



**GLADSTONE CAPITAL**

*2006 Annual Report*

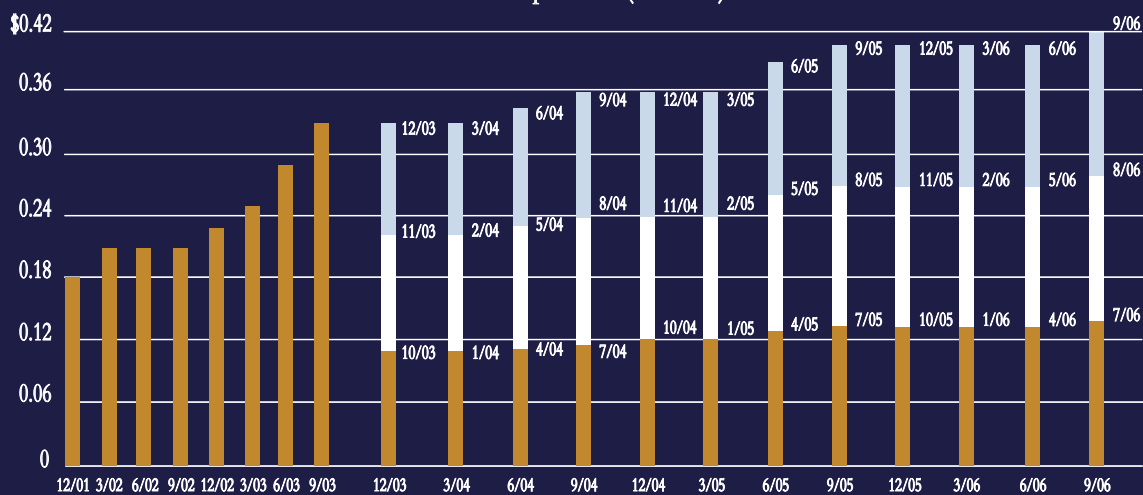




**GLADSTONE CAPITAL** is a specialty finance company that pays monthly dividends to its stockholders. We provide loans to small and medium-sized businesses across the U.S. We seek to invest in private companies with profitable operations and strong management teams. Gladstone Capital does not limit its 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](http://www.GladstoneCapital.com). Our common stock is traded on the Nasdaq® under the trading symbol GLAD.

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

**Gladstone Capital Monthly Dividend History**  
Dividend per Share (in dollars)





GLADSTONE CAPITAL CORPORATION

## Selected Financial Data

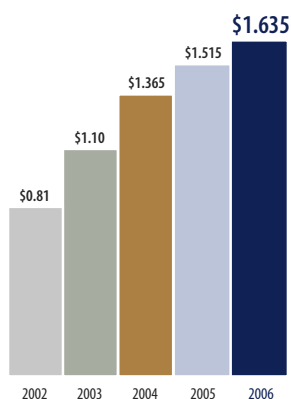
	Year Ended September 30, 2006	Year Ended September 30, 2005	Year Ended September 30, 2004	Year Ended September 30, 2003	Year Ended September 30, 2002
Total Investment Income	\$ 26,899,846	\$ 23,949,759	\$ 20,395,968	\$ 15,154,874	\$ 10,455,703
Total Expenses	\$ 9,498,349	\$ 7,531,436	\$ 7,103,193	\$ 3,858,953	\$ 2,839,102
Net Investment Income	\$ 19,350,580	\$ 17,286,145	\$ 13,292,775	\$ 11,295,921	\$ 7,616,601
Net Increase in Net Assets Resulting from Operations	\$ 24,430,235	\$ 15,490,682	\$ 10,570,290	\$ 11,073,581	\$ 7,616,601
Per Share Data:					
Net Increase in Net Assets Resulting from Operations					
Basic	\$ 2.15	\$ 1.37	\$ 1.05	\$ 1.10	\$ 0.76
Diluted	\$ 2.10	\$ 1.33	\$ 1.02	\$ 1.09	\$ 0.75
Cash Distributions Declared per Share	\$ 1.635	\$ 1.515	\$ 1.365	\$ 1.10	\$ 0.81
Statement of Assets and Liabilities Data:					
Total Assets	\$225,783,215	\$205,793,094	\$215,333,727	\$214,566,663	\$172,922,039
Net Assets	\$172,570,487	\$151,610,683	\$152,226,655	\$130,802,382	\$130,663,273
Other Data:					
Number of Portfolio Companies at Period End	32	28	16	11	7
Principal Amount of Loan Originations	\$135,954,879	\$143,794,006	\$ 86,267,500	\$ 47,011,278	\$ 97,705,054
Principal Amount of Loan Repayments	\$124,009,929	\$ 88,019,136	\$ 47,158,995	\$ 18,005,827	\$ 18,387,191
Total Return <sup>(1)</sup>	5.21%	5.93%	24.40%	21.74%	9.60%
Weighted Average Yield on Investments <sup>(2)</sup> :					
With PIK Interest <sup>(3)</sup>	12.74%	12.36%	13.78%	13.86%	14.79%
Without PIK Interest <sup>(3)</sup>	12.74%	12.23%	13.44%	13.14%	13.82%

(1) For the fiscal years ended September 30, 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 and prior periods, total return equals the increase of the ending market value over the beginning market value, plus distributions, divided by the beginning market value.

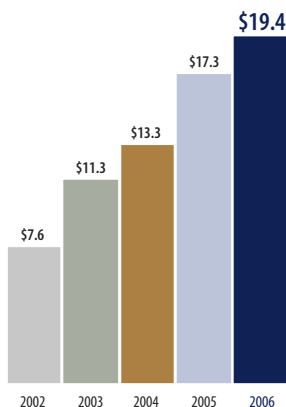
(2) Weighted average yield on investments equals interest income on investments divided by the average investment balance throughout the year.

(3) Refer to Note 2 of the "Notes to Consolidated Financial Statements" for an explanation of PIK, or "Paid-in-Kind," interest.

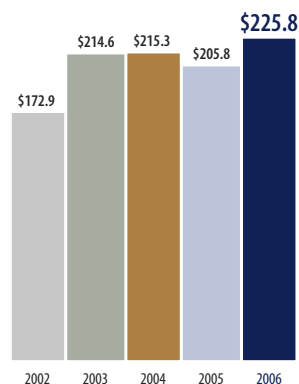
Cash Distributions  
Declared per Share  
(in dollars)



Net Investment  
Income  
(dollars in millions)



Total Assets  
(dollars in millions)



## To Our Stockholders

*Fiscal 2006 was a good year for our company in many ways. Net Investment Income was up and that is always a good sign. The Net Increase in Shareholders' Value was up substantially this year. The Total Assets increased but not as much as we wished.*

*The monthly dividend was increased to 14 cents per share. Your company is now paying \$1.68 per share on an annual basis.*

For the year ending September 30, 2006, Net Investment Income increased from \$17.3 million to \$19.4 million, and on a diluted per-share basis it increased from \$1.49 to \$1.67. This is a 12% increase and is good progress in the goal to grow our Net Investment Income. This figure is important because Net Investment Income is the source from which we pay most of our monthly dividends.

For the year, the second most important number is our Net Increase in Shareholder Value, which increased from \$15.5 million to \$24.4 million, or a 58% increase, over our last fiscal year results. This is a very strong showing and is due to the appreciation of some of our investments. This is unusually high for the conservative investments we make and shareholders should not expect such a strong increase every year.

During the year we invested \$136 million in 22 companies. We exited from 19 companies and received \$124 million in returned funds. The net increase in total assets was from \$205.8 million to \$225.8 million. This is a relatively low performance and is due to the increase in loan repayments. We will seek to do much better in 2007.

The marketplace for the type of financing we provide to small and medium-sized business is very robust now and was so during all of our fiscal year 2006. We do not see anything that will slow down

the large amount of funds seeing to make loans to business in our areas of private finance. This competitive market has made us very cautious. We all know that the lending market cycle has an upswing and a downswing. We are certainly at a high point in the credit cycle. How long this will last is anyone's guess. We have built a well diversified portfolio of loans to good companies. We believe our portfolio companies have the ability to weather any downturn that should occur in the next year or two.

We see good and bad signs in the economy today. The housing industry has big problems. It is down substantially. We have a very limited exposure to this area but worry that the downturn in the new home construction market will eventually pull down the economy. And we worry that the continued decline of the domestic auto manufacturers will hurt our economy. The other side of that coin is that the foreign auto manufacturers seem to be doing well with the plants that they have established in the US.

The excess spending by federal, state and local governments is creating a drain on the economy. So much of the spending is for nonessentials. In Washington DC they call that pork spending because such spending goes for non-productive projects that pull our economy down. If you removed all the pork spenders in the US Congress there would not be a man or woman there. They all spend on their pet



GLADSTONE CAPITAL CORPORATION



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

projects, helping their job security but undermining our economy. It is one part of our American system of government that does not work.

The US is on a collision course because federal, state and local governments are spending without much concern for where the money is coming from. At some point the excessive spending can cripple the value of the US currency and it will plummet like the currencies of so many Latin American countries. The value of the dollar compared to most major currencies (like the Euro) has already fallen to historical lows. The value of the dollar compared to the Chinese currency would fall if the Chinese government were not subsidizing it. That too will change in time.

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 more small businesses miss their projections and that is a sign that the future is not as bright as many might think. We expect 2007 to be an "ok year" with weak growth. It is time to remain conservative in investment selections and be prepared for the down part of the economic cycle.

The team that manages Gladstone Capital is hard at work seeking out 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 in this life, we

will do our best to make solid investments that will pay our shareholders a good monthly dividend. We all love to pay monthly dividends at Gladstone Capital. 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 2007 fiscal year and believe it will be a winner!

**David Gladstone**

*Chairman of the Board and Chief Executive Officer*

**Terry L. Brubaker**

*Vice Chairman of the Board, Chief Operating Officer and Secretary*

**George "Chip" Stelljes III**

*President, Chief Investment Officer and Director*



*We* are a specialty finance company that makes loans to small and medium-sized businesses. Businesses approach us because they do not have sufficient access to traditional lending sources. Borrowers need funds to finance growth, consolidate their debts into long-term debt or finance the sale of their business. We provide a variety of financing options to these companies including:

- *Senior term loans*
- *Second lien loans*
- *Senior subordinated loans*

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.

- *Junior subordinated loans*
- *Mezzanine loans*
- *Warrants to buy stock*

Our business strategy is to invest in securities 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. We are not burdened with the regulatory requirements of the banking and saving and loan industries, and we have relatively low overhead and administrative expenses. Perhaps most importantly, we have the experience and expertise to satisfy the financing needs of such businesses.



GLADSTONE CAPITAL CORPORATION

## Corporate Information

### Board of Directors and Executive Officers

**David Gladstone**  
*Chairman of the Board and  
Chief Executive Officer*

**Terry Brubaker**  
*Vice Chairman of the Board,  
Chief Operating Officer and Secretary*

**George Stelljes, III**  
*President, Chief Investment Officer  
and Director*

**Paul Adelgren**  
*Director and Pastor of  
Missionary Alliance Church*

**Maurice 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 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 Outland**  
*Director and Private Investor*

**Anthony W. Parker**  
*Director and Founder and Chairman of  
the Board of Medical Funding Corp.*

**Harry Brill**  
*Chief Financial Officer*

**Gary Gerson**  
*Treasurer*

### Gladstone Team Members

**Michael Brown**  
*Managing Director*

**Joseph Bute**  
*Managing Director*

**Buzz Cooper**  
*Managing Director*

**Robert Corry**  
*Managing Director*

**John Freal**  
*Managing Director*

**Laura Gladstone**  
*Managing Director*

**Paul Guisti**  
*Managing Director*

**Clifford Gookin**  
*Managing Director*

**Chris Massey**  
*Managing Director*

**Robert Pierce**  
*Managing Director*

**Virginia Rollins**  
*Managing Director*

**Donya Kolcio**  
*Controller*

**Allyson Williams**  
*Chief Compliance Officer*

**Paula Novara**  
*Compliance Officer*

### Financial Information

Shareholders 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](http://www.GladstoneCapital.com), the SEC website at [www.SEC.gov](http://www.SEC.gov) or by visiting the SEC at 100 F Street NE, Washington, DC 20549.

### Stock Exchange Listing

The common stock of the company trades on The Nasdaq Global Select 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

### Stockholder Inquiries:

Email:  
[shareowners@bankofny.com](mailto:shareowners@bankofny.com)  
Web site: [www.stockbny.com](http://www.stockbny.com)  
Inside the US:  
1 (800) 524-4458 (toll-free)  
Outside the US:  
1 (610) 382-7833  
(collect calls accepted)

### Company Website

[www.GladstoneCapital.com](http://www.GladstoneCapital.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.

### Auditors and Tax Consultants

PricewaterhouseCoopers LLP

### Legal Counsel

Cooley Godward, LLP  
Kirkpatrick & Lockhart  
Nicholson Graham LLP



GLADSTONE CAPITAL CORPORATION

1521 Westbranch Drive  
McLean, VA 22102

TELEPHONE: 703-287-5800

FAX: 703-287-5801

EMAIL: [info@GladstoneCapital.com](mailto:info@GladstoneCapital.com)

WEB: [www.GladstoneCapital.com](http://www.GladstoneCapital.com)