
**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 JUNE 30, 2006

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
(State or other jurisdiction of incorporation or organization)

83-0423116
(I.R.S. Employer Identification No.)

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 and (2) has been subject to such filing requirements for the past 90 days. Yes No .

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12 b-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, outstanding as of August 1, 2006 was 16,560,100.

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GLADSTONE INVESTMENT CORPORATION
STATEMENTS OF ASSETS AND LIABILITIES
(UNAUDITED)

	<u>June 30, 2006</u>	<u>March 31, 2006</u>
ASSETS		
Non-Control/Non-Affiliate investments (Cost 6/30/06: \$114,228,222; 3/31/06: \$97,423,004)	\$ 113,251,478	\$ 97,585,972
Control investments (Cost 6/30/06: \$56,246,318; 3/31/06: \$55,846,318)	56,028,640	55,796,318
Total investments at fair value (Cost 6/30/06: \$170,474,540; 3/31/06: \$153,269,322)	169,280,118	153,382,290
Cash and cash equivalents	58,283,609	75,672,605
Interest receivable	911,817	761,388
Prepaid directors fees	108,750	—
Prepaid insurance	27,262	99,874
Due from Adviser	—	234,551
Other assets	87,488	173,099
TOTAL ASSETS	\$ 228,699,044	\$ 230,323,807
LIABILITIES		
Accounts payable	\$ 11,583	\$ —
Administration fee payable to Gladstone Administration	115,389	110,002
Base management fee payable to Gladstone Management	801,309	—
Accrued expenses	124,876	367,031
Other liabilities	4,763	5,077
Total Liabilities	1,057,920	482,110
NET ASSETS	\$ 227,641,124	\$ 229,841,697
ANALYSIS OF NET ASSETS:		
Common stock, \$0.001 par value, 100,000,000 shares authorized and 16,560,100 shares issued and outstanding	\$ 16,560	\$ 16,560
Capital in excess of par value	230,229,279	230,229,279
Net unrealized (depreciation) appreciation of investment portfolio	(1,194,421)	112,968
Distributions in excess of net investment income	(1,410,294)	(517,110)
Total Net Assets	\$ 227,641,124	\$ 229,841,697
Net assets per share	\$ 13.75	\$ 13.88

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

June 30, 2006
(UNAUDITED)

<u>Company (1)</u>	<u>Industry</u>	<u>Investment (2)</u>	<u>Cost</u>	<u>Fair Value</u>
NON-CONTROL/NON-AFFILIATE INVESTMENTS				
Activant	Service - enterprise software and services	Senior Term Debt (7.2%, Due 5/2013) (3)	\$ 4,011,648	\$ 3,955,084
Compsych	Service - independent employee assistance programs	Senior Term Debt (7.8%, Due 2/2012) (3) (7)	3,987,621	3,970,000
CRC Health Group, Inc.	Service - substance abuse treatment	Senior Term Debt (7.7%, Due 2/2016) (3)	7,873,671	7,751,323
Graham Packaging Holdings Co.	Manufacturing - custom blow molded	Senior Term Debt (7.3%, Due 10/2011) (3)	10,812,573	10,672,535
Hertz Equipment Rental Corp.	Service - car rentals	Senior Term Debt (7.1%, Due 12/2010) (3)	907,056	905,996
J. Crew Operating Corp.	Retail - apparel	Senior Term Debt (9.5%, Due 5/2013) (3)	2,002,783	1,995,000
Latham Manufacturing Corp.	Manufacturing - swimming pool components accessories	Senior Term Debt (7.8%, Due 6/2012) (3)	4,452,061	4,411,557
Lexicon Marketing USA, Inc.	Service - marketing to Hispanic community	Senior Term Debt (7.8%, Due 5/2012) (3)	3,002,678	3,015,000
LVI Services, Inc.	Service - asbestos and mold remediation	Senior Term Debt (7.8%, Due 11/2010) (3)	6,493,631	6,402,825
Madison River Capital LLC	Service - communications and information	Senior Term Debt (7.3%, Due 7/2012) (3)	5,787,111	5,757,188
Maidenform, Inc.	Manufacturing - intimate apparel	Senior Term Debt (7.0%, Due 5/2010) (3)	2,919,899	2,902,084
MedAssets, Inc.	Service - pharmaceuticals and healthcare GPO	Senior Term Debt (8.5%, Due 7/2010) (3) (7)	2,276,757	2,262,316
NPC International Inc.	Service - Pizza Hut franchisee	Senior Term Debt (6.9%, Due 5/2013) (3)	3,379,643	3,342,198
Nutro Products, Inc.	Manufacturing - pet food	Senior Term Debt (7.3%, Due 4/2012) (3)	2,518,023	2,493,750
Ozburn-Hessey Holding Co. LLC	Service - third party logistics	Senior Term Debt (7.3%, Due 8/2012) (3)	6,117,829	6,036,407
Patriot Media & Communications CNJ, LLC	Service - telecommunications	Senior Term Debt (7.5%, Due 3/2013) (3)	4,338,104	4,300,922
RPG Holdings, Inc.	Manufacturing and design - greeting cards	Senior Term Debt (8.6%, Due 12/2011) (3)	5,001,274	5,000,000
SGS International, Inc.	Service - digital imaging and graphics	Senior Term Debt (7.3%, Due 12/2011) (3)	1,403,752	1,396,500
SunGard Data Systems, Inc.	Service & manufacturing — integrated software and processing solutions and information availability services	Senior Term Debt (7.7%, Due 2/2013) (3)	10,004,546	9,937,125
Survey Sampling, LLC	Service - telecommunications-based sampling	Senior Term Debt (8.8%, Due 5/2011) (3)	3,501,284	3,467,650
Triad Laboratory Alliance, LLC	Service - regional medical laboratories	Senior Term Debt (8.7%, Due 12/2011) (3) (7)	4,993,624	4,987,438
TexStar Operating, L.P.	Manufacturing - midstream natural gas processing	Senior Term Debt (8.3%, Due 12/2011) (3) (7)	2,992,315	2,970,075
US Investigative Services, Inc.	Service - background investigations	Senior Term Debt (7.9%, Due 10/2012) (3)	9,945,495	9,873,402
Wastequip, Inc.	Manufacturing - waste removal equipment	Senior Term Debt (7.7%, Due 7/2011) (3)	5,504,844	5,445,103
Total Non-Control/Non-Affiliate Investments			114,228,222	113,251,478

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GLADSTONE INVESTMENT CORPORATION
SCHEDULE OF INVESTMENTS (Continued)
June 30, 2006
(UNAUDITED)

<u>Company (1)</u>	<u>Industry</u>	<u>Investment (2)</u>	<u>Cost</u>	<u>Fair Value</u>
CONTROL INVESTMENTS				
Chase II Holdings Corporation	Manufacturing - traffic doors	Revolving Credit Facility (5)	—	—
		Senior Term Debt (9.6%, Due 3/2011) (7)	12,900,000	12,900,000
		Senior Term Debt (12.0% Due 3/2011) (7)	8,000,000	7,970,000
		Subordinated Term Debt (13% Due 3/2013) (7)	6,167,810	6,106,132
		Redeemable Preferred Stock (4) (8)	6,960,806	6,960,806
		Common Stock (4) (8)	61,384	61,384
			<u>34,090,000</u>	<u>33,998,322</u>
Hailey Transport Corporation	Retail and service - school buses and parts	Senior Subordinated Term Debt (12.0%, Due 1/2012) (7)	4,000,000	3,940,000
		Common Stock (4) (8)	2,500,000	2,500,000
			<u>6,500,000</u>	<u>6,440,000</u>
Quench Holdings Corporation	Service - sales, installation and service of water coolers	Revolving Credit Facility (9.1%, Due 3/2009) (6) (7)	400,000	394,000
		Senior Term Debt (9.1%, Due 3/2011) (7)	4,000,000	4,000,000
		Subordinated Term Debt (11.5%, Due 3/2011) (7)	8,000,000	7,940,000
		Common Stock (4) (8)	3,256,318	3,256,318
			<u>15,656,318</u>	<u>15,590,318</u>
Total Control Investments			56,246,318	56,028,640
Total Investments			\$ 170,474,540	\$ 169,280,118
Cash equivalents				
	Government	US Treasury Bill (4.4%, 7/13/2006)	4,033,771	4,033,771
	Government	US Treasury Bill (4.5%, 8/3/2006)	17,821,896	17,821,896
	Government	US Treasury Bill (4.5%, 8/31/2006)	17,702,440	17,702,440
Total cash equivalents:			39,558,107	39,558,107

- (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 June 30, 2006 and due date represents the contractual maturity date.
(3) Marketable securities are valued based on the indicative bid price, as of June 30, 2006, from the respective originating syndication agent's trading desk.
(4) Security is non-income producing.
(5) Total available under the revolving credit facility is \$500,000 which was undrawn as of June 30, 2006.
(6) Total available under the revolving credit facility is \$2,000,000, of which \$1,600,000 remains undrawn at June 30, 2006.
(7) Valued using S&P estimates at June 30, 2006.
(8) Fair value is equal to cost due to recent acquisition.

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

GLADSTONE INVESTMENT CORPORATION
SCHEDULE OF INVESTMENTS
March 31, 2006
(UNAUDITED)

Company (1)	Industry	Investment (2)	Cost	Fair Value
NON-CONTROL/NON-AFFILIATE INVESTMENTS				
CRC Health Group, Inc.	Service - substance abuse treatment	Senior Term Debt (6.9%, Due 2/2016) (3)	\$ 5,056,761	\$ 5,056,250
Graham Packaging Holdings Co.	Manufacturing - custom blow molded	Senior Term Debt (7.0%, Due 10/2011) (3)	10,071,296	10,061,087
Hertz Equipment Rental Corporation	Service - car rentals	Senior Term Debt (6.7%, Due 12/2010) (3)	871,388	876,560
Latham Manufacturing Corp.	Manufacturing - swimming pool components accessories	Senior Term Debt (7.8%, Due 12/2010) (3)	4,454,333	4,461,188
Le-Natures, Inc.	Marketing & development - natural beverages	Senior Term Debt (7.7%, Due 6/2010) (3)	5,042,467	5,074,713
LVI Services, Inc.	Service - asbestos and mold remediation	Senior Term Debt (7.3%, Due 11/2010) (3)	6,511,390	6,540,483
Madison River Capital LLC	Service - communications and information information	Senior Term Debt (6.8%, Due 7/2012) (3)	5,788,660	5,829,062
Maidenform, Inc.	Manufacturing - intimate apparel	Senior Term Debt (6.5%, Due 5/2010) (3)	3,118,448	3,122,787
MedAssets, Inc.	Service - pharmaceuticals and healthcare GPO	Senior Term Debt (7.7%, Due 7/2010) (3) (7)	2,340,111	2,348,526
Ozburn-Hessey Holding Co. LLC	Service - third party logistics	Senior Term Debt (7.3%, Due 8/2012) (3)	6,382,673	6,376,646
Patriot Media & Communications CNJ, LLC	Service - telecommunications	Senior Term Debt (7.0%, Due 3/2013) (3)	4,360,777	4,359,125
Revere Industries, LLC	Manufacturing-plastic and metal components	Senior Term Debt (7.6%, Due 9/2010) (3)	3,508,831	3,504,546
RPG Holdings, Inc.	Manufacturing and design - greeting cards	Senior Term Debt (8.2%, Due 12/2011) (3)	5,001,332	5,000,000
SGS International, Inc.	Service - digital imaging and graphics	Senior Term Debt (7.2%, Due 12/2011) (3)	1,404,081	1,415,702
SunGard Data Systems, Inc.	Service & manufacturing - integrated software and processing	Senior Term Debt (7.2%, Due 2/2013) (3)	10,033,531	10,049,063
Triad Laboratory Alliance, LLC	Service - regional medical laboratories	Senior Term Debt (7.8%, Due 12/2011) (3) (7)	5,006,982	5,012,438
TexStar Operating, L.P.	Manufacturing - midstream natural gas processing	Senior Term Debt (8.3%, Due 12/2011) (3) (7)	3,000,161	2,999,981
US Investigative Services, Inc.	Service - background investigations	Senior Term Debt (7.4%, Due 10/2012) (3)	9,948,345	9,984,478
Wastequip, Inc.	Manufacturing - waste removal equipment	Senior Term Debt (7.0%, Due 7/2011) (3)	5,521,437	5,513,337
Total Non-Control/Non-Affiliate Investments			97,423,004	97,585,972

GLADSTONE INVESTMENT CORPORATION
SCHEDULE OF INVESTMENTS (Continued)
March 31, 2006
(UNAUDITED)

Company (1)	Industry	Investment (2)	Cost	Fair Value
CONTROL INVESTMENTS				
Chase II Holdings Corporation	Manufacturing - traffic doors	Revolving Credit Facility (5)	—	—
		Senior Term Debt (9.1%, Due 3/2011)	12,900,000	12,900,000
		Senior Term Debt (12.0% Due 3/2011)	8,000,000	8,000,000
		Subordinated Term Debt (13% Due 3/2013)	6,167,810	6,167,810
		Redeemable Preferred Stock (4) (8)	6,960,806	6,960,806
		Common Stock (4) (8)	61,384	61,384
			<u>34,090,000</u>	<u>34,090,000</u>
Hailey Transport Corporation	Retail and Service - school buses and parts	Senior Subordinated Term Debt (12.0%, Due 1/2012) (7)	4,000,000	3,950,000
		Common Stock (4) (8)	2,500,000	2,500,000
			<u>6,500,000</u>	<u>6,450,000</u>
Quench Holdings Corporation	Service - sales, installation and service of water coolers	Revolving Credit Facility (6)	—	—
		Senior Term Debt (9.1%, Due 3/2011)	4,000,000	4,000,000
		Subordinated Term Debt (11.5%, Due 3/2011)	8,000,000	8,000,000
		Common Stock (4) (8)	3,256,318	3,256,318

		15,256,318	15,256,318
Total Control Investments		55,846,318	55,796,318
Total Investments		\$ 153,269,322	\$ 153,382,290
Cash equivalents			
	Government	US Treasury Bill (4.2%, 4/20/2006)	3,989,800
			3,989,800
	Government	US Treasury Bill (4.4%, 4/27/2006)	15,241,694
			15,241,694
	Government	US Treasury Bill (4.4%, 5/4/2006)	35,132,347
			35,132,347
	Government	US Treasury Bill (4.4%, 5/25/2006)	15,243,245
			15,243,245
Total cash equivalents:		69,607,086	69,607,086
Total investments and cash equivalents:		\$ 222,876,408	\$ 222,989,376

- (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, 2006 and due date represents the contractual maturity date.
- (3) Marketable securities are valued based on the indicative bid price, as of March 31, 2006, from the respective originating syndication agent's trading desk.
- (4) Security is non-income producing.
- (5) Total available under the revolving credit facility is \$500,000 which was undrawn as of March 31, 2006.
- (6) Total available under the revolving credit facility is \$2,000,000 which was undrawn as of March 31, 2006.
- (7) Valued using S&P estimates at March 31, 2006.
- (8) Fair value is equal to cost due to recent acquisition.

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

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**GLADSTONE INVESTMENT CORPORATION
STATEMENTS OF OPERATIONS
(UNAUDITED)**

	For the three months ended June 30, 2006	For the period June 22, 2005 (Commencement of Operations) to June 30, 2005
INVESTMENT INCOME		
Interest income		
Non-Control/Non-Affiliate investments	\$ 1,964,480	\$ —
Control investments	1,190,302	—
Cash and cash equivalents	708,340	48,198
Total interest income	3,863,122	48,198
Other income	316	—
Total investment income	3,863,438	48,198
EXPENSES		
Administration fee	115,389	27,083
Base management fee	801,309	—
Directors fees	43,250	—
Insurance expense	72,611	—
Professional fees	79,748	—
Stockholder related costs	93,766	635
Interest expense	—	378
Taxes and licenses	57,107	—
Other expenses	19,094	302
Total expenses	1,282,274	28,398
NET INVESTMENT INCOME	2,581,164	19,800
REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS		
Realized gain on sale of Non-Control/Non-Affiliate investments	3,273	—
Net unrealized depreciation of investment portfolio	(1,307,389)	—
Net loss on investments	(1,304,116)	—
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS (Refer to Note 5)	\$ 1,277,048	\$ 19,800
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS PER COMMON SHARE:		
Basic and Diluted	\$ 0.08	\$ 0.00
SHARES OF COMMON STOCK OUTSTANDING:		
Basic and diluted weighted average shares	16,560,100	14,400,100

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

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GLADSTONE INVESTMENT CORPORATION
STATEMENTS OF CHANGES IN NET ASSETS
(UNAUDITED)

	For the three months ended June 30, 2006	For the period June 22, 2005 (Commencement of Operations) to June 30, 2005
<i>Operations:</i>		
Net investment income	\$ 2,581,164	\$ 19,800
Realized gain on sale of investments	3,273	—
Unrealized depreciation of portfolio	(1,307,389)	—
Increase in net assets from operations	<u>1,277,048</u>	<u>19,800</u>
<i>Capital transactions:</i>		
Issuance of common stock	—	200,116,680
Dividends from net investment income	(3,477,621)	—
Total change in net assets from capital transactions	<u>(3,477,621)</u>	<u>200,116,680</u>
Total change in net assets	<u>(2,200,573)</u>	<u>200,136,480</u>
Net Assets		
Beginning of period	229,841,697	1,500
End of period	<u>\$ 227,641,124</u>	<u>\$ 200,137,980</u>

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

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GLADSTONE INVESTMENT CORPORATION
STATEMENTS OF CASH FLOWS
(UNAUDITED)

	For the three months ended June 30, 2006	For the period June 22, 2005 (Commencement of Operations) to June 30, 2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Net increase in net assets resulting from operations	\$ 1,277,048	\$ 19,800
Adjustments to reconcile net increase in net assets resulting from operations to net cash used in operating activities:		
Purchase of investments	(33,665,549)	—
Principal repayments of investments	874,222	—
Proceeds from the sale of debt investments	15,551,727	—
Net unrealized depreciation of investment portfolio	1,307,389	—
Net realized gains on sales of investments	(3,273)	—
Net amortization of premiums and discounts	37,656	—
Increase in interest receivable	(150,429)	—
Increase in prepaid assets	(36,138)	(17,792)
Decrease in other assets	85,611	—
Decrease in other liabilities	(314)	—
Increase in administration fee payable to Gladstone Administration	5,387	27,083
Increase in base management fee payable to Gladstone Management	1,035,860	—
Increase in accounts payable	11,583	128,029
(Decrease) increase in accrued expenses	(242,155)	335,711
Net cash (used in) provided by operating activities	<u>(13,911,375)</u>	<u>492,831</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from the issuance of common stock	—	200,164,544
Distributions paid	(3,477,621)	—
Decrease in loan payable to affiliate	—	(50,000)
Net cash (used in) provided by financing activities	<u>(3,477,621)</u>	<u>200,114,544</u>
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS (1)	<u>(17,388,996)</u>	<u>200,607,375</u>
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	<u>75,672,605</u>	<u>3,636</u>
CASH AND CASH EQUIVALENTS, END OF PERIOD	<u>\$ 58,283,609</u>	<u>\$ 200,611,011</u>
CASH PAID DURING PERIOD FOR INTEREST TO AFFILIATE	<u>\$ —</u>	<u>\$ 378</u>

(1) Cash and cash equivalents consist of demand deposits and highly liquid investments with original maturities of three months or less when purchased.

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

GLADSTONE INVESTMENT CORPORATION
FINANCIAL HIGHLIGHTS
(UNAUDITED)

	For the three months ended June 30, 2006	For the period June 22, 2005 (Commencement of Operations) to June 30, 2005
Per Share Data (1)		
Balance at beginning of period	\$ 13.88	\$ —
Net proceeds from initial public offering (2)	—	13.95
Offering costs	—	(0.05)
<i>Income from investment operations:</i>		
Net investment income (3)	0.16	—
Realized gain on sale of investments(3)	—	—
Net unrealized appreciation of investments (3)	(0.08)	—
Total from investment operations	0.08	—
Distributions	(0.21)	—
Net asset value at end of period	\$ 13.75	\$ 13.90
Per share market value at beginning of period	\$ 14.90	\$ 15.00
Per share market value at end of period	\$ 15.00	\$ 15.05
Total return (4)	2.13%	0.33%
Shares outstanding at end of period	16,560,100	14,400,100
Ratios/Supplemental Data		
Net assets at end of period	\$ 227,641,124	\$ 200,137,980
Average net assets (5)	\$ 227,718,666	\$ 200,137,980
Ratio of expenses to average net assets (annualized)	2.25%	0.06%
Ratio of net investment income to average net assets (annualized)	4.53%	0.04%

(1) Based on actual shares outstanding.

(2) Net of initial underwriting discount of \$1.05 per share.

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

(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 our dividend reinvestment plan.

(5) Calculated using the average of the ending monthly net assets for the respective periods.

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

GLADSTONE INVESTMENT CORPORATION
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006
(UNAUDITED)

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 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, or 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.

The Company is externally managed by Gladstone Management Corporation ("GMC"), an unconsolidated affiliate of the Company.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Interim Financial Statements

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. Accordingly, certain disclosures accompanying annual financial statements prepared in accordance with GAAP are omitted. In the opinion of 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, 2006, as filed with the Securities and Exchange Commission on June 14, 2006.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and

liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Classification of Investments

The 1940 Act requires classification of the Company's investments by its respective level of control. As defined in the 1940 Act, "Control Investments" are investments in those portfolio companies that the Company is deemed to "Control". "Affiliate Investments" are investments in those portfolio companies that are "Affiliated Companies" of the Company, as defined in the 1940 Act, other than Control Investments. "Non-Control/Non-Affiliate Investments" are those that are neither Control Investments nor Affiliate Investments. In general, the 1940 Act prescribes that the Company has control over a portfolio company if it owns greater than 25% of the voting securities of the portfolio company. The Company is deemed to be an affiliate of a portfolio company if it owns between 5% and 25% of the voting securities of such portfolio company or has one or more seats on the affiliated company's Board of Directors. However, if the Company holds 50% or more representation on a portfolio company's Board of Directors, the Company will be deemed to have control over the portfolio company.

Investment Valuation

The Company carries its investments at fair value, as determined by its Board of Directors. Securities that are publicly traded are valued at the closing price on the valuation date. Securities for which a limited market exists, such as participations in syndicated loans, are valued at the indicative bid price on the valuation date from the respective originating syndication agent's trading desk. Debt and equity securities that are not publicly traded are valued at fair value as determined in good faith by the Board of Directors. The Company currently engages Standard & Poor's Loan Evaluation Service (S&P) to perform independent valuations of some of its

investments. The Board of Directors uses the recommended valuations as prepared by S&P as a component of the foundation for the final fair value determination. In making such determination, the Board of Directors values non-convertible debt securities at cost plus amortized original issue discount plus payment in kind ("PIK") interest, if any, unless adverse factors lead to a determination of a lesser valuation. In valuing convertible debt, equity, success or exit fees or other equity-like securities, the Board of Directors determines the fair value based on the collateral, the issuer's ability to make payments, the earnings of the issuer, sales to third parties of similar securities, the comparison to publicly traded securities, discounted cash flow and other pertinent factors. Due to the uncertainty inherent in the valuation process, such estimates of fair value may differ significantly from the values that would have resulted 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 ultimately realized on these investments to be different than the valuation currently assigned. Because there is a delay between when the Company closes a loan and when the loan can be evaluated by S&P, new loans are not valued immediately by S&P; rather, the Board of Directors makes its own independent determination about the value of the loan in accordance with the Company's valuation policy without the input of S&P. Because S&P does not perform independent valuations of equity securities, the Board of Directors also determines the fair value of these investments without the input of S&P. The Board of Directors considers a number of qualitative and quantitative factors in current market conditions when performing valuations and is ultimately responsible for the fair value and disclosure of investments in the financial statements.

Interest 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. The Company stops accruing interest on its investments when it is determined that interest is no longer collectible. Conditional interest or a success fee is recorded upon full repayment of a loan investment.

Fee Income

The 1940 Act requires that a business development company make available managerial assistance to its portfolio companies by providing significant guidance and counsel concerning the management, operations, or business objectives and policies of the respective portfolio company. The Company provides these and other services through its adviser, GMC. Currently, neither the Company nor GMC receives fees in connection with managerial assistance. GMC provides managerial assistance to the Company's portfolio companies and currently does not charge for those services. If GMC does charge managerial assistance fees in the future, any such fees will be credited to the base management fee otherwise due to GMC from the Company under the Advisory Agreement. However, GMC also receives fees for the other services it provides, and 50% of those fees for other services are credited to the investment advisory fees due to GMC. These other fees are generally paid to GMC upon the closing of the investment. These fees are generally non-recurring, are recognized as revenue when earned and are paid directly to GMC by the borrower or potential borrower upon closing of the investment. The services GMC provides vary by investment, but generally include a wide variety of services to the portfolio companies such as investment banking services, arranging bank financing, arranging equity financing, structuring financing from multiple lenders and investors, reviewing existing credit facilities, restructuring existing loans, raising equity and debt capital, turnaround management, merger and acquisition services and recruiting new management personnel. Any services of this nature subsequent to the closing would generally generate a separate fee at the time of completion which is payable either to the Company or GMC. From time to time, the Company is invited to participate as a co-lender in a transaction. In the event that the Company does not provide significant services in connection with our investment, loan fees paid directly to GMC in such situations are deferred and amortized over the life of the loan.

Cash and Cash Equivalents

The Company considers all short-term, highly liquid investments that are both readily convertible to cash and have a maturity of three months or less at the time of purchase to be cash equivalents. Items classified as cash equivalents include temporary investments in US Treasury bills and can also include commercial paper and money-market funds. All of the Company's cash at June 30, 2006 was deposited with two financial institutions, and the Company's balances exceed federally insurable limits. The Company seeks to mitigate this risk by depositing funds with major financial institutions.

Realized Gain or Loss and Unrealized Appreciation or Depreciation of Portfolio Investments

Realized gain or loss is recognized when an investment is sold and is computed as the difference between the Company's cost basis in the investment at the date of sale and the net proceeds received from such sale. Unrealized appreciation or depreciation reflects the difference between the fair market value of the investment and the cost basis of such investment.

Income Taxes

The Company intends to qualify for treatment as a RIC under subchapter M of the Code. As a RIC, the Company will not be subject to federal income tax on the portion of its taxable income and gains distributed to stockholders. To qualify as a RIC, the Company is required to distribute at least 90% of investment company taxable income, as

defined by the Code. The Company intends to distribute at least 90% of its ordinary income. The Company may, but does not intend to, pay out a return of capital.

NOTE 3. RELATED PARTY TRANSACTIONS

Investment Advisory and Management Agreement

We have entered into an investment advisory and management agreement with GMC (the “Advisory Agreement”), which is controlled by our chairman and chief executive officer. In accordance with the Advisory Agreement, we pay GMC a fee, as compensation for its services, consisting of a base management fee and an incentive fee.

The base management fee is assessed at an annual rate of 2% computed on the basis of the average value of the Company’s gross invested assets at the end of the two most recently completed quarters, which are total assets less the cash proceeds and cash and cash equivalents from the proceeds of the Company’s initial public offering that are not invested in debt and equity securities of portfolio companies. Through December 31, 2005, the base management fee was computed and payable monthly in arrears. Subsequent to December 31, 2005, the base management fee has and will be computed and payable quarterly in arrears. Beginning in periods subsequent to September 30, 2006, the base management fee will be assessed at an annual rate of 2% computed on the basis of the average 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. This new calculation was originally scheduled to begin in periods after March 31, 2006; however, on April 11, 2006, the Company’s Board of Directors accepted a voluntary waiver from GMC that allowed the current calculation of the base management fee to be effective through June 30, 2006. In addition, on July 11, 2006, the Company’s Board of Directors accepted another voluntary waiver from GMC that will allow the current calculation of the base management fee to be effective through September 30, 2006.

When GMC receives fees from the Company’s portfolio companies, such as investment banking fees, structuring fees or executive recruiting services fees, one half of these fees will be credited against the base management fee that the Company would otherwise be required to pay to GMC. For the three months ended June 30, 2006, the Company recognized a base management fee of \$801,309 which was unpaid at June 30, 2006 and is reflected in the accompanying statements of assets and liabilities as a base management fee payable to GMC. No base management fee was recorded in for the period from June 22, 2005 (Commencement of operations) through June 30, 2005 as the Company had no gross invested assets as of June 30, 2005.

The incentive fee consists of two parts: an income-based incentive fee and a capital gains incentive fee. The income-based incentive fee is calculated and payable quarterly in arrears based on our pre-incentive fee net investment income for the immediately preceding calendar quarter. The capital gains incentive fee will be determined and payable annually in arrears as of the end of each fiscal year (or upon termination of the Advisory Agreement, as of the termination date), commencing on March 31, 2006, and will equal 20.0% of the realized capital gains since inception through the end of the current fiscal year, if any, computed net of all realized capital losses, and net unrealized capital depreciation since inception at the end of each fiscal year. Refer to the Company’s Form 10-K for the fiscal year ended March 31, 2006 for more information regarding the calculation of the incentive fee.

Because pre-incentive fee net investment income was below the hurdle rate of 1.75% of net assets, no income-based incentive fee was recorded for the three months ended June 30, 2006 and the period June 22, 2005 (Commencement of operations) to June 30, 2005.

Administration Agreement

The Company has entered into an administration agreement (the “Administration Agreement”) with Gladstone Administration, LLC (“Gladstone Administration”), a wholly owned subsidiary of GMC, which is controlled by the Company’s chairman and chief executive officer. Pursuant to the Administration Agreement, Gladstone Administration furnishes the Company with office facilities, equipment and clerical, bookkeeping and record keeping services at such facilities and performs, or oversees the performance of the

Company’s required administrative services. Such required administrative services include, among other things, being responsible for the financial records which we are required to maintain and preparing reports to our stockholders and reports filed with the Securities and Exchange Commission (the “SEC”).

The Administration Agreement requires the Company to reimburse Gladstone Administration for the performance of its obligations under the Administration Agreement. The reimbursement is based upon the allocable portion of Gladstone Administration’s overhead, including, but not limited to, rent and the allocable portion of salaries and benefits of the Company’s chief financial officer, controller, chief compliance officer and their respective staff. The Company recorded fees to Gladstone Administration on the statement of operations of \$115,389 for the three months ended June 30, 2006 and \$27,083 for the period June 22, 2005 (Commencement of operations) to June 30, 2005. As of June 30, 2006, \$115,389 was unpaid and included in the administration fee payable to Gladstone Administration in the accompanying statements of assets and liabilities.

Loan Payable to Affiliate

On June 30, 2005, the Company repaid a \$50,000 loan payable to its chairman and chief executive officer. The demand recourse promissory note accrued interest at the rate of 3% per annum and was repaid with accrued interest of \$378 using a portion of the net proceeds from the Company’s initial public offering.

NOTE 4. COMMON STOCK

As of June 30, 2006 and March 31, 2006, 100,000,000 shares of \$0.001 par value common stock were authorized and 16,560,100 shares were outstanding.

NOTE 5. INCREASE IN NET ASSETS PER SHARE RESULTING FROM OPERATIONS

The following table sets forth the computation of basic and diluted net increase in net assets per share resulting from operations for the three months ended June 30, 2006 and the period June 22, 2005 (Commencement of Operations) to June 30, 2005:

	For the three months ended June 30, 2006	For the period June 22, 2005 (Commencement of Operations) to June 30, 2005
Numerator for basic and diluted net increase in net assets resulting from operations per share	\$ 1,277,048	\$ 19,800
Denominator for basic and diluted shares	16,560,100	14,400,100

NOTE 6. DIVIDENDS

The Company is required to pay out as a dividend, 90% of its ordinary income and realized net short-term capital gains in excess of realized net short-term capital losses, if any, for each taxable year in order to maintain its status as a RIC under Subtitle A, Chapter 1 of Subchapter M of the Code. It is the policy of the Company to pay out as a dividend up to 100% of those amounts. The amount to be paid out monthly as a dividend is determined by the Board of Directors each quarter and is based on the annual earnings estimated by the management of the Company. At year-end the Company may pay a bonus dividend, in addition to the monthly dividends, to ensure that it has paid out at least 90% of its ordinary income and realized net short-term capital gains for the year. The Company's Board of Directors declared the following monthly dividends which it believes were paid from ordinary income:

Declaration Date	Record Date	Payment Date	Dividend per Share
April 11, 2006	June 22, 2006	June 30, 2006	\$0.07
April 11, 2006	May 22, 2006	May 31, 2006	\$0.07
April 11, 2006	April 20, 2006	April 28, 2006	\$0.07

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NOTE 7. SUBSEQUENT EVENTS

Loan Participations

In July 2006, the Company purchased additional loan participations of two portfolio companies of approximately \$0.5 million and a loan participation of two companies not currently in our investment portfolio of approximately \$5.0 million. In addition, the Company sold one of its loan participations of \$1.0 million realizing a nominal loss on the transaction and one loan participation repaid in full for \$3.0 million.

Quench USA, LLC

In July 2006, Quench USA, LLC borrowed \$500,000 under its revolving credit facility leaving \$1.1 million available for future borrowings.

Dividends

On July 11, 2006, the Company's Board of Directors declared the following monthly dividends which it believes were and will be paid, as applicable, from ordinary income:

Declaration Date	Record Date	Payment Date	Dividend per Share
July 11, 2006	July 19, 2006	July 31, 2006	\$0.07
July 11, 2006	August 21, 2006	August 31, 2006	\$0.07
July 11, 2006	September 21, 2006	September 29, 2006	\$0.07

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

All statements contained herein, other than historical facts, may constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements may relate to, among other things, future events or our future performance or financial condition. In some cases, you can identify forward-looking statements by terminology such as "may," "might," "believe," "will," "provided," "anticipate," "future," "could," "growth," "plan," "intend," "expect," "should," "would," "if," "seek," "possible," "potential," "likely" or the negative of such terms or comparable terminology. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others: (1) our future operating results as we are a company with a limited operating history; (2) the loss of one or more of our executive officers, in particular David Gladstone, Terry Lee Brubaker, or George Stelljes, III; (3) the impact of the investments that we make and the ability of these investments to achieve their objectives; (4) our contractual relationships with third parties; (5) the adequacy of our cash resources and working capital; (6) our ability to obtain future financing, if at all; and (7) those factors listed under the caption "Risk Factors" of the Company's Annual Report on Form 10-K dated March 31, 2006, as filed with the Securities and Exchange Commission on June 14, 2006. We caution readers not to place undue reliance on any such forward-looking statements, which are made pursuant to the Private Securities Litigation Reform Act of 1995 and, as such, speak only as of the date made. 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 financial statements and the notes thereto contained elsewhere in this report and our annual report on Form 10-K for the fiscal year ended March 31, 2006.

OVERVIEW

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 recapitalizations. We also may invest in common stock and from time to time, we also may invest in 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 under the Investment Company Act of 1940, as amended (the "1940 Act").

Our primary investment focuses are situations involving buyouts and recapitalizations of small and mid-sized companies with established management teams. We expect that our investments will generally range between \$10 million and \$30 million each, although this investment size may vary proportionately as the size of our capital base changes. We intend to invest either by ourselves or jointly with other buyout funds, depending on the opportunity. If we are participating in an investment with one or more co-investors, then our investment is likely to be smaller than if we were to be investing alone.

Following the completion of our initial public offering in June 2005, we began investing the proceeds of our initial public offering in senior secured syndicated loans because these investments typically may be originated more quickly than investments in companies undergoing a buyout or recapitalization. We employed this strategy in order to more quickly invest our initial capital to generate current income. Senior secured syndicated loans typically involve a number of banks or other financial institutions and are generally more marketable than loans that are not syndicated. We believe we will be able to sell our interests in senior secured syndicated loans and reinvest the proceeds in subordinated debt, mezzanine debt, preferred stock and other higher yielding investments when such investment opportunities are more readily available. In order to invest in certain senior secured syndicated loans, we may purchase these investments at a premium or discount. We amortize premiums and discounts over the contractual life of the investment. In the event that an investment is sold prior to its contractual maturity date, we recognize a loss on any unamortized premium or a gain on any unamortized discount. While the majority of our portfolio currently consists of senior secured loans, over time we expect that it will consist primarily of subordinated debt, mezzanine debt and preferred stock that we receive when making investments in connection with buyouts and recapitalizations. To date, we have acquired interests in 24 such syndicated loans in the aggregate principal amount, net of any repayments, of approximately \$113.3 million. We expect to continue purchasing syndicated loans using the proceeds from our initial public offering.

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At June 30, 2006, we have investments of approximately \$43.5 million in revolving credit facilities, senior and subordinated debt of three portfolio companies, including borrowings under revolving credit facilities. In addition, at June 30, 2006 we have invested approximately \$12.8 million in preferred and common equity of those companies. These investments are the result of buyout and recapitalization transactions and represent our primary investment focus. We intend to continue to invest in such investments using the remaining proceeds from our initial public offering or by the potential future sale of our existing senior syndicated loans, however, from time to time we may continue to invest in syndicated loans.

Certain loan investments may have a form of interest that is not paid currently but is accrued and added to the loan balance and paid at the end of the term. This interest is called "paid in kind" interest or "PIK." We will generally seek investments that do not generate PIK interest as we have to pay out this accrued interest as dividends to our stockholders and we may have to borrow money or raise additional capital in order to meet the tax test for a regulated investment company ("RIC") by having to pay out at least 90% of our income. As of June 30, 2006, none of our investments bear PIK interest.

We may also encounter "original issue discount" income, or "OID" income, which arises when an investor simultaneously purchases a warrant and a note from a company. This transaction requires an allocation of a portion of the purchase price to the warrant and reduces the note by the same amount. This would cause us to have to record the note as if we paid less than the face amount of the note and, therefore, we would have to amortize the OID over the life of the loan. This would create income that would be required to be paid out as dividends to our stockholders in accordance with the tax test for RICs to pay out at least 90% of our income. We will seek to purchase warrants from the issuer at fair market value in order to avoid OID income.

As a business development company under the 1940 Act, we are required to make available significant managerial assistance to our portfolio companies. We provide these services through Gladstone Management Corporation (the "Adviser" or "GMC"), who provides these services on our behalf through its officers who are also our officers. GMC provides additional services to our portfolio companies, for which it receives fees, in connection with our investments. These fees are generally non-recurring, however in some instances they may have a recurring component that is also paid to GMC. One half of any such fees received, with the exception of any recurring fees, by GMC are credited against the management advisory fee payable to GMC pursuant to the terms of our advisory agreement, which has the effect of reducing our expenses to the extent of any such fees received by GMC. The specific services GMC provides vary by portfolio company, but generally include a wide variety of services such as investment banking, arranging bank financing and equity financing, structuring financing from multiple lenders and investors, reviewing existing credit facilities, restructuring existing loans, raising equity and debt capital, turnaround management, merger and acquisition services and recruiting new management personnel.

In the event that we expend significant effort in considering and negotiating a potential investment that ultimately is not consummated, we generally will seek reimbursement from the proposed borrower for our reasonable expenses incurred in connection with the proposed transaction. Any amounts collected for expenses incurred by GMC in connection with unconsummated investments will be reimbursed to GMC. Amounts collected for these expenses incurred by us will be reimbursed to us and will be recognized in the period in which such reimbursement is received. Also, in the event that we have incurred significant legal fees in connection with the transaction, we will typically seek reimbursement for these expenses from the proposed borrower. However, there can be no guarantee that we will be successful in collecting any such reimbursements.

Our Adviser

Our affiliate, GMC, is our investment adviser and is led by a management team, which has extensive experience in our lines of business. GMC is controlled by David Gladstone, our chairman and chief executive officer. Mr. Gladstone is also the chairman and chief executive officer of GMC. Terry Lee Brubaker, our vice chairman, chief operating officer and director, is a member of the Board of Directors of GMC and is its vice chairman and chief operating officer. George Stelljes III, our president, chief investment officer and director, is a member of the Board of Directors of GMC and is its president and chief investment officer. Harry Brill, our chief financial officer, is the chief financial officer of GMC.

GMC also provides investment advisory and administrative services to our affiliates Gladstone Commercial Corporation, a publicly traded real estate investment trust; Gladstone Capital Corporation, a publicly traded business development company; and Gladstone Land Corporation, an agricultural real estate company owned by Mr. Gladstone. All of our directors and executive officers serve as either directors or executive officers, or both, of Gladstone Commercial Corporation and Gladstone Capital Corporation. In the future, GMC may provide investment advisory and administrative services to other funds, both public and private, of which it is the sponsor.

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We have been externally managed by GMC pursuant to an advisory agreement since our inception. GMC was organized as a corporation under the laws of the State of Delaware on July 2, 2002, and is a registered investment adviser under the 1940 Act. GMC is headquartered in McLean, Virginia, a suburb of Washington, DC, and has offices in New York, New York, Chicago, Illinois, Pittsburgh, Pennsylvania, Morristown, New Jersey, Lexington, Kentucky and Dallas, Texas.

Investment Advisory and Management Agreement

Pursuant to the advisory agreement with GMC we pay GMC a fee, as compensation for its services, consisting of a base management fee and an incentive fee.

The base management fee is assessed at an annual rate of 2% computed on the basis of the average value of our gross invested assets at the end of the two most recently

completed quarters, which are total assets less the cash proceeds and cash and cash equivalent investments from the proceeds of our initial public offering that are not invested in debt and equity securities of portfolio companies. Through June 30, 2006, the base management fee was computed and payable quarterly. Beginning in periods subsequent to September 30, 2006, the base management fee will be assessed at an annual rate of 2% computed on the basis of the average value of our 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. This calculation was originally scheduled to begin in periods after March 31, 2006, however, on April 11, 2006 our Board of Directors accepted a voluntary waiver from GMC that allowed the current calculation of the base management fee to be effective through June 30, 2006. Further, on July 11, 2006 our Board of Directors accepted an additional voluntary waiver from GMC allowing the current calculation of the base management fee to extend to September 30, 2006. When GMC also receives fees from our portfolio companies, such as investment banking fees, structuring fees or executive recruiting services fees, one half of these fees will be credited against the base management fee that we would otherwise be required to pay to GMC.

The incentive fee consists of two parts: an income-based incentive fee and a capital gains incentive fee. The income-based incentive fee will reward GMC if our quarterly net investment income (before giving effect to the incentive fee) exceeds 1.75% of our net assets. GMC will receive a capital gains incentive fee of 20% of our realized capital gains (net of realized capital losses and unrealized capital depreciation).

Administration Agreement

We have entered into an administration agreement with Gladstone Administration, LLC (“Gladstone Administration”), a wholly owned subsidiary of GMC. Pursuant to the administration agreement, Gladstone Administration furnishes us with office facilities, equipment and clerical, bookkeeping and record keeping services at such facilities and performs, or oversees the performance of our required administrative services. Such required administrative services include, among other things, being responsible for the financial records which we are required to maintain and preparing reports to our stockholders and reports filed with the Securities and Exchange Commission.

The administration agreement requires us to reimburse Gladstone Administration for the performance of its obligations under the administration agreement based upon our allocable portion of Gladstone Administration’s overhead, including, but not limited to, rent and our allocable portion of the salaries and benefits of our chief financial officer, chief compliance officer, controller and their respective staffs. Our allocable portion of expenses is derived by multiplying Gladstone Administration’s total expenses by the percentage of our average total assets (the total assets at the beginning and ending of each quarter) in comparison to the average total assets of all companies managed by GMC.

Our Investment Strategy

We seek to achieve returns from current income and capital gains from senior, subordinated and mezzanine debt, as well as preferred stock and warrants to purchase common stock, representing controlling investments that we make in connection with buyouts and recapitalizations of small and mid-sized companies. We expect that our target portfolio over time will include mostly subordinated loans, mezzanine debt, preferred stock, and warrants to buy common stock. Structurally, subordinated loans and mezzanine loans usually rank lower in priority of payment to senior debt, such as senior bank debt, and may be unsecured. However, subordinated debt and mezzanine loans rank senior to common and preferred equity in a borrower’s capital structure. Typically, subordinated debt and mezzanine loans have elements of both debt and equity instruments, offering the returns in the form of interest payments associated with senior debt, while providing lenders an opportunity to participate in the capital appreciation of a borrower, if any, through an equity interest. This equity interest typically takes the form of warrants. Due to its higher risk profile and often less restrictive

covenants as compared to senior debt, mezzanine debt generally earns a higher return than senior secured debt. The warrants associated with mezzanine loans are typically detachable, which allows lenders to receive repayment of their principal on an agreed amortization schedule while retaining their equity interest in the borrower. Mezzanine debt also may include a “put” feature, which permits the holder to sell its equity interest back to the borrower at a price determined through an agreed formula. We believe that mezzanine loans offer an alternative investment opportunity based upon their historic returns and resilience during economic downturns.

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and 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. Our accounting policies are more fully described in the “Notes to Financial Statements” contained elsewhere in this report. 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 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 investment portfolio each quarter. We carry our investments at fair value, as determined in good faith by our Board of Directors. Securities that are publicly traded, if any, are valued at the closing price of the exchange or securities market on which they are listed on the valuation date. Securities which are not traded on a public exchange or securities market, but for which a limited market exists and that have been rated by a nationally recognized statistical rating organizations (“NRSRO”), such as certain participations in syndicated loans, are valued at the indicative bid price offered by the syndication agent on the valuation date.

Debt and equity securities that are not publicly traded, for which a limited market does not exist, or for which a limited market exists but that have not been rated by a NRSRO (or for which we have various degrees of trading restrictions) are valued at fair value as determined in good faith by our Board of Directors. In making the good faith determination of the value of these securities, we start with the cost basis of the security, which includes the amortized OID and PIK interest, if any. We then apply the methods set out below in “Valuation Methods.” Members of our portfolio management team prepare the valuations of our investments in portfolio companies using the most recent portfolio company financial statements and forecasts. These individuals also consult with portfolio company senior management and ownership to obtain further updates on the portfolio company’s performance, including information such as industry trends, new product development, and other operational issues. 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 we might reasonably expect to receive upon the current sale of the security.

We currently engage Standard & Poor’s Loan Evaluation Service (“S&P”) to help evaluate the value of 7 of our loan securities (other than those which are publicly traded or for which a limited market exists, as described above), as well as for evaluations on success fees (conditional interest included in some loan securities). We and S&P only evaluate the value of a success fee if the probability of receiving the success fee on a given loan is above 6-8%, a threshold of significance. Upon completing our collection of data with respect to the investments (including the information described under “Credit Information,” the risk ratings of the loans described under “Loan Grading and Risk Rating” and the factors described under “Valuation Methods”), this valuation data is presented to S&P. S&P makes its independent assessment of the data that we have assembled and assesses its own data to determine market values for the securities. With regard to its work, S&P has issued the following paragraph:

S&P provides evaluated price opinions which are reflective of what S&P 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 S&P'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, S&P 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 has been obtained from reputable secondary market sources. Although these sources are considered reliable, S&P cannot guarantee their accuracy.

With our assessment and the supplemental S&P value estimates, our Board of Directors votes to accept or not accept the analyses and values recommended by management and S&P. At the July 11, 2006 meeting of the Board of Directors, the Board of Directors elected to accept the valuations recommended by S&P on the loans in our portfolio as denoted on the Schedule of Investments as of June 30, 2006 in our consolidated financial statements.

Because there is a delay between when we close an investment and when the investment can be evaluated by S&P, new loans are not valued immediately by S&P; rather, the Board of Directors makes its own determination about the value of these investments in accordance with our valuation policy. Because S&P does not provide values for equity securities our Board of Directors also independently determines the fair value of these investments using our valuation policy.

Credit Information: We monitor a wide variety of key credit statistics that provide information regarding our portfolio companies to help us assess credit quality and portfolio performance. We require our portfolio companies to provide annual audited and either monthly or quarterly unaudited financial statements. Using these statements, we calculate and evaluate the credit statistics. For purposes of analyzing the financial performance of our portfolio companies, we may make certain adjustments to their cash flow statements to reflect the pro forma results of a company consistent with a change of control transaction, to reflect anticipated cost savings resulting from a merger or restructuring, costs related to new product development, compensation to previous owners, and other acquisition or restructuring related items. For those investments for which S&P prepares valuation recommendations, we provide this credit information to S&P for its use in preparing its recommendations. For those investments for which S&P does not prepare valuation recommendations, management uses this credit information in connection with its preparation of valuation recommendations.

Loan Grading and Risk Rating: As part of our valuation procedures we risk rate all of our investments in debt securities. 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 our 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. For those investments for which S&P prepares valuation recommendations, we compile this information and provide it to S&P for its consideration in determining its valuation recommendations. For those investments for which S&P does not prepare valuation recommendations, management uses this information to develop valuation recommendations.

We seek to have our risk rating system mirror the risk rating systems of major risk rating organizations such as those provided by a NRSRO as defined in Rule 2a-7 under the 1940 Act. While we seek to mirror the NRSRO systems, we cannot provide any assurance that our risk rating system provides the same risk rating as a NRSRO. 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 we have established our system to rate 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 that can afford to pay an NRSRO to rate their securities. 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 middle market companies do not exceed the grade of BBB on a 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 a NRSRO, however, no assurance can be given that a 10 on our scale is equal to a BBB on a NRSRO scale.

Company's System	First NRSRO	Second NRSRO	Gladstone Investment's Description(a)
>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 22.0 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 10.0 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%
0	N/a	D	PD is 85 or there is a Payment Default and the EL is greater than 20%

(a) the default rates set forth are for a ten year term debt security.. If the company's 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 the company's 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. The following table lists the risk ratings for all of the debt securities at June 30, 2006 and March 31, 2006:

Rating	June 30, 2006	March 31, 2006
Average	7.3	7.1
Weighted Average	6.7	6.6
Highest	9	9
Lowest	5	5

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. At June 30, 2006, no payments were past due on any of our debt securities. Additionally, we do not risk rate our equity securities.

Valuation Methods: For debt securities, we first determine if the debt security is publicly traded (i.e., if it is listed on an exchange or securities market). If it is publicly traded, then we determine the value based on the closing price for the security on the exchange or securities market on which it is listed on the valuation date. If the security is not publicly traded, but a limited market for the security exists, such as for a participation in a syndicated loan, then we value it at the indicative bid price offered by the syndication agent on the valuation date. At June 30, 2006, none of the debt securities in our portfolio were publicly traded and there was a limited market for 18 debt securities in our portfolio.

For debt securities that are not publicly traded, for which there is no market, or for which there is a market but have not been rated by a NRSRO, we begin with the risk rating designation of the security described above. Using the risk rating designation above, we seek to determine the value of the security as if we intended to currently sell the security. To determine the current sale price of the security, we consider some or all of the following factors:

- financial standing of the issuer of the security;
- comparison of the business and financial plan of the issuer with actual results;
- the cost of the security;
- the size of the security held as it relates to the liquidity of the market for such securities;
- contractual restrictions on the disposition of the security;
- pending public offering of the issuer of the security;
- pending reorganization activity affecting the issuer such as mergers or debt restructuring;
- reported prices of similar securities of the issuer or comparable issuers;
- ability of the issuer to obtain needed financing;
- changes in the economy affecting the issuer;
- recent purchases or sale of a security of the issuer;
- pricing and sales by other buyers or sellers of similar securities;
- financial statements of the borrower;
- reports from portfolio company senior management and ownership;
- the type of security;
- cost at date of purchase;
- size of holding;
- discount from market value of unrestricted securities of the same class at the time of purchase;
- special reports prepared by analysts;

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- information as to any transactions or offers with respect to the security;
 - existence of merger proposals or tender offers affecting the securities;
 - the collateral;
 - the issuer's ability to make payments;
 - the current and forecasted earnings of the issuer;
 - statistical ratios compared to lending standards;
 - statistical ratios compared to similar securities; and
 - other pertinent factors.

For those debt securities for which S&P prepares valuation recommendations, we provide the foregoing information to S&P for its use in preparing such recommendations.

For convertible debt, equity, success fees or other equity-like securities, we first determine if there is any market for the security. If there is a market, then we determine the value based on the market prices for the security, even if that market is not robust. At June 30, 2006 there was no market for any of the equity securities we owned. If there is no market for the equity securities, then we use the same information we would use for a debt security valuation described above, except risk-rating, as well as standard valuation techniques used by major valuation firms to value the equity securities of private companies. These valuation techniques consist of discounted cash flow of the expected sale price in the future, valuation of the securities based on recent sales in comparable transactions, and a review of similar companies that are publicly traded and

the market multiple of their equity securities. For equity securities that have been in our portfolio for less than one year, we estimate fair value at cost. At June 30, 2006 we had \$12.8 million invested, at cost, in equity securities compared to our debt portfolio with a cost basis of \$157.7 million.

At June 30, 2006 we had total unrealized depreciation of approximately \$1.2 million which was primarily composed of net unrealized depreciation of our syndicated loan investments.

Tax Status

Federal Income Taxes

We currently qualify and 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 are required to distribute to stockholders at least 90% of investment company taxable income, as defined by the Code. In an effort to avoid certain excise taxes imposed on RICs, we currently intend to distribute during each calendar year, an amount at least equal 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 for preceding years that were not distributed during such years.

Revenue Recognition

Interest Income Recognition

Interest income is recorded on the accrual basis to the extent that such amounts are expected to be collected. We will stop accruing interest on investments when it is determined that interest is no longer collectible. Conditional interest, or a success fee, is recorded when earned upon full repayment of a loan investment.

Fee Income

The 1940 Act requires that a business development company make available managerial assistance to its portfolio companies by providing significant guidance and counsel concerning the management, operations, or business objectives and policies of the respective portfolio company. We provide these and other services through our adviser, GMC. Currently, neither we nor GMC receive fees in connection with managerial assistance. GMC provides managerial assistance to our portfolio companies and currently does not charge for those services. If GMC does charge managerial assistance fees in the future, any such fees will be credited to the base management fee otherwise due to GMC from us under the advisory agreement. However, GMC also receives fees for the other services it provides, and 50% of those fees for other services are credited to the investment advisory fees due to GMC. These other fees are generally non-recurring, are recognized as revenue when earned and are paid directly to GMC by the borrower or potential borrower upon the closing of the investment. The services GMC provides vary by investment, but generally include a wide variety of services to the portfolio companies such as investment banking services, arranging bank financing, arranging equity financing,

structuring financing from multiple lenders and investors, reviewing existing credit facilities, restructuring existing loans, raising equity and debt capital, turnaround management, merger and acquisition services and recruiting new management personnel. Any services of this nature subsequent to the closing would generally generate a separate fee at the time of completion which is payable either to us or GMC. From time to time, we are invited to participate as a co-lender in a transaction. In the event that we do not provide significant services in connection with our investment, loan fees paid directly to GMC in such situations are deferred and amortized over the life of the loan.

RESULTS OF OPERATIONS

Three months ended June 30, 2006 compared to the period June 22, 2005 (Commencement of operations) to June 30, 2005

Investment Income

Investment income for the three months ended June 30, 2006 was \$3,863,438 and consisted of interest income of \$3,154,782 on our portfolio of investments and interest income of \$708,340 from cash and cash equivalents, representing income earned on the investment of the remaining proceeds of our initial public offering.

Investment income for the period June 22, 2005 (commencement of operations) to June 30, 2005 was \$48,198 and consisted solely of interest earned on our cash and cash equivalents that we received from the proceeds of our initial public offering.

The weighted average yield on our portfolio of investments, excluding cash and cash equivalents, was 8.77% for the three months ended June 30, 2006.

Operating Expenses

Operating expenses for the three months ended June 30, 2006 were \$1,282,274.

The administration fee payable to Gladstone Administration was \$115,389 for the three months ended June 30, 2006 compared to \$27,083 for the period June 22, 2005 (commencement of operations) to June 30, 2005. This fee consists of our allocable portion of Gladstone Administration's rent and other overhead expenses, and our allocable portion of the salaries and benefits of our chief financial officer, chief compliance officer, controller and their respective staffs. Our allocable portion of expenses is derived by multiplying the percentage of our average assets (the assets at the beginning and ending of each quarter) in comparison to the average assets of all companies managed by GMC.

The base management fee to GMC was \$801,309 for the three months ended June 30, 2006. The base management fee is currently computed quarterly as described under "Investment Advisory and Management Agreement." There was no base management fee for the period June 22, 2005 (commencement of operations) to June 30, 2005 as none of the proceeds from our initial public offering were invested during that period.

Directors' fees for the three months ended June 30, 2006 were \$43,250 and consisted of the amortization of the directors' annual stipend and individual meeting fees. The directors' fees for the prior year period were not declared until July 2005 and, therefore, no expense was recorded for the period June 22, 2005 (commencement of operations) to June 30, 2005.

Insurance expense for the three months ended June 30, 2006 was \$72,611 and consisted of the amortization of the directors and officers insurance policy and professional liability policy. There was no insurance expense for the prior year period as the premiums were not in effect until July 2005.

Professional fees for the three months ended June 30, 2006 were \$79,748 and primarily consisted of legal fees and audit and accounting fees. There were no professional fees expensed in the prior period as the legal and accounting fees incurred related to our initial public offering and were capitalized.

Stockholder related costs for the three months ended June 30, 2006 were \$93,766 and consisted of the amortization of annual Nasdaq listing fees, transfer agent fees, annual report printing fees, Securities and Exchange Commission filing fees and press release costs. The \$635 of stockholder related costs for the period June 22, 2005 (commencement of operations) to June 30, 2005 consisted solely of press release costs for the respective period.

Interest expense for the period June 22, 2005 (commencement of operations) to June 30, 2005 was \$378 and consisted of interest due on a loan payable to affiliate, which was repaid in June 2005.

Taxes and licenses expense for the three months ended June 30, 2006 was \$57,107 was primarily comprised of franchise taxes due to the state of Delaware and other fees surrounding state and regulatory licensing, registration and other corporate filing fees.

Other expenses for the three months ended June 30, 2006 were \$19,094 and consisted of conferences, travel, bank fees, document custody charges and miscellaneous expenses. Other expenses for the period June 22, 2005 (commencement of operations) to June 30, 2005 were \$302 and consisted primarily of bank fees and miscellaneous expenses.

Realized and Unrealized Gain (Loss) on Investments

For the three months ended June 30, 2006, we recognized gains on the sale of four loan participations in the aggregate amount of \$3,273 and we recorded net unrealized depreciation of investments in the aggregate amount of \$1,307,389.

At March 31, 2006, the fair value of our investment portfolio exceeded the cost basis of our portfolio by approximately \$113,000. At June 30, 2006, the fair value of our investment portfolio was less than the cost basis of our portfolio by approximately \$1.2 million, representing an overall decrease of approximately \$1.3 million. This decrease is primarily the result of the decline in market value of our syndicated loan investments.

Net Increase in Net Assets from Operations

Overall, we realized a net increase in net assets resulting from operations of \$1,277,048 for the three months ended June 30, 2006 as a result of the factors discussed above. Based on basic and diluted weighted average common shares of 16,560,100 outstanding, our net increase in net assets from operations per basic and diluted weighted average common share for the three months ended June 30, 2006 was \$0.08. Net increase in net assets resulting from operations for the period June 22, 2005 (commencement of operations) to June 30, 2005 was \$19,800 and was comprised solely of net investment income for that period.

LIQUIDITY AND CAPITAL RESOURCES

Net cash used in operating activities for the three months ended June 30, 2006 was approximately \$13.9 million and consisted primarily of the purchase of syndicated loan investments, an increase in interest receivable on our portfolio investments and a decrease in accrued expenses from the prior year end, offset by sales of existing portfolio investments, increases in base management fee and administrative fees payable and unrealized depreciation of our portfolio investments.

A summary of our investment activity for the three months ended June 30, 2006 is as follows:

	New Investments	Principal Repayments	Investments Sold	Gain on Disposal
Three months ended June 30, 2006	\$ 33,665,549	\$ 874,222	\$ 15,548,454	\$ 3,273

During the three months ended June 30, 2006, we purchased new investments using a portion of the remaining proceeds from our initial public offering. We will continue to use the proceeds from our initial public offering to make investments in syndicated loans, subordinated debt, mezzanine debt, preferred stock and other higher yielding investments. We also expect to establish a line of credit facility to enable us to continue our investment activities once the proceeds from our initial public offering have been fully invested.

The following table summarizes the contractual principal amortization and maturity of our investment portfolio by fiscal year:

<u>Fiscal Year Ended March 31,</u>	<u>Amount</u>
2007	\$ 2,041,291
2008	4,409,693
2009	5,044,633
2010	6,476,665
2011	33,138,630
Thereafter	105,699,984
Total contractual repayments	156,810,896
Investments in equity securities	12,778,508
Unamortized premiums on debt securities:	885,136
Total	\$ 170,474,540

For the period June 22, 2005 (commencement of operations) to June 30, 2005, we recorded net cash proceeds resulting from our initial public offering of \$200,164,544, which were primarily invested in cash and short-term investments at June 30, 2005.

For the three months ended June 30, 2006, our dividends paid of \$3,477,621 exceeded our net investment income (including realized gains) by \$893,184. We declared these dividends based on net investment income for the quarter. Our investment pace continues to be slower than expected entering our second year of operations and, consequently, our net investment income was lower than our original estimates.

In order to qualify as a RIC and to 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 realized net short-term capital gains to our stockholders on an annual basis. In accordance with these requirements, we have declared the following dividends since our inception:

<u>Declaration Date</u>	<u>Record Date</u>	<u>Payment Date</u>	<u>Dividend per Share</u>
April 11, 2006	June 22, 2006	June 30, 2006	\$0.07
April 11, 2006	May 22, 2006	May 31, 2006	\$0.07
April 11, 2006	April 20, 2006	April 28, 2006	\$0.07
January 10, 2006	March 17, 2006	March 31, 2006	\$0.07
January 10, 2006	February 16, 2006	February 28, 2006	\$0.07
January 10, 2006	January 23, 2006	January 31, 2006	\$0.07
October 7, 2005	December 21, 2005	December 31, 2005	\$0.04
October 7, 2005	November 21, 2005	November 30, 2005	\$0.04
October 7, 2005	October 21, 2005	October 30, 2005	\$0.04
July 7, 2005	September 22, 2005	September 30, 2005	\$0.02
July 7, 2005	August 23, 2005	August 31, 2005	\$0.02
July 7, 2005	July 21, 2005	July 29, 2005	\$0.02

Contractual Obligations and Off-Balance Sheet Arrangements

As of June 30, 2006, we were a party to signed and non-binding term sheets for three allocations of syndicate loan participations. The future scheduled contractual payments at June 30, 2006 are as follows:

<u>Contractual Obligations</u>	<u>Payment Due by Period</u>				
	<u>Total</u>	<u>Less than 1 Year</u>	<u>1-3 Years</u>	<u>3-5 Years</u>	<u>More than 5 Years</u>
Investments	7,000,000	7,000,000			
Total	\$ 7,000,000	\$ 7,000,000	\$ —	\$ —	\$ —

As of the date of this report, \$5 million of the investment purchase obligations summarized above has been funded. See Note 7 “Subsequent Events” in our Consolidated Financial Statements for further information.

We do not have any significant off-balance sheet arrangements as defined in Item 303(a)(4)(ii) of SEC Regulation S-K as of June 30, 2006.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

We are subject to financial market risks, including changes in interest rates. General interest rate fluctuations may have a substantial negative impact on our investments and investment opportunities and, accordingly have a material adverse effect on our investment objectives and our rate of return on invested capital. Currently our entire investment portfolio is at variable rates. In addition, an increase in interest rates would make it more expensive to use debt for our financing needs, if any.

We expect to borrow funds to finance future lending activities after we have substantially fully invested the proceeds of our initial public offering. These future borrowings may be at fixed or variable rates. To date, we have not borrowed any funds nor do we currently foresee the short-term necessity to borrow funds.

To illustrate the potential impact of changes in interest rates on our net increase in net assets resulting from operations, we have performed the following analysis, which assumes that our balance sheet remains constant. Under this analysis, a hypothetical increase in the one month London Interbank Offered Rate (“LIBOR”) by 1% would increase our net increase in net assets resulting from operations by approximately \$1.3 million or 18%, over the next twelve months, compared to the net increase in net assets resulting from operations for the period July 1, 2005 to June 30, 2006. A hypothetical decrease in the one month LIBOR by 1% would decrease our net increase in net assets resulting from operations by approximately \$1.3 million or 18%, over the next twelve months, compared to the net increase in net assets from operations for the period July 1, 2005 to June 30, 2006. Although management believes that this analysis is indicative of our existing interest rate sensitivity, it does not adjust for potential changes in credit quality, size and composition of our investment portfolio and other business developments that could affect net increase in net assets resulting from operations. Accordingly, no assurances can be given that actual results would not differ materially from the results under this hypothetical analysis.

We expect to hedge against interest rate fluctuations in the future by using standard hedging instruments such as forward contracts, futures, currency options, interest rate swaps, caps, collars and floors. While hedging activities may insulate us against adverse fluctuations in interest rates, they may also limit our ability to participate in the benefits of lower interest rates with respect to our portfolio of investments. We currently are not engaged in any hedging activities.

We may also experience risk associated with investing in securities of companies with foreign operations. We currently do not anticipate investing in debt or equity of foreign companies, however, some potential portfolio companies may have operations located outside the United States. These risks include, but are not limited to, fluctuations in foreign currency exchange rates, imposition of foreign taxes, changes in exportation regulations and political and social instability.

ITEM 4. CONTROLS AND PROCEDURES.

As of June 30, 2006, we, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective 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.

There have been no changes in our internal control over financial reporting that occurred during the quarter ended June 30, 2006 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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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.

There have been no material changes to the risk factors as disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2006 filed with the Securities and Exchange Commission on June 14, 2006.

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

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

Not applicable.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

Not applicable.

ITEM 5. OTHER INFORMATION.

Not applicable

ITEM 6. EXHIBITS

See the exhibit index.

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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/ HARRY BRILL
Harry Brill
Chief Financial Officer

Date: August 2, 2006

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EXHIBIT INDEX

<u>Exhibit</u>	<u>Description</u>
3.1	Articles of Amendment and Restatement of the Articles 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 March 31, 2005.
3.2	By-laws, incorporated by reference to Exhibit b to the Registration Statement on Form N-2 (File No. 333-123699), filed March 31, 2005.
4.1	Specimen Stock Certificate, incorporated by reference to Exhibit 99.E on Form N-2/A (File No. 333-123699), filed June 21, 2005.

- 10.1* Joint Directors Nonqualified Excess Plan of Gladstone Commercial Corporation, Gladstone Capital Corporation and Gladstone Investment Corporation incorporated by reference to the Company's Current Report on Form 8-K (File No. 0-51233) filed on July 11, 2006.
- 11 Computation of Per Share Earnings (included in the notes to the unaudited 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.

* Denotes management contract or compensatory plan or arrangement.

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.

CERTIFICATION
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, David Gladstone, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Gladstone Investment Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any changes in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 2, 2006

/s/ DAVID GLADSTONE

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

CERTIFICATION
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Harry Brill, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Gladstone Investment Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any changes in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 2, 2006

/s/ HARRY BRILL

Harry Brill
Chief Financial Officer

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

The undersigned, the Chief Executive Officer and Chairman of the Board of Gladstone Investment Corporation (the "Company"), hereby certifies on the date hereof, pursuant to 18 U.S.C. §1350(a), as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q for the quarter ended June 30, 2006 ("Form 10-Q"), filed concurrently herewith by the Company, fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended, and that the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 2, 2006

/s/ David Gladstone
David Gladstone
Chief Executive Officer and
Chairman of the Board of Directors

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

The undersigned, the Chief Financial Officer of Gladstone Investment Corporation (the "Company"), hereby certifies on the date hereof, pursuant to 18 U.S.C. §1350(a), as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q for the quarter ended June 30, 2006 ("Form 10-Q"), filed concurrently herewith by the Company, fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended, and that the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 2, 2006

/s/ Harry Brill

Harry Brill
Chief Financial Officer