, LLC	Control	(3,725)
Other (<\$100)		78
<b>Total:</b>		<b>\$ 22,981</b>

(1) Includes the reversal of approximately \$34.4 million of previously-recorded unrealized depreciation relating to Syndicated Loan Sales during the quarter ended June 30, 2009, as well as the net unrealized appreciation experienced during the quarter on non-proprietary investments held at June 30, 2009.

(2) Investment was reclassified from an Affiliate investment to a Control investment in the third quarter of the fiscal year ended March 31, 2010.

The primary change in our net unrealized appreciation for the quarter ended June 30, 2009 was the reversal of previously-recorded unrealized depreciation on our Syndicated Loan Sales. Significant depreciation was experienced in our equity holdings of Country Club Enterprises, LLC, Galaxy, A. Stucki and Chase II Holdings Corp. Excluding reversals, the unrealized depreciation recognized on our portfolio investments was primarily due to a decrease in certain comparable multiples and, to a lesser extent, the performance of some of our portfolio companies used to estimate the fair value of our investments.

Over our entire investment portfolio, we recorded an aggregate of approximately \$0.3 million of net unrealized appreciation on our debt positions for the quarter ended June 30, 2010, while our equity holdings experienced an aggregate of approximately \$16.1 million of net unrealized depreciation. At June 30, 2010, the fair value of our investment portfolio was less than the cost basis of our portfolio by approximately \$36.5 million, as compared to \$20.7 million at March 31, 2010, representing net unrealized depreciation of \$15.8 million for the period. We believe that our aggregate investment portfolio was valued at a depreciated value due primarily to the general instability of the

loan markets and resulting decrease in market multiples relative to where multiples were when we originated the investments in our portfolio. Even though valuations have stabilized over the past two quarters, our entire portfolio was fair valued at 80.2% of cost as of June 30, 2010. The unrealized depreciation of our investments does not have an impact on our current ability to pay distributions to stockholders; however, it may be an indication of future realized losses, which could ultimately reduce our income available for distribution.

*Net Increase (Decrease) in Net Assets Resulting from Operations*

For the quarter ended June 30, 2010, we recorded a net increase in net assets resulting from operations of \$5.4 million as a result of the factors discussed above. For the quarter ended June 30, 2009, we recorded a net

**Table of Contents**

decrease in net assets resulting from operations of \$9.2 million. Our net increase (decrease) in net assets resulting from operations per basic and diluted weighted average common share for the quarters ended June 30, 2010 and 2009 were \$0.24 and (\$0.42), respectively.

**Comparison of the Fiscal Year Ended March 31, 2010 to the Fiscal Year Ended March 31, 2009***Investment Income*

Total investment income decreased by 19.5% for the year ended March 31, 2010 as compared to the prior year. This decrease was due mainly to a decrease in the size of our loan portfolio, specifically the senior syndicated loans, as well as continuing decreases in LIBOR, as compared to the year ended March 31, 2009.

Interest income from our investments in debt securities decreased for the year ended March 31, 2010 as compared to the prior year several reasons. The level of interest income from investments is directly related to the balance, at cost, of the interest-bearing investment portfolio outstanding during the period multiplied by the weighted average yield. The weighted average yield varies from period to period based on the current stated interest rate on interest-bearing investments and the amounts of loans for which interest is not accruing. The weighted average cost basis of our interest-bearing investment portfolio during the year ended March 31, 2010 was approximately \$179.2 million, compared to approximately \$297.5 million for the prior year, due primarily to the aggregate senior syndicated loan sales that occurred during the current fiscal year ended March 31, 2010. The weighted average cost basis of loans on non-accrual for the years ended March 31, 2010 and 2009 was \$6.6 million and \$12.0 million, respectively. The decrease in the non-accrual amount is due to the write-off of two additional loans in the prior year that were on non-accrual during fiscal year 2009. As of March 31, 2010, one loan, ASH Holdings Corp., was on non-accrual.

Also contributing to the decrease in our interest income from investments in debt securities was a decrease in the average LIBOR between the two fiscal years, which was approximately 0.28% for the year ended March 31, 2010, as compared to 1.96% for the prior year.

The following table lists the interest income from investments for our five largest portfolio company investments at fair value during the respective periods:

Company	As of March 31, 2010		Year Ended March 31, 2010	
	Fair Value	% of Portfolio	Revenues	% of Total Revenues
A. Stucki Holding Corp.	\$ 50,379	24.3%	\$ 3,246	15.6%
Chase II Holdings Corp.	29,101	14.1	2,545	12.2
Cavert II Holding Corp.	18,731	9.1	1,204	5.8
Galaxy Tool Holding Corp.	17,099	8.3	2,361	11.4
Danco Acquisition Corp.	13,953	6.7	1,661	8.0
<b>Subtotal five largest investments</b>	<b>129,263</b>	<b>62.5</b>	<b>11,017</b>	<b>53.0</b>
Other portfolio companies	77,595	37.5	9,768	47.0
<b>Total investment portfolio</b>	<b>\$ 206,858</b>	<b>100.0%</b>	<b>\$ 20,785</b>	<b>100.0%</b>



**Table of Contents**

Company	As of March 31, 2009		Year Ended March 31, 2009	
	Fair Value	% of Portfolio	Revenues	% of Total Revenues
A. Stucki Holding Corp.	\$ 49,431	15.8%	\$ 2,716	10.5%
Chase II Holdings Corp.	40,880	13.0	2,811	10.9
Galaxy Tool Holding Corp.	22,437	7.2	1,436	5.6
Acme Cryogenics, Inc.	21,420	6.8	1,691	6.6
Cavert II Holding Corp.	18,632	5.9	1,587	6.1
<b>Subtotal five largest investments</b>	<b>152,800</b>	<b>48.7</b>	<b>10,241</b>	<b>39.7</b>
Other portfolio companies	161,130	51.3	15,571	60.3
<b>Total investment portfolio</b>	<b>\$ 313,930</b>	<b>100.0%</b>	<b>\$ 25,812</b>	<b>100.0%</b>

The annualized weighted average yield on our portfolio, excluding cash and cash equivalents, for the year ended March 31, 2010 was 11.02%, compared to 8.22% for the prior year. The weighted average yield varies from period to period based on the current stated interest rate on interest-bearing investments and the amounts of loans for which interest is not accruing. The increase in the weighted average yield for the current year ended March 31, 2010 resulted primarily from our sales of lower interest-bearing senior syndicated loans subsequent to March 31, 2009. The composition of our investment portfolio is primarily Control and Affiliate investments as of March 31, 2010.

Other income increased for the year ended March 31, 2010, as compared the prior year, due to the receipt of approximately \$953 of dividends from our preferred equity investment in A. Stucki. The prior year balance was due to dividends received during the restructuring of our investment in Quench Holdings Corp. The remaining balance in other income is comprised of other miscellaneous income amounts.

*Operating Expenses*

Total operating expenses, excluding any voluntary and irrevocable credits to the base management and incentive fees, decreased for the year ended March 31, 2010, primarily due to a reduction in interest expense associated with the Credit Facility, as well as an overall decrease in the amount of fees due to our Adviser, partially offset by an increase in deferred financing fees related to the Credit Facility entered into in April 2009, as compared to the prior year.

Loan servicing fees decreased for the year ended March 31, 2010, as compared to the prior year. These fees were incurred in connection with a loan servicing agreement between Business Investment and our Adviser, which is based on the value of the aggregate outstanding balance of eligible loans in our portfolio, and were directly credited against the amount of the base management fee due to our Adviser. The decrease in fees is a result of the reduced size of our pledged loan portfolio, caused primarily by the Syndicated Loan Sales.

The base management fee decreased for the year ended March 31, 2010, as compared to the prior year, which is reflective of fewer total assets held during the 2010 fiscal year when compared to the prior year. Likewise, due to the liquidation of the majority of our syndicated loans, the credit received against the gross base management fee for investments in syndicated loans has also been reduced. The base management fee is computed quarterly, as





**Table of Contents**

described under *Investment Advisory and Management Agreement* in Note 4 of the notes to the accompanying consolidated financial statements and is summarized in the table below:

	<b>Year Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
<b>Average total assets subject to base management fee(1)</b>	\$ 224,200	\$ 335,050
Multiplied by annual base management fee of 2%	2%	2%
<b>Unadjusted base management fee</b>	4,484	6,701
Reduction for loan servicing fees(2)	(3,747)	(5,002)
<b>Base management fee(2)</b>	\$ 737	\$ 1,699
<i>Credits to base management fee from Adviser:</i>		
Fee reduction for the waiver of 2% fee on senior syndicated loans to 0.5%	(291)	(1,613)
Credit for fees received by Adviser from the portfolio companies	(433)	(861)
<b>Credit to base management fee from Adviser</b>	(724)	(2,474)
<b>Net base management fee</b>	\$ 13	\$ (775)
<b>Incentive fee(2)</b>	\$ 588	\$
Credit from voluntary, irrevocable waiver issued by Adviser's board of directors	(102)	
<b>Net incentive fee</b>	\$ 486	\$
<b>Total credits to fees:</b>		
Fee reduction for the voluntary, irrevocable waiver of 2% fee on senior syndicated loans to 0.5%	\$ (291)	\$ (1,613)
Credit for fees received by Adviser from portfolio companies	(433)	(861)
Incentive fee credit	(102)	
<b>Credit to base management and incentive fees from Adviser(2)</b>	\$ (826)	\$ (2,474)

(1) Average total assets subject to the base management fee is defined as total assets, including investments made with proceeds of borrowings, less any uninvested cash or cash equivalents resulting from borrowings, valued at the end of the four most recently completed quarters and appropriately adjusted for any share issuances or repurchases during the current year.

(2) Reflected as a line item on the consolidated statement of operations located elsewhere in this prospectus.

For the first time since our inception, an incentive fee was earned by the Adviser during the third quarter of the year ended March 31, 2010, due in part to a one-time dividend received from A. Stucki.

The administration fee decreased for the year ended March 31, 2010, as compared the prior year. This decrease was also a result of fewer total assets held during the year ended March 31, 2010 in relation to the other funds administered by our Administrator, as compared to the prior year. The calculation of the administration fee is described in detail under *Administration Agreement* in Note 4 of the notes to the accompanying consolidated financial statements.

Interest expense decreased for the year ended March 31, 2010, as compared to the prior year primarily due to decreased borrowings under the Credit Facility, partially offset by increased borrowing costs, during the year ended March 31, 2010. The weighted average balance outstanding on our line of credit during the year ended March 31, 2010 was approximately \$25.8 million, as compared to \$107.4 million in the prior year, a decrease of 76%. The effective interest rate, excluding the impact of deferred financing fees, charged on our borrowings increased under our Credit Facility during the year ended March 31, 2010 to 7.59%, up from 4.98% under our Prior Credit Facility utilized during the prior fiscal year.

**Table of Contents**

We incurred significant one-time costs related to the termination of our Prior Credit Facility and transition to our Credit Facility, resulting in increased amortization of deferred financing fees during the year ended March 31, 2010 when compared to the prior year.

*Realized and Unrealized (Loss) Gain on Investments***Realized Losses**

During the year ended March 31, 2010, we exited 30 senior syndicated loans and a portion of another senior syndicated loan for aggregate proceeds of approximately \$74.7 million in cash and recorded a realized loss of approximately \$35.9 million. For the year ended March 31, 2009, we recognized a net loss on ten sales and three early exits of senior syndicated loans in the aggregate amount of approximately \$5.0 million. The increase in realized losses is attributable to the Syndicated Loan Sales, which resulted from the liquidity needs associated with the repayment of amounts outstanding under our Prior Credit Facility that matured in April 2009.

**Unrealized Appreciation and Depreciation**

Net unrealized appreciation (depreciation) of investments is the net change in the fair value of our investment portfolio during the reporting period, including the reversal of previously recorded unrealized appreciation or depreciation when gains and losses are actually realized. During the year ended March 31, 2010, we recorded net unrealized appreciation of investments in the aggregate amount of \$14.3 million, which included the reversal of \$35.7 million in unrealized depreciation related to sales during the year. Excluding reversals, we had \$21.4 million in net unrealized depreciation for the year ended March 31, 2010. During the prior year, we had net unrealized depreciation of investments in the aggregate amount of \$19.8 million. The unrealized appreciation (depreciation) across our investments for the year ended March 31, 2010 was as follows:

<b>Year Ended March 31, 2010</b>		
<b>Portfolio Company</b>	<b>Investment Classification</b>	<b>Net Unrealized Appreciation (Depreciation)</b>
Aggregate Non-Proprietary Investments	Non-Control / Non-Affiliate	\$ 37,997(1)
Cavert II Holding Corp.	Control	3,162
A.Stucki Holding Corp.	Control	2,773
Quench Holdings Corp.	Affiliate	1,032
B-Dry, LLC	Non-Control / Non-Affiliate	370
ASH Holdings Corp.	Control	(684)
Mathey Investments, Inc.	Control	(838)(2)
Tread Corp.	Affiliate	(1,227)
Danco Acquisition Corp.	Affiliate	(1,875)
Noble Logistics, Inc.	Affiliate	(2,251)
Country Club Enterprises, LLC	Control	(3,856)
Galaxy Tool Holding Corp.	Control	(5,338)
Chase II Holdings Corp.	Control	(7,124)
Acme Cryogenics, Inc.	Control	(7,836)
<b>Total:</b>		<b>\$ 14,305</b>

- (1) Includes the reversal of approximately \$35.7 million of previously-recorded unrealized depreciation relating to loans sold during the year ended March 31, 2010, as well as the net unrealized appreciation experienced during the year on Non-Control/Non-Affiliate investments held at March 31, 2010.
- (2) Investment was reclassified from an Affiliate investment to a Control investment in the third quarter of the year ended March 31, 2010. Net unrealized depreciation of \$838 includes \$260 of unrealized appreciation recorded

**Table of Contents**

while classified as an Affiliate investment and \$1,098 of unrealized depreciation recorded while classified as a Control investment.

The primary driver of our net unrealized appreciation for the year ended March 31, 2010 was the reversal of previously-recorded unrealized depreciation on our senior syndicated loan sales. Significant appreciation was also experienced in our equity holdings of Cavert and A. Stucki, as well as in our debt position of Interstate FiberNet. Substantial depreciation occurred in our equity holdings of several Control and Affiliate investments, most notably Chase, Acme Cryogenics, Galaxy Tool, and Country Club Enterprises. The unrealized depreciation recognized on our portfolio investments was due predominantly to a reduction in certain comparable multiples and, to a lesser extent, the performance of some of our portfolio companies used to estimate the fair value of our investments.

The unrealized appreciation (depreciation) across our investments for the year ended March 31, 2009 was as follows:

Portfolio Company	Year Ended March 31, 2009	
	Investment Classification	Net Unrealized Appreciation (Depreciation)
A.Stucki Holding Corp.	Control	\$ 4,339
Chase II Holdings Corp.	Control	2,874
ASH Holdings Corp.	Control	1,101
Galaxy Tool Holding Corp.	Control	1,027
Tread Corp.	Affiliate	418
Quench Holdings Corp.	Affiliate	392(1)
Cavert II Holding Corp.	Control	384
Mathey Investments, Inc.	Affiliate	(260)
B-Dry, LLC	Non-Control / Non-Affiliate	(617)
Danco Acquisition Corp.	Affiliate	(1,908)
Acme Cryogenics, Inc.	Control	(4,143)
Noble Logistics, Inc.	Affiliate	(7,620)
Aggregate Non-Proprietary Investments	Non-Control / Non-Affiliate	(15,801)
<b>Total:</b>		<b>\$ (19,814)</b>

- (1) Investment was reclassified from a Control investment to an Affiliate investment in the second quarter of fiscal year 2009. Net unrealized appreciation of \$392 includes \$3,447 of unrealized depreciation recorded while classified as a Control investment and \$3,055 of unrealized appreciation recorded while classified as an Affiliate investment.

The primary driver of our net unrealized depreciation the year ended March 31, 2009 was the decline in value of our senior syndicated loans, which depreciated by \$14.9 million, as well as significant decreases in value of our equity holdings in Acme and our overall investment in Noble Logistics. Partially offsetting these declines were sizeable appreciations in our equity holdings of A. Stucki, Chase, and Quench.

Over our entire investment portfolio, we recorded an aggregate of approximately \$35.1 million of net unrealized appreciation on our debt positions for the year ended March 31, 2010, while our equity holdings experienced an

aggregate of approximately \$20.8 million of net unrealized depreciation. At March 31, 2010, the fair value of our investment portfolio was less than the cost basis of our portfolio by approximately \$20.7 million, as compared to \$35.0 million at March 31, 2009, representing net unrealized appreciation of \$14.3 million for the period. We believe that our aggregate investment portfolio was valued at a depreciated value due primarily to the general instability of the loan markets and resulting decrease in market multiples. Due to the continued devaluations over the past year on our equity investments, our entire portfolio was fair valued at 90.9% of cost as of March 31, 2010. The unrealized depreciation of our investments does not have an impact on our current ability to pay

**Table of Contents**

distributions to stockholders; however, it may be an indication of future realized losses, which could ultimately reduce our income available for distribution.

*Net Decrease in Net Assets Resulting from Operations*

For the year ended March 31, 2010, we recorded a net decrease in net assets resulting from operations of \$11.1 million as a result of the factors discussed above. For the year ended March 31, 2009, we recorded a net decrease in net assets resulting from operations of \$11.4 million. Our net decrease in net assets resulting from operations per basic and diluted weighted average common share for the years ended March 31, 2010 and 2009 were \$0.50 and \$0.53, respectively.

***Comparison of the Fiscal Year Ended March 31, 2009 to the Fiscal Year Ended March 31, 2008***

*Investment Income*

Investment income decreased for the year ended March 31, 2009, as compared to the year ended March 31, 2008, due mainly to a reduction in the size of our loan portfolio, as well as decreases in LIBOR over the respective periods.

Interest income from our investments in debt securities decreased for the year ended March 31, 2009, as compared to the prior year for several reasons. The level of interest income from investments is directly related to the balance, at cost, of the interest-bearing investment portfolio outstanding during the period multiplied by the weighted average yield. The weighted average yield varies from period to period based on the current stated interest rate on interest-bearing investments and the amounts of loans for which interest is not accruing. The decline in interest income from our debt securities was primarily due to the decrease in the weighted average yield of our portfolio, attributable mainly to a reduction in the average LIBOR during the comparable time periods, which was approximately 1.96% for the year ended March 31, 2009, compared to 4.74% in the prior year.

Interest income from Non-Control/Non-Affiliate investments decreased for the year ended March 31, 2009, as compared to the prior year. This decrease was the result of an overall decrease in the number of Non-Control/Non-Affiliate investments held at March 31, 2009 compared to the prior year, primarily due to sales and settlements of syndicated loans subsequent to March 31, 2008. This decrease was further accentuated by drops in LIBOR, due to the instability and tightening of the credit markets.

Interest income from Control investments increased slightly for the year ended March 31, 2009 compared to the prior year. The increase is attributable to the acquisition of two additional Control investments, Galaxy Tool Holding Corp. and Country Club Enterprises, LLC, purchased during the year ended March 31, 2009 as compared to the prior year; however, this increase was partially offset by the reclassification of Quench, a Control investment at March 31, 2008, as an Affiliate investment in the second quarter of fiscal year 2009. Decreases in LIBOR during the fiscal year ended March 31, 2009 played a minimal role in interest income from our proprietary deals, as the majority of them include interest rate floors to protect against such circumstances.

Interest income from Affiliate investments also increased for the year ended March 31, 2009, as compared to the prior year. This increase was due mainly to the reclassification of Quench Holdings Corp. as an Affiliate investment, as noted above, and the additional interest income accrued under the Affiliate investments classification as a result.

The interest-bearing investment portfolio had an average cost basis of approximately \$297.5 million for the year ended March 31, 2009, as compared to an average cost basis of \$292.9 million for the year ended March 31,





**Table of Contents**

2008. The following table lists the interest income from investments for the five largest portfolio company investments at fair value during the respective periods:

Company	As of March 31, 2009		Year Ended March 31, 2009	
	Fair Value	% of Portfolio	Revenues	% of Total Revenues
	A. Stucki Holding Corp.	\$ 49,431	15.8%	\$ 2,716
Chase II Holdings Corp.	40,880	13.0	2,811	10.9
Galaxy Tool Holding Corp.	22,437	7.2	1,436	5.6
Acme Cryogenics, Inc.	21,420	6.8	1,691	6.6
Cavert II Holding Corp.	18,632	5.9	1,587	6.1
<b>Subtotal five largest investments</b>	<b>152,800</b>	<b>48.7</b>	<b>10,241</b>	<b>39.7</b>
Other portfolio companies	161,130	51.3	15,571	60.3
<b>Total investment portfolio</b>	<b>\$ 313,930</b>	<b>100.0%</b>	<b>\$ 25,812</b>	<b>100.0%</b>

Company	As of March 31, 2008		Year Ended March 31, 2008	
	Fair Value	% of Portfolio	Revenues	% of Total Revenues
	A. Stucki Holding Corp.	\$ 44,687	13.3%	\$ 3,377
Chase II Holdings Corp.	39,151	11.7	3,026	10.8
Acme Cryogenics, Inc.	25,563	7.6	1,695	6.1
Cavert II Holding Corp.	21,348	6.4	740	2.7
Noble Logistics, Inc.	18,532	5.5	1,518	5.4
<b>Subtotal five largest investments</b>	<b>149,281</b>	<b>44.5</b>	<b>10,356</b>	<b>37.1</b>
Other portfolio companies	186,324	55.5	17,538	62.9
<b>Total investment portfolio</b>	<b>\$ 335,604</b>	<b>100.0%</b>	<b>\$ 27,894</b>	<b>100.0%</b>

The annualized weighted average yield on our portfolio, excluding cash and cash equivalents, for the year ended March 31, 2009 was 8.22%, compared to 8.91% for the prior year. The decrease in the weighted average yield resulted primarily from a reduction in the average LIBOR, due to the instability and tightening of the credit markets.

Interest income from invested cash and cash equivalents decreased for the year ended March 31, 2009 as compared to the prior year. This decrease is a result of lower interest rates offered by banks, as this income is derived mainly from

interest earned on overnight sweeps of cash held at financial institutions, in addition to us using the proceeds from repayments on outstanding loans during the year to pay down our line of credit.

Other income increased for the year ended March 31, 2009, as compared to the prior year period, due to dividends received during the restructuring of our investment in Quench Holdings Corp. during August 2008.

*Operating Expenses*

Total operating expenses, excluding any voluntary and irrevocable credits to the base management fee and incentive fees, decreased for the year ended March 31, 2009 as compared to the prior year, primarily due to a reduction in interest costs associated with our line of credit, as well as a decrease in the amount of deferred financing costs that were fully amortized during the fiscal year ended March 31, 2009.

Loan servicing fees remained relatively flat for the year ended March 31, 2009 when compared to the prior year. These fees were incurred in connection with a loan servicing agreement between Business Investment and our Adviser, which is based on the value of the aggregate outstanding portfolio pledged against the credit facilities. These fees were directly credited against the amount of the base management fee due to our Adviser. The

**Table of Contents**

consistency in loan servicing fees is the result of similar balances in our portfolio of loans being serviced by our Adviser during the comparable years.

The base management fee decreased for the year ended March 31, 2009, as compared to the prior year period, which is reflective of fewer total assets held during the year ended March 31, 2009 when compared to the prior fiscal year. The base management fee is computed quarterly, as described under *Investment Advisory and Management Agreement* in Note 4 of the notes to the consolidated financial statements and is summarized in the table below:

	<b>2009</b>	<b>2008</b>
<b>Average total assets subject to base management fee(1)</b>	\$ 335,050	\$ 340,850
Multiplied by annual base management fee of 2%	2%	2%
<b>Unadjusted base management fee</b>	6,701	6,817
Reduction for loan servicing fees(2)	(5,002)	(5,014)
<b>Base management fee(2)</b>	1,699	1,803
<i>Credits to base management fee from Adviser:</i>		
Fee reduction for the waiver of 2% fee on senior syndicated loans to 0.5%	(1,613)	(1,764)
Credit for fees received by Adviser from the portfolio companies	(861)	(1,045)
<b>Credit to base management fee from Adviser(2)</b>	(2,474)	(2,809)
<b>Net base management fee</b>	\$ (775)	\$ (1,006)

(1) Average total assets subject to the base management fee is defined as total assets, including investments made with proceeds of borrowings, less any uninvested cash or cash equivalents resulting from borrowings, valued at the end of the four most recently completed quarters and appropriately adjusted for any share issuances or repurchases during the current year.

(2) Reflected as a line item on the consolidated statement of operations located elsewhere in this prospectus.

The administration fees payable to our Administrator decreased slightly for the year ended March 31, 2009 as compared to the prior year period. 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, and their respective staffs. Our allocable portion of expenses is derived by multiplying the total expenses by the percentage of our average assets (the assets at the beginning 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. This decrease was attributable to a modest decrease in our total assets in relation to the other funds serviced by our Administrator during the fiscal year ended March 31, 2008.

Interest expense decreased for the year ended March 31, 2009 as compared to the prior year as a direct result of decreased borrowings under our line of credit during the fiscal year ended March 31, 2009 as compared to the prior fiscal year. While there was an increase in the interest rate margin charged on the outstanding borrowings upon

renewing the facility during October 2009, the overall LIBOR base rate decrease during the period offset this interest rate margin increase.

Other operating expenses for the year ended March 31, 2009 (including amortization of deferred financing fees, professional fees, stockholder related costs, insurance expense, directors' fees, and other direct expenses) decreased slightly over the prior year, driven primarily by lower deferred financing fee amortization than in the prior year, as amortization of costs incurred in connection with the previous line of credit were fully realized by October 2008.

*Realized and Unrealized (Loss) Gain on Investments*

For the year ended March 31, 2009, we recognized a net loss on ten sales and three premature exits of senior syndicated loans in the aggregate amount of \$5.0 million, and we recorded net unrealized depreciation of investments in the aggregate amount of \$19.8 million. At March 31, 2008, we recognized a net loss on the sale

## **Table of Contents**

of 17 syndicated loans in the aggregate amount of \$2.4 million, and we recorded net unrealized depreciation of investments in the aggregate amount of \$11.5 million.

At March 31, 2009, the fair value of our investment portfolio was less than the cost basis of our portfolio by approximately \$35.0 million, as compared to \$15.2 at March 31, 2008, representing net unrealized depreciation of \$19.8 million for the year. The majority of our unrealized depreciation for the year occurred in our senior syndicated loans, which decreased in value by \$14.9 million during the fiscal year, primarily as a result of the pending consummation of the Syndicated Loan Sales. The most significant losses occurred in Interstate FiberNet, LVI Services, Generac, CRC Health Group, PTS Acquisition Corp., and Network Solutions, all of which were sold subsequent to March 31, 2009. Our Affiliate investments also experienced an overall devaluation, driven primarily by losses on Noble Logistics and on our debt and equity portions of Quench and Danco, respectively. Slightly offsetting this was an appreciation in the value of our equity held in Quench. We valued the debt portion of bundled debt and equity investments in non-controlled companies in accordance with board approved valuation policies, which valued the debt securities through the use of a liquidity waterfall approach. Consistent with our Board of Directors ongoing review and analysis of appropriate valuation policies, and in conjunction with our adoption of ASC 820 on April 1, 2008, our Board of Directors modified our valuation procedures so that the debt portion of bundled investments in non-controlled companies is valued by SPSE, which change had a positive impact on net unrealized appreciation in the amount of approximately \$8.5 million for the fiscal year ended March 31, 2009. Our Control investments, however, performed quite well, appreciating in value by an aggregate of approximately \$5.6 million during the fiscal year. This increase was led by our equity positions in A. Stucki, Chase and Galaxy Tools, as well as an increase in the fair market value of the debt portion of ASH, which previously had no fair value. Countering this appreciation in value was an unrealized loss in the equity of Acme Cryogenics, which depreciated in fair value by approximately \$4.1 million.

Although our investment portfolio had depreciated, our entire portfolio was fair valued at 90% of the cost of the investments as of March 31, 2009. We believe that the depreciation was due primarily to the general instability of the loan markets. The unrealized depreciation of our investments does not have an impact on our current ability to pay distributions to stockholders; however, it may be an indication of future realized losses, which could ultimately reduce our income available for distribution. The Syndicated Loan Sales, for example, resulted in a realized loss of approximately \$34.6 million.

### *Net Decrease in Net Assets Resulting from Operations*

For the year ended March 31, 2009, we recorded a net decrease in net assets resulting from operations of \$11.4 million as a result of the factors discussed above. Our net decrease in net assets resulting from operations per basic and diluted weighted average common share for the years ended March 31, 2009 and 2008 were \$0.53 and \$0.06, respectively. For the year ended March 31, 2008, we recorded a net decrease in net assets resulting from operations of \$0.9 million. We will continue to incur base management fees, which are likely to increase to the extent our investment portfolio grows, and we may begin to incur incentive fees. The administrative fee payable to our Administrator is also likely to grow during future periods to the extent our average total assets grow in comparison to prior periods and as the expenses incurred by our Administrator to support our operations increase.

## **LIQUIDITY AND CAPITAL RESOURCES (dollar amounts in thousands, except per share amounts or unless otherwise indicated)**

### *Operating Activities*

At June 30, 2010, we had investments in equity of, loans to, or syndicated participations in, 15 private companies with an aggregate cost basis of approximately \$184.8 million. At June 30, 2009, we had investments in equity of, loans to,

or syndicated participations in, 17 private companies with an aggregate cost basis of

**Table of Contents**

approximately \$239.0 million. The following table summarizes our total portfolio investment activity during the quarters ended June 30, 2010 and 2009:

	<b>Quarter Ended June 30,</b>	
	<b>2010</b>	<b>2009</b>
Beginning investment portfolio, at fair value	\$ 206,858	\$ 313,930
New investments	95	
Disbursements to existing investments	744	650
Scheduled principal repayments	(836)	(2,004)
Unscheduled principal repayments	(38,749)	(4,721)
Amortization of premiums and discounts	(2)	
Proceeds from sales	(21,474)	(69,222)
Net realized gain (loss)	16,976	(34,605)
Net unrealized (depreciation) appreciation(1)	(15,798)	22,981
Other non-cash activity, net	515	
<b>Ending investment portfolio, at fair value</b>	<b>\$ 148,329</b>	<b>\$ 227,009</b>

(1) Includes the reversal of unrealized (appreciation) depreciation due to investment exits for the quarters ended June 30, 2010 and 2009 of (\$17.4) and \$34.4 million, respectively.

During the three months ended June 30, 2010, we exited our largest portfolio investment, A. Stucki, for \$52.3 million in total proceeds and a realized gain of \$17.0 million. During the three months ended June 30, 2009, we exited 29 of the 32 senior syndicated loans for aggregate proceeds of approximately \$69.2 million in cash and recorded a realized loss of approximately \$34.6 million. The realized losses are attributable to liquidity needs from the Syndicated Loan Sales associated with the repayment of amounts outstanding under our Prior Credit Facility, which matured in April 2009.

At March 31, 2010, we had investments in equity of, loans to, or syndicated participations in, 16 private companies with an aggregate cost basis of approximately \$227.6 million. At March 31, 2009, we had investments in equity of, loans to or syndicated participations in 46 private companies with an aggregate cost basis of approximately \$348.9 million. The following table summarizes our total portfolio investment activity during the years ended March 31, 2010 and 2009:

	<b>Year Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
Beginning investment portfolio at fair value	\$ 313,930	\$ 335,604
New investments	4,788	53,002
Principal repayments	(15,534)	(35,871)
Proceeds from sales	(74,706)	(13,914)
Net unrealized appreciation (depreciation)(2)	14,305	(19,814)
Net realized loss	(35,923)	(5,023)
Amortization of premiums and discounts	(2)	(54)



<b>Ending investment portfolio at fair value</b>	<b>\$ 206,858</b>	\$ 313,930
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(2) Includes the reversal of unrealized depreciation due to investment exits for the years ended March 31, 2010 and 2009 of \$35.7 and \$6.1 million, respectively.

**Table of Contents**

During the years ended March 31, 2010 and 2009, the following investment activity occurred during each quarter of the respective fiscal year:

Quarter Ended	Investment Disbursements(1)	Principal Repayments(2)	Proceeds from Sales/Exits(3)	Net Loss on Disposal
June 30, 2009	\$ 1,500(a)	\$ 7,575(a)	\$ 69,222	\$ (34,605)
September 30, 2009	318	2,757		
December 31, 2009	595	4,496	5,484	(1,318)
March 31, 2010	2,375	706		
<b>Total fiscal year 2010</b>	<b>\$ 4,788</b>	<b>\$ 15,534</b>	<b>\$ 74,706</b>	<b>\$ (35,923)</b>
June 30, 2008	\$ 8,980	\$ 3,493	\$ 13,227	\$ (1,718)
September 30, 2008	27,632	18,841		(2,498)
December 31, 2008	11,043	4,469		
March 31, 2009	5,347(b)	9,068(b)	687	(807)
<b>Total fiscal year 2009</b>	<b>\$ 53,002</b>	<b>\$ 35,871</b>	<b>\$ 13,914</b>	<b>\$ (5,023)</b>

- (a) Includes a non-cash transaction whereby a portfolio company, Cavert II Holdings Corp., drew \$850 on its revolving line of credit and immediately used the proceeds to pay down its senior term A and senior term B loans. No cash was disbursed in this transaction, as it was simply a transfer of balance. The \$850 drawn on the credit line was subsequently paid off in full, and the line was sold to a third party for a nominal fee.
- (b) Includes a non-cash assumption of \$3,043 worth of senior notes received from American Greetings Corporation for our agreement to the RPG bankruptcy settlement in which we received the aforementioned notes and \$909 in cash and recognized a loss on the settlement of approximately \$601.

**(1) Investment Disbursements:**

Quarter Ended	New Investments		Disbursements to Existing Portfolio Companies	Total Disbursements
	Companies	Investments	Companies	Disbursements
June 30, 2009	0	\$	\$ 1,500(a)	\$ 1,500(a)
September 30, 2009	0		318	318
December 31, 2009	0		595	595
March 31, 2010	0		2,375	2,375
<b>Total</b>	<b>0</b>	<b>\$</b>	<b>\$ 4,788</b>	<b>\$ 4,788</b>

Quarter Ended	New Investments		Disbursements to	Total
	Companies	Investments	Existing Portfolio Companies	
June 30, 2008	1(b)	\$ 5,753	\$ 3,227	\$ 8,980
September 30, 2008	1(c)	21,410	6,222	27,632
December 31, 2008	1(d)	10,725	318	11,043
March 31, 2009	1(e)	3,043(e)	2,304	5,347(e)
Total	4	\$ 40,931	\$ 12,071	\$ 53,002

(a) See note (a) in previous table.

(b) Tread Corporation.

(c) Galaxy Tool Corporation

(d) Country Club Enterprises, LLC.

(e) See note (b) in previous table.

**Table of Contents****(2) Principal Repayments:**

<b>Quarter Ended</b>	<b>Scheduled Principal Repayments</b>	<b>Unscheduled Principal Repayments(a)</b>	<b>Total Principal Repayments</b>
<b>June 30, 2009</b>	\$ 2,004	\$ 5,571(b)	\$ 7,575
<b>September 30, 2009</b>	387	2,370(c)	2,757
<b>December 31, 2009</b>	396	4,100(d)	4,496
<b>March 31, 2010</b>	506	200	706
<b>Total</b>	\$ 3,293	\$ 12,241	\$ 15,534

<b>Quarter Ended</b>	<b>Scheduled Principal Repayments</b>	<b>Unscheduled Principal Repayments(a)</b>	<b>Total Principal Repayments</b>
June 30, 2008	\$ 2,516	\$ 977	\$ 3,493
September 30, 2008	3,294	15,547(e)	18,841
December 31, 2008	2,018	2,451	4,469
March 31, 2009	1,920	7,148(f)	9,068
<b>Total</b>	\$ 9,748	\$ 26,123	\$ 35,871

(a) Includes principal repayments due to excess cash flows, covenant trips, exits, refinancing, etc.

(b) Includes principal payments received in connection with the refinancing of Stucki and Cavert.

(c) Includes \$2.0 million voluntary prepayment from Cavert on its Senior Term Debt.

(d) Includes full repayment of Chase line of credit in the amount of \$3.5 million.

(e) Includes early payoff of Hudson in the amount of \$6.0 million and principal proceeds of \$7.0 million received in connection with the Quench Holdings Corp. restructuring.

(f) Includes the receipt of approximately