

GLADSTONE CAPITAL CORP

Form 10-K

November 14, 2018

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended September 30, 2018

OR

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

For the transition period from _____ to _____

Commission file number 814-00237

GLADSTONE CAPITAL CORPORATION

(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of
incorporation or organization)

54-2040781
(I.R.S. Employer
Identification No.)

1521 Westbranch Drive, Suite 100
McLean, Virginia
(Address of principal executive offices)
(703) 287-5800

22102
(Zip Code)

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, \$0.001 par value per share	Nasdaq Global Select Market
6.00% Series 2024 Term Preferred Stock, \$0.001 par value per share	Nasdaq Global Select Market
6.125% Notes due 2023, \$25.00 par value per share	Nasdaq Global Select Market

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of large accelerated filer, accelerated

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filer, smaller reporting company, and emerging growth company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The aggregate market value of the voting common stock held by non-affiliates of the Registrant on March 29, 2018, based on the closing price on that date of \$8.60 on the Nasdaq Global Select Market, was \$217,196,999. For the purposes of calculating this amount only, all directors and executive officers of the Registrant have been treated as affiliates. There were 28,504,745 shares of the Registrant's common stock, \$0.001 par value per share, outstanding as of November 13, 2018.

Documents Incorporated by Reference. Portions of the Registrant's definitive proxy statement filed with the Securities and Exchange Commission pursuant to Regulation 14A in connection with the Registrant's 2019 Annual Meeting of Stockholders, which will be filed subsequent to the date hereof, are incorporated by reference into Part III of this Form 10-K. Such proxy statement will be filed with the Securities and Exchange Commission not later than 120 days following the end of the Registrant's fiscal year ended September 30, 2018.

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FORM 10-K FOR THE FISCAL YEAR ENDED
SEPTEMBER 30, 2018
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FORWARD-LOOKING STATEMENTS

All statements contained herein, other than historical facts, may constitute forward-looking statements. These statements may relate to, among other things, our future operating results, our business prospects and the prospects of our portfolio companies, actual and potential conflicts of interest with Gladstone Management Corporation, our adviser, and its affiliates, the use of borrowed money to finance our investments, the adequacy of our financing sources and working capital, and our ability to co-invest, among other factors. In some cases, you can identify forward-looking statements by terminology such as estimate, may, might, believe, will, provided, anticipate, future, could, growth, plan, intend, expect, should, would, if, 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, but are not limited to: (1) the recurrence of adverse events in the economy and the capital markets; (2) risks associated with negotiation and consummation of pending and future transactions; (3) the loss of one or more of our executive officers, in particular David Gladstone, Terry Lee Brubaker or Robert L. Marcotte; (4) changes in our investment objectives and strategy; (5) availability, terms (including the possibility of interest rate volatility) and deployment of capital; (6) changes in our industry, interest rates, exchange rates or the general economy; (7) the degree and nature of our competition; (8) our ability to maintain our qualification as a regulated investment company, or RIC, and as a business development company, or BDC; and (9) those factors described in the *Risk Factors* section of this Annual Report on Form 10-K. We caution readers not to place undue reliance on any such forward-looking statements. Actual results could differ materially from those anticipated in our forward-looking statements and future results could differ materially from historical performance. We have based forward-looking statements on information available to us on the date of this Annual Report on Form 10-K. Except as required by the federal securities laws, 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 Annual Report on Form 10-K. Although we undertake no obligation to revise or update any forward-looking statements, whether as a result of new information, future events or otherwise, you are advised to consult any additional disclosures that we may make directly to you or through reports that we have filed or in the future may file with the Securities and Exchange Commission, including quarterly reports on Form 10-Q and current reports on Form 8-K.

In this Annual Report on Form 10-K, or Annual Report, the Company, we, us, and our refer to Gladstone Capital Corporation and its wholly-owned subsidiaries unless the context otherwise indicates. Dollar amounts are in thousands unless otherwise indicated.

PART I

The information contained in this section should be read in conjunction with our accompanying Consolidated Financial Statements and the notes thereto appearing elsewhere in this Annual Report on Form 10-K.

ITEM 1. BUSINESS

Overview

Organization

Gladstone Capital Corporation was incorporated under the Maryland General Corporation Law on May 30, 2001 and completed an initial public offering on August 24, 2001. We are an externally managed, closed-end, non-diversified management investment company that has elected to be treated as a business development company (BDC) under the Investment Company Act of 1940, as amended (the 1940 Act), and is applying the guidance of the Financial Accounting Standards Board (the FASB) Accounting Standards Codification (ASC) Topic 946 Financial Services-Investment Companies (ASC 946). In addition, we have elected to be treated for tax purposes as a regulated investment company (RIC) under the Internal Revenue Code of 1986, as amended (the Code). We were established for the purpose of investing in debt and equity securities of established private businesses operating in the United States (U.S.).

Our shares of common stock and mandatorily redeemable preferred stock are traded on the Nasdaq Global Select Market (Nasdaq) under the trading symbols GLAD and GLADN, respectively and our Notes due 2023 trade on Nasdaq under the trading symbol GLADD.

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Investment Adviser and Administrator

We are externally managed by our affiliated investment adviser, Gladstone Management Corporation (the *Adviser*), pursuant to an investment advisory and management agreement (the *Advisory Agreement*). Administrative services are provided by our affiliate, Gladstone Administration, LLC (the *Administrator*), pursuant to an administration agreement (the *Administration Agreement*). Each of the Adviser and Administrator are privately-held companies that are indirectly owned and controlled by David Gladstone, our chairman and chief executive officer. Mr. Gladstone and Terry Lee Brubaker, our vice chairman and chief operating officer, also serve on the board of directors of the Adviser, the board of managers of the Administrator, and serve as executive officers of the Adviser and the Administrator. The Administrator employs, among others, our chief financial officer and treasurer, chief valuation officer, chief compliance officer, general counsel and secretary (who also serves as the president of the Administrator) and their respective staffs. The Adviser and Administrator have extensive experience in our lines of business and also provide investment advisory and administrative services, respectively, to our affiliates, including, but not limited to: Gladstone Commercial Corporation (*Gladstone Commercial*), a publicly-traded real estate investment trust; Gladstone Investment Corporation (*Gladstone Investment*), a publicly-traded BDC and RIC; and Gladstone Land Corporation, a publicly-traded real estate investment trust (*Gladstone Land*, with *Gladstone Commercial*, and *Gladstone Investment*, collectively the *Affiliated Public Funds*). In the future, the Adviser and Administrator may provide investment advisory and administrative services, respectively, to other funds and companies, both public and private.

The Adviser was organized as a corporation under the laws of the State of Delaware on July 2, 2002, and is a U.S. Securities and Exchange Commission (the *SEC*) registered investment adviser under the Investment Advisers Act of 1940, as amended. The Administrator was organized as a limited liability company under the laws of the State of Delaware on March 18, 2005. The Adviser and Administrator are headquartered in McLean, Virginia, a suburb of Washington, D.C.

Investment Objectives and Strategy

Our investment objectives are to: (1) achieve and grow current income by investing in debt securities of established lower middle market companies (which we generally define as companies with annual earnings before interest, taxes, depreciation and amortization (*EBITDA*) of \$3 million to \$15 million) in the U.S. that we believe will provide stable earnings and cash flow to pay expenses, make principal and interest payments on our outstanding indebtedness and make distributions to stockholders that grow over time; and (2) provide our stockholders with long-term capital appreciation in the value of our assets by investing in equity securities of established businesses that we believe can grow over time to permit us to sell our equity investments for capital gains. To achieve our objectives, our primary investment strategy is to invest in several categories of debt and equity securities, with each investment generally ranging from \$8 million to \$30 million, although investment size may vary, depending upon our total assets or available capital at the time of investment. We lend to borrowers that need funds for growth capital, to finance acquisitions, or to recapitalize or refinance their existing debt facilities. We seek to avoid investing in high-risk, early-stage enterprises. Our targeted portfolio companies are generally considered too small for the larger capital marketplace. We intend for our investment portfolio to consist of approximately 90.0% debt investments and 10.0% equity investments, at cost. As of September 30, 2018, our investment portfolio was made up of approximately 91.4% debt investments and 8.6% equity investments, at cost.

We invest by ourselves or jointly with other funds and/or management of the portfolio company, depending on the opportunity. If we are participating in an investment with one or more co-investors, our investment is likely to be smaller than if we were investing alone.

In July 2012, the SEC granted us an exemptive order (the "Co-Investment Order") that expands our ability to co-invest with certain of our affiliates under certain circumstances and any future business development company or closed-end management investment company that is advised (or sub-advised if it controls the fund) by the Adviser, or any combination of the foregoing, subject to the conditions in the SEC's order.

In general, our investments in debt securities have a term of no more than seven years, accrue interest at variable rates (based on the one month London Interbank Offered Rate ("LIBOR")) and, to a lesser extent, at fixed rates. We seek debt instruments that pay interest monthly or, at a minimum, quarterly, and which may include a yield enhancement, such as a success fee or deferred interest provision and may include interest only with all principal and any accrued but unpaid interest due at maturity. Generally, success fees accrue at a set rate and are contractually due upon a change of control of the business. Some debt securities have deferred interest whereby some portion of the interest payment is added to the principal balance so that the interest is paid, together with the principal, at maturity. This form of deferred interest is often called paid-in-kind ("PIK") interest. Typically, our equity investments take the form of preferred or common stock, limited liability company interests, or warrants or options to purchase the foregoing. Often, these equity investments occur in connection with our original investment, recapitalizing a business, or refinancing existing debt.

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Since our initial public offering in 2001 and through September 30, 2018, we have invested in over 226 different companies, while making 188 consecutive monthly or quarterly cash distributions to common stockholders. We expect that our investment portfolio will primarily include the following three categories of investments in private companies operating in the U.S.:

First Lien Secured Debt Securities: We seek to invest a portion of our assets in first lien secured debt securities also known as senior loans, senior term loans, lines of credit and senior notes. Using its assets as collateral, the borrower typically uses first lien debt to cover a substantial portion of the funding needs of the business. These debt securities usually take the form of first priority liens on all, or substantially all, of the assets of the business. First lien debt securities may include investments sourced from the syndicated loan market.

Second Lien Secured Debt Securities: We seek to invest a portion of our assets in second lien secured debt securities, also known as subordinated loans, subordinated notes and mezzanine loans. These second lien secured debt securities rank junior to the borrowers' first lien secured debt securities and may be secured by second priority liens on all or a portion of the assets of the business. Additionally, we may receive other yield enhancements in addition to or in lieu of success fees such as warrants to buy common and preferred stock or limited liability interests in connection with these second lien secured debt securities. Second lien debt securities may include investments sourced from the syndicated loan market.

Preferred and Common Equity/Equivalents: In some cases we will purchase equity securities which consist of preferred and common equity or limited liability company interests, or warrants or options to acquire such securities, and are in combination with our debt investment in a business. Additionally, we may receive equity investments derived from restructurings on some of our existing debt investments. In some cases, we will own a significant portion of the equity and in other cases we may have voting control of the businesses in which we invest.

Pursuant to the 1940 Act, we must maintain at least 70.0% of our total assets in qualifying assets, which generally include each of the investment types listed above. Therefore, the 1940 Act permits us to invest up to 30.0% of our assets in other non-qualifying assets. See *Regulation as a BDC – Qualifying Assets* for a discussion of the types of qualifying assets in which we are permitted to invest pursuant to Section 55(a) of the 1940 Act.

Because the majority of the loans in our portfolio consist of term debt in private companies that typically cannot or will not expend the resources to have their debt securities rated by a credit rating agency, we expect that most, if not all, of the debt securities we acquire will be unrated. Investors should assume that these loans would be rated below what is today considered investment grade quality. Investments rated below investment grade are often referred to as high yield securities or junk bonds and may be considered higher risk, as compared to investment-grade debt instruments. In addition, many of the debt securities we hold typically do not amortize prior to maturity.

Investment Policies

We seek to achieve a high level of current income and capital gains through investments in debt securities and preferred and common stock that we generally acquire in connection with buyouts and other recapitalizations. The following investment policies, along with these investment objectives, may not be changed without the approval of our board of directors (the Board of Directors):

We will at all times conduct our business so as to retain our status as a BDC. In order to retain that status, we must operate for the purpose of investing in certain categories of qualifying assets. In addition, we may not acquire any assets (other than non-investment assets necessary and appropriate to our operations as a BDC or qualifying assets) if, after giving effect to such acquisition, the value of our qualifying assets is less than 70.0% of the value of our total assets. We anticipate that the securities we seek to acquire will generally be qualifying assets.

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We will at all times endeavor to conduct our business so as to retain our status as a RIC under the Code. To do so, we must meet income source, asset diversification and annual distribution requirements. We may issue senior securities, such as debt or preferred stock, to the extent permitted by the 1940 Act for the purpose of making investments, to fund share repurchases, or for temporary emergency or other purposes. With the exception of our policy to conduct our business as a BDC, these policies are not fundamental and may be changed without stockholder approval.

Investment Concentrations

As of September 30, 2018, our investment portfolio consisted of investments in 50 companies located in 24 states across 18 different industries with an aggregate fair value of \$390.0 million. Our five largest investments at fair value as of September 30, 2018, totaled \$122.8 million, or 31.5% of our total investment portfolio.

The following table outlines our investments by security type at September 30, 2018 and 2017:

	September 30, 2018				September 30, 2017			
	Cost		Fair Value		Cost		Fair Value	
Secured first lien debt	\$ 206,523	48.3%	\$ 199,625	51.2%	\$ 198,942	48.4%	\$ 173,896	49.4%
Secured second lien debt	180,274	42.2	156,373	40.1	168,247	40.9	155,249	44.1
Unsecured debt	3,708	0.9	3,655	0.9	3,324	0.8	3,324	0.9
Total debt investments	390,505	91.4	359,653	92.2	370,513	90.1	332,469	94.4
Preferred equity	12,920	3.0	7,749	2.0	18,794	4.5	6,561	1.9
Common equity/equivalents	24,042	5.6	22,644	5.8	22,128	5.4	13,343	3.7
Total equity investments	36,962	8.6	30,393	7.8	40,922	9.9	19,904	5.6
Total Investments	\$ 427,467	100.0%	\$ 390,046	100.0%	\$ 411,435	100.0%	\$ 352,373	100.0%

Our investments at fair value consisted of the following industry classifications at September 30, 2018 and 2017:

Industry Classification	September 30, 2018		September 30, 2017	
	Fair Value	Percentage of Total Investments	Fair Value	Percentage of Total Investments
Diversified/Conglomerate Service	\$ 79,066	20.3%	\$ 80,723	22.9%
Healthcare, education and childcare	53,916	13.8	46,288	13.1
Oil and gas	50,172	12.9	34,712	9.9
Telecommunications	47,794	12.3	31,350	8.9
Diversified/Conglomerate Manufacturing	43,421	11.1	40,843	11.6
Diversified natural resources, precious metals and minerals	23,040	5.9	18,949	5.4

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Automobile	18,209	4.7	20,082	5.7
Cargo Transportation	15,164	3.9	13,081	3.7
Beverage, food and tobacco	13,727	3.5	14,103	4.0
Machinery	11,058	2.8	5,114	1.4
Home and Office Furnishings, Housewares and Durable Consumer Products	10,125	2.6	10,100	2.9
Textiles and leather	6,556	1.7	4,879	1.4
Hotels, Motels, Inns, and Gaming	6,337	1.6	7,136	2.0
Personal and non-durable consumer products	4,892	1.3	7,035	2.0
Buildings and real estate	2,455	0.6	3,004	0.9
Printing and publishing	1,998	0.5	3,628	1.0
Leisure, Amusement, Motion Pictures, Entertainment			9,225	2.6
Other, < 2.0%	2,116	0.5	2,121	0.6
Total Investments	\$ 390,046	100.0%	\$ 352,373	100.0%

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Our investments at fair value were included in the following U.S. geographic regions and Canada at September 30, 2018 and 2017:

Location	September 30, 2018		September 30, 2017	
	Fair Value	Percentage of Total Investments	Fair Value	Percentage of Total Investments
South	\$ 168,917	43.3%	\$ 150,727	42.8%
West	114,286	29.3	116,302	33.0
Midwest	61,733	15.8	58,915	16.7
Northeast	37,589	9.7	26,429	7.5
Canada	7,521	1.9		
Total Investments	\$ 390,046	100.0%	\$ 352,373	100.0%

The geographic composition is determined by the location of the headquarters for each of our portfolio companies. A portfolio company may have a number of other business locations in other geographic locations.

Investment Process***Overview of Investment and Approval Process***

To originate investments, the Adviser's investment professionals use an extensive referral network comprised primarily of private equity sponsors, leveraged buyout funds, investment bankers, attorneys, accountants, commercial bankers, and business brokers. The Adviser's investment professionals review information received from these and other sources in search of potential financing opportunities. If a potential opportunity matches our investment objectives, the investment professionals will seek an initial screening of the opportunity with our president, Robert L. Marcotte, to authorize the submission of an indication of interest (IOI) to the prospective portfolio company. If the prospective portfolio company passes this initial screening and the IOI is accepted by the prospective company, the investment professionals will seek approval to issue a letter of intent (LOI) to the prospective company from the Adviser's investment committee, which is composed of Messrs. Gladstone, Brubaker and Marcotte. If this LOI is issued, then the Adviser and Gladstone Securities, LLC (Gladstone Securities) (collectively, the Due Diligence Team) will conduct a due diligence investigation and create a detailed profile summarizing the prospective portfolio company's historical financial statements, industry, competitive position and management team, analyzing its conformity to our general investment criteria. The investment professionals then present this profile to the Adviser's investment committee, which must approve each investment. Further, each investment is available for review by the members of our Board of Directors, a majority of whom are not interested persons, as defined in Section 2(a)(19) of the 1940 Act.

Prospective Portfolio Company Characteristics

We have identified certain characteristics that we believe are important in identifying and investing in prospective portfolio companies. The criteria listed below provide general guidelines for our investment decisions, although not all of these criteria may be met by each portfolio company.

Growth-and-Income Orientation and Positive Cash Flow. Our investment philosophy places a premium on fundamental analysis from an investor's perspective and has a distinct growth-and-income orientation. In seeking income, we typically invest in companies that generate growing sales and cash flow to provide some assurance that they will be able to service their debt and deleverage over time. We do not expect to invest in start-up companies or companies with what we believe to be cyclical industries or speculative business plans.

Experienced Management. We typically require that the businesses in which we invest have experienced management teams. We also require the businesses to have proper incentives in place to induce management teams to succeed and act in concert with our interests as an investor, including having significant equity or other interests in the financial performance of their respective companies.

Strong Competitive Position in an Industry. We seek to invest in businesses that have developed strong market positions within their respective markets and that we believe are well-positioned to capitalize on growth opportunities. We seek businesses that demonstrate significant competitive advantages versus their competitors, which we believe will help to protect their market positions and profitability.

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Enterprise Collateral Value. The projected enterprise valuation of the business, based on market based comparable cash flow multiples, is an important factor in our investment analysis in determining the collateral coverage of our debt securities.

Extensive Due Diligence

The Due Diligence Team conducts what we believe are extensive due diligence investigations of our prospective portfolio companies and investment opportunities. The due diligence investigation may begin with a review of publicly available information followed by in depth business analysis, including, but not limited to, any of the following:

a review of the prospective portfolio company's historical and projected financial information, including a quality of earnings analysis;

detailed review of the track record of the private equity firm or ownership group acquiring or controlling any prospective borrower;

visits to the prospective portfolio company's business site(s);

interviews with the prospective portfolio company's management, employees, customers, and vendors;

review of loan documents and material contracts;

background checks and a management capabilities assessment on the prospective portfolio company's management team and controlling shareholders; and

research on the prospective portfolio company's products, services or particular industry and its competitive position therein.

Upon completion of a due diligence investigation and a decision to proceed with an investment, the Adviser's investment professionals who have primary responsibility for the investment present the investment opportunity to the Adviser's investment committee. The investment committee then determines whether to pursue the potential investment. Prior to the closing of an investment, additional due diligence may be conducted on our behalf by attorneys, independent accountants, and other outside advisers, as appropriate.

We also rely on the long-term relationships that the Adviser's investment professionals have with leveraged buyout funds, investment bankers, commercial bankers, private equity sponsors, attorneys, accountants, and business brokers. In addition, the extensive direct experiences of our executive officers and managing directors in the operations of lower middle market companies and providing debt and equity capital to lower middle market companies plays a significant role in our investment evaluation and assessment of risk.

Investment Structure

Once the Adviser has determined that an investment meets our standards and investment criteria, the Adviser works with the management of that company, the private equity firm or ownership group controlling any prospective borrower, and other capital providers to structure the transaction in a way that we believe will provide us with the greatest opportunity to maximize our return on the investment, while providing appropriate incentives to the shareholders and management of the company. As discussed above, the capital classes through which we typically structure a deal include first lien secured debt, second lien secured debt, and preferred and common equity or equivalents. Through its risk management process, the Adviser seeks to limit the downside risk of our investments by:

seeking collateral or superior positions in the portfolio company's capital structure where possible;

negotiating covenants in connection with our investments that afford our portfolio companies as much flexibility as possible in managing their businesses, consistent with preserving our capital;

securing board observation rights at the portfolio company;

incorporating call protection into the investment structure where possible; and

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making investments with an expected total return (including both interest and potential equity appreciation) that it believes compensates us for the credit risk of the investment.

We expect to hold most of our debt investments until maturity or repayment, but may sell our investments (including our equity investments) earlier if a liquidity event takes place, such as the sale or recapitalization of a portfolio company. Occasionally, we may sell some or all of our investment interests in a portfolio company to a third party in a privately negotiated transaction to manage our credit or sector exposures or to enhance our portfolio yield.

Competitive Advantages

A large number of entities compete with us and make the types of investments that we seek to make in lower middle market privately-owned businesses. Such competitors include other BDCs, non-equity based investment funds, and other financing sources, including traditional financial services companies such as commercial banks. Many of our competitors are substantially larger than we are and have considerably greater funding sources or are able to access capital more cost effectively. In addition, certain of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments, serve a broader customer base, and establish a greater market share. Furthermore, many of these competitors are not subject to the regulatory restrictions that the 1940 Act imposes on us as a BDC or the regulatory requirements we must comply with as a publicly traded company. However, we believe that we have the following competitive advantages over other providers of financing to lower middle market companies.

Management Expertise

Our Adviser has a separate investment committee for the Company and each of the Affiliated Public Funds. The Adviser's investment committee for the Company is comprised of Messrs. Gladstone, Brubaker and Marcotte, each of whom have a wealth of experience in our area of operation. Mr. Gladstone and Mr. Brubaker also serve on the Adviser's investment committee for the other Affiliated Public Funds. Mr. Gladstone and Mr. Marcotte both have over 25 years of experience in investing in middle market companies and with operating in the BDC marketplace in general. Mr. Brubaker has over 25 years of experience in acquisitions and operations of companies. Messrs. Gladstone and Brubaker also have principal management responsibility for the Adviser as its executive officers. These three individuals dedicate a significant portion of their time to managing our investment portfolio. Our senior management has extensive experience providing capital to lower middle market companies and Messrs. Gladstone and Brubaker have worked together at the Gladstone Companies for more than 15 years. In addition, we have access to the resources and expertise of the Adviser's investment professionals and support staff who possess a broad range of transactional, financial, managerial, and investment skills. See the additional discussion regarding management of portfolio companies by our Adviser below under *Ongoing Management of Investments and Portfolio Company Relationships*.

Increased Access to Investment Opportunities Developed Through Extensive Research Capability and Network of Contacts

The Adviser seeks to identify potential investments through active origination and due diligence and through its dialogue with numerous private equity firms and other members of the financial community with whom the Adviser's investment professionals have long-term relationships. We believe that the Adviser's investment professionals have developed a broad network of contacts within the investment, commercial banking, private equity and investment management communities, and that their reputation, experience and focus on investing in lower middle market companies enables us to source and identify well-positioned prospective portfolio companies that provide attractive investment opportunities. Additionally, the Adviser expects to generate information from its professionals' network of accountants, consultants, lawyers and management teams of portfolio companies and other contacts to support the Adviser's investment activities.

Disciplined, Value and Income-Oriented Investment Philosophy with a Focus on Preservation of Capital

In making its investment decisions, the Adviser focuses on the risk and reward profile of each prospective portfolio company, seeking to minimize the risk of capital loss without foregoing the potential for capital appreciation. We expect the Adviser to use the same investment philosophy that its professionals use in the management of the other Gladstone Companies and to commit resources to manage downside exposure. The Adviser's approach seeks to reduce our risk in investments by using some or all of the following approaches:

focusing on companies with sustainable market positions and cash flow;

investing in businesses with experienced and established management teams;

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engaging in extensive due diligence from the perspective of a long-term investor;

investing in businesses backed by successful private equity sponsors or owner operators; and

adopting flexible transaction structures by drawing on the experience of the investment professionals of the Adviser and its affiliates.

Longer Investment Horizon

Unlike private equity funds that are typically organized as finite-life partnerships, we are not subject to standard periodic capital return requirements. The partnership agreements of most private equity funds typically provide that these funds may only invest investors' capital once and must return all capital and realized gains to investors within a finite time period, often seven to ten years. These provisions often force private equity funds to seek returns on their investments by causing their portfolio companies to pursue mergers, public equity offerings, or other liquidity events more quickly than might otherwise be optimal or desirable, potentially resulting in a lower overall return to investors and/or an adverse impact on their portfolio companies. In contrast, we are an exchange-traded corporation of perpetual duration. We believe that our flexibility to make investments with a long-term view and without the capital return requirements of traditional private investment vehicles provides us with the opportunity to achieve greater long-term returns on invested capital.

Flexible Transaction Structuring

We believe our management team's broad expertise and years of combined experience enables the Adviser to identify, assess, and structure investments successfully across all levels of a company's capital structure and manage potential risk and return at all stages of the economic cycle. We are not subject to many of the regulatory limitations that govern traditional lending institutions, such as banks. As a result, we are flexible in selecting and structuring investments, adjusting investment criteria and transaction structures and, in some cases, the types of securities in which we invest. We believe that this approach enables the Adviser to craft a financing structure which best fits the investment and growth profile of the underlying business and yields attractive investment opportunities that will continue to generate current income and capital gain potential throughout the economic cycle, including during turbulent periods in the capital markets.

Ongoing Management of Investments and Portfolio Company Relationships

The Adviser's investment professionals actively oversee each investment by continuously evaluating the portfolio company's performance and typically working collaboratively with the portfolio company's management to identify and incorporate best resources and practices that help us achieve our projected investment performance.

Monitoring

The Adviser's investment professionals monitor the financial performance, trends, and changing risks of each portfolio company on an ongoing basis to determine if each company is performing within expectations and to guide the portfolio company's management in taking the appropriate courses of action. The Adviser employs various methods of evaluating and monitoring the performance of our investments in portfolio companies, which can include the following:

monthly analysis of financial and operating performance;

assessment of the portfolio company's performance against its business plan and our investment expectations;

attendance at and/or participation in the portfolio company's board of directors or management meetings;

assessment of portfolio company management, sponsor, governance, and strategic direction;

assessment of the portfolio company's industry and competitive environment; and

review and assessment of the portfolio company's operating outlook and financial projections.

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Relationship Management

The Adviser's investment professionals interact with various parties involved with a portfolio company, or investment, by actively engaging with internal and external constituents, including:

management;

boards of directors;

private equity sponsors;

capital partners; and

advisers and consultants.

Managerial Assistance and Services

As a BDC, we make available significant managerial assistance, as defined in the 1940 Act, to our portfolio companies and provide other services (other than such managerial assistance) to such portfolio companies. Neither we, nor the Adviser, currently receive fees in connection with the managerial assistance we make available. At times, the Adviser may also provide other services to our portfolio companies under certain agreements and may receive fees for services other than managerial assistance. Such services may include, but are not limited to: (i) assistance obtaining, sourcing or structuring credit facilities, long term loans or additional equity from unaffiliated third parties; (ii) negotiating important contractual financial relationships; (iii) consulting services regarding restructuring of the portfolio company and financial modeling as it relates to raising additional debt and equity capital from unaffiliated third parties; and (iv) taking a primary role in interviewing, vetting and negotiating employment contracts with candidates in connection with adding and retaining key portfolio company management team members. The Adviser non-contractually, unconditionally, and irrevocably credits 100% of these fees against the base management fee that we would otherwise be required to pay to the Adviser as discussed below in *Transactions with Related Parties Investment Advisory and Management Agreement Base Management Fee*. However, pursuant to the terms of the Advisory Agreement, a small percentage of certain of such fees is retained by the Adviser in the form of reimbursement, at cost, for tasks completed by personnel of the Adviser, primarily for the valuation of portfolio companies.

Gladstone Securities also provides other services (such as investment banking and due diligence services) to certain of our portfolio companies; see *Transactions with Related Parties Other Transactions* below.

Valuation Process

The following is a general description of the investment valuation policy (the *Policy*) (which has been approved by our Board of Directors) that the professionals of the Adviser and Administrator, with oversight and direction from our chief valuation officer, an employee of the Administrator who reports directly to our Board of Directors (collectively, the *Valuation Team*), use each quarter to determine the value of our investment portfolio. In accordance with the 1940

Act, our Board of Directors has the ultimate responsibility for reviewing and approving, in good faith, the fair value of our investments based on the Policy. The Adviser values our investments in accordance with the requirements of the 1940 Act and accounting principles generally accepted in the U.S. (GAAP). There is no single standard for determining fair value (especially for privately-held businesses), as fair value depends upon the specific facts and circumstances of each individual investment. Each quarter, our Board of Directors reviews the Policy to determine if changes thereto are advisable and assesses whether the Valuation Team has applied the Policy consistently. With respect to the valuation of our investment portfolio, the Valuation Team performs the following steps each quarter:

Each investment is initially assessed by the Valuation Team using the Policy, which may include:

obtaining fair value quotes or utilizing input from third party valuation firms; and

using techniques, such as total enterprise value, yield analysis, market quotes and other factors, including but not limited to: the nature and realizable value of the collateral, including external parties' guaranties; any relevant offers or letters of intent to acquire the portfolio company; and the markets in which the portfolio company operates.

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Preliminary valuation conclusions are then discussed amongst the Valuation Team and with our management and documented for review by our Board of Directors. Written valuation recommendations and supporting material are sent to the Board of Directors in advance of the quarterly meetings.

The Valuation Committee of the Board of Directors (comprised entirely of independent directors) meets to review this documentation and discusses the information provided by our Valuation Team, and determines whether the Valuation Team has followed the Policy, determines whether the Valuation Team's recommended fair value is reasonable in light of the Policy and reviews other facts and circumstances. Then, the Valuation Committee and chief valuation officer present the Valuation Committee's findings to the entire Board of Directors, so that the full Board of Directors may review and approve, with a vote, to accept or reject the fair value recommendations in accordance with the Policy.

Fair value measurements of our investments may involve subjective judgment and estimates. Due to the inherent uncertainty of determining these fair values, the fair value of our investments may fluctuate, from period to period. Our valuation policies, procedures and processes are more fully described in Note 2 *Summary of Significant Accounting Policies* in our accompanying *Notes to Consolidated Financial Statements* included elsewhere in this Annual Report on Form 10-K.

Transactions with Related Parties

Investment Advisory and Management Agreement

In 2006, we entered into the Advisory Agreement, which was subsequently amended in October 2015, as approved unanimously by our Board of Directors, including the unanimous approval of our independent directors, to reduce the base management fee payable to the Adviser effective July 1, 2015, as discussed further below. In accordance with the Advisory Agreement, we pay the Adviser fees as compensation for its services, consisting of a base management fee and an incentive fee. On July 10, 2018, our Board of Directors, including a majority of the directors who are not parties to the agreement or interested person of any such party, unanimously approved the annual renewal of the Advisory Agreement with the Adviser through August 31, 2019. Mr. Gladstone, our chairman and chief executive officer, controls the Adviser. The Board of Directors considered the following factors as the basis for its decision to renew the Advisory Agreement: (1) the nature, extent and quality of services provided by the Adviser to our shareholders; (2) the investment performance of the Company and the Adviser; (3) the costs of the services to be provided and profits to be realized by the Adviser and its affiliates from the relationship with the Company; (4) the extent to which economies of scale will be realized as the Company and the Affiliated Public Funds grow and whether the fee level under the Advisory Agreement reflects the economies of scale for the Company's investors; (5) the fee structure of the advisory and administrative agreements of comparable funds; (6) indirect profits to the Adviser created through the Company; and (7) in light of the foregoing considerations, the overall fairness of the advisory fee paid under the Advisory Agreement.

Based on the information reviewed and the considerations detailed above, our Board of Directors, including all of the directors who are not interested persons as that term is defined in the 1940 Act, concluded that the investment advisory fee rates and terms are fair and reasonable in relation to the services provided and approved the Advisory Agreement, as being in the best interests of our stockholders.

Base Management Fee

The base management fee is payable quarterly to the Adviser pursuant to our Advisory Agreement and is assessed at an annual rate of 1.75%, computed on the basis of the value of our average total assets at the end of the two most recently-completed quarters (inclusive of the current quarter), which are total assets, including investments made with proceeds of borrowings, less any uninvested cash or cash equivalents resulting from borrowings and adjusted appropriately for any share issuances or repurchases during the period. Prior to July 1, 2015, the annual rate was 2.0%. Our Board of Directors may (as it has for the years ended September 30, 2018, 2017 and 2016) accept an unconditional and irrevocable credit from the Adviser to reduce the annual 1.75% (or prior to July 1, 2015, 2.0%) base management fee on syndicated loan participations to 0.5%, to the extent that proceeds resulting from borrowings were used to purchase such syndicated loan participations.

Additionally, pursuant to the requirements of the 1940 Act, the Adviser makes available significant managerial assistance to our portfolio companies. The Adviser may also provide other services to our portfolio companies under certain agreements and may receive fees for services other than managerial assistance. The Adviser non-contractually, unconditionally, and irrevocably credits 100% of these fees against the base management fee that we would otherwise be required to pay to the Adviser; however, pursuant to the terms of the Advisory Agreement, a small percentage of certain of such fees is retained by the Adviser in the form of reimbursement, at cost, for tasks completed by personnel of the Adviser, primarily for the

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valuation of portfolio companies. Loan servicing fees that are payable to the Adviser pursuant to our Fifth Amended and Restated Credit Agreement, with KeyBank National Association (KeyBank), as administrative agent, lead arranger and a lender, as amended (our Credit Facility), are also 100% credited against the base management fee as discussed below, *Loan Servicing Fee Pursuant to Credit Agreement* .

Incentive Fee

The incentive fee consists of two parts: an income-based incentive fee and a capital gains-based incentive fee. The income-based incentive fee rewards the Adviser if our quarterly net investment income (before giving effect to any incentive fee) exceeds 1.75% of our net assets, which we define as total assets less indebtedness and before taking into account any incentive fees payable or contractually due but not payable during the period, at the end of the immediately preceding calendar quarter, adjusted appropriately for any share issuances or repurchases during the period (the hurdle rate). The income-based incentive fee with respect to our pre-incentive fee net investment income is generally payable quarterly to the Adviser and is computed as follows:

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

100.0% of our pre-incentive fee net investment income with respect to that portion of such pre-incentive fee net investment income, if any, that exceeds the hurdle rate but is less than 2.1875% of our net assets, adjusted appropriately for any share issuances or repurchases during the period, in any calendar quarter (8.75% annualized); and

20.0% of the amount of our pre-incentive fee net investment income, if any, that exceeds 2.1875% of our net assets, adjusted appropriately for any share issuances or repurchases during the period, in any calendar quarter (8.75% annualized).

Quarterly Incentive Fee Based on Net Investment Income

Pre-incentive fee net investment income

(expressed as a percentage of the value of net assets)

Percentage of pre-incentive fee net investment income

allocated to income-related portion of incentive fee

The second part of the incentive fee is a capital gains-based incentive fee that will be determined and payable in arrears as of the end of each fiscal year (or upon termination of the Advisory Agreement, as of the termination date) and equals 20.0% of our realized capital gains, less any realized capital losses and unrealized depreciation, as of the end of the fiscal year. In determining the capital gains-based incentive fee payable to the Adviser, we calculate the cumulative aggregate realized capital gains and cumulative aggregate realized capital losses since our inception, and

the entire portfolio's aggregate unrealized capital depreciation, if any and excluding any unrealized capital appreciation, as of the date of the calculation. For this purpose, cumulative aggregate realized capital gains, if any, equals the sum of the differences between the net sales price of each investment, when sold, and the original cost of such investment since inception. Cumulative aggregate realized capital losses equals the sum of the amounts by which the net sales price of each investment, when sold, is less than the original cost of such investment since inception. The entire portfolio's aggregate unrealized capital depreciation, if any, equals the sum of the difference, between the valuation of each investment as of the applicable calculation date and the original cost of such investment. At the end of the applicable fiscal year, the amount of capital gains that serves as the basis for our calculation of the capital gains-based incentive fee equals the cumulative aggregate realized capital gains less cumulative aggregate realized capital losses, less the entire portfolio's aggregate unrealized capital depreciation, if any. If this number is positive at the end of such fiscal year, then the capital gains-based incentive fee for such year equals 20.0% of such amount, less the aggregate amount of any capital gains-based incentive fees paid in respect of our portfolio in all prior years. No capital gains-based incentive fee has been recorded or paid from our inception through September 30, 2018, as cumulative unrealized capital depreciation has exceeded cumulative realized capital gains net of cumulative realized capital losses.

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Additionally, in accordance with GAAP, a capital gains-based incentive fee accrual is calculated using the aggregate cumulative realized capital gains and losses and aggregate unrealized capital depreciation included in the calculation of the capital gains-based incentive fee plus the aggregate unrealized capital appreciation. If such amount is positive at the end of a period, then GAAP requires us to record a capital gains-based incentive fee equal to 20.0% of such amount, less the aggregate amount of actual capital gains-based incentive fees paid in all prior years. If such amount is negative, then there is no accrual for such period. GAAP requires that the capital gains-based incentive fee accrual consider the cumulative aggregate unrealized capital appreciation in the calculation, as a capital gains-based incentive fee would be payable if such unrealized capital appreciation were realized. There can be no assurance that such unrealized capital appreciation will be realized in the future. No GAAP accrual for a capital gains-based incentive fee has been recorded or paid from our inception through September 30, 2018.

Our Board of Directors accepted non-contractual, unconditional and irrevocable credits from the Adviser to reduce the income-based incentive fee to the extent net investment income did not cover 100.0% of distributions to common stockholders for the years ended September 30, 2018, 2017, and 2016, which credits totaled \$1.7 million, \$2.3 million, and \$1.4 million, respectively.

Loan Servicing Fee Pursuant to Credit Agreement

The Adviser also services the loans held by our wholly-owned subsidiary, Gladstone Business Loan, LLC ("Business Loan") (the borrower under our Credit Facility), in return for which the Adviser receives a 1.5% annual fee payable monthly based on the monthly aggregate outstanding balance of loans pledged under our Credit Facility. Since Business Loan is a consolidated subsidiary of ours, and the total base management fee paid to the Adviser pursuant to the Advisory Agreement cannot exceed 1.75% of total assets (as reduced by cash and cash equivalents pledged to creditors and adjusted appropriately for any share issuances or repurchases during the period) during any given calendar year, we treat payment of the loan servicing fee pursuant to our line of credit as a pre-payment of the base management fee under the Advisory Agreement. Accordingly, these loan servicing fees are 100% non-contractually, unconditionally, and irrevocably credited back to us by the Adviser.

Administration Agreement

We pay the Administrator pursuant to the Administration Agreement for our allocable portion of the Administrator's expenses incurred while performing services to us, which are primarily rent and salaries and benefits expenses of the Administrator's employees, including our chief financial officer and treasurer, chief compliance officer, chief valuation officer and general counsel and secretary (who also serves as the Administrator's president), and their respective staffs.

Our allocable portion of the Administrator's expenses are generally derived by multiplying the Administrator's total expenses by the approximate percentage of time during the current quarter the Administrator's employees performed services for us in relation to their time spent performing services for all companies serviced by the Administrator. On July 10, 2018, our Board of Directors, including a majority of the directors who are not parties to the Advisory Agreement or interested persons of such party, approved the annual renewal of the Administration Agreement through August 31, 2019.

Other Transactions

Mr. Gladstone also serves on the board of managers of our affiliate, Gladstone Securities, a privately-held broker-dealer registered with the Financial Industry Regulatory Authority and insured by the Securities Investor Protection Corporation. Gladstone Securities is 100% indirectly owned and controlled by Mr. Gladstone and has provided other services, such as investment banking and due diligence services, to certain of our portfolio companies,

for which Gladstone Securities receives a fee. Any such fees paid by portfolio companies to Gladstone Securities do not impact the fees we pay to the Adviser or the non-contractual, unconditional, and irrevocable credits against the base management fee or incentive fee. For additional information refer to Note 4 *Related Party Transactions* of our accompanying *Notes to Consolidated Financial Statements*.

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Material U.S. Federal Income Tax Considerations

RIC Status

To qualify for treatment as a RIC under Subchapter M of the Code, we must generally distribute to our stockholders, for each taxable year, at least 90.0% of our investment company taxable income, which is our ordinary income plus the excess of our net short-term capital gains over net long-term capital losses. We refer to this as the annual distribution requirement. We must also meet several additional requirements, including:

Business Development Company status. At all times during the taxable year, we must maintain our status as a BDC.

Income source requirements. At least 90.0% of our gross income for each taxable year must be from dividends, interest, payments with respect to securities, loans, gains from sales or other dispositions of securities or other income derived with respect to our business of investing in securities, and net income derived from an interest in a qualified publicly traded partnership.

Asset diversification requirements. As of the close of each quarter of our taxable year: (1) at least 50.0% of the value of our assets must consist of cash, cash items, U.S. government securities, the securities of other regulated investment companies and other securities to the extent that (a) we do not hold more than 10.0% of the outstanding voting securities of an issuer of such other securities, and (b) such other securities of any one issuer do not represent more than 5.0% of our total assets; and (2) no more than 25.0% of the value of our total assets may be invested in the securities of one issuer (other than U.S. government securities or the securities of other regulated investment companies), or of two or more issuers that are controlled by us and are engaged in the same or similar or related trades or businesses or in the securities of one or more qualified publicly traded partnerships.

Failure to Qualify as a RIC

If we are unable to qualify for treatment as a RIC, we will be subject to tax on all of our taxable income at regular corporate rates. We would not be able to deduct distributions to stockholders, nor would we be required to make such distributions. Distributions would be taxable to our stockholders as dividend income to the extent of our current and accumulated earnings and profits. Subject to certain limitations under the Code, corporate distributees would be eligible for the dividends received deduction. Distributions in excess of our current and accumulated earnings and profits would be treated first as a return of capital to the extent of the stockholder's adjusted tax basis, and then as a gain realized from the sale or exchange of property. If we fail to meet the RIC requirements for more than two consecutive years and then seek to requalify as a RIC, we generally would be subject to corporate-level federal income tax on any unrealized appreciation with respect to our assets to the extent that any such unrealized appreciation is recognized during a specified period up to five years.

Qualification as a RIC

If we qualify as a RIC and distribute to stockholders each year in a timely manner at least 90.0% of our investment company taxable income, we will not be subject to federal income tax on the portion of our taxable income and gains we distribute to stockholders. We would, however, be subject to a 4.0% nondeductible federal excise tax if we do not

distribute, actually or on a deemed basis, an amount at least equal to the sum of (1) 98.0% of our ordinary income for the calendar year, (2) 98.2% 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 capital gains in excess of capital losses for preceding years that were not distributed during such years. For the years ended December 31, 2017, 2016 and 2015, we did not incur any excise taxes.

The federal excise tax would apply only to the amount by which the required distributions exceed the amount of income we distribute, actually or on a deemed basis, to stockholders. We will be subject to regular corporate income tax, currently a flat rate of 21.0%, on any undistributed income, including both ordinary income and capital gains.

If we acquire debt obligations that (i) were originally issued at a discount, (ii) bear interest at rates that are not either fixed rates or certain qualified variable rates, or (iii) are not unconditionally payable at least annually over the life of the obligation, we will be required to include in taxable income each year a portion of the original issue discount (OID) that accrues over the life of the obligation. Additionally, PIK interest, which is computed at the contractual rate specified in a loan agreement and is added to the principal balance of a loan, is also a non cash source of income that we are required to include in taxable income each year. Both OID and PIK income will be included in our investment company taxable income even though we

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receive no cash corresponding to such amounts. As a result, we may be required to make additional distributions corresponding to such OID and PIK amounts in order to satisfy the annual distribution requirement and to continue to qualify as a RIC or to avoid the imposition of federal income and excise taxes. In this event, we may be required to sell investments or other assets to meet the RIC distribution requirements. For the year ended September 30, 2018, we recorded \$0.2 million of OID income and the unamortized balance of OID investments (which are primarily all syndicated loans) as of September 30, 2018 totaled \$0.4 million. As of September 30, 2018, we had five investments which had a PIK interest component and we recorded PIK interest income of \$3.8 million during the year ended September 30, 2018.

Regulation as a BDC

We are a closed-end, non-diversified management investment company that has elected to be regulated as a BDC under Section 54 of the 1940 Act. As such, we are subject to regulation under the 1940 Act. The 1940 Act contains prohibitions and restrictions relating to transactions between BDCs and their affiliates, principal underwriters and affiliates of those affiliates or underwriters and requires that a majority of the directors be persons other than interested persons, as defined in the 1940 Act. In addition, the 1940 Act provides that we may not change the nature of our business so as to cease to be, or to withdraw our election as, a BDC unless approved by a majority of our outstanding voting securities, as defined in the 1940 Act.

We intend to conduct our business so as to retain our status as a BDC. A BDC may use capital provided by public stockholders and from other sources to invest in long-term private investments in businesses. A BDC provides stockholders the ability to retain the liquidity of a publicly traded stock while sharing in the possible benefits, if any, of investing in primarily privately owned companies. In general, a BDC must have been organized and have its principal place of business in the U.S. and must be operated for the purpose of making investments in qualifying assets, as described in Sections 55(a)(1) through (a)(3) of the 1940 Act.

Qualifying Assets

Under the 1940 Act, a BDC may not acquire any asset other than assets of the type listed in Section 55(a) of the 1940 Act, which are referred to as qualifying assets, unless, at the time the acquisition is made, qualifying assets, other than certain interests in furniture, equipment, real estate, or leasehold improvements (operating assets) represent at least 70.0% of total assets, exclusive of operating assets. The types of qualifying assets in which we may invest under the 1940 Act include, but are not limited to, the following:

- (1) Securities purchased in transactions not involving any public offering from the issuer of such securities, which issuer is an eligible portfolio company. An eligible portfolio company is generally defined in the 1940 Act as any issuer which:
 - (a) is organized under the laws of, and has its principal place of business in, any State or States in the U.S.;
 - (b) is not an investment company (other than a small business investment company wholly owned by the BDC or otherwise excluded from the definition of investment company); and

(c) satisfies one of the following:

- (i) it does not have any class of securities with respect to which a broker or dealer may extend margin credit;
- (ii) it is controlled by the BDC and for which an affiliate of the BDC serves as a director;
- (iii) it has total assets of not more than \$4.0 million and capital and surplus of not less than \$2 million;
- (iv) it does not have any class of securities listed on a national securities exchange; or
- (v) it has a class of securities listed on a national securities exchange, with an aggregate market value of outstanding voting and non-voting equity of less than \$250.0 million.

- (2) Securities received in exchange for or distributed on or with respect to securities described in (1) above, or pursuant to the exercise of options, warrants or rights relating to such securities.
- (3) Cash, cash items, government securities or high quality debt securities maturing in one year or less from the time of investment.

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Asset Coverage

Pursuant to Section 61(a)(2) of the 1940 Act, we are permitted, under specified conditions, to issue multiple classes of senior securities representing indebtedness. However, pursuant to Section 18(c) of the 1940 Act, we are permitted to issue only one class of senior securities that is stock. In either case, we may only issue such senior securities if such class of senior securities, after such issuance, has an asset coverage, as defined in Section 18(h) of the 1940 Act, of at least 200% (as the law applies to the Company currently) or 150% (as the law will apply to the Company effective April 10, 2019; refer to *Management's Discussion and Analysis of Financial Condition and Results of Operations Overview Regulatory Compliance* for a discussion of changes to the asset coverage requirements pursuant to the Small Business Credit Availability Act (SBCAA)).

In addition, our ability to pay dividends or distributions (other than dividends payable in our stock) to holders of any class of our capital stock would be restricted if our senior securities representing indebtedness fail to have an asset coverage of at least 200% (measured at the time of declaration of such distribution and accounting for such distribution). The 1940 Act does not apply this limitation to privately arranged debt that is not intended to be publicly distributed, unless this limitation is specifically negotiated by the lender. In addition, our ability to pay dividends or distributions (other than dividends payable in our common stock) to our common stockholders would also be restricted if our senior securities that are stock fail to have an asset coverage of at least 200% (measured at the time of declaration of such distribution and accounting for such distribution). If the value of our assets declines, we might be unable to satisfy these asset coverage requirements. To satisfy the 200% asset coverage requirement in the event that we are seeking to pay a distribution, we might either have to (i) liquidate a portion of our loan portfolio to repay a portion of our indebtedness or (ii) issue common stock. This may occur at a time when a sale of a portfolio asset may be disadvantageous, or when we have limited access to capital markets on agreeable terms. In addition, any amounts that we use to service our indebtedness or for offering expenses will not be available for distributions to our stockholders. If we are unable to regain the requisite asset coverage through these methods, we may be forced to suspend the payment of such dividends or distributions.

Significant Managerial Assistance

Generally, a BDC must make available significant managerial assistance to issuers of certain of its portfolio securities that the BDC counts as qualifying assets for the 70.0% test described above. Making available significant managerial assistance means, among other things, any arrangement whereby the BDC, through its directors, officers or employees, offers to provide, and, if accepted, does so provide, significant guidance and counsel concerning the management, operations or business objectives and policies of a portfolio company. Significant managerial assistance also includes the exercise of a controlling influence over the management and policies of the portfolio company. However, with respect to certain, but not all such securities, where the BDC purchases such securities in conjunction with one or more other persons acting together, one of the other persons in the group may make available such managerial assistance, or the BDC may exercise such control jointly.

Code of Ethics

We, and all of the Gladstone companies, have adopted a code of ethics and business conduct applicable to all of the officers, directors and employees of such companies that complies with the guidelines set forth in Item 406 of Regulation S-K of the Securities Act of 1933 (the Securities Act) and Rule 17j-1 of the 1940 Act. As required by the 1940 Act, this code establishes procedures for personal investments, restricts certain transactions by such personnel and requires the reporting of certain transactions and holdings by such personnel. This code of ethics and business conduct is publicly available on our website under Corporate Governance at www.GladstoneCapital.com. We intend to provide any required disclosure of any amendments to or waivers of the provisions of this code by posting

information regarding any such amendment or waiver to our website or in a Current Report on Form 8-K.

Compliance Policies and Procedures

We and the Adviser have adopted and implemented written policies and procedures reasonably designed to prevent violation of the federal securities laws, and our Board of Directors is required to review these compliance policies and procedures annually to assess their adequacy and the effectiveness of their implementation. We have designated a chief compliance officer, John Dellafiora, Jr., who also serves as chief compliance officer for all of the Gladstone companies.

Staffing

We do not currently have any employees and do not expect to have any employees in the foreseeable future. Currently, services necessary for our business are provided by individuals who are employees of the Adviser and the Administrator pursuant to the terms of the Advisory Agreement and the Administration Agreement, respectively. No employee of the Adviser or the Administrator will dedicate all of his or her time to us. However, we expect that 25 to 30 full time employees of the Adviser and the Administrator will spend substantial time on our matters during the remainder of calendar year 2018 and all of calendar year 2019. As of November 14, 2018, the Adviser and the Administrator collectively had 67 full-time employees. A breakdown of these employees is summarized by functional area in the table below:

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Number of Individuals	Functional Area
12	Executive management
20	Accounting, administration, compliance, human resources, legal and treasury
35	Investment management, portfolio management and due diligence

Available Information

Copies of our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments, if any, to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the Exchange Act) are available free of charge through our website at www.GladstoneCapital.com as soon as reasonably practicable after such materials are electronically filed with or furnished to the SEC. Information on our website should not be considered part of this Annual Report on Form 10-K. A request for any of these reports may also be submitted to us by sending a written request addressed to Investor Relations, Gladstone Capital Corporation, 1521 Westbranch Drive, Suite 100, McLean, VA 22102, or by calling our toll-free investor relations line at 1-866-366-5745. The SEC also maintains a website that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at www.sec.gov.

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ITEM 1A. RISK FACTORS

You should carefully consider these risk factors, together with all of the other information included in this Annual Report on Form 10-K and the other reports and documents filed or furnished by us with the SEC. The risks set out below are not the only risks we face. Additional risks and uncertainties not presently known to us, or not presently deemed material by us, may also impair our operations and performance. If any of the following events occur, our business, financial condition, results of operations and cash flows could be materially and adversely affected. In such case, our net asset value and the trading price of our securities could decline, and you may lose all or part of your investment. The risk factors described below are the principal risk factors associated with an investment in our securities as well as those factors generally associated with an investment company with investment objectives, investment policies, capital structure or trading markets similar to ours.

Risks Related to the Economy

Market conditions could negatively impact our business, results of operations, cash flows and financial condition.

The market in which we operate is affected by a number of factors that are largely beyond our control but can nonetheless have a potentially significant, negative impact on us. These factors include, among other things:

changes in interest rates and credit spreads;

the availability of credit, including the price, terms and conditions under which it can be obtained;

the quality, pricing and availability of suitable investments and credit losses with respect to our investments;

the ability to obtain accurate market-based valuations;

loan values relative to the value of the underlying assets;

default rates on the loans underlying our investments and the amount of related losses;

prepayment rates, delinquency rates and legislative / regulatory changes with respect to our investments and loans, and the timing and amount of servicer advances;

competition;

the actual and perceived state of the economy and public capital markets generally;

the impact of potential changes to the tax code; and

the attractiveness of other types of investments relative to investments in lower middle market companies generally.

Changes in these factors are difficult to predict, and a change in one factor can affect other factors resulting in adverse effects to our financial condition.

The illiquidity of our investments may make it difficult for us to sell such investments if required. As a result, we may realize significantly less than the value at which we have recorded our investments.

Given the volatility and dislocation that the capital markets have historically experienced, many BDCs have faced, and may in the future face, a challenging environment in which to raise capital. We may in the future have difficulty accessing debt and equity capital, and a severe disruption in the global financial markets or deterioration in credit and financing conditions could have a material adverse effect on our business, financial condition and results of operations. In addition, significant changes in the capital markets have had, and may in the future have, a negative effect on the valuations of our investments and on the potential for liquidity events involving our investments. An inability to raise capital, and any required sale of our investments for liquidity purposes, could have a material adverse impact on our business, financial condition or results of operations.

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Market interest rates may have an effect on the value of our common stock.

One of the factors that will influence the price of our common stock will be the distribution yield on our common stock (as a percentage of the price of our common stock) relative to market interest rates. An increase in market interest rates, which are currently at low levels relative to historical rates, may lead prospective purchasers of our common stock to expect a higher distribution yield. In addition, higher interest rates would likely increase our borrowing costs and potentially decrease funds available for distribution. As a result, higher market interest rates could cause the market price of our common stock to decrease.

Rising interest rates may negatively impact our investments and have an adverse effect on our business, financial condition, results of operations, and cash flows.

In recent years, the Fed has incrementally raised the target range for the federal funds rate, with additional increases expected to come over the next year. As interest rates increase, generally, the cost of borrowing increases, affecting our ability to make new investments on favorable terms or at all. More generally, interest rate fluctuations and changes in credit spreads on floating rate loans may have a negative impact on our investments and investment opportunities and, accordingly, may have a material adverse effect on our rate of return on invested capital, our net investment income, our net asset value and the market price of our securities. A substantial portion of our debt investments have variable interest rates that reset periodically and are generally based on LIBOR, so an increase in interest rates from the current interest rate may make it more difficult for our portfolio companies to service their obligations under the debt investments that we hold. To the extent that interest rates increase, this may negatively impact the operating performance of our portfolio companies due to increasing debt service obligations and, therefore, may affect our results of operations. In addition, to the extent that an increase in interest rates makes it difficult or impossible to make payments on outstanding indebtedness to us or other financial sponsors or refinance debt that is maturing in the near term, some of our portfolio companies may be unable to repay such debt at maturity and may be forced to sell assets, undergo a recapitalization or seek bankruptcy protection. There can be no guaranty the Fed will raise rates at the gradual pace they originally proposed, nor can there be any assurance that the Fed will make sound decisions as to when to raise rates. The increase in interest rates could have a negative effect on our investments, which could negatively impact our operating results, financial condition, and cash flows.

We may experience fluctuations in our quarterly and annual results based on the impact of inflation in the U.S.

The majority of our portfolio companies are in industries that are directly impacted by inflation, such as consumer goods and services and manufacturing. Our portfolio companies may not be able to pass on to customers increases in their costs of operations which could greatly affect their operating results, impacting their ability to repay our loans. In addition, any projected future decreases in our portfolio companies' operating results due to inflation could adversely impact the fair value of those investments. Any decreases in the fair value of our investments could result in future unrealized losses and therefore reduce our net assets resulting from operations.

Volatility of oil and natural gas prices could impair certain of our portfolio companies' operations and ability to satisfy obligations to their respective lenders and investors, including us, which could negatively impact our financial condition.

Our portfolio includes a concentration of companies related to the oil and gas industry with the fair value of these investments representing approximately \$50.2 million, or 12.9% of our total portfolio at fair value as of September 30, 2018. These businesses provide services to oil and gas companies and are indirectly impacted by the prices of, and demand for, oil and natural gas, which have recently experienced volatility, including significant decline in prices, and such volatility could continue or increase in the future. A substantial or extended decline in oil and natural gas demand

or prices may adversely affect the business, financial condition, cash flows, liquidity or results of operations of these portfolio companies and might impair their ability to meet capital expenditure obligations and financial commitments. A prolonged or continued decline in oil prices could therefore have a material adverse effect on our business, financial condition and results of operations.

Risks Related to Our Investments

We operate in a highly competitive market for investment opportunities.

There has been increased competitive pressure in the BDC and investment company marketplace for first and second lien secured debt, resulting in lower yields for increasingly riskier investments. A large number of entities compete with us and make the types of investments that we seek to make in lower middle market companies. We compete with public and private buyout funds, commercial and investment banks, commercial financing companies, and, to the extent that they provide an

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alternative form of financing, hedge funds. Many of our competitors are substantially larger and have considerably greater financial, technical and marketing resources than we do. For example, some competitors may have a lower cost of funds and access to funding sources that are not available to us. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which would allow them to consider a wider variety of investments and establish more relationships than us. Furthermore, many of our competitors are not subject to the regulatory restrictions that the 1940 Act imposes on us as a BDC. The competitive pressures we face could have a material adverse effect on our business, financial condition and results of operations. Also, as a result of this competition, we may not be able to take advantage of attractive investment opportunities from time to time and we can offer no assurance that we will be able to identify and make investments that are consistent with our investment objective. We do not seek to compete based on the interest rates we offer, and we believe that some of our competitors may make loans with interest rates that will be comparable to or lower than the rates we offer. We may lose investment opportunities if we do not match our competitors' pricing, terms, and structure. However, if we match our competitors' pricing, terms, and structure, we may experience decreased net interest income and increased risk of credit loss.

Our investments in lower middle market companies are extremely risky and could cause you to lose all or a part of your investment.

Investments in lower middle market companies are subject to a number of significant risks including the following:

Lower middle market companies are likely to have greater exposure to economic downturns than larger businesses. Our portfolio companies may have fewer resources than larger businesses, and thus any economic downturns or recessions are more likely to have a material adverse effect on them. If one of our portfolio companies is adversely impacted by a recession, its ability to repay our loan or engage in a liquidity event, such as a sale, recapitalization or initial public offering would be diminished.

Lower middle market companies may have limited financial resources and may not be able to repay the loans we make to them. Our strategy includes providing financing to portfolio companies that typically do not have readily available access to financing. While we believe that this provides an attractive opportunity for us to generate profits, this may make it difficult for the portfolio companies to repay their loans to us upon maturity. A borrower's ability to repay its loan may be adversely affected by numerous factors, including the failure to meet its business plan, a downturn in its industry, or negative economic conditions. Deterioration in a borrower's financial condition and prospects usually will be accompanied by deterioration in the value of any collateral and a reduction in the likelihood of us realizing on any guaranties we may have obtained from the borrower's management. As of September 30, 2018, loans to one portfolio company were on non-accrual status with an aggregate debt cost basis of approximately \$26.9 million, or 6.9% of the cost basis of all debt investments in our portfolio. While we are working with the portfolio company to improve their profitability and cash flows, there can be no assurance that our efforts will prove successful. Although we will sometimes seek to be the senior, secured lender to a borrower, in some of our loans we expect to be subordinated to a senior lender, and our interest in any collateral would, accordingly, likely be subordinate to another lender's security interest.

Lower middle market companies typically have narrower product lines and smaller market shares than large businesses. Because our target portfolio companies are lower middle market businesses, they will tend to be

more vulnerable to competitors' actions and market conditions, as well as general economic downturns. In addition, our portfolio companies may face intense competition, including competition from companies with greater financial resources, more extensive development, manufacturing, marketing, and other capabilities and a larger number of qualified managerial, and technical personnel.

There is generally little or no publicly available information about these businesses. Because we seek to invest in privately owned businesses, there is generally little or no publicly available operating and financial information about our potential portfolio companies. As a result, we rely on our officers, the Adviser and its employees, Gladstone Securities and certain consultants to perform due diligence investigations of these portfolio companies, their operations, and their prospects. We may not learn all of the material information we need to know regarding these businesses through our investigations to make a well-informed investment decision.

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Lower middle market companies generally have less predictable operating results. We expect that our portfolio companies may have significant variations in their operating results, may from time to time be exposed to litigation, may be engaged in rapidly changing businesses with products subject to a substantial risk of obsolescence, may require substantial additional capital to support their operations, to finance expansion or to maintain their competitive position, may otherwise have a weak financial position, or may be adversely affected by changes in the business cycle. Our portfolio companies may not meet net income, cash flow, and other coverage tests typically imposed by their senior lenders. A borrower's failure to satisfy financial or operating covenants imposed by senior lenders could lead to defaults and, potentially, foreclosure on its senior credit facility, which could additionally trigger cross-defaults in other agreements. If this were to occur, it is possible that the borrower's ability to repay any of our loans would be jeopardized.

Lower middle market companies are more likely to be dependent on one or two persons. Typically, the success of a lower middle market business also depends on the management talents and efforts of one or two persons or a small group of persons. The death, disability, or resignation of one or more of these persons could have a material adverse impact on our borrower and, in turn, on us.

Lower middle market companies may have limited operating histories. While we intend to target stable companies with proven track records, we may make loans to new companies that meet our other investment criteria. Portfolio companies with limited operating histories will be exposed to all of the operating risks that new businesses face and may be particularly susceptible to, among other risks, market downturns, competitive pressures and the departure of key executive officers.

Debt securities of lower middle market companies typically are not rated by a credit rating agency.

Typically a lower middle market private business cannot or will not expend the resources to have their debt securities rated by a credit rating agency. We expect that most, if not all, of the debt securities we acquire will be unrated. Investors should assume that these loans would be at rates below what is today considered investment grade quality. Investments rated below investment grade are often referred to as high yield securities or junk bonds and may be considered high risk as compared to investment-grade debt instruments.

Because the loans we make and equity securities we receive when we make loans are not publicly traded, there is uncertainty regarding the value of our privately held securities that could adversely affect our determination of our net asset value (NAV).

Our portfolio investments are, and we expect will continue to be, in the form of securities that are not publicly traded. The fair value of securities and other investments that are not publicly traded may not be readily determinable. Our Board of Directors has ultimate responsibility for reviewing and approving, in good faith, the fair value of our investments, based on the Policy. Our Board of Directors reviews valuation recommendations that are provided by the Valuation Team. In valuing our investment portfolio, several techniques are used, including, a total enterprise value approach, a yield analysis, market quotes, and independent third party assessments. Currently, ICE Data Pricing and Reference Data, LLC (formerly Standard & Poor's Securities Evaluation, Inc.) provides estimates of fair value on our proprietary debt investments and we use another independent valuation firm to provide valuation inputs for our significant equity investments, including earnings multiple ranges, as well as other information. In addition to these techniques, other factors are considered when determining fair value of our investments, including but limited to: the nature and realizable value of the collateral, including external parties' guarantees; any relevant offers or letters of intent to acquire the portfolio company; and the markets in which the portfolio company operates. If applicable, new and follow-on proprietary debt and equity investments made during the current three month reporting period ended

September 30, 2018 are generally valued at original cost basis. For additional information on our valuation policies, procedures and processes, refer to Note 2 *Summary of Significant Accounting Policies* in our accompanying *Notes to Consolidated Financial Statements* included elsewhere in this Annual Report on Form 10-K.

Fair value measurements of our investments may involve subjective judgments and estimates and due to the inherent uncertainty of determining these fair values, the fair value of our investments may fluctuate from period to period. Additionally, changes in the market environment and other events that may occur over the life of the investment may cause the gains or losses ultimately realized on these investments to be different than the valuations currently assigned. Further, such investments are generally subject to legal and other restrictions on resale or otherwise are less liquid than publicly traded securities. If we were required to liquidate a portfolio investment in a forced or liquidation sale, we could realize significantly less than the value at which it is recorded.

Our NAV would be adversely affected if the fair value of our investments that are approved by our Board of Directors are higher than the values that we ultimately realize upon the disposal of such securities.

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Our most recent NAV was calculated on September 30, 2018 and our NAV when calculated effective December 31, 2018 and thereafter may be higher or lower.

As of September 30, 2018, our NAV per share was \$8.32, which was based on the fair value of our investments that were reviewed and approved by the Valuation Committee and Board of Directors in connection with financial statements that were audited by our independent registered public accounting firm. NAV per share as of December 31, 2018 may be higher or lower than \$8.32 based on potential changes in valuations, our issuance of shares of common stock under our at-the-market program subsequent to September 30, 2018, or dividends paid and earnings for the quarter then ended. Our Board of Directors determines the fair value of our portfolio investments on a quarterly basis and if our December 31, 2018 fair value is less than the September 30, 2018 fair value, we will record an unrealized loss on our investment portfolio. If the fair value is greater, we will record an unrealized gain on our investment portfolio. Upon publication of our next quarterly NAV per share determination (generally in our next Quarterly Report on Form 10-Q), the market price of our common stock may fluctuate materially.

The valuation process for certain of our portfolio holdings creates a conflict of interest.

A substantial portion of our portfolio investments are made in the form of securities that are not publicly traded. As a result, our Board of Directors determines the fair value of these securities in good faith pursuant to the Policy. In connection with that determination, the Valuation Team prepares portfolio company valuations based upon the most recent portfolio company financial statements available and projected financial results of each portfolio company. The participation of the Adviser's investment professionals in our valuation process, and the pecuniary interest in the Adviser by Mr. Gladstone, may result in a conflict of interest as the management fees that we pay the Adviser are based on our gross assets less uninvested cash or cash equivalents from borrowings, and adjusted appropriately for any share issuances or repurchases during the period.

The lack of liquidity of our privately held investments may adversely affect our business.

We will generally make investments in private companies whose securities are not traded in any public market. Substantially all of the investments we presently hold and the investments we expect to acquire in the future are, and will be, subject to legal and other restrictions on resale and will otherwise be less liquid than publicly traded securities. The illiquidity of our investments may make it difficult for us to quickly obtain cash equal to the value at which we record our investments if the need arises. This could cause us to miss important investment opportunities. In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may record substantial realized losses upon liquidation. We may also face other restrictions on our ability to liquidate an investment in a portfolio company to the extent that we, the Adviser, or our respective officers, employees or affiliates have material non-public information regarding such portfolio company.

Due to the uncertainty inherent in valuing these securities, the Valuation Team's determinations of fair value may differ materially from the values that could be obtained if a ready market for these securities existed. Our NAV could be materially affected if the Valuation Team's determinations regarding the fair value of our investments that are ultimately approved by our Board of Directors are materially different from the values that we ultimately realize upon our disposal of such securities. Additional discussion regarding risks associated with determinations made by the Adviser is found in the risk factor *The valuation process for certain of our portfolio holdings creates a conflict of interest.*

When we are a debt or minority equity investor in a portfolio company, which we expect will generally be the case, we may not be in a position to control the entity, and its management may make decisions that could decrease the value of our investment.

We anticipate that most of our investments will continue to be either debt or minority equity investments in our portfolio companies. Therefore, we are and will remain subject to the risk that a portfolio company may make business decisions with which we disagree, and the shareholders and management of such company may take risks or otherwise act in ways that do not serve our best interests. As a result, a portfolio company may make decisions that could decrease the value of our portfolio holdings.

In addition, we will generally not be in a position to control any portfolio company by investing in its debt securities. This is particularly true when we invest in syndicated loans, which are loans made by a larger group of investors whose investment objectives may not be completely aligned with ours. As of September 30, 2018, syndicated loans made up approximately 9.6% of our portfolio at cost, or \$41.0 million. We therefore are subject to the risk that other lenders in these investments may make decisions that could decrease the value of our portfolio holdings.

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The interest rates of some of our term loans to our portfolio companies are priced using a spread over LIBOR, which may be phased out in the future.

LIBOR is the basic rate of interest used in lending between banks on the London interbank market and is widely used as a reference for setting the interest rate on loans globally. In general, our investments in debt securities have a term of five to seven years, accrue interest at variable rates based on LIBOR and, to a lesser extent, at fixed rates. As of September 30, 2018, based on the total principal balance of debt outstanding, our portfolio consisted of approximately 90.6% of loans at variable rates with floors and approximately 9.4% at fixed rates.

On July 27, 2017, the United Kingdom's Financial Conduct Authority, which regulates LIBOR, announced that it intends to phase out LIBOR by the end of 2021. It is unclear if at that time whether or not LIBOR will cease to exist or if new methods of calculating LIBOR will be established such that it continues to exist after 2021. The Fed, in conjunction with the Alternative Reference Rates Committee, a steering committee comprised of large U.S. financial institutions, announced replacement of U.S. dollar LIBOR with a new index calculated by short-term repurchase agreements, backed by U.S. Treasury securities called the Secured Overnight Financing Rate (SOFR). The first publication of SOFR was released in April 2018. Whether or not SOFR attains market traction as a LIBOR replacement tool remains in question and the future of LIBOR at this time is uncertain. If LIBOR ceases to exist, we may need to renegotiate the loan documents with our portfolio companies that utilize LIBOR as a factor in determining the interest rate to replace LIBOR with the new standard that is established.

We generally will not be involved in the day-to-day operations and decision making of our portfolio companies.

We generally are not, and do not expect to be, involved in the day-to-day operations and decision making of our portfolio companies, even though we may have board observation rights and our debt agreements may contain certain restrictive covenants. As a result, we are subject to the risk that a portfolio company in which we invest may make business decisions with which we disagree and the management of such company, as representatives of the holders of their common stock, may take risks or otherwise act in ways that do not serve our interests of maximizing our investment value.

We typically invest in transactions involving acquisitions, buyouts and recapitalizations of companies, which will subject us to the risks associated with change in control transactions.

Our strategy, in part, includes making debt and minority equity investments in companies in connection with acquisitions, buyouts and recapitalizations, which subjects us to the risks associated with change in control transactions. Change in control transactions often present a number of uncertainties. Companies undergoing change in control transactions often face challenges retaining key employees and maintaining relationships with customers and suppliers. While we hope to avoid many of these difficulties by participating in transactions where the management team is retained and by conducting thorough due diligence in advance of our decision to invest, if our portfolio companies experience one or more of these problems, we may not realize the value that we expect in connection with our investments, which would likely harm our operating results and financial condition.

Our portfolio companies may incur debt that ranks equally with, or senior to, our investments in such companies and/or we could be subject to lender liability claims.

We invest primarily in debt securities issued by our portfolio companies. In some cases portfolio companies will be permitted to have other debt that ranks equally with, or senior to, the debt securities in which we invest. By their terms, such debt instruments may provide that the holders thereof are entitled to receive payment of interest and principal on or before the dates on which we are entitled to receive payments in respect of the debt securities in which

we invest. Also, in the event of insolvency, liquidation, dissolution, reorganization, or bankruptcy of a portfolio company, holders of debt instruments ranking senior to our investment in that portfolio company would typically be entitled to receive payment in full before we receive any distribution in respect of our investment. In addition, even though we have structured some of our investments as senior loans, if one of our portfolio companies were to go bankrupt, depending on the facts and circumstances, including the extent to which we actually provided managerial assistance to that portfolio company, a bankruptcy court might re-characterize our debt investments and subordinate all, or a portion, of our claims to that of other creditors. After repaying such senior creditors, such portfolio company may not have any remaining assets to use to repay its obligation to us. We may also be subject to lender liability claims for actions taken by us with respect to a borrower's business or in instances in which

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we exercised control over the borrower. It is possible that we could become subject to a lender's liability claim, including as a result of actions taken in rendering significant managerial assistance. In the case of debt ranking equally with debt securities in which we invest, we would have to share on an equal basis any distributions with other creditors holding such debt in the event of an insolvency, liquidation, dissolution, reorganization, or bankruptcy of a portfolio company.

Prepayments of our investments by our portfolio companies could adversely impact our results of operations and reduce our return on equity.

In addition to risks associated with delays in investing our capital, we are also subject to the risk that investments we make in our portfolio companies may be repaid prior to maturity. For the year ended September 30, 2018, we received prepayments of investments totaling \$58.9 million. We will generally first use any proceeds from prepayments to repay any borrowings outstanding on our Credit Facility. In the event that funds remain after repayment of our outstanding borrowings, then we will generally reinvest these proceeds in government securities, pending their future investment in new debt and/or equity securities. These government securities will typically have substantially lower yields than the debt securities being prepaid and we could experience significant delays in reinvesting these amounts. As a result, our results of operations could be materially adversely affected if one or more of our portfolio companies elect to prepay amounts owed to us. Additionally, prepayments could negatively impact our return on equity, which could result in a decline in the market price of our common stock.

Our portfolio is concentrated in a limited number of companies and industries, which subjects us to an increased risk of significant loss if any one of these companies does not repay us or if the industries experience downturns.

As of September 30, 2018, we had investments in 50 portfolio companies, of which there were five investments that comprised approximately \$122.8 million, or 31.5% of our total investment portfolio, at fair value. A consequence of a concentration in a limited number of investments is that the aggregate returns we realize may be substantially adversely affected by the unfavorable performance of a small number of such investments or a substantial write-down of any one investment. Beyond our regulatory and income tax diversification requirements, we do not have fixed guidelines for industry concentration and our investments could potentially be concentrated in relatively few industries. In addition, while we do not intend to invest 25.0% or more of our total assets in a particular industry or group of industries at the time of investment, it is possible that as the values of our portfolio companies change, one industry or a group of industries may comprise in excess of 25.0% of the value of our total assets. As a result, a downturn in an industry in which we have invested a significant portion of our total assets could have a materially adverse effect on us. As of September 30, 2018, our largest industry concentrations of our total investments at fair value were in diversified/conglomerate service companies, representing 20.3%; healthcare, education and childcare companies, representing 13.8%; and oil and gas companies, representing 12.9%. Therefore, we are susceptible to the economic circumstances in these industries, and a downturn in one or more of these industries could have a material adverse effect on our results of operations and financial condition.

Our investments are typically long term and will require several years to realize liquidation events.

Since we generally make five to seven year term loans and hold our loans and related warrants or other equity positions until the loans mature, you should not expect realization events, if any, to occur over the near term. In addition, we expect that any warrants or other equity positions that we receive when we make loans may require several years to appreciate in value and we cannot give any assurance that such appreciation will occur.

The disposition of our investments may result in contingent liabilities.

Currently, all of our investments involve private securities. In connection with the disposition of an investment in private securities, we may be required to make representations about the business and financial affairs of the underlying portfolio company typical of those made in connection with the sale of a business. We may also be required to indemnify the purchasers of such investment to the extent that any such representations turn out to be inaccurate or with respect to certain potential liabilities. These arrangements may result in contingent liabilities that ultimately yield funding obligations that must be satisfied through our return of certain distributions previously made to us.

Portfolio company litigation or other litigation or claims against us or our personnel could result in additional costs and the diversion of management time and resources.

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In the course of investing in and often providing significant managerial assistance to certain of our portfolio companies, certain persons employed by the Adviser may serve as directors on the boards of such companies. To the extent that litigation arises out of our investments in these companies, even if without merit, we or such employees may be named as defendants in such litigation, which could result in additional costs, including defense costs, and the diversion of management time and resources. Additionally, other litigations or claims against us or our personnel could result in additional costs, including defense costs, and the diversion of management time and resources. We may be unable to accurately estimate our exposure to litigation risk if we record balance sheet reserves for probable loss contingencies. As a result, any reserves we establish to cover any settlements or judgments may not be sufficient to cover our actual financial exposure, which may have a material impact on our results of operations, financial condition, or cash flows.

While the Company believes it would have valid defenses to potential claims brought due to our investment in any portfolio company, and will defend any such claims vigorously, it may nevertheless expend significant amounts of money in defense costs and expenses. Further, if the Company enters into settlements or suffers an adverse outcome in any litigation, the Company could be required to pay significant amounts. In addition, if any of the Company's portfolio companies become subject to direct or indirect claims or other obligations, such as defense costs or damages in litigation or settlement, the Company's investment in such companies could diminish in value and the Company could suffer indirect losses. Further, these matters could cause the Company to expend significant management time and effort in connection with assessment and defense of any claims.

We may not realize gains from our equity investments and other yield enhancements.

When we make an investment, we may receive warrants to purchase stock issued by the borrower or other yield enhancements, such as success fees. Our goal is to ultimately dispose of these equity interests and realize gains upon our disposition of such interests. We expect that, over time, the gains we realize on these warrants and other yield enhancements will offset any losses we experience on loan defaults. However, any equity interests we receive may not appreciate in value and, in fact, may decline in value and any other yield enhancements, such as success fees, may not be realized. Accordingly, we may not be able to realize gains from our equity interests or other yield enhancements and any gains we do recognize may not be sufficient to offset losses we experience on our loan portfolio.

Any unrealized depreciation we experience on our investment portfolio may be an indication of future realized losses, which could reduce our income available for distribution.

As a BDC we are required to carry our investments at market value or, if no market value is ascertainable, at fair value as determined in good faith by or under the direction of our Board of Directors. We will record decreases in the market values or fair values of our investments as unrealized depreciation. Since our inception, we have, at times, incurred a cumulative net unrealized depreciation of our portfolio. Any unrealized depreciation in our investment portfolio could result in realized losses in the future and ultimately in reductions of our income available for distribution to stockholders in future periods.

Risks Related to Our External Financing

In addition to regulatory limitations on our ability to raise capital, our Credit Facility contains various covenants which, if not complied with, could accelerate our repayment obligations under the facility, thereby materially and adversely affecting our liquidity, financial condition, results of operations and ability to pay distributions.

We will have a continuing need for capital to finance our investments. As of September 30, 2018, we had \$110.0 million in borrowings, at cost, outstanding under our Credit Facility, which provides for maximum borrowings

of \$190.0 million, with a revolving period end date of January 15, 2021. Our Credit Facility permits us to fund additional loans and investments as long as we are within the conditions set forth in the credit agreement. Our Credit Facility contains covenants that require our wholly-owned subsidiary Business Loan to maintain its status as a separate legal entity, prohibit certain significant corporate transactions (such as mergers, consolidations, liquidations or dissolutions) and restrict material changes to our credit and collection policies without lenders' consent. The Credit Facility also limits distributions to our stockholders on a fiscal year basis to the sum of our net investment income, net capital gains and amounts deemed to have been paid during the prior year in accordance with Section 855(a) of the Code. We are also subject to certain limitations on the type of loan investments we can make, including restrictions on geographic concentrations, sector concentrations, loan size, interest rate type, payment frequency and status, average life and lien property. Our Credit Facility further requires us to comply with other financial and operational covenants, which obligate us to, among other things, maintain certain financial ratios, including asset and interest coverage, and a minimum number of 25 obligors in the borrowing base. Additionally, we are subject to a performance guaranty that requires us to maintain (i) a minimum net worth (defined in our Credit Facility to include our mandatorily redeemable preferred stock) of \$205.0 million plus 50.0% of all equity and subordinated debt raised after May 1, 2015 less 50% of any equity and subordinated debt retired or redeemed after May 1, 2015, which equates to \$232.8 million as of September 30, 2018, (ii) asset coverage with respect to senior securities representing indebtedness of at least 200%, in accordance with Section 18 of the 1940 Act and (iii) our status as a BDC under the 1940 Act and as a RIC under the Code. As of September 30, 2018, and as defined in the performance guaranty of our Credit Facility, we were in compliance with all of our Credit Facility covenants; however, our continued compliance depends on many factors, some of which are beyond our control.

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Given the continued uncertainty in the capital markets, the cumulative unrealized depreciation in our portfolio may increase in future periods and threaten our ability to comply with the minimum net worth covenant and other covenants under our Credit Facility. Our failure to satisfy these covenants could result in foreclosure by our lenders, which would accelerate our repayment obligations under the facility and thereby have a material adverse effect on our business, liquidity, financial condition, results of operations and ability to pay distributions to our stockholders.

Any inability to renew, extend or replace our Credit Facility on terms favorable to us, or at all, could adversely impact our liquidity and ability to fund new investments or maintain distributions to our stockholders.

The revolving period end date of our Credit Facility is January 15, 2021 (the Revolving Period End Date) and if our Credit Facility is not renewed or extended by the Revolving Period End Date, all principal and interest will be due and payable on or before April 15, 2022. Subject to certain terms and conditions, our Credit Facility may be expanded to a total of \$265.0 million through the addition of other lenders to the facility. However, if additional lenders are unwilling to join the facility on its terms, we will be unable to expand the facility and thus will continue to have limited availability to finance new investments under our Credit Facility. There can be no guarantee that we will be able to renew, extend or replace our Credit Facility upon its Revolving Period End Date on terms that are favorable to us, if at all. Our ability to expand our Credit Facility, and to obtain replacement financing at or before the Revolving Period End Date, will be constrained by then-current economic conditions affecting the credit markets. In the event that we are not able to expand our Credit Facility, or to renew, extend or refinance our Credit Facility by the Revolving Period End Date, this could have a material adverse effect on our liquidity and ability to fund new investments, our ability to make distributions to our stockholders and our ability to qualify as a RIC under the Code.

If we are unable to secure replacement financing, we may be forced to sell certain assets on disadvantageous terms, which may result in realized losses, and such realized losses could materially exceed the amount of any unrealized depreciation on these assets as of our most recent balance sheet date, which would have a material adverse effect on our results of operations. Such circumstances would also increase the likelihood that we would be required to redeem some or all of our outstanding mandatorily redeemable preferred stock, which could potentially require us to sell more assets. In addition to selling assets, or as an alternative, we may issue equity in order to repay amounts outstanding under our Credit Facility. Based on the recent trading prices of our stock, such an equity offering may have a substantial dilutive impact on our existing stockholders' interest in our earnings, assets and voting interest in us. If we are not able to renew, extend or refinance our Credit Facility prior to its maturity, it could result in significantly higher interest rates and related charges and may impose significant restrictions on the use of borrowed funds to fund investments or maintain distributions to stockholders.

Our business plan is dependent upon external financing, which is constrained by the limitations of the 1940 Act.

We completed an equity offering of our Series 2024 Term Preferred Stock in September 2017 and sold 2,341,296 common shares under our at-the-market program during the year ended September 30, 2018. In addition, in November 2018, we completed a public debt offering of \$57.5 million aggregate principal amount of 6.125% Notes due 2023 (the 2023 Notes), inclusive of the overallotment. However, there can be no assurance that we will be able to raise capital through issuing equity in the near future. Our business requires a substantial amount of cash to operate and grow. We may acquire such additional capital from the following sources:

Senior Securities. We may issue senior securities representing indebtedness (including borrowings under our Credit Facility and our 2023 Notes) and senior securities that are stock, such as our Series 2024 Term Preferred Stock, up to the maximum amount permitted by the 1940 Act. The 1940 Act currently permits us,

as a BDC, to issue such senior securities in amounts such that our asset coverage, as defined in Section 18(h) of the 1940 Act, is at least 200% (as the law applies to the Company currently) or 150% (as the law will apply to the Company effective April 10, 2019; refer to *Management's Discussion and Analysis of Financial Condition and Results of Operations Overview Regulatory Compliance* for a discussion of changes to the asset coverage requirements pursuant to the SBCAA) on such senior security immediately after each issuance of such senior security. As a result of incurring indebtedness (in whatever form), we will be exposed to the risks associated with leverage. Although borrowing money for investments increases the potential for gain, it also increases the risk of a loss. A decrease in the value of our investments will have a greater impact on the value of our common stock to the extent that we have borrowed money to

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make investments. There is a possibility that the costs of borrowing could exceed the income we receive on the investments we make with such borrowed funds. In addition, our ability to pay distributions, issue senior securities or repurchase shares of our common stock would be restricted if the asset coverage on each of our senior securities is not at least 200% or 150%, as applicable. If the aggregate value of our assets declines, we might be unable to satisfy that 200% or 150% requirement, as applicable. To satisfy the 200% or 150%, as applicable, asset coverage requirement in the event that we are seeking to pay a distribution, we might either have to (i) liquidate a portion of our loan portfolio to repay a portion of our indebtedness or (ii) issue common stock. This may occur at a time when a sale of a portfolio asset may be disadvantageous, or when we have limited access to capital markets on agreeable terms. In addition, any amounts that we use to service our indebtedness or for offering expenses will not be available for distributions to stockholders. Furthermore, if we have to issue common stock at below NAV per common share, any non-participating stockholders will be subject to dilution, as described below. Pursuant to Section 61(a)(2) of the 1940 Act, we are permitted, under specified conditions, to issue multiple classes of senior securities representing indebtedness. However, pursuant to Section 18(c) of the 1940 Act, we are permitted to issue only one class of senior securities that are stock.

Common and Convertible Preferred Stock. Because we are constrained in our ability to issue debt or senior securities for the reasons given above, we are dependent on the issuance of equity as a financing source. If we raise additional funds by issuing more common stock, the percentage ownership of our stockholders at the time of the issuance would decrease and our existing common stockholder may experience dilution. In addition, under the 1940 Act, we will generally not be able to issue additional shares of our common stock at a price below NAV per common share to purchasers, other than to our existing stockholders through a rights offering, without first obtaining the approval of our stockholders and our independent directors. If we were to sell shares of our common stock below our then-current NAV per common share, such sales would result in an immediate dilution to the NAV per common share. This dilution would occur as a result of the sale of shares at a price below the then-current NAV per share of our common stock and a proportionately greater decrease in a stockholder's interest in our earnings and assets and voting percentage than the increase in our assets resulting from such issuance. For example, if we issue and sell an additional 10.0% of our common stock at a 5.0% discount from NAV, a stockholder who does not participate in that offering for its proportionate interest will suffer NAV dilution of up to 0.5% or \$5 per \$1,000 of NAV. This imposes constraints on our ability to raise capital when our common stock is trading below NAV per common share, as it generally has in previous years. As noted above, the 1940 Act prohibits the issuance of multiple classes of senior securities that are stock. As a result, we would be prohibited from issuing convertible preferred stock to the extent that such a security was deemed to be a separate class of stock from our outstanding Series 2024 Term Preferred Stock.

We financed certain of our investments with borrowed money and capital from the issuance of senior securities, which will magnify the potential for gain or loss on amounts invested and may increase the risk of investing in us.

The use of leverage, including through the issuance of senior securities that are debt or stock, magnifies the potential for gain or loss on amounts invested, and, if we incur additional leverage as permitted by the SBCAA, this potential will be further magnified. We have incurred leverage in the past and currently incur leverage through the Credit Facility, shares of our mandatorily redeemable preferred stock and the 2023 Notes and, from time to time, intend to incur additional leverage to the extent permitted under the 1940 Act. The use of leverage is generally considered a speculative investment technique and increases the risks associated with investing in our securities. In the future, we may borrow from, and issue senior securities, to banks and other lenders. Holders of these senior securities will have fixed dollar claims on our assets that are superior to the claims of our common stockholders, and we would expect such holders to seek recovery against our assets in the event of a default. The following table illustrates the effect of

leverage on returns from an investment in our common stock assuming various annual returns on our portfolio, net of expenses. The calculations in the table below are hypothetical, and actual returns may be higher or lower than those appearing in the table below.

	Assumed Return on Our Portfolio (Net of Expenses)				
	(10.0)%	(5.0)%	0.0%	5.0%	10.0%
Corresponding return to common stockholder ^(A)	(18.4)%	(9.9)%	(1.5)%	6.9%	15.3%

^(A) The hypothetical return to common stockholders is calculated by multiplying our total assets as of September 30, 2018 by the assumed rates of return and subtracting all interest accrued on our debt for the year ended September 30, 2018, adjusted for the dividends on our Series 2024 Term Preferred Stock; and then dividing the resulting difference by our total assets attributable to common stock. Based on \$399.5 million in total assets, \$110.0 million drawn on our Credit Facility (at cost), \$51.8 million in aggregate liquidation preference of our Series 2024 Term Preferred Stock, and \$237.1 million in net assets, each as of September 30, 2018.

Based on the outstanding balance on our Credit Facility of \$110.0 million at cost, as of September 30, 2018, the effective annual interest rate of 5.1% as of that date, and aggregate liquidation preference of our Series 2024 Term Preferred Stock of \$51.8 million, our investment portfolio at fair value would have had to produce an annual return of at least 2.2% to cover annual interest payments on the outstanding debt and dividends on our Series 2024 Term Preferred Stock.

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A change in interest rates may adversely affect our profitability and our hedging strategy may expose us to additional risks.

We anticipate using a combination of equity and long-term and short-term borrowings to finance our investment activities. As a result, a portion of our income will depend upon the difference between the rate at which we borrow funds and the rate at which we loan these funds. Higher interest rates on our borrowings will decrease the overall return on our portfolio.

As of September 30, 2018, based on the total principal balance of debt outstanding, our portfolio consisted of approximately 90.6% of loans at variable rates with floors and approximately 9.4% at fixed rates.

As of September 30, 2018, we did not have any hedging arrangement, such as interest rate hedges. 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 the hedged portfolio. Adverse developments resulting from changes in interest rates or any future hedging transactions could have a material adverse effect on our business, financial condition and results of operations. Our ability to receive payments pursuant to an interest rate cap agreement is linked to the ability of the counter-party to that agreement to make the required payments. To the extent that the counter-party to the agreement is unable to pay pursuant to the terms of the agreement, we may lose the hedging protection of the interest rate cap agreement. For additional information on market interest rate fluctuations, see *Management's Discussion and Analysis of Financial Condition and Results of Operations Quantitative and Qualitative Disclosures About Market Risk*.

Risks Related to Our Regulation and Structure

We will be subject to corporate-level tax if we are unable to satisfy Code requirements for RIC qualification.

To maintain our qualification as a RIC, we must meet income source, asset diversification, and annual distribution requirements. The annual distribution requirement is satisfied if we distribute at least 90.0% of our investment company taxable income to our stockholders on an annual basis. Because we use leverage, we are subject to certain asset coverage ratio requirements under the 1940 Act and could, under certain circumstances, be restricted from making distributions necessary to qualify as a RIC. Warrants we receive with respect to debt investments will create original issue discount, which we must recognize as ordinary income over the term of the debt investment or PIK interest which is accrued generally over the term of the debt investment but not paid in cash, both of which will increase the amounts we are required to distribute to maintain RIC status. Because such OIDs and PIK interest will not produce distributable cash for us at the same time as we are required to make distributions, we will need to use cash from other sources to satisfy such distribution requirements. The asset diversification requirements must be met at the end of each calendar quarter. If we fail to meet these tests, we may need to quickly dispose of certain investments to prevent the loss of RIC status. Since most of our investments will be illiquid, such dispositions, if even possible, may not be made at prices advantageous to us and, in fact, may result in substantial losses. If we fail to qualify as a RIC for any reason and become fully subject to corporate income tax, the resulting corporate taxes could substantially reduce our net assets, the amount of income available for distribution, and the actual amount distributed. Such a failure would have a material adverse effect on us and our shares. Refer to *Business Material U.S. Federal Income Tax Considerations RIC Status* for additional information regarding asset coverage ratio and RIC requirements and to *Management's Discussion and Analysis of Financial Condition and Results of Operations Overview Regulatory Compliance* for a discussion of changes to the asset coverage requirements pursuant to the SBCAA.

Some of our debt investments may include success fees that would generate payments to us if the business is ultimately sold. Because the satisfaction of these success fees, and the ultimate payment of these fees, is uncertain, we generally only recognize them as income when the payment is received. Success fee amounts are characterized as ordinary income for tax purposes and, as a result, we are required to distribute such amounts to our stockholders in order to maintain RIC status.

If we do not invest a sufficient portion of our assets in qualifying assets, we could fail to qualify as a BDC or be precluded from investing according to our current business strategy.

As a BDC, we may not acquire any assets other than qualifying assets unless, at the time of and after giving effect to such acquisition, at least 70% of our total assets are qualifying assets, as defined in Section 55(a) of the 1940 Act.

We believe that most of the investments that we may acquire in the future will constitute qualifying assets. However, we may be precluded from investing in what we believe to be attractive investments if such investments are not qualifying assets for purposes of the 1940 Act. If we do not invest a sufficient portion of our assets in qualifying assets, we could violate the 1940 Act provisions applicable to BDCs. As a result of such violation, specific rules under the 1940 Act could prevent us, for

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example, from making follow-on investments in existing portfolio companies (which could result in the dilution of our position) or could require us to dispose of investments at inappropriate times in order to come into compliance with the 1940 Act. If we need to dispose of such investments quickly, it could be difficult to dispose of such investments on favorable terms. We may not be able to find a buyer for such investments and, even if we do find a buyer, we may have to sell the investments at a substantial loss. Any such outcomes would have a material adverse effect on our business, financial condition, results of operations and cash flows.

If we do not maintain our status as a BDC, we would be subject to regulation as a registered closed-end investment company under the 1940 Act. As a registered closed-end investment company, we would be subject to substantially more regulatory restrictions under the 1940 Act, which would significantly decrease our operating flexibility. Refer to *Business Regulation as a BDC Qualifying Assets* for additional information regarding qualifying assets.

Changes in laws or regulations governing our operations, or changes in the interpretation thereof, and any failure by us to comply with laws or regulations governing our operations may adversely affect our business.

We and our portfolio companies are subject to regulation by laws at the local, state and federal levels. These laws and regulations, as well as their interpretation, may be changed from time to time. Accordingly, any change in these laws or regulations, or their interpretation, or any failure by us or our portfolio companies to comply with these laws or regulations may adversely affect our business. For additional information regarding the regulations to which we are subject, see *Business Material U.S. Federal Income Tax Considerations* and *Business Regulation as a BDC*.

We are subject to restrictions that may discourage a change of control. Certain provisions contained in our articles of incorporation and Maryland law may prohibit or restrict a change of control and adversely impact the price of our shares.

Our Board of Directors is divided into three classes, with the term of the directors in each class expiring every third year. At each annual meeting of stockholders, the successors to the class of directors whose term expires at such meeting will be elected to hold office for a term expiring at the annual meeting of stockholders held in the third year following the year of their election. After election, a director may only be removed by our stockholders for cause. Election of directors for staggered terms with limited rights to remove directors makes it more difficult for a hostile bidder to acquire control of us. The existence of this provision may negatively impact the price of our securities and may discourage third-party bids to acquire our securities. This provision may reduce any premiums paid to stockholders in a change in control transaction.

Certain provisions of Maryland law applicable to us prohibit business combinations with:

any person who beneficially owns 10.0% or more of the voting power of our common stock (an interested stockholder);

an affiliate of ours who at any time within the two-year period prior to the date in question was an interested stockholder; or

an affiliate of an interested stockholder.

These prohibitions last for five years after the most recent date on which the interested stockholder became an interested stockholder. Thereafter, any business combination with the interested stockholder must be recommended by our Board of Directors and approved by the affirmative vote of at least 80.0% of the votes entitled to be cast by holders of our outstanding shares of common stock and two-thirds of the votes entitled to be cast by holders of our common stock other than shares held by the interested stockholder. These requirements could have the effect of inhibiting a change in control even if a change in control were in our stockholders' interest. These provisions of Maryland law do not apply, however, to business combinations that are approved or exempted by our Board of Directors prior to the time that someone becomes an interested stockholder.

Our articles of incorporation permit our Board of Directors to issue up to 50.0 million shares of capital stock. In addition, our Board of Directors, without any action by our stockholders, may amend our articles of incorporation from time to time to increase or decrease the aggregate number of shares or the number of shares of any class or series of stock that we have authority to issue. Our Board of Directors may classify or reclassify any unissued common stock or preferred stock and establish the preferences, conversion or other rights, voting powers, restrictions, limitations as to distributions, qualifications and terms or conditions of redemption of any such stock. Thus, our Board of Directors could authorize the issuance of preferred stock with terms and conditions that could have a priority as to distributions and amounts payable upon liquidation.

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over the rights of the holders of our common stock, which it did in connection with our issuance of approximately 2.1 million shares of Series 2024 Term Preferred Stock. Preferred stock, including our Series 2024 Term Preferred Stock, could also have the effect of delaying, deferring or preventing a change in control of us, including an extraordinary transaction (such as a merger, tender offer or sale of all or substantially all of our assets) that might provide a premium price for holders of our common stock.

We may not be permitted to declare a dividend or make any distribution to stockholders or repurchase shares until such time as we satisfy the asset coverage tests under the provisions of the 1940 Act that apply to BDCs. As a BDC, we have the ability to issue senior securities only in amounts such that our asset coverage, as defined in the 1940 Act, equals at least 200% (or 150%, provided certain conditions are met) after each issuance of senior securities. If the value of our assets declines, we may be unable to satisfy this test. If that happens, we may be required to sell a portion of our investments and, depending on the nature of our leverage, repay a portion of our debt at a time when such sales and/or repayments may be disadvantageous.

Regulations governing our operation as a BDC and RIC will affect our ability to raise, and the way in which we raise, additional capital or borrow for investment purposes, which may have a negative effect on our growth. As a result of the annual distribution requirement to qualify as a RIC, we may need to periodically access the capital markets to raise cash to fund new investments. We may issue senior securities representing indebtedness, including borrowing money from banks or other financial institutions or senior securities that are stock, such as our mandatorily redeemable preferred stock, only in amounts such that our asset coverage on each senior security, as defined in the 1940 Act, equals at least 200% or 150% (effective April 10, 2019; refer to *Management's Discussion and Analysis of Financial Condition and Results of Operations Overview Regulatory Compliance* for a discussion of changes to the asset coverage requirements pursuant to the SBCAA) after each such incurrence or issuance. Further, we may not be permitted to declare a dividend or make any distribution to our outstanding stockholders or repurchase shares until such time as we satisfy these tests. Our ability to issue different types of securities is also limited. Compliance with these requirements may unfavorably limit our investment opportunities and reduce our ability in comparison to other companies to profit from favorable spreads between the rates at which we can borrow and the rates at which we can lend. As a BDC, therefore, we intend to continuously issue equity at a rate more frequent than our privately owned competitors, which may lead to greater stockholder dilution. We have incurred leverage to generate capital to make additional investments. If the value of our assets declines, we may be unable to satisfy the asset coverage test under the 1940 Act, which could prohibit us from paying distributions and could prevent us from qualifying as a RIC. If we cannot satisfy the asset coverage test, we may be required to sell a portion of our investments and, depending on the nature of our debt financing, repay a portion of our indebtedness at a time when such sales and repayments may be disadvantageous.

Recently-enacted legislation allows us to incur additional leverage under the 1940 Act, distinct from certain of our obligations under our Credit Facility and our Term Preferred Stock.

Historically, as a BDC, under the 1940 Act, we are generally required to maintain asset coverage of 200% for senior securities representing indebtedness (i.e., debt) or stock (i.e., preferred stock). On March 23, 2018, President Trump signed into legislation the Consolidated Appropriations Act of 2018, also known as the omnibus spending package. Included in Title VIII therein is the SBCAA that includes certain regulations under the federal securities laws impacting BDCs. Among other items, the SBCAA allows a BDC to increase the amount of debt it may incur by modifying the asset coverage percentage from 200% to 150% (subject to specific approval and disclosure requirements).

On April 10, 2018, our Board of Directors, including a required majority (as such term is defined in Section 57(o) of the 1940 Act) thereof, approved the modified asset coverage requirements set forth in Section 61(a)(2) of the 1940

Act, as amended by the SBCAA. As a result, the Company's asset coverage requirements for senior securities will be changed from 200% to 150%, effective one year after the date of the Board of Directors approval; or on April 10, 2019. Under the current 200% asset coverage standard, we may borrow debt or issue senior securities in the amount of \$1.00 for every \$1.00 of equity in the Company. Starting from April 10, 2019, under the 150% asset coverage standard, we may borrow debt or issue senior securities in the amount of \$2.00 for every \$1.00 of equity in the Company. This reduction in the asset coverage ratio will allow us to double the amount of debt that we may incur and, therefore, your risk of an investment in us may increase. In addition, our management fee is based on our average gross assets, which include investments made with proceeds of borrowings, and, as a result, if we were to incur additional leverage, management fees paid to the Adviser would increase.

Notwithstanding the modified asset coverage leverage ratio under the 1940 Act described above, we remain subject to a minimum asset coverage requirement of 200% with respect to certain provisions of our Credit Facility and our Series 2024 Term Preferred Stock. If we drop below the 200% minimum asset coverage requirement, we may under certain circumstances be required to repay all outstanding indebtedness under our Credit Facility and redeem our Series 2024 Term Preferred Stock. In addition, in the event we fall below the 200% minimum asset coverage requirement, we may need to renegotiate our Credit Facility and issue additional series of term preferred stock with a lower asset coverage requirement. Such events, if they were to occur, could have a significant adverse effect on our business, financial condition, results of operations, and cash flows.

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The recently enacted legislation informally titled the Tax Cuts and Jobs Act and other legislative, regulatory and administrative developments may adversely affect the Company or its stockholders.

On December 22, 2017, President Trump signed into law P.L. 115-97, informally titled the Tax Cuts and Jobs Act (the Tax Act). The Tax Act makes major changes to the Code, including a number of provisions of the Code that affect the taxation of RICs and their stockholders. Certain provisions of the Tax Act that may impact us and our stockholders include:

temporarily reducing individual U.S. federal income tax rates on ordinary income; the highest individual U.S. federal income tax rate will be reduced from 39.6% to 37% (through taxable years ending in 2025);

reducing the maximum corporate income tax rate from 35% to 21%;

permitting a deduction for certain pass-through business income, which generally will allow individuals, trusts, and estates to deduct up to 20% of such amounts, resulting in an effective maximum U.S. federal income tax rate of 29.6% on such dividends (through taxable years ending in 2025);

limiting the deduction for net operating losses to 80% of taxable income (prior to the application of the dividends paid deduction);

amending the limitation on the deduction of net interest expense for all businesses, other than certain electing businesses; and

eliminating the corporate alternative minimum tax.

The individual and collective impact of these provisions and other provisions of the Tax Act on the Company and its stockholders remains uncertain, and may not become evident for some period of time. In addition, other legislative, regulatory or administrative changes may be enacted or promulgated, either prospectively or with retroactive effect, and may adversely affect the Company or its stockholders. The Company's stockholders should consult their individual tax advisors regarding the implications of the Tax Act and other potential legislative, regulatory or administrative changes on their investment in the Company's securities.

Risks Related to Our External Management

We are dependent upon our key management personnel and the key management personnel of the Adviser, particularly David Gladstone, Terry Lee Brubaker and Robert L. Marcotte and on the continued operations of the Adviser, for our future success.

We have no employees. Our chief executive officer, chief operating officer, chief financial officer and treasurer, and the employees of the Adviser, do not spend all of their time managing our activities and our investment portfolio. We are particularly dependent upon David Gladstone, Terry Lee Brubaker, and Robert L. Marcotte for their experience, skills and networks. Our executive officers and the employees of the Adviser allocate some, and in some cases a

material portion, of their time to businesses and activities that are not related to our business. We have no separate facilities and are completely reliant on the Adviser, which has significant discretion as to the implementation and execution of our business strategies and risk management practices. We are subject to the risk of discontinuation of the Adviser's operations or termination of the Advisory Agreement and the risk that, upon such event, no suitable replacement will be found. We believe that our success depends to a significant extent upon the Adviser and that discontinuation of its operations or the loss of its key management personnel could have a material adverse effect on our ability to achieve our investment objectives.

Our success depends on the Adviser's ability to attract and retain qualified personnel in a competitive environment.

The Adviser experiences competition in attracting and retaining qualified personnel, particularly investment professionals and senior executives, and we may be unable to maintain or grow our business if we cannot attract and retain such personnel. The Adviser's ability to attract and retain personnel with the requisite credentials, experience and skills depends on several factors including, but not limited to, its ability to offer competitive wages, benefits and professional growth opportunities. The Adviser competes with investment funds (such as private equity funds and mezzanine funds) and traditional financial services companies for qualified personnel, many of which have greater resources than us. Searches for qualified personnel may divert management's time from the operation of our business. Strain on the existing personnel resources of the Adviser, in the event that it is unable to attract experienced investment professionals and senior executives, could have a material adverse effect on our business.

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In addition, we depend upon the Adviser to maintain its relationships with private equity sponsors, placement agents, investment banks, management groups and other financial institutions, and we expect to rely to a significant extent upon these relationships to provide us with potential investment opportunities. If the Adviser or members of our investment team fail to maintain such relationships, or to develop new relationships with other sources of investment opportunities, we will not be able to grow our investment portfolio. In addition, individuals with whom the Adviser has relationships are not obligated to provide us with investment opportunities, and we can offer no assurance that these relationships will generate investment opportunities for us in the future.

The Adviser can resign on 60 days' notice, and we may not be able to find a suitable replacement within that time, resulting in a disruption in our operations that could adversely affect our financial condition, business and results of operations.

The Adviser has the right to resign under the Advisory Agreement at any time upon not less than 60 days' written notice, whether we have found a replacement or not. If the Adviser resigns, we may not be able to find a new investment adviser or hire internal management with similar expertise and ability to provide the same or equivalent services on acceptable terms within 60 days, or at all. If we are unable to do so quickly, our operations are likely to experience a disruption, our financial condition, business and results of operations as well as our ability to pay distributions are likely to be adversely affected and the market price of our shares may decline. In addition, the coordination of our internal management and investment activities is likely to suffer if we are unable to identify and reach an agreement with a single institution or group of executives having the expertise possessed by the Adviser and its affiliates. Even if we are able to retain comparable management, whether internal or external, the integration of such management and their lack of familiarity with our investment objective may result in additional costs and time delays that may adversely affect our business, financial condition, results of operations and cash flows.

Our incentive fee may induce the Adviser to make certain investments, including speculative investments.

The management compensation structure that has been implemented under the Advisory Agreement may cause the Adviser to invest in high-risk investments or take other risks. In addition to its management fee, the Adviser is entitled under the Advisory Agreement to receive incentive compensation based in part upon our achievement of specified levels of income. In evaluating investments and other management strategies, the opportunity to earn incentive compensation based on net income may lead the Adviser to place undue emphasis on the maximization of net income at the expense of other criteria, such as preservation of capital, maintaining sufficient liquidity, or management of credit risk or market risk, in order to achieve higher incentive compensation. Investments with higher yield potential are generally riskier or more speculative. This could result in increased risk to the value of our investment portfolio.

We may be obligated to pay the Adviser incentive compensation even if we incur a loss.

The Advisory Agreement entitles the Adviser to incentive compensation for each fiscal quarter in an amount equal to a percentage of the excess of our investment income for that quarter (before deducting incentive compensation, net operating losses and certain other items) above a threshold return for that quarter. When calculating our incentive compensation, our pre-incentive fee net investment income excludes realized and unrealized capital losses that we may incur in the fiscal quarter, even if such capital losses result in a net loss on our statement of operations for that quarter. Thus, we may be required to pay the Adviser incentive compensation for a fiscal quarter even if there is a decline in the value of our portfolio or we incur a net loss for that quarter. For additional information on incentive compensation under the Advisory Agreement with the Adviser, see *Business Transactions with Related Parties*.

We may be required to pay the Adviser incentive compensation on income accrued, but not yet received in cash.

That part of the incentive fee payable by us that relates to our net investment income is computed and paid on income that may include interest that has been accrued but not yet received in cash, such as debt instruments with PIK interest or OID. If a portfolio company defaults on a loan, it is possible that such accrued interest previously used in the calculation of the incentive fee will become uncollectible. Consequently, we may make incentive fee payments on income accruals that we may not collect in the future and with respect to which we do not have a clawback right against the Adviser. Our OID investments totaled \$20.7 million as of September 30, 2018, at cost, which are all syndicated loan investments. For the year ended September 30, 2018, we recognized \$0.2 million of OID income and the unamortized balance of OID investments as of September 30, 2018 totaled \$0.4 million. As of September 30, 2018, we had five investments which had a PIK interest component and we recorded PIK interest income of \$3.8 million during the year ended September 30, 2018. We collected \$0.8 million in PIK interest in cash for the year ended September 30, 2018.

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The Adviser's failure to identify and invest in securities that meet our investment criteria or perform its responsibilities under the Advisory Agreement would likely adversely affect our ability for future growth.

Our ability to achieve our investment objectives will depend on our ability to grow, which in turn will depend on the Adviser's ability to identify and invest in securities that meet our investment criteria. Accomplishing this result on a cost-effective basis will be largely a function of the Adviser's structuring of the investment process, its ability to provide competent and efficient services to us, and our access to financing on acceptable terms. The senior management team of the Adviser has substantial responsibilities under the Advisory Agreement. In order to grow, the Adviser will need to hire, train, supervise, and manage new employees successfully. Any failure to manage our future growth effectively would likely have a material adverse effect on our business, financial condition, and results of operations.

There are significant potential conflicts of interest, including with the Adviser, which could impact our investment returns.

Our executive officers and directors, and the officers and directors of the Adviser, serve or may serve as officers, directors, or principals of entities that operate in the same or a related line of business as we do or of investment funds managed by our affiliates. Accordingly, they may have obligations to investors in those entities, the fulfillment of which might not be in the best interests of us or our stockholders. For example, Mr. Gladstone, our chairman and chief executive officer, is the chairman of the board and chief executive officer of each of the Gladstone Companies. In addition, Mr. Brubaker, our vice chairman and chief operating officer, is the vice chairman and chief operating officer of each of the Gladstone Companies. Mr. Marcotte is an executive managing director of the Adviser. Moreover, the Adviser may establish or sponsor other investment vehicles which from time to time may have potentially overlapping investment objectives with ours and accordingly may invest in, whether principally or secondarily, asset classes we target. While the Adviser generally has broad authority to make investments on behalf of the investment vehicles that it advises, the Adviser has adopted investment allocation procedures to address these potential conflicts and intends to direct investment opportunities to the Affiliated Public Fund with the investment strategy that most closely fits the investment opportunity. Nevertheless, the management of the Adviser may face conflicts in the allocation of investment opportunities to other entities managed by the Adviser. As a result, it is possible that we may not be given the opportunity to participate in certain investments made by other funds managed by the Adviser. Our Board of Directors approved a revision of our investment objectives and strategies that became effective on January 1, 2013, which may enhance the potential for conflicts in the allocation of investment opportunities to us and other entities managed by the Adviser.

In certain circumstances, we may make investments in a portfolio company in which one of our affiliates has or will have an investment, subject to satisfaction of any regulatory restrictions and, where required, to the prior approval of our Board of Directors. As of September 30, 2018, our Board of Directors has approved the following types of co-investment transactions:

Our affiliate, Gladstone Commercial, may, under certain circumstances, lease property to portfolio companies that we do not control. We may pursue such transactions only if (i) the portfolio company is not controlled by us or any of our affiliates, (ii) the portfolio company satisfies the tenant underwriting criteria of Gladstone Commercial, and (iii) the transaction is approved by a majority of our independent directors and a majority of the independent directors of Gladstone Commercial. We expect that any such negotiations between Gladstone Commercial and our portfolio companies would result in lease terms consistent with the terms that the portfolio companies would be likely to receive were they not portfolio companies of ours.

We may invest simultaneously with our affiliate Gladstone Investment in senior loans in the broadly syndicated market whereby neither we nor any affiliate has the ability to dictate the terms of the loans.

Pursuant to the Co-Investment Order, under certain circumstances, we may co-invest with Gladstone Investment and any future BDC or closed-end management investment company that is advised by the Adviser (or sub-advised by the Adviser if it controls the fund), or any combination of the foregoing, subject to the conditions included therein.

Certain of our officers, who are also officers of the Adviser, may from time to time serve as directors of certain of our portfolio companies. If an officer serves in such capacity with one of our portfolio companies, such officer will owe fiduciary duties to stockholders of the portfolio company, which duties may from time to time conflict with the interests of our stockholders.

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In the course of our investing activities, we will pay base management and incentive fees to the Adviser and will reimburse the Administrator for certain expenses it incurs. As a result, investors in our common stock will invest on a gross basis and receive distributions on a net basis after expenses, resulting in, among other things, a lower rate of return than one might achieve through our investors themselves making direct investments. As a result of this arrangement, there may be times when the management team of the Adviser has interests that differ from those of our stockholders, giving rise to a conflict. In addition, as a BDC, we make available significant managerial assistance to our portfolio companies and provide other services to such portfolio companies. While, neither we nor the Adviser currently receives fees in connection with managerial assistance, the Adviser and Gladstone Securities have, at various times, provided other services to certain of our portfolio companies and received fees for these other services.

The Adviser is not obligated to provide a credit of the base management fee or incentive fee, which could negatively impact our earnings and our ability to maintain our current level of distributions to our stockholders.

The Advisory Agreement provides for a base management fee based on our gross assets and an incentive fee which consists of two parts: an income-based incentive fee and a capital gains-based incentive fee. Our Board of Directors has historically accepted and may accept in the future quarterly or annual non-contractual, unconditional and irrevocable credits to reduce the annual base management fee. Further, our Board of Directors has accepted on a quarterly basis non-contractual, unconditional and irrevocable credits from the Adviser to reduce the income-based incentive fee to the extent net investment income did not cover 100.0% of distributions to common stockholders. Any waived fees may not be recouped by the Adviser in the future. However, the Adviser is not required to issue these or other credits of fees under the Advisory Agreement, and to the extent our investment portfolio grows in the future, we expect these management and incentive fees will increase. If the Adviser does not issue these credits in future quarters, it could negatively impact our earnings and may compromise our ability to maintain our current level of distributions to our stockholders, which could have a material adverse impact on our stock price.

Our business model is dependent upon developing and sustaining strong referral relationships with investment bankers, business brokers and other intermediaries and any change in our referral relationships may impact our business plan.

We are dependent upon informal relationships with investment bankers, business brokers and traditional lending institutions to provide us with deal flow. If we fail to maintain our relationship with such funds or institutions, or if we fail to establish strong referral relationships with other funds, we will not be able to grow our portfolio of investments and fully execute our business plan.

Our base management fee may induce the Adviser to incur leverage.

The fact that our base management fee is payable based upon our gross assets, which would include any investments made with proceeds of borrowings, may encourage the Adviser to use leverage to make additional investments. Under certain circumstances, the use of increased leverage may increase the likelihood of default, which would disfavor holders of our securities. Given the subjective nature of the investment decisions made by the Adviser on our behalf, we will not be able to monitor this potential conflict of interest.

Risks Related to an Investment in Our Securities

We may experience fluctuations in our quarterly and annual operating results.

We may experience fluctuations in our quarterly and annual operating results due to a number of factors, including, among others, variations in our investment income, the interest rates payable on the debt securities we acquire, the

default rates on such securities, variations in and the timing of the recognition of realized and unrealized gains or losses, the level of our expenses, the degree to which we encounter competition in our markets, and general economic conditions, including the impacts of inflation. The majority of our portfolio companies are in industries that are directly impacted by inflation, such as manufacturing and consumer goods and services. Our portfolio companies may not be able to pass on to customers increases in their costs of production which could greatly affect their operating results, impacting their ability to repay our loans. In addition, any projected future decreases in our portfolio companies' operating results due to inflation could adversely impact the fair value of those investments. Any decreases in the fair value of our investments could result in future realized and unrealized losses and therefore reduce our net assets resulting from operations. As a result of these factors, results for any period should not be relied upon as being indicative of performance in future periods.

There is a risk that you may not receive distributions or that distributions may not grow over time.

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We intend to distribute at least 90.0% of our investment company taxable income to our stockholders on a quarterly basis by paying monthly distributions. We cannot assure you that we will achieve investment results that will allow us to make a specified level of cash distributions or year-to-year increases in cash distributions. Furthermore, we expect to retain some or all net realized long-term capital gains by first offsetting them with realized capital losses, and secondly through a deemed distribution to supplement our equity capital and support the growth of our portfolio, although our Board of Directors may determine in certain cases to distribute these gains to our common stockholders. In addition, our Credit Facility restricts the amount of distributions we are permitted to make. We cannot assure you that we will achieve investment results or maintain a tax status that will allow or require any specified level of cash distributions.

Investing in our securities may involve an above average degree of risk.

The investments we make in accordance with our investment objective may result in a higher amount of risk than alternative investment options and a higher risk of volatility or loss of principal. Our investments in portfolio companies may be highly speculative, and therefore, an investment in our shares may not be suitable for someone with lower risk tolerance.

Distributions to our stockholders have included and may in the future include a return of capital.

Quarterly, our Board of Directors declares monthly distributions based on then-current estimates of taxable income for each fiscal year, which may differ, and in the past have differed, from actual results. Because our distributions are based on estimates of taxable income that may differ from actual results, future distributions payable to our stockholders may also include a return of capital. Moreover, to the extent that we distribute amounts that exceed our current and accumulated earnings and profits, these distributions constitute a return of capital. A return of capital represents a return of a stockholder's original investment in shares of our stock and should not be confused with a distribution from earnings and profits. Although return of capital distributions may not be taxable, such distributions may increase an investor's tax liability for capital gains upon the sale of our shares by reducing the investor's tax basis for such shares. Such returns of capital reduce our asset base and also adversely impact our ability to raise debt capital as a result of the leverage restrictions under the 1940 Act, which could have material adverse impact on our ability to make new investments.

Shares of closed-end investment companies frequently trade at a discount from NAV.

Shares of closed-end investment companies frequently trade at a discount from NAV per common share. Since our inception, our common stock has at times traded above NAV, and at times below NAV per share. This characteristic of shares of closed-end investment companies is separate and distinct from the risk that our NAV per share will decline. As with any stock, the price of our shares will fluctuate with market conditions and other factors. If shares are sold, the price received may be more or less than the original investment. Whether investors will realize gains or losses upon the sale of our shares will not depend directly upon our NAV, but will depend upon the market price of the shares at the time of sale. Since the market price of our shares will be affected by such factors as the relative demand for and supply of the shares in the market, general market and economic conditions and other factors beyond our control, we cannot predict whether the shares will trade at, below, or above our NAV.

Under the 1940 Act, we are generally not able to issue additional shares of our common stock at a price below NAV per share to purchasers other than our existing stockholders through a rights offering without first obtaining the approval of our common stockholders and our independent directors. Additionally, when our common stock is trading below its NAV per share, our dividend yield may exceed the weighted average returns that we would expect to realize on new investments that would be made with the proceeds from the sale of such stock, making it unlikely that we

would determine to issue additional shares in such circumstances. Thus, for as long as our common stock may trade below NAV, we will be subject to significant constraints on our ability to raise capital through the issuance of common stock. Additionally, an extended period of time in which we are unable to raise capital may restrict our ability to grow and adversely impact our ability to increase or maintain our distributions.

Common stockholders may incur dilution if we sell shares of our common stock in one or more offerings at prices below the then-current NAV per share of our common stock.

We did not request that our stockholders approve the Company's ability to issue shares of common stock at a price below NAV per share at our annual meetings of stockholders held on February 9, 2017 and February 8, 2018. Absent such stockholder approval, we are not able to access the capital markets in an offering at prices below the then-current NAV per share due to restrictions applicable to BDCs under the 1940 Act. Should we decide to issue shares of common stock at a price below NAV per share in the future, we will seek the requisite approval of our stockholders at such time.

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If we were to sell shares of our common stock below NAV per share, such sales would result in an immediate dilution to the NAV per share. This dilution would occur as a result of the sale of shares at a price below the then-current NAV per share of our common stock and a proportionately greater decrease in a stockholder's interest in our earnings and assets and voting interest in us than the increase in our assets resulting from such issuance. The greater the difference between the sale price and the NAV per share at the time of the offering, the more significant the dilutive impact would be. Because the number of shares of common stock that could be so issued and the timing of any issuance is not currently known, the actual dilutive effect, if any, cannot be currently predicted. However, if, for example, we sold an additional 10.0% of our common stock at a 5.0% discount from NAV, a stockholder who did not participate in that offering for its proportionate interest would suffer NAV dilution of up to 0.5% or \$5 per \$1,000 of NAV.

If we fail to pay dividends on our Series 2024 Term Preferred Stock for two years, the holders of our Series 2024 Term Preferred Stock will be entitled to elect a majority of our directors.

The terms of our Series 2024 Term Preferred Stock provide for annual dividends in the amount of \$1.50 per outstanding share of Series 2024 Term Preferred Stock. In accordance with the terms of our Series 2024 Term Preferred Stock, if dividends thereon are unpaid in an amount equal to at least two years of dividends, the holders of Series 2024 Term Preferred Stock will be entitled to elect a majority of our Board of Directors.

Risks Related to the 2023 Notes

The 2023 Notes are unsecured and therefore are effectively subordinated to any secured indebtedness we have incurred or may incur in the future and will rank pari passu with, or equal to, all outstanding and future unsecured indebtedness issued by us and our general liabilities (total liabilities, less debt).

The 2023 Notes are not secured by any of our assets or any of the assets of our subsidiaries. As a result, the 2023 Notes are subordinated to any secured indebtedness we or our subsidiaries have currently incurred and may incur in the future (or any indebtedness that is initially unsecured to which we subsequently grant security) to the extent of the value of the assets securing such indebtedness. In any liquidation, dissolution, bankruptcy or other similar proceeding, the holders of any of our existing or future secured indebtedness and the secured indebtedness of our subsidiaries may assert rights against the assets pledged to secure that indebtedness in order to receive full payment of their indebtedness before the assets may be used to pay other creditors, including the holders of the 2023 Notes. In addition, the 2023 Notes rank pari passu with, or equal to, all outstanding and future unsecured indebtedness issued by us and our general liabilities (total liabilities, less debt).

The 2023 Notes will be structurally subordinated to the indebtedness and other liabilities of our subsidiaries.

The 2023 Notes are obligations exclusively of the Company and not of any of our subsidiaries. None of our subsidiaries is a guarantor of the 2023 Notes and the 2023 Notes are not required to be guaranteed by any subsidiaries we may acquire or create in the future. Except to the extent we are a creditor with recognized claims against our subsidiaries, all claims of creditors of our subsidiaries will have priority over our equity interests in such subsidiaries (and therefore the claims of our creditors, including holders of the 2023 Notes) with respect to the assets of such subsidiaries. Even if we are recognized as a creditor of one or more of our subsidiaries, our claims would still be effectively subordinated to any security interests in the assets of any such subsidiary and to any indebtedness or other liabilities of any such subsidiary senior to our claims. Consequently, the 2023 Notes are structurally subordinated to all indebtedness and other liabilities of any of our subsidiaries and any subsidiaries that we may in the future acquire or establish. As of September 30, 2018, there was \$110.0 million outstanding under the Credit Facility. Borrowings under the Credit Facility are the obligation of Business Loan, and are structurally senior to the 2023 Notes. In addition, our subsidiaries may incur substantial additional indebtedness in the future, all of which would be

structurally senior to the 2023 Notes.

The indenture under which the 2023 Notes were issued contains limited protection for holders of the 2023 Notes.

The indenture under which the 2023 Notes were issued offers limited protection to holders of the 2023 Notes. The terms of the indenture and the 2023 Notes do not restrict our or any of our subsidiaries' ability to engage in, or otherwise be a party to, a variety of corporate transactions, circumstances or events that could have an adverse impact on your investment in the 2023 Notes. In particular, the terms of the indenture and the 2023 Notes do not place any restrictions on our or our subsidiaries' ability to:

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issue securities or otherwise incur additional indebtedness or other obligations, including (1) any indebtedness or other obligations that would be equal in right of payment to the 2023 Notes, (2) any indebtedness or other obligations that would be secured and therefore effectively rank senior in right of payment to the 2023 Notes to the extent of the values of the assets securing such debt, (3) our indebtedness that is guaranteed by one or more of our subsidiaries and which therefore is structurally senior to the 2023 Notes and (4) securities, indebtedness or obligations issued or incurred by our subsidiaries that would be senior to our equity interests in our subsidiaries and therefore rank structurally senior to the 2023 Notes with respect to the assets of our subsidiaries, in each case other than an incurrence of indebtedness or other obligation that would cause a violation of Section 18(a)(1)(A) as modified by such provisions of Section 61(a) of the 1940 Act as may be applicable to us from time to time or any successor provisions, whether or not we continue to be subject to such provisions of the 1940 Act, which generally prohibit us incurring additional debt or issuing additional debt or preferred securities, unless our asset coverage, as defined in the 1940 Act, equals at least 200% (or 150% effective April 10, 2019) after such incurrence or issuance. See the risk factor *Recently-enacted legislation allows us to incur additional leverage under the 1940 Act, distinct from certain of our obligations under our Credit Facility and our term preferred stock below*;

pay dividends on, or purchase or redeem or make any payments in respect of, capital stock or other securities ranking junior in right of payment to the 2023 Notes, including our preferred stock and any subordinated indebtedness, in each case other than dividends, purchases, redemptions or payments that would cause our asset coverage to fall below the threshold specified in Section 18(a)(1)(B) as modified by such provisions of Section 61(a) of the 1940 Act as may be applicable to us from time to time or any successor provisions, giving effect to any no-action relief granted by the SEC to another BDC (or to us if we determine to seek such similar SEC no-action or other relief) permitting the BDC to declare any cash dividend or distribution notwithstanding the prohibition contained in Section 18(a)(1)(B) as modified by such provisions of Section 61(a) of the 1940 Act as may be applicable to us from time to time in order to maintain the BDC's status as a RIC under Subchapter M of the Code;

sell assets (other than certain limited restrictions on our ability to consolidate, merge or sell all or substantially all of our assets);

enter into transactions with affiliates;

create liens (including liens on the shares of our subsidiaries) or enter into sale and leaseback transactions;

make investments; or

create restrictions on the payment of dividends or other amounts to us from our subsidiaries.

In addition, the indenture and the 2023 Notes will not require us to make an offer to purchase the Notes in connection with a change of control or any other event.

Furthermore, the terms of the indenture and the 2023 Notes do not protect holders of the 2023 Notes in the event that we experience changes (including significant adverse changes) in our financial condition, results of operations or credit ratings, if any, as they do not require that we or our subsidiaries adhere to any financial tests or ratios or specified levels of net worth, revenues, income, cash flow, or liquidity.

Our ability to recapitalize, incur additional debt (including additional debt that matures prior to the maturity of the 2023 Notes), and take a number of other actions that are not limited by the terms of the 2023 Notes may have important consequences for you as a holder of the 2023 Notes, including making it more difficult for us to satisfy our obligations with respect to the 2023 Notes or negatively affecting the trading value of the 2023 Notes.

Other debt we issue or incur in the future could contain more protections for its holders than the indenture and the 2023 Notes, including additional covenants and events of default. The issuance or incurrence of any such debt with incremental protections could affect the market for trading levels and prices of the 2023 Notes.

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If we default on our obligations to pay our other indebtedness, we may not be able to make payments on the 2023 Notes.

Any default under the agreements governing our indebtedness, including a default under the Credit Facility or other indebtedness to which we may be a party, that is not waived by the required lenders or holders, and the remedies sought by the holders of such indebtedness could make us unable to pay principal and interest on the 2023 Notes and substantially decrease the market value of the 2023 Notes. If we are unable to generate sufficient cash flow and are otherwise unable to obtain funds necessary to meet required payments of principal and interest on our indebtedness, or if we otherwise fail to comply with the various covenants, including financial and operating covenants, in the instruments governing our indebtedness, we could be in default under the terms of the agreements governing such indebtedness. In the event of such default, the holders of such indebtedness could elect to declare all the funds borrowed thereunder to be due and payable, together with accrued and unpaid interest, the lenders under the Credit Facility or other debt we may incur in the future could elect to terminate their commitments, cease making further loans and institute foreclosure proceedings against our assets, and we could be forced into bankruptcy or liquidation. If our operating performance declines, we may in the future need to refinance or restructure our debt, including the 2023 Notes, sell assets, reduce or delay capital investments, seek to raise additional capital or seek to obtain waivers from the required lenders under the Credit Facility or other debt that we may incur in the future to avoid being in default. If we are unable to implement one or more of these alternatives, we may not be able to meet our payment obligations under the 2023 Notes or our other debt. If we breach our covenants under the Credit Facility or other debt and seek a waiver, we may not be able to obtain a waiver from the required lenders or holders. If this occurs, we would be in default under the Credit Facility or other debt, the lenders or holders could exercise their rights as described above, and we could be forced into bankruptcy or liquidation. If we are unable to repay debt, lenders having secured obligations, including the lenders under the Credit Facility, could proceed against the collateral securing the debt. Because the Credit Facility has, and any future credit facilities will likely have, customary cross-default provisions, if the indebtedness under the 2023 Notes or the Credit Facility or under any future credit facility is accelerated, we may be unable to repay or finance the amounts due.

We may choose to redeem the 2023 Notes when prevailing interest rates are relatively low.

On or after November 1, 2020, we may choose to redeem the 2023 Notes from time to time, especially if prevailing interest rates are lower than the rate borne by the 2023 Notes. If prevailing rates are lower at the time of redemption, and we redeem the 2023 Notes, you likely would not be able to reinvest the redemption proceeds in a comparable security at an effective interest rate as high as the interest rate on the 2023 Notes being redeemed. Our redemption right also may adversely impact your ability to sell the 2023 Notes as the optional redemption date or period approaches.

A downgrade, suspension or withdrawal of the credit rating assigned by a rating agency to us or our securities, could cause the liquidity or market value of the 2023 Notes to decline significantly.

Any credit rating assigned to us or the 2023 Notes represents an assessment by the assigning rating agency of our ability to pay our debts when due. Consequently, real or anticipated changes in our credit ratings will generally affect the market value of the 2023 Notes. These credit ratings may not reflect the potential impact of risks relating to the structure or marketing of the 2023 Notes. Credit ratings are paid for by the issuer and are not a recommendation to buy, sell or hold any security, and may be revised or withdrawn at any time by the issuing organization in its sole discretion.

Other Risks

Cybersecurity risks and cyber incidents may adversely affect our business by causing a disruption to our operations, or the operations of businesses in which we invest, a compromise or corruption of our confidential information and/or damage to our business relationships, all of which could negatively impact our business, financial condition and operating results.

A cyber incident is considered to be any adverse event that threatens the confidentiality, integrity or availability of our information resources. These incidents may be an intentional attack or an unintentional event and could involve gaining unauthorized access to our information systems for purposes of misappropriating assets, stealing confidential information, corrupting data or causing operational disruption. The result of these incidents may include disrupted operations, misstated or unreliable financial data, liability for stolen assets or information, increased cybersecurity protection and insurance costs, litigation and damage to our business relationships. As our reliance on technology has increased, so have the risks posed to our information systems, both internal and those provided to us by third-party service providers. We have implemented processes, procedures and internal controls to help mitigate cybersecurity risks and cyber intrusions, but these measures, as well as our increased awareness of the nature and extent of a risk of a cyber incident, do not guarantee that a cyber incident will not occur and/or that our financial results, operations or confidential information will not be negatively impacted by such an incident. In addition, any such incident, disruption or other loss of information could result in legal claims or proceedings, liability under laws that protect the privacy of personal information, and regulatory penalties, disrupt our operations, and damage our and our Adviser's reputations, and cause a loss of confidence in us and our Adviser's services, which could adversely affect our business.

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We are dependent on information systems and systems failures could significantly disrupt our business, which may, in turn, negatively affect the market price of our common stock and our ability to pay dividends.

Our business is dependent on our and third parties' communications and information systems. Any failure or interruption of those systems, including as a result of the termination of an agreement with any third-party service providers, could cause delays or other problems in our activities. Our financial, accounting, data processing, backup or other operating systems and facilities may fail to operate properly or become disabled or damaged as a result of a number of factors including events that are wholly or partially beyond our control and adversely affect our business. There could be:

sudden electrical or telecommunications outages;

natural disasters such as earthquakes, tornadoes and hurricanes;

disease pandemics;

events arising from local or larger scale political or social matters, including terrorist acts; and

cyber-attacks.

These events, in turn, could have a material adverse effect on our operating results and negatively affect the market price of our common stock and our ability to pay dividends to our stockholders.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We do not own any real estate or other physical properties material to our operations. The Adviser is the current leaseholder of all properties in which we operate. We occupy these premises pursuant to the Advisory and Administration Agreements with the Adviser and Administrator, respectively.

ITEM 3. LEGAL PROCEEDINGS

We are not currently subject to any material legal proceedings, nor, to our knowledge, is any material legal proceeding threatened against us.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is traded on the Nasdaq under the symbol GLAD. As of November 13, 2018, there were 39 record owners of our common stock.

Distributions

We generally intend to distribute in the form of cash distributions a minimum of 90.0% of our investment company taxable income, if any, on a quarterly basis to our stockholders in the form of monthly distributions. We generally intend to retain some or all of our long-term capital gains, if any, but generally intend to designate the retained amount as a deemed distribution, after giving effect to any prior year realized losses that are carried forward, to supplement our equity capital and support the growth of our portfolio. However, in certain cases, our Board of Directors may choose to distribute our net realized long-term capital gains, if any, by paying a one-time special distribution. Additionally, our Credit Facility contains a covenant that limits distributions to our stockholders on an annual basis to the sum of our net investment income, net capital gains and amounts deemed to have been paid during the prior year in accordance with Section 855(a) of the Code.

Recent Sales of Unregistered Securities

We did not sell any unregistered shares of stock during the fiscal year ended September 30, 2018.

Purchases of Equity Securities

We did not repurchase any shares of our stock during the fourth quarter ended September 30, 2018.

Table of Contents**Stock Performance Graph**

The following graph shows the total stockholder return on an investment of \$100 in cash on September 30, 2013 for (i) our common stock, (ii) the Nasdaq's 100 total return index (Nasdaq 100 TR), (iii) the Standard & Poor's 500 total return Index (the S&P 500 TR), and (iv) the Wells Fargo BDC Total Return index (WF BDC TR). This year we replaced our peer group of four companies included in our 2017 annual report with the WF BDC TR. By utilizing the WF BDC TR, which includes over 40 BDCs, we are able to include a larger representation of the BDC landscape. The WF BDC TR includes BDCs that are listed on the Nasdaq or the New York Stock Exchange and have a market capitalization greater than \$100 million on the evaluation date. We believe the WF BDC TR is a more appropriate comparative market index because, among other reasons, it better reflects the price volatility that BDCs experience.

The following stock performance graph compares our cumulative total return with that of both the newly selected index and the peer group used in our 2017 annual report to stockholders. The returns on each investment assume reinvestment of dividends. This stock performance graph and the related textual information are not necessarily indicative of future performance.

	GLAD	Nasdaq 100 TR	S&P 500 TR	WF BDC TR	Peer Group
9/30/2013	\$ 100.00	\$ 100.00	\$ 100.00	\$ 100.00	\$ 100.00
9/30/2014	111.51	127.52	119.73	100.57	102.71
9/30/2015	114.19	133.21	119.00	89.47	87.49
9/30/2016	127.51	157.37	137.36	109.71	109.61
9/30/2017	163.08	195.26	162.92	119.62	123.83
9/28/2018	178.63	251.72	192.10	123.92	136.22

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The following consolidated selected financial data for the fiscal years ended September 30, 2018, 2017, 2016, 2015 and 2014 are derived from our audited accompanying *Consolidated Financial Statements*. The other data included in the second table below is unaudited. The data should be read in conjunction with our accompanying *Notes to Consolidated Financial Statements* and notes thereto and *Management's Discussion and Analysis of Financial Condition and Results of Operations* included elsewhere in this Annual Report on Form 10-K.

GLADSTONE CAPITAL CORPORATION**CONSOLIDATED SELECTED FINANCIAL AND OTHER DATA****(DOLLAR AMOUNTS IN THOUSANDS, EXCEPT PER SHARE)**

	Year Ended September 30,				
	2018	2017	2016	2015	2014
<u>Statement of Operations Data:</u>					
Total Investment Income	\$ 45,581	\$ 39,233	\$ 39,112	\$ 38,058	\$ 36,585
Total Expenses, Net of Credits from Adviser	22,493	17,800	19,625	20,358	18,217
Net Investment Income	23,088	21,433	19,487	17,700	18,368
Net Realized and Unrealized (Loss) Gain	(4,440)	(4,253)	(8,120)	(9,216)	(7,135)
Net Increase in Net Assets Resulting from Operations	\$ 18,648	\$ 17,180	\$ 11,367	\$ 8,484	\$ 11,233
<u>Per Share Data:</u>					
Net Investment Income per Common Share - Basic and Diluted ^(A)	\$ 0.85	\$ 0.84	\$ 0.84	\$ 0.84	\$ 0.87
Net Increase in Net Assets Resulting from Operations per Common Share - Basic and Diluted ^(A)	0.69	0.67	0.49	0.40	0.53
Distributions Declared and Paid Per Common Share ^(B)	0.84	0.84	0.84	0.84	0.84
<u>Statement of Assets and Liabilities Data:</u>					
Total Assets	\$ 399,508	\$ 365,860	\$ 337,178	\$ 382,482	\$ 301,429
Net Assets	237,092	219,650	201,207	191,444	199,660
Net Asset Value Per Common Share	8.32	8.40	8.62	9.06	9.51
Common Shares Outstanding	28,501,980	26,160,684	23,344,422	21,131,622	21,000,160

Weighted Common Shares

Outstanding	Basic and Diluted	27,104,077	25,495,117	23,200,642	21,066,844	21,000,160
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Senior Securities Data:

Total borrowings, at cost ^(C)	\$	110,000	\$	93,000	\$	71,300	\$	127,300	\$	36,700
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Mandatorily redeemable

preferred

stock ^{(C)(D)}		51,750		51,750		61,000		61,000		61,000
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- (A) Per share data is based on the weighted average common stock outstanding for both basic and diluted.
- (B) The tax character of distributions is determined on an annual basis. For further information on the estimated character of our distributions to common stockholders, please refer to Note 9 *Distributions to Common Stockholders* in the accompanying *Notes to Consolidated Financial Statements* included elsewhere in this Annual Report on Form 10-K.
- (C) See *Management's Discussion and Analysis of Financial Condition and Results of Operations* for more information regarding our level of indebtedness.
- (D) Represents the total liquidation preference of our mandatorily redeemable term preferred stock.

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	Year Ended September 30,				
	2018	2017	2016	2015	2014
Other Unaudited Data:					
Number of Portfolio Companies	50	47	45	48	45
Average Size of Portfolio Company Investment at Cost	\$ 8,549	\$ 8,754	\$ 8,484	\$ 8,547	\$ 7,762
Principal Amount of New Investments	67,936	99,241	79,401	102,299	81,731
Disbursements to Existing Portfolio Companies	38,679	12,851	10,145	33,824	20,314
Proceeds from Loan Repayments, Investments Sold and Exits ^(A)	67,944	83,444	121,144	40,273	72,560
Weighted Average Yield on Investments, excluding loans on non-accrual status ^(B)	11.80%	11.57%	11.08%	10.93%	11.47%
Weighted Average Yield on Investments, including loans on non-accrual status ^(C)	10.72	10.61	10.27	9.84	9.99
Total Return ^(D)	9.53	27.90	11.68	2.40	9.62

(A) Includes non-cash reductions in cost basis.

(B) Weighted average yield on investments, excluding loans on non-accrual status, equals interest income on investments divided by the weighted average interest-bearing principal balance throughout the fiscal year.

(C) Weighted average yield on investments, including loans on non-accrual status, equals interest income on investments divided by the weighted average total principal balance throughout the fiscal year.

(D) Total return equals the change in the ending market value of our common stock from the beginning of the fiscal year, taking into account dividends reinvested in accordance with the terms of the dividend reinvestment plan. Total return does not take into account distributions that may be characterized as a return of capital. For further information on the estimated character of our distributions to common stockholders, refer to Note 9 *Distributions to Common Stockholders* elsewhere in this Annual Report on Form 10-K.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following analysis of our financial condition and results of operations should be read in conjunction with our accompanying *Consolidated Financial Statements* and the notes thereto contained elsewhere in this Annual Report on Form 10-K. Historical financial condition and results of operations and percentage relationships among any amounts in the financial statements are not necessarily indicative of financial condition, results of operations or percentage relationships for any future periods. Except per share amounts, dollar amounts in the tables included herein are in thousands unless otherwise indicated.

OVERVIEW

General

We were incorporated under the Maryland General Corporation Law on May 30, 2001. We operate as an externally managed, closed-end, non-diversified management investment company, and have elected to be treated as a BDC under the 1940 Act. In addition, for federal income tax purposes we have elected to be treated as a RIC under the Code. To continue to qualify as a RIC for federal income tax purposes and obtain favorable RIC tax treatment, we must meet certain requirements, including certain minimum distribution requirements.

We were established for the purpose of investing in debt and equity securities of established private businesses operating in the U.S. Our investment objectives are to: (1) achieve and grow current income by investing in debt securities of established businesses that we believe will provide stable earnings and cash flow to pay expenses, make principal and interest payments on our outstanding indebtedness and make distributions to stockholders that grow over time; and (2) provide our stockholders with long-term capital appreciation in the value of our assets by investing in equity securities of established businesses that we believe can grow over time to permit us to sell our equity investments for capital gains. To achieve our investment objectives, our investment strategy is to invest in several categories of debt and equity securities, with each investment generally ranging from \$8 million to \$30 million, although investment size may vary, depending upon our total assets or available capital at the time of investment. We expect that our investment portfolio over time will consist of approximately 90.0% debt investments and 10.0% equity investments, at cost. As of September 30, 2018, our investment portfolio was made up of approximately 91.4% debt investments and 8.6% equity investments, at cost.

We focus on investing in lower middle market companies (which we generally define as companies with annual earnings before interest, taxes, depreciation and amortization of \$3 million to \$15 million) in the U.S. that meet certain criteria, including, but not limited to, the following: the sustainability of the business free cash flow and its ability to grow it over time, adequate assets for loan collateral, experienced management teams with a significant ownership interest in the borrower, reasonable capitalization of the borrower, including an ample equity contribution or cushion based on prevailing enterprise valuation multiples and, to a lesser extent, the potential to realize appreciation and gain liquidity in our equity position, if any. We lend to borrowers that need funds for growth capital or to finance acquisitions or recapitalize or refinance their existing debt facilities. We seek to avoid investing in high-risk, early-stage enterprises. Our targeted portfolio companies are generally considered too small for the larger capital marketplace. We invest by ourselves or jointly with other funds and/or management of the portfolio company, depending on the opportunity and have opportunistically made several co-investments with our affiliate Gladstone Investment, a BDC also managed by our Adviser, pursuant to an exemptive order granted by the SEC. We believe this ability to co-invest will continue to enhance our ability to further our investment objectives and strategies. If we are participating in an investment with one or more co-investors, our investment is likely to be smaller than if we were investing alone.

Business

Portfolio and Investment Activity

In general, our investments in debt securities have a term of no more than seven years, accrue interest at variable rates (generally based on the one-month LIBOR) and, to a lesser extent, at fixed rates. We seek debt instruments that pay interest monthly or, at a minimum, quarterly, may have a success fee or deferred interest provision and are primarily interest only, with all principal and any accrued but unpaid interest due at maturity. Generally, success fees accrue at a set rate and are contractually due upon a change of control of a portfolio company, typically from an exit or sale. Some debt securities have deferred interest whereby some portion of the interest payment is added to the principal balance so that the interest is paid, together with the principal, at maturity. This form of deferred interest is often called PIK interest.

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Typically, our equity investments consist of common stock, preferred stock, limited liability company interests, or warrants to purchase the foregoing. Often, these equity investments occur in connection with our original investment, recapitalizing a business, or refinancing existing debt.

During the year ended September 30, 2018, we invested \$67.9 million in ten new portfolio companies and extended \$38.7 million of investments to existing portfolio companies. In addition, during the year ended September 30, 2018, we exited seven portfolio companies through sales and early payoffs. We received a total of \$66.9 million in combined net proceeds and principal repayments from the aforementioned portfolio company exits as well as existing portfolio companies during the year ended September 30, 2018. This activity resulted in a net increase in our overall portfolio by three portfolio companies to 50 and a net increase of \$16.0 million in our portfolio at cost since September 30, 2017. From our initial public offering in August 2001 through September 30, 2018, we have made 495 different loans to, or investments in, 226 companies for a total of approximately \$1.8 billion, before giving effect to principal repayments on investments and divestitures.

During the year ended September 30, 2018, the following significant transactions occurred:

In October 2017, we sold our investment in Flight Fit N Fun LLC for a realized gain of \$0.6 million. In connection with the sale, we received net cash proceeds of approximately \$9.4 million, including the repayment of our debt investment of \$7.8 million at par.

In October 2017, we invested \$11.0 million in Applied Voice & Speech Technologies, Inc. through secured first lien debt.

In October 2017, our investment in PSC Industrial Holdings, LLC paid off at par for net cash proceeds of \$3.5 million.

In November 2017, we invested \$7.5 million in Arc Drilling Holdings LLC through a combination of secured first lien debt and equity.

In November 2017, we invested \$7.5 million in Gray Matter Systems, LLC through secured second lien debt. In March 2018, we invested an additional \$3.6 million in Gray Matter Systems, LLC, through secured second lien debt.

In November 2017, our investment in DataPipe, Inc. paid off at par for net cash proceeds of \$2.0 million.

In November 2017, we invested \$5.0 million in DigiCert Holdings, Inc. through secured second lien debt. In March 2018, we sold \$2.0 million of this investment for net cash proceeds of \$2.0 million.

In November 2017, we invested \$4.0 million in Red Ventures, LLC through secured second lien debt.

In November 2017, we invested \$1.0 million in ABG Intermediate Holdings 2, LLC through secured second lien debt. In January 2018, we sold this investment for net cash proceeds of \$1.0 million.

In December 2017, we invested \$20.0 million in Impact! Chemical Technologies, Inc. through secured first lien debt.

In January 2018, we invested \$8.1 million in XMedius Solutions Inc. through secured first lien debt.

In February 2018, we invested an additional \$4.0 million in an existing portfolio company, Lignetics, Inc., through secured first lien debt.

In March, July and September 2018, an existing portfolio company, EL Academies, Inc., drew \$1.4 million, \$4.4 million and \$3.2 million, respectively, on the unused portion of its secured first lien delayed draw term loan.

In March 2018, we sold our \$1.0 million investment in Neustar, Inc. for net cash proceeds of \$1.0 million.

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In April 2018, we invested \$3.0 million in CHA Holdings, Inc. through secured second lien debt.

In May 2018, our investment in TapRoot Partners, Inc. paid off, which resulted in prepayment fees of \$0.5 million and success fee income of \$0.4 million. In connection with the pay off, we received net cash proceeds of \$22.9 million, including the repayment of our debt investment of \$22.0 million at par.

In May 2018, we invested an additional \$10.0 million in an existing portfolio company, Merlin International, Inc., through secured second lien debt.

In June 2018, we invested an additional \$7.0 million in an existing portfolio company, IA Tech, LLC, through secured first lien debt.

In July 2018, our investment in NetSmart Technologies, Inc. paid off at par for net cash proceeds of \$3.7 million.

In July 2018, the holding company for Impact! Chemical Technologies, Inc. (Impact) merged with and into the holding company for WadeCo Specialties, Inc. (WadeCo) to form Chemical & Injection Holdings Company, LLC (Chemical & Injection Holdings). Our preferred equity ownership related to WadeCo with a cost basis of \$0.6 million, was converted into preferred equity ownership in the newly formed Chemical & Injection Holdings with the same cost basis. Our existing debt investments in Impact and WadeCo remained unchanged in conjunction with the merger.

In September 2018, we restructured our \$30.0 million investment in Sunshine Media Holdings (Sunshine) resulting in a \$28.2 million realized loss and a new \$2.0 million investment in TNCP Intermediate HoldCo, LLC.

Refer to Note 15 *Subsequent Events* in the accompanying *Consolidated Financial Statements* included elsewhere in this Annual Report on Form 10-K for portfolio activity occurring subsequent to September 30, 2018.

Capital Raising

We have been able to meet our capital needs through extensions of and increases to the Credit Facility and by accessing the capital markets in the form of public equity offerings of common and preferred stock. We have successfully extended the Credit Facility's revolving period multiple times, most recently to January 2021, and currently have a total commitment amount of \$190.0 million. Additionally, we issued 2.1 million shares of our 6.00% Series 2024 Term Preferred Stock, par value \$0.001 per share (Series 2024 Term Preferred Stock) at a public offering price of \$25 per share, for gross proceeds of \$51.8 million in September 2017, inclusive of the overallotment, and approximately 2.2 million shares of our common stock for gross proceeds of \$17.3 million in October 2016, inclusive of the November 2016 overallotment. Additionally, during the year ended September 30, 2018, we sold 2,341,296 shares of our common stock under our at-the-market program at a weighted-average price of \$9.39 per share and raised \$22.0 million of gross proceeds. Refer to *Liquidity and Capital Resources* *Equity* *Common Stock* and *Liquidity and Capital Resources* *Equity* *Term Preferred Stock* for further discussion of our common stock and mandatorily redeemable preferred stock and *Liquidity and Capital Resources* *Revolving Credit Facility* for further

discussion of the Credit Facility.

Although we were able to access the capital markets historically and in recent years, we believe uncertain market conditions could affect the trading price of our capital stock and thus may inhibit our ability to finance new investments through the issuance of equity. When our common stock trades below NAV per common share, as it has often done in previous years, our ability to issue equity is constrained by provisions of the 1940 Act, which generally prohibits the issuance and sale of our common stock below NAV per common share without first obtaining approval from our stockholders and our independent directors, other than through sales to our then-existing stockholders pursuant to a rights offering. We did not request that our stockholders approve the Company's ability to issue shares of common stock at a price below NAV per share at our annual meeting of stockholders held on February 8, 2018. Should we decide to issue shares of common stock at a price below NAV per share in the future, we will seek the requisite approval of our stockholders at such time.

On November 13, 2018, the closing market price of our common stock was \$9.28, an 11.5% premium to our September 30, 2018 NAV per share of \$8.32.

Refer to Note 15 Subsequent Events in the notes to the Consolidated Financial Statements included elsewhere in this Annual Report on Form 10-K for a discussion of additional capital raised in connection with issuance of the 2023 Notes.

Table of Contents***Regulatory Compliance***

Our ability to seek external debt financing, to the extent that it is available under current market conditions, is further subject to the asset coverage limitations of the 1940 Act, which require us to have an asset coverage (as defined in Sections 18 and 61 of the 1940 Act) of at least 200% (currently) or 150% (effective April 10, 2019) on our senior securities representing indebtedness and our senior securities that are stock.

On April 10, 2018, our Board of Directors, including a required majority (as such term is defined in Section 57(o) of the 1940 Act) thereof, approved the modified asset coverage requirements set forth in Section 61(a)(2) of the 1940 Act, as amended by the Small Business Credit Availability Act. As a result, the Company's asset coverage requirements for senior securities will be changed from 200% to 150%, effective one year after the date of the Board of Directors' approval; or April 10, 2019. Under the current 200% asset coverage standard, we may borrow debt or issue senior securities in the amount of \$1.00 for every \$1.00 of equity in the Company. Starting from April 10, 2019, under the 150% asset coverage standard, we may borrow debt or issue senior securities in the amount of \$2.00 for every \$1.00 of equity in the Company. Notwithstanding the modified asset coverage requirement under the 1940 Act described above, we are separately subject to a minimum asset coverage requirement of 200% with respect to certain provisions of our Credit Facility and our Series 2024 Term Preferred Stock.

As of September 30, 2018, our asset coverage on our senior securities representing indebtedness was 359.0% and our asset coverage on our senior securities that are stock was 244.4%.

Recent Developments***Debt Offering***

In November 2018, we completed a public debt offering of \$57.5 million aggregate principal amount of 6.125% Notes due 2023 (the 2023 Notes), inclusive of the overallotment, for net proceeds of \$55.5 million after deducting underwriting discounts, commissions and offering expenses borne by us. The Notes will mature on November 1, 2023, and may be redeemed in whole or in part at any time or from time to time at the Company's option on or after November 1, 2020. The 2023 Notes are traded under the ticker symbol GLADD on the Nasdaq Global Select Market.

Distributions

On October 9, 2018, our Board of Directors declared the following monthly cash distributions to common and preferred stockholders:

Record Date	Payment Date	Distribution per Common Share	Distribution per Series 2024 Term Preferred Share
October 19, 2018	October 31, 2018	\$ 0.07	\$ 0.125
November 20, 2018	November 30, 2018	0.07	0.125
December 20, 2018	December 31, 2018	0.07	0.125

Total for the Quarter \$ 0.21 \$ 0.375

Portfolio and Investment Activity

In October 2018, our investment in TWS Acquisition Corporation paid off at par for net cash proceeds of \$2.0 million.

In October and November 2018, we invested a total of \$1.6 million in 8th Avenue Food & Provisions, Inc. through secured second lien debt.

In November 2018, we invested \$2.0 million in GOBP Holdings, Inc. (d/b/a Grocery Outlet) through secured second lien debt.

In November 2018, our investment in Red Ventures, LLC paid off at par for net cash proceeds of \$3.1 million.

Table of Contents**RESULTS OF OPERATIONS****Comparison of the Year Ended September 30, 2018 to the Year Ended September 30, 2017**

	For the Year Ended September 30,			
	2018	2017	\$ Change	% Change
INVESTMENT INCOME				
Interest income	\$ 43,958	\$ 37,073	\$ 6,885	18.6%
Other income	1,623	2,160	(537)	(24.9)
Total investment income	45,581	39,233	6,348	16.2
EXPENSES				
Base management fee	7,033	5,781	1,252	21.7
Loan servicing fee	5,042	4,146	896	21.6
Incentive fee	5,348	4,779	569	11.9
Administration fee	1,250	1,102	148	13.4
Interest expense on borrowings	5,858	3,073	2,785	90.6
Dividend expense on mandatorily redeemable preferred stock	3,105	4,152	(1,047)	(25.2)
Amortization of deferred financing fees	1,014	1,094	(80)	(7.3)
Other expenses	1,966	1,945	21	1.1
Expenses, before credits from Adviser	30,616	26,072	4,544	17.4
Credit to base management fee loan servicing fee	(5,042)	(4,146)	(896)	21.6
Credit to fees from Adviser - other	(3,081)	(4,126)	1,045	(25.3)
Total expenses, net of credits	22,493	17,800	4,693	26.4
NET INVESTMENT INCOME	23,088	21,433	1,655	7.7
NET REALIZED AND UNREALIZED (LOSS) GAIN				
Net realized loss on investments	(26,063)	(3,475)	(22,588)	650.0
Net realized loss on other	(133)	(1,288)	1,155	(89.7)
Net unrealized appreciation of investments	21,641	625	21,016	3,362.6
Net unrealized appreciation (depreciation) of other	115	(115)	230	(200.0)
Net loss from investments and other	(4,440)	(4,253)	(187)	4.4
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS	\$ 18,648	\$ 17,180	\$ 1,468	8.5%

PER BASIC AND DILUTED COMMON SHARE

Net investment income	\$ 0.85	\$ 0.84	\$ 0.01	1.2%
Net increase in net assets resulting from operations	\$ 0.69	\$ 0.67	\$ 0.02	3.0%

Investment Income

Interest income increased by 18.6% for the year ended September 30, 2018, as compared to the prior year. This increase was due primarily to an increase in the weighted average balance outstanding on our interest-bearing portfolio and an increase in the weighted average yield on our interest-bearing portfolio. The weighted average principal balance of our interest-bearing investment portfolio during the year ended September 30, 2018, was \$372.2 million, compared to \$320.1 million for the prior year, an increase of \$52.1 million, or 16.3%. The weighted average yield on our interest-bearing investments is based on the current stated interest rates on interest-bearing investments which increased to 11.8% for the year ended September 30, 2018 compared to 11.6% for the year ended September 30, 2017, inclusive of any allowances on interest receivables made during those periods.

As of September 30, 2018, one portfolio company, Francis Drilling Fluids, Ltd. (FDF) was on non-accrual status, with an aggregate debt cost basis of approximately \$26.9 million, or 6.9% of the cost basis of all debt investments in our portfolio. As of September 30, 2017, two portfolio companies, Sunshine and Alloy Die Casting Co. (ADC), were on non-accrual status, with an aggregate debt cost basis of approximately \$27.9 million, or 7.5% of the cost basis of all debt investments in our portfolio.

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Other income decreased by 24.9% during the year ended September 30, 2018, as compared to the prior year. This decrease was primarily due to a \$1.1 million decrease in success fees recognized year over year. For the year ended September 30, 2018, other income consisted primarily of \$0.6 million in prepayment fees received, \$0.5 million in dividend income, and \$0.4 million in success fees recognized. For the year ended September 30, 2017, other income consisted primarily of \$1.5 million in success fees recognized, \$0.3 million in dividend income, and \$0.3 million in prepayment fees received.

The following tables list the investment income for our five largest portfolio company investments at fair value during the respective years:

Portfolio Company	As of September 30, 2018		Year Ended September 30, 2018	
	Fair Value	% of Portfolio	Investment Income	% of Total Investment Income
IA Tech, LLC	\$ 30,900	7.9%	\$ 3,208	7.0%
NetFortris Corp.	24,325	6.2	2,522	5.5
Lignetics, Inc.	23,040	5.9	2,410	5.3
Impact! Chemical Technologies, Inc. ^(A)	22,472	5.8	1,849	4.1
EL Academies, Inc.	22,018	5.7	1,535	3.4
Subtotal five largest investments	122,755	31.5	11,524	25.3
Other portfolio companies	267,291	68.5	34,018	74.7
Total Investment Portfolio	\$ 390,046	100.0%	\$ 45,542	100.0%

Portfolio Company	As of September 30, 2017		Year Ended September 30, 2017	
	Fair Value	% of Portfolio	Investment Income	% of Total Investment Income
NetFortris Corp. ^(A)	\$ 24,240	6.9%	\$ 1,566	4.0%
IA Tech, LLC	23,633	6.7	2,813	7.2
HB Capital Resources, Ltd. ^(A)	22,110	6.3	1,107	2.8
WadeCo Specialties, Inc.	22,016	6.2	1,936	4.9
Lignetics, Inc.	18,949	5.4	1,862	4.8
Subtotal five largest investments	110,948	31.5	9,284	23.7
Other portfolio companies	241,425	68.5	29,922	76.3
Total Investment Portfolio	\$ 352,373	100.0%	\$ 39,206	100.0%

^(A) New investment during applicable period.

Expenses

Expenses, net of any non-contractual, unconditional and irrevocable credits to fees from the Adviser, increased \$4.7 million, or 26.4%, for the year ended September 30, 2018 as compared to the prior year period. This increase was primarily due to a \$2.9 million increase in our net base management and incentive fees to the Adviser and a \$2.8 million increase in interest expense on borrowings, partially offset by a \$1.0 million decrease in dividend expense on mandatorily redeemable preferred stock.

Interest expense increased by 90.6% during the year ended September 30, 2018, as compared to the prior year, due primarily to an increase in the weighted average balance outstanding on our Credit Facility. The weighted average balance outstanding during the year ended September 30, 2018, was \$114.7 million, as compared to \$58.4 million in the prior year, an increase of 96.4%. The effective interest rate on our Credit Facility, including unused commitment fees incurred but excluding the impact of deferred financing costs, was 5.1% during the year ended September 30, 2018, compared to 5.3% during the prior year. The decrease in the effective interest rate was driven by a decrease in the marginal interest rate on our Credit Facility effective March 9, 2018 and a decrease in unused commitment fees paid in the current year due to a greater amount outstanding on the credit facility. These factors were partially offset by an increase in LIBOR as compared to the prior year.

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The net base management fee earned by the Adviser increased by \$1.7 million, or 42.2%, during the year ended September 30, 2018, as compared to the prior year, resulting from an increase in average total assets subject to the base management fee and a decrease in credits from the Adviser year over year.

The net income-based incentive fee increased by \$1.2 million, or 48.3%, for the year ended September 30, 2018, as compared to the prior year, due to higher pre-incentive fee net investment income, partially offset by an increase in net assets, which drives the hurdle, over the prior year. Our Board of Directors accepted a non-contractual, unconditional and irrevocable credit from the Adviser of \$1.7 million to reduce the income-based incentive fee to the extent net investment income did not cover 100.0% of our distributions to common stockholders during the year ended September 30, 2018. The credit granted during the year ended September 30, 2017, totaled \$2.3 million.

The base management, loan servicing and incentive fees, and associated non-contractual, unconditional and irrevocable credits, are computed quarterly, as described under Transactions with the Adviser in Note 4 Related Party Transactions of the accompanying Notes to Consolidated Financial Statements and are summarized in the following table:

	Year Ended September 30,	
	2018	2017
Average total assets subject to base management fee ^(A)	\$ 401,886	\$ 330,343
Multiplied by annual base management fee of 1.75%	1.75%	1.75%
Base management fee^(B)	7,033	5,781
Portfolio company fee credit	(1,020)	(1,588)
Syndicated loan fee credit	(364)	(221)
Net Base Management Fee	\$ 5,649	\$ 3,972
Loan servicing fee^(B)	\$ 5,042	\$ 4,146
Credit to base management fee loan servicing fee ^(B)	(5,042)	(4,146)
Net Loan Servicing Fee	\$	\$
Incentive fee^(B)	\$ 5,348	\$ 4,779
Incentive fee credit	(1,697)	(2,317)
Net Incentive Fee	\$ 3,651	\$ 2,462
Portfolio company fee credit	\$ (1,020)	\$ (1,588)
Syndicated loan fee credit	(364)	(221)
Incentive fee credit	(1,697)	(2,317)
Credit to Fees from Adviser - Other^(B)	\$ (3,081)	\$ (4,126)

- (A) Average total assets subject to the base management fee is defined as total assets, including investments made with proceeds of borrowings, less any uninvested cash or cash equivalents resulting from borrowings, valued at the end of the four most recently completed quarters within the respective years and adjusted appropriately for any share issuances or repurchases during the applicable year.
- (B) Reflected, on a gross basis, as a line item on our accompanying *Consolidated Statement of Operations* located elsewhere in this Annual Report on Form 10-K.

Realized Loss and Unrealized Appreciation

Net Realized Loss on Investments

For the year ended September 30, 2018, we recorded a net realized loss on investments of \$26.1 million, which resulted primarily from the restructure of our investment in Sunshine, previously on non-accrual status, and the associated recognition of a \$28.2 million realized loss. This was partially offset by a \$0.7 million realized gain from the sale of a portion of our equity investment in Funko Acquisition Holdings, LLC (Funko) and a \$0.6 million realized gain associated with the sale of our investment in Flight Fit N Fun LLC.

For the year ended September 30, 2017, we recorded a net realized loss on investments of \$3.5 million, which resulted primarily from the sale of substantially all the assets of RBC Acquisition Corp. (RBC) for a \$2.3 million realized loss and the write-off of \$5.0 million on our investment in Sunshine, partially offset by the sale of Behrens Manufacturing, LLC (Behrens) for a \$2.5 million realized gain and a \$1.2 million realized gain related to an additional earn-out from Funko, LLC, which we exited in the prior year.

Table of Contents**Net Realized Loss on Other**

We incurred a loss on extinguishment of debt of \$1.3 million during the year ended September 30, 2017, which resulted from the write-off of unamortized deferred issuance costs at the time of redemption of our 6.75% Series 2021 Term Preferred Stock, par value \$0.001 per share (Series 2021 Preferred Stock) in September 2017.

Net Unrealized Appreciation of Investments

During the year ended September 30, 2018, we recorded net unrealized appreciation of investments in the aggregate amount of \$21.6 million. The net realized gain (loss) and unrealized appreciation (depreciation) across our investments for the year ended September 30, 2018, were as follows:

Portfolio Company	Year Ended September 30, 2018			
	Realized Gain (Loss)	Unrealized Appreciation (Depreciation)	Reversal of Unrealized Depreciation (Appreciation)	Net Gain (Loss)
Edge Adhesives Holdings, Inc.	\$	\$ 2,830	\$	\$ 2,830
United Flexible, Inc.		2,475		2,475
Alloy Die Casting Co.		2,341		2,341
AG Transportation Holdings, LLC		2,083		2,083
Targus Cayman HoldCo, Ltd.		1,677		1,677
PIC 360, LLC		1,306		1,306
Funko Acquisition Holdings, LLC	745	869	(356)	1,258
Sea Link International IRB, Inc.		559		559
Leeds Novamark Capital I, L.P.		526		526
Merlin International, Inc.		450		450
WadeCo Specialties, Inc.		385		385
EL Academies, Inc.		379		379
Precision International, LLC		306		306
RBC Acquisition Corp.	284			284
IA Tech, LLC		267		267
Triple H Food Processors, LLC		236		236
Canopy Safety Brands, LLC		195		195
Funko, LLC	127			127
Flight Fit N Fun LLC	630		(725)	(95)
HB Capital Resources, Ltd.		330	(440)	(110)
Vision Government Solutions, Inc.		(412)		(412)
Frontier Financial Group, Inc.		(500)		(500)
GFRC Holdings, LLC		(519)		(519)
Meridian Rack & Pinion, Inc.		(671)		(671)
Vacation Rental Pros Property Management, LLC		(1,020)		(1,020)
Defiance Integrated Technologies, Inc.		(1,768)		(1,768)
Sunshine Media Holdings	(28,169)	(1,319)	27,660	(1,828)
Arc Drilling Holding LLC		(2,006)		(2,006)

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New Trident Holdcorp, Inc.		(2,794)		(2,794)
LWO Acquisitions Company, LLC		(3,190)		(3,190)
Francis Drilling Fluids, Ltd.		(7,436)		(7,436)
Other, net (<\$250)	320	28	(105)	243
Total:	\$ (26,063)	\$ (4,393)	\$ 26,034	\$ (4,422)

The primary drivers of our net unrealized appreciation for the year ended September 30, 2018, were the reversal of previously recorded depreciation on our investment in Sunshine upon restructure and improved performance on certain of our portfolio companies, namely Edge Adhesives Holdings, Inc. These factors were partially offset by a decline in performance of certain of our other portfolio companies, namely FDF.

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During the year ended September 30, 2017, we recorded net unrealized appreciation of investments in the aggregate amount of \$0.6 million. The net realized gain (loss) and unrealized appreciation (depreciation) across our investments for the year ended September 30, 2017, were as follows:

Portfolio Company	Year Ended September 30, 2017			
	Realized Gain (Loss)	Unrealized Appreciation (Depreciation)	Reversal of Unrealized Depreciation (Appreciation)	Net Gain (Loss)
WadeCo Specialties, Inc.	\$	\$ 2,900	\$	\$ 2,900
SourceHOV LLC	(218)	1,756	97	1,635
Funko, LLC	1,273	(106)		1,167
Targus Cayman HoldCo, Ltd.		662		662
LWO Acquisitions Company, LLC		608		608
Flight Fit N Fun LLC		456		456
IA Tech, LLC		403		403
Vitera Healthcare Solutions, LLC		213	115	328
PIC 360, LLC		315		315
B+T Group Acquisition Inc.		305		305
Travel Sentry, Inc.		255		255
Leeds Novamark Capital I, L.P.		229		229
NetFortris Corp.	(14)	239		225
PSC Industrial Holdings Corp.		219		219
United Flexible, Inc.		177		177
Drumcree, LLC		169	(15)	154
Merlin International, Inc.		150		150
Vision Government Solutions, Inc.		141		141
TWS Acquisition Corporation		127		127
Westland Technologies, Inc.	126			126
Meridian Rack & Pinion, Inc.		(246)		(246)
L Discovery		(265)		(265)
Edge Adhesives Holdings, Inc.		(468)		(468)
FedCap Partners, LLC		(514)		(514)
Behrens Manufacturing, LLC	2,544		(3,211)	(667)
New Trident Holdcorp, Inc.		(878)		(878)
Defiance Integrated Technologies, Inc.		(1,125)		(1,125)
RBC Acquisition Corp.	(2,330)		1,119	(1,211)
Vertellus Holdings LLC	109	(1,456)		(1,347)
Francis Drilling Fluids, Ltd.		(2,066)		(2,066)
Alloy Die Casting, Corp.		(2,303)		(2,303)
Sunshine Media Holdings	(5,000)	(995)	3,612	(2,383)
Other, net (<\$250)	35	33	(27)	41
Total:	\$ (3,475)	\$ (1,065)	\$ 1,690	\$ (2,850)

The primary drivers of our net unrealized appreciation for the year ended September 30, 2017, were an increase in the value of WadeCo, increased performance on certain of our portfolio companies, and the reversal of previously recorded depreciation on our investment in Sunshine upon partial write-off. These factors were partially offset by a decline in performance and decrease in comparable multiples used in the valuation of certain of our other portfolio companies and the reversal of \$3.2 million of previously recorded unrealized appreciation on our investment in Behrens upon exit.

As of September 30, 2018, the fair value of our investment portfolio was less than its cost basis by approximately \$37.4 million and our entire investment portfolio was valued at 91.2% of cost, as compared to cumulative net unrealized depreciation of \$59.1 million and a valuation of our entire portfolio at 85.6% of cost as of September 30, 2017. This year over year increase in the cumulative unrealized depreciation on investments represents net unrealized appreciation of \$21.6 million for the year ended September 30, 2018.

The cumulative net unrealized depreciation of our investments does not have an impact on our current ability to pay distributions to stockholders; however, it may be an indication of future realized losses, which could ultimately reduce our income available for distribution to stockholders.

Table of Contents**Net Unrealized (Appreciation) Depreciation of Other**

During the year ended September 30, 2018, we recorded \$0.1 million of unrealized appreciation on our Credit Facility at fair value as compared to \$0.1 million of unrealized depreciation during the year ended September 30, 2017.

Comparison of the Year Ended September 30, 2017 to the Year Ended September 30, 2016

	For the Year Ended September 30,			
	2017	2016	\$ Change	% Change
INVESTMENT INCOME				
Interest income	\$ 37,073	\$ 35,219	\$ 1,854	5.3%
Other income	2,160	3,893	(1,733)	(44.5)
Total investment income	39,233	39,112	121	0.3
EXPENSES				
Base management fee	5,781	5,684	97	1.7
Loan servicing fee	4,146	3,890	256	6.6
Incentive fee	4,779	4,514	265	5.9
Administration fee	1,102	1,182	(80)	(6.8)
Interest expense on borrowings	3,073	2,899	174	6.0
Dividend expense on mandatorily redeemable preferred stock	4,152	4,118	34	0.8
Amortization of deferred financing fees	1,094	1,075	19	1.8
Other expenses	1,945	2,459	(514)	(20.9)
Expenses, before credits from Adviser	26,072	25,821	251	1.0
Credit to base management fee loan servicing fee	(4,146)	(3,890)	(256)	6.6
Credit to fees from Adviser - other	(4,126)	(2,306)	(1,820)	78.9
Total expenses, net of credits	17,800	19,625	(1,825)	(9.3)
NET INVESTMENT INCOME	21,433	19,487	1,946	10.0
NET REALIZED AND UNREALIZED (LOSS) GAIN				
Net realized (loss) gain on investments	(3,475)	7,216	(10,691)	(148.2)
Net realized loss on other	(1,288)	(64)	(1,224)	(1,912.5)
Net unrealized appreciation (depreciation) of investments	625	(15,334)	15,959	104.1
Net unrealized (depreciation) appreciation of other	(115)	62	(177)	(285.5)
Net loss from investments and other	(4,253)	(8,120)	3,867	47.6
	\$ 17,180	\$ 11,367	\$ 5,813	51.1%

NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS

PER BASIC AND DILUTED COMMON SHARE

Net investment income	\$ 0.84	\$ 0.84	\$	%
Net increase in net assets resulting from operations	\$ 0.67	\$ 0.49	\$ 0.18	36.7%

Investment Income

Interest income increased by 5.3% for the year ended September 30, 2017, as compared to the prior year. This increase was due primarily to an increase in the weighted average yield on our interest-bearing portfolio. The weighted average yield on our interest-bearing investments is based on the current stated interest rate on interest-bearing investments which increased to 11.6% for the year ended September 30, 2017 compared to 11.1% for the year ended September 30, 2016, inclusive of any allowances on interest receivables made during those periods. The weighted average principal balance of our interest-bearing investment portfolio during the year ended September 30, 2017, was \$320.1 million, compared to \$317.0 million for the prior year, an increase of \$3.1 million, or 1.0%.

As of September 30, 2017, certain loans to two portfolio companies, Sunshine and ADC, were on non-accrual status, with an aggregate debt cost basis of approximately \$27.9 million, or 7.5% of the cost basis of all debt investments in our portfolio. As of September 30, 2016, certain loans to two portfolio companies, Sunshine and Vertellus Holdings, LLC, were on non-accrual status, with an aggregate debt cost basis of approximately \$26.5 million, or 7.7% of the cost basis of all debt investments in our portfolio.

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Other income decreased by 44.5% during the year ended September 30, 2017, as compared to the prior year. This decrease was primarily due to a \$1.9 million decrease in success fees recognized year over year. For the year ended September 30, 2017, other income consisted primarily of \$1.5 million in success fees recognized, \$0.3 million in dividend income, and \$0.3 million in prepayment fees received. For the year ended September 30, 2016, other income consisted primarily of \$3.4 million in success fees recognized, \$0.3 million in dividend income, and \$0.2 million in prepayment fees.

The following tables list the investment income for our five largest portfolio company investments at fair value during the respective years:

	As of September 30, 2017		Year Ended September 30, 2017	
				% of Total
Portfolio Company	Fair Value	% of Portfolio	Investment Income	Investment Income
NetFortris Corp. ^(A)	\$ 24,240	6.9%	\$ 1,566	4.0%
IA Tech, LLC	23,633	6.7	2,813	7.2
HB Capital Resources, Ltd. ^(A)	22,110	6.3	1,107	2.8
WadeCo Specialties, Inc.	22,016	6.2	1,936	4.9
Lignetics, Inc.	18,949	5.4	1,862	4.8
Subtotal five largest investments	110,948	31.5	9,284	23.7
Other portfolio companies	241,425	68.5	29,922	76.3
Total Investment Portfolio	\$ 352,373	100.0%	\$ 39,206	100.0%

	As of September 30, 2016		Year Ended September 30, 2016	
				% of Total
Portfolio Company	Fair Value	% of Portfolio	Investment Income	Investment Income
RBC Acquisition Corp.	\$ 37,345	11.6%	\$ 3,347	8.6%
IA Tech, LLC ^(A)	23,230	7.2	888	2.3
WadeCo Specialties, Inc.	18,980	5.9	2,059	5.3
United Flexible, Inc.	17,744	5.5	2,108	5.4
Lignetics, Inc.	14,821	4.6	1,708	4.3
Subtotal five largest investments	112,120	34.8	10,110	25.9
Other portfolio companies	209,994	65.2	28,997	74.1
Total Investment Portfolio	\$ 322,114	100.0%	\$ 39,107	100.0%

^(A) New investment during applicable period.

Expenses

Expenses, net of credits from the Adviser, decreased by 9.3% for the year ended September 30, 2017 as compared to the prior year. This decrease was primarily due to decreases in our net base management and incentive fees to the Advisor.

Interest expense increased by 6.0% during the year ended September 30, 2017, as compared to the prior year, due to an increase in the LIBOR component of the effective interest rate partially offset by a lower weighted average balance outstanding. The effective interest rate on our Credit Facility, excluding the impact of deferred financing costs, was 5.3% during the year ended September 30, 2017 compared to 4.5% during the prior year period. The weighted average balance outstanding on our Credit Facility during the year ended September 30, 2017, was approximately \$58.4 million, as compared to \$64.0 million in the prior year period, a decrease of 8.8%.

Other expenses decreased by 20.9% during the year ended September 30, 2017, as compared to the prior year, primarily due to decreases in shareholder related costs and professional fees.

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Net base management fee earned by the Adviser decreased by \$0.8 million, or 17.4%, during the year ended September 30, 2017, as compared to the prior year period, resulting from an increase in portfolio company fee credits due to new investments made in the current year period.

Our Board of Directors accepted non-contractual, unconditional and irrevocable credits from the Adviser to reduce the income-based incentive fee to the extent net investment income did not cover 100.0% of our distributions to common stockholders during the years ended September 30, 2017 and 2016, which credits totaled \$2.3 million and \$1.4 million, respectively.

The base management, loan servicing and incentive fees, and associated non-contractual, unconditional and irrevocable credits, are computed quarterly, as described under *Transactions with the Adviser* in Note 4 *Related Party Transactions* of the accompanying *Notes to Consolidated Financial Statements* and are summarized in the following table:

	Year Ended September 30,	
	2017	2016
Average total assets subject to base management fee ^(A)	\$ 330,343	\$ 324,800
Multiplied by annual base management fee of 1.75%	1.75%	1.75%
Base management fee^(B)	5,781	5,684
Portfolio company fee credit	(1,588)	(785)
Syndicated loan fee credit	(221)	(92)
Net Base Management Fee	\$ 3,972	\$ 4,807
Loan servicing fee^(B)	\$ 4,146	\$ 3,890
Credit to base management fee loan servicing fee ^(B)	(4,146)	(3,890)
Net Loan Servicing Fee	\$	\$
Incentive fee^(B)	\$ 4,779	\$ 4,514
Incentive fee credit	(2,317)	(1,429)
Net Incentive Fee	\$ 2,462	\$ 3,085
Portfolio company fee credit	\$ (1,588)	\$ (785)
Syndicated loan fee credit	(221)	(92)
Incentive fee credit	(2,317)	(1,429)
Credit to Fees from Adviser - Other^(B)	\$ (4,126)	\$ (2,306)

(C)

Average total assets subject to the base management fee is defined as total assets, including investments made with proceeds of borrowings, less any uninvested cash or cash equivalents resulting from borrowings, valued at the end of the four most recently completed quarters within the respective years and adjusted appropriately for any share issuances or repurchases during the applicable year.

- (D) Reflected, on a gross basis, as a line item on our accompanying *Consolidated Statement of Operations* located elsewhere in this Annual Report on Form 10-K.

Realized Loss and Unrealized Appreciation

Net Realized Loss on Investments

For the year ended September 30, 2017, we recorded a net realized loss on investments of \$3.5 million, which resulted primarily from the sale of substantially all the assets of RBC for a \$2.3 million realized loss and the write-off of \$5.0 million on our investment in Sunshine, partially offset by the sale of Behrens for a \$2.5 million realized gain and a \$1.2 million realized gain related to an additional earn-out from Funko, LLC, which we exited in the prior year.

For the year ended September 30, 2016, we recorded a net realized gain on investments of \$7.2 million, which resulted primarily from the sales of Funko, LLC, Southern Petroleum Laboratories, Inc., Westland Technologies, Inc., and Ashland Acquisitions, LLC (Ashland) for a combined realized gain of \$18.7 million and net proceeds of \$35.4 million. This realized gain was partially offset by a combined realized loss of \$11.7 million recognized from the sale of Heartland Communications Group and the restructures of Targus Group International, Inc. (Targus) and Precision Acquisition Group Holdings, Inc. during the year ended September 30, 2016. We also recognized a realized loss of \$0.6 million during the year ended September 30, 2016 related to a settlement associated with WP Evenflo Group Holdings, Inc., which we previously exited at a realized gain of \$1.0 million in September 2014.

Table of Contents**Net Realized Loss on Other**

We incurred a loss on extinguishment of debt of \$1.3 million during the year ended September 30, 2017, which resulted from the write-off of unamortized deferred issuance costs at the time of redemption of our Series 2021 Preferred Stock in September 2017. During the year ended September 30, 2016, we recorded a net realized loss of \$0.1 million due to the expiration of our interest rate cap agreement in January 2016.

Net Unrealized Appreciation of Investments

During the year ended September 30, 2017, we recorded net unrealized appreciation of investments in the aggregate amount of \$0.6 million. The net realized gain (loss) and unrealized appreciation (depreciation) across our investments for the year ended September 30, 2017, were as follows:

Portfolio Company	Year Ended September 30, 2017			
	Realized Gain (Loss)	Unrealized Appreciation (Depreciation)	Reversal of Unrealized Depreciation (Appreciation)	Net Gain (Loss)
WadeCo Specialties, Inc.	\$	\$ 2,900	\$	\$ 2,900
SourceHOV LLC	(218)	1,756	97	1,635
Funko, LLC	1,273	(106)		1,167
Targus Cayman HoldCo, Ltd.		662		662
LWO Acquisitions Company, LLC		608		608
Flight Fit N Fun LLC		456		456
IA Tech, LLC		403		403
Vitera Healthcare Solutions, LLC		213	115	328
PIC 360, LLC		315		315
B+T Group Acquisition Inc.		305		305
Travel Sentry, Inc.		255		255
Leeds Novamark Capital I, L.P.		229		229
NetFortris Corp.	(14)	239		225
PSC Industrial Holdings Corp.		219		219
United Flexible, Inc.		177		177
Drumcree, LLC		169	(15)	154
Merlin International, Inc.		150		150
Vision Government Solutions, Inc.		141		141
TWS Acquisition Corporation		127		127
Westland Technologies, Inc.	126			126
Meridian Rack & Pinion, Inc.		(246)		(246)
L Discovery		(265)		(265)
Edge Adhesives Holdings, Inc.		(468)		(468)
FedCap Partners, LLC		(514)		(514)
Behrens Manufacturing, LLC	2,544		(3,211)	(667)
New Trident Holdcorp, Inc.		(878)		(878)
Defiance Integrated Technologies, Inc.		(1,125)		(1,125)
RBC Acquisition Corp.	(2,330)		1,119	(1,211)

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Vertellus Holdings LLC	109	(1,456)		(1,347)
Francis Drilling Fluids, Ltd.		(2,066)		(2,066)
Alloy Die Casting, Corp.		(2,303)		(2,303)
Sunshine Media Holdings	(5,000)	(995)	3,612	(2,383)
Other, net (<\$250)	35	33	(27)	41
Total:	\$ (3,475)	\$ (1,065)	\$ 1,690	\$ (2,850)

The primary drivers of our net unrealized appreciation for the year ended September 30, 2017, were an increase in the value of WadeCo, increased performance on certain of our portfolio companies, and the reversal of previously recorded depreciation on our investment in Sunshine upon partial write-off. These factors were partially offset by a decline in performance and decrease in comparable multiples used in the valuation of certain of our other portfolio companies and the reversal of \$3.2 million of previously recorded unrealized appreciation on our investment in Behrens upon exit.

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The net realized gain (loss) and unrealized appreciation (depreciation) across our investments for the year ended September 30, 2016, were as follows:

Portfolio Company	Year Ended September 30, 2016			
	Realized Gain (Loss)	Unrealized Appreciation (Depreciation)	Reversal of Unrealized Depreciation (Appreciation)	Net Gain (Loss)
RBC Acquisition Corp.	\$ 1,207	\$ 11,896	\$	\$ 13,103
Legend Communications of Wyoming, LLC		2,857	27	2,884
Behrens Manufacturing, LLC		2,206		2,206
Funko, LLC	16,874	98	(16,009)	963
Southern Petroleum Laboratories, Inc.	873	871	(995)	749
Precision Acquisition Group Holdings, Inc.	(3,821)	(1,282)	5,805	702
Westland Technologies, Inc.	909	622	(866)	665
J. America, Inc.		482		482
Triple H Food Processors, LLC		351		351
RP Crown Parent, LLC		276		276
GFRC Holdings, LLC		(271)		(271)
Ashland Acquisitions, LLC	72	183	(572)	(317)
Mikawaya		(379)		(379)
FedCap Partners, LLC		(381)		(381)
New Trident Holdcorp, Inc.		(442)		(442)
AG Transportation Holdings, LLC		(454)		(454)
WP Evenflo Group Holdings, Inc.	(550)			(550)
WadeCo Specialties, Inc.		(722)		(722)
Vision Government Solutions, Inc.		(779)		(779)
Vertellus Specialties Inc.		(975)		(975)
Lignetics, Inc.		(1,251)		(1,251)
SourceHOV LLC		(1,380)		(1,380)
LWO Acquisitions Company, LLC		(3,170)		(3,170)
Defiance Integrated Technologies, Inc.		(3,184)		(3,184)
Sunshine Media Holdings		(3,360)		(3,360)
Targus Cayman HoldCo, Ltd.	(5,500)	(2,952)	4,198	(4,254)
Francis Drilling Fluids, Ltd.		(8,156)		(8,156)
Other, net (<\$250)	(2,848)	(528)	2,902	(474)
Total:	\$ 7,216	\$ (9,824)	\$ (5,510)	\$ (8,118)

The primary drivers of our net unrealized depreciation for the year ended September 30, 2016, were a decline in financial and operation performance of certain portfolio companies and the reversal of \$16.0 million of previously recorded unrealized appreciation on our investment in Funko, LLC upon exit. This depreciation was partially offset by unrealized appreciation, primarily on RBC of \$11.9 million, which was driven by proceeds received associated with the sale of RBC in November 2016, and the reversal of \$4.2 million of previously recorded unrealized depreciation on

our investment in Targus upon restructure.

As of September 30, 2017, the fair value of our investment portfolio was less than its cost basis by approximately \$59.1 million and our entire investment portfolio was valued at 85.6% of cost, as compared to cumulative net unrealized depreciation of \$59.7 million and a valuation of our entire portfolio at 84.4% of cost as of September 30, 2016. This year over year increase in the cumulative unrealized depreciation on investments represents net unrealized appreciation of \$0.6 million for the year ended September 30, 2017.

The cumulative net unrealized depreciation of our investments does not have an impact on our current ability to pay distributions to stockholders; however, it may be an indication of future realized losses, which could ultimately reduce our income available for distribution to stockholders.

Net Unrealized (Appreciation) Depreciation of Other

During the year ended September 30, 2017, we recorded \$0.1 million of unrealized depreciation on our Credit Facility at fair value. During the year ended September 30, 2016, we reversed \$0.1 million of unrealized depreciation related to the expiration of our interest rate cap agreement in January 2016.

Table of Contents**LIQUIDITY AND CAPITAL RESOURCES****Operating Activities**

Our cash flows from operating activities are primarily generated from the interest payments on debt securities that we receive from our portfolio companies, as well as net proceeds received through repayments or sales of our investments. We utilize this cash primarily to fund new investments, make interest payments on our Credit Facility, make distributions to our stockholders, pay management and administrative fees to the Adviser and Administrator, and for other operating expenses.

Net cash used in operating activities for the year ended September 30, 2018 was \$17.6 million as compared to \$12.9 million for the year ended September 30, 2017. The change was primarily due to a decrease in principal repayments and net proceeds from sales of investments partially offset by a decrease in purchases of investments year over year. Repayments and net proceeds from sales were \$67.9 million during the year ended September 30, 2018 compared to \$83.4 million during the year ended September 30, 2017. Purchase of investments was \$106.6 million during the year ended September 30, 2018, compared to \$112.1 million during the year ended September 30, 2017.

Net cash used in operating activities for the year ended September 30, 2017 was \$12.9 million as compared to net cash provided by operating activities of \$60.0 million for the year ended September 30, 2016. The change was primarily due to an increase in purchases of investments and a decrease in principal repayments on investments and net proceeds from sale of investments period over period. Purchases of investments were \$112.1 million during the year ended September 30, 2017 compared to \$80.0 million during the prior year period. Repayments and net proceeds from sales were \$83.4 million during the year ended September 30, 2017 compared to \$121.1 million during the year ended September 30, 2016.

As of September 30, 2018, we had loans to, syndicated participations in or equity investments in 50 companies, with an aggregate cost basis of approximately \$427.5 million. As of September 30, 2017, we had loans to, syndicated participations in or equity investments in 47 companies, with an aggregate cost basis of approximately \$411.4 million.

The following table summarizes our total portfolio investment activity during the years ended September 30, 2018 and 2017:

	Year Ended September 30,	
	2018	2017
Beginning investment portfolio, at fair value	\$ 352,373	\$ 322,114
New investments	67,936	99,241
Disbursements to existing portfolio companies	38,679	12,851
Scheduled principal repayments	(6,455)	(3,646)
Unscheduled principal repayments	(58,941)	(71,558)
Net proceeds from sales of investments	(2,548)	(8,240)
Net unrealized depreciation of investments	(4,393)	(1,065)
Reversal of prior period net depreciation of investments	26,034	1,690
Net realized loss on investments	(26,818)	(3,475)
Increase in investment balance due to PIK interest ^(A)	4,060	4,729
Net change in premiums, discounts and amortization	119	(268)

Ending Investment Portfolio, at Fair Value **\$ 390,046** \$ 352,373

(A) PIK interest is a non-cash source of income and is calculated at the contractual rate stated in a loan agreement and added to the principal balance of a loan.

The following table summarizes the contractual principal repayment and maturity of our investment portfolio by fiscal year, assuming no voluntary prepayments, at September 30, 2018.

Year Ending September 30,	Amount
2019	\$ 39,272
2020	81,633
2021	68,819
2022	46,687
2023	115,796
Thereafter	38,975
Total contractual repayments	\$ 391,182
Equity investments	36,961
Adjustments to cost basis on debt investments	(676)
Investment Portfolio as of September 30, 2018, at Cost:	\$ 427,467

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Financing Activities

Net cash provided by financing activities for the year ended September 30, 2018 was \$14.5 million, which consisted primarily of \$17.0 million in net borrowings on our Credit Facility and \$22.0 million in proceeds from the issuance of common stock, partially offset by \$22.8 million in distributions to common stockholders.

Net cash provided by financing activities for the year ended September 30, 2017 was \$11.7 million, which consisted primarily of \$21.7 million in net borrowings on our Credit Facility and \$22.7 million in proceeds from the issuance of common stock, partially offset by \$21.4 million in distributions to common stockholders and a net decrease of \$9.3 million in term preferred stock due to the redemption of our Series 2021 Term Preferred Stock and issuance of a lesser amount of Series 2024 Term Preferred Stock.

Net cash used in financing activities for the year ended September 30, 2016 was \$57.7 million, which consisted primarily of \$56.0 million in net repayments on our Credit Facility and \$19.5 million in distributions to common stockholders, partially offset by \$19.7 million in proceeds from the issuance of common stock, net of underwriting costs.

Distributions to Stockholders

Common Stock Distributions

To qualify to be taxed as a RIC and thus avoid corporate level federal income tax on the income we distribute to our stockholders, we are required to distribute to our stockholders on an annual basis at least 90.0% of our investment company taxable income. Additionally, our Credit Facility has a covenant that generally restricts the amount of distributions to stockholders that we can pay out to be no greater than our aggregate net investment income, net capital gains and amounts elected to have been paid during the prior year in accordance with Section 855(a) of the Code. In accordance with these requirements, we paid monthly cash distributions of \$0.07 per common share for each month during the years ended September 30, 2018, 2017 and 2016, which totaled an aggregate of \$22.8 million, \$21.4 million and \$19.5 million, respectively. In October 2018, our Board of Directors declared a monthly distribution of \$0.07 per common share for each of October, November and December 2018. Our Board of Directors declared these distributions to our stockholders based on our estimates of our investment company taxable income for the fiscal year ending September 30, 2019. From inception through September 30, 2018, we have paid 188 either monthly or quarterly consecutive distributions to common stockholders totaling approximately \$320.6 million or \$18.61 per share.

For each of the fiscal years ended September 30, 2018, 2017, and 2016, Investment Company Taxable Income exceeded distributions declared and paid, and, in accordance with Section 855(a) of the Code, we elected to treat \$0.3 million, \$0.3 million, and \$5.5 million, respectively, of the first distributions paid to common stockholders in the respective subsequent fiscal year as having been paid in the respective prior year.

Preferred Stock Dividends

Our Board of Directors declared and we paid monthly cash dividends of \$0.140625 per share to holders of our Series 2021 Term Preferred Stock for each month during the years ended September 30, 2017 and 2016, which totaled an aggregate of \$4.1 million during each of the years ended September 30, 2017 and 2016. In October 2017, our Board of Directors declared a combined dividend for the pro-rated period from and including the issuance date, September 27, 2017, to and including September 30, 2017 and the full month of October 2017, which totaled \$0.141667 per share, to the holders of our Series 2024 Term Preferred Stock and monthly cash dividends of \$0.125 per share to holders of our

Series 2024 Term Preferred Stock for each of the eleven months from November 2017 through September 2018.

In accordance with GAAP, we treat these monthly dividends as an operating expense. For federal income tax purposes, the dividends paid by us to preferred stockholders generally constitute ordinary income to the extent of our current and accumulated earnings and profits and is reported after the end of the calendar year based on tax information for the full fiscal year. Such a characterization made on an interim, quarterly basis may not be representative of the actual tax characterization for the full year.

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Dividend Reinvestment Plan

Our common stockholders who hold their shares through our transfer agent, Computershare, Inc. (Computershare), have the option to participate in a dividend reinvestment plan offered by Computershare, as the plan agent. This is an opt in dividend reinvestment plan, meaning that common stockholders may elect to have their cash distributions automatically reinvested in additional shares of our common stock. Common stockholders who do make such election will receive their distributions in cash. Common stockholders who receive distributions in the form of stock will be subject to the same federal, state and local tax consequences as stockholders who elect to receive their distributions in cash. The common stockholder will have an adjusted basis in the additional common shares purchased through the plan equal to the amount of the reinvested distribution. The additional shares will have a new holding period commencing on the day following the date on which the shares are credited to the common stockholder's account. Computershare purchases shares in the open market in connection with the obligations under the plan. The Computershare dividend reinvestment plan is not open to holders of our preferred stock.

Equity

Registration Statement

We filed Post-Effective Amendment No. 5 to our current universal shelf registration statement on Form N-2 (our Registration Statement) (File No. 333-208637) with the SEC on December 19, 2017, which was declared effective by the SEC on February 1, 2018. Our Registration Statement permits us to issue, through one or more transactions, up to an aggregate of \$300.0 million in securities, consisting of common stock, preferred stock, subscription rights, debt securities and warrants to purchase common stock, preferred stock or debt securities. As of September 30, 2018, we had the ability to issue up to \$202.6 million in securities under the Registration Statement.

Common Stock

In February 2015, we entered into equity distribution agreements (commonly referred to as at-the-market agreements or the Sales Agreements) with KeyBanc Capital Markets Inc. and Cantor Fitzgerald & Co., each a Sales Agent, under which we had the ability to issue and sell, from time to time, through the Sales Agents, up to an aggregate offering price of \$50.0 million shares of our common stock. In May 2017, we terminated the Sales Agreement with KeyBanc Capital Markets Inc. and amended the Sales Agreement with Cantor Fitzgerald & Co. to reference our current registration statement. All other material terms of the Sales Agreement with Cantor Fitzgerald & Co. remained unchanged. During the year ended September 30, 2018, we sold 2,341,296 shares of our common stock under the Sales Agreement with Cantor Fitzgerald & Co., at a weighted-average price of \$9.39 per share and raised \$22.0 million of gross proceeds. Net proceeds, after deducting commissions and offering costs borne by us, were approximately \$21.6 million. As of September 30, 2018, we had a remaining capacity to sell up to \$20.5 million of common stock under the Sales Agreement with Cantor Fitzgerald & Co. During the year ended September 30, 2017, we sold 642,818 shares of our common stock under the Sales Agreement with Cantor Fitzgerald & Co., at a weighted-average price of \$9.88 per share and raised \$6.4 million of gross proceeds. Net proceeds, after deducting commissions and offering costs borne by us, were approximately \$6.1 million.

Pursuant to our Registration Statement, in October 2016, we completed a public offering of 2.0 million shares of our common stock at a public offering price of \$7.98 per share, which was below our then-current NAV per share. In November 2016, the underwriters partially exercised their overallotment option to purchase an additional 173,444 shares of our common stock. Gross proceeds totaled \$17.3 million and net proceeds, after deducting underwriting discounts and offering costs borne by us, were approximately \$16.4 million. The net proceeds of this offering were used to repay borrowings under our Credit Facility.

We anticipate issuing equity securities to obtain additional capital in the future. However, we cannot determine the timing or terms of any future equity issuances or whether we will be able to issue equity on terms favorable to us, or at all. To the extent that our common stock trades at a market price below our NAV per share, we will generally be precluded from raising equity capital through public offerings of our common stock, other than pursuant to stockholder and independent director approval or a rights offering to existing common stockholders. We did not request that our stockholders approve the Company's ability to issue shares of common stock at a price below NAV at our annual meeting of stockholders held on February 8, 2018. Should we decide to issue shares of common stock at a price below NAV in the future, we will seek the requisite approval of our stockholders at such time.

On November 13, 2018, the closing market price of our common stock was \$9.28, an 11.5% premium to our September 30, 2018 NAV per share of \$8.32.

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Pursuant to our Registration Statement, in September 2017, we completed a public offering of approximately 2.1 million shares of our Series 2024 Term Preferred Stock at a public offering price of \$25.00 per share. Gross proceeds totaled \$51.8 million and net proceeds, after deducting underwriting discounts, commissions and offering expenses borne by us, were approximately \$49.8 million. We incurred approximately \$1.9 million in total underwriting discounts and offering costs related to the issuance of the Series 2024 Term Preferred Stock, which have been recorded as discounts to the liquidation value on our accompanying Consolidated Statements of Assets and Liabilities and are being amortized over the period from issuance through September 30, 2024, the mandatory redemption date. The offering proceeds plus borrowings under our Credit Facility were used to voluntarily redeem all 2.4 million outstanding shares of our then existing Series 2021 Term Preferred Stock, par value \$0.001 per share. In connection with the voluntary redemption of our Series 2021 Term Preferred Stock, we incurred a loss on extinguishment of debt of \$1.3 million, which has been reflected in Realized loss on other in our accompanying Consolidated Statement of Operations and which is primarily comprised of the unamortized deferred issuance costs at the time of redemption.

The shares of our Series 2024 Term Preferred Stock are traded under the ticker symbol `GLADN` on the Nasdaq Global Select Market. Our Series 2024 Term Preferred Stock is not convertible into our common stock or any other security and provides for a fixed dividend equal to 6.00% per year, payable monthly (which equates in total to approximately \$3.1 million per year). We are required to redeem all of the outstanding Series 2024 Term Preferred Stock on September 30, 2024 for cash at a redemption price equal to \$25.00 per share plus an amount equal to all unpaid dividends and distributions per share accumulated to (but excluding) the date of redemption (the *Redemption Price*). We may additionally be required to mandatorily redeem some or all of the shares of our Series 2024 Term Preferred Stock early, at the Redemption Price, in the event of the following: (1) upon the occurrence of certain events that would constitute a change in control, or (2) if we fail to maintain an asset coverage of at least 200% on our senior securities that are stock (which is currently only our Series 2024 Term Preferred Stock) and the failure remains for a period of 30 days following the filing date of our next SEC quarterly or annual report. The asset coverage on our senior securities that are stock as of September 30, 2018 was 244.4%, calculated in accordance with Sections 18 and 61 of the 1940 Act.

We may also voluntarily redeem all or a portion of the Series 2024 Term Preferred Stock at our option at the Redemption Price at any time after September 30, 2019. If we fail to redeem our Series 2024 Term Preferred Stock pursuant to the mandatory redemption required on September 30, 2024, or in any other circumstance in which we are required to mandatorily redeem our Series 2024 Term Preferred Stock, then the fixed dividend rate will increase by 4.0% for so long as such failure continues. As of September 30, 2018, we have not redeemed, nor have we been required to redeem, any shares of our outstanding Series 2024 Term Preferred Stock.

Revolving Credit Facility

On March 9, 2018, we, through Business Loan, entered into Amendment No. 4 to our Credit Facility with KeyBank, which increased the commitment amount from \$170.0 million to \$190.0 million, extended the revolving period end date by approximately 2 years to January 15, 2021, decreased the marginal interest rate added to 30-day LIBOR from 3.25% to 2.85% per annum, and changed the unused commitment fee from 0.50% of the total unused commitment amount to 0.50% when the average unused commitment amount for the reporting period is less than or equal to 50%, 0.75% when the average unused commitment amount for the reporting period is greater than 50% but less than or equal to 65%, and 1.00% when the average unused commitment amount for the reporting period is greater than 65%. If our Credit Facility is not renewed or extended by January 15, 2021, all principal and interest will be due and payable on or before April 15, 2022 (fifteen months after the revolving period end date). Subject to certain terms and

conditions, our Credit Facility may be expanded up to a total of \$265.0 million through additional commitments of new or existing lenders. We incurred fees of approximately \$1.2 million in connection with this amendment, which are being amortized through our Credit Facility's revolving period end date of January 15, 2021.

Interest is payable monthly during the term of our Credit Facility. Available borrowings are subject to various constraints imposed under our Credit Facility, based on the aggregate loan balance pledged by Business Loan, which varies as loans are added and repaid, regardless of whether such repayments are prepayments or made as contractually required. Our Credit Facility also requires that any interest or principal payments on pledged loans be remitted directly by the borrower into a lockbox account with KeyBank and with The Bank of New York Mellon Trust Company, N.A. as custodian. KeyBank, which also serves as the trustee of the account, generally remits the collected funds to us once a month.

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Our Credit Facility contains covenants that require Business Loan to maintain its status as a separate legal entity, prohibit certain significant corporate transactions (such as mergers, consolidations, liquidations or dissolutions), and restrict material changes to our credit and collection policies without the lenders' consents. Our Credit Facility generally limits distributions to our stockholders on a fiscal year basis to the sum of our net investment income, net capital gains and amounts elected to have been paid during the prior year in accordance with Section 855(a) of the Code. Business Loan is also subject to certain limitations on the type of loan investments it can apply as collateral towards the borrowing base to receive additional borrowing availability under our Credit Facility, including restrictions on geographic concentrations, sector concentrations, loan size, payment frequency and status, average life, portfolio company leverage and lien property. Our Credit Facility further requires Business Loan to comply with other financial and operational covenants, which obligate Business Loan to, among other things, maintain certain financial ratios, including asset and interest coverage and a minimum number of 25 obligors required in the borrowing base.

Additionally, we are subject to a performance guaranty that requires us to maintain (i) a minimum net worth (defined in our Credit Facility to include our mandatorily redeemable preferred stock) of \$205.0 million plus 50% of all equity and subordinated debt raised after May 1, 2015 less 50% of any equity and subordinated debt retired or redeemed after May 1, 2015, which equates to \$232.8 million as of September 30, 2018, (ii) asset coverage with respect to senior securities representing indebtedness of at least 200%, in accordance with Sections 18 and 61 of the 1940 Act and (iii) our status as a BDC under the 1940 Act and as a RIC under the Code.

As of September 30, 2018, and as defined in the performance guaranty of our Credit Facility, we had a net worth of \$285.8 million, asset coverage on our senior securities representing indebtedness of 359.0% and an active status as a BDC and RIC. In addition, we had 32 obligors in our Credit Facility's borrowing base as of September 30, 2018. As of September 30, 2018, we were in compliance with all of our Credit Facility covenants. Refer to Note 5 Borrowings of our accompanying Note to Consolidated Financial Statements included elsewhere in this Annual Report on Form 10-K for additional information regarding our Credit Facility.

Off-Balance Sheet Arrangements

We generally recognize success fee income when the payment has been received. As of September 30, 2018 and 2017, we had off-balance sheet success fee receivables on our accruing debt investments of \$5.1 million and \$4.6 million (or approximately \$0.18 per common share for each period), respectively, that would be owed to us, generally upon a change of control of the portfolio companies. Consistent with GAAP, we generally have not recognized our success fee receivables and related income in our Consolidated Financial Statements until earned. Due to the contingent nature of our success fees, there are no guarantees that we will be able to collect all of these success fees or know the timing of such collections.

Contractual Obligations

We have lines of credit, delayed draw term loans, and an uncalled capital commitment with certain of our portfolio companies that have not been fully drawn. Since these commitments have expiration dates and we expect many will never be fully drawn, the total commitment amounts do not necessarily represent future cash requirements. We estimate the fair value of the combined unused lines of credit, the unused delayed draw term loans and the uncalled capital commitment as of September 30, 2018 and September 30, 2017 to be immaterial.

The following table shows our contractual obligations as of September 30, 2018, at cost:

	Payments Due by Period				Total
	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years	
Contractual Obligations^(A)					
Credit Facility ^(B)	\$	\$ 110,000	\$	\$	\$ 110,000
Mandatorily Redeemable Preferred Stock			51,750		51,750
Interest expense on debt obligations ^(C)	9,249	24,932	6,210		40,391
Total	\$ 9,249	\$ 134,932	\$ 57,960	\$	\$ 202,141

(A) Excludes our unused line of credit commitments, an unused delayed draw term loan and uncalled capital commitments to our portfolio companies in an aggregate amount of \$10.1 million, at cost, as of September 30, 2018.

(B) Principal balance of borrowings outstanding under our Credit Facility, based on the current contractual revolver period end date to the revolving nature of the facility.

(C) Includes estimated interest payments on our Credit Facility and dividend obligations on our Series 2024 Term Preferred Stock. The amount of interest expense calculated for purposes of this table was based upon rates and balances as of September 30, 2018. Dividend payments on our Series 2024 Term Preferred Stock assume quarterly dividend declarations and monthly dividend distributions through the date of mandatory redemption.

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Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with GAAP requires management to make estimates and assumptions that affect the reported consolidated amounts of assets and liabilities, including disclosure of contingent assets and liabilities at the date of the financial statements, and revenues and expenses during the period reported. Actual results could differ materially from those estimates under different assumptions or conditions. We have identified our investment valuation policy (which has been approved by our Board of Directors) (the Policy) as our most critical accounting policy, which is described in Note 2 *Summary of Significant Accounting Policies* in the accompanying notes to our *Consolidated Financial Statements* included elsewhere in this Annual Report on Form 10-K. Additionally, refer to Note 3 *Investments* in our accompanying *Notes to Consolidated Financial Statements* included elsewhere in this Annual Report on Form 10-K for additional information regarding fair value measurements and our application of Financial Accounting Standards Board Accounting Standards Codification Topic 820, *Fair Value Measurements and Disclosures*. We have also identified our revenue recognition policy as a critical accounting policy, which is described in Note 2 *Summary of Significant Accounting Policies* in our accompanying *Notes to Consolidated Financial Statements* included elsewhere in this Annual Report on Form 10-K.

Investment Valuation

Credit Monitoring and Risk Rating

The Adviser monitors a wide variety of key credit statistics that provide information regarding our portfolio companies to help us assess credit quality and portfolio performance and, in some instances, used as inputs in our valuation techniques. Generally, we, through the Adviser, participate in periodic board meetings of our portfolio companies in which we hold board seats and also require them to provide annual audited and monthly unaudited financial statements. Using these statements or comparable information and board discussions, the Adviser calculates and evaluates certain credit statistics.

The Adviser risk rates all of our investments in debt securities. The Adviser does not risk rate our equity securities. For syndicated loans that have been rated by an SEC registered Nationally Recognized Statistical Rating Organization (NRSRO), the Adviser generally uses the average of two corporate level NRSRO s risk ratings for such security. For all other debt securities, the Adviser uses a proprietary risk rating system. While the Adviser seeks to mirror the NRSRO systems, we cannot provide any assurance that the Adviser s risk rating system will provide the same risk rating as an NRSRO would for these securities. The Adviser s risk rating system is used to estimate the probability of default on debt securities and the expected loss if there is a default. The Adviser s risk rating system uses a scale of 0 to >10, with >10 being the lowest probability of default. It is the Adviser s understanding that most debt securities of medium-sized companies do not exceed the grade of BBB on an NRSRO scale, so there would be no debt securities in the middle market that would meet the definition of AAA, AA or A. Therefore, the Adviser s scale begins with the designation >10 as the best risk rating which may be equivalent to a BBB from an NRSRO; however, no assurance can be given that a >10 on the Adviser s scale is equal to a BBB or Baa2 on an NRSRO scale. The Adviser s risk rating system covers both qualitative and quantitative aspects of the business and the securities we hold.

The following table reflects risk ratings for all proprietary loans in our portfolio (all of which were risk rated by our Adviser) at September 30, 2018 and 2017, representing approximately 92.3% and 91.9%, respectively, of the principal balance of all debt investments in our portfolio at the end of each period:

As of September 30,

Rating	2018	2017
Highest	10.0	9.0
Average	6.7	5.7
Weighted Average	6.8	5.8
Lowest	0.0	1.0

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The following table reflects the risk ratings for all syndicated loans in our portfolio that were rated by an NRSRO at September 30, 2018 and 2017, representing approximately 5.7% and 6.9%, respectively, of the principal balance of all debt investments in our portfolio at the end of each fiscal year:

Rating	As of September 30,	
	2018	2017
Highest	6.0	6.0
Average	3.7	4.4
Weighted Average	4.0	4.6
Lowest	1.0	3.0

The following table reflects the risk ratings for all syndicated loans in our portfolio that were not rated by an NRSRO at September 30, 2018 and 2017, representing approximately 2.0% and 1.2%, respectively, of the principal balance of all debt investments in our portfolio at the end of each fiscal year:

Rating	As of September 30,	
	2018	2017
Highest	5.0	3.0
Average	4.3	3.0
Weighted Average	4.7	3.0
Lowest	3.0	3.0

Tax Status

We intend to continue to maintain our qualification as a RIC under Subchapter M of the Code for federal income tax purposes and also to limit certain federal excise taxes imposed on RICs. Refer to Note 10 *Federal and State Income Taxes* in our accompanying *Notes to Consolidated Financial Statements* included elsewhere in this Annual Report on Form 10-K for additional information regarding our tax status.

Recent Accounting Pronouncements

Refer to Note 2 *Summary of Significant Accounting Policies* in the notes to our accompanying *Consolidated Financial Statements* included elsewhere in this Annual Report on Form 10-K for a description of recent accounting pronouncements.

Table of Contents**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK (DOLLAR AMOUNTS IN THOUSANDS, UNLESS OTHERWISE INDICATED)**

Market risk includes risks that arise from changes in interest rates, foreign currency exchange rates, commodity prices, equity prices and other market changes that affect market sensitive instruments. The prices of securities held by us may decline in response to certain events, including those directly involving the companies whose securities are owned by us; conditions affecting the general economy; overall market changes; local, regional or global political, social or economic instability; and interest rate fluctuations.

The primary risk we believe we are exposed to is interest rate risk. Because we borrow money to make investments, our net investment income is dependent upon the difference between the rate at which we borrow funds and the rate at which we invest those funds. As a result, there can be no assurance that a significant change in market interest rates will not have a material adverse effect on our net investment income. We use a combination of debt and equity capital to finance our investing activities. We may use interest rate risk management techniques from time to time to limit our exposure to interest rate fluctuations. Such techniques may include various interest rate hedging activities to the extent permitted by the 1940 Act.

All of our variable-rate debt investments have rates generally associated with either the current LIBOR or prime rate. As of September 30, 2018, our portfolio of debt investments on a principal basis consisted of the following:

90.6%	Variable rates with a LIBOR or prime rate floor
9.4	Fixed rates
100.0%	total

To illustrate the potential impact of changes in market interest rates on our net increase in net assets resulting from operations, we have performed the following hypothetical analysis, which assumes that our balance sheet and contractual interest rates remain constant as of September 30, 2018 and no further actions are taken to alter our existing interest rate sensitivity.

Basis Point Change (A)	Increase (Decrease) in Interest Income	Increase (Decrease) in Interest Expense	Net Increase in Net Assets Resulting from Operations
Up 300 basis points	\$ 10,300	\$ 3,300	\$ 7,000
Up 200 basis points	6,754	2,200	4,554
Up 100 basis points	3,209	1,100	2,109
Down 226 basis points	(3,481)	(2,487)	(994)

(A) As of September 30, 2018, our effective average LIBOR was 2.26%, therefore, the largest decrease in basis points that could occur was 226 basis points.

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 loan portfolio on the balance sheet and other business developments that could affect net increase in net assets resulting from operations. Accordingly, actual

results could differ significantly from those in the hypothetical analysis in the table above.

We may also experience risk associated with investing in securities of companies with foreign operations. Some of our portfolio companies have operations located outside the U.S. 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.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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Management's Annual Report on Internal Control over Financial Reporting

To the Stockholders and Board of Directors of Gladstone Capital Corporation:

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. Our internal control over financial reporting is designed 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 and include those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect our transactions and the dispositions of our assets; (2) provide reasonable assurance that our transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with appropriate authorizations; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Under the supervision and with the participation of our management, we assessed the effectiveness of our internal control over financial reporting as of September 30, 2018, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control - Integrated Framework (2013)*. Based on its assessment, management has concluded that our internal control over financial reporting was effective as of September 30, 2018.

The effectiveness of the Company's internal control over financial reporting as of September 30, 2018 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein.

November 14, 2018

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and the Stockholders of Gladstone Capital Corporation:

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated statements of assets and liabilities, including the consolidated schedules of investments, of Gladstone Capital Corporation and its subsidiaries (the Company) as of September 30, 2018 and 2017, and the related consolidated statements of operations, changes in net assets and cash flows for each of the three years in the period ended September 30, 2018, including the related notes and financial statement schedules listed in the index appearing under item 15(a)(2) (collectively referred to as the consolidated financial statements). We also have audited the Company's internal control over financial reporting as of September 30, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of September 30, 2018 and 2017, and the results of their operations, changes in their net assets and their cash flows for each of the three years in the period ended September 30, 2018 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of September 30, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the COSO.

Basis for Opinions

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express opinions on the Company's consolidated financial statements and on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our procedures included confirmation of securities owned as of September 30, 2018 and 2017 by correspondence with the custodian and portfolio company investees. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the

circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

McLean, VA

November 14, 2018

We have served as the Company's auditor since 2002.

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	September 30,	
	2018	2017
ASSETS		
Investments at fair value:		
Non-Control/Non-Affiliate investments (Cost of \$359,304 and \$318,952, respectively)	\$ 325,567	\$ 290,860
Affiliate investments (Cost of \$54,667 and \$49,868, respectively)	48,856	42,648
Control investments (Cost of \$13,496 and \$42,615, respectively)	15,623	18,865
Cash and cash equivalents	1,971	5,012
Restricted cash and cash equivalents	33	258
Interest receivable, net	2,601	1,699
Due from administrative agent	2,807	3,086
Deferred financing fees	1,363	853
Other assets, net	687	2,579
TOTAL ASSETS	\$ 399,508	\$ 365,860
LIABILITIES		
Borrowings at fair value (Cost of \$110,000 and \$93,000, respectively)	\$ 110,000	\$ 93,115
Mandatorily redeemable preferred stock, \$0.001 par value per share, \$25 liquidation preference per share; 5,440,000 and 5,440,000 shares authorized, respectively, and 2,070,000 and 2,070,000 shares issued and outstanding, respectively	50,077	49,849
Accounts payable and accrued expenses	290	522
Interest payable	330	264
Fees due to Adviser ^(A)	1,084	1,292
Fee due to Administrator ^(A)	317	244
Other liabilities	318	924
TOTAL LIABILITIES	\$ 162,416	\$ 146,210
Commitments and contingencies^(B)		
NET ASSETS		
Common stock, \$0.001 par value, 44,560,000 and 44,560,000 shares authorized, respectively, and 28,501,980 and 26,160,684 shares issued and outstanding, respectively	\$ 29	\$ 26
Capital in excess of par value ^(C)	343,076	348,248
Cumulative net unrealized depreciation of investments	(37,421)	(59,062)
Cumulative net unrealized depreciation of other		(115)
Overdistributed net investment income ^(C)	(219)	(139)
Accumulated net realized losses	(68,373)	(69,308)

Total distributable loss	(106,013)	(128,624)
TOTAL NET ASSETS	\$ 237,092	\$ 219,650
NET ASSET VALUE PER COMMON SHARE AT END OF YEAR	\$ 8.32	\$ 8.40

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

(B) Refer to Note 11 *Commitments and Contingencies* for additional information.

(C) Refer to Note 9 *Distributions to Common Stockholders* for additional information.

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

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GLADSTONE CAPITAL CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

(DOLLAR AMOUNTS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	Year ended September 30,		
	2018	2017	2016
INVESTMENT INCOME			
Interest income			
Non-Control/Non-Affiliate investments	\$ 33,497	\$ 26,147	\$ 24,171
Affiliate investments	4,800	4,282	7,459
Control investments	1,817	1,626	1,226
Cash and cash equivalents	39	27	5
Total interest income (excluding PIK interest income)	40,153	32,082	32,861
PIK interest income			
Non-Control/Non-Affiliate investments	3,524	4,299	1,095
Affiliate investments	281	692	1,263
Total PIK interest income	3,805	4,991	2,358
Total interest income	43,958	37,073	35,219
Success fee income			
Non-Control/Non-Affiliate investments	430	392	1,566
Affiliate investments		1,142	914
Control investments			958
Total success fee income	430	1,534	3,438
Other income	1,193	626	455
Total investment income	45,581	39,233	39,112
EXPENSES			
Base management fee ^(A)	7,033	5,781	5,684
Loan servicing fee ^(A)	5,042	4,146	3,890
Incentive fee ^(A)	5,348	4,779	4,514
Administration fee ^(A)	1,250	1,102	1,182
Interest expense on borrowings	5,858	3,073	2,899
Dividend expense on mandatorily redeemable preferred stock	3,105	4,152	4,118
Amortization of deferred financing fees	1,014	1,094	1,075
Professional fees	880	828	1,113
Other general and administrative expenses	1,086	1,117	1,346
Expenses, before credits from Adviser	30,616	26,072	25,821
Credit to base management fee - loan servicing fee ^(A)	(5,042)	(4,146)	(3,890)
Credit to fees from Adviser other ^(A)	(3,081)	(4,126)	(2,306)

Total expenses, net of credits	22,493	17,800	19,625
NET INVESTMENT INCOME	23,088	21,433	19,487
NET REALIZED AND UNREALIZED (LOSS) GAIN			
Net realized (loss) gain:			
Non-Control/Non-Affiliate investments	1,812	3,849	6,253
Affiliate investments	325	(2,330)	1,280
Control investments	(28,200)	(4,994)	(317)
Other	(133)	(1,288)	(64)
Total net realized (loss) gain	(26,196)	(4,763)	7,152
Net unrealized (depreciation) appreciation:			
Non-Control/Non-Affiliate investments	(5,645)	(3,133)	(14,946)
Affiliate investments	1,409	1,951	5,858
Control investments	25,877	1,807	(6,246)
Other	115	(115)	62
Total net unrealized appreciation (depreciation)	21,756	510	(15,272)
Net realized and unrealized loss	(4,440)	(4,253)	(8,120)
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS	\$ 18,648	\$ 17,180	\$ 11,367
BASIC AND DILUTED PER COMMON SHARE:			
Net investment income	\$ 0.85	\$ 0.84	\$ 0.84
Net increase in net assets resulting from operations	\$ 0.69	\$ 0.67	\$ 0.49
WEIGHTED AVERAGE SHARES OF COMMON STOCK OUTSTANDING: Basic and Diluted	27,104,077	25,495,117	23,200,642

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

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

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GLADSTONE CAPITAL CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS
(DOLLAR AMOUNTS IN THOUSANDS)

	Year ended September 30,		
	2018	2017	2016
OPERATIONS			
Net investment income	\$ 23,088	\$ 21,433	\$ 19,487
Net realized (loss) gain on investments	(26,063)	(3,475)	7,216
Net realized loss on other	(133)	(1,288)	(64)
Net unrealized appreciation (depreciation) of investments	21,641	625	(15,334)
Net unrealized appreciation (depreciation) of other	115	(115)	62
Net increase in net assets from operations	18,648	17,180	11,367
DISTRIBUTIONS			
Distributions to common stockholders from ordinary income	(22,801)	(21,433)	(16,298)
Distributions to common stockholders from realized gains			(3,189)
Net decrease in net assets from distributions	(22,801)	(21,433)	(19,487)
CAPITAL TRANSACTIONS			
Issuance of common stock	21,991	23,695	19,665
Offering costs for issuance of common stock	(396)	(999)	(1,210)
Repurchase of common stock, net of costs			(572)
Net increase in net assets from capital transactions	21,595	22,696	17,883
NET INCREASE IN NET ASSETS	17,442	18,443	9,763
NET ASSETS, BEGINNING OF YEAR	219,650	201,207	191,444
NET ASSETS, END OF YEAR	\$ 237,092	\$ 219,650	\$ 201,207

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

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GLADSTONE CAPITAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(DOLLAR AMOUNTS IN THOUSANDS)

	Year ended September 30,		
	2018	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES			
Net increase in net assets resulting from operations	\$ 18,648	\$ 17,180	\$ 11,367
Adjustments to reconcile net increase in net assets resulting from operations to net cash (used in) provided by operating activities:			
Purchase of investments	(106,115)	(112,092)	(80,024)
Principal repayments on investments	64,896	75,204	99,705
Net proceeds from sale of investments	2,892	8,240	21,439
Increase in investments due to paid-in-kind interest or other	(4,060)	(4,729)	(5,002)
Net change in premiums, discounts and amortization	(119)	268	(70)
Cost adjustments on non-accrual loans			(388)
Net realized loss (gain) on investments	26,063	3,475	(7,216)
Net unrealized (appreciation) depreciation of investments	(21,641)	(625)	15,333
Net realized loss on other		1,288	64
Net unrealized (depreciation) appreciation of other	(115)	115	(62)
Changes in assets and liabilities:			
Decrease (increase) in restricted cash and cash equivalents	225	148	(123)
(Increase) decrease in interest receivable, net	(902)	634	3,248
Decrease (increase) in funds due from administrative agent	279	(922)	(978)
Amortization of deferred financing fees	1,014	1,094	1,075
Decrease (increase) in other assets, net	1,857	(1,731)	723
(Decrease) increase in accounts payable and accrued expenses	(232)	(497)	422
Increase (decrease) in interest payable	66	63	(72)
(Decrease) increase in fees due to Adviser ^(A)	(208)	70	318
Increase (decrease) in fee due to Administrator ^(A)	73	(38)	32
(Decrease) increase in other liabilities	(192)	(23)	232
Net cash (used in) provided by operating activities	(17,571)	(12,878)	60,023
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from borrowings	118,900	138,700	103,000
Repayments on borrowings	(101,900)	(117,000)	(159,000)
Proceeds from issuance of mandatorily redeemable preferred stock		51,750	
Redemption of mandatorily redeemable preferred stock		(61,000)	
Repurchase of common stock			(572)
Deferred financing fees	(1,329)	(1,975)	(75)
Proceeds from issuance of common stock	21,991	23,695	19,665
Offering costs for issuance of common stock	(331)	(999)	(1,210)
Distributions paid to common stockholders	(22,801)	(21,433)	(19,487)

Net cash provided by (used in) financing activities	14,530	11,738	(57,679)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(3,041)	(1,140)	2,344
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	5,012	6,152	3,808
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 1,971	\$ 5,012	\$ 6,152
CASH PAID DURING YEAR FOR INTEREST	\$ 5,792	\$ 3,010	\$ 2,971
NON-CASH ACTIVITIES^(B)	500		9,522

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

^(B) Significant non-cash operating activities consisted principally of the following transactions:

In September 2016, our investment in Precision Acquisition Group Holdings, Inc. was restructured, resulting in non-cash activity of \$1.9 million and new investments in PIC 360, LLC and Precision International, LLC, which are listed on the accompanying *Consolidated Schedule of Investments* as of September 30, 2017 and 2016.

In February 2016, our investment in Targus Group International, Inc. was restructured resulting in non-cash activity of \$3.9 million and a new investment in Targus Cayman HoldCo Limited, which is listed on the accompanying *Consolidated Schedule of Investments* as of September 30, 2017 and September 30, 2016.

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

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GLADSTONE CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS
SEPTEMBER 30, 2018
(DOLLAR AMOUNTS IN THOUSANDS)

Company and Investment ^{(A)(B)(W)(Y)}	Principal/ Shares/ Units ^{(J)(X)}	Cost	Fair Value
NON-CONTROL/NON-AFFILIATE INVESTMENTS^(M) 137.3%			
Secured First Lien Debt 75.3%			
Automobile 1.3%			
Meridian Rack & Pinion, Inc. ^(S) Term Debt (L + 11.5%, 13.8% Cash, Due 6/2019) ^(C)	\$ 4,140	\$ 4,140	\$ 3,105
Beverage, Food, and Tobacco 2.6%			
Triple H Food Processors, LLC Line of Credit, \$750 available (L + 6.8%, 9.0% Cash, Due 8/2020) ^(C)			
Triple H Food Processors, LLC Term Debt (L + 8.3%, 10.5% Cash, Due 8/2020) ^(C)	6,000	6,000	6,135
		6,000	6,135
Buildings and Real Estate 0.9%			
GFRC Holdings, LLC Line of Credit, \$0 available (L + 8.0%, 10.3% Cash, Due 9/2018) ^(E)	1,150	1,150	1,150
GFRC Holdings, LLC Term Debt (L + 8.0%, 10.3% Cash, Due 9/2018) ^(F)	1,000	1,000	1,000
		2,150	2,150
Diversified/Conglomerate Service 21.3%			
IA Tech, LLC Term Debt (L + 11.0%, 13.3% Cash, Due 6/2023) ^(J)	30,000	30,000	30,900
Travel Sentry, Inc. Term Debt (L + 8.0%, 10.4% Cash, Due 12/2021) ^{(J)(U)}	8,415	8,415	8,646
Vision Government Solutions, Inc. Line of Credit, \$0 available (L + 8.8%, 11.0% Cash, Due 6/2021) ^(C)	1,450	1,446	1,305
Vision Government Solutions, Inc. Delayed Draw Term Loan, \$900 available (10.0% Cash, Due 6/2021) ^{(C)(F)}	1,600	1,596	1,448
Vision Government Solutions, Inc. Term Debt (L + 8.8%, 11.0% Cash, Due 6/2021) ^(C)	9,000	8,978	8,100
		50,435	50,399
Healthcare, education, and childcare 9.7%			
EL Academies, Inc. Line of Credit, \$2,000 available (L + 9.5%, 11.8% Cash, Due 8/2020) ^(C)			
EL Academies, Inc. Delayed Draw Term Loan, \$1,010 available (L + 9.5%, 11.8% Cash, Due 8/2022) ^(C)	8,990	8,990	9,069
EL Academies, Inc. Term Debt (L + 9.5%, 11.8% Cash, Due 8/2022) ^(J)	12,000	12,000	12,105

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TWS Acquisition Corporation	Term Debt (L + 8.0%, 10.3% Cash, Due 7/2020) ^{(Q)(AA)}	2,000	2,000	2,000
			22,990	23,174
Machinery 2.7%				
Arc Drilling Holdings LLC	Line of Credit, \$1,000 available (L + 8.0%, 10.3% Cash, Due 11/2020) ^(C)			
Arc Drilling Holdings LLC	Term Debt (L + 9.5%, 11.8% Cash, 3.0% PIK, Due 11/2022) ^(C)	5,960	5,960	5,454
Precision International, LLC	Term Debt (10.0%, Due 9/2021) ^(F)	836	836	836
			6,796	6,290
Oil and Gas 17.0%				
Impact! Chemical Technologies, Inc.	Line of Credit, \$0 available (L + 8.8%, 11.0% Cash, Due 12/2020) ^(C)	2,500	2,500	2,497
Impact! Chemical Technologies, Inc.	Term Debt (L + 8.8%, 11.0% Cash, Due 12/2020) ^(C)	20,000	20,000	19,975
WadeCo Specialties, Inc.	Line of Credit, \$1,100 available (L + 7.0%, 9.3% Cash, Due 3/2019) ^(C)	900	900	909
WadeCo Specialties, Inc.	Term Debt (L + 7.0%, 9.3% Cash, Due 3/2019) ^(F)	9,691	9,691	9,788
WadeCo Specialties, Inc.	Term Debt (L + 9.0%, 12.0% Cash, Due 3/2019) ^(F)	7,000	7,000	7,035
			40,091	40,204
Printing and Publishing 0.0%				
Chinese Yellow Pages Company	Line of Credit, \$0 available (PRIME + 4.0%, 9.3% Cash, Due 2/2015) ^{(E)(V)}	107	107	
Telecommunications 19.8%				
Applied Voice & Speech Technologies, Inc.	Term Debt (L + 9.3%, 11.5% Cash, Due 10/2022) ^(C)	10,100	10,100	9,948
B+T Group Acquisition, Inc. ^(S)	Term Debt (L + 11.0%, 13.3% Cash, Due 12/2019) ^(C)	6,000	6,000	6,000
NetFortris Corp.	Term Debt (L + 8.4%, 10.7% Cash, Due 2/2021) ^(F)	23,700	23,700	23,522
XMedius Solutions Inc.	Term Debt (L + 9.3%, 11.5% Cash, Due 10/2022) ^(F)	7,493	7,493	7,521
			47,293	46,991
Total Secured First Lien Debt			\$ 180,002	\$ 178,448

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

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GLADSTONE CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS

SEPTEMBER 30, 2018

(DOLLAR AMOUNTS IN THOUSANDS)

Company and Investment^{(A)(B)(W)(Y)}	Principal/ Shares/ Units^{(J)(X)}	Cost	Fair Value
Secured Second Lien Debt 53.5%			
Automobile 2.1%			
Sea Link International IRB, Inc. Term Debt (11.3% Cash, Due 3/2023) ^(F)	\$ 5,000	\$ 4,980	\$ 5,094
Beverage, Food, and Tobacco 2.9%			
The Mochi Ice Cream Company Term Debt (L + 10.5%, 12.8% Cash, Due 12/2023) ^(C)	6,750	6,726	6,767
Cargo Transportation 5.5%			
AG Transportation Holdings, LLC. Term Debt (L + 10.0%, 13.3% Cash, Due 3/2020) ^(C)	13,000	13,000	13,097
Chemicals, Plastics, and Rubber 0.5%			
Vertellus Holdings LLC Term Debt (L + 12.0%, 14.3% Cash, Due 10/2021) ^(F)	1,099	1,099	1,096
Diversified/Conglomerate Manufacturing 8.7%			
Alloy Die Casting Co. ^(S) Term Debt (L + 4.0%, 6.3% Cash, Due 4/2021) ^(F)	5,235	5,235	4,934
Alloy Die Casting Co. ^(S) Term Debt (L + 4.0%, 6.3% Cash, Due 4/2021) ^(F)	75	75	71
Alloy Die Casting Co. ^(S) Term Debt (L + 4.0%, 6.3% Cash, Due 4/2021) ^(F)	390	390	368
United Flexible, Inc. Term Debt (L + 9.3%, 11.5% Cash, Due 2/2022) ^(F)	15,300	15,232	15,300
		20,932	20,673
Diversified/Conglomerate Service 12.1%			
CHA Holdings, Inc. Term Debt (L + 8.8%, 11.1% Cash, Due 4/2026) ^{(P)(U)}	3,000	2,942	3,030
DigiCert Holdings, Inc. Term Debt (L + 8.0%, 10.3% Cash, Due 10/2025) ^(P)	3,000	2,977	2,989
Gray Matter Systems, LLC Delayed Draw Term Loan, \$2,000 available (12.0% Cash, Due 11/2023) ^{(C)(F)}			
Gray Matter Systems, LLC Term Debt (12.0% Cash, Due 11/2023) ^(F)	11,100	11,100	11,045
Keystone Acquisition Corp. Term Debt (L + 9.3%, 11.6% Cash, Due 5/2025) ^{(D)(U)}	4,000	3,929	4,015
LDiscovery, LLC Term Debt (L + 10.0%, 12.3% Cash, Due 12/2023) ^(P)	5,000	4,836	4,400
Red Ventures, LLC Term Debt (L + 8.0%, 10.3% Cash, Due 11/2025) ^{(P)(AA)}	3,125	3,069	3,188
		28,853	28,667
Healthcare, education, and childcare 10.0%			
Medical Solutions Holdings, Inc. Term Debt (L + 8.3%, 10.5% Cash, Due 6/2025) ^(D)	3,000	2,960	3,000
Merlin International, Inc. Term Debt (L + 10.0%, 12.3% Cash, Due 10/2022) ^(C)	20,000	20,000	20,600

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New Trident Holdcorp, Inc. Term Debt (L + 10.0%, 5.5% Cash, 6.8% PIK, Due 7/2020) ^(E)	4,382	4,382	
		27,342	23,600
Home and Office Furnishings, Housewares and Durable Consumer Products 4.3%			
Belnick, Inc. Term Debt (11.0% Cash, Due 8/2023) ^(F)	10,000	10,000	10,125
Hotels, Motels, Inns, and Gaming 2.6%			
Vacation Rental Pros Property Management, LLC Term Debt (L + 10.0%, 12.3% Cash, 3.0% PIK, Due 6/2023) ^(C)	7,366	7,366	6,337
Oil and Gas 3.2%			
Francis Drilling Fluids, Ltd. Term Debt (L + 10.4%, 12.6% Cash, Due 4/2020) ^{(E)(H)(I)}	18,510	18,427	5,281
Francis Drilling Fluids, Ltd. Term Debt (L + 9.3%, 11.5% Cash, Due 4/2020) ^{(E)(H)(I)}	8,473	8,434	2,417
		26,861	7,698
Personal and Non-Durable Consumer Products (Manufacturing Only) 1.6%			
Canopy Safety Brands, LLC Term Debt (L + 10.5%, 12.8% Cash, Due 7/2022) ^(C)	3,750	3,750	3,802
Total Secured Second Lien Debt		\$ 150,909	\$ 126,956
Unsecured Debt 1.5%			
Healthcare, education, and childcare 1.5%			
Edmentum Ultimate Holdings, LLC Term Debt (10.0% PIK, Due 6/2020) ^{(C)(F)}	\$ 3,613	\$ 3,613	\$ 3,603
Preferred Equity 1.9%			
Automobile 0.0%			
Meridian Rack & Pinion, Inc. ^(S) Preferred Stock ^{(E)(G)}	1,449	\$ 1,449	\$
Buildings and Real Estate 0.1%			
GFRC Holdings, LLC Preferred Stock ^{(E)(G)}	1,000	1,025	305
<i>THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.</i>			

Table of Contents**GLADSTONE CAPITAL CORPORATION****CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)****SEPTEMBER 30, 2018****(DOLLAR AMOUNTS IN THOUSANDS)**

Company and Investment^{(A)(B)(W)(Y)}	Principal/ Shares/ Units^{(J)(X)}	Cost	Fair Value
Diversified/Conglomerate Manufacturing 0.5%			
Alloy Die Casting Co. ^(S) Preferred Stock ^{(E)(G)}	2,192	2,192	533
United Flexible, Inc. Preferred Stock ^{(E)(G)}	538	538	708
		2,730	1,241
Diversified/Conglomerate Service 0.0%			
Frontier Financial Group Inc. Preferred Stock ^{(E)(G)}	766	500	
Frontier Financial Group Inc. Preferred Stock Warrant ^{(E)(G)}	169		
		500	
Oil and Gas 0.9%			
Chemical & Injection Holdings Company, LLC Preferred Equity Unit ^{(E)(G)}	13,830	618	2,137
Francis Drilling Fluids, Ltd. Preferred Equity Unit ^{(E)(G)(I)}	1,656	1,215	
		1,833	2,137
Telecommunications 0.4%			
B+T Group Acquisition, Inc. ^(S) Preferred Stock ^{(E)(G)}	5,503	1,799	
NetFortris Corp. Preferred Stock ^{(E)(G)}	2,677,070	268	803
		2,067	803
Total Preferred Equity		\$ 9,604	\$ 4,486
Common Equity 5.1%			
Aerospace and Defense 0.3%			
FedCap Partners, LLC Class A Membership Units (\$0 Uncalled Commitment) ^{(G)(K)(R)}	80	\$ 1,449	\$ 616
Automobile 0.4%			
Sea Link International IRB, Inc. Common Equity Unit ^{(E)(G)}	494,902	495	857
Beverage, Food, and Tobacco 0.3%			
The Mochi Ice Cream Company Common Stock ^{(E)(G)}	450	450	230
Triple H Food Processors, LLC Common Stock ^{(E)(G)}	250,000	250	595
		700	825
Buildings and Real Estate 0.0%			
GFRC Holdings, LLC Common Stock Warrants ^{(E)(G)}	45.0%		

Cargo Transportation 0.9%				
AG Transportation Holdings, LLC	Member Profit Participation ^{(E)(G)}	18.0%	1,000	1,375
AG Transportation Holdings, LLC	Profit Participation Warrants ^{(E)(G)}	12.0%	244	692
			1,244	2,067
Chemicals, Plastics, and Rubber 0.2%				
Vertellus Holdings LLC	Common Stock ^{(E)(G)}	879,121	3,017	404
Diversified/Conglomerate Manufacturing 0.9%				
Alloy Die Casting Co. ^(S)	Common Stock ^{(E)(G)}	270	18	
United Flexible, Inc.	Common Stock ^{(E)(G)}	1,158	148	2,247
			166	2,247
Healthcare, education, and childcare 1.4%				
Edmentum Ultimate Holdings, LLC	Common Stock ^{(E)(G)}	21,429	2,636	
EL Academies, Inc.	Common Stock ^{(E)(G)}	649	649	844
Leeds Novamark Capital I, L.P.	Limited Partnership Interest (\$843 uncalled capital commitment) ^{(G)(L)(R)}	3.5%	2,152	2,695
			5,437	3,539
Machinery 0.1%				
Arc Drilling Holdings LLC	Common Stock ^{(E)(G)}	16.7%	1,500	
Precision International, LLC	Membership Unit Warrants ^{(E)(G)}	33.3%		296
			1,500	296
Oil and Gas 0.1%				
Francis Drilling Fluids, Ltd.	Common Equity Units ^{(E)(G)(I)}	1,656	1	
W3, Co.	Common Equity ^{(E)(G)}	435	499	133
			500	133
Personal and Non-Durable Consumer Products (Manufacturing Only) 0.5%				
Canopy Safety Brands, LLC	Participation Warrants ^{(E)(G)}	1	500	418
Funko Acquisition Holdings, LLC ^(S)	Common Units ^{(G)(T)}	39,483	167	672
			667	1,090

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

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GLADSTONE CAPITAL CORPORATION

CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)

SEPTEMBER 30, 2018

(DOLLAR AMOUNTS IN THOUSANDS)

(UNAUDITED)

Company and Investment ^{(A)(B)(W)(Y)}	Principal/ Shares/ Units ^{(J)(X)}	Cost	Fair Value
Telecommunications 0.0%			
NetFortris Corp. Common Stock Warrant ^{(E)(G)}	1	1	
Total Common Equity		\$ 15,176	\$ 12,074
Total Non-Control/Non-Affiliate Investments		\$ 359,304	\$ 325,567
AFFILIATE INVESTMENTS^(N) 20.6%			
Secured First Lien Debt 7.1%			
Diversified/Conglomerate Manufacturing 7.1%			
Edge Adhesives Holdings, Inc. ^(S) Term Debt (L + 10.5%, 12.8% Cash, Due 2/2019) ^(C)	\$ 6,200	\$ 6,200	\$ 6,061
Edge Adhesives Holdings, Inc. ^(S) Term Debt (L + 11.8%, 14.0% Cash, Due 2/2019) ^(C)	1,600	1,600	1,572
LWO Acquisitions Company LLC Line of Credit, \$0 available (L + 5.5%, 7.8% Cash, 2.0% PIK, Due 12/2019) ^(C)	3,205	3,205	3,105
LWO Acquisitions Company LLC Term Debt (L + 8.5%, 10.8% Cash, 2.0% PIK, Due 12/2019) ^(C)	11,166	11,166	6,089
		22,171	16,827
Total Secured First Lien Debt		\$ 22,171	\$ 16,827
Secured Second Lien Debt 9.0%			
Diversified Natural Resources, Precious Metals and Minerals 9.0%			
Lignetics, Inc. Term Debt (L + 9.0%, 12.0% Cash, Due 11/2022) ^(J)	\$ 6,000	\$ 6,000	\$ 6,014
Lignetics, Inc. Term Debt (L + 9.0%, 12.0% Cash, Due 11/2022) ^(J)	8,000	8,000	8,020
Lignetics, Inc. Term Debt (L + 9.0%, 12.0% Cash, Due 11/2022) ^(J)	3,300	3,300	3,308
Lignetics, Inc. Term Debt (L + 9.0%, 12.0% Cash, Due 11/2022) ^(J)	4,000	4,000	4,010
		21,300	21,352
Total Secured Second Lien Debt		\$ 21,300	\$ 21,352

Unsecured Debt 0.0%**Diversified/Conglomerate Manufacturing 0.0%**

LWO Acquisitions Company LLC	Term Debt (Due 6/2020) ^{(C)(P)}	\$ 95	\$ 95	\$ 52
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Preferred Equity 1.4%**Diversified/Conglomerate Manufacturing 1.0%**

Edge Adhesives Holdings, Inc. ^(S)	Preferred Stock ^{(E)(G)}	2,516	\$ 2,516	\$ 2,381
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Diversified Natural Resources, Precious Metals and Minerals 0.4%

Lignetics, Inc.	Preferred Stock ^{(E)(G)}	40,000	800	882
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Total Preferred Equity			\$ 3,316	\$ 3,263
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Common Equity 3.1%**Diversified/Conglomerate Manufacturing 0.0%**

LWO Acquisitions Company LLC	Common Unit ^{(E)(G)}	921,000	\$ 921	\$
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Diversified Natural Resources, Precious Metals and Minerals 0.3%

Lignetics, Inc.	Common Stock ^{(E)(G)}	152,603	1,855	806
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Textiles and Leather 2.8%

Targus Cayman HoldCo, Ltd.	Common Stock ^{(E)(G)}	3,076,414	5,009	6,556
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Total Common Equity			\$ 7,785	\$ 7,362
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Total Affiliate Investments			\$ 54,667	\$ 48,856
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THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

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GLADSTONE CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)
SEPTEMBER 30, 2018
(DOLLAR AMOUNTS IN THOUSANDS)

Company and Investment ^{(A)(B)(W)(Y)}	Principal/ Shares/ Units ^{(J)(X)}	Cost	Fair Value
CONTROL INVESTMENTS^(O) 6.6%			
Secured First Lien Debt 1.8%			
Machinery 1.2%			
PIC 360, LLC Term Debt (14.0% Cash, Due 9/2019) ^(F)	\$ 2,850	\$ 2,850	\$ 2,850
Printing and Publishing 0.6%			
TNCP Intermediate HoldCo, LLC Line of Credit, \$500 available (8.0% Cash, Due 9/2021) ^{(E)(F)}	\$ 1,500	1,500	1,500
Total Secured First Lien Debt		\$ 4,350	\$ 4,350
Secured Second Lien Debt 3.4%			
Automobile 3.4%			
Defiance Integrated Technologies, Inc. Term Debt (L + 9.5%, 11.8% Cash, Due 8/2023) ^(E)	\$ 8,065	\$ 8,065	\$ 8,065
Common Equity 1.4%			
Automobile 0.5%			
Defiance Integrated Technologies, Inc. Common Stock ^{(E)(G)}	33,321	\$ 580	\$ 1,088
Machinery 0.7%			
PIC 360, LLC Common Equity Units ^{(E)(G)}	750	1	1,622
Printing and Publishing 0.2%			
TNCP Intermediate HoldCo, LLC Common Equity Units ^{(E)(G)}	790,000	500	498
Total Common Equity		\$ 1,081	\$ 3,208
Total Control Investments		\$ 13,496	\$ 15,623
TOTAL INVESTMENTS^(Z) 164.5%		\$ 427,467	\$ 390,046

^(A) Certain of the securities listed in this schedule are issued by affiliate(s) of the indicated portfolio company. The majority of the securities listed, totaling \$332.3 million at fair value, are pledged as collateral to our revolving line of credit, as described further in Note 5 *Borrowings* in the accompanying *Notes to Consolidated Financial*

Statements. Under the Investment Company Act of 1940, as amended, (the 1940 Act), we may not acquire any non-qualifying assets unless, at the time such acquisition is made, qualifying assets represent at least 70% of our total assets. As of September 30, 2018, our investments in FedCap Partners, LLC (FedCap), Leeds Novamark Capital I, L.P. (Leeds), Funko Acquisition Holdings, LLC (Funko), and XMedius Solutions Inc. (XMedius) are considered non-qualifying assets under Section 55 of the 1940 Act. Such non-qualifying assets represent 2.9% of total investments, at fair value, as of September 30, 2018.

- (B) Unless indicated otherwise, all cash interest rates are indexed to 30-day London Interbank Offered Rate (LIBOR or L), which was 2.27% as of September 30, 2018. If applicable, paid-in-kind (PIK) interest rates are noted separately from the cash interest rate. Certain securities are subject to an interest rate floor. The cash interest rate is the greater of the floor or LIBOR plus a spread. Due dates represent the contractual maturity date.
- (C) Fair value was based on an internal yield analysis or on estimates of value submitted by ICE Data Pricing and Reference Data, LLC (ICE)(formerly Standard and Poor s Securities Evaluations, Inc.).
- (D) Fair value was based on the indicative bid price on or near September 30, 2018, offered by the respective syndication agent s trading desk.
- (E) Fair value was based on the total enterprise value of the portfolio company, which was then allocated to the portfolio company s securities in order of their relative priority in the capital structure.
- (F) Debt security has a fixed interest rate.
- (G) Security is non-income producing.
- (H) Debt security is on non-accrual status.
- (I) On September 29, 2018, Francis Drilling Fluids, Ltd. filed for Chapter 11 bankruptcy protection.
- (J) Where applicable, aggregates all shares of a class of stock owned without regard to specific series owned within such class (some series of which may or may not be voting shares) or aggregates all warrants to purchase shares of a class of stock owned without regard to specific series of such class of stock such warrants allow us to purchase.
- (K) There are certain limitations on our ability to transfer our units owned, withdraw or resign prior to dissolution of the entity, which must occur no later than May 3, 2020.
- (L) There are certain limitations on our ability to withdraw our partnership interest prior to dissolution of the entity, which must occur no later than May 9, 2024 or two years after all outstanding leverage has matured.
- (M) Non-Control/Non-Affiliate investments, as defined by the 1940 Act, are those that are neither Control nor Affiliate investments and in which we own less than 5.0% of the issued and outstanding voting securities.

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- (N) Affiliate investments, as defined by the 1940 Act, are those in which we own, with the power to vote, between and inclusive of 5.0% and 25.0% of the issued and outstanding voting securities.
- (O) Control investments, as defined by the 1940 Act, are those where we have the power to exercise a controlling influence over the management or policies of the portfolio company, which may include owning, with the power to vote, more than 25.0% of the issued and outstanding voting securities.
- (P) Debt security does not have a stated interest rate that is payable thereon.
- (Q) Fair value was based on the expected exit or payoff amount, where such event has occurred or is expected to occur imminently.
- (R) Fair value was based on net asset value provided by the fund as a practical expedient.
- (S) One of our affiliated funds, Gladstone Investment Corporation, co-invested with us in this portfolio company pursuant to an exemptive order granted by the U.S. Securities and Exchange Commission.
- (T) Our investment in Funko was valued using Level 2 inputs within the FASB Accounting Standard Codification (ASC) Topic 820, Fair Value Measurements and Disclosures (ASC 820) fair value hierarchy. Our common units in Funko are convertible to class A common stock in Funko, Inc. upon meeting certain requirements. Fair value was based on the closing market price of shares of Funko, Inc. as of the reporting date, less a discount for lack of marketability. Funko, Inc. is traded on the Nasdaq Stock Market under the trading symbol FNKO. Refer to Note 3 *Investments* in the accompanying *Notes to Consolidated Financial Statements* for additional information.
- (U) The cash interest rate on this investment was indexed to 90-day LIBOR, which was 2.40% as of September 30, 2018.
- (V) The cash interest rate on this investment was indexed to the U.S. Prime Rate (PRIME), which was 5.25% as of September 30, 2018.
- (W) Unless indicated otherwise, all of our investments are valued using Level 3 inputs within the ASC 820 fair value hierarchy. Refer to Note 3 *Investments* in the accompanying *Notes to Consolidated Financial Statements* for additional information.
- (X) Represents the principal balance for debt investments and the number of shares/units held for equity investments. Warrants are represented as a percentage of ownership, as applicable.
- (Y) Category percentages represent the fair value of each category and subcategory as a percentage of net assets as of September 30, 2018.
- (Z) Cumulative gross unrealized depreciation for federal income tax purposes is \$62.7 million; cumulative gross unrealized appreciation for federal income tax purposes is \$15.4 million. Cumulative net unrealized depreciation is \$47.4 million, based on a tax cost of \$437.4 million.
- (AA) Investment was exited subsequent to September 30, 2018. Refer to Note 15 *Subsequent Events* in the accompanying *Notes to Consolidated Financial Statements* for additional information.

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

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GLADSTONE CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS
SEPTEMBER 30, 2017
(DOLLAR AMOUNTS IN THOUSANDS)

Company and Investment ^{(A)(B)(W)(Z)}	Principal/ Shares/ Units		
Total debt	\$	3,499	\$4,514
Rent x 8		2,408	2,344
Adjusted debt	\$	5,907	\$6,858
Operating income	\$	1,361	\$1,416
Depreciation and amortization		964	991
Rent expense		301	293
EBITDAR		2,626	2,700
Impairments, store closing and other costs		104	-
Adjusted EBITDAR	\$	2,730	\$2,700
Adjusted debt to adjusted EBITDAR		2.16	2.54

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The following table includes our debt ratio calculation, as defined by our debt agreements:

(Dollars in Millions)	2018
Included Indebtedness	
Consolidated indebtedness	\$3,511
Permitted exclusions for L/C obligations	-
Permitted exclusions for unamortized debt discount	(2)
Subtotal	3,509
Rent x 8	2,408
Included indebtedness	\$5,917
Debt Compliance EBITDAR	
Net income	\$801
Impairments, store closing and other costs	104
Interest charges	256
Income taxes	241
Depreciation and amortization	964
Loss on extinguishment of debt	63
Capital losses from the disposition of fixed assets	-
Other non-cash expenses reducing net income	100
Subtotal	2,529
Non-cash items increasing net income	(7)
Capital gains from the disposition of fixed assets	(1)
Subtotal	2,521
Rent	301
Consolidated EBITDAR	\$2,822
Debt ratio (a)	2.10
Maximum permitted debt ratio	3.75

(a) Included Indebtedness divided by Consolidated EBITDAR

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Contractual Obligations

Our contractual obligations as of February 2, 2019 were as follows:

(Dollars in Millions)	Maturing in:				
	2020 and 2021		2022 and 2023	2024 and after	
Total	2019	2021	2023	after	
Recorded contractual obligations:					
Outstanding long-term debt	\$ 1,873	\$—	\$—	\$534	\$ 1,339
Capital lease and financing obligations	1,157	103	218	170	666
	3,030	103	218	704	2,005
Unrecorded contractual obligations:					
Interest payments:					
Long-term debt	1,169	89	177	171	732
Capital lease and financing obligations	2,054	157	286	250	1,361
Operating leases (a)	4,977	275	535	498	3,669
Other (b)	856	386	275	142	53
	9,056	907	1,273	1,061	5,815
Total	\$ 12,086	\$ 1,010	\$ 1,491	\$ 1,765	\$ 7,820

(a) Our leases typically require that we pay taxes, insurance and maintenance costs in addition to the minimum rental payments included in the table above. Such costs vary from period to period and totaled \$183 million for 2018, \$184 million for 2017, and \$179 million for 2016. The lease term includes cancelable option periods where failure to exercise such options would result in an economic penalty.

(b) Other includes royalties, legally binding minimum lease and interest payments for stores opening in 2019 or later, as well as payments associated with technology and marketing agreements.

Off-Balance Sheet Arrangements

We have not provided any financial guarantees as of year-end 2018.

We have not created, and are not party to, any special-purpose or off-balance sheet entities for the purpose of raising capital, incurring debt or operating our business. We do not have any arrangements or relationships with entities that are not consolidated into the financial statements that are reasonably likely to materially affect our financial condition, liquidity, results of operations or capital resources.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect the reported amounts. Management has discussed the development, selection and disclosure of these estimates and assumptions with the Audit Committee of our Board of Directors. There have been no significant changes in the critical accounting policies and estimates discussed in our 2018 Form 10-K.

Retail Inventory Method and Inventory Valuation

Merchandise inventories are valued at the lower of cost or market using the retail inventory method ("RIM"). Under RIM, the valuation of inventory at cost and the resulting gross margins are calculated by applying a cost-to-retail ratio to the retail value of inventory. RIM is an averaging method that has been widely used in the retail industry due to its practicality. The use of RIM will result in inventory being valued at the lower of cost or market since permanent markdowns are taken as a reduction of the retail value of inventories. We would record an additional reserve if the future estimated selling price is less than cost.

RIM inherently requires management judgment and estimates, such as the amount and timing of permanent markdowns to clear unproductive or slow-moving inventory, which may impact the ending inventory valuation as well

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as gross margin. Factors considered in the determination of permanent markdowns include current and anticipated demand, customer preferences, age of the merchandise, fashion trends and weather conditions.

Inventory shrinkage is estimated as a percent of sales for the period between the last physical inventory count and the balance sheet date. Shrink is the difference between the recorded amount of inventory and the physical inventory. We perform an annual physical inventory count at the majority of our stores and distribution centers. The shrinkage rate from the most recent physical inventory, in combination with current events and historical experience, is used as the standard for the shrinkage accrual rate for the next inventory cycle. Historically, our actual physical inventory count results have shown our estimates to be reliable.

Vendor Allowances

We frequently receive allowances from our vendors for discounts that we have taken in order to sell the vendor's merchandise and/or to support gross margins earned on those sales. This markdown support generally relates to sold inventory or permanent markdowns and, accordingly, is reflected as a reduction to cost of merchandise sold. Markdown support related to merchandise that has not yet been sold is recorded in inventory.

We also receive support from vendors for marketing and other costs that we have incurred to sell the vendors' merchandise. To the extent the reimbursements are for specific, incremental and identifiable costs incurred to sell the vendor's products and do not exceed the costs incurred, they are recognized as a reduction of selling, general, and administrative expenses. If these criteria are not met, the support is recorded in inventory and reflected as a reduction of costs of merchandise sold when the related merchandise is sold.

Insurance Reserve Estimates

We are primarily self-insured for costs related to workers' compensation, general liability, and employee-related health care benefits. We use a third-party actuary to estimate the liabilities associated with these risks. The actuary considers historical claims experience, demographic and severity factors, health care trends, and actuarial assumptions to estimate the liabilities associated with these risks. Historically, our actuarial estimates have not been materially different from actual results.

Impairment of Long-Lived Assets

We review our long-lived assets for impairment when events or changes in circumstances, such as decisions to close a store or significant operating losses, indicate the carrying value of the asset may not be recoverable. All long-lived assets are reviewed for impairment at least annually.

If our evaluations, which are performed on an undiscounted cash flow basis, indicate that the carrying amount of the asset may not be recoverable, the potential impairment is measured as the excess of carrying value over the fair value of the impaired asset.

Identifying impaired assets and quantifying the related impairment loss, if any, requires significant estimates by management. The most significant of these estimates is the cash flow expected to result from the use and eventual disposition of the asset. When determining the stream of projected future cash flows associated with an individual store, management estimates future store performance including sales, gross margin, and controllable expenses, such as store payroll and occupancy expense. Projected cash flows must be estimated for future periods throughout the remaining life of the property, which may be as many as 40 years in the future. The accuracy of these estimates will be impacted by a number of factors including general economic conditions, changes in competitive landscape and our ability to effectively manage the operations of the store.

Other than stores which we have closed and the trademark that was impaired in the fourth quarter of 2018, we have not historically experienced any significant impairment of long-lived assets. Additionally, impairment of an

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individual building and related improvements, net of accumulated depreciation, would not generally be material to our financial results.

Store Closure Reserve

In 2016, we closed numerous leased stores prior to their scheduled lease expiration. In addition to future rent obligations, the closed store reserve includes estimates for operating and other expenses expected to be incurred over the remaining lease term, some of which extend through January 2030.

Income Taxes

We regularly evaluate the likelihood of realizing the benefit for income tax positions we have taken in various federal and state filings by considering all relevant facts, circumstances and information available to us. If we believe it is more likely than not that our position will be sustained, we recognize a benefit at the largest amount which we believe is cumulatively greater than 50% likely to be realized.

Unrecognized tax benefits require significant management judgment regarding applicable statutes and their related interpretation, the status of various income tax audits and our particular facts and circumstances. Also, as audits are completed or statutes of limitations lapse, it may be necessary to record adjustments to our taxes payable, deferred tax assets, tax reserves or income tax expense. Although we believe we have adequately reserved for our uncertain tax positions, no assurance can be given that the final tax outcome of these matters will not be different.

Leases

Accounting for leased properties requires compliance with technical accounting rules and significant judgment by management. Application of these accounting rules and assumptions made by management will determine whether we are considered the owner for accounting purposes or whether the lease is accounted for as a capital or operating lease.

If we are considered the owner for accounting purposes or the lease is considered a capital lease, we record the property and related financing or capital lease obligation on our balance sheet. The asset is then depreciated over its expected lease term. Rent payments for these properties are recognized as interest expense and a reduction of the financing or capital lease obligation.

If the lease is considered an operating lease, it is not recorded on our balance sheet and rent expense is recognized on a straight-line basis over the expected lease term.

The most significant estimates used by management in accounting for property leases and the impact of these estimates are as follows:

Expected lease term—Our expected lease term includes both contractual lease periods and cancelable option periods where failure to exercise such options would result in an economic penalty. The expected lease term is used in determining whether the lease is accounted for as an operating lease or a capital lease. A lease is considered a capital lease if the lease term exceeds 75% of the leased asset's useful life. The expected lease term is also used in determining the depreciable life of the asset or the straight-line rent recognition period. Increasing the expected lease term will increase the probability that a lease will be considered a capital lease and will generally result in higher rent expense for an operating lease and higher interest and depreciation expenses for a leased property recorded on our balance sheet.

Incremental borrowing rate—We estimate our incremental borrowing rate using treasury rates for debt with maturities comparable to the expected lease term plus our credit spread. The incremental borrowing rate is primarily used in

determining whether the lease is accounted for as an operating lease or a capital lease. A lease is considered a capital lease if the net present value of the lease payments is greater than 90% of the

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fair market value of the property. Increasing the incremental borrowing rate decreases the net present value of the lease payments and reduces the probability that a lease will be considered a capital lease. For leases which are recorded on our balance sheet with a related capital lease or financing obligation, the incremental borrowing rate, subject to certain limitations, is also used in allocating our rental payments between interest expense and a reduction of the outstanding obligation.

Fair market value of leased asset—The fair market value of leased retail property is generally estimated based on comparable market data as provided by third-party appraisers or consideration received from the landlord. Fair market value is used in determining whether the lease is accounted for as an operating lease or a capital lease. A lease is considered a capital lease if the net present value of the lease payments is greater than 90% of the fair market value of the property. Increasing the fair market value reduces the probability that a lease will be considered a capital lease. Fair market value is also used in determining the amount of property and related financing obligation to be recognized on our balance sheet for certain leased properties which are considered owned for accounting purposes.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

All of our long-term debt at year-end 2018 is at fixed interest rates and, therefore, is not affected by changes in interest rates. When our long-term debt instruments mature, we may refinance them at the existing market interest rates, which may be more or less than interest rates on the maturing debt.

We share in the net risk-adjusted revenue of the Kohl's credit card portfolio as defined by the sum of finance charges, late fees and other revenue less write-offs of uncollectible accounts. We also share the costs of funding the outstanding receivables as interest rates exceed defined rates. As a result, our share of profits from the credit card portfolio may be negatively impacted by increases in interest rates. The reduced profitability, if any, will be impacted by various factors, including our ability to pass higher funding costs on to the credit card holders and the outstanding receivable balance. Recent increases in interest rates have not had a material impact on our financial results. The impact of future increases, if any, cannot be reasonably estimated at this time.

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Schedules have been omitted as they are not applicable.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and the Board of Directors of Kohl's Corporation

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Kohl's Corporation (the "Company") as of February 2, 2019 and February 3, 2018, the related consolidated statements of income, changes in shareholders' equity and cash flows, for each of the three years in the period ended February 2, 2019, and the related notes (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at February 2, 2019 and February 3, 2018, and the results of its operations and its cash flows for each of the three years in the period ended February 2, 2019, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of February 2, 2019, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated March 22, 2019 expressed an unqualified opinion thereon.

Adoption of ASU No. 2014-09

As discussed in Note 2 to the consolidated financial statements, the Company changed its method of accounting for revenue recognition in each of the three years in the period ended February 2, 2019 due to the adoption of ASU No. 2014-09, Revenue from Contracts with Customers.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Ernst & Young LLP

We have served as the Company's auditor since 1986.

Milwaukee, Wisconsin

March 22, 2019

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KOHL'S CORPORATION

CONSOLIDATED BALANCE SHEETS

	February 2, 2019	February 3, 2018
(Dollars in Millions)		As Adjusted (a)
Assets		
Current assets:		
Cash and cash equivalents	\$934	\$1,308
Merchandise inventories	3,475	3,542
Other	426	530
Total current assets	4,835	5,380
Property and equipment, net	7,428	7,773
Other assets	206	236
Total assets	\$12,469	\$13,389
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$1,187	\$1,271
Accrued liabilities	1,364	1,213
Income taxes payable	64	99
Current portion of capital lease and financing obligations	115	126
Total current liabilities	2,730	2,709
Long-term debt	1,861	2,797
Capital lease and financing obligations	1,523	1,591
Deferred income taxes	184	211
Other long-term liabilities	644	662
Shareholders' equity:		
Common stock - 374 and 373 million shares issued	4	4
Paid-in capital	3,204	3,078
Treasury stock, at cost, 211 and 205 million shares	(11,076)	(10,651)
Accumulated other comprehensive loss	—	(11)
Retained earnings	13,395	12,999
Total shareholders' equity	\$5,527	\$5,419
Total liabilities and shareholders' equity	\$12,469	\$13,389

(a) Refer to Note 2 for details on the adoption of the new revenue recognition accounting standard and the impact on previously reported results.

See accompanying Notes to Consolidated Financial Statements

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KOHL'S CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(Dollars in Millions, Except per Share Data)	2018	2017	2016
		As Adjusted (a)	As Adjusted (a)
Net sales	\$ 19,167	\$ 19,036	\$ 18,636
Other revenue	1,062	1,048	1,045
Total revenue	20,229	20,084	19,681
Cost of merchandise sold	12,199	12,176	11,944
Operating expenses:			
Selling, general and administrative	5,601	5,501	5,430
Depreciation and amortization	964	991	938
Impairments, store closing and other costs	104	—	186
Operating income	1,361	1,416	1,183
Interest expense, net	256	299	308
Loss on extinguishment of debt	63	—	—
Income before income taxes	1,042	1,117	875
Provision for income taxes	241	258	319
Net income	\$ 801	\$ 859	\$ 556
Net income per share:			
Basic	\$ 4.88	\$ 5.14	\$ 3.12
Diluted	\$ 4.84	\$ 5.12	\$ 3.11

(a) Refer to Note 2 for details on the adoption of the new revenue recognition accounting standard and the impact on previously reported results.

See accompanying Notes to Consolidated Financial Statements

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KOHL'S CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(Dollars in Millions, Except per Share Data)	Common Stock		Paid-In		Treasury Stock		Accumulated Other Comprehensive Loss (a)		Retained Earnings	Total
	Shares	Amount	Capital	Shares	Amount		Loss (a)			
Balance at January 30, 2016 (previously reported)	370	\$ 4	\$2,944	(184)	\$(9,769)		\$ (17)		\$12,329	\$5,491
Change in accounting standard (b)	—	—	—	—	—		—		(7)	(7)
Balance at January 30, 2016 (as adjusted)	370	4	2,944	(184)	(9,769)		(17)		12,322	5,484
Comprehensive income	—	—	—	—	—		3		556	559
Stock options and awards, net of tax	1	—	59	—	(17)		—		—	42
Dividends paid (\$2.00 per common share)	—	—	—	—	5		—		(363)	(358)
Treasury stock purchases	—	—	—	(13)	(557)		—		—	(557)
Balance at January 28, 2017 (as adjusted) (b)	371	4	3,003	(197)	(10,338)		(14)		12,515	5,170
Comprehensive income	—	—	—	—	—		3		859	862
	2	—	75	—	(14)		—		—	61

Stock options and awards, net of tax									
Dividends paid (\$2.20 per common share)	—	—	—	—	7	—	(375)	(368)	
Treasury stock purchases	—	—	—	(8)	(306)	—	—	(306)	
Balance at February 3, 2018									
(as adjusted)									
(b)	373	4	3,078	(205)	(10,651)	(11)	12,999	5,419	
Comprehensive income	—	—	—	—	—	11	801	812	
Stock options and awards, net of tax	1	—	126	—	(34)	—	—	92	
Dividends paid (\$2.44 per common share)	—	—	—	—	5	—	(405)	(400)	
Treasury stock purchases	—	—	—	(6)	(396)	—	—	(396)	
Balance at February 2, 2019	374	\$ 4	\$3,204	(211)	\$(11,076)	\$ —	\$13,395	\$5,527	

(a) Includes loss on interest rate derivative and reclassification adjustment for interest expense included in net income.

Tax effects of interest rate derivatives were \$1 million in 2018 and \$2 million in 2017 and 2016.

(b) Refer to Note 2 for details on the adoption of the new revenue recognition accounting standard and the impact on previously reported results.

See accompanying Notes to Consolidated Financial Statements

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KOHL'S CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in Millions)	2018	2017	2016
		As Adjusted (a)	As Adjusted (a)
Operating activities			
Net income	\$801	\$ 859	\$ 556
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	964	991	938
Share-based compensation	87	55	41
Deferred income taxes	(31)	(61)	13
Impairments, store closing and other costs	72	—	57
Loss on extinguishment of debt	63	—	—
Other non-cash revenues and expenses	18	2	30
Changes in operating assets and liabilities:			
Merchandise inventories	79	264	249
Other current and long-term assets	72	(81)	(46)
Accounts payable	(84)	(236)	256
Accrued and other long-term liabilities	67	(52)	82
Income taxes	(1)	(50)	(23)
Net cash provided by operating activities	2,107	1,691	2,153
Investing activities			
Acquisition of property and equipment	(578)	(672)	(768)
Other	6	23	12
Net cash used in investing activities	(572)	(649)	(756)
Financing activities			
Treasury stock purchases	(396)	(306)	(557)
Shares withheld for taxes on vested restricted shares	(34)	(14)	(17)
Dividends paid	(400)	(368)	(358)
Reduction of long-term borrowing	(943)	—	—
Premium paid on redemption of debt	(46)	—	—
Capital lease and financing obligation payments	(126)	(138)	(127)
Proceeds from stock option exercises	36	18	18
Proceeds from financing obligations	—	—	11
Net cash used in financing activities	(1,909)	(808)	(1,030)
Net increase (decrease) in cash and cash equivalents	(374)	234	367
Cash and cash equivalents at beginning of period	1,308	1,074	707
Cash and cash equivalents at end of period	\$934	\$ 1,308	\$ 1,074
Supplemental information			
Interest paid, net of capitalized interest	\$282	\$ 297	\$ 299
Income taxes paid	308	272	314
Non-cash investing and financing activities			
Property and equipment acquired through additional liabilities	\$41	\$ 42	\$ 54

(a) Refer to Note 2 for details on the adoption of the new revenue recognition accounting standard and the impact on previously reported results.

See accompanying Notes to Consolidated Financial Statements

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KOHL'S CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Business and Summary of Accounting Policies

Business

As of February 2, 2019, we operated 1,159 department stores, a website (www.Kohls.com), 12 FILA outlets, and four Off-Aisle clearance centers. Our Kohl's stores and website sell moderately-priced proprietary and national brand apparel, footwear, accessories, beauty and home products. Our Kohl's stores generally carry a consistent merchandise assortment with some differences attributable to local preferences. Our website includes merchandise which is available in our stores, as well as merchandise which is available only online.

Our authorized capital stock consists of 800 million shares of \$0.01 par value common stock and 10 million shares of \$0.01 par value preferred stock.

Consolidation

The consolidated financial statements include the accounts of Kohl's Corporation and its subsidiaries including Kohl's Department Stores, Inc., its primary operating company. All intercompany accounts and transactions have been eliminated.

Accounting Period

Our fiscal year ends on the Saturday closest to January 31st each year. Unless otherwise stated, references to years in these notes relate to fiscal years rather than to calendar years. The following fiscal periods are presented in these notes:

		Number of
Fiscal year	Ended	Weeks
2018	February 2, 2019	52
2017	February 3, 2018	53
2016	January 28, 2017	52

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents

In addition to money market investments, cash equivalents include commercial paper and certificates of deposit with original maturities of three months or less. We carry these investments at cost which approximates fair value.

Also included in cash and cash equivalents are amounts due from credit card transactions with settlement terms of less than five days. Credit and debit card receivables included within cash were \$89 million at February 2, 2019 and \$83 million at February 3, 2018.

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KOHL'S CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Merchandise Inventories

Merchandise inventories are valued at the lower of cost or market using the retail inventory method ("RIM"). Under RIM, the valuation of inventory at cost and the resulting gross margins are calculated by applying a cost-to-retail ratio to the retail value of inventory. RIM is an averaging method that has been widely used in the retail industry due to its practicality. The use of RIM will result in inventory being valued at the lower of cost or market since permanent markdowns are taken as a reduction of the retail value of inventories. We would record an additional reserve if the future estimated selling price is less than cost.

Property and Equipment

Property and equipment consist of the following:

	Feb 2,	Feb 3,
(Dollars in Millions)	2019	2018
Land	\$1,110	\$1,115
Buildings and improvements:		
Owned	8,048	8,062
Leased	1,816	1,813
Fixtures and equipment	1,489	1,700
Information technology	2,628	2,337
Construction in progress	299	152
Total property and equipment, at cost	15,390	15,179
Less accumulated depreciation and amortization	(7,962)	(7,406)
Property and equipment, net	\$7,428	\$7,773

Construction in progress includes property and equipment which is not ready for its intended use.

Property and equipment are recorded at cost, less accumulated depreciation. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets. Leased property and improvements to leased property are amortized on a straight-line basis over the term of the lease or useful life of the asset, whichever is less.

The annual provisions for depreciation and amortization generally use the following ranges of useful lives:

Buildings and improvements	5-40 years
Fixtures and equipment	3-15 years
Information technology	3-8 years

Store Closure and Restructure Reserve

The following table summarizes changes in the store closure and restructure reserve during 2018:

(Dollars in Millions)	Store Lease		Total
	Obligations	Severance	
Balance - February 3, 2018	\$ 87	-	\$ 87
Payments and reversals	(21)	-	(21)
Additions	1	31	32
Balance - February 2, 2019	\$ 67	\$ 31	\$ 98

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KOHL'S CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Long-Lived Assets

All property and equipment and other long-lived assets are reviewed for potential impairment when events or changes in circumstances indicate that the asset's carrying value may not be recoverable. If such indicators are present, it is determined whether the sum of the estimated undiscounted future cash flows attributable to such assets is less than the carrying value of the assets. A potential impairment has occurred if projected future undiscounted cash flows are less than the carrying value of the assets. We recorded impairments of \$72 million in 2018 and \$76 million in 2016.

Accrued Liabilities

Accrued liabilities consist of the following:

	Feb 2,	Feb 3,
(Dollars in Millions)	2019	2018
Gift cards and merchandise return cards	\$330	\$330
Sales, property and use taxes	160	151
Payroll and related fringe benefits	154	173
Credit card liabilities	122	125
Accrued capital	117	62
Other	481	372
Accrued liabilities	\$1,364	\$1,213

Self-Insurance

We use a combination of insurance and self-insurance for a number of risks.

We retain the initial risk of \$500,000 per occurrence in workers' compensation claims and \$250,000 per occurrence in general liability claims. We record reserves for workers' compensation and general liability claims which include the total amounts that we expect to pay for a fully developed loss and related expenses, such as fees paid to attorneys, experts and investigators.

We are fully self-insured for employee-related health care benefits, a portion of which is paid by our associates.

We use a third-party actuary to estimate the liabilities associated with workers' compensation, general liability and employee-related health care risks. These liabilities include amounts for both reported claims and incurred, but not reported losses. The total liabilities, net of collateral held by third parties, for these risks were \$56 million as of February 2, 2019 and \$53 million as of February 3, 2018.

Our self-insured retention for property losses differs based on the type of claim. For the calendar year ended December 31, 2018, the retained amount for catastrophic claims such as earthquakes, floods and windstorms, varied from 2 - 5% of the insurance claim. For other standard claims, such as fire and building damages, we were

self-insured for the first \$250,000 per occurrence of the property loss.

Treasury Stock

We account for repurchases of common stock and shares withheld in lieu of taxes when restricted stock vests using the cost method with common stock in treasury classified in the Consolidated Balance Sheets as a reduction of shareholders' equity.

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KOHL'S CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Revenue Recognition

Net Sales

Net sales includes revenue from the sale of merchandise and shipping revenues. Net sales are recognized when merchandise is received by the customer and we have fulfilled all performance obligations. We do not have any sales that are recorded as commissions.

The following table summarizes net sales by line of business:

(Dollars in Millions)	2018	2017	2016
Women's	\$ 5,366	\$ 5,711	\$ 5,591
Men's	4,025	3,807	3,727
Home	3,642	3,617	3,541
Children's	2,492	2,475	2,423
Footwear	1,917	1,785	1,595
Accessories	1,725	1,641	1,759
Net sales	\$ 19,167	\$ 19,036	\$ 18,636

We maintain various rewards programs whereby customers earn rewards based on their spending and other promotional activities. The rewards are typically in the form of dollar-off discounts which can be used on future purchases. These programs create performance obligations which require us to defer a portion of the original sale until the rewards are redeemed. Sales are recorded net of returns. At the end of each reporting period, we record a reserve based on historical return rates and patterns which reverses sales that we expect to be returned in the following period. Revenue from the sale of Kohl's gift cards is recognized when the gift card is redeemed. Liabilities for performance obligations resulting from our rewards programs, return reserves, and unredeemed gift cards and

merchandise return cards totaled \$413 million as of February 2, 2019 and \$422 million as of February 3, 2018.

Net sales do not include sales tax as we are considered a pass-through conduit for collecting and remitting sales taxes.

Other Revenue

Other revenue consists primarily of revenue from our credit card operations, unredeemed gift and merchandise return cards (breakage), and other non-merchandise revenues.

Revenue from credit card operations includes our share of the finance charges and interest fees, less charge-offs of the Kohl's credit card pursuant to the Private Label Credit Card Program Agreement. Expenses related to our credit card operations are reported in SG&A.

Income from unredeemed gift cards and merchandise return cards (breakage) is recorded in proportion and over the time period the cards are actually redeemed.

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KOHL'S CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Cost of Merchandise Sold and Selling, General and Administrative Expenses

The following table illustrates the primary costs classified in Cost of Merchandise Sold and Selling, General and Administrative Expenses:

Cost of Merchandise Sold	Selling, General and Administrative Expenses
<ul style="list-style-type: none"> • Total cost of products sold including product development costs, net of vendor payments other than reimbursement of specific, incremental and identifiable costs • Inventory shrink • Markdowns • Freight expenses associated with moving merchandise from our vendors to our distribution centers • Shipping expenses for digital sales • Terms cash discount • Depreciation of product development facilities and equipment 	<ul style="list-style-type: none"> • Compensation and benefit costs including: <ul style="list-style-type: none"> • Stores • Corporate headquarters, including buying and merchandising • Distribution centers • Occupancy and operating costs of our retail, distribution and corporate facilities • Expenses related to our Kohl's credit card operations • Freight expenses associated with moving merchandise from our distribution centers to our retail stores and between distribution and retail facilities • Marketing expenses, offset by vendor payments for reimbursement of specific, incremental and identifiable costs • Other non-operating revenues and expenses

The classification of these expenses varies across the retail industry.

Vendor Allowances

We receive consideration for a variety of vendor-sponsored programs, such as markdown allowances, volume rebates, and promotion and marketing support. The vendor consideration is recorded as earned either as a reduction of inventory costs or Selling, General and Administrative Expenses. Promotional and marketing allowances are intended to offset our marketing costs to promote vendors' merchandise. Markdown allowances and volume rebates are recorded as a reduction of inventory costs.

Fair Value

Fair value measurements are required to be classified and disclosed in one of the following pricing categories:

Level 1: Financial instruments with unadjusted, quoted prices listed on active market exchanges.

Level 2: Financial instruments lacking unadjusted, quoted prices from active market exchanges, including over-the-counter traded financial instruments. The prices for the financial instruments are determined using prices for recently traded financial instruments with similar underlying terms as well as directly or indirectly observable inputs, such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3: Financial instruments that are not actively traded on a market exchange. This category includes situations where there is little, if any, market activity for the financial instrument. The prices are determined using significant unobservable inputs or valuation techniques.

Current assets and liabilities are reported at cost, which approximates fair value.

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KOHL'S CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Leases

We lease certain property and equipment used in our operations.

We are often involved extensively in the construction of leased stores. In many cases, we are responsible for construction cost overruns or non-standard tenant improvements (e.g. roof or HVAC systems). As a result of this involvement, we are deemed the “owner” for accounting purposes during the construction period, so are required to capitalize the construction costs on our Balance Sheet. Upon completion of the project, we perform a sale-leaseback analysis to determine if we can remove the assets from our Balance Sheet. In many of our leases, we are reimbursed a portion of the construction costs via adjusted rental payments and/or cash payments or have terms which fix the rental payments for a significant percentage of the leased asset’s economic life. These items generally are considered “continuing involvement” which precludes us from derecognizing the assets from our Balance Sheet when construction is complete. In conjunction with these leases, we also record financing obligations equal to the cash proceeds or fair market value of the assets received from the landlord. At the end of the lease term, including exercise of any renewal options, the net remaining financing obligation over the net carrying value of the fixed asset will be recognized as a non-cash gain on sale of the property. We do not report rent expense for the properties which are owned for accounting purposes. Rather, rental payments under the lease are recognized as a reduction of the financing obligation and interest expense.

Some of our leased property and equipment are recorded as capital leases. These assets are included in property and equipment and depreciated over the term of the lease. We do not report rent expense for capital leases. Rather, rental payments under the lease are recognized as a reduction of the capital lease obligation and interest expense.

All other leases are considered operating leases. Assets subject to an operating lease and the related lease payments are not recorded on our Balance Sheet. Rent expense is recognized on a straight-line basis over the expected lease term.

The lease term for all types of leases begins on the date we become legally obligated for the rent payments or we take possession of the building or land, whichever is earlier. The lease term includes cancelable option periods where failure to exercise such options would result in an economic penalty. Failure to exercise such options would result in the recognition of accelerated depreciation expense of the related assets.

Marketing

Marketing costs are expensed when the marketing is first seen. Marketing costs, net of related vendor allowances, are as follows:

(Dollars in Millions)	2018	2017	2016
Gross marketing costs	\$1,133	\$1,124	\$1,164

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Vendor allowances	(143)	(138)	(148)
Net marketing costs	\$990	\$986	\$1,016
Net marketing costs as a percent of total revenue	4.9 %	4.9 %	5.2 %

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KOHL'S CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Income Taxes

Income taxes are accounted for under the asset and liability method. Under this method, deferred tax assets and liabilities are recorded based on differences between the amounts of assets and liabilities recognized for financial reporting purposes and such amounts recognized for income tax purposes. Deferred tax assets and liabilities are calculated using the enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. We establish valuation allowances for deferred tax assets when we believe it is more likely than not that the asset will not be realizable for tax purposes. We recognize interest and penalty expense related to unrecognized tax benefits in our provision for income tax expense.

Net Income Per Share

Basic net income per share is net income divided by the average number of common shares outstanding during the period. Diluted net income per share includes incremental shares assumed for share-based awards.

The information required to compute basic and diluted net income per share is as follows:

(Dollars and Shares in Millions, Except per Share Data)	2018	2017	2016
Numerator—net income	\$801	\$859	\$556
Denominator—weighted average shares			
Basic	164	167	178
Impact of dilutive share-based awards	1	1	1
Diluted	165	168	179
Anti-dilutive shares	-	2	3
Net income per share:			
Basic	\$4.88	\$5.14	\$3.12
Diluted	\$4.84	\$5.12	\$3.11

Share-Based Awards

Stock-based compensation expense is generally recognized on a straight-line basis over the vesting period based on the fair value of awards which are expected to vest. The fair value of all share-based awards is estimated on the date of grant.

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KOHL'S CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Recent Accounting Pronouncements

The following table provides a brief description of issued, but not yet effective, accounting standards:

Standard	Description	Effect on our Financial Statements
Leases (ASC Topic 842)	We will adopt the new standard effective February 3, 2019, as required, using a modified prospective transition method.	<p>The new standard includes several practical expedients that were available to reduce the burden of implementing the standard.</p> <ul style="list-style-type: none"> •We will not restate prior period financials. •We elected the package of practical expedients, which, among other things, allowed us to carryforward our historical lease classifications. •We did not elect the hindsight practical expedient which would allow us to revisit key assumptions, such as lease term, that were made when we originally entered into the lease. •We are combining lease and non-lease costs. <p>Adoption of the new standard is expected to result in the recording of additional assets and liabilities of approximately \$2 billion as of February 3, 2019. Substantially all of the change will be due to recording right-of-use assets and lease liabilities for land and other operating leases on the balance sheet. The difference between additional lease assets and lease liabilities, net of tax, will be recorded as an adjustment to retained earnings.</p> <p>Adoption of the new standard is expected to increase 2019 net income by approximately \$5 million. We expect Selling, General and Administrative expense will increase by approximately \$25 million, Depreciation and Amortization will decrease by approximately \$25 million and Interest will decrease by approximately \$10 million. Substantially all of the income statement changes will be due to leases that changed classification under the new standard.</p>
Issued February 2016		
Effective Q1 2019		
Cloud Computing (ASU 2018-15)	Under the new standard, implementation costs related to a cloud computing arrangement will be deferred or expensed as incurred, in accordance with the existing	We are evaluating the impact of the new standard, but believe it is generally consistent with our current accounting for cloud computing arrangements and will not have a material impact on our financials.

internal-use software guidance for similar costs.

Issued
August 2018The new standard also prescribes the balance sheet, income statement, and cash flow classification of the capitalized implementation costs

Effective Q1 and related amortization expense.
2020

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KOHL'S CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

2. Revenue Recognition

Effective February 4, 2018, we adopted Revenue from Contracts with Customers (ASC Topic 606) as required. We adopted the new standard using the full retrospective method. The standard eliminated the transaction and industry specific revenue recognition guidance under prior U.S. GAAP and replaced it with the principles-based approach for revenue recognition and disclosures. Under the standard, revenue is recognized when a customer obtains control of promised goods or services in an amount that reflects the consideration the entity expects to receive in exchange for those goods or services.

The following tables summarize the impact of adoption of the new standard by financial statement line item:

2017	As Previously Reported	New Standard Adjustment	Adjusted
(Dollars in Millions, Except per Share Data)			
Net sales	\$ 19,095	\$ (59))\$ 19,036
Other revenue		1,048	1,048
Total revenue		989	20,084
Cost of merchandise sold	12,176	-	12,176
Gross margin	6,919		
Operating expenses:			
Selling, general and administrative	4,512	989	5,501
Depreciation and amortization	991	-	991
Operating income	1,416	-	1,416
Interest expense, net	299	-	299
Income before income taxes	1,117	-	1,117
Provision for income taxes	258	-	258
Net income	\$ 859	\$ -	\$ 859
Net income per share:			
Basic	\$ 5.14	\$ -	\$ 5.14
Diluted	\$ 5.12	\$ -	\$ 5.12

2016	As Previously Reported	New Standard Adjustment	Adjusted
(Dollars in Millions, Except per Share Data)			
Net sales	\$ 18,686	\$ (50))\$ 18,636
Other revenue		1,045	1,045

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Total revenue		995	19,681
Cost of merchandise sold	11,944		11,944
Gross margin	6,742		
Operating expenses:			
Selling, general and administrative	4,435	995	5,430
Depreciation and amortization	938	-	938
Impairments, store closing and other costs	186	-	186
Operating income	1,183	-	1,183
Interest expense, net	308	-	308
Income before income taxes	875	-	875
Provision for income taxes	319	-	319
Net income	\$ 556	\$ -	\$ 556
Net income per share:			
Basic	\$ 3.12	\$ -	\$ 3.12
Diluted	\$ 3.11	\$ -	\$ 3.11

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KOHL'S CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

February 3, 2018	As	New	
(Dollars in Millions)	Previously	Standard	Adjusted
Reported	Adjustment		
Assets			
Current assets:			
Cash and cash equivalents	\$ 1,308	\$ -	\$ 1,308
Merchandise inventories	3,542	-	3,542
Other	481	49	530
Total current assets	5,331	49	5,380
Property and equipment, net	7,773	-	7,773
Other assets	236	-	236
Total assets	\$ 13,340	\$ 49	\$ 13,389
Liabilities and Shareholders' Equity			
Current liabilities:			
Accounts payable	\$ 1,271	\$ -	\$ 1,271
Accrued liabilities	1,155	58	1,213
Income taxes payable	99	-	99
Current portion of capital lease and financing obligations	126	-	126
Total current liabilities	2,651	58	2,709
Long-term debt	2,797	-	2,797
Capital lease and financing obligations	1,591	-	1,591
Deferred income taxes	213	(2)	211
Other long-term liabilities	662	-	662
Total shareholders' equity	5,426	(7)	5,419
Total liabilities and shareholders' equity	\$ 13,340	\$ 49	\$ 13,389

The adoption of the new standard had no impact on our basic or diluted earnings per share or our net cash provided by (used in) operating, financing, or investing activities.

3. Debt

Long-term debt includes the following unsecured senior debt:

Maturity	Effective Coupon		Outstanding	
(Dollars in Millions)	Rate	Rate	Feb 2, 2019	Feb 3, 2018
2021	4.81 %	4.00 %	\$ -	\$650

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2023	3.25 %	3.25 %	350	350
2023	4.78 %	4.75 %	184	300
2025	4.25 %	4.25 %	650	650
2029	7.36 %	7.25 %	42	99
2033	6.05 %	6.00 %	113	166
2037	6.89 %	6.88 %	101	150
2045	5.57 %	5.55 %	433	450
Outstanding long-term debt			1,873	2,815
Unamortized debt discounts and deferred financing costs			(12)	(18)
Long-term debt			\$1,861	\$2,797
Effective interest rate			4.74 %	4.88 %

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Our long-term debt is classified as Level 1, financial instruments with unadjusted, quoted prices listed on active market exchanges. The estimated fair value of our long-term debt was \$1.8 billion at February 2, 2019 and \$2.9 billion at February 3, 2018.

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KOHL'S CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

In 2018, we reduced our outstanding debt by \$943 million including \$500 million of which was repurchased pursuant to a cash tender offer, \$413 million of which was the voluntary redemption of our 2021 bonds, and \$30 million of which was bonds we repurchased on the open market. In conjunction with the debt reduction, we recorded a \$63 million loss on extinguishment of debt which includes \$46 million of premiums paid to holders of the debt, \$12 million related to an interest rate hedge, and \$5 million of deferred financing fees and original issue discounts. These actions extended the remaining maturity of the portfolio for an additional two years.

Our various debt agreements contain covenants including limitations on additional indebtedness and certain financial tests. As of February 2, 2019, we were in compliance with all covenants of the various debt agreements.

We also had outstanding trade letters of credit totaling approximately \$54 million at February 2, 2019 issued under uncommitted lines with two banks.

4. Lease Commitments

Rent expense charged to operations was \$301 million for 2018, \$293 million for 2017, and \$276 million for 2016. In addition to rent payments, we are often required to pay real estate taxes, insurance and maintenance costs on leased properties. These items are not included in the future minimum lease payments listed below. Many store leases include multiple renewal options, exercisable at our options that generally range from four to eight additional five-year periods.

Future minimum lease payments at February 2, 2019 were as follows:

(Dollars in Millions)	Capital Lease and Financing Obligations	Operating Leases
Fiscal year:		
2019	\$ 260	\$ 275
2020	263	270
2021	241	265
2022	222	254
2023	198	244
Thereafter	2,027	3,669
	3,211	\$ 4,977
Non-cash gain on future sale of property	481	
Amount representing interest	(2,054)	
Present value of lease payments	\$ 1,638	

5. Benefit Plans

We have a defined contribution savings plan covering all full-time and certain part-time associates. Participants in this plan may invest up to 99% of their base compensation, subject to certain statutory limits. We match 100% of the first 5% of each participant's contribution, subject to certain statutory limits.

We also offer a non-qualified deferred compensation plan to a group of executives which provides for pre-tax compensation deferrals up to 75% of salary and 100% of bonus. Deferrals and credited investment returns are 100% vested.

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KOHL'S CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The total costs for these benefit plans were \$50 million for 2018, \$49 million for 2017, and \$47 million for 2016.

6. Income Taxes

Deferred income taxes consist of the following:

	Feb 2,	Feb 3,
(Dollars in Millions)	2019	2018
Deferred tax liabilities:		
Property and equipment	\$756	\$788
Merchandise inventories	73	63
Total deferred tax liabilities	829	851
Deferred tax assets:		
Capital lease and financing obligations	425	445
Accrued and other liabilities, including stock-based compensation	136	108
Accrued step rent liability	79	76
Federal benefit on state tax reserves	29	30
Unrealized loss on interest rate swap	—	5
Total deferred tax assets	669	664
Net deferred tax liability	\$160	\$187

Deferred tax assets included in other long-term assets totaled \$24 million as of February 2, 2019 and \$25 million as of February 3, 2018.

The components of the provision for income taxes were as follows:

(Dollars in Millions)	2018	2017	2016
Current federal	\$229	\$299	\$272
Current state	43	26	25
Deferred federal	(36)	(86)	16
Deferred state	5	19	6
Provision for income taxes	\$241	\$258	\$319

On December 22, 2017, H.R. 1, originally the Tax Cuts & Jobs Act, was signed into law making significant changes to the Internal Revenue Code. Changes include a corporate rate decrease from 35% to 21%, effective January 1, 2018, as well as a variety of other changes including the acceleration of expensing of certain business assets and reductions in the amount of executive pay that could qualify as a tax deduction.

On December 22, 2017, Staff Accounting Bulletin No. 118 was issued to address the application of U.S. GAAP in situations when a registrant does not have the necessary information available, prepared or analyzed in reasonable detail to complete the accounting for certain income tax effects of the Act. As of December 22, 2018, all impacts of the Act were analyzed and recorded. Adjustments recorded in 2018 were not material.

The effective tax rate differs from the amount that would be provided by applying the statutory U.S. corporate tax rate due to the following items:

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KOHL'S CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	2018	2017	2016
Provision at statutory rate	21.0 %	33.7 %	35.0 %
State income taxes, net of federal tax benefit	3.8	1.0	2.4
Re-measurement of deferred tax assets and liabilities	—	(10.9)	—
Other federal tax credits	(1.0)	(0.7)	(0.9)
Other	(0.6)	—	—
Provision for income taxes	23.2 %	23.1 %	36.5 %

The re-measurement of deferred tax assets and liabilities in 2017 includes the following impacts:

Revaluation of deferred taxes that existed on December 22, 2017, the enactment date of the Act

Deferred taxes that were created after December 22, 2017. These items were deducted at the federal statutory rate of 33.7%, but will reverse at the 21% rate.

We have analyzed filing positions in all of the federal and state jurisdictions where we are required to file income tax returns, as well as all open tax years in these jurisdictions. The federal returns subject to examination are for 2008 through 2018 tax years, excluding the 2014 tax year. State returns subject to examination vary depending upon the state. Generally, 2015 through 2018 tax years are subject to state examination. The earliest state open period is 2006. Certain states have proposed adjustments which we are currently appealing. If we do not prevail on our appeals, we do not anticipate that the adjustments would result in a material change in our financial position.

A reconciliation of the beginning and ending gross amount of unrecognized tax benefits is as follows:

(Dollars in Millions)	2018	2017
Balance at beginning of year	\$135	\$149
Increases due to tax positions taken in current year	13	18
Decreases due to:		
Tax positions taken in prior years	(3)	(13)
Settlements with taxing authorities	(3)	(16)
Lapse of applicable statute of limitations	(9)	(3)
Balance at end of year	\$133	\$135

Not included in the unrecognized tax benefits reconciliation above are gross unrecognized accrued interest and penalties of \$31 million at February 2, 2019 and \$33 million at February 3, 2018. Interest and penalty expenses were \$5 million in 2018, \$4 million in 2017, and \$6 million in 2016.

Our total unrecognized tax benefits that, if recognized, would affect our effective tax rate were \$110 million as of February 2, 2019 and \$112 million as of February 3, 2018. It is reasonably possible that our unrecognized tax positions may change within the next 12 months, primarily as a result of ongoing audits. While it is possible that one or more of these examinations may be resolved in the next year, it is not anticipated that a significant impact to the unrecognized tax benefit balance will occur.

We have both payables and receivables for current income taxes recorded on our balance sheet. Receivables included in other current assets totaled \$29 million as of February 2, 2019 and \$62 million as of February 3, 2018.

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KOHL'S CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

7. Stock-Based Compensation

We currently grant share-based compensation pursuant to the Kohl's Corporation 2017 Long-Term Compensation Plan, which provides for the granting of various forms of equity-based awards, including nonvested stock, performance share units and options to purchase shares of our common stock, to officers, key employees and directors. As of February 2, 2019, there were 9.0 million shares authorized and 8.3 million shares available for grant under the 2017 Long-Term Compensation Plan. Options and nonvested stock that are surrendered or terminated without issuance of shares are available for future grants. We also have outstanding options and other awards which were granted under previous compensation plans.

Annual grants are typically made in the first quarter of the fiscal year. Grants to newly-hired and promoted employees and other discretionary grants are made periodically throughout the remainder of the year.

Stock Options

The majority of stock options granted to employees vest in five equal annual installments. Outstanding options granted to employees after 2005 have a term of seven years. Outstanding options granted to employees prior to 2006 have a term of up to 15 years. Outstanding options granted to directors have a term of 10 years.

All stock options have an exercise price equal to the fair market value of the common stock on the date of grant. The fair value of each option award was estimated using a Black-Scholes option valuation model.

The following table summarizes our stock option activity:

	2018		2017		2016	
	Weighted		Weighted		Weighted	
	Average		Average		Average	
	Exercise		Exercise		Exercise	
(Shares in Thousands)	Shares	Price	Shares	Price	Shares	Price
Balance at beginning of year	1,139	\$ 50.51	2,350	\$ 53.29	3,076	\$ 52.65
Exercised	(1,001)	50.37	(359)	50.94	(410)	46.86
Forfeited/expired	(2)	53.52	(852)	58.00	(316)	55.39
Balance at end of year	136	\$ 51.48	1,139	\$ 50.51	2,350	\$ 53.29

The intrinsic value of options exercised represents the excess of our stock price at the time the option was exercised over the exercise price and was \$16 million in 2018, \$3 million in 2017, and \$2 million in 2016.

Additional information related to stock options outstanding and exercisable at February 2, 2019 is summarized below:

(Shares in Thousands)	Stock Options Outstanding			Stock Options Exercisable		
	Weighted			Weighted		
	Average			Average		
	Remaining	Weighted		Remaining	Weighted	
	Contractual	Average		Contractual	Average	
	Life (in	Exercise		Life (in	Exercise	
Range of Exercise Prices	Shares	years)	Price	Shares	years)	Price
\$ 46.20 - \$ 58.09	136	1.7	\$ 51.48	116	1.6	\$ 51.03
Intrinsic value (in thousands)	\$ 2,072			\$ 1,820		

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KOHL'S CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The intrinsic value of outstanding and exercisable stock options represents the excess of our closing stock price on February 2, 2019 (\$66.69) over the exercise price multiplied by the applicable number of stock options.

Nonvested Stock Awards

We have also awarded shares of nonvested common stock to eligible key employees and to our Board of Directors. Substantially all awards have restriction periods tied primarily to employment and/or service. Employee awards generally vest over five years. Director awards vest over the term to which the director was elected, generally one year. In lieu of cash dividends, holders of nonvested stock awards are granted restricted stock equivalents which vest consistently with the underlying nonvested stock awards.

The fair value of nonvested stock awards is the closing price of our common stock on the date of grant. We may acquire shares from employees in lieu of amounts required to satisfy minimum tax withholding requirements upon the vesting of the employee's unvested stock award. Such shares are then designated as treasury shares.

The following table summarizes nonvested stock activity, including restricted stock equivalents issued in lieu of cash dividends:

	2018		2017		2016	
	Weighted		Weighted		Weighted	
	Average		Average		Average	
	Grant		Grant		Grant	
	Date Fair		Date Fair		Date Fair	
(Shares in Thousands)	Shares	Value	Shares	Value	Shares	Value
Balance at beginning of year	2,811	\$ 45.60	2,163	\$ 52.75	2,211	\$ 57.37
Granted	1,086	63.25	1,624	39.69	1,128	46.61
Vested	(1,202)	47.69	(772)	52.14	(935)	55.54
Forfeited	(94)	49.08	(204)	59.58	(241)	55.54
Balance at end of year	2,601	\$ 51.90	2,811	\$ 45.60	2,163	\$ 52.75

The aggregate fair value of awards at the time of vesting was \$57 million in 2018, \$40 million in 2017 and \$52 million in 2016.

Performance Share Units

We grant performance-based share units ("performance share units") to certain executives. The performance measurement period for these performance share units is three fiscal years. The fair market value of the grants is determined using a Monte-Carlo valuation on the date of grant.

The actual number of shares which will be earned at the end of the three-year vesting periods will vary based on our cumulative financial performance over the vesting periods. The number of performance share units earned will be modified up or down based on Kohl's Relative Total Shareholder Return against a defined peer group during the vesting periods. The payouts, if earned, will be settled in Kohl's common stock after the end of each multi-year performance periods.

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KOHL'S CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following table summarizes performance share unit activity by year of grant:

	2018		2017		2016	
	Weighted		Weighted		Weighted	
	Average		Average		Average	
	Grant		Grant		Grant	
	Date Fair		Date Fair		Date Fair	
(Shares in Thousands)	Shares	Value	Shares	Value	Shares	Value
Balance at beginning of year	660	\$ 44.97	512	\$ 57.82	357	\$ 63.58
Granted	253	61.47	365	40.83	309	47.89
Vested	(38)	78.35	(106)	57.58	—	—
Forfeited	(5)	46.91	(111)	78.35	(154)	59.74
Balance at end of year	870	\$ 51.68	660	\$ 44.97	512	\$ 57.82

Other Required Disclosures

Stock-based compensation expense, other than that included in Impairments, store closing and other costs, is included in Selling, General and Administrative Expenses in our Consolidated Statements of Income. Stock-based compensation expense totaled \$87 million for 2018, \$55 million for 2017 and \$44 million for 2016. At February 2, 2019, we had approximately \$109 million of unrecognized share-based compensation expense, which is expected to be recognized over a weighted-average period of 1.3 years.

8. Contingencies

At any time, we may be subject to investigations, legal proceedings, or claims related to the on-going operation of our business, including claims both by and against us. Such proceedings typically involve claims related to various forms of liability, contract disputes, allegations of violations of laws or regulations or other actions brought by us or others including our employees, consumers, competitors, suppliers or governmental agencies. We routinely assess the likelihood of any adverse outcomes related to these matters on a case by case basis, as well as the potential ranges of losses and fees. We establish accruals for our potential exposure, as appropriate, for significant claims against us when losses become probable and reasonably estimable. Where we are able to reasonably estimate a range of potential losses relating to significant matters, we record the amount within that range that constitutes our best estimate. We also disclose the nature of and range of loss for claims against us when losses are reasonably possible and material. These accruals and disclosures are determined based on the facts and circumstances related to the individual cases and require estimates and judgments regarding the interpretation of facts and laws, as well as the effectiveness of strategies or other factors beyond our control.

9. Quarterly Financial Information (Unaudited)

(Dollars and Shares in Millions, Except per Share Data)	2018			
	First	Second	Third	Fourth
Total revenue	\$4,208	\$4,570	\$4,628	\$6,823
Cost of merchandise sold	\$2,496	\$2,605	\$2,752	\$4,345
Selling, general and administrative expenses	\$1,259	\$1,272	\$1,375	\$1,694
Loss on extinguishment of debt	\$42	—	—	\$21
Impairments, store closing and other costs	—	—	—	\$104
Net income	\$75	\$292	\$161	\$272
Basic shares	165	165	164	162
Basic net income per share	\$0.46	\$1.77	\$0.98	\$1.68
Diluted shares	167	166	165	163
Diluted net income per share	\$0.45	\$1.76	\$0.98	\$1.67

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KOHL'S CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars and Shares in Millions, Except per Share Data)	2017 As adjusted (a)			
	First	Second	Third	Fourth
Total revenue	\$4,065	\$4,395	\$4,567	\$7,057
Cost of merchandise sold	\$2,428	\$2,525	\$2,727	\$4,497
Selling, general and administrative expenses	\$1,214	\$1,220	\$1,340	\$1,726
Net income	\$66	\$208	\$117	\$468
Basic shares	170	168	166	165
Basic net income per share	\$0.39	\$1.24	\$0.70	\$2.83
Diluted shares	171	168	166	167
Diluted net income per share	\$0.39	\$1.24	\$0.70	\$2.81

(a) Refer to Note 2 for details on the adoption of the new revenue recognition accounting standard and the impact on previously reported results

Due to changes in stock prices during the year and timing of share repurchases and issuances, the sum of quarterly net income per share may not equal the annual net income per share.

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Item 9. Changes In and Disagreements with Accountants on Accounting and Financial Disclosures

None

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (the “Evaluation”) at a reasonable assurance level as of the last day of the period covered by this Report.

Based upon the Evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective at the reasonable assurance level. "Disclosure controls and procedures" is defined by Rule 13a-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act") as controls and other procedures that are designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures.

It should be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving our stated goals under all potential future conditions, regardless of how remote.

Management’s Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control system was designed to provide reasonable assurance to our management and Board of Directors regarding the preparation and fair presentation of our published financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Our management assessed the effectiveness of our internal control over financial reporting as of February 2, 2019. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) in Internal Control—Integrated Framework (2013 Framework). Based on this assessment, our management has concluded that as of February 2, 2019, our internal control over financial reporting was effective based on those criteria.

Ernst & Young LLP, an independent registered public accounting firm, has audited the Consolidated Financial Statements included in this Annual Report on Form 10-K and, as part of its audit, has issued an attestation report, included herein, on the effectiveness of our internal control over financial reporting.

Changes in Internal Control Over Financial Reporting

During the last fiscal quarter, there were no changes in our internal controls that have materially affected or are reasonably likely to materially affect such controls, including any corrective actions with regard to significant deficiencies and material weaknesses.

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Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of Kohl's Corporation

Opinion on Internal Control over Financial Reporting

We have audited Kohl's Corporation's internal control over financial reporting as of February 2, 2019, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 Framework) (the COSO criteria). In our opinion, Kohl's Corporation (the Company) maintained, in all material respects, effective internal control over financial reporting as of February 2, 2019, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of the Company as of February 2, 2019 and February 3, 2018, and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the three years in the period ended February 2, 2019, and the related notes and our report dated March 22, 2019, expressed an unqualified opinion thereon.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that

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controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Ernst & Young LLP

Milwaukee, Wisconsin

March 22, 2019

Item 9B. Other Information

None

PART III

Item 10. Directors, Executive Officers and Corporate Governance

For information with respect to our Directors, the Board of Directors' committees and our written code of ethics, see the applicable portions of the "Questions and Answers About our Board of Directors and Corporate Governance Matters" and "Item One: Election of Directors" sections of the Proxy Statement for our May 15, 2019 Annual Meeting of Shareholders ("our 2019 Proxy"), which information is incorporated herein by reference. For information with respect to Section 16 reports, see the information provided in the "Section 16(a) Beneficial Ownership Reporting Compliance" section of our 2019 Proxy, which information is incorporated herein by reference.

Any amendment to or waiver from the provisions of the Code of Ethics that is applicable to our Chief Executive Officer, Chief Financial Officer or other key finance associates will be disclosed on the "Corporate Governance" portion of <http://corporate.kohls.com>. We intend to satisfy our disclosure requirements under item 5.05 of form 8-K regarding any amendments or waivers by posting such information at this location or our website.

See also Item 4A, Executive Officers of Part 1.

Item 11. Executive Compensation

See the information provided in the applicable portions of the "Questions and Answers About our Board of Directors and Corporate Governance Matters" and "Item One: Election of Directors" sections of our 2019 Proxy, including the "Compensation Committee Report" and "Compensation Discussion & Analysis", which information is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

See the information provided in the “Security Ownership of Certain Beneficial Owners, Directors and Management” section of our 2019 Proxy, which information is incorporated herein by reference.

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The following table includes shares of common stock outstanding and available for issuance under our existing equity compensation plans as of February 2, 2019:

Plan Category	(a)		(c)
	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	(b) Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	136,209	\$ 51.48	8,260,763
Equity compensation plans not approved by security holders (a)	—	—	—
Total	136,209	\$ 51.48	8,260,763

(a) All of our existing equity compensation plans have been approved by shareholders.

Item 13. Certain Relationships and Related Transactions, and Director Independence

See the information provided in the “Independence Determinations & Related Person Transactions” section of our 2019 Proxy, which information is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services

See the information provided in the “Fees Paid to Ernst & Young” section of our 2019 Proxy, which information is incorporated herein by reference.

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PART IV

Item 15. Exhibits and Financial Statement Schedules

Documents filed as part of this report

1. Consolidated Financial Statements:

See Index to Consolidated Financial Statements, the Report of Independent Registered Public Accounting Firm and the Consolidated Financial Statements, in Part II, Item 8 of this Form 10-K.

2. Financial Statement Schedule:

All schedules have been omitted as they are not applicable.

3. Exhibits:

Exhibit Description	Document if Incorporated by Reference
3.1 <u>Amended and Restated Articles of Incorporation of the Company</u>	Exhibit 3.1 of the Company's Current Report on Form 8-K filed on May 16, 2011
3.2 <u>Amended and Restated Bylaws of the Company</u>	Exhibit 3.1 of the Company's Current Report on Form 8-K filed on November 13, 2015
4.1 <u>Second Amended and Restated Credit Agreement dated as of November 3, 2017 by and among the Company, the Lenders party thereto, Wells Fargo Bank, National Association, as Administrative Agent, Swing Line Lender and Issuing Bank, Bank of America, N.A., JPMorgan Chase Bank, N.A., The Bank of Tokyo-Mitsubishi UFJ, Ltd. and U.S. Bank National Association, as Syndication Agents, Swing Line Lenders and Issuing Banks, Capital One, N.A., Goldman Sachs Bank USA and Morgan Stanley Senior Funding, Inc., as Documentation Agents, and Wells Fargo Securities, LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated, JP Morgan Chase Bank, N.A., The Bank of Tokyo-Mitsubishi UFJ, Ltd. and U.S. Bank National Association, as Joint Lead Arrangers and Bookrunner</u>	Exhibit 4.1 of the Company's Current Report on Form 8-K filed on November 3, 2017
4.2 Certain other long-term debt is described in Note 2 of the Notes to Consolidated Financial Statements. The Company agrees to furnish to the Commission, upon request, copies of any instruments defining the rights of holders of any such long-term debt described in Note 2 and not filed herewith.	
10.1 <u>Private Label Credit Card Program Agreement dated as of August 11, 2010 by and between Kohl's Department Stores, Inc. and Capital One, National Association</u>	Exhibit 10.1 of the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended July 31, 2010
10.2 <u>Amendment to Private Label Credit Card Program Agreement dated as of May 13, 2014 by and between Kohl's Department Stores, Inc. and Capital One, National Association</u>	Exhibit 10.2 of the Company's Quarterly Report on Form 10-Q

10.3	<u>Amended and Restated Executive Deferred Compensation Plan*</u>	for the fiscal quarter ended May 3, 2014 Exhibit 10.1 of the Company's Annual Report on Form 10-K for the fiscal year ended February 1, 2003
10.4	<u>Kohl's Corporation 2005 Deferred Compensation Plan, as amended and restated effective January 1, 2005*</u>	Exhibit 10.4 of the Company's Annual Report on Form 10-K for the fiscal year ended January 28, 2006

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Exhibit	Description	Document if Incorporated by Reference
10.5	<u>Summary of Executive Medical Plan*</u>	Exhibit 10.6 of the Company's Annual Report on Form 10-K for the fiscal year ended January 29, 2005
10.6	<u>Summary of Executive Life and Accidental Death and Dismemberment Plans*</u>	Exhibit 10.7 of the Company's Annual Report on Form 10-K for the fiscal year ended January 29, 2005
10.7	<u>Kohl's Corporation Annual Incentive Plan*</u>	Annex B to the Proxy Statement on Schedule 14A filed on March 24, 2016 in connection with the Company's 2016 Annual Meeting of Shareholders
10.8	<u>1997 Stock Option Plan for Outside Directors*</u>	Exhibit 4.4 of the Company's registration statements on Form S-8 (File No. 333-26409), filed on May 2, 1997
10.9	<u>Amended and Restated 2003 Long-Term Compensation Plan*</u>	Exhibit 10.1 of the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended August 2, 2008
10.10	<u>Kohl's Corporation 2010 Long-Term Compensation Plan*</u>	Annex A to the Proxy Statement on Schedule 14A filed on March 24, 2016 in connection with the Company's 2016 Annual Meeting
10.11	<u>Form of Executive Performance Share Agreement pursuant to the Kohl's Corporation 2010 Long Term Compensation Plan*</u>	Exhibit 99.1 of the Company's Current Report on Form 8-K filed on January 15, 2014
10.12	<u>Form of Executive Restricted Stock Agreement pursuant to the Kohl's Corporation 2010 Long Term Compensation Plan (4-year vesting)*</u>	Exhibit 99.2 of the Company's Current Report on Form 8-K filed on January 15, 2014
10.13	<u>Form of Outside Director Restricted Stock Agreement pursuant to the Kohl's Corporation 2010 Long Term Compensation Plan*</u>	Exhibit 10.4 of the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended May 1, 2010
10.14	<u>Kohl's Corporation 2017 Long-Term Compensation Plan*</u>	Annex A to the Proxy Statement on Schedule 14A filed on March 13, 2017 in connection with the company's 2017 Annual Meeting
10.15	<u>Form of Executive Restricted Stock Agreement pursuant to the Kohl's Corporation 2017 Long-Term Compensation Plan*</u>	Exhibit 10.2 of the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended July 29, 2017
10.16	<u>Form of Executive Performance Share Unit Agreement pursuant to the Kohl's Corporation 2017 Long-Term Compensation Plan*</u>	Exhibit 10.1 of the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended July 29, 2017
10.17	<u>Non-Employee Director Compensation Program*</u>	Exhibit 10.1 of the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended November 3, 2018
10.18	<u>Amended and Restated Employment Agreement between Kohl's Corporation and Kohl's Department Stores, Inc. and Kevin Mansell dated as of November 14, 2014*</u>	Exhibit 99.1 of the Company's Current Report on Form 8-K filed on November 14, 2014

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Exhibit	Description	Document if Incorporated by Reference
10.19	<u>Amended and Restated Employment Agreement between Kohl's Department Stores, Inc. and Kohl's Corporation and Michelle Gass effective as of September 25, 2017*</u>	Exhibit 10.1 of the Company's Current Report on Form 8-K filed on September 29, 2017
10.20	<u>Amended and Restated Employment Agreement between Kohl's Department Stores, Inc. and Kohl's Corporation and Sona Chawla effective as of September 25, 2017*</u>	Exhibit 10.3 of the Company's Current Report on Form 8-K filed on September 29, 2017
10.21	<u>Employment Agreement between Kohl's Department Stores, Inc. and Kohl's Corporation and Bruce H. Besanko effective as of July 10, 2017*</u>	Exhibit 10.2 of the Company's Current Report on Form 8-K filed on July 14, 2017
10.22	<u>Employment Agreement between Kohl's Department Stores, Inc. and Kohl's Corporation and Doug Howe effective as of May 14, 2018*</u>	Exhibit 10.1 of the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended August 4, 2018
10.23	<u>Form of SEVP Employment Agreement*</u>	Exhibit 10.1 of the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended May 5, 2018
21.1	<u>Subsidiaries of the Registrant</u>	
23.1	<u>Consent of Ernst & Young LLP.</u>	
31.1	<u>Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>	
31.2	<u>Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>	
32.1	<u>Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>	
32.2	<u>Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>	
101.INS	XBRL Instance Document	
101.SCH	XBRL Taxonomy Extension Schema	
101.CAL	XBRL Taxonomy Extension Calculation Linkbase	
101.DEF	XBRL Taxonomy Extension Definition Linkbase	
101.LAB	XBRL Taxonomy Extension Label Linkbase	
101.PRE	XBRL Taxonomy Extension Presentation Linkbase	

*A management contract or compensatory plan or arrangement.

Not applicable.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) 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.

Kohl's Corporation

By: /s/ MICHELLE GASS

Michelle Gass

Chief Executive Officer and Director

(Principal Executive Officer)

/s/ BRUCE BESANKO

Bruce Besanko

Chief Financial Officer

(Principal Financial and Accounting Officer)

Dated: March 22, 2019

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the date indicated above:

/s/ FRANK V. SICA

Frank V. Sica

Chairman

/s/ PETER BONEPARTH

Peter Boneparth

Director

/s/ JOHN E. SCHLIFSKE

John E. Schlifske

Director

/s/ STEVEN A. BURD

Steven A. Burd

Director

/s/ ADRIANNE SHAPIRA

Adrianne Shapira

Director

/s/ H. CHARLES FLOYD

/s/ STEPHANIE A. STREETER

H. Charles Floyd	Stephanie A. Streeter
Director	Director
/s/ MICHELLE GASS	/s/ NINA G. VACA
Michelle Gass	Nina G. Vaca
Chief Executive Officer	Director
Director (Principal Executive Officer)	
/s/ JONAS PRISING	/s/ STEPHEN E. WATSON
Jonas Prising	Stephen E. Watson
Director	Director