

GLADSTONE INVESTMENT CORPORATION\DE

Form 10-Q

January 31, 2011

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q**

**☐ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
FOR THE QUARTER ENDED DECEMBER 31, 2010**

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

**COMMISSION FILE NUMBER: 000-51233
GLADSTONE INVESTMENT CORPORATION
(Exact name of registrant as specified in its charter)**

DELAWARE **83-0423116**
(State or other jurisdiction of incorporation or (I.R.S. Employer Identification No.)
organization)

**1521 WESTBRANCH DRIVE, SUITE 200
MCLEAN, VIRGINIA 22102**

(Address of principal executive office)

(703) 287-5800

(Registrant's telephone number, including area code)

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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ○ No ○

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

Large accelerated filer ○	Accelerated filer ☐	Non-accelerated filer ○ (Do not check if a smaller reporting company)	Smaller reporting company ○.
------------------------------	------------------------	---	---------------------------------

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. The number of shares of the issuer's Common Stock, \$0.001 par value per share, outstanding as of January 28, 2011 was 22,080,133.

**GLADSTONE INVESTMENT CORPORATION
TABLE OF CONTENTS**

PART	
I.	FINANCIAL INFORMATION:
Item 1.	Financial Statements (Unaudited)
	<u>Condensed Consolidated Statements of Assets and Liabilities as of December 31, 2010 and March 31, 2010</u> 3
	<u>Condensed Consolidated Statements of Operations for the three and nine months ended December 31, 2010 and 2009</u> 4
	<u>Condensed Consolidated Statements of Changes in Net Assets for the nine months ended December 31, 2010 and 2009</u> 5
	<u>Condensed Consolidated Statements of Cash Flows for the nine months ended December 31, 2010 and 2009</u> 6
	<u>Condensed Consolidated Schedules of Investments as of December 31, 2010 and March 31, 2010</u> 7
	<u>Notes to Condensed Consolidated Financial Statements</u> 11
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>
	<u>Overview</u> 27
	<u>Results of Operations</u> 31
	<u>Liquidity and Capital Resources</u> 41
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u> 50
Item 4.	<u>Controls and Procedures</u> 51
PART	
II.	OTHER INFORMATION:
Item 1.	<u>Legal Proceedings</u> 52
Item	
1A.	<u>Risk Factors</u> 52
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u> 52
Item 3.	<u>Defaults Upon Senior Securities</u> 52
Item 4.	<u>Reserved</u> 52
Item 5.	<u>Other Information</u> 52
Item 6.	<u>Exhibits</u> 52
	<u>SIGNATURES</u> 53
	<u>EX-31.1</u>
	<u>EX-31.2</u>

EX-32.1

EX-32.2

Table of Contents

GLADSTONE INVESTMENT CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES
(DOLLAR AMOUNTS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	December 31, 2010	March 31, 2010
ASSETS		
Cash and cash equivalents	\$ 79,963	\$ 87,717
Investments at fair value		
Non-Control/Non-Affiliate investments (Cost of \$15,784 and \$22,674, respectively)	14,565	20,946
Control investments (Cost of \$134,293 and \$152,166, respectively)	101,791	148,248
Affiliate investments (Cost of \$45,805 and \$52,727, respectively)	34,754	37,664
Total investments (Cost of \$195,882 and \$227,567, respectively)	151,110	206,858
Interest receivable	748	1,234
Due from custodian	40,289	935
Deferred financing fees	480	83
Prepaid assets	319	221
Other assets	5,031	113
TOTAL ASSETS	\$ 277,940	\$ 297,161
LIABILITIES		
Borrowings at fair value		
Short-term loan (Cost of \$67,400 and \$75,000, respectively)	\$ 67,400	\$ 75,000
Credit Facility (Cost of \$8,000 and \$27,800, respectively)	8,000	27,812
Total borrowings (Cost of \$75,400 and \$102,800, respectively)	75,400	102,812
Accounts payable and accrued expenses	198	206
Fee due to Administrator ⁽¹⁾	143	149
Fees due to Adviser ⁽¹⁾	2,184	721
Other liabilities	1,333	295
TOTAL LIABILITIES	79,258	104,183
NET ASSETS	\$ 198,682	\$ 192,978
ANALYSIS OF NET ASSETS:		
Common stock, \$0.001 par value per share, 100,000,000 shares authorized, 22,080,133 shares issued and outstanding at December 31, 2010 and March 31, 2010	\$ 22	\$ 22
Capital in excess of par value	257,216	257,206

Net unrealized depreciation of investment portfolio	(44,772)	(20,710)
Net unrealized depreciation of derivatives	(74)	(39)
Net unrealized appreciation of borrowings		(12)
Accumulated net realized investment loss	(13,710)	(43,489)
TOTAL NET ASSETS	\$ 198,682	\$ 192,978
NET ASSETS PER SHARE	\$ 9.00	\$ 8.74

(1) Refer to Note 4 *Related Party Transactions* for additional information.

*THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS.*

Table of Contents

GLADSTONE INVESTMENT CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(DOLLAR AMOUNTS IN THOUSANDS EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	Three Months Ended		Nine Months Ended	
	December 31,		December 31,	
	2010	2009	2010	2009
INVESTMENT INCOME				
Interest income				
Non-Control/Non-Affiliate investments	\$ 391	\$ 489	\$ 1,175	\$ 1,840
Control investments	2,557	2,856	7,701	8,593
Affiliate investments	970	1,605	3,031	4,533
Cash and cash equivalents	7	1	21	1
Total interest income	3,925	4,951	11,928	14,967
Other income	6,812	970	10,358	1,066
Total investment income	10,737	5,921	22,286	16,033
EXPENSES				
Loan servicing fee ⁽¹⁾	634	886	2,124	2,892
Base management fee ⁽¹⁾	343	113	846	588
Incentive fee ⁽¹⁾	1,898	588	2,949	588
Administration fee ⁽¹⁾	142	156	582	527
Interest expense	135	385	558	1,640
Amortization of deferred financing fees	116	436	383	1,187
Professional fees	84	182	306	502
Stockholder related costs	26	49	245	276
Insurance expense	74	71	219	190
Directors fees	43	48	152	147
Other expenses	101	61	314	198
Expenses before credits from Adviser	3,596	2,975	8,678	8,735
Credits to fees from Adviser ⁽¹⁾	(450)	(127)	(630)	(591)
Total expenses net of credits to fees	3,146	2,848	8,048	8,144
NET INVESTMENT INCOME	7,591	3,073	14,238	7,889
REALIZED AND UNREALIZED GAIN (LOSS) ON:				
Realized gain (loss) on sale of investments	6,514	(1,318)	23,489	(35,922)
Realized loss on termination of derivative				(53)
Net unrealized appreciation of Non-Control/Non-Affiliate investments	52	1,383	509	36,597

Net unrealized depreciation of Control investments	(1,399)	(8,853)	(28,583)	(35,234)
Net unrealized appreciation (depreciation) of Affiliate investments	2,373	1,257	4,011	(4,862)
Net unrealized appreciation (depreciation) of derivatives	4	(7)	(34)	19
Net unrealized depreciation (appreciation) of borrowings		45	13	(133)
Net gain (loss) on investments, derivatives and borrowings	7,544	(7,493)	(595)	(39,588)
NET INCREASE (DECREASE) IN NET ASSETS RESULTING FROM OPERATIONS	\$ 15,135	\$ (4,420)	\$ 13,643	\$ (31,699)
NET INCREASE (DECREASE) IN NET ASSETS RESULTING FROM OPERATIONS PER COMMON SHARE:				
Basic and diluted	\$ 0.69	\$ (0.20)	\$ 0.62	\$ (1.44)
WEIGHTED AVERAGE SHARES OF COMMON STOCK OUTSTANDING:				
Basic and diluted weighted average shares	22,080,133	22,080,133	22,080,133	22,080,133

(1) Refer to Note 4 *Related Party Transactions* for additional information.

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

Table of Contents

GLADSTONE INVESTMENT CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS
(DOLLAR AMOUNTS IN THOUSANDS)
(UNAUDITED)

	Nine Months Ended December	
	31,	
	2010	2009
<i>Operations:</i>		
Net investment income	\$ 14,238	\$ 7,889
Realized gain (loss) on sale of investments	23,489	(35,922)
Realized loss on termination of derivative		(53)
Net unrealized depreciation of investment portfolio	(24,063)	(3,499)
Unrealized (depreciation) appreciation of derivatives	(34)	19
Unrealized appreciation (depreciation) of borrowings	13	(133)
Net increase (decrease) in net assets from operations	13,643	(31,699)
<i>Capital transactions:</i>		
Shelf offering registration costs, net	10	(153)
Distributions to stockholders	(7,949)	(7,949)
Net decrease in net assets from capital transactions	(7,939)	(8,102)
Total increase (decrease) in net assets	5,704	(39,801)
Net assets at beginning of period	192,978	214,802
Net assets at end of period	\$ 198,682	\$ 175,001

*THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS.*

Table of Contents

GLADSTONE INVESTMENT CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(DOLLAR AMOUNTS IN THOUSANDS)
(UNAUDITED)

	Nine Months Ended December	
	31,	
	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Net increase (decrease) in net assets resulting from operations	\$ 13,643	\$ (31,699)
Adjustments to reconcile net decrease in net assets resulting from operations to net cash provided by operating activities:		
Purchase of investments	(41,616)	(2,413)
Principal repayments of investments	61,774	14,828
Proceeds from sales of investments	35,010	74,706
Net realized (gain) loss on sales of investments	(23,489)	35,922
Net realized loss on termination of derivative		53
Net unrealized depreciation of investment portfolio	24,063	3,499
Net unrealized depreciation (appreciation) of derivatives	34	(19)
Net unrealized (depreciation) appreciation of borrowings	(13)	133
Net amortization of premiums and discounts	6	2
Amortization of deferred financing fees	383	1,187
Decrease in interest receivable	486	127
(Increase) decrease in due from custodian	(39,354)	1,940
Increase in prepaid assets	(98)	(128)
(Increase) decrease in other assets	(4,911)	67
Decrease in accounts payable and accrued expenses	(42)	(1,083)
Decrease in administration fee payable to Administrator ⁽¹⁾	(6)	(23)
Increase in fees due to Adviser ⁽¹⁾	1,463	606
Increase in other liabilities	1,038	119
 Net cash provided by operating activities	 28,371	 97,824
CASH FLOWS FROM FINANCING ACTIVITIES		
Shelf offering registration costs, net	10	(153)
Borrowings from Credit Facility	24,000	93,000
Repayments on Credit Facility	(43,800)	(176,515)
Proceeds from short-term borrowings	167,400	215,000
Repayments on short-term borrowings	(175,000)	(140,000)
Purchase of derivatives	(41)	(39)
Deferred financing fees	(745)	(532)
Distributions paid	(7,949)	(7,949)
 Net cash used in financing activities	 (36,125)	 (17,188)
 NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	 (7,754)	 80,636
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	87,717	7,236

CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 79,963	\$ 87,872
NON-CASH ACTIVITIES⁽²⁾	\$ 515	\$ 850

(1) Refer to Note 4 *Related Party Transactions* for additional information.

(2) 2010: Non-cash activities represent real property distributed to shareholders of A. Stucki Holding Corp. prior to its sale in June 2010. This property is included in the Company's Schedule of Investments under Neville Limited at December 31, 2010, and its fair market value was recognized as other income during the quarter ended June 30, 2010.

2009: Non-cash activities represent an investment disbursement to Cavert II Holding Corp. on its revolving line of credit, which proceeds were used to make the next four quarterly payments due under normal amortization for both its senior term A and senior term B loans in a non-cash transaction.

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

Table of Contents

GLADSTONE INVESTMENT CORPORATION
CONDENSED CONSOLIDATED SCHEDULES OF INVESTMENTS
DECEMBER 31, 2010
(DOLLAR AMOUNTS IN THOUSANDS)
(UNAUDITED)

Company ⁽¹⁾	Industry	Investment ⁽²⁾	Cost	Fair Value
NON-CONTROL/NON-AFFILIATE INVESTMENTS:				
<i>Senior Syndicated Loans:</i>				
Fifth Third Processing Solutions, LLC	Service electronic payment processing	Senior Subordinated Term Debt (8.3%, Due 11/2017) ⁽³⁾	\$ 495	\$ 507
Survey Sampling, LLC	Service telecommunications-based sampling	Senior Term Debt (10.4%, Due 5/2011) ⁽³⁾	2,324	1,509
<i>Subtotal Syndicated Loans</i>			2,819	2,016
<i>Non-syndicated Loans:</i>				
American Greetings Corporation	Manufacturing and design greeting cards	Senior Notes (7.4%, Due 6/2016) ⁽³⁾	3,043	2,838
B-Dry, LLC	Service basement waterproofer	Senior Term Debt (10.5%, Due 5/2014) ⁽⁵⁾	6,562	6,554
		Senior Term Debt (10.5%, Due 5/2014) ⁽⁵⁾	3,060	3,056
		Common Stock Warrants ⁽⁴⁾	300	101
			9,922	9,711
Total Non-Control/Non-Affiliate Investments (represents 9.6% of total investments at fair value)			\$ 15,784	\$ 14,565
CONTROL INVESTMENTS:				
Acme Cryogenics, Inc.	Manufacturing manifolds and pipes for industrial gasses	Senior Subordinated Term Debt (11.5%, Due 3/2012)	\$ 14,500	\$ 14,500
		Senior Subordinated Term Debt (12.5%, Due 12/2011)	415	415
		Preferred Stock ⁽⁴⁾	6,984	4,113
		Common Stock ⁽⁴⁾	1,045	
			24	

Common Stock
Warrants⁽⁴⁾

				22,968	19,028
ASH Holdings Corp.	Retail and Service buses and parts	school	Revolving Credit Facility, \$931 available (non-accrual, Due 3/2013) ⁽⁴⁾ Senior Subordinated Term Debt (non-accrual, Due 3/2013) ⁽⁴⁾ Preferred Stock ⁽⁴⁾ Common Stock Warrants ⁽⁴⁾ Guaranty (\$750)	2,528 6,060 2,500 4	
				11,092	
Cavert II Holding Corp.	Manufacturing	bailing wire	Senior Term Debt (10.0%, Due 10/2012) ⁽⁶⁾ Senior Subordinated Term Debt (13.0%, Due 10/2014) Preferred Stock ⁽⁴⁾ Common Stock ⁽⁴⁾	2,650 4,671 4,110 69	2,650 4,671 5,252 5,007
				11,500	17,580
Country Club Enterprises, LLC	Service	golf cart distribution	Senior Subordinated Term Debt (16.6%, Due 11/2014) ⁽⁵⁾ Preferred Stock ⁽⁴⁾ Guaranty (\$3,751)	7,000 3,725	6,720
				10,725	6,720
Galaxy Tool Holding Corp.	Manufacturing and plastics	aerospace	Senior Subordinated Term Debt (13.5%, Due 8/2013) Preferred Stock ⁽⁴⁾ Common Stock ⁽⁴⁾	5,220 19,658 48	5,220 2,158
				24,926	7,378
Mathey Investments, Inc.	Manufacturing and pipe-fitting equipment	pipe-cutting	Revolving Credit Facility, \$718 available (10.0%, Due 3/2011) ⁽⁵⁾ Senior Term Debt (10.0%, Due 3/2013) ⁽⁵⁾ Senior Term Debt (12.0%, Due 3/2014) ⁽⁵⁾	1,032 2,375 3,727	1,018 2,339 3,624

Edgar Filing: GLADSTONE INVESTMENT CORPORATION/DE - Form 10-Q

		Senior Term Debt (2.5%, Due 3/2014) ⁽⁵⁾⁽⁶⁾	3,500	3,404
		Common Stock ⁽⁴⁾	500	
		Common Stock Warrants ⁽⁴⁾	277	
			11,411	10,385
Neville Limited ⁽⁹⁾	Real Estate investments	Common Stock ⁽⁴⁾	610	551
			610	551

7

Table of Contents

GLADSTONE INVESTMENT CORPORATION
CONDENSED CONSOLIDATED SCHEDULES OF INVESTMENTS (Continued)
DECEMBER 31, 2010
(DOLLAR AMOUNTS IN THOUSANDS)
(UNAUDITED)

Company ⁽¹⁾	Industry	Investment ⁽²⁾	Cost	Fair Value
CONTROL INVESTMENTS (Continued):				
Precision Southeast, Inc.	Manufacturing injection molding and plastics	Revolving Credit Facility, \$551 available (7.5%, Due 12/2011) ⁽⁷⁾ Senior Term Debt (14.0%, Due 12/2015) ⁽⁷⁾ Preferred Stock ⁽⁴⁾⁽⁷⁾ Common Stock ⁽⁴⁾⁽⁷⁾	\$ 449 7,775 1,909 91 10,224	\$ 449 7,775 1,909 91 10,224
Tread Corp. ⁽⁸⁾	Manufacturing storage and transport equipment	Senior Subordinated Term Debt (12.5%, Due 5/2013) ⁽⁵⁾ Preferred Stock ⁽⁴⁾ Common Stock ⁽⁴⁾ Preferred Stock & Debt Warrants ⁽⁴⁾	5,000 833 1 3 5,837	4,925 4,925
Venyu Solutions, Inc.	Service online servicing suite	Senior Subordinated Term Debt (11.3%, Due 10/2015) ⁽⁷⁾ Senior Subordinated Term Debt (14.0%, Due 10/2015) ⁽⁷⁾ Preferred Stock ⁽⁴⁾⁽⁷⁾	7,000 12,000 6,000 25,000	7,000 12,000 6,000 25,000
Total Control Investments (represents 67.4% of total investments at fair value)			\$ 134,293	\$ 101,791
AFFILIATE INVESTMENTS:				
Danco Acquisition Corp.	Manufacturing machining and sheet metal work	Revolving Credit Facility, \$400 available (10.0%, Due 10/2011) ⁽⁵⁾	\$ 1,100	\$ 1,092

		Senior Term Debt (10.0%, Due 10/2012) ⁽⁵⁾	3,262	3,238
		Senior Term Debt (12.5%, Due 4/2013) ⁽⁵⁾	8,984	8,894
		Preferred Stock ⁽⁴⁾	2,500	
		Common Stock Warrants ⁽⁴⁾	3	
			15,849	13,224
Noble Logistics, Inc.	Service aftermarket auto parts delivery	Revolving Credit Facility, \$0 available (4.3%, Due 6/2011) ⁽⁵⁾	600	393
		Senior Term Debt (9.2%, Due 12/2012) ⁽⁵⁾	7,227	4,734
		Senior Term Debt (10.5%, Due 12/2012) ⁽⁵⁾	3,650	2,391
		Senior Term Debt (10.5%, Due 12/2012) ⁽⁵⁾⁽⁶⁾	3,650	2,390
		Preferred Stock ⁽⁴⁾	1,750	2,072
		Common Stock ⁽⁴⁾	1,682	
			18,559	11,980
Quench Holdings Corp.	Service sales, installation and service of water coolers	Senior Subordinated Term Debt (10.0%, Due 8/2013) ⁽⁵⁾	8,000	6,090
		Preferred Stock ⁽⁴⁾	2,950	3,460
		Common Stock ⁽⁴⁾	447	
			11,397	9,550
Total Affiliate Investments (represents 23.0% of total investments at fair value)			\$ 45,805	\$ 34,754
TOTAL INVESTMENTS			\$ 195,882	\$ 151,110

- (1) Certain of the listed securities are issued by affiliate(s) of the indicated portfolio company.
- (2) Percentage represents the weighted average interest rates in effect at December 31, 2010, and due date represents the contractual maturity date.
- (3) Valued based on the indicative bid price on or near December 31, 2010, offered by the respective syndication agent's trading desk or secondary desk.
- (4) Security is non-income producing.
- (5) Fair value based on opinions of value submitted by Standard & Poor's Securities Evaluations, Inc. at December 31, 2010.

- (6) Last Out Tranche (LOT) of senior debt, meaning if the portfolio company is liquidated, the holder of the LOT is paid after the other senior debt and before the senior subordinated debt.
- (7) New proprietary portfolio investment valued at cost, as it was determined that the price paid by the Company through an orderly transaction during the current quarter best represents fair value as of December 31, 2010.
- (8) In June 2010, an additional equity investment increased the Company's fully-diluted ownership percentage above 25%, resulting in the investment being reclassified as Control during the quarter ended June 30, 2010.
- (9) In July 2010, Gladstone Neville Corp. changed its name to Neville Limited.

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

Table of Contents

GLADSTONE INVESTMENT CORPORATION
CONSOLIDATED SCHEDULES OF INVESTMENTS
MARCH 31, 2010
(DOLLAR AMOUNTS IN THOUSANDS)
(UNAUDITED)

Company ⁽¹⁾	Industry	Investment ⁽²⁾	Cost	Fair Value
NON-CONTROL/NON-AFFILIATE INVESTMENTS:				
<i>Senior Syndicated Loans:</i>				
Interstate FiberNet, Inc.	Service provider of voice and data telecommunications services	Senior Term Debt (4.3%, Due 7/2013) ⁽⁸⁾	\$ 6,743	\$ 6,762
Survey Sampling, LLC	Service telecommunications-based sampling	Senior Term Debt (9.5%, Due 5/2011) ⁽³⁾	2,385	1,069
<i>Subtotal Syndicated Loans</i>			\$ 9,128	\$ 7,831
<i>Non-syndicated Loans:</i>				
American Greetings Corporation	Manufacturing and design greeting cards	Senior Notes (7.4%, Due 6/2016) ⁽³⁾	\$ 3,043	\$ 2,895
B-Dry, LLC	Service basement waterproofer	Senior Term Debt (10.5%, Due 5/2014) ⁽⁵⁾	6,613	6,596
		Senior Term Debt (10.5%, Due 5/2014) ⁽⁵⁾	3,590	3,581
		Common Stock Warrants ⁽⁴⁾	300	43
			10,503	10,220
Total Non-Control/Non-Affiliate Investments (represents 10.1% of total investments at fair value)			\$ 22,674	\$ 20,946
CONTROL INVESTMENTS:				
A. Stucki Holding Corp.	Manufacturing railroad freight car products	Senior Term Debt (4.7%, Due 3/2012)	\$ 9,101	\$ 9,101
		Senior Term Debt (7.0%, Due 3/2012) ⁽⁶⁾	9,900	9,900
		Senior Subordinated Term Debt (13.0%, Due 3/2014)	9,456	9,456
		Preferred Stock	4,387	4,529
		Common Stock ⁽⁴⁾	130	17,393

Edgar Filing: GLADSTONE INVESTMENT CORPORATION/DE - Form 10-Q

				32,974	50,379
Acme Cryogenics, Inc.	Manufacturing	manifolds and pipes for industrial gasses	Senior Subordinated Term Debt (11.5%, Due 3/2012)	14,500	13,585
			Preferred Stock ⁽⁴⁾	6,984	
			Common Stock ⁽⁴⁾	1,045	
			Common Stock Warrants ⁽⁴⁾	24	
				22,553	13,585
ASH Holdings Corp.	Retail and Service	school buses and parts	Revolving Credit Facility, \$496 available (non-accrual, Due 3/2013) ⁽⁵⁾	1,504	421
			Senior Subordinated Term Debt (non-accrual, Due 3/2013) ⁽⁵⁾	6,250	1,750
			Preferred Stock ⁽⁴⁾	2,500	
			Common Stock Warrants ⁽⁴⁾	4	
			Guaranty (\$250)		
				10,258	2,171
Cavert II Holding Corp.	Manufacturing	bailing wire	Senior Term Debt (8.3%, Due 10/2012) ⁽¹⁰⁾	2,875	2,875
			Senior Term Debt (10.0%, Due 10/2012) ⁽⁶⁾	2,700	2,700
			Senior Subordinated Term Debt (13.0%, Due 10/2014)	4,671	4,671
			Preferred Stock ⁽⁴⁾	4,110	4,959
			Common Stock ⁽⁴⁾	69	3,526
				14,425	18,731
Chase II Holding Corp.	Manufacturing	traffic doors	Senior Term Debt (8.8%, Due 3/2011)	7,700	7,700
			Senior Term Debt (12.0%, Due 3/2011) ⁽⁶⁾	7,520	7,520
			Senior Subordinated Term Debt (13.0%, Due 3/2013)	6,168	6,168
			Preferred Stock ⁽⁴⁾	6,961	7,713
			Common Stock ⁽⁴⁾	61	

			28,410	29,101
Country Club Enterprises, LLC	Service	golf cart distribution		
		Senior Subordinated		
		Term Debt (16.6%,		
		Due 11/2014) ⁽⁵⁾	7,000	6,869
		Preferred Stock ⁽⁴⁾	3,725	
		Guaranty (\$2,000)		
			10,725	6,869

9

Table of Contents

GLADSTONE INVESTMENT CORPORATION
CONSOLIDATED SCHEDULES OF INVESTMENTS (Continued)
MARCH 31, 2010
(DOLLAR AMOUNTS IN THOUSANDS)
(UNAUDITED)

Company ⁽¹⁾	Industry	Investment ⁽²⁾	Cost	Fair Value
CONTROL INVESTMENTS (Continued):				
Galaxy Tool Holding Corp.	Manufacturing and plastics	aerospace Senior Subordinated Term Debt (13.5%, Due 8/2013) ⁽⁵⁾ Preferred Stock ⁽⁴⁾ Common Stock ⁽⁴⁾	\$ 17,250 4,112 48 21,410	\$ 17,099 17,099
Mathey Investments, Inc. ⁽⁷⁾	Manufacturing pipe-cutting and pipe-fitting equipment	Revolving Credit Facility, \$718 available (10.0%, Due 3/2011) ⁽⁵⁾ Senior Term Debt (10.0%, Due 3/2013) ⁽⁵⁾ Senior Term Debt (17.0%, Due 3/2014) ^{(5) (6) (9)} Common Stock ⁽⁴⁾ Common Stock Warrants ⁽⁴⁾	1,032 2,375 7,227 500 277 11,411	1,011 2,328 6,974 10,313
Total Control Investments (represents 71.7% of total investments at fair value)			\$ 152,166	\$ 148,248
AFFILIATE INVESTMENTS:				
Danco Acquisition Corp.	Manufacturing machining and sheet metal work	Revolving Credit Facility, \$600 available (10.0%, Due 10/2010) ⁽⁵⁾ Senior Term Debt (10.0%, Due 10/2012) ⁽⁵⁾ Senior Term Debt (12.5%, Due 4/2013) ⁽⁵⁾ Preferred Stock ⁽⁴⁾ Common Stock Warrants ⁽⁴⁾	\$ 900 4,163 9,053 2,500 2 16,618	\$ 893 4,131 8,929 13,953
Noble Logistics, Inc.			2,000	1,210

Edgar Filing: GLADSTONE INVESTMENT CORPORATION/DE - Form 10-Q

	Service aftermarket auto parts delivery	Revolving Credit Facility, \$0 available (4.2%, Due 5/2010) ⁽⁵⁾		
		Senior Term Debt (9.3%, Due 12/2011) ⁽⁵⁾	6,227	3,767
		Senior Term Debt (10.5%, Due 12/2011) ^{(5) (6)}	7,300	4,417
		Preferred Stock ⁽⁴⁾	1,750	
		Common Stock ⁽⁴⁾	1,682	
			18,959	9,394
Quench Holdings Corp.	Service sales, installation and service of water coolers	Senior Subordinated Term Debt (10.0%, Due 8/2013) ⁽⁵⁾	8,000	6,150
		Preferred Stock ⁽⁴⁾	2,950	3,224
		Common Stock ⁽⁴⁾	447	
			11,397	9,374
Tread Corp.	Manufacturing storage and transport equipment	Senior Subordinated Term Debt (12.5%, Due 5/2013) ⁽⁵⁾	5,000	4,943
		Preferred Stock ⁽⁴⁾	750	
		Common Stock & Debt Warrants ⁽⁴⁾	3	
			5,753	4,943
Total Affiliate Investments (represents 18.2% of total investments at fair value)			\$ 52,727	\$ 37,664
TOTAL INVESTMENTS			\$ 227,567	\$ 206,858

- (1) Certain of the listed securities are issued by affiliate(s) of the indicated portfolio company.
- (2) Percentage represents the weighted average interest rates in effect at March 31, 2010, and due date represents the contractual maturity date.
- (3) Valued based on the indicative bid price on or near March 31, 2010, offered by the respective syndication agent's trading desk or secondary desk.
- (4) Security is non-income producing.
- (5) Fair value based on opinions of value submitted by Standard & Poor's Securities Evaluations, Inc. at March 31, 2010.
- (6) LOT of senior debt, meaning if the portfolio company is liquidated, the holder of the LOT is paid after the other senior debt and before the senior subordinated debt.

- (7) Restructured in December 2009, resulting in the Company owning 100% of Mathey Investments, Inc. and thus reclassifying it as a Control investment.
- (8) Security was paid off, at par, subsequent to March 31, 2010 and was valued based on the pay off.
- (9) Loan was restructured into two separate term loans with face values of \$3.7 million and \$3.5 million effective February 2010.
- (10) Loan was repaid, in full, subsequent to March 31, 2010.

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

Table of Contents

GLADSTONE INVESTMENT CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
DECEMBER 31, 2010
(DOLLAR AMOUNTS IN THOUSANDS, EXCEPT PER SHARE DATA AND AS OTHERWISE INDICATED)

NOTE 1. ORGANIZATION

Gladstone Investment Corporation (the Company) was incorporated under the General Corporation Laws of the State of Delaware on February 18, 2005 and completed an initial public offering on June 22, 2005. The Company is a closed-end, non-diversified management investment company that has elected to be treated as a business development company (BDC) under the Investment Company Act of 1940, as amended (the 1940 Act). In addition, the Company has elected to be treated for tax purposes as a regulated investment company (RIC) under the Internal Revenue Code of 1986, as amended (the Code). The Company's investment objectives are to achieve a high level of current income and capital gains by investing in debt and equity securities of established private businesses.

Gladstone Business Investment, LLC (Business Investment), a wholly-owned subsidiary of the Company, was established on August 11, 2006 for the sole purpose of owning the Company's portfolio of investments in connection with its line of credit. The financial statements of Business Investment are consolidated with those of the Company. The Company is externally managed by Gladstone Management Corporation (the Adviser), an affiliate of the Company.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Unaudited Interim Financial Statements and Basis of Presentation

Interim financial statements of the Company are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 10 of Regulation S-X under the Securities Act of 1933, as amended (the Securities Act). Accordingly, certain disclosures accompanying annual financial statements prepared in accordance with GAAP are omitted. The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated. Under Article 6 of Regulation S-X under the Securities Act, and the authoritative accounting guidance provided by the AICPA Audit and Accounting Guide for Investment Companies, the Company is not permitted to consolidate any portfolio company investments, including those in which the Company has a controlling interest. In the opinion of the Company's management, all adjustments, consisting solely of normal recurring accruals, necessary for the fair statement of financial statements for the interim periods have been included. The current period's results of operations are not necessarily indicative of results that ultimately may be achieved for the year. The interim financial statements and notes thereto should be read in conjunction with the financial statements and notes thereto included in the Company's Form 10-K for the fiscal year ended March 31, 2010, as filed with the Securities and Exchange Commission (the SEC) on May 24, 2010.

The year-end *Condensed Consolidated Statement of Assets and Liabilities* was derived from audited financial statements but does not include all disclosures required by GAAP.

Reclassifications

Certain amounts in the prior period's financial statements have been reclassified to conform to the presentation for the periods ended December 31, 2010 with no effect to net increase (decrease) in net assets resulting from operations.

Investment Valuation Policy

The Company carries its investments at market value to the extent that market quotations are readily available and reliable, and otherwise at fair value, as determined in good faith by its Board of Directors. In determining the fair value of the Company's investments, the Adviser has established an investment valuation policy (the Policy). The Policy has been approved by the Company's Board of Directors, and each quarter the Board of Directors reviews whether the Adviser has applied the Policy consistently and votes whether or not to accept the recommended valuation of the Company's investment portfolio.

The Company uses generally accepted valuation techniques to value its portfolio unless the Company has specific information about the value of an investment to determine otherwise. From time to time, the Company may accept an

appraisal of a business in which the Company holds securities. These appraisals are expensive and occur infrequently but provide a third-party valuation opinion that may differ in results, techniques and scopes used to value the Company's investments. When these specific third-party appraisals are engaged or accepted, the Company uses estimates of value provided by such appraisals and its 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 the Company has in that business.

Table of Contents

The Policy, summarized below, applies to publicly-traded securities, securities for which a limited market exists and securities for which no market exists.

Publicly-traded securities: The Company determines 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 the Company owns restricted securities that are not freely tradable, but for which a public market otherwise exists, the Company 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: The Company values 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, the Company assesses trading activity in an asset class and evaluates variances in prices and other market insights to determine if any available quote prices are reliable. If the Company concludes 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, the Company bases the value of the security upon the indicative bid price (IBP) offered by the respective originating syndication agent s trading desk, or secondary desk, on or near the valuation date. To the extent that the Company uses the IBP as a basis for valuing the security, the 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, the Company will value its syndicated loans using alternative methods, such as estimated net present values of the future cash flows, or discounted cash flows (DCF). The use of a DCF methodology follows that prescribed by the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820, Fair Value Measurements and Disclosures, 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 valuation of investments based on DCF. For the purposes of using DCF to provide fair value estimates, the Company considers 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, the Company develops 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 the Company believes a market participant would pay to purchase a syndicated loan in an active market, thereby establishing a fair value. The Company will apply the DCF methodology in illiquid markets until quoted prices are available or are deemed reliable based on trading activity.

As of December 31, 2010, the Company assessed trading activity in its 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 the Company s syndicated loans as of December 31, 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 (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 (Non-Public Debt Securities), and that are issued by portfolio companies in which the Company has no equity, or equity-like securities, are fair valued in accordance with the terms of the Policy, which utilizes opinions of value submitted to the Company by Standard & Poor s Securities Evaluations, Inc. (SPSE). The Company may also submit paid in kind (PIK) interest to SPSE for its evaluation when it is determined that PIK interest is likely to be received.

(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

(TEV) of the portfolio company, or issuer, utilizing a liquidity waterfall approach under ASC 820 for the Company's Non-Public Debt Securities and equity or equity-like securities (e.g. preferred equity, common equity, or other equity-like securities) that are purchased together as part of a package, where the Company has 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 acquisition market as the principal market, generally through a sale or recapitalization of the portfolio company. In accordance with ASC 820, the Company applies the in-use premise of value which assumes the debt and equity securities are sold together. Under this liquidity waterfall approach, the Company first calculates the TEV of the issuer by incorporating some or all of the following factors to determine the TEV of the issuer:

the issuer's ability to make payments;

the earnings of the issuer;

Table of Contents

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, the Company may reference industry statistics and use outside experts. Once the Company has estimated the TEV of the issuer, the Company will 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 the Adviser's judgment, the liquidity waterfall approach does not accurately reflect the value of the debt component, the Adviser may recommend that the Company 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:

The Company values Non-Public Debt Securities that are purchased together with equity or equity-like securities from the same portfolio company, or issuer, for which the Company does not control or cannot gain control as of the measurement date, using a hypothetical secondary market as the Company's principal market. In accordance with ASC 820, the Company determines its 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 such, the Company estimates the fair value of the debt component using estimates of value provided by SPSE and its 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 the Company does not control or cannot gain control as of the measurement date, the Company estimates 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 is also given to capital structure and other contractual obligations that may impact the fair value of the equity.

Further, the Company may utilize comparable values of similar companies, recent investments and indices with similar structures and risk characteristics or its 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 the Company might reasonably expect to receive upon the current sale of the security in an arms-length transaction in the security's principal market. Refer to Note 3 below for additional information regarding fair value measurements and the Company's adoption of ASC 820.

Interest and Dividend Income Recognition

Interest income, adjusted for amortization of premiums and acquisition costs, the accretion of discounts and the amortization of amendment fees, 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 the Company's qualitative assessment indicates that the debtor is unable to service its debt or other obligations, the Company 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, the Company remains 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 are paid

and, in management's judgment, are likely to remain current, or due to a restructuring such that the interest income is deemed to be collectible. At December 31, 2010, one Control investment, ASH Holdings Corp. (ASH), was on non-accrual with a fair value of \$0. At March 31, 2010, ASH was on non-accrual with a fair value of approximately \$2.2 million, or 1.0% of the fair value of all loans held in the Company's portfolio at March 31, 2010.

The Company has one loan in its portfolio which contains a PIK provision. The PIK interest, computed at the contractual rate specified in each loan agreement, is added to the principal balance of the loan and recorded as income. To maintain the Company's status as a RIC, this non-cash source of income must be paid out to stockholders in the form of distributions, even though the Company has not yet collected the cash. The Company recorded PIK income of \$7 for both the three and nine months ended December 31, 2010. No PIK interest was recorded during the nine months ended December 31, 2009.

Success fees are recorded upon receipt. Success fees are contractually due upon a change of control in a portfolio company and are recorded in Other income in the accompanying *Condensed Consolidated Statements of Operations*. The Company recorded \$2.7 million of success fees during the quarter ended December 31, 2010, \$2.3 million of which resulted from the exit and payoff of Chase

Table of Contents

II Holding Corp. (Chase) and \$0.4 million of which resulted from a prepayment received from Mathey Investments, Inc. (Mathey). During the nine months ended December 31, 2010, the Company also received success fees of \$2.0 million from A. Stucki Holding Corp. (A. Stucki), which resulted from the exit and payoff of A. Stucki, and \$0.8 million from a prepayment received from Cavert II Holdings Corp. (Cavert). Prior to the current fiscal year, the Company 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 the Company has the option to collect such amounts in cash. During the quarter ended December 31, 2010, the Company recorded and collected \$4.0 million of dividends accrued on preferred shares of Chase. During the nine months ended December 31, 2010, the Company recorded and collected \$0.3 million of dividends on preferred shares of A. Stucki and accrued and received a special dividend of property valued at \$0.5 million in connection with the A. Stucki sale. During the nine months ended December 31, 2009, the Company recorded and collected \$1.0 million of cash dividends on preferred shares of A. Stucki.

Recent Accounting Pronouncements

In January 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-06, Fair Value Measurements and Disclosures, which requires that reporting entities make new disclosures about recurring or nonrecurring fair-value measurements, including significant transfers into and out of Level 1 and Level 2 fair-value measurements and information on purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair-value measurements. The FASB also clarified existing fair-value measurement disclosure guidance about the level of disaggregation, inputs and valuation techniques. The new and revised disclosures are required to be implemented in fiscal interim or annual periods beginning after December 15, 2009, except for the gross presentation of the Level 3 roll-forward, which is required for annual reporting periods beginning after December 15, 2010. The Company adopted ASU No. 2010-06 beginning with the year ended March 31, 2010. The adoption of this standard did not have a material effect on the Company's financial position and results of operations.

NOTE 3. INVESTMENTS

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 the Company's own assumptions that market participants would use to price the asset or liability based upon the best available information.

As of December 31, 2010, all of the Company's investments were valued using Level 3 inputs.

The following table presents the financial instruments carried at fair value as of December 31, 2010, by caption on the accompanying *Condensed Consolidated Statements of Assets and Liabilities* for each of the three levels of hierarchy established by ASC 820:

As of December 31, 2010

Total Fair Value

	Level 1	Level 2	Level 3	Reported in Condensed Consolidated Statement of Assets and Liabilities
Non-Control/Non-Affiliate investments				
Senior term debt	\$	\$	\$ 13,956	\$ 13,956
Senior subordinated term debt			508	508
Common equity/equivalents			101	101
Total Non-Control/Non-Affiliate investments			14,565	14,565
Control investments				
Senior term debt			21,259	21,259
Senior subordinated term debt			55,451	55,451
Preferred equity			19,432	19,432
Common equity/equivalents			5,649	5,649
Total Control investments			101,791	101,791
Affiliate investments				
Senior term debt			23,132	23,132
Senior subordinated term debt			6,090	6,090
Preferred equity			5,532	5,532
Total Affiliate investments			34,754	34,754
Total investments at fair value	\$	\$	\$ 151,110	\$ 151,110
Cash Equivalents	75,000			75,000
Total Investments and Cash Equivalents	\$ 75,000	\$	\$ 151,110	\$ 226,110

Table of Contents*Changes in Level 3 Fair Value Measurements of Investments*

The following tables provide a roll-forward in the changes in fair value during the three and nine months ended December 31, 2010 and 2009 for all investments for which the Company determines fair value using unobservable (Level 3) factors. When a determination is made to classify a financial instrument within Level 3 of the valuation hierarchy, the determination is based upon the significance of the unobservable factors to the overall fair value measurement. However, Level 3 financial instruments typically include, in addition to the unobservable or Level 3 components, observable components (that is, components that are actively quoted and can be validated to external sources). Accordingly, the gains and losses in the table below include changes in fair value due in part to observable factors that are part of the valuation methodology. Two tables are provided for each period: the first table is broken out by Control, Affiliate and Non-Control/Non-Affiliate investment classification, and the second table is broken out by major security type.

Fair value measurements using unobservable data inputs (Level 3)**Periods ended December 31, 2010:**

	Non-Control/ Non-Affiliate Investments	Control Investments	Affiliate Investments	Total
Three months ended December 31, 2010:				
Fair value as of September 30, 2010	\$ 14,060	\$ 95,050	\$ 32,504	\$ 141,614
Total realized gains ⁽¹⁾⁽⁶⁾		6,857		6,857
Total unrealized gains (losses) ⁽¹⁾	52	(1,399)	2,373	1,026
Issuances/Originations	502	35,920	200	36,622
Sales ⁽⁶⁾		(13,879)		(13,879)
Settlements/Repayments	(49)	(20,758)	(323)	(21,130)
Fair value as of December 31, 2010	\$ 14,565	\$ 101,791	\$ 34,754	\$ 151,110
Nine months ended December 31, 2010:				
Fair value as of March 31, 2010	\$ 20,946	\$ 148,248	\$ 37,664	\$ 206,858
Total realized gains ⁽¹⁾	18	23,471		23,489
Total unrealized gains (losses) ⁽¹⁾	509	(28,583)	4,011	(24,063)
Issuances/Originations	502	40,914	200	41,616
Sales		(35,010)		(35,010)
Settlements/Repayments	(7,410)	(53,001)	(1,369)	(61,780)
Transfers ⁽²⁾		5,752	(5,752)	
Fair value as of December 31, 2010	\$ 14,565	\$ 101,791	\$ 34,754	\$ 151,110

	Senior Term Debt	Senior Subordinated Term Debt	Preferred Equity	Common Equity/ Equivalents	Total
Three months ended December 31, 2010:					
Fair value as of September 30, 2010	\$ 64,826	\$ 50,481	\$ 19,356	\$ 6,951	\$ 141,614
Total realized gains ⁽¹⁾⁽⁶⁾				6,857	6,857
Total unrealized gains (losses) ⁽¹⁾	53	(2,456)	4,660	(1,231)	1,026

Edgar Filing: GLADSTONE INVESTMENT CORPORATION/DE - Form 10-Q

Issuances/Originations	8,431	20,191	7,909	91	36,622
Sales ⁽⁶⁾			(6,961)	(6,918)	(13,879)
Settlements/Repayments	(14,962)	(6,168)			(21,130)
Fair value as of December 31, 2010	\$ 58,348	\$ 62,048	\$ 24,964	\$ 5,750	\$ 151,110

Nine months ended December 31, 2010:

Fair value as of March 31, 2010	\$ 94,359	\$ 71,112	\$ 20,425	\$ 20,962	\$ 206,858
Total realized gains ⁽¹⁾	18			23,471	23,489
Total unrealized gains (losses) ⁽¹⁾	1,465	(2,154)	(7,651)	(15,723)	(24,063)
Issuances/Originations	8,431	21,245	11,238	702	41,616
Sales			(11,348)	(23,662)	(35,010)
Settlements/Repayments	(45,925)	(15,855)			(61,780)
Transfers ⁽³⁾		(12,300)	12,300		
Fair value as of December 31, 2010	\$ 58,348	\$ 62,048	\$ 24,964	\$ 5,750	\$ 151,110

Table of Contents**Periods ended December 31, 2009:**

	Non-Control/ Non-Affiliate Investments	Control Investments	Affiliate Investments	Total
Three months ended December 31, 2009:				
Fair value as of September 30, 2009	\$ 25,004	\$ 132,399	\$ 46,900	\$ 204,303
Total realized losses ⁽¹⁾	(1,318)			(1,318)
Total unrealized gains (losses) ⁽¹⁾	1,383	(8,853)	1,257	(6,213)
Issuances/Originations		595		595
Settlements/Repayments	(182)	(4,315)	(1)	(4,498)
Sales	(5,483)			(5,483)
Transfers ⁽⁴⁾		11,129	(11,129)	
Fair value as of December 31, 2009	\$ 19,404	\$ 130,955	\$ 37,027	\$ 187,386

Nine months ended December 31, 2009:

Fair value as of March 31, 2009	\$ 94,740	\$ 166,163	\$ 53,027	\$ 313,930
Total realized losses ⁽¹⁾	(35,922)			(35,922)
Total unrealized gains (losses) ⁽¹⁾	36,597	(35,234)	(4,862)	(3,499)
Issuances/Originations	150	700	713	1,563
Settlements/Repayments	(1,455)	(11,803)	(722)	(13,980)
Sales	(74,706)			(74,706)
Transfers ⁽⁴⁾		11,129	(11,129)	
Fair value as of December 31, 2009	\$ 19,404	\$ 130,955	\$ 37,027	\$ 187,386

	Senior Term Debt	Senior Subordinated Term Debt	Preferred Equity	Common Equity/ Equivalents	Total
Three months ended December 31, 2009:					
Fair value as of September 30, 2009	\$ 103,092	\$ 70,466	\$ 25,229	\$ 5,516	\$ 204,303
Total realized losses ⁽¹⁾	(1,318)				(1,318)
Total unrealized gains (losses) ⁽¹⁾	585	201	(5,975)	(1,024)	(6,213)
Issuances/Originations	283	312			595
Settlements/Repayments	(3,998)	(500)			(4,498)
Sales	(5,483)				(5,483)
Fair value as of December 31, 2009	\$ 93,161	\$ 70,479	\$ 19,254	\$ 4,492	\$ 187,386

Nine months ended December 31, 2009:

Fair value as of March 31, 2009	\$ 179,676	\$ 72,061	\$ 40,043	\$ 22,150	\$ 313,930
Total realized losses ⁽¹⁾	(35,922)				(35,922)

Edgar Filing: GLADSTONE INVESTMENT CORPORATION/DE - Form 10-Q

Total unrealized gains (losses) ⁽¹⁾	34,593	355	(20,789)	(17,658)	(3,499)
Issuances/Originations	1,250	313			1,563
Settlements/Repayments	(12,230)	(1,750)			(13,980)
Sales	(74,706)				(74,706)
Transfers ⁽⁵⁾	500	(500)			
Fair value as of December 31, 2009	\$ 93,161	\$ 70,479	\$ 19,254	\$ 4,492	\$ 187,386

- (1) Included in the realized and unrealized gain (loss) section on the accompanying *Condensed Consolidated Statement of Operations* for the three and nine months ended December 31, 2010 and 2009.
- (2) Transfer represents the cost basis as of March 31, 2010 of Tread Corporation, which was reclassified from an Affiliate to a Control investment during the three months ended June 30, 2010.
- (3) Transfer represents \$12.3 million of senior subordinated term debt of Galaxy Tool Holding Corp. at cost as of June 30, 2010 that was converted to preferred and common equity during the three months ended September 30, 2010.
- (4) Transfer represents the cost basis of Mathey as of September 30, 2009, which was reclassified from an Affiliate to a Control investment during the three months ended December 31, 2009.

Table of Contents

- (5) Transfer represents the cost basis as of March 31, 2009 of Noble senior subordinated term debt that was converted into senior term debt during the three months ended June 30, 2009.
- (6) There was a \$0.3 million realized loss adjustment in the three months ended December 31, 2010 related to the A Stucki sale due to a subsequent cost that arose from the closing statement. This amount is not included in the three month Level 3 rollforward because the A Stucki investment is not in the beginning balance as of September 30, 2010. However, the \$0.3 million realized loss adjustment is included in the realized gain (loss) section on the accompanying *Condensed Consolidated Statement of Operations* for the three months ended December 31, 2010.

Non-Proprietary Investment Activity

Non-proprietary investments are investments that were not originated by the Company. During the three months ended December 31, 2010, the Company invested in one non-proprietary investment, a syndicated loan, to Fifth Third Processing Solutions (Fifth Third), at a cost of \$0.5 million; there were no exits of non-proprietary investments during the quarter. During the nine months ended December 31, 2010, Interstate FiberNet, Inc. made full repayment of its senior term debt owed to the Company, resulting in the receipt of approximately \$6.7 million in cash proceeds. The non-proprietary loans in the Company's investment portfolio, consisting of all Non-Control/Non-Affiliate investments other than B-Dry, LLC, had a fair value of approximately \$4.9 million, or 3.2% of its total investments at December 31, 2010.

During April and May 2009, the Company finalized the sale of 29 of the 32 senior syndicated loans that were held in its portfolio of investments at March 31, 2009 to various investors in the syndicated loan market. The loans, in the aggregate, had a cost value of approximately \$104.2 million, or 29.9% of the cost value of the Company's total investments, and an aggregate fair market value of approximately \$69.8 million, or 22.2% of the fair market value of the Company's total investments, at March 31, 2009. As a result of these sales, the Company received approximately \$69.2 million in net cash proceeds and recorded a realized loss of approximately \$34.6 million.

Proprietary Investment Activity

During the nine months ended December 31, 2010, the following significant transactions occurred:

In December 2010, the Company sold its equity investment and received full repayment of its debt investment in Chase in connection with the sale of 100% of the outstanding capital stock of Chase. The net cash proceeds to the Company from the sale of its equity in Chase were \$13.9 million, resulting in a realized gain of \$6.9 million. In connection with the equity sale, the Company accrued and received cash dividend proceeds of \$4.0 million from its preferred stock investment in Chase. At the same time, the Company received \$22.9 million in repayment of its principal, accrued interest and success fees on the loans to Chase.

In December 2010, the Company invested \$10.8 million in Precision Southeast, Inc. (Precision), consisting of senior debt and preferred and common equity. Precision, headquartered in Myrtle Beach, South Carolina, is a custom injection molding company, focused on the filtration, consumer and industrial markets and is included as a Control investment on the accompanying *Condensed Consolidated Schedule of Investments* as of December 31, 2010

In October and November 2010, Mathey prepaid \$0.4 million of its success fee on its senior term debt.

In October 2010, the Company invested \$25.0 million in Venyu Solutions, Inc. (Venyu), consisting of subordinated debt and preferred equity. Venyu, headquartered in Baton Rouge, Louisiana, is a leader in commercial-grade, customizable solutions for data protection, data hosting and disaster recovery and is included as a Control investment on the accompanying *Condensed Consolidated Schedule of Investments* as of December 31, 2010

In September 2010, Cavert prepaid \$0.8 million of its success fee on its senior term debt and senior subordinated term debt.

In July and August 2010, the Company restructured Galaxy Tool Holding Corp. (Galaxy) by converting \$12.3 million of its senior subordinated term note into preferred and common stock and investing an additional \$3.2 million into preferred stock. After the restructuring, the Company's investments at cost in Galaxy consisted of a \$5.2 million senior subordinated term note, \$19.6 million in preferred stock and \$0.1 million in common stock.

In June 2010, the Company sold its equity investment and received full repayment of its 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 the Company from the sale of its equity in A. Stucki were \$21.4 million, resulting in a realized gain of \$16.7 million, which includes a \$0.3 million closing adjustment decrease during the three months ended December 31, 2010. In connection with the equity sale, the Company accrued and received cash dividend proceeds of \$0.2 million from its preferred stock investment in A. Stucki. At the same time, the Company received \$30.6 million in repayment of its principal, accrued interest and success fees on the loans to A. Stucki. Additionally, immediately prior to the sale of A. Stucki, the Company 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 Control investment, Neville Limited, on the accompanying *Condensed Consolidated Schedule of Investments* as of December 31, 2010.

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

Table of Contents*Investment Concentrations*

Approximately 38.6% of the aggregate fair value of the Company's investment portfolio at December 31, 2010 was comprised of senior term debt, 41.1% was senior subordinated term debt, and 20.3% was preferred and common equity securities or their equivalents. At December 31, 2010, the Company had investments in 17 portfolio companies with an aggregate fair value of \$151.1 million, of which Venyu, Acme Cryogenics, Inc. (Acme) and Cavert, collectively, comprised approximately \$61.6 million, or 40.8% of the Company's total investment portfolio, at fair value. The following table outlines the Company's investments by security type at December 31, 2010 and March 31, 2010:

	December 31, 2010		March 31, 2010	
	Cost	Fair Value	Cost	Fair Value
Senior term debt	\$ 64,970	\$ 58,348	\$ 102,446	\$ 94,359
Senior subordinated term debt	72,889	62,048	79,799	71,112
Preferred equity	52,921	24,964	40,728	20,425
Common equity/equivalents	5,102	5,750	4,594	20,962
Total investments	\$ 195,882	\$ 151,110	\$ 227,567	\$ 206,858

Investments at fair value consisted of the following industry classifications at December 31, 2010 and March 31, 2010:

	December 31, 2010		March 31, 2010	
	Fair Value	Percentage of Total Investments	Fair Value	Percentage of Total Investments
Containers, packaging and glass	\$ 27,804	18.4%	\$ 18,731	9.1%
Electronics	25,000	16.5		
Chemicals, plastics and rubber	19,028	12.6	13,585	6.6
Diversified/Conglomerate manufacturing	13,224	8.8	43,054	20.8
Cargo transport	11,980	7.9	9,394	4.5
Machinery	10,385	6.9	60,692	29.3
Buildings and real estate	10,262	6.8	10,220	4.9
Home and office furnishings/consumer products	9,550	6.3	9,374	4.5
Aerospace and defense	7,378	4.9	17,099	8.3
Automobile	6,720	4.4	9,040	4.4
Oil and gas	4,925	3.3	4,943	2.4
Printing and publishing	2,838	1.9	2,895	1.4
Telecommunications	1,509	1.0	7,831	3.8
Diversified/Conglomerate service	507	0.3		
Total investments	\$ 151,110	100.0%	\$ 206,858	100.0%

The investments, at fair value, were included in the following geographic regions of the United States at December 31, 2010 and March 31, 2010:

December 31, 2010

March 31, 2010

	Fair Value	Percentage of Total Investments	Fair Value	Percentage of Total Investments
South	\$ 89,805	59.4%	\$ 60,363	29.2%
Northeast	37,358	24.7	81,276	39.3
West	13,224	8.8	16,124	7.8
Midwest	10,723	7.1	49,095	23.7
Total investments	\$ 151,110	100.0%	\$ 206,858	100.0%

The geographic region indicates the location of the headquarters for the Company's portfolio companies. A portfolio company may have a number of other business locations in other geographic regions.

Table of Contents*Investment Principal Repayments*

The following table summarizes the contractual principal repayments and maturity of the Company's investment portfolio by fiscal year, assuming no voluntary prepayments, at December 31, 2010:

	Amount
For the remaining three months ending March 31, 2011:	\$ 1,640
For the fiscal year ending March 31:	
2012	20,753
2013	30,109
2014	34,331
2015	20,942
2016	26,775
Thereafter	3,543
Total contractual repayments	\$ 138,093
Investments in equity securities	58,023
Adjustments to cost basis on debt securities	(234)
Total cost basis of investments held at December 31, 2010:	\$ 195,882

NOTE 4. RELATED PARTY TRANSACTIONS*Investment Advisory and Management Agreement*

The Company has entered into an investment advisory and management agreement with the Adviser (the Advisory Agreement), which is controlled by the Company's chairman and chief executive officer. In accordance with the Advisory Agreement, the Company pays the Adviser fees as compensation for its services, consisting of a base management fee and an incentive fee. On July 7, 2010, the Company's Board of Directors approved the renewal of the Advisory Agreement through August 31, 2011.

The following tables summarize the management fees, incentive fees and associated credits reflected in the accompanying *Condensed Consolidated Statements of Operations*:

	Three Months Ended		Nine Months Ended	
	December 31,		December 31,	
	2010	2009	2010	2009
Average total assets subject to base management fee ⁽¹⁾	\$ 195,400	\$ 199,800	\$ 198,000	\$ 232,000
Multiplied by pro-rated annual base management fee of 2.0%	0.5%	0.5%	1.5%	1.5%
Unadjusted base management fee	977	999	2,970	3,480
Reduction for loan servicing fees ⁽²⁾	(634)	(886)	(2,124)	(2,892)
Base management fee ⁽²⁾	\$ 343	\$ 113	\$ 846	\$ 588

Credits to base management fee from Adviser:

Fee reduction for the waiver of 2.0% fee on senior syndicated loans to 0.5%	\$	\$ (34)	\$ (15)	\$ (265)
---	----	---------	---------	----------

Credit for fees received by Adviser from the portfolio companies	(450)	(93)	(615)	(326)
Credit to base management fee from Adviser ⁽²⁾	(450)	(127)	(630)	(591)
Net base management fee	\$ (107)	\$ (14)	\$ 216	\$ (3)
Incentive fee ⁽²⁾	\$ 1,898	\$ 588	\$ 2,949	\$ 588

(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 report.

Base Management Fee

The base management fee is payable quarterly and assessed at an annual rate of 2.0%, computed on the basis of the value of the Company's average gross assets at the end of the two most recently completed quarters, which are total assets, including investments made with proceeds of borrowings, less any uninvested cash or cash equivalents resulting from borrowings. In addition, the following three items are adjustments to the base management fee calculation.

Loan Servicing Fees

The Adviser also services the loans held by Business Investment, in return for which it receives a 2.0% annual fee based on the monthly aggregate outstanding balance of loans pledged under the Company's line of credit. Since the Company owns these loans, all loan servicing fees paid to the Adviser are treated as reductions directly against the 2.0% base management fee under the Advisory Agreement.

Table of Contents

Senior Syndicated Loan Fee Waiver

The Company's Board of Directors accepted an unconditional and irrevocable voluntary waiver from the Adviser to reduce the annual 2.0% 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, for the nine months ended December 31, 2010 and 2009.

Portfolio Company Fees

Under the Advisory Agreement, the Adviser has also provided, and continues to provide, managerial assistance and other services to the Company's portfolio companies and may receive fees for services other than managerial assistance. 50% of certain of these fees and 100% of others are credited against the base management fee that the Company would otherwise be required to pay to the Adviser.

Incentive Fee

The incentive fee consists of two parts: an income-based incentive fee and a capital gains-based incentive fee. The income-based incentive fee rewards the Adviser if the Company's quarterly net investment income (before giving effect to any incentive fee) exceeds 1.75% of the Company's net assets (the hurdle rate). The Company will pay the Adviser an income-based incentive fee with respect to the Company's pre-incentive fee net investment income in each calendar quarter as follows:

no incentive fee in any calendar quarter in which its pre-incentive fee net investment income does not exceed the hurdle rate (7.0% annualized);

100% of the Company's pre-incentive fee net investment income with respect to that portion of such pre-incentive fee net investment income, if any, that exceeds the hurdle rate but is less than 2.1875% in any calendar quarter (8.75% annualized); and

20% of the amount of the Company's pre-incentive fee net investment income, if any, that exceeds 2.1875% in any calendar quarter (8.75% annualized).

The second part of the incentive fee is a capital gains-based incentive fee that will be 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 the Company's realized capital gains as of the end of the fiscal year. In determining the capital gains-based incentive fee payable to the Adviser, the Company will calculate the cumulative aggregate realized capital gains and cumulative aggregate realized capital losses since the Company's inception, and the aggregate unrealized capital depreciation as of the date of the calculation, as applicable, with respect to each of the investments in the Company's portfolio. For this purpose, cumulative aggregate realized capital gains, if any, equals the sum of the differences between the net sales price of each investment, when sold, and the original cost of such investment since the Company's inception. Cumulative aggregate realized capital losses equals the sum of the amounts by which the net sales price of each investment, when sold, is less than the original cost of such investment since the Company's inception. Aggregate unrealized capital depreciation equals the sum of the difference, if negative, between the valuation of each investment as of the applicable calculation date and the original cost of such investment. At the end of the applicable year, the amount of capital gains that serves as the basis for the Company's calculation of the capital gains-based incentive fee equals the cumulative aggregate realized capital gains less cumulative aggregate realized capital losses, less aggregate unrealized capital depreciation, with respect to the Company's portfolio of investments. If this number is positive at the end of such year, then the capital gains-based incentive fee for such year equals 20% of such amount, less the aggregate amount of any capital gains-based incentive fees paid in respect of the Company's portfolio in all prior years.

For the three and nine months ended December 31, 2010, the Company recorded income-based incentive fees of \$1.9 million and \$2.9 million, respectively, as its pre-incentive fee net investment income was above the 1.75% hurdle rate of net assets for both the three months ended June 30, 2010 and the three months ended December 31, 2010. The

Company recorded \$0.1 million of income-based incentive fees for both the three and nine months ended December 31, 2009. No capital gains-based incentive fee has been recorded for the Company from its inception through December 31, 2010, as cumulative unrealized capital depreciation exceeded cumulative realized capital gains net of cumulative realized capital losses.

Administration Agreement

The Company has entered into an administration agreement (the Administration Agreement) with Gladstone Administration, LLC (the Administrator), an affiliate of the Adviser, whereby it pays separately for administrative services. The Administration Agreement provides for payments equal to the Company s allocable portion of its Administrator s overhead expenses in performing its obligations under the Administration Agreement, including, but not limited to, rent and the salaries and benefits expenses of the Company s chief financial officer, chief compliance officer, treasurer, internal counsel and their respective staffs. The Company s allocable portion of administrative expenses is derived by multiplying the Administrator s total allocable expenses by the percentage of the Company s total assets at the beginning of the quarter in comparison to the total assets at the beginning of the quarter of all

Table of Contents

companies managed by the Adviser under similar agreements. On July 7, 2010, the Company's Board of Directors approved the renewal of the Administration Agreement through August 31, 2011. For the three and nine months ended December 31, 2010, the Company recorded fees to the Administrator on the *Condensed Consolidated Statements of Operations* of \$0.1 million and \$0.6 million, respectively, as compared to \$0.2 million and \$0.5 million for the three and nine months ended December 31, 2009, respectively.

Related Party Fees Due

Amounts due to related parties on the accompanying *Condensed Consolidated Statements of Assets and Liabilities* were as follows:

	As of December 31, 2010	As of March 31, 2010
Unpaid base management fee due (from) to Adviser	\$ (107)	\$ 16
Unpaid loan servicing fee due to Adviser	172	219
Unpaid incentive fee due to Adviser	1,898	486
Unpaid loan closing fees due to Adviser ⁽¹⁾	221	
Total Fees due to Adviser	2,184	721
Unpaid administration fee due to Administrator	142	149
Total related party fees due	\$ 2,326	\$ 870

⁽¹⁾ Represents closing fees owed to Adviser relating to the funding of Precision in December 2010.

NOTE 5. BORROWINGS*Line of Credit*

On April 14, 2009, the Company, through its wholly-owned subsidiary, Business Investment, entered into a second amended and restated credit agreement providing for a \$50.0 million revolving line of credit (the "Credit Facility") arranged by Branch Banking and Trust Company ("BB&T") as administrative agent. Key Equipment Finance Inc. also joined the Credit Facility as a committed lender. In connection with entering into the Credit Facility, the Company borrowed \$43.8 million under the Credit Facility to make a final payment in satisfaction of all unpaid principal and interest owed to Deutsche Bank AG under a prior line of credit. On April 13, 2010, the Company, through Business Investment, entered into a third amended and restated credit agreement providing for a \$50.0 million, two year revolving line of credit, which extended the maturity date of the Credit Facility to April 13, 2012. If the Credit facility is not renewed or extended by April 13, 2012, all unpaid principal and interest will be due and payable within one year of the maturity date. Advances under the Credit Facility generally bear interest at the 30-day London Interbank Offered Rate ("LIBOR") (subject to a minimum rate of 2.0%), plus 4.5% per annum, with a commitment fee of 0.50% per annum on undrawn amounts when advances outstanding are above 50.0% of the commitment and 1.0% on undrawn amounts if the advances outstanding are below 50.0% of the commitment. As of December 31, 2010, the Company had \$8.0 million outstanding with approximately \$24.7 million of availability under the Credit Facility. Interest is payable monthly during the term of the Credit Facility. Available borrowings are subject to various constraints imposed under the Credit Facility, based on the aggregate loan balance pledged by Business Investment, which varies as loans are added and repaid, regardless of whether such repayments are prepayments or made as contractually required.

The administrative agent also requires that any interest or principal payments on pledged loans be remitted directly by the borrower into a lockbox account with The Bank of New York Mellon Trust Company, N.A as custodian. BB&T is also the trustee of the account and once a month remits the collected funds to the Company.

The Credit Facility contains covenants that require Business Investment to maintain its status as a separate legal entity; prohibit certain significant corporate transactions (such as mergers, consolidations, liquidations or dissolutions); and restrict material changes to the Company's credit and collection policies without the lenders' consent. The Credit Facility also limits payments on distributions to the aggregate net investment income for each of the twelve month periods ending March 31, 2011 and 2012. The Company is also subject to certain limitations on the type of loan investments it can make, including restrictions on geographic concentrations, sector concentrations, loan size, dividend payout, payment frequency and status, average life and lien property. The Credit Facility further requires the Company to comply with other financial and operational covenants, which obligate the Company to, among other things, maintain certain financial ratios, including asset and interest coverage, a minimum net worth, and a minimum number of obligors required in the borrowing base of the credit agreement. Additionally, the Company is subject to a performance guaranty that requires the Company to maintain a (i) minimum net worth of \$155.0 million plus 50.0% of all equity and subordinated debt raised after April 13, 2010, (ii) asset coverage with respect to senior securities representing indebtedness of at least 200%, in accordance with Section 18 of the 1940 Act, and (iii) its status as a BDC under the 1940 Act and as a RIC under the Code. As of December 31, 2010, the Company was in compliance with all covenants.

Table of Contents*Short-Term Loan*

Similar to what has been done at the close of several of the prior quarters, the Company purchased \$75.0 million of short-term United States Treasury Bills (T-Bills) through Jefferies & Company, Inc. (Jefferies) on December 30, 2010. The T-Bills were purchased with \$7.6 million in funds drawn on the Credit Facility and the proceeds from a \$67.4 million short-term loan from Jefferies with an effective annual interest rate of approximately 0.72%. On January 4, 2011, the Company repaid the \$7.6 million drawn on the Credit Facility for the transaction and, on January 6, 2011, when the T-Bills matured, the Company repaid the \$67.4 million loan from Jefferies.

Fair Value

The Company elected to apply ASC 825, Financial Instruments, specifically for the Credit Facility and short-term loan, which was consistent with its application of ASC 820 to its investments. The Company estimated the fair value of the Credit Facility using estimates of value provided by an independent third party and its own assumptions in the absence of observable market data, including estimated remaining life, credit party risk, current market yield and interest rate spreads of similar securities as of the measurement date. Because the Credit Facility had a zero outstanding balance during the three months ended December 31, 2010, except for December 28, 2010 through December 31, 2010, and was paid down to a zero balance on January 4, 2011, the cost basis of the Credit Facility was determined to be the best approximation of fair value as of December 31, 2010. Due to the seven-day duration of the short-term loan, cost approximated fair value. The following tables present the Credit Facility carried at fair value as of December 31, 2010, by caption on the accompanying *Condensed Consolidated Statements of Assets and Liabilities* for each of the three levels of hierarchy established by ASC 820 and a roll-forward in the changes in fair value during the three and nine months ended December 31, 2010 and 2009, for the Credit Facility for which the Company determines fair value using unobservable (Level 3) factors:

	As of December 31, 2010			Total Fair Value Reported in Condensed Consolidated Statement of
	Level 1	Level 2	Level 3	Assets and Liabilities
Credit Facility	\$	\$	\$ 8,000	\$ 8,000
Short-term loan			67,400	67,400
Total	\$	\$	\$ 75,400	\$ 75,400
				Total Fair Value Reported in Condensed Consolidated Statement of Assets and Liabilities
Three months ended December 31, 2010:				
Fair value at September 30, 2010	\$		\$ 25,000	\$ 25,000
Borrowings		8,000	67,400	75,400
Repayments			(25,000)	(25,000)
Net unrealized depreciation of Credit Facility ⁽¹⁾				
Fair value at December 31, 2010	\$ 8,000		\$ 67,400	\$ 75,400

Nine months ended December 31, 2010:

Fair value at March 31, 2010	\$ 27,812	\$ 75,000	\$	102,812
Borrowings	24,000	167,400		191,400
Repayments	(43,800)	(175,000)		(218,800)
Net unrealized depreciation of Credit Facility ⁽¹⁾	(12)			(12)
Fair value at December 31, 2010	\$ 8,000	\$ 67,400	\$	75,400

Table of Contents

	Credit Facility	Short-Term Loan	Total Fair Value Reported in Condensed Consolidated Statement of Assets and Liabilities
Three months ended December 31, 2009:			
Fair value at September 30, 2009	\$ 36,278	\$ 75,000	\$ 111,278
Borrowings	14,000	75,000	89,000
Repayments	(23,350)	(75,000)	(98,350)
Net unrealized appreciation of Credit Facility ⁽¹⁾	(45)		(45)
Fair value at December 31, 2009	\$ 26,883	\$ 75,000	\$ 101,883
Nine months ended December 31, 2009:			
Fair value at March 31, 2009 ⁽²⁾	\$ 110,265	\$	\$ 110,265
Borrowings	93,000	215,000	308,000
Repayments	(176,515)	(140,000)	(316,515)
Net unrealized appreciation of Credit Facility ⁽¹⁾	133		133
Fair value at December 31, 2009	\$ 26,883	\$ 75,000	\$ 101,883

(1) Unrealized appreciation (depreciation) is reported on the accompanying *Condensed Consolidated Statements of Operations*.

(2) ASC 825 was not adopted until the second quarter of fiscal year 2010; therefore, the Credit Facility is shown at its principal balance outstanding at March 31, 2009 in the table above.

The fair value of the collateral under the Credit Facility was approximately \$144.3 million and \$201.8 million at December 31, 2010 and March 31, 2010, respectively. The fair value of the collateral under the short-term loan was approximately \$75.0 million and \$85.0 million as of December 31, 2010 and March 31, 2010, respectively.

NOTE 6. INTEREST RATE CAP AGREEMENTS

In May 2009, the Company cancelled its interest rate cap agreement with Deutsche Bank AG and entered into an interest rate cap agreement with BB&T that effectively limits the interest rate on a portion of the borrowings under the line of credit pursuant to the terms of the Credit Facility. The interest rate cap has a notional amount of \$45.0 million at a cost of approximately \$39. At December 31, 2010, the interest rate cap agreement had a nominal fair market value. The Company records changes in the fair market value of the interest rate cap agreement quarterly based on the current market valuation at quarter end as unrealized depreciation or appreciation on derivative on the accompanying *Condensed Consolidated Statement of Operations*. The interest rate cap agreement expires in May 2011. The agreement provides that the Company's interest rate or cost of funds on a portion of its borrowings will be capped at 6.5% when the LIBOR is in excess of 6.5%.

In April 2010, the Company entered into a forward interest rate cap agreement, effective May 2011 and expiring in May 2012, with BB&T for a notional amount of \$45.0 million that will effectively limit the interest rate on a portion of the borrowings under the line of credit pursuant to the terms of the Credit Facility. In conjunction with this agreement, the Company incurred a premium fee of approximately \$41. The agreement provides that the Company's interest rate or cost of funds on a portion of its borrowings will be capped at 6.0% when the LIBOR is in excess of 6.0%. At December 31, 2010, the interest rate cap agreement had a fair market value of \$7.

The use of a cap involves risks that are different from those associated with ordinary portfolio securities transactions. Cap agreements may be considered to be illiquid. Although the Company will not enter into any such agreements unless it believes that the other party to the transaction is creditworthy, the Company does bear the risk of loss of the amount expected to be received under such agreements in the event of default or bankruptcy of the agreement counterparty.

NOTE 7. COMMON STOCK

As of December 31, 2010 and March 31, 2010, 100,000,000 shares of common stock, \$0.001 par value per share, were authorized and 22,080,133 shares of common stock were outstanding.

Registration Statement

On July 21, 2009, the Company filed a registration statement on Form N-2 (Registration No. 333-160720) that was amended on October 2, 2009 and which the SEC declared effective on October 8, 2009. The Company filed a post-effective amendment to such registration statement on August 24, 2010, which the SEC declared effective on December 23, 2010. The registration statement permits the Company to issue, through one or more transactions, up to an aggregate of \$300.0 million in securities, consisting of common stock, preferred stock, subscription rights, debt securities and warrants to purchase common stock, or a combination of these securities.

Table of Contents**NOTE 8. NET INCREASE (DECREASE) IN NET ASSETS RESULTING FROM OPERATIONS PER SHARE**

The following table sets forth the computation of basic and diluted net increase (decrease) in net assets resulting from operations per share for the three and nine months ended December 31, 2010 and 2009:

	Three months ended December 31,		Nine months ended December 31,	
	2010	2009	2010	2009
Numerator for basic and diluted net increase (decrease) in net assets per share resulting from operations	\$ 15,135	\$ (4,420)	\$ 13,643	\$ (31,699)
Denominator for basic and diluted weighted average shares	22,080,133	22,080,133	22,080,133	22,080,133
Basic and diluted net increase (decrease) in net assets per share resulting from operations	\$ 0.69	\$ (0.20)	\$ 0.62	\$ (1.44)

NOTE 9. DISTRIBUTIONS

The Company's Board of Directors declared the following monthly distributions per share for the nine months ended December 31, 2010 and 2009:

Declaration Date	Record Date	Payment Date	Distribution per Share
April 7, 2010	April 22, 2010	April 30, 2010	\$ 0.04
April 7, 2010	May 20, 2010	May 28, 2010	0.04
April 7, 2010	June 22, 2010	June 30, 2010	0.04
July 7, 2010	July 22, 2010	July 30, 2010	0.04
July 7, 2010	August 23, 2010	August 31, 2010	0.04
July 7, 2010	September 22, 2010	September 30, 2010	0.04
October 5, 2010	October 21, 2010	October 29, 2010	0.04
October 5, 2010	November 19, 2010	November 30, 2010	0.04
October 5, 2010	December 23, 2010	December 31, 2010	0.04
Nine months ended December 31, 2010:			\$ 0.36

Declaration Date	Record Date	Payment Date	Distribution per Share
April 16, 2009	April 27, 2009	May 8, 2009	\$ 0.04
April 16, 2009	May 20, 2009	May 29, 2009	0.04
April 16, 2009	June 22, 2009	June 30, 2009	0.04
July 8, 2009	July 23, 2009	July 31, 2009	0.04
July 8, 2009	August 21, 2009	August 31, 2009	0.04
July 8, 2009	September 22, 2009	September 30, 2009	0.04
October 6, 2009	October 22, 2009	October 30, 2009	0.04
October 6, 2009	November 19, 2009	November 30, 2009	0.04
October 6, 2009	December 22, 2009	December 31, 2009	0.04

Nine months ended December 31, 2009:**\$ 0.36**

Aggregate distributions declared and paid for both the nine months ended December 31, 2010 and 2009 were approximately \$7.9 million, which were declared based on estimates of net investment income for the respective fiscal years. Distributions declared for the fiscal year ended March 31, 2010 equaled net investment income. The characterization of the distributions declared and paid for the fiscal year ended March 31, 2011 will be determined at year end and cannot be determined at this time.

NOTE 10. COMMITMENTS AND CONTINGENCIES

At December 31, 2010, the Company was not party to any signed commitments for potential investments. However, the Company has certain lines of credit with its portfolio companies that have not been fully drawn. Since these lines of credit have expiration dates and the Company expects many will never be fully drawn, the total line of credit commitment amounts do not necessarily represent future cash requirements. The Company estimates the fair value of these unused line of credit commitments as of December 31, 2010 and March 31, 2010 to be nominal.

In October 2008, the Company executed a guaranty of a vehicle finance facility agreement (the Finance Facility) between Ford Motor Credit Company and ASH. The Finance Facility provides ASH with a line of credit of up to \$0.8 million for component Ford parts used by ASH to build truck bodies under a separate contract. Title and ownership of the parts are retained by Ford. The guaranty of the Finance Facility will expire upon termination of the separate parts supply contract with Ford or upon replacement of the Company as guarantor. The Finance Facility is secured by all of the assets of Business Investment. As of December 31, 2010, the Company has not been required to make any payments on the guaranty of the Finance Facility, and the Company considers the credit risk to be remote and the fair value of the guaranty to be minimal.

Table of Contents

In February 2010, the Company executed a guaranty of a wholesale financing facility agreement (the Floor Plan Facility) between Agricredit Acceptance, LLC (Agricredit) and Country Club Enterprises, LLC (CCE). The Floor Plan Facility provides CCE with financing of up to \$2.0 million to bridge the time and cash flow gap between the order and delivery of golf cars to customers. The guaranty expires in February 2011, unless it is renewed by the Company, CCE and Agricredit. In connection with this guaranty, the Company received a premium of \$84 from CCE. As of December 31, 2010, the Company has not been required to make any payments on the guaranty of the Floor Plan Facility, and the Company considers the credit risk to be remote and the fair value of the guaranty to be minimal. In April 2010, the Company executed a guaranty of vendor recourse for up to \$1.8 million in individual customer transactions (the Recourse Facility) between Wells Fargo Financial Leasing, Inc. and CCE. The Recourse Facility provides CCE with the ability to provide vendor recourse up to a limit of \$1.8 million on transactions with long-time customers who lack the financial history to qualify for third party financing. In connection with this guaranty, the Company received a premium of \$0.1 million from CCE. As of December 31, 2010, the Company has not been required to make any payments on the guaranty of the Recourse Facility, and the Company considers the credit risk to be remote and the fair value of the guaranty to be minimal.

NOTE 11. FINANCIAL HIGHLIGHTS

	Three months ended December 31,		Nine months ended December 31,	
	2010	2009	2010	2009
Per Share Data ⁽¹⁾				
Net asset value at beginning of period	\$ 8.43	\$ 8.24	\$ 8.74	\$ 9.73
<i>Income from investment operations</i>				
Net investment income ⁽²⁾	0.34	0.14	0.65	0.36
Realized gain (loss) on exit ⁽²⁾	0.30	(0.05)	1.06	(1.63)
Net unrealized appreciation (depreciation) ⁽²⁾	0.05	(0.28)	(1.09)	(0.17)
Total from investment operations	0.69	(0.19)	0.62	(1.44)
<i>Distributions from:</i>				
Net investment income	(0.12)	(0.12)	(0.36)	(0.36)

(1) Based on actual shares outstanding at the end of the corresponding period.

(2) Based on weighted average basic per share data.

(3) Distributions are determined based on taxable income calculated in accordance with income tax regulations which may differ from amounts determined under accounting principles generally accepted in the United States of America.

(4) Total return equals the change in the market value of the Company's common stock from the beginning of the period, taking into account dividends reinvested in accordance with the terms of the Company's dividend reinvestment plan.

(5) Calculated using the average of the balance of net assets at the end of each month of the reporting period.

(6) As a business development company, the Company is generally required to maintain an asset coverage ratio of at least 200% of total consolidated assets, less all liabilities and indebtedness not represented by senior securities, to

total borrowings and guaranty commitments.

- (7) Asset coverage per unit is the asset coverage ratio expressed in terms of dollar amounts per one thousand dollars of indebtedness.
- (8) Amounts are annualized.
- (9) Ratio of expenses to average net assets is computed using expenses before credits from the Adviser.
- (10) Ratio of net expenses to average net assets is computed using total expenses net of credits to the management fee.

Table of Contents**NOTE 12. SUBSEQUENT EVENTS*****Short-Term Loan***

On December 30, 2010, the Company purchased \$75.0 million of T-Bills through Jefferies. The T-Bills were purchased using \$7.6 million in funds drawn on the Credit Facility and the proceeds from a \$67.4 million short-term loan from Jefferies with an effective annual interest rate of approximately 0.72%. On January 4, 2011, the Company repaid the \$7.6 million drawn on the Credit Facility for the transaction and, on January 6, 2011, when the T-Bills matured, the Company repaid the \$67.4 million loan from Jefferies.

Distributions

On January 11, 2011, the Company's Board of Directors declared the following monthly distributions:

Record Date	Payment Date	Distribution per Share
January 21, 2011	January 31, 2011	\$ 0.04
February 21, 2011	February 28, 2011	0.04
March 21, 2011	March 31, 2011	0.04

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (dollar amounts in thousands, except per share data and as otherwise indicated).

All statements contained herein, 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, growth, plan, intend, expect, should, would, if, seek, likely, estimate 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. 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-Q.

The following analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and the notes thereto contained elsewhere in this report and in our annual report on Form 10-K for the fiscal year ended March 31, 2010.

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 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).

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, as well as 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 new investment opportunities 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.

These new investment opportunities translated into two new proprietary deals during the quarter ended December 31, 2010. In October 2010, we invested \$25.0 million in Venyu Solutions, Inc. (Venyu), consisting of subordinated debt and preferred equity. Venyu, headquartered in Baton Rouge, Louisiana, is a leader in commercial-grade, customizable solutions for data protection, data hosting and disaster recovery. In December 2010, we invested \$10.8 million in Precision Southeast, Inc. (Precision), consisting of senior debt and preferred and common equity. Precision, headquartered in Myrtle Beach, South Carolina, is a custom injection molding company, focused on the filtration, consumer and industrial markets.

Similar to our sale of A. Stucki Holding Corp. (A. Stucki) in June 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 Chase II Holding Corp. (Chase) in December 2010. The net cash proceeds to us from the sale of our equity in Chase were \$13.9 million, resulting in a realized gain of \$6.9 million. In connection with the equity sale, we accrued and received cash dividend proceeds of \$4.0 million from our preferred stock investment. At the same time, we received \$22.9 million in repayment of our principal, accrued interest and success fees on the loans to Chase.

The sale of our equity in A. Stucki, which occurred during the quarter ended June 30, 2010, resulted in net cash proceeds to us of \$21.4 million, and a realized gain of \$16.7 million, which includes a \$0.3 million closing adjustment decrease during the three months ended December 31, 2010. 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 Control investment, Neville Limited, on our *Condensed Consolidated Schedule of Investments* as of December 31, 2010.

Table of Contents

The A. Stucki and Chase sales were the first and second of our management-supported buyout liquidity events, respectively, and each was an equity investment success, highlighting 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 potentially increase our net investment income and generate capital gains to enhance our ability to pay dividends to our stockholders. Due to previous realized losses during the fiscal year-ended March 31, 2010, which occurred in connection with the Syndicated Loan Sales as described below and are available to offset future realized gains, we are not required to distribute the realized gains from the A. Stucki and Chase sales to shareholders. 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 (the "Syndicated Loan Sales") to repay amounts outstanding under our prior line of credit with Deutsche Bank AG (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 \$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, as well as one new syndicated loan investment, at December 31, 2010, we had two remaining syndicated loans. 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. 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 (the "50% threshold"). During the quarter ended December 31, 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, provided that 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 December 31, 2010, 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 December 31, 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. As of the date of this filing, we remain below the 50% threshold. 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 9.6% of our total portfolio as of March 31, 2009 and December 31, 2010, respectively. In addition, the size of our portfolio decreased because we exited \$198.6 million in investments, at cost, partially offset by \$45.0 million in disbursements to new and existing portfolio companies, from March 31, 2009 to December 31, 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 our wholly-owned subsidiary, Gladstone Business Investment, LLC (Business Investment), we entered into a third amended and restated credit agreement providing for a \$50.0 million, two year revolving line of credit (the Credit Facility) arranged by Branch Banking and Trust Company (BB&T) as administrative agent. Key Equipment Finance Company Inc. also joined the Credit Facility as a committed lender. 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

Table of Contents

Credit Facility were modified to generally bear interest at the 30-day London Interbank Offered Rate (LIBOR) (subject to a minimum rate of 2.0%), plus 4.5% per annum, with a commitment fee of 0.50% per annum on undrawn amounts when advances outstanding are above 50.0% of the commitment and 1.0% on undrawn amounts if the advances outstanding are below 50.0% of the commitment. In connection with the Credit Facility renewal, we paid an upfront fee of 1.0%. 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 50.0% 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 January 28, 2011, there was no balance outstanding under the Credit Facility, and \$24.1 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 our 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, 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 January 28, 2011, the closing market price of our common stock was \$6.92, which represented a 23.1% discount to our December 31, 2010 net asset value (NAV) per share of \$9.00. When our stock trades below NAV, as it has consistently 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 at an issuance price 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. This proposal is in effect until our next annual stockholders meeting in 2011, at which time we expect to ask our stockholders to vote in favor of this proposal for another year.

Unstable economic conditions may also continue to decrease the value of collateral securing some of our loans, as well as the value of our equity investments, which has impacted and may continue to impact our ability to borrow under our 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 December 31, 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 and Chase sales and resulting liquidity, the general stabilization of our portfolio valuations, over the past year and increased investing opportunities that we see in our target markets as demonstrated by our three new investments totaling \$36.3 million during the three months ended December 31, 2010, 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 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. This should result in increased investment activity when compared to 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.

Investment Highlights

During the quarter ended December 31, 2010, we extended approximately \$36.6 million of investments to new and existing portfolio companies through revolver draws or additions to term notes. From the time of our initial public offering in June 2005 through December 31, 2010, we have made 153 investments in 91 companies for a total of approximately \$624.5 million, before giving effect to principal repayments on investments and divestitures.

Table of Contents

Recent Developments

Short-Term Loan

Similar to previous quarter ends, we purchased \$75.0 million of short-term United States Treasury Bills (T-Bills) through Jefferies & Company, Inc. (Jefferies) on December 30, 2010. The T-Bills were purchased with \$7.6 million in funds drawn on the Credit Facility and the proceeds from a \$67.4 million short-term loan from Jefferies with an effective annual interest rate of approximately 0.72%. On January 4, 2011, we repaid the \$7.6 million drawn on the Credit Facility for the transaction and, on January 6, 2011, when the T-Bills matured, we repaid the \$67.4 million loan from Jefferies.

Investment Activity

During the nine months ended December 31, 2010, the following significant transactions occurred:

In December 2010, we sold our equity investment and received full repayment of our debt investment in Chase in connection with Chase's sale of 100% of its outstanding capital stock. The net cash proceeds to us from the sale of our equity in Chase were \$13.9 million, resulting in a realized gain of \$6.9 million. In connection with the equity sale, we accrued and received cash dividend proceeds of \$4.0 million from our preferred stock investment in Chase. At the same time, we received \$22.9 million in repayment of our principal, accrued interest and success fees on the loans to Chase.

In December 2010, we invested \$10.8 million in Precision, consisting of senior debt and preferred and common equity. Precision, headquartered in Myrtle Beach, South Carolina, is a custom injection molding company, focused on the filtration, consumer and industrial markets and is included as a Control investment on our *Condensed Consolidated Schedule of Investments* as of December 31, 2010.

In November 2010, we participated in a syndicated loan, Fifth Third Processing Solutions (Fifth Third), at a cost of \$0.5 million.

In October and November 2010, Mathey Investments, Inc. (Mathey) prepaid \$0.4 million of its success fee on its senior term debt.

In October 2010, we invested \$25.0 million in Venyu, consisting of subordinated debt and preferred equity. Venyu, headquartered in Baton Rouge, Louisiana, is a leader in commercial-grade, customizable solutions for data protection, data hosting and disaster recovery and is included as a Control investment on our *Condensed Consolidated Schedule of Investments* as of December 31, 2010.

In September 2010, Cavert II Holding Corp. (Cavert) prepaid \$0.8 million of its success fee on its senior term debt and senior subordinated term debt.

In July and August 2010, we restructured Galaxy Tool Holding Corporation (Galaxy) by converting \$12.3 million of our senior subordinated term note into preferred and common stock and investing an additional \$3.2 million into preferred stock. After the restructuring, our investments at cost in Galaxy consisted of a \$5.2 million senior subordinated term note, \$19.6 million in preferred stock and \$0.1 million in common stock.

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 \$21.4 million, resulting in a realized gain of \$16.7 million, which includes a \$0.3 million closing adjustment decrease during the three months ended December 31, 2010. 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 has been reflected as a Control investment, Neville Limited, on our *Condensed Consolidated Schedule of Investments* since June 30, 2010.

In May 2010, Cavert 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. (ITC) made full repayment of its senior term debt owed to us resulting in the receipt of approximately \$6.7 million in cash proceeds.

Table of Contents**RESULTS OF OPERATIONS**

Comparison of the Three months ended December 31, 2010 to the Three months ended December 31, 2009

A comparison of our operating results for the three months ended December 31, 2010 and 2009 is below:

	For the three months ended December 31,			
	2010	2009	\$ Change	% Change
INVESTMENT INCOME				
Interest income	\$ 3,925	\$ 4,951	\$ (1,026)	(20.7)%
Other income	6,812	970	5,842	602.3
Total investment income	10,737	5,921	4,816	81.3
EXPENSES				
Loan servicing fee	634	886	(252)	(28.4)
Base management fee	343	113	230	203.5
Incentive fee	1,898	588	1,310	222.8
Administration fee	142	156	(14)	(9.0)
Interest expense	135	385	(250)	(64.9)
Amortization of deferred financing fees	116	436	(320)	(73.4)
Other	328	411	(83)	(20.2)
Expenses before credits from Adviser	3,596	2,975	621	20.9
Credits to fees	(450)	(127)	(323)	254.3
Total expenses net of credits to fee	3,146	2,848	298	10.5
NET INVESTMENT INCOME	7,591	3,073	4,518	147.0
REALIZED AND UNREALIZED GAIN (LOSS) ON:				
Net realized gain (loss) on sale of investments	6,514	(1,318)	7,832	NM
Net unrealized appreciation (depreciation) on investments	1,026	(6,213)	7,239	NM
Net unrealized appreciation on other	4	38	(34)	(89.5)
Net gain (loss) on investments and other	7,544	(7,493)	15,037	NM
NET INCREASE (DECREASE) IN NET ASSETS RESULTING FROM OPERATIONS	\$ 15,135	\$ (4,420)	\$ 19,555	NM

NM = Not Meaningful

Investment Income

Total net investment income for the three months ended December 31, 2010 increased considerably over the three months ended December 31, 2009. This increase was due mainly to success fee and dividend income resulting from

our exit in Chase, partially offset by an overall decrease in the size of our loan portfolio and an increase in incentive fee, as compared to the three months ended December 31, 2009.

Interest income from our investments in debt securities decreased for the three months ended December 31, 2010 as compared to the three months ended December 31, 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 December 31, 2010 was approximately \$135.2 million, compared to approximately \$179.6 million for the prior year quarter, due primarily to the exits from A. Stucki and Chase, the restructure of Galaxy and the payoff of ITC, partially offset with new investments in Venyu and Precision, all of which occurred subsequent to December 31, 2009. As of December 31, 2010 and 2009, one loan, ASH Holdings Corp. (ASH), was on non-accrual, with a weighted average cost basis of \$8.6 million and \$6.7 million, respectively.

Other income increased significantly during the three months ended December 31, 2010, due primarily to our sale of Chase. We received \$2.3 million in success fee income resulting from our sale of Chase in December 2010. In addition, we recorded and collected approximately \$4.0 million of cash dividends on preferred shares of Chase. In total, we recorded \$6.3 million in other income resulting from the sale of Chase. Other income for the three months ended December 31, 2009 primarily consisted of \$1.0 million of accrued cash dividends received from A. Stucki. No success fee income was recorded during the quarter ended December 31, 2009.

Table of Contents

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 December 31, 2010		Three months ended December 31, 2010	
	Fair Value	% of Portfolio	Revenues	% of Total Revenues
Chase II Holding Corp. ⁽¹⁾	\$	%	\$ 6,902	64.3%
Venyu Solutions, Inc.	25,000	16.5	439	4.1
Acme Cryogenics, Inc.	19,028	12.6	439	4.1
Cavert II Holding Corp.	17,580	11.6	223	2.0
Danco Acquisition Corp.	13,224	8.8	398	3.7
Subtotal five largest investments	74,832	49.5	8,401	78.2
Other portfolio companies	76,278	50.5	2,336	21.8
Total investment portfolio	\$151,110	100.0%	\$ 10,737	100.0%

⁽¹⁾ Chase II Holding Corp. was sold on December 29, 2010.

Company	As of December 31, 2009		Three months ended December 31, 2009	
	Fair Value	% of Portfolio	Revenues	% of Total Revenues
A. Stucki Holding Corp.	\$ 33,601	17.9%	\$ 1,526	25.8%
Chase II Holding Corp.	28,917	15.5	622	10.5
Cavert II Holding Corp.	18,035	9.6	285	4.8
Galaxy Tool Holding Corp.	16,991	9.1	595	10.0
Acme Cryogenics, Inc.	14,479	7.7	426	7.2
Subtotal five largest investments	112,023	59.8	3,454	58.3
Other portfolio companies	75,363	40.2	2,467	41.7
Total investment portfolio	\$187,386	100.0%	\$ 5,921	100.0%

The annualized weighted average yield on our interest-bearing investment portfolio, excluding cash and cash equivalents, for the three months ended December 31, 2010 was 10.81%, compared to 10.68% 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 December 31, 2010 resulted primarily from the sale and repayment of lower interest-bearing loans, specifically HMTBP Acquisition II Corp. and ITC, as well as the exit from A. Stucki prior to September 30, 2010. The composition of our investment portfolio was primarily Control and Affiliate investments as of December 31, 2010. Due to the sales of A. Stucki and Chase, 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, as we did in Venyu and Precision, there can be no guarantee that that we will be able to close such investments.

Operating Expenses

Total operating expenses, excluding any voluntary and irrevocable credits to the base management and incentive fees, increased for the three months ended December 31, 2010, as compared to the prior year period, primarily due to an increase in the incentive fee earned for the three months ended December 31, 2010, partially offset by reductions in loan servicing fees, interest expense and deferred financing fees associated with the Credit Facility.

Loan servicing fees decreased for the three months ended December 31, 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 was a result of the reduced size of our pledged loan portfolio, caused primarily by the exits from A. Stucki in June 2010 and Chase in December 2010.

The net base management fee decreased for the three months ended December 31, 2010, as compared to the prior year period, which is due to the increase in credits received for fees paid to our Adviser from our portfolio companies during the current quarter, primarily from fees earned on the closing of investments in Venyu and Precision. The net base management fee decrease was partially offset by holding fewer loans that generate loan servicing fees that reduce the base management fee as compared to the prior year period. An incentive fee was earned by our Adviser during the three months ended December 31, 2010, due primarily to Other income recorded in connection with the Chase sale.

The incentive fee earned during the prior year period was due in part to a one-time dividend received from A. Stucki.

The base management and incentive fees are computed quarterly, as described under *Investment*

Table of Contents

Advisory and Management Agreement in Note 4 of the notes to the accompanying *Condensed Consolidated Financial Statements* and are summarized in the following table:

	Three months ended December 31,	
	2010	2009
Average total assets subject to base management fee ⁽¹⁾	\$ 195,400	\$ 199,800
Multiplied by pro-rated annual base management fee of 2.0%	0.5%	0.5%
Unadjusted base management fee	\$ 977	\$ 999
Reduction for loan servicing fees ⁽²⁾	(634)	(886)
Base management fee ⁽²⁾	\$ 343	\$ 113
<i>Credits to base management fee from Adviser:</i>		
Fee reduction for the waiver of 2.0% fee on senior syndicated loans to 0.5%		(34)
Credit for fees received by Adviser from the portfolio companies	(450)	(93)
Credit to base management fee from Adviser ⁽²⁾	(450)	(127)
Net base management fee	\$ (107)	\$ (14)
Incentive fee ⁽²⁾	\$ 1,898	\$ 588

(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 report. The administration fee decreased slightly for the three months ended December 31, 2010, as compared to the prior year period, primarily due to fewer total assets held during the quarter ended December 31, 2010 in relation to the other funds administered by Gladstone Administration, LLC, as compared to the prior year period. The calculation of the administration fee is described in detail under *Investment Advisory and Management Agreement* in Note 4 of the notes to the accompanying *Condensed Consolidated Financial Statements*.

Interest expense decreased for the quarter ended December 31, 2010, as compared to the prior year period, primarily due to decreased borrowings under the Credit Facility. The weighted average balance outstanding on our Credit Facility during the quarter ended December 31, 2010 was approximately \$0.3 million, as compared to \$16.9 million in the prior year period, a decrease of 98.2%. The effective interest rate, excluding the impact of deferred financing fees, charged on our borrowings under our Credit Facility during the quarter ended December 31, 2010 is not meaningful due to nominal borrowings outstanding; however, the effective interest rate during the prior year period was 9.01%. We incurred few deferred financing costs with the renewal of the Credit Facility in April 2010, and, as a result, our amortization of deferred financing fees decreased in the quarter ended December 31, 2010, as compared to the prior year period. During the three months ended December 31, 2009, we incurred significant one-time costs related to the

termination of our Prior Credit Facility and transition to our Credit Facility, resulting in significant amortization of deferred financing fees during the quarter ended December 31, 2009.

Realized and Unrealized Gain (Loss) on Investments

Realized Gains (Losses)

During the three months ended December 31, 2010, we exited one proprietary investment, Chase, for \$40.6 million in total proceeds and recorded a realized gain of \$6.9 million. Partially offsetting this gain was a \$0.3 million markdown in the three months ended December 31, 2010 to the realized gain recorded on the sale of A. Stucki in June 2010, due to a subsequent cost that arose from the closing statement. During the three months ended December 31, 2009, we completed the sales of certain syndicated loans for aggregate proceeds of \$5.5 million and recorded a realized loss of \$1.3 million.

Unrealized Appreciation (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 quarter ended December 31, 2010, we recorded net unrealized appreciation of investments in the aggregate amount of \$1.0 million, which included the reversal of approximately \$4.5 million in unrealized appreciation related to the Chase sale. Excluding reversals, we recorded an aggregate of \$5.5 million in net unrealized appreciation of investments for the quarter ended December 31, 2010. During the prior year period, we recorded net unrealized depreciation of investments in the

Table of Contents

aggregate amount of \$6.2 million. The net unrealized appreciation (depreciation) across our investments for the three months ended December 31, 2010 was as follows:

	Investment Classification	Three Months Ended December 31, 2010			
		Realized Gain (Loss)	Unrealized Appreciation (Depreciation)	Reversal of Unrealized (Appreciation) Depreciation	Net Gain (Loss)
Acme Cryogenics, Inc.	Control	\$	\$ 3,933	\$	\$ 3,933
Chase II Holding Corp.	Control	6,857		(4,444)	2,413
Noble Logistics, Inc.	Affiliate		2,147		2,147
Galaxy Tool Holding Corp.	Control		2,011		2,011
Quench Holdings Corp.	Affiliate		435		435
Country Club Enterprises, LLC	Control		(105)		(105)
Danco Acquisition Corp.	Affiliate		(209)		(209)
A. Stucki Holding Corp.	Control	(343)			(343)
Cavert II Holding Corp.	Control		(488)		(488)
ASH Holdings Corp.	Control		(2,321)		(2,321)
Other, net (<\$100 Net)	Various		67		67
Total		\$ 6,514	\$ 5,470	\$ (4,444)	\$ 7,540

The primary drivers in our net unrealized appreciation for the quarter ended December 31, 2010 were notable appreciations in the equity of Acme Cryogenics, inc., Noble Logistics, Inc. and Galaxy, largely offset by the reversal of previously-recorded unrealized appreciation on our sale of Chase, as well as a full markdown in fair value on ASH, which had a fair value of \$0 as of December 31, 2010. Excluding reversals, the unrealized appreciation of \$5.5 million 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. The net unrealized appreciation (depreciation) across our investments for the three months ended December 31, 2009 was as follows:

	Investment Classification	Three Months Ended December 31, 2009			
		Realized Gain (Loss)	Unrealized Appreciation (Depreciation)	Reversal of Unrealized (Appreciation) Depreciation	Net Gain (Loss)
Cavert II Holding Corp.	Control	\$	\$ 1,686	\$	\$ 1,686
Quench Holdings Corp.	Affiliate		1,150		1,150
American Greetings Corp.	Non-Control/Non-Affiliate		306		306
ASH Holdings Corp.	Control		272		272
Danco Acquisition Corp.	Affiliate		148		148
Galaxy Tool Holding Corp.	Control		129		129
Survey Sampling, LLC	Non-Control/Non-Affiliate		128		128
Tread Corp.	Affiliate		(144)		(144)
Mathey Investments, Inc.	Control		(170)		(170)

Edgar Filing: GLADSTONE INVESTMENT CORPORATION/DE - Form 10-Q

HMTBP Acquisition II Corp.	Non-Control/Non-Affiliate	(757)		755	(2)
Noble Logistics, Inc.	Affiliate		(776)		(776)
Interstate FiberNet, Inc.	Non-Control/Non-Affiliate	(561)	(405)	559	(407)
A. Stucki Holding Corp.	Control		(2,830)		(2,830)
Chase II Holding Corp.	Control		(3,221)		(3,221)
Acme Cryogenics, Inc.	Control		(3,849)		(3,849)
Other, net (<\$100 Net)	Various		49		49
Total		\$ (1,318)	\$ (7,527)	\$ 1,314	\$ (7,531)

Significant unrealized depreciation was experienced in the equity holdings of our Control investments during the quarter ended December 31, 2009, while the value of our debt positions remained relatively stable. The unrealized depreciation recognized on our portfolio investments was primarily due the a general instability of the loan markets, 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 \$2.4 million of net unrealized depreciation on our debt positions for the quarter ended December 31, 2010, while our equity holdings experienced an aggregate of approximately \$3.4 million of net unrealized appreciation. At December 31, 2010, the fair value of our investment portfolio was less than the cost basis of our portfolio by approximately \$44.8 million, as compared to \$45.8 million at September 30, 2010, representing net unrealized appreciation of \$1.0 million for the three months ended December 31, 2010. 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 generally

Table of Contents

stabilized over the past several quarters, our entire portfolio was fair valued at 77.1% of cost as of December 31, 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 to stockholders.

Net Increase (Decrease) in Net Assets Resulting from Operations

For the three months ended December 31, 2010, we recorded a net increase in net assets resulting from operations of \$15.1 million as a result of the factors discussed above. For the three months ended December 31, 2009, we recorded a net decrease in net assets resulting from operations of \$4.4 million. Our net increase (decrease) in net assets resulting from operations per basic and diluted weighted average common share for the three months ended December 31, 2010 and 2009 was \$0.69 and \$(0.20), respectively.

Table of Contents**Comparison of the Nine months ended December 31, 2010 to the Nine months ended December 31, 2009**

A comparison of our operating results for the nine months ended December 31, 2010 and 2009 is below:

	For the nine months ended December 31,			
	2010	2009	\$ Change	% Change
INVESTMENT INCOME				
Interest income	\$ 11,928	\$ 14,967	\$ (3,039)	(20.3)%
Other income	10,358	1,066	9,292	871.7
Total investment income	22,286	16,033	6,253	39.0
EXPENSES				
Loan servicing fee	2,124	2,892	(768)	(26.6)
Base management fee	846	588	258	43.9
Incentive fee	2,949	588	2,361	401.5
Administration fee	582	527	55	10.4
Interest expense	558	1,640	(1,082)	(66.0)
Amortization of deferred financing fees	383	1,187	(804)	(67.7)
Other	1,236	1,313	(77)	(5.9)
Expenses before credits from Adviser	8,678	8,735	(57)	(0.7)
Credits to fees	(630)	(591)	(39)	6.6
Total expenses net of credits to fee	8,048	8,144	(96)	(1.2)
NET INVESTMENT INCOME	14,238	7,889	6,349	80.5
REALIZED AND UNREALIZED LOSS ON:				
Net realized gain (loss) on investments	23,489	(35,922)	59,411	NM
Net realized loss on other		(53)	53	(100.0)
Net unrealized depreciation on investments	(24,063)	(3,499)	(20,564)	587.7
Net unrealized depreciation on other	(21)	(114)	93	(81.6)
Net loss on investments and other	(595)	(39,588)	38,993	(98.5)
NET INCREASE (DECREASE) IN NET ASSETS RESULTING FROM OPERATIONS	\$ 13,643	\$ (31,699)	\$ 45,342	NM

NM = Not Meaningful

Investment Income

Total net investment income increased by 80.5% for the nine months ended December 31, 2010 as compared to the nine months ended December 31, 2009. This increase was due mainly to success fee and dividend income resulting from our exits from A. Stucki and Chase in June and December, 2010, respectively, and the success fee prepayments from Cavert and Mathey; partially offset by an overall decrease in the size of our loan portfolio and an increase in

incentive fees earned for the nine months ended December 31, 2010, as compared to the prior year period. Interest income from our investments in debt securities decreased for the nine months ended December 31, 2010 as compared to the nine months ended December 31, 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 nine months ended December 31, 2010 was approximately \$141.0 million, compared to approximately \$210.6 million for the prior year period, due primarily to the Syndicated Loan Sales, the exits from A. Stucki and Chase, the restructuring of Galaxy and the payoff of ITC, partially offset with new investments in Venyu and Precision, all of which occurred subsequent to December 31, 2009. As of December 31, 2010 and 2009, one loan, ASH, was on non-accrual, with a weighted average cost basis of \$8.0 million and \$6.6 million for the nine months ended December 31, 2010 and 2009, respectively.

Other income increased significantly due to our sales of A. Stucki and Chase and success fee prepayments from Cavert and Mathey. We received an aggregate of \$4.3 million in success fee income resulting from our sales of A. Stucki and Chase in June and December, 2010, respectively. In addition, we recorded and collected \$4.3 million of aggregate cash dividends on preferred shares of A. Stucki and Chase. We also accrued and received a special dividend of property valued at \$0.5 million in connection with the A. Stucki sale. In total, we recorded \$9.1 million in other income resulting from the sales of A. Stucki and Chase. During the nine months ended December 31, 2010, we also recorded \$0.8 million and \$0.4 million in success fee income resulting from prepayments

Table of Contents

received from Cavert and Mathey, respectively. Other income for the nine months ended December 31, 2009 primarily consisted of \$1.0 million of accrued cash dividends received from A. Stucki.

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 December 31, 2010		Nine months ended December 31, 2010	
	Fair Value	% of Portfolio	Revenues	% of Total Revenues
Chase II Holding Corp. ⁽¹⁾	\$	%	\$ 8,093	36.3%
A. Stucki Holding Corp. ⁽²⁾			3,317	14.9
Venju Solutions, Inc.	25,000	16.6	439	2.0
Acme Cryogenics, Inc.	19,028	12.6	1,307	5.9
Cavert II Holding Corp.	17,580	11.6	1,457	6.5
Subtotal five largest investments	61,608	40.8	14,613	65.6
Other portfolio companies	89,502	59.2	7,673	34.4
Total investment portfolio	\$151,110	100.0%	\$ 22,286	100.0%

⁽¹⁾ Chase II Holding Corp. was sold on December 29, 2010.

⁽²⁾ A. Stucki Holding Corp. was sold on June 29, 2010.

Company	As of December 31, 2009		Nine months ended December 31, 2009	
	Fair Value	% of Portfolio	Revenues	% of Total Revenues
A. Stucki Holding Corp.	\$ 33,601	17.9%	\$ 2,677	16.7%
Chase II Holding Corp.	28,917	15.5	1,948	12.2
Cavert II Holding Corp.	18,035	9.6	926	5.8
Galaxy Tool Holding Corp.	16,991	9.1	1,779	11.1
Acme Cryogenics, Inc.	14,479	7.7	1,274	7.9
Subtotal five largest investments	112,023	59.8	8,604	53.7
Other portfolio companies	75,363	40.2	7,429	46.3
Total investment portfolio	\$187,386	100.0%	\$ 16,033	100.0%

The annualized weighted average yield on our interest-bearing investment portfolio, excluding cash and cash equivalents, for the nine months ended December 31, 2010 was 10.61%, compared to 10.16% 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 nine months ended December 31, 2010 resulted primarily from our sales of lower

interest-bearing senior syndicated loans during the quarter ended June 30, 2009. The composition of our investment portfolio was primarily Control and Affiliate investments as of December 31, 2010. Due to the sales of A. Stucki and Chase, as well as 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, as we did in Venyu and Precision, there can be no guarantee that that we will be able to close such investments.

Operating Expenses

Total operating expenses, excluding any voluntary and irrevocable credits to the base management and incentive fees, decreased slightly for the nine months ended December 31, 2010, primarily due to a reduction in interest expense and deferred financing fees associated with the Credit Facility, partially offset by an increase in the incentive fee accrual, as compared to the prior year period.

Loan servicing fees decreased for the nine months ended December 31, 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 was a result of the reduced size of our pledged loan portfolio, caused primarily by the A. Stucki and Chase exits in June 2010 and December 2010, respectively.

The net base management fee increased for the nine months ended December 31, 2010, as compared to the prior year period, which is reflective of holding fewer loans that generate loan servicing fees that reduce the base management fee, partially offset by increased unencumbered cash holdings that are subject to the base management fee during the nine months ended December 31, 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. However, the credit we received for fees

Table of Contents

paid to our Adviser from our portfolio companies increased during the nine months ended December 31, 2010, due to fees earned on the closing of new investments in Venyu and Precision. An incentive fee was earned by the Adviser during the nine months ended December 31, 2010, due in part to Other income recorded in connection with the A. Stucki and Chase sales. The incentive fee earned during the prior year period was due primarily to a one-time dividend prepayment received from A. Stucki. The base management and incentive fees are computed quarterly, as described under *Investment Advisory and Management Agreement* in Note 4 of the notes to the accompanying *Condensed Consolidated Financial Statements* and are summarized in the following table:

	Nine Months Ended December 31,	
	2010	2009
Average total assets subject to base management fee ⁽¹⁾	\$ 198,000	\$ 232,000
Multiplied by pro-rated annual base management fee of 2.0%	1.5%	1.5%
Unadjusted base management fee	2,970	3,480
Reduction for loan servicing fees ⁽²⁾	(2,124)	(2,892)
Base management fee ⁽²⁾	\$ 846	\$ 588
<i>Credits to base management fee from Adviser:</i>		
Fee reduction for the waiver of 2.0% fee on senior syndicated loans to 0.5%	(15)	(265)
Credit for fees received by Adviser from the portfolio companies	(615)	(326)
Credit to base management fee from Adviser ⁽²⁾	(630)	(591)
Net base management fee	\$ 216	\$ (3)
Incentive fee ⁽²⁾	\$ 2,949	\$ 588

(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 report. Interest expense decreased for the nine months ended December 31, 2010, as compared to the prior year period, primarily due to decreased borrowings under the Credit Facility. The weighted average balance outstanding on our line of credit during the nine months ended December 31, 2010 was approximately \$3.8 million, as compared to \$29.0 million in the prior year period, a decrease of 86.9%. The effective interest rate, excluding the impact of deferred financing fees, charged on our borrowings increased under our Credit Facility during the nine months ended December 31, 2010 to 18.90%, up from 7.47% during the prior year period. The increase in the effective interest rate was due to the unused commitment fee, which accrued at a higher rate and had a higher unused commitment base than our Prior Credit Facility, and a lower balance of borrowings outstanding to which allocate the expenses during the nine months ended December 31, 2010, when compared to the prior year period.

We incurred few deferred financing costs with the renewal of the Credit Facility in April 2010, and, as a result, our amortization of deferred financing fees decreased during the nine months ended December 31, 2010, as compared to the prior year. Last year, we incurred significant one-time costs related to the termination of our Prior Credit Facility and transition to our Credit Facility, resulting in significant amortization of deferred financing fees during the nine months ended December 31, 2009.

Realized and Unrealized Gain (Loss) on Investments

Realized Gains (Losses)

During the nine months ended December 31, 2010, we exited two proprietary investments, A. Stucki and Chase, for total proceeds of \$92.5 million and recorded a realized gain of \$23.5 million. During the nine months ended December 31, 2009, 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. The realized losses were primarily 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.

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 nine months ended December 31, 2010, we recorded net unrealized depreciation of investments in the aggregate amount of \$24.1 million, which included the reversal of \$21.9 million in aggregate unrealized appreciation related to the A. Stucki and Chase sales. Excluding reversals, we had \$2.2 million in net unrealized depreciation for the nine months ended December 31, 2010. The unrealized appreciation (depreciation) across our investments for the nine months ended December 31, 2010 was as follows:

Table of Contents

Nine Months Ended December 31, 2010					
Portfolio Company	Investment Classification	Realized Gain (Loss)	Unrealized Appreciation (Depreciation)	Reversal of Unrealized (Appreciation) Depreciation	Net Gain (Loss)
Chase II Holding Corp.	Control	\$ 6,857	\$ 3,753	\$ (4,444)	\$ 6,166
Acme Cryogenics, Inc.	Control		5,028		5,028
Noble Logistics, Inc.	Affiliate		2,986		2,986
Cavert II Holding Corp.	Control		1,774		1,774
Survey Sampling, LLC	Non-Control/Non-Affiliate		500		500
Quench Holdings Corp.	Affiliate		176		176
Interstate FiberNet, Inc.	Non-Control/Non-Affiliate	18		(19)	(1)
Tread Corp.	Control		(103)		(103)
Country Club Enterprises, LLC	Control		(149)		(149)
A. Stucki Holding Corp.	Control	16,614		(17,405)	(791)
ASH Holdings Corp.	Control		(3,005)		(3,005)
Galaxy Tool Holding Corp.	Control		(13,238)		(13,238)
Other, net (<\$100 Net)	Various		83		83
Total		\$ 23,489	\$ (2,195)	\$ (21,868)	\$ (574)

The primary changes in our net unrealized depreciation for the nine months ended December 31, 2010 were the reversal of previously recorded unrealized appreciation on the A. Stucki sale, the unrealized depreciation recorded on Galaxy, which underwent a restructuring which resulted in the conversion of \$12.1 million of debt at fair value as of June 30, 2010 into preferred and common equity, and a full markdown in fair value on ASH, which had a fair value of \$0 as of December 31, 2010. Noteworthy appreciation was experienced in our equity holdings of Acme Cryogenics, Inc., Noble Logistics, Inc., and Cavert, as well as in our debt position in Survey Sampling, LLC. Excluding the impact of Galaxy and A. Stucki, the net 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.

During the nine months ended December 31, 2009, we had net unrealized depreciation of investments in the aggregate amount of \$3.5 million, which included the reversal of \$35.7 million in unrealized depreciation, primarily related to the Syndicated Loan Sales. Excluding reversals, we had \$32.2 million in net unrealized depreciation for the nine months ended December 31, 2009. 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. The unrealized appreciation (depreciation) across our investments for the nine months ended December 31, 2009 was as follows:

Nine Months Ended December 31, 2009					
Portfolio Company	Investment Classification	Realized Gain (Loss)	Unrealized Appreciation (Depreciation)	Reversal of Unrealized (Appreciation) Depreciation	Net Gain (Loss)
Cavert II Holding Corp.	Control	\$	\$ 2,466	\$	\$ 2,466
Interstate FiberNet, Inc.	Non-Control/Non-Affiliate	(561)	872	559	870
American Greetings Corp.	Non-Control/Non-Affiliate		714		714

Edgar Filing: GLADSTONE INVESTMENT CORPORATION/DE - Form 10-Q

Quench Holdings Corp.	Affiliate		427		427
ASH Holdings Corp.	Control		368		368
B-Dry, LLC	Non-Control/Non-Affiliate		300		300
HMTBP Acquisition II Corp.	Non-Control/Non-Affiliate	(757)	142	755	140
Mathey Investments, Inc.	Control		(789)		(789)
Survey Sampling, LLC	Non-Control/Non-Affiliate		(1,169)		(1,169)
Tread Corp.	Affiliate		(1,196)		(1,196)
Danco Acquisition Corp.	Affiliate		(2,024)		(2,024)
Noble Logistics, Inc.	Affiliate		(2,328)		(2,328)
Country Club Enterprises, LLC	Control		(3,874)		(3,874)
Galaxy Tool Holding Corp.	Control		(5,445)		(5,445)
Acme Cryogenics, Inc.	Control		(6,942)		(6,942)
Chase II Holding Corp.	Control		(7,623)		(7,623)
A. Stucki Holding Corp.	Control		(13,135)		(13,135)
Syndicated Loan Sales, net	Non-Control/Non-Affiliate	(34,604)		34,423	(181)
Total			\$ (35,922)	\$ (39,236)	\$ 35,737
					\$ (39,421)

Significant unrealized depreciation was experienced in the equity holdings of our Control and Affiliate investments, during the nine months ended December 31, 2010, primarily due to general instability of the loan markets, 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.

Table of Contents

Over our entire investment portfolio, we recorded an aggregate of approximately \$0.7 million of net unrealized depreciation on our debt positions for the nine months ended December 31, 2010, while our equity holdings experienced an aggregate of approximately \$23.4 million of net unrealized depreciation. At December 31, 2010, the fair value of our investment portfolio was less than the cost basis of our portfolio by approximately \$44.8 million, as compared to \$20.7 million at March 31, 2010, representing net unrealized depreciation of \$24.1 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 generally stabilized over the past several quarters, our entire portfolio was fair valued at 77.1% of cost as of December 31, 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 nine months ended December 31, 2010, we recorded a net increase in net assets resulting from operations of \$13.6 million as a result of the factors discussed above. For the nine months ended December 31, 2009, we recorded a net decrease in net assets resulting from operations of \$31.7 million. Our net increase (decrease) in net assets resulting from operations per basic and diluted weighted average common share for the nine months ended December 31, 2010 and 2009 was \$0.62 and \$(1.44), respectively.

Table of Contents**LIQUIDITY AND CAPITAL RESOURCES (dollar amounts in thousands, except per share amounts or unless otherwise indicated)****Operating Activities**

Net cash provided by operating activities for the nine months ended December 31, 2010 was approximately \$28.4 million and consisted primarily of proceeds received from the A. Stucki and Chase sales, principal payments received from existing investments and the net unrealized depreciation of our investment portfolio over the period. Net cash provided by operating activities for the nine months ended December 31, 2009 was approximately \$97.8 million and consisted primarily of the proceeds received from the Syndicated Loan Sales and the net loss realized on those sales and principal payments received from existing investments.

At December 31, 2010, we had investments in equity of, loans to, or syndicated participations in, 17 private companies with an aggregate cost basis of approximately \$195.9 million. At December 31, 2009, we had investments in equity of, loans to, or syndicated participations in, 16 private companies with an aggregate cost basis of approximately \$225.9 million. The following table summarizes our total portfolio investment activity during the nine months ended December 31, 2010 and 2009:

	Nine months ended December 31,	
	2010	2009
Beginning investment portfolio, at fair value	\$ 206,858	\$ 313,930
New investments	35,814	
Disbursements to existing investments	5,280	2,413
Scheduled principal repayments	(2,506)	(2,787)
Unscheduled principal repayments	(59,037)	(12,041)
Amortization of premiums and discounts	(6)	(2)
Proceeds from sales	(35,010)	(74,706)
Net realized gain (loss)	23,489	(35,922)
Net unrealized depreciation	(2,195)	(39,236)
Reversal of net unrealized (appreciation) depreciation	(21,868)	35,737
Other cash activity, net	(231)	
Other non-cash activity, net	522	
Ending investment portfolio, at fair value	\$ 151,110	\$ 187,386

The following table summarizes the contractual principal repayment and maturity of our investment portfolio by fiscal year, assuming no voluntary prepayments, at December 31, 2010.

	Amount
For the remaining three months ending March 31, 2011:	\$ 1,640
For the fiscal year ending March 31:	
2012	20,753
2013	30,109
2014	34,331
2015	20,942
2016	26,775
Thereafter	3,543
Total contractual repayments	\$ 138,093
Investments in equity securities	58,023
Adjustments to cost basis on debt securities	(234)

Total cost basis of investments held at December 31, 2010: **\$ 195,882**

Prior to our new proprietary investments in Venyu in October 2010 and in Precision in December 2010, our most recent proprietary investment in a new portfolio company occurred in November 2008. In light of the A. Stucki and Chase sales and resulting liquidity, the general stabilization of our portfolio valuations over the past year and the increased investing opportunities that we see in our target markets, as demonstrated by our new \$25.0 million and \$10.8 million investments in Venyu and Precision, respectively, we are cautiously optimistic about the long-term prospects and are shifting our investment activity from being focused primarily on retaining capital and building the value of our existing portfolio companies to one that includes making new conservative investments in businesses that we believe will weather the current economic conditions and that 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. Increasing new investment activity over the long run will require accessing capital markets, which continue to be challenging in these unstable economic conditions, and maintaining our RIC status.

Table of Contents**Financing Activities**

Net cash used in financing activities for the nine months ended December 31, 2010 was approximately \$36.1 million, which was primarily a result of net repayments on our line of credit and short-term loan in excess of borrowings by approximately \$27.4 million, in addition to distributions paid to stockholders of \$7.9 million.

Net cash used in financing activities during the nine months ended December 31, 2009 was approximately \$17.2 million, which primarily consisted of net repayments made on the line of credit, in connection with the termination of our prior credit facility, in addition to our distributions paid to stockholders of \$7.9 million, partially offset by net proceeds received on the short-term loan from Jefferies.

Distributions

To qualify as a RIC and, therefore, avoid corporate level tax on the income we distribute to our stockholders, we are required, under Subchapter M of the Code, to distribute at least 90% of our ordinary income and short-term capital gains to our stockholders on an annual basis. In accordance with these requirements, we declared and paid monthly cash distributions of \$0.04 per common share for each month during the nine months ended December 31, 2010 and 2009. In January 2011, our Board of Directors declared a monthly distribution of \$0.04 per common share for each of January, February and March 2011. We declared these distributions based on our estimates of net investment income for the fiscal year.

For the quarter ended December 31, 2010, please refer to *Section 19(a) Disclosure* below for estimated tax characterization. For the fiscal year ended March 31, 2010, which includes the three months ended December 31, 2009, our distribution payments of approximately \$10.6 million equaled our net investment income of approximately \$10.6 million. Additionally, the covenants in our Credit Facility restrict the amount of distributions that we can pay out to be no greater than our net investment income.

Section 19(a) Disclosure

Our Board of Directors estimates the source of the distributions at the time of their declaration, as required by Section 19(a) of the 1940 Act. On a monthly basis, if required under Section 19(a), we post a Section 19(a) notice through the Depository Trust Company's Legal Notice System and also sends to our registered stockholders a written Section 19(a) notice along with the payment of distributions for any payment which includes a distribution estimated to be paid from any source other than accumulative net investment income during the fiscal year. The estimates of the source of the distribution are interim estimates based on accounting principles generally accepted in the United States (GAAP) that are subject to revision, and the exact character of the distributions for tax purposes cannot be determined until our books and records are finalized for the calendar year. Following the calendar year end, after we have determined definitive information, if we have made distributions of taxable income (or return of capital), we will deliver a Form 1099-DIV to our stockholders specifying such amount and the tax characterization of such amount. Therefore, these estimates are made solely to comply with the requirements of Section 19(a) of the 1940 Act and should not be relied upon for tax reporting or any other purposes and could differ significantly from the actual character of distributions for tax purposes.

Issuance of Equity

On July 21, 2009, we filed a registration statement (the *Registration Statement*) with the Securities and Exchange Commission (the *SEC*) that was amended on October 2, 2009 and which the SEC declared effective on October 8, 2009. We filed a post-effective amendment to the Registration Statement on August 24, 2010, which the SEC declared effective on December 23, 2010. The Registration Statement permits us to issue, through one or more transactions, up to an aggregate of \$300.0 million in securities, consisting of common stock, preferred stock, subscription rights, debt securities, warrants to purchase common stock, or a combination of these securities.

We anticipate issuing equity securities to obtain additional capital in the future. However, we cannot determine the terms of any future equity issuances or whether we will be able to issue equity on terms favorable to us, or at all. Additionally, when our common stock is trading below net asset value, we will have regulatory constraints under the 1940 Act on our ability to obtain additional capital in this manner. At December 31, 2010, our stock closed trading at \$7.65, representing a 15.0% discount to our NAV of \$9.00 per share. Generally, the 1940 Act provides that we may not issue stock for a price below NAV per share, without first obtaining the approval of our stockholders and our independent directors, or through a rights offering.

Future Capital Resources

At our 2010 annual stockholders meeting, held on August 5, 2010, our stockholders approved a proposal that allows us to sell shares of our common stock at a price below our then current NAV per share should we choose to do so. This proposal is in effect until our next annual stockholders meeting in 2011, at which time we intend to ask our stockholders to vote in favor of this proposal for another year.

Table of Contents

Revolving Credit Facility

On April 14, 2009, we entered into the Credit Facility, providing for a \$50.0 million revolving line of credit arranged by BB&T as administrative agent, replacing Deutsche Bank AG, which served as administrative agent under our prior credit facility. Key Equipment Finance Company Inc. also joined the Credit Facility as a committed lender. In connection with our entry into the Credit Facility, we borrowed \$43.8 million under the Credit Facility to repay in full all amounts outstanding under the Prior Credit Facility.

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 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 2.0%), plus 4.5% per annum, with a commitment fee of 0.50% per annum on undrawn amounts when advances outstanding are above 50.0% of the commitment and 1.0% on undrawn amounts if the advances outstanding are below 50.0% of the commitment. In connection with the Credit Facility renewal, we paid an upfront fee of 1.0%. As of December 31, 2010, we had \$8.0 million of principal outstanding with approximately \$24.7 million of availability under the Credit Facility. As of January 28, 2011, there was no balance outstanding under the Credit Facility, and \$24.1 million was available for borrowing due to certain limitations on our borrowing base.

The Credit Facility contains covenants that require Business Investment to maintain its status as a separate legal entity; prohibit certain significant corporate transactions (such as mergers, consolidations, liquidations or dissolutions); and restrict material changes to our credit and collection policies without lenders' consent. The facility also limits payments as distributions to the aggregate net investment income for each of the twelve months ended March 31, 2011 and 2012. We are also subject to certain limitations on the type of loan investments we can make, including restrictions on geographic concentrations, sector concentrations, loan size, dividend payout, payment frequency and status, average life and lien property. The Credit Facility also requires us to comply with other financial and operational covenants, which obligate us to, among other things, maintain certain financial ratios, including asset and interest coverage, a minimum net worth, and a minimum number of obligors required in the borrowing base of the credit agreement. Additionally, we are subject to a performance guaranty that requires us to maintain (i) minimum net worth of \$155.0 million plus 50% of all equity and subordinated debt raised after April 13, 2010, (ii) asset coverage with respect to senior securities representing indebtedness of at least 200%, in accordance with Section 18 of the 1940 Act, and (iii) our status as a BDC under the 1940 Act and as a RIC under the Code. As of December 31, 2010, we were in compliance with all covenants.

During May 2009, we cancelled our interest rate cap agreement with Deutsche Bank AG and entered into a new interest rate cap agreement for a notional amount of \$45.0 million that will effectively limit the interest rate on a portion of the borrowings under the Credit Facility. We incurred a premium fee of approximately \$39 in conjunction with this agreement.

In April 2010, we entered into a forward interest rate cap agreement, effective May 2011 and expiring in May 2012, for a notional amount of \$45.0 million that will effectively limit the interest rate on a portion of the borrowings under the line of credit pursuant to the terms of the Credit Facility. We incurred a premium fee of approximately \$41 in conjunction with this agreement.

The administrative agent also requires that any interest or principal payments on pledged loans be remitted directly by the borrower into a lockbox account, with The Bank of New York Mellon Trust Company, N.A. as custodian. BB&T is also the trustee of the account and once a month remits the collected funds to us. At January 28, 2011, the amount due from the custodian was approximately \$62.

The Adviser services the loans pledged under the Credit Facility. As a condition to this servicing arrangement, we executed a performance guaranty whereby the Adviser guaranteed it would comply with all of its obligations under the Credit Facility. As of December 31, 2010 and January 28, 2011, we were in compliance with the covenants under the performance guaranty.

Our continued compliance with these covenants, however, depends on many factors, some of which are beyond our control. In particular, depreciation in the valuation of our assets, which is subject to changing market conditions that

are presently very volatile, affects our ability to comply with these covenants. Our entire portfolio was fair valued at 77.1% of cost as of December 31, 2010. Given the unstable capital markets, net unrealized depreciation in our portfolio may return in future periods and threaten our ability to comply with the covenants under our Credit Facility. Accordingly, there are no assurances that we will be able to continue to comply with these covenants. Failure to comply with these covenants would result in a default, which, if we are unable to obtain a waiver from the lenders, could accelerate our repayment obligations under the Credit Facility and thereby have a material adverse impact on our liquidity, financial condition, results of operations and ability to pay distributions to our stockholders, as more fully described below.

The Credit Facility matures on April 13, 2012, and, if the facility is not renewed or extended by this date, all unpaid principal and interest will be due and payable on or before April 13, 2013. There can be no guarantee that we will be able to renew, extend or replace the Credit Facility on terms that are favorable to us, or at all. Our ability to obtain replacement financing will be constrained by then current economic conditions affecting the credit markets. If we are not able to renew, extend or refinance the Credit Facility, this would likely have a material adverse effect on our liquidity and ability to fund new investments or pay distributions to our stockholders. Our inability to pay distributions could result in our failing to qualify as a RIC. Consequently, any income or gains

Table of Contents

could become taxable at corporate rates. If we are unable to secure replacement financing, we may be forced to sell certain assets on disadvantageous terms, which may result in realized losses, such as those recorded in connection with the Syndicated Loan Sales, which resulted in a realized loss of approximately \$34.6 million during the quarter ended June 30, 2009. Such realized losses could materially exceed the amount of any unrealized depreciation on these assets as of our most recent balance sheet date, which would have a material adverse effect on our results of operations. In addition to selling assets, or as an alternative, we may issue equity in order to repay amounts outstanding under the Credit Facility. Based on the recent trading prices of our stock, such an equity offering may have a substantial dilutive impact on our existing stockholders' interest in our earnings and assets and voting interest in us.

Short-Term Note

For each of June 30, 2009, September 30, 2009, December 31, 2009, March 31, 2010, June 30, 2010, September 30, 2010, and December 31, 2010 (the Measurement Dates), 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 Measurement Dates, the short-term qualified securities matured and we repaid the short-term loan, at which time we again fell below the 50% threshold. Therefore, for the quarter ended December 31, 2010, we purchased \$75.0 million of short-term T-Bills through Jefferies. The T-Bills were purchased with \$7.6 million in funds drawn on the Credit Facility and the proceeds from a \$67.4 million short-term loan from Jefferies, with an effective annual interest rate of approximately 0.72%. On January 4, 2011, we repaid the \$7.6 million drawn on the Credit Facility for the transaction and, on January 6, 2011, when the T-Bills matured, we repaid the \$67.4 million loan from Jefferies.

Contractual Obligations and Off-Balance Sheet Arrangements

We were not a party to any signed term sheets for potential investments as of December 31, 2010. However, we have certain lines of credit with our portfolio companies that have not been fully drawn. Since these lines of credit have expiration dates and we expect many will never be fully drawn, the total line of credit commitment amounts do not necessarily represent future cash requirements. We estimate the fair value of these unused line of credit commitments as of December 31, 2010 and March 31, 2010 to be nominal.

In October 2008, we executed a guaranty of a vehicle finance facility agreement (the Finance Facility) between Ford Motor Credit Company and ASH. The Finance Facility provides ASH with a line of credit of up to \$0.8 million for component Ford parts used by ASH to build truck bodies under a separate contract. Title and ownership of the parts is retained by Ford. The guaranty of the Finance Facility will expire upon termination of the separate parts supply contract with Ford or upon our replacement as guarantor. The Finance Facility is secured by all of the assets of Business Investment. As of December 31, 2010, we have not been required to make any payments on the guaranty of the Finance Facility, and we consider the credit risk to be remote and the fair value of the guaranty to be minimal.

In February 2010, we executed a guaranty of a wholesale financing facility agreement (the Floor Plan Facility) between Agrifacit Acceptance, LLC (Agrifacit) and Country Club Enterprise, LLC (CCE). The Floor Plan Facility provides CCE with financing of up to \$2.0 million to bridge the time and cash flow gap between the order and delivery of golf cars to customers. The guaranty will expire in February 2011 unless it is renewed by us, CCE and Agrifacit. In connection with this guaranty, we received a premium of \$0.1 million from CCE, which approximates fair value. As of December 31, 2010, we have not been required to make any payments on the guaranty of the Floor Plan Facility, and we consider the credit risk to be remote and the fair value of the guaranty to be minimal.

In April 2010, we executed a guaranty of vendor recourse for up to \$1.8 million in individual customer transactions (the Recourse Facility) between Wells Fargo Financial Leasing, Inc. and CCE. The Recourse Facility provides CCE with the ability to provide vendor recourse up to a limit of \$1.8 million of transactions with long-time customers who lack the financial history to qualify for third party financing. In connection with this guaranty, we received a premium of \$0.1 million from CCE, which approximates fair value. As of December 31, 2010, we have not been required to make any payments on the guaranty of the Recourse Facility, and we consider the credit risk to be remote and the fair value of the guaranty to be minimal.

In accordance with GAAP, the unused portions of these commitments are not recorded on the accompanying *Condensed Consolidated Statements of Assets and Liabilities*. The following table summarizes the nominal dollar balance of unused line of credit commitments and guarantees as of December 31, 2010 and March 31, 2010:

	As of December 31, 2010	As of March 31, 2010
Unused lines of credit	\$ 2,600	\$ 1,814
Guarantees	4,501	2,250

Table of Contents

The following table shows our contractual obligations as of December 31, 2010:

	Payments Due by Period				Total
	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years	
Contractual Obligations⁽¹⁾					
<i>Borrowings:</i>					
Short-term loan ⁽²⁾	\$ 67,400	\$	\$	\$	\$ 67,400
Credit Facility ⁽³⁾		8,000			8,000
Total borrowings	\$ 67,400	\$ 8,000	\$	\$	\$ 75,400

(1) Excludes the unused commitments to extend credit to our customers of \$1.8 million, as discussed above.

(2) On January 6, 2011, we repaid the entire short-term loan.

(3) On January 4, 2011, we repaid the full balance outstanding on the Credit Facility.

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 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.

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 report 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 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 (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

Table of Contents

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 (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 (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 valuation of 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 December 31, 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 syndicated loans at December 31, 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 (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 (Non-Public Debt Securities), and that are issued by portfolio companies in which 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 Standard and Poor's Securities Evaluations, Inc (SPSE). We may also submit paid in kind (PIK) interest to SPSE for its 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

Table of Contents

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 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, common 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 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 that 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

Table of Contents

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;

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

Company s System	First NRSRO	Second NRSRO	Gladstone Investment s Description ⁽¹⁾
>10	Baa2	BBB	Probability of Default (PD) during the next ten years is 4% and the Expected Loss (EL) is 1% or less
10	Baa3	BBB-	PD is 5% and the EL is 1% to 2%
9	Ba1	BB+	PD is 10% and the EL is 2% to 3%
8	Ba2	BB	PD is 16% and the EL is 3% to 4%
7	Ba3	BB-	PD is 17.8% and the EL is 4% to 5%
6	B1	B+	PD is 22% and the EL is 5% to 6.5%
5	B2	B	PD is 25% and the EL is 6.5% to 8%
4	B3	B-	PD is 27% and the EL is 8% to 10%
3	Caa1	CCC+	PD is 30% and the EL is 10% to 13.3%
2	Caa2	CCC	PD is 35% and the EL is 13.3% to 16.7%
1	Caa3	CC	PD is 65% and the EL is 16.7% to 20%
<1	N/A	D	PD is 85% or there is a payment default and the EL is greater than 20%

(1) 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 December 31, 2010, one Control investment, ASH, was on non-accrual with a fair value of \$0. At March 31, 2010, ASH was on non-accrual with a fair value of approximately \$2.2 million, which represented 1.0% of the fair value of all loans held in our portfolio at March 31, 2010. 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 December 31, 2010 and March 31, 2010, representing approximately 96.0% and 93.5%, respectively, of all loans in our portfolio at fair value at the end of each period:

	As of December 31, 2010	As of March 31, 2010
Rating		
Highest	9.0	9.0
Average	5.5	5.3
Weighted Average	5.8	5.9
Lowest	3.0	2.0

The risk rating for the syndicated loan that was not rated by an NRSRO, Survey Sampling, LLC, was 9.0 as of December 31, 2010 and March 31, 2010, representing approximately 1.2% and 0.7%, 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 loans in our portfolio that were rated by an NRSRO were BB+/Ba2 and B/B2 as of December 31, 2010 and March 31, 2010, respectively, representing approximately 2.8% and 5.8%, 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 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 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. However, for the calendar year ended December 31, 2010, we did incur an excise tax of approximately \$24.

We sought and received a private letter ruling from the Internal Revenue Service (IRS) related to our tax treatment for success fees. In the ruling, executed by our consent on January 3, 2011, we, in effect, will continue to account for the recognition of income from the success fees upon receipt, or when the amount becomes fixed. However, starting January 1, 2011, the tax characterization of the success fee amount will be treated as ordinary income. Prior to January 1, 2011, we had treated the success fee amount as a realized gain for tax characterization purposes. The private letter ruling does not require us to retroactively change the capital gains treatment of the success fees received prior to January 1, 2011.

Table of Contents**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 December 31, 2010, one Control investment, ASH, was on non-accrual with a fair value of \$0. At March 31, 2010, ASH was on non-accrual with a fair value of approximately \$2.2 million, or 1.0% of the fair value of all loans held in our portfolio at March 31, 2010.

We have one loan in our portfolio which contains a PIK provision. The PIK interest, computed at the contractual rate specified in each loan agreement, is added to the principal balance of the loan and recorded as income. To maintain our status as a RIC, this non-cash source of income must be paid out to stockholders in the form of distributions, even though we have not yet collected the cash. We recorded PIK income of \$7 for both the three and nine months ended December 31, 2010. No PIK interest was recorded during the three or nine months ended December 31, 2009.

Success fees are recorded upon receipt. Success fees are contractually due upon a change of control in a portfolio company and are recorded in Other income in our *Condensed Consolidated Statements of Operations*. We recorded \$2.7 million of success fees during the quarter ended December 31, 2010, \$2.3 million of which resulted from the exit and payoff of Chase and \$0.4 million of which resulted from a prepayment received from Mathey. During the nine months ended December 31, 2010, we also received success fees of \$2.0 million from A. Stucki, which resulted from the exit and payoff A. Stucki, and \$0.8 million from a prepayment received from Cavert. Prior to the current fiscal year, 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 December 31, 2010, we recorded and collected \$4.0 million of dividends accrued on preferred shares of Chase. During the nine months ended December 31, 2010, we also recorded and collected \$0.3 million of dividends on preferred shares of A. Stucki and accrued and received a special dividend of property valued at \$0.5 million in connection with the A. Stucki sale. During the nine months ended December 31, 2009, we recorded and collected approximately \$1.0 million of cash dividends on preferred shares of A. Stucki.

Recent Accounting Pronouncements

See Note 2, *Summary of Significant Accounting Policies* in the accompanying notes to our *Condensed Consolidated Financial Statements* included elsewhere in this report for a description and our application of recent accounting pronouncements. Our adoption of these recent accounting pronouncements did not have a material effect on our financial position and results of operations.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk includes risks that arise from changes in interest rates, foreign currency exchange rates, commodity prices, equity prices and other market changes that affect market sensitive instruments. The primary risk we believe we are exposed to is interest rate risk. While we expect that ultimately approximately 20% of the loans in our portfolio will be made at fixed rates, with approximately 80% made at variable rates or variables rates with a floor mechanism, all of our variable-rate loans have rates associated with either the current LIBOR or Prime Rate. At December 31, 2010, our portfolio, at cost, consisted of the following breakdown in relation to all outstanding debt investments:

2.1%	Variable rates
65.1	Variable rates with a floor
32.8	Fixed rates

100.0% **Total**

There have been no material changes in the quantitative and qualitative market risk disclosures for the nine months ended December 31, 2010 from those disclosed in our Annual Report on Form 10-K for the fiscal year ended March 31, 2010, as filed with the SEC on May 24, 2010.

Table of Contents

In May 2009, we cancelled our interest rate cap agreement with Deutsche Bank AG and entered into an interest rate cap agreement with BB&T that effectively limits the interest rate on a portion of the borrowings under the line of credit pursuant to the terms of the Credit Facility. The interest rate cap has a notional amount of \$45.0 million at a cost of approximately \$39. The interest rate cap agreement expires in May 2011.

In April 2010, we entered into a forward interest rate cap agreement, effective May 2011 and expiring in May 2012, for a notional amount of \$45.0 million that will effectively limit the interest rate on a portion of the borrowings under the line of credit pursuant to the terms of the Credit Facility. We incurred a premium fee of approximately \$41 in conjunction with this agreement.

ITEM 4. CONTROLS AND PROCEDURES.

a) Evaluation of Disclosure Controls and Procedures

As of December 31, 2010, we, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)). Based on that evaluation, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective at a reasonable assurance level in timely alerting management, including the Chief Executive Officer and Chief Financial Officer, of material information about us required to be included in periodic Securities and Exchange Commission filings. However, in evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

b) Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2010, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

Neither we, nor any of our subsidiaries, are currently subject to any material legal proceeding, nor, to our knowledge, is any material legal proceeding threatened against us or any of our subsidiaries.

ITEM 1A. RISK FACTORS.

Our business is subject to certain risks and events that, if they occur, could adversely affect our financial condition and results of operations and the trading price of our common stock. For a discussion of these risks, please refer to the Risk Factors section in our Post-Effective Amendment No. 2 to the Registration Statement on Form N-2 (No. 333-160720) as filed with the Securities and Exchange Commission on November 22, 2010.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

Not applicable.

ITEM 4. RESERVED

ITEM 5. OTHER INFORMATION.

Not applicable.

ITEM 6. EXHIBITS

See the exhibit index.

Table of Contents

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**GLADSTONE INVESTMENT
CORPORATION**

By: /s/ David Watson
David Watson
Chief Financial Officer

Date: January 31, 2011

Table of Contents

EXHIBIT INDEX

Exhibit	Description
3.1	Amended and Restated Certificate of Incorporation, incorporated by reference to Exhibit a.2 to Pre-Effective Amendment No. 1 to the Registration Statement on Form N-2 (File No. 333-123699), filed May 13, 2005.
3.2	Amended and Restated Bylaws, incorporated by reference to Exhibit b.2 to Pre-Effective Amendment No. 3 to the Registration Statement on Form N-2 (File No. 333-123699), filed June 21, 2005.
3.3	First Amendment to Amended and Restated Bylaws, incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K (File No. 814-00704), filed on July 10, 2007.
4.1	Specimen Stock Certificate, incorporated by reference to Exhibit 99.1 to Pre-Effective Amendment No. 3 to the Registration Statement on Form N-2 (File No. 333-123699), filed June 21, 2005.
11	Computation of Per Share Earnings (included in the notes to the unaudited Condensed Consolidated Financial Statements contained in this report).
31.1	Certification of Chief Executive Officer pursuant to section 302 of The Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to section 302 of The Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to section 906 of The Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to section 906 of The Sarbanes-Oxley Act of 2002.

All other exhibits for which provision is made in the applicable regulations of the Securities and Exchange Commission are not required under the related instruction or are inapplicable and therefore have been omitted.