



GLADSTONE CAPITAL

2007 Annual Report





In the late 1700s, President George Washington picked a site on the Potomac River, midway between the northern and southern states. This spot would come to be called Washington, District of Columbia. Pierre L'Enfant, a city planner from France, designed the new city. He decided to place the Capitol Building on one hill and the "President's House" on another hill. The oval office in the White House will have a new president sit behind the desk pictured above in 2009.

GLADSTONE CAPITAL

GLADSTONE CAPITAL is a specialty finance company that pays monthly dividends to its stockholders. We provide loans to small and medium-sized businesses across the U.S. We seek to invest in private companies with profitable operations and strong management teams. Gladstone Capital does not limit its investments to any particular industries and has invested in small and medium-sized businesses in the manufacturing, distribution, and service sectors. To learn about our company, visit our website at: www.GladstoneCapital.com. Our common stock is traded on the Nasdaq® Global Market under the trading symbol GLAD.

Our headquarters are located in Washington, DC's suburb of McLean, VA and we have offices in Morristown, NJ, New York, NY, Pittsburgh, PA, Chicago, IL, Dallas, TX and Spokane, WA.

The picture of the White House on the cover is by Peter Gridley. The oval office inside the White House is the most sought after office in the world. Picture by Ping Amranand.

Selected Financial Data

	Year Ended September 30,				
	2007	2006	2005	2004	2003
Total Investment Income	\$ 36,686,519	\$ 26,899,846	\$ 23,949,759	\$ 20,395,968	\$ 15,154,874
Total Expenses	\$ 14,425,963	\$ 7,447,349	\$ 6,454,336	\$ 7,103,193	\$ 3,858,953
Net Investment Income	\$ 22,260,556	\$ 19,350,580	\$ 17,286,145	\$ 13,292,775	\$ 11,295,921
Net (Loss) Gain on Investments	\$ (7,308,552)	\$ 5,079,655	\$ (1,795,463)	\$ (2,722,485)	\$ (222,340)
Net Increase in Net Assets Resulting from Operations	\$ 14,952,004	\$ 24,430,235	\$ 15,490,682	\$ 10,570,290	\$ 11,073,581
Per Share Data ⁽¹⁾ :					
Net Investment Income:					
Basic	\$ 1.69	\$ 1.70	\$ 1.53	\$ 1.32	\$ 1.12
Diluted	\$ 1.69	\$ 1.67	\$ 1.49	\$ 1.29	\$ 1.11
Net Increase in Net Assets Resulting from Operations:					
Basic	\$ 1.13	\$ 2.15	\$ 1.37	\$ 1.05	\$ 1.10
Diluted	\$ 1.13	\$ 2.10	\$ 1.33	\$ 1.02	\$ 1.09
Cash Distributions Declared per Share	\$ 1.68	\$ 1.64	\$ 1.52	\$ 1.37	\$ 1.10
Statement of Assets and Liabilities Data:					
Total Assets	\$367,729,138	\$225,783,215	\$205,793,094	\$215,333,727	\$214,566,663
Net Assets	\$220,958,735	\$172,570,487	\$151,610,683	\$152,226,655	\$130,802,382
Net Asset Value Per Share	\$ 14.97	\$ 14.02	\$ 13.41	\$ 13.50	\$ 12.97
Common Shares Outstanding at Year End	14,762,574	12,305,008	11,303,510	11,278,510	10,081,844
Other Data:					
Number of Portfolio Companies at Period End	56	32	28	16	11
Principal Amount of Loan Originations	\$261,700,222	\$135,954,879	\$143,794,006	\$ 86,267,500	\$ 47,011,278
Principal Amount of Loan Repayments	\$121,817,837	\$124,009,929	\$ 88,019,136	\$ 47,158,995	\$ 18,005,827
Weighted Average Yield on Investments ⁽²⁾ :	11.98%	12.74%	12.23%	13.44%	13.14%
Total Return ⁽³⁾	(4.40)%	5.21%	5.93%	24.40%	21.74%

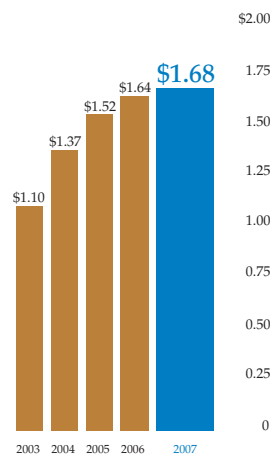
(1) Per share data for net investment income and net increase in net assets resulting from operations is based on the weighted common stock outstanding for both basic and diluted.

(2) Weighted average yield on investments equals interest income on investments divided by the average investment balance throughout the year.

(3) For the fiscal years ended September 30, 2007, 2006, 2005 and 2004, the total return equals the increase of the ending market value over the beginning market value plus monthly dividends divided by the monthly beginning market value. For the fiscal year ended September 30, 2003, total return equals the increase of the ending market value over the beginning market value, plus distributions, divided by the beginning market value.

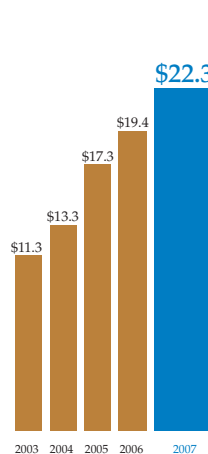
Cash Distributions Declared per Share

(in dollars)



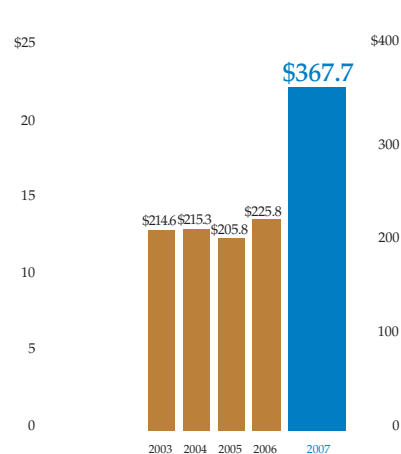
Net Investment Income

(dollars in millions)



Total Assets

(dollars in millions)





To Our Shareholders

*F*iscal 2007 was a good year for our company in many ways. Net Investment Income increased, although the volatile changes in the financial markets caused our Net Increase in Net Assets Resulting from Operations to decline. Total Assets increased at a good pace with most of the increase occurring in the last few months of the third quarter.

The monthly dividend is currently at 14 cents per share. Your company is now paying \$1.68 per share on an annual basis.

For the year ending September 30, 2007, Net Investment Income increased from \$19 million to \$22 million, a 15% increase. On a diluted per share basis, Net Investment Income increased from \$1.67 to \$1.69, a 1% increase. The per share percentage increase is less because we sold additional common shares during the year. However, the increased number of shares did not affect our ability to pay our dividend. As most shareholders know, the Net Investment Income number is important because we use this figure to determine the amount of our monthly distributions to shareholders.

The second most important figure is our Net Increase in Net Assets Resulting from Operations, which decreased from \$24 million to \$15 million. This was partially due to the very strong portfolio valuation at the 2006 fiscal year end compared to the decrease in the portfolio valuation for the 2007 fiscal year end. The 2007 decrease was primarily due to the turmoil in the debt markets in August and September 2007. We do not see any additional weakness in the portfolio and believe we will see our portfolio of loans increase in value. The decrease in the portfolio value does not reduce our ability to pay dividends and distributions to our shareholders.

During the fiscal year we invested \$262 million in 52 companies, exited from 29 companies and received \$122 million in repayments. Total assets increased from \$226 million to \$368 million. This is a

relatively strong performance and is due in part to the purchase of a media loan portfolio towards the end of our third quarter. We will seek to keep up the pace in 2008.

After the fiscal year end, the board declared monthly distributions for the last three calendar months of 2007 of \$0.14 per share. Since the end of the fiscal year, we invested \$57 million in loans to several small businesses and were repaid about \$2 million in loans. We are off to a good start for our 2008 fiscal year.

The downturn we thought might happen this year came with the discovery by many holders of securities backed by sub-prime home mortgages that the default rate was very high on those types of mortgages. We do not have investments in either the home building area or in home mortgages. This terrible problem in the home mortgage area caused a panic in the senior syndicated loan market beginning on July 20th (Black Friday). On that day the “music stopped” and like the game of musical chairs, there were not enough seats for everyone to sit down. In this case there were no buyers of senior syndicated loans so prices fell. The value of many loans decreased simply because there was no one to buy them. We believe that the value of our portfolio of senior syndicated loans decreased in the last quarter for that reason, as all of our syndicated loans are paying as agreed and we have a positive outlook for their continued



Pictured here from left to right are David Gladstone, Terry Brubaker and George "Chip" Stelljes III

payment. If history is a guide, this panic will pass and the market will swing back. We all know that the lending market cycle has an upswing and a downswing. The good news is that we are making new loans at increased rates, and these loans are on better terms than we have seen in many years. This will be good for the company for many years to come.

We have a well diversified portfolio of loans to good companies. We believe our diverse group of portfolio companies has the ability to weather an economic downturn that may occur in the future.

We see good and bad signs in the economy today. The housing industry will take a few more years to recover. We have a very limited indirect exposure to this area but worry that the prolonged downturn in the housing and domestic auto industries will eventually pull down the economy. The excess spending by federal, state and local governments is creating a drain on the economy. Those combined governments spend \$44 of every \$100 spent in the US. So much of the spending is for non-essentials. In Washington, DC they call that "pork barrel spending" because such spending goes for non-productive projects which pull our economy down. It is the part of our governmental system that does not work. The excessive spending decreases the value of the dollar as the government prints more money to finance the deficit spending. The value of the dollar compared to most major currencies (like the Euro) has already fallen to historical lows.

Much of the US economy is continuing to hum along. At this stage of the economic cycle, smaller companies are not overextended. We are seeing some small businesses miss their projections and that may be a sign that the future is not as bright as many may think. We expect 2008 to be a reasonably good year with weak economic growth. With so much volatility in the market, it is time to remain conservative

in investment selection and be ready for a downturn in the economy. However, the terms and conditions, which we are now seeing from potential borrowers, offer us a good opportunity to make some very good loans.

The team that manages Gladstone Capital is hard at work seeking good investments. We are very careful because one of the tenets of our investment strategy is the preservation of our shareholders' capital. While there are no guarantees, we will do our best to make solid investments that will pay our shareholders consistent monthly dividends. We are blessed to have a team that believes so strongly in the highest ethical standards and service to shareholders. We look forward to the 2008 fiscal year and believe it will be a good one!

David Gladstone
Chairman

Terry Brubaker
Vice Chairman

Chip Stelljes
President



The Oval Office is where the President does the business of the country—signing bills and Executive Orders and meeting with staff, visitors, and guests. The Oval Office changes with each Administration, as each President brings personal mementos and favorite furniture or artwork, and each makes selections from the White House art collection. In 1880, Queen Victoria of England gave the Resolute Desk to President Rutherford B. Hayes. It was made from the timbers of a historic British ship, the HMS Resolute, which the United States rescued and returned to England. When the ship was dismantled, the desk was made from timbers of the ship. In 2009 a new person will sit behind that desk and we all have a vote to determine who that will be.

We are a specialty finance company that makes loans to small and medium-sized businesses.

- Senior loans
- Senior subordinated loans
- Mezzanine loans
- Second lien loans
- Junior subordinated loans
- Warrants to buy stock

Senior term loans are exposed to the least risk of default because they command a senior position with respect to scheduled interest payments, principal payments and collateral. However, these types of loans traditionally have lower returns and lenders typically do not receive any profit enhancements, such as success fees or stock ownership.

Second lien loans and senior subordinated loans are typically subordinated in their rights to receive principal and interest payments from the borrower to the rights of the holders of senior debt. As a result, these loans are riskier loans than senior debt. Second lien loans and senior subordinated loans sometimes entitle the lender to obtain additional income from success fees and stock ownership.

Junior subordinated loans and mezzanine loans are subordinated in their rights to receive principal and interest payments from the borrower to the rights of the holders of senior debt and senior subordinated debt, which permits the junior subordinated lender to obtain higher interest rates and other income such as success fees and stock ownership.

Currently the company focuses on opportunities to invest in senior term loans, and second lien loans.

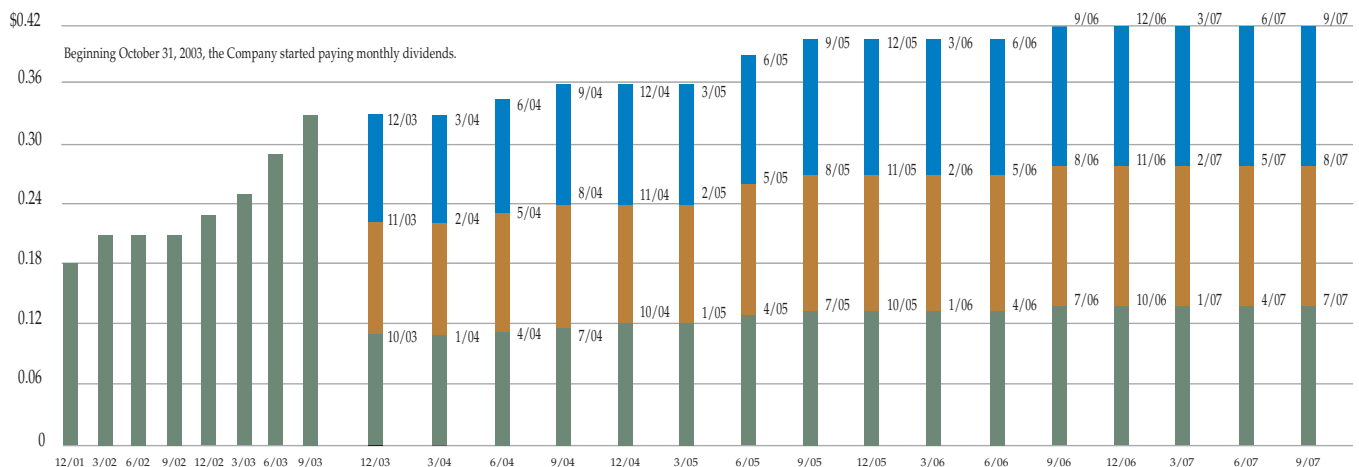
Our business strategy is to invest in senior subordinated loans where:

- Interest income will be the primary source of our revenue and will be used to pay our monthly dividends and distributions;
- Net capital gains from the sale of any warrants or stock (or any other profit enhancements) we receive in connection with our lending activities over the long term will exceed any losses we may experience from loans that are not repaid; and
- Fee income we derive from our lending activities will provide us with a source of revenue that will cover some of our general and administrative expenses (excluding interest expense from our lines of credit).

We believe we are well positioned to provide financing to small and medium-sized businesses undergoing a change of ownership, including management-led and third party leveraged buyouts, or those with good growth characteristics.

Gladstone Capital Monthly Dividends History

Distribution per Share (in dollars)



Corporate Information

Board of Directors and Executive Officers

David Gladstone

Chairman of the Board and Chief Executive Officer

Terry Lee Brubaker

Vice Chairman of the Board,
Chief Operating Officer and Secretary

George Stelljes III

Director, President and Chief Investment Officer

Paul Adelgren

Director and Pastor of Missionary Alliance Church

Maurice W. Coulon

Director and Private Real Estate Investor

David A.R. Dullum

Director and President of Harbor Acquisition Corp.
and Partner of New England Partners

Michela A. English

Director and President and CEO of Fight for Children

Gerard Mead

Director and Founder and
Chairman of the Board of
Gerard Mead Capital Management

John H. Outland

Director and Private Investor

Anthony W. Parker

Director and Founder and
Chairman of Medical Funding Corp.

Harry Brill

Chief Financial Officer

Gary Gerson

Treasurer

Gladstone Management Team Members

Michael Brown

Managing Director

Joseph Bute

Managing Director

Bill Cooke

Managing Director

Arthur S. "Buzz" Cooper

Managing Director

Robert Corry

Managing Director

Brian Eick

Managing Director

John Freal

Managing Director

Paul Giusti

Managing Director

Laura Gladstone

Managing Director

Chris Massey

Managing Director

David Meier

Managing Director

Robert Pierce

Managing Director

Virginia Rollins

Managing Director

John Sateri

Managing Director

Jennifer Simpson

Managing Director

John Weller

Managing Director

Donya Kolcio

Deputy CFO and Controller

Jack Dellafiora

Chief Compliance Officer

Kevin Cheetham

President Gladstone Administration

Stock Exchange Listing

The common stock of the Company trades on the Nasdaq Global Market under the symbol GLAD.

Transfer Agent

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Shareholder Relations Department
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New York, NY 10286 USA

Stockholder Inquiries

Email: shareowners@bankofny.com

Website: www.stockbny.com

Inside the US:

1 (800) 524 4458 (toll free)

Outside the US:

1 (610) 382 7833 (collect calls accepted)

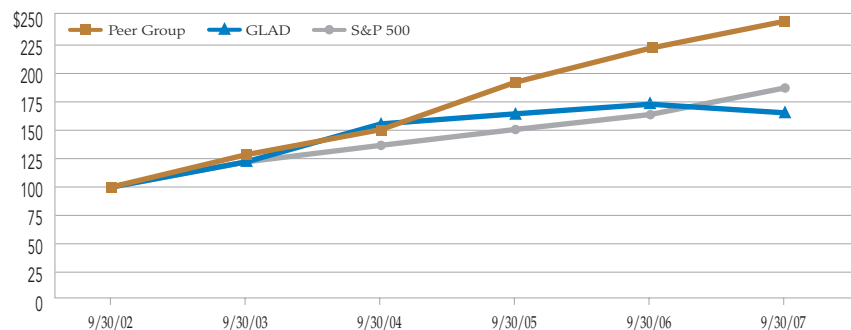
Financial Information

Stockholders may receive a copy of the Company's Annual Report on Form 10-K and Quarterly Reports on Form 10-Q by contacting the company or going to the company's website at www.GladstoneCapital.com, the SEC website at www.SEC.gov or by visiting the SEC at 100 F Street NE, Washington, DC 20549.

Performance Measurement Comparison⁽¹⁾

The following graph shows the total stockholder return of an investment of \$100 in cash on September 30, 2002 for (i) our common stock, (ii) the Standard & Poor's 500 Index (the "S&P 500") and (iii) our peer group. The Company's peer group is composed of Allied Capital Corporation and American Capital Strategies, Ltd. We are primarily a mezzanine lender that focuses on investments in senior, senior subordinated, and junior subordinated debt as well as warrants and other equity-like instruments. The companies that we have selected for our peer group are also business development companies and engage in similar investment activity, however, they have a higher focus on equity investments and buyout transactions than we do. We wish to include companies that share a more closely aligned focus in their investment activities in our peer group, and believe that companies such as Ares Capital Corporation and Apollo Investment Corporation more closely share our investment focus. However, due to the fact that these companies have less than five years of history as publicly traded companies, we did not have sufficient data available to use these companies in our peer group. Thus, our former peer group companies have been retained. All values assume reinvestment of the full amount of all dividends and are calculated as of September 30, 2003, 2004, 2005, 2006 and 2007:

Comparison Cumulative Total Return on Investment (in dollars)



(1) This Section is not "soliciting material," is not deemed "filed" with the Securities and Exchange Commission, and is not to be incorporated by reference in any filing of our filings under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation language in any such filing.



GLADSTONE CAPITAL

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