Gladstone Capital Corporation

2002 ANNUAL REPORT

Gladstone Capital Corporation is a publicly traded, specialty finance company traded on the Nasdaq®: GLAD. Our capital resources exceed $135 million. We invest our capital in debt securities, consisting primarily of senior notes, senior subordinated notes and junior subordinated notes, of established private businesses that are backed by leveraged buyout funds, venture capital funds or others. We seek to provide our stockholders with consistent quarterly cash dividends that we pay from the interest income we receive from our long-term loans. We seek some long-term capital growth through the appreciation in the value of warrants or other enhancements that we may receive when we make loans.

See our website for more information about us: www.GladstoneCapital.com.

Our headquarters are in McLean, VA, a suburb of Washington, DC and we have offices in Pittsburgh, PA and New York, NY.

David Gladstone, *Chairman*

Terry Brubaker, *President*

To Our Shareholders

The year that ended September 30, 2002 was as strange as any we have seen in the last 25 years. After the terrorist attack of September 11, 2001 and the anthrax letters that followed, we adopted a very cautious approach for about six months, watching carefully to understand which way the economy and business performance might go. Early on, we concluded it was imprudent to make investment commitments in such a rough and unpredictable climate; so we sat on a lot of cash for what seemed an eternity. We saw wonderful entrepreneurs who were simply unable to prevent their company's earnings from dropping 50% or more. Our company made a few investments, but we turned away hundreds of opportunities that we may have made in better times. We trust that those wonderful people that called on us, only to receive a polite "sorry but no," can understand the reasons underlying our decisions.

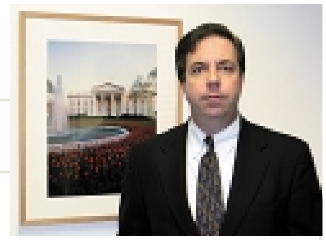
By April 2002, we began to feel better about the economy and closed a few new loans. However, during the summer, with mixed signals about the economy, we turned cautious again and again slowed down our lending pace. It was not until September 2002 that we began to see evidence that the bottom of this recession was becoming a base from which the economy could build.

During this recession, the U.S. has been blessed with relatively good employment figures compared to the last few recessions. This higher-than-normal employment for a recession has permitted those employees/consumers to buy more goods and services than they would in a normal recession. Their ability to tap easy credit at very low interest rates has permitted them to spend 103% of their salaries on houses, cars, furniture, washing machines, computers, and every other thing you can think of. The question for predicting economic health is "Where is employment heading?" At September 2002, the outlook for employment to remain at reasonable levels seems good to us.

At this point in time we have a solid portfolio of loans and investments. Since making the loans, none has missed a single due date, and as of September 2002, none was past due in their payments. We hope that our portfolio will continue to take shape in 2003 with the quality we have seen in 2002. We continue to work hard to meet our objectives of increasing dividends to our shareholders each year.

David Gladstone and Terry Brubaker

Business strategy



George Stelljes, III, *Chief Investment Officer*

Gladstone Capital concentrates on making loans at favorable interest rates to small and medium sized businesses that we believe have traditionally been underserved by conventional lenders. We plan to make senior and subordinated loans to selected businesses that we believe do not have sufficient access to traditional lending sources. We expect to make loans to borrowers that need funds to finance growth, restructure their balance sheets or effect a change of control, all of which we believe are typically under-served by banks and other traditional institutional lenders.

Our business strategy contemplates that

(1) our interest income will be the primary source of our revenue,

(2) the net capital gains from the sale of the warrants or stock (as well as other profit enhancements) we receive in connection with our lending activities will exceed any losses we may experience from loans that are not repaid, and

(3) the fee income we derive from our lending will provide us with a source of revenue that will cover our general and administrative expenses (excluding interest expense).

We believe that we are well positioned to provide financing to small and medium sized businesses that are undergoing a change of ownership, including management-led and third-party leveraged buyouts, or those businesses that have good growth characteristics. We are not burdened with the regulatory requirements of the banking and savings and loan industries and we have relatively low overhead and administrative expenses. Moreover, our strategy of accepting warrants to purchase stock of our borrowers is intended to closely align our interests with those of our portfolio companies, conveying our commitment to the borrowers and enhancing our attractiveness as a financing source. Perhaps most importantly, we believe that we have the experience and expertise to satisfy the financing needs of such businesses.

Teamwork

At our company, teamwork is the bond that holds us together and gives us the extra strength to win. Teamwork permits us to overcome the rough waters that challenge us. Regardless of the outcome, we depend on each other to achieve our goals. We are proud to have a great team that is building a great company for our shareholders and us.

Our portfolio companies

We make loans to small and medium sized private businesses that meet certain criteria, including the potential for growth, adequate assets for loan collateral, experienced management teams with significant ownership interest in the business, adequate capitalization, profitable operations based on cash flow and potential opportunities for us to realize appreciation and gain liquidity in our various equity positions. We may achieve liquidity 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 buy back our warrants.

We make available significant managerial assistance to our portfolio companies. Such assistance will typically involve helping find additional financing, structuring various financings, monitoring the operations of each borrower, participating in its board and management meetings, being available for consultation with officers of the portfolio company and providing organizational and financial guidance.

We expect to invest in senior, senior subordinated and junior subordinated notes. We expect that our loans typically will range from $5 million to $15 million, mature in no more than seven years and accrue interest at a fixed rate or an annualized variable rate that exceeds the prime rate.

We expect that most if not all of the debt securities we acquire will be unrated by credit rating agencies. To the extent possible, our loans generally will be collateralized by a security interest in the borrower's assets though we may not have the first claim on these assets.

Interest payments will generally be 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 will generally become due at maturity in five to seven years. We will focus on making loans accompanied by warrants to purchase stock in the borrowers.

These warrants will typically entitle us to purchase a modest percentage of the borrower's stock. From time to time, a portfolio company may request additional financing, providing us with additional lending opportunities. We will consider such requests for additional financing under the criteria we have established for initial investments and we anticipate that any debt securities we acquire in a follow-on financing will have characteristics comparable to those issued in the original financing. In some situations, our failure, inability or decision not to make a follow-on investment may be detrimental to the operations or survival of a portfolio company and thus jeopardize our investment in that borrower. We expect to receive warrants to purchase stock in many of our borrowers. If a financing is successful, not only will our debt securities have been repaid with interest, we will be in a position to realize a gain on the accompanying equity interests.

Partnership

We are partners with some great businesses. Many are owned by first-class buyout funds. We work with the owners and managers to form a partnership that will make the business a success. Each time we look at a business opportunity we look at it as a partnership. While we are lending money to the business, we seek to bring more than money to the partnership. We work hard to help the managers of the business succeed. We know that if they are successful we are too.

Selection of opportunities

We have identified certain characteristics that we believe are important to profitably lend to small and medium sized businesses. The criteria listed below provide a general guidepost for our lending and investment decisions, although not all of these criteria may be followed in each instance.

Growth

In addition to generating sufficient cash flow to service its debt, a potential borrower generally will be required to establish its ability to grow its cash flow. Anticipated growth will be a key factor in determining the value ascribed to the warrants we acquire in connection with many of our loans.

Significant Sponsor

We seek businesses in which leveraged buy-out funds or venture capital funds have invested. We believe a business that has a substantial equity sponsor and has made a meaningful investment is a good borrowing candidate.

Liquidation Value of Assets

Although we do not intend to operate as an asset-based lender, liquidation value of the assets collateralizing our loans is an important factor in each credit decision. Emphasis is placed both on tangible assets and intangible assets.

Experienced Management Team

We will generally require that each borrower have a management team that is experienced and properly incentivized through a significant ownership interest in the borrower. We generally will require that a borrower have, at a minimum, a strong chief executive officer and chief financial officer who have demonstrated the ability to accomplish the borrower's objectives and implement its business plan.

Profitable or Near Profitable Operations

We focus on borrowers that are profitable or near profitable at the operating level. We do not intend typically to lend to or invest in startup or other early stage companies, nor do we intend typically to lend to or invest in businesses that are experiencing operating problems.

Exit Strategy

Prior to making a loan for which we receive a warrant to purchase stock of the borrower, we will analyze the potential for the borrower to experience a liquidity event that will allow us to realize value for our equity position. Liquidity events include, among other things, an initial public offering, a private sale of our financial interest, a merger or acquisition of the borrower or a purchase of our equity position by the borrower or one of its stockholders.

Memories

We will always remember and honor the people who were taken from us because of the events on September 11th. God bless each individual who was lost or injured and bless their families and friends who experienced that loss. We will remember you in our hearts and prayers forever. Your sacrifice will never be forgotten.

Corporate Information

Directors and Officers

David Gladstone
Chief Executive Officer and Chairman of the Board

Terry Brubaker
Chief Operating Officer and President

George Stelljes, III
Chief Investment Officer

Harry Brill
Chief Financial Officer

David A.R. Dullum
Director and Partner, New England Partners

Michela English
Director and President, Discovery Consumer Products

Anthony W. Parker
Director and Chairman, Medical Funding Corp.

Joseph Bute, *Principal*

Buzz Cooper, *Principal*

John Freal, *Principal*

Laura Gladstone, *Principal*

Virginia Rollins, *Principal*

Brian McCahill, *Associate*

Skye Breeden
Director of Shareholder Relations

Pamela Keene
Director of Corporate Records

Stock Exchange Listing

The common stock of the company trades on the Nasdaq National Market® under the symbol GLAD.

Transfer Agent

The Bank of New York
Shareholder Relations Department
P.O. Box 11258
Church Street Station
New York, NY 10286, USA
Email:
shareowner-svcs@bankofny.com
Website: www.stockbny.com

Dividend Reinvestment Plan

The company offers a dividend reinvestment plan to its shareholders. Shareholders whose shares are held in their names should contact the transfer agent to enroll. Shareholders whose shares are held by a brokerage firm should contact their broker to enroll.

Financial Information

Shareholders may receive a copy of SEC Forms 10-K and 10-Q by contacting the company or going to the SEC website at www.SEC.gov or by visiting the SEC at 450 5th Street, N.W., Washington, DC 20549.

Auditors

Ernst & Young LLP

Tax Consultants

PricewaterhouseCoopers LLP

Legal Counsel

Cooley Godward, LLP

Pepper Hamilton, LLP

Company Website

The company has its website at www.GladstoneCapital.com.

Gladstone Capital Corporation

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