

GLADSTONE CAPITAL CORP

Form 10-K

November 23, 2009

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

for the fiscal year ended September 30, 2009

OR

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

for the transition period from to

Commission file number 814-00237

GLADSTONE CAPITAL CORPORATION

(Exact name of registrant as specified in its charter)

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Maryland

(State or other jurisdiction of
incorporation or organization)

54-2040781

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

1521 Westbranch Drive, Suite 200

McLean, Virginia

(Address of principal executive offices)

22102

(Zip Code)

(703) 287-5800

(Registrant's telephone number, including area code)

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Securities registered pursuant to Section 12(b) of the Act: **Common Stock, \$0.001 par value per share**

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES NO .

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES NO .

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act). See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12 b-2 of the Exchange Act.

Large Accelerated filer

Accelerated filer

Non-Accelerated filer

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12 b-2 of the Exchange Act). YES NO .

The aggregate market value of the voting stock held by non-affiliates of the Registrant on March 31, 2009, based on the closing price on that date of \$6.26 on the Nasdaq Global Select Market, was \$123,940,569. For the purposes of calculating this amount only, all directors and executive officers of the Registrant have been treated as affiliates.

There were 21,087,574 shares of the Registrant's Common Stock, \$0.001 par value, outstanding as of November 23, 2009.

Documents Incorporated by Reference. Portions of the Registrant's Proxy Statement relating to the Registrant's 2010 Annual Meeting of Stockholders are incorporated by reference into Part III of this Report.

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**GLADSTONE CAPITAL CORPORATION
FORM 10-K FOR THE FISCAL YEAR ENDED
SEPTEMBER 30, 2009**

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FORWARD-LOOKING STATEMENTS

All statements contained herein, other than historical facts, may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21 of the Securities Act of 1934, as amended (the Exchange Act). These statements may relate to, among other things, future events or our future performance or financial condition. In some cases, you can identify forward-looking statements by terminology such as may, might, believe, will, provided, anticipate, future, could, growth, plan, intend, expect, should, would, if, seek, possible, potential, likely or the negative of such terms or comparable terminology. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others: (1) 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, or George Stelljes III; (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 Form 10-K. We caution readers not to place undue reliance on any such forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, after the date of this Form 10-K.

PART I

(Dollar amounts in thousands, unless otherwise indicated)

In this Annual Report on Form 10-K, or Annual Report, the Company, we, us, and our refer to Gladstone Capital Corporation and its wholly-owned subsidiaries unless the context otherwise indicates.

Item 1. Business

Overview

We were incorporated under the General Corporation Laws of the State of Maryland on May 30, 2001 and completed our initial public offering on August 24, 2001. We operate as a closed-end, non-diversified management investment company, and we have elected to be treated as a business development company (BDC) under the Investment Company Act of 1940, as amended (the 1940 Act). In addition, for tax purposes we have elected to be treated as a regulated investment company (RIC) under the Internal Revenue Code of 1986, as amended (the Code).

We seek to achieve a high level of current income by investing in debt securities, consisting primarily of senior notes, senior subordinated notes and junior subordinated notes, of established private businesses that are substantially owned by leveraged buyout funds, or individual investors or are family-owned businesses, with a particular focus on senior notes. In addition, we may acquire from others existing loans that meet this profile. We also seek to provide our stockholders with long-term capital growth through appreciation in the value of warrants or other equity instruments that we may receive when we make loans.

We seek to invest in small and medium-sized private U.S. businesses that meet certain criteria, including some but not necessarily all of the following: the potential for growth in cash flow, adequate assets for loan collateral, experienced management teams with a significant ownership interest in the borrower, profitable operations based on the borrower's cash flow, reasonable capitalization of the borrower (usually by leveraged buyout funds or venture capital funds) and the potential to realize appreciation and gain liquidity in our equity positions, if any. We anticipate that liquidity in our equity position will be achieved through a merger or acquisition of the borrower, a public offering of the borrower's stock or by exercising our right to require the borrower to repurchase our warrants, though there can be no assurance that we will always have these rights. We seek to lend to borrowers that need funds to finance growth, restructure their balance sheets or effect a change of control.

We seek to invest primarily in three categories of debt of private companies:

- *Senior Notes.* We seek to invest a portion of our assets in senior notes of borrowers. Using its assets and cash flow as collateral, the borrower typically uses senior notes to cover a substantial portion of the funding needed to operate. Senior

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lenders are exposed to the least risk of all providers of debt because they command a senior position with respect to scheduled interest and principal payments. However, unlike senior subordinated and junior subordinated lenders, these senior lenders typically do not receive any stock, warrants to purchase stock of the borrowers or other yield enhancements. As such, they generally do not participate in the equity appreciation of the value of the business. Senior notes may include revolving lines of credit, senior term loans, senior syndicated loans and senior last-out tranche loans.

- *Senior Subordinated Notes.* We seek to invest a portion of our assets in senior subordinated notes, which include second lien notes. Holders of senior subordinated notes are subordinated to the rights of holders of senior debt in their right to receive principal and interest payments or, in the case of last out tranches of senior debt, liquidation proceeds from the borrower. As a result, senior subordinated notes are riskier than senior notes. Although such loans are sometimes secured by significant collateral, the lender is largely dependent on the borrower's cash flow for repayment. Additionally, lenders may receive warrants to acquire shares of stock in borrowers or other yield enhancements in connection with these loans. Senior subordinated notes include second lien loans and syndicated second lien loans.

- *Junior Subordinated Notes.* We also seek to invest a small portion of our assets in junior subordinated notes, which include mezzanine notes. Holders of junior subordinated notes are subordinated to the rights of the holders of senior debt and senior subordinated debt in their rights to receive principal and interest payments from the borrower. The risk profile of junior subordinated notes is high, which permits the junior subordinated lender to obtain higher interest rates and more equity and equity-like compensation.

Investment Concentrations

At September 30, 2009, we had aggregate investments in 48 portfolio companies, and approximately 66.1% of the aggregate fair value of such investments was senior term debt, approximately 33.0% was senior subordinated term debt, no investments were in junior subordinated debt and approximately 0.9% was in equity securities. The following table outlines our investments by type at September 30, 2009 and 2008:

	September 30, 2009		September 30, 2008	
	Cost	Fair Value	Cost	Fair Value
Senior Notes	\$ 240,172	\$ 212,290	\$ 297,910	\$ 265,297
Senior Subordinated Notes	118,743	105,794	157,927	140,676
Junior Subordinated Notes				
Preferred Equity Securities	2,028		1,584	
Common Equity Securities	3,450	2,885	3,449	1,960
Total Investments	\$ 364,393	\$ 320,969	\$ 460,870	\$ 407,933

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Investments at fair value consisted of the following industry classifications as of September 30, 2009 and 2008:

Industry Classification	September 30, 2009			September 30, 2008		
	Fair Value	Total Percentage Investments	Net Assets	Fair Value	Total Percentage Investments	Net Assets
Aerospace & Defense	\$ 1,857	0.6%	0.7%	\$ 4,192	1.0%	1.6%
Automobile	7,999	2.5%	3.2%	5,055	1.2%	1.9%
Broadcast (TV & Radio)	43,403	13.5%	17.4%	52,336	12.8%	19.2%
Buildings & Real Estate	12,882	4.0%	5.2%	13,519	3.3%	5.0%
Cargo Transport	5,427	1.7%	2.2%	15,805	3.9%	5.8%
Chemicals, Plastics & Rubber	15,884	4.9%	6.4%	16,375	4.0%	6.0%
Diversified/Conglomerate						
Manufacturing	1,236	0.4%	0.5%	3,195	0.8%	1.2%
Diversified Natural Resources,						
Precious Metals & Minerals	13,589	4.2%	5.5%	12,936	3.2%	4.8%
Electronics	27,899	8.7%	11.2%	35,208	8.6%	13.0%
Farming & Agriculture	9,309					