

GLADSTONE CAPITAL CORP
Form 10-Q
January 31, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTER ENDED DECEMBER 31, 2011

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

COMMISSION FILE NUMBER: 814-00237

GLADSTONE CAPITAL CORPORATION

(Exact name of registrant as specified in its charter)

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MARYLAND
(State or other jurisdiction of

54-2040781
(I.R.S. Employer

incorporation or organization)

Identification No.)

1521 WESTBRANCH DRIVE, SUITE 200

MCLEAN, VIRGINIA 22102

(Address of principal executive office)

(703) 287-5800

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No .

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. The number of shares of the issuer's common stock, \$0.001 par value per share, outstanding as of January 27, 2012 was 21,000,160.

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GLADSTONE CAPITAL CORPORATION

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| | December 31, 2011 | September 30, 2011 |
|--|----------------------|-----------------------|
| ASSETS | | |
| Investments at fair value | | |
| Non-Control/Non-Affiliate investments (Cost of \$273,177 and \$288,266, respectively) | \$ 248,832 | \$ 257,302 |
| Control investments (Cost of \$97,293 and \$94,549, respectively) | 44,014 | 45,645 |
| Total investments at fair value (Cost of \$370,470 and \$382,815, respectively) | 292,846 | 302,947 |
| Cash | 5,772 | 6,732 |
| Restricted cash | 1,225 | |
| Interest receivable investments in debt securities | 2,921 | 3,066 |
| Interest receivable employees ^(S) | 13 | |
| Due from custodian | 1,669 | 2,547 |
| Deferred financing fees | 2,261 | 650 |
| Prepaid assets | 825 | 996 |
| Other assets | 584 | 686 |
| TOTAL ASSETS | \$ 308,116 | \$ 317,624 |
| LIABILITIES | | |
| Borrowings at fair value (Cost of \$56,900 and \$99,400, respectively) | \$ 57,213 | \$ 100,012 |
| Mandatorily redeemable preferred stock, \$0.001 per share par value, \$25 per share liquidation preference; 4,000,000 and no shares authorized; 1,539,882 and no shares issued and outstanding at December 31, 2011 and September 30, 2011, respectively | 38,497 | |
| Accounts payable and accrued expenses | 524 | 513 |
| Interest payable | 205 | 289 |
| Fees due to Adviser ^(A) | 1,414 | 1,760 |
| Fee due to Administrator ^(A) | 195 | 194 |
| Other liabilities | 2,052 | 1,135 |
| TOTAL LIABILITIES | \$ 100,100 | \$ 103,903 |
| NET ASSETS | \$ 208,016 | \$ 213,721 |
| ANALYSIS OF NET ASSETS | | |
| Common stock, \$0.001 par value per share, 46,000,000 and 50,000,000 shares authorized; 21,019,242 and 21,039,242 shares issued and outstanding at December 31, 2011 and September 30, 2011, respectively | \$ 21 | \$ 21 |
| Capital in excess of par value | 326,756 | 326,913 |
| Notes receivable employees ^(S) | (3,699) | (3,858) |
| Cumulative net unrealized depreciation on investments | (77,624) | (79,867) |
| Cumulative net unrealized appreciation on borrowings | (313) | (612) |
| Under distributed net investment income | 108 | 108 |
| Accumulated net realized losses | (37,233) | (28,984) |

| | | |
|--|-------------------|-------------------|
| TOTAL NET ASSETS | \$ 208,016 | \$ 213,721 |
| NET ASSET VALUE PER COMMON SHARE AT END OF PERIOD | \$ 9.90 | \$ 10.16 |

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

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

Table of Contents**GLADSTONE CAPITAL CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(DOLLAR AMOUNTS IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)****(UNAUDITED)**

| | Three Months Ended December 31, | |
|---|------------------------------------|----------|
| | 2011 | 2010 |
| INVESTMENT INCOME | | |
| Interest income | | |
| Non-Control/Non-Affiliate investments | \$ 7,889 | \$ 6,926 |
| Control investments | 1,358 | 797 |
| Cash | 6 | |
| Notes receivable from employees ^(A) | 67 | 122 |
| Total interest income | 9,320 | 7,845 |
| Other income | | |
| Non-Control/Non-Affiliate investments | | 161 |
| Total other income | | 161 |
| Total investment income | 9,320 | 8,006 |
| EXPENSES | | |
| Loan servicing fee ^(A) | 959 | 842 |
| Base management fee ^(A) | 597 | 505 |
| Incentive fee ^(A) | 1,035 | 1,159 |
| Administration fee ^(A) | 195 | 186 |
| Interest expense on borrowings | 1,139 | (120) |
| Dividend expense on mandatorily redeemable preferred stock | 434 | |
| Amortization of deferred financing fees | 457 | 297 |
| Professional fees | 292 | 332 |
| Other expenses | 244 | 220 |
| Expenses before credits from Adviser | 5,352 | 3,421 |
| Credits to fees from Adviser ^(A) | (450) | (52) |
| Total expenses net of credits to fees | 4,902 | 3,369 |
| NET INVESTMENT INCOME | 4,418 | 4,637 |
| REALIZED AND UNREALIZED (LOSS) GAIN: | | |
| Net realized loss on investments | (8,249) | |
| Net unrealized appreciation (depreciation) on investments | 2,243 | (2,944) |
| Net unrealized depreciation on borrowings | 299 | 439 |
| Net loss on investments and borrowings | (5,707) | (2,505) |
| NET (DECREASE) INCREASE IN NET ASSETS RESULTING FROM OPERATIONS | \$ (1,289) | \$ 2,132 |

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NET (DECREASE) INCREASE IN NET ASSETS RESULTING FROM OPERATIONS PER
COMMON SHARE:

| | | | | |
|-------------------|----|--------|----|------|
| Basic and Diluted | \$ | (0.06) | \$ | 0.10 |
|-------------------|----|--------|----|------|

WEIGHTED AVERAGE SHARES OF COMMON STOCK OUTSTANDING:

| | | | | |
|-------------------|--|-------------------|--|------------|
| Basic and Diluted | | 21,038,590 | | 21,039,242 |
|-------------------|--|-------------------|--|------------|

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

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

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

| | Three Months Ended December 31, | |
|---|--|-------------|
| | 2011 | 2010 |
| <i>Operations:</i> | | |
| Net investment income | \$ 4,418 | \$ 4,637 |
| Net realized loss on investments | (8,249) | |
| Net unrealized appreciation (depreciation) on investments | 2,243 | (2,944) |
| Net unrealized depreciation on borrowings | 299 | 439 |
| Net (decrease) increase in net assets resulting from operations | (1,289) | 2,132 |
| <i>Distributions:</i> | | |
| Distributions to common stockholders | (4,418) | (4,418) |
| <i>Capital transactions:</i> | | |
| Stock redemption for repayment of principal on employee note | (155) | |
| Repayment of principal on employee notes | 158 | |
| Net increase in net assets from capital transactions | 3 | |
| Total decrease in net assets | (5,704) | (2,286) |
| Net assets at beginning of period | 213,720 | 249,246 |
| Net assets at end of period | \$ 208,016 | \$ 246,960 |

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

Table of Contents**GLADSTONE CAPITAL CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(DOLLAR AMOUNTS IN THOUSANDS, EXCEPT SHARE AMOUNTS)****(UNAUDITED)**

| | Three Months Ended December 31, | |
|--|--|-----------------|
| | 2011 | 2010 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net (decrease) increase in net assets resulting from operations | \$ (1,289) | \$ 2,132 |
| Adjustments to reconcile net (decrease) increase in net assets resulting from operations to net cash provided by (used in) operating activities: | | |
| Purchase of investments | (11,251) | (11,794) |
| Principal repayments on investments | 10,780 | 13,208 |
| Proceeds from sale of investments | 4,489 | 37 |
| Increase in investment balance due to paid-in-kind interest | | (4) |
| Net change in premiums, discounts and amortization | (74) | 213 |
| Net realized loss on investments | 8,400 | |
| Net unrealized (appreciation) depreciation on investments | (2,243) | 2,944 |
| Net unrealized depreciation on borrowings | (299) | (439) |
| Increase in restricted cash | (1,225) | |
| Amortization of deferred financing fees | 457 | 297 |
| Decrease (increase) in interest receivable | 132 | (82) |
| Decrease (increase) in due from custodian | 877 | (10,509) |
| Decrease (increase) in prepaid assets | 171 | (15) |
| Decrease in other assets | 102 | 108 |
| Increase (decrease) in accounts payable and accrued expenses | 11 | (373) |
| Decrease in interest payable | (84) | (578) |
| (Decrease) increase in fees due to Adviser ^(A) | (346) | 1,143 |
| Increase (decrease) in fee due to Administrator ^(A) | 1 | (81) |
| Increase (decrease) in other liabilities | 917 | (207) |
| Net cash provided by (used in) operating activities | 9,526 | (4,000) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Proceeds from borrowings | 11,000 | 10,000 |
| Repayments on borrowings | (53,500) | (2,200) |
| Proceeds from issuance of mandatorily redeemable preferred stock | 38,497 | |
| Deferred financing fees | (2,068) | (682) |
| Distributions paid to common stockholders | (4,418) | (4,418) |
| Receipt of principal on employee notes | 3 | |
| Net cash (used in) provided by financing activities | (10,486) | 2,700 |
| NET DECREASE IN CASH | (960) | (1,300) |
| CASH, BEGINNING OF PERIOD | 6,732 | 7,734 |
| CASH, END OF PERIOD | \$ 5,772 | \$ 6,434 |

| | | | |
|--|-----------|------------|-----------|
| NON-CASH ACTIVITIES^(B) | \$ | 155 | \$ |
|--|-----------|------------|-----------|

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

^(B) Redemption of 20,000 shares of common stock as consideration to reduce the principal balance of an employee loan by \$155. Refer to Note 7 *Common Stock* for additional information.

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

Table of Contents**GLADSTONE CAPITAL CORPORATION****CONDENSED CONSOLIDATED SCHEDULE OF INVESTMENTS****AS OF DECEMBER 31, 2011****(DOLLAR AMOUNTS IN THOUSANDS)****(UNAUDITED)**

| Company^(A) | Industry | Investment^(B) | Principal | Cost | Fair Value |
|--|--|--|----------------------------------|---|---|
| NON-CONTROL/NON-AFFILIATE INVESTMENTS | | | | | |
| Non-syndicated Loans: | | | | | |
| Access Television Network, Inc. | Service-cable airtime (infomercials) | Senior Term Debt (14.0%, Due 2/2011) ^{(D) (H)} | \$ 903 | \$ 903 | \$ 9 |
| Allison Publications, LLC | Service-publisher of consumer oriented Magazines | Senior Term Debt (10.5%, Due 9/2012) ^(D) | 8,314 | 8,325 | 7,763 |
| BAS Broadcasting | Service-radio station operator | Senior Term Debt (11.5%, Due 7/2013) ^(D) | 7,465 | 7,465 | 5,226 |
| Chinese Yellow Pages Company | Service-publisher of Chinese language directories | Line of Credit, \$0 available (7.3%, Due 11/2012) ^(D) Senior Term Debt (7.3%, Due 11/2012) ^(D) | 450 108 | 450 108 | 315 76 |
| CMI Acquisition, LLC | Service-recycling | Senior Subordinated Term Debt (13.5%, Due 12/2016) ^(D) | 14,265 | 14,265 | 14,354 |
| FedCap Partners, LLC | Private equity fund | Class A Membership Units (80 units) ^(G) Uncalled Capital Commitment (\$800) | | 1,200 | 1,153 |
| GFRC Holdings, LLC | Manufacturing-glass-fiber reinforced concrete | Senior Term Debt (11.5%, Due 12/2012) ^(D) Senior Subordinated Term Debt (14.0%, Due 12/2012) ^(D) | 5,424 6,598 | 5,424 6,598 | 3,525 4,289 |
| Global Materials Technologies, Inc. | Manufacturing-steel wool products and metal fibers | Senior Term Debt (13.0%, Due 6/2012) ^{(C) (I)} | 2,435 | 2,435 | 2,435 |
| Heartland Communications Group | Service-radio station operator | Line of Credit, \$43 available (5.0%, Due 3/2013) ^(D) Line of Credit, \$100 available (10.0%, Due 3/2013) ^(D) Senior Term Debt (5.0%, Due 3/2013) ^(D) Common Stock Warrants (8.8% ownership) ^{(F) (G)} | 57 4,342 | 57 4,320 66 | 22 1,672 |
| International Junior Golf Training Acquisition Company | Service-golf training | Line of Credit, \$0 available (11.0%, Due 5/2012) ^{(D) (J)} Senior Term Debt (10.5%, Due 5/2012) ^{(D) (J)} Senior Term Debt (12.5%, Due 5/2012) ^{(C)(D) (J)} | 1,500 859 2,500 | 1,500 858 2,500 | 1,088 622 1,813 |
| Legend Communications of Wyoming, LLC | Service-operator of radio stations | Senior Term Debt (16.0%, Due 6/2013) ^(D) Senior Term Debt (18.0%, Due 7/2011) ^(D) | 9,474 220 | 9,474 220 | 4,737 110 |
| North American Aircraft Services, LLC | Service - repairs and maintains aircraft fuel tanks and fuel systems | Line of Credit, \$750 available (6.5%, Due 8/2012) ^(D) Senior Term Debt (7.5%, Due 8/2016) ^(D) Senior Subordinated Term Debt (11.8%, Due 8/2016) ^(D) Senior Subordinated Term Debt (12.5%, Due 8/2016) ^(D) Common Stock Warrants (5.8% ownership) ^{(F) (G)} | 1,250 5,017 4,750 2,820 | 1,250 5,017 4,750 2,820 350 | 1,225 4,917 4,655 2,764 420 |
| Northstar Broadband, LLC | Service-cable TV franchise owner | Senior Term Debt (0.7%, Due 12/2012) ^(D) | 65 | 57 | 53 |
| Ohana Media Group | Service AM/FM radio broadcast | Senior Term Debt (10.0%, Due 10/2016) ^(D) | 1,590 | 1,590 | 1,439 |
| Precision Acquisition Group Holdings, Inc. | Manufacturing-consumable components for the Aluminum industry | Equipment Note (13.0%, Due 3/2013) ^(D) Senior Term Debt (13.0%, Due 3/2013) ^(D) | 1,000 4,125 | 1,000 4,125 | 887 3,661 |

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| | | | | | |
|---|--|---|-----------------------------------|-----------------------------------|-----------------------------------|
| | | Senior Term Debt (13.0%, Due 3/2013) (C) (D) | 4,053 | 4,053 | 3,597 |
| PROFIT Systems Acquisition Co. | Service-design and develop ERP Software | Line of Credit, \$350 available (11.3%, Due 7/2012) (D) Senior Term Debt (10.5%, Due 7/2014) (C) (D) | 3,000 | 3,000 | 2,865 |
| RCS Management Holding Co. | Service-healthcare supplies | Senior Term Debt (9.5%, Due 1/2013) (D) Senior Term Debt (11.5%, Due 1/2013) (C) (D) | 1,312 3,060 | 1,312 3,060 | 1,221 2,846 |
| Reliable Biopharmaceutical Holdings, Inc. | Manufacturing-pharmaceutical and biochemical intermediates | Line of Credit, \$2,500 available (9.0%, Due 1/2013) (D) Mortgage Note (9.5%, Due 12/2014) (D) Senior Term Debt (12.0%, Due 12/2014) (C)(D) Senior Subordinated Term Debt (12.5%, Due 12/2014) (D) Common Stock Warrants (764 shares) (F) (G) | 1,500 7,145 11,543 6,000 | 1,500 7,145 11,543 6,000 | 1,472 7,011 10,922 5,678 |
| Saunders & Associates | Manufacturing-equipment provider for frequency control devices | Line of Credit, \$2,500 available (11.3%, Due 5/2013) (D) Senior Term Debt (11.3%, Due 5/2013) (D) | 8,947 | 8,947 | 8,868 |
| Sunburst Media - Louisiana, LLC | Service-radio station operator | Senior Term Debt (10.5%, Due 1/2012) (D) | 6,000 | 6,000 | 3,300 |
| Thibaut Acquisition Co. | Service-design and distribute wall covering | Line of Credit, \$475 available (9.0%, Due 1/2014) (D) Senior Term Debt (8.5%, Due 1/2014) (D) Senior Term Debt (12.0%, Due 1/2014) (C) (D) | 525 419 3,000 | 525 419 3,000 | 513 409 2,918 |
| Westlake Hardware, Inc. | Retail-hardware and variety | Senior Subordinated Term Debt (12.3%, Due 1/2014) (D) Senior Subordinated Term Debt (13.5%, Due 1/2014) (D) | 12,000 8,000 | 12,000 8,000 | 11,685 7,730 |

Table of Contents**GLADSTONE CAPITAL CORPORATION****CONDENSED CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)****AS OF DECEMBER 31, 2011****(DOLLAR AMOUNTS IN THOUSANDS)****(UNAUDITED)**

| Company^(A) | Industry | Investment^(B) | Principal | Cost | Fair Value |
|---|--|---|------------------|-------------|-------------------|
| NON-CONTROL/NON-AFFILIATE INVESTMENTS (Continued): | | | | | |
| Westland Technologies, Inc. | Service-diversified conglomerate | Line of Credit, \$1,000 available (6.5%, Due 4/2012) (D) | \$ | \$ | \$ |
| | | Senior Term Debt (7.5%, Due 4/2016) (D) | 2,000 | 2,000 | 2,000 |
| | | Senior Term Debt (12.5%, Due 4/2016) (D) | 4,000 | 4,000 | 4,000 |
| | | Common Stock Warrants (77,287 shares) (F) (G) | | 350 | 302 |
| Winchester Electronics | Manufacturing-high bandwidth connectors and cables | Senior Term Debt (5.3%, Due 5/2012) (D) | 1,250 | 1,250 | 1,239 |
| | | Senior Term Debt (5.8%, Due 5/2013) (D) | 1,669 | 1,669 | 1,650 |
| | | Senior Subordinated Term Debt (14.0%, Due 6/2013) (D) | 9,775 | 9,775 | 9,616 |
| Subtotal Non-syndicated loans | | | | \$ 182,884 | \$ 159,659 |
| Syndicated Loans: | | | | | |
| Airvana Network Solutions, Inc. | Service-telecommunications | Senior Term Debt (10.0%, Due 3/2015) (E) | \$ 4,381 | \$ 4,267 | \$ 4,381 |
| Allied Security Holdings, LLC | | | | | |