

2018 Gladstone Capital Shareholder's Letter

To Our Shareholders,

We are pleased to share with you our results for the fiscal year ended September 30, 2018. During the fiscal year, we generated positive asset growth, and maintained our average investment yields while managing to reduce our leverage and operating costs. These factors combined to generate a 7.7% increase in our net investment income for the year. We attribute much of this performance to our continued focus on originating high quality investment opportunities in growth oriented lower middle-market companies.

During the fiscal year, we closed on \$67.9 million of new proprietary investments, representing eight new portfolio companies, in addition to \$38.7 million in follow-on investments to existing borrowers to help them expand their operations. This new investment activity outpaced repayments on the year, resulting in a 10.7% increase in our investment portfolio at fair value over the prior year. Lower middle market investments do not generally attract the same level of competition of larger middle market investments, which enabled us to maintain our average portfolio yield despite the overall compression in investment spreads during the year. The majority of our investments continue to be senior secured loans and we maintained our conservative underwriting and emphasis on portfolio diversity by industry and investment size, which limited the impact of any under-performing investments in the portfolio. We ended the year with investments in 50 businesses, representing 18 different industries, with an average investment cost of \$8.5 million.

For fiscal 2018, total investment income rose by 16.2% and contributed to the 7.7% increase in net investment income, which allowed us to maintain and cover 100% of all common shareholder dividends. Based on the performance trends outlined above, our common stock outperformed the majority of our BDC peers, generating a total return (including reinvestment dividends) of 9.5% on the year.

Our specific financial accomplishments for the year ended September 30, 2018 include:

- Paid monthly cash dividends that totaled \$0.84 for the year, bringing the cumulative distributions paid since our inception to \$18.61 per share and the consecutive distributions paid to 188;
- The one year return to stockholders for the year was 9.5%, inclusive of dividends reinvested;
- Invested an additional \$106.6 million in new and existing portfolio companies;
- Maintained our conservative investment strategy, as the mix of our secured first or second lien loans was largely unchanged on the year.;
- Increased our overall portfolio yield to 11.8% for the year and ended the year with non-earning assets of 2%;
- Issued 2.3 million shares of common stock, generating net proceeds of \$21.7 million, representing a premium to our net asset value of \$1.4 million; and

- Amended our line of credit agreement with KeyBank thereby reducing the interest rate margin by 40 basis points, extending the maturity to April of 2022, and increasing the commitment amount to \$190 million.

Subsequent to September 30, 2018, we closed four additional new investments, totaling \$21.3 million, and successfully exited two investments at par, resulting in net originations of approximately \$16.2 million. In addition, in November 2018, we successfully completed a public debt offering of \$57.5 million 6.125% notes due 2023.

FINANCIAL RESULTS: Our net investment income increased to \$23.1 million for the year ended September 30, 2018, which, combined with net realized and unrealized portfolio depreciation, lifted our net assets from operations by 8.5% to \$18.6 million for the year, or \$0.69 per share.

Net assets, as reflected in our balance sheet, increased by 7.9%, from \$219.7 million, as of September 30, 2017, to \$237.1 million, as of September 30, 2018. Net asset value per share decreased slightly by 1.0%, year over year, to \$8.32 per share as of September 30, 2018.

INVESTMENT CLIMATE: We believe there are many opportunities in the current marketplace for lending to lower middle market companies that can support attractive risk-adjusted returns. In particular, we believe the general health of the U.S. economy, as well as specific factors reducing lending by banks, have benefited our company. We have focused our investment origination efforts in support of private equity firms and well capitalized companies with experienced management. We will continue to emphasize our investment adviser's extensive experience, long-standing dedication to, and reputation in, serving companies in the lower middle market. We have the ability to offer flexible, customized financing solutions to support the growth and equity appreciation of smaller businesses. The risk profile of companies in the lower middle market is different than that of the broader syndicated debt capital markets and we expect that our adviser's focus and experience in managing these risks through various economic cycles will prove a key differentiator over time.

OBJECTIVES AND OUTLOOK: Our objective going into fiscal 2019 is to maintain our strong credit discipline while continuing to grow the portfolio to increase interest income and support our shareholder distributions. Our team is dedicated to reinforcing our position as one of the most well-recognized debt providers to lower middle market, privately-held companies in the U.S., which has demonstrated the ability to withstand various economic cycles and produce consistent returns for our shareholders. We believe our portfolio and capital base are well positioned to withstand capital market volatility and potentially benefit from the modest increase in interest rates expected in fiscal 2019. We believe our fund, Gladstone Capital, is an attractive investment for shareholders seeking an attractive yield from consistent monthly distributions supported by a well secured loan portfolio.

Our 2019 Annual Meeting of Stockholders will be held on Thursday, February 7, 2019, at 11:00 a.m. EST. The 2019 Annual Meeting of Stockholders will be a completely "virtual meeting." You will receive information in the mail on how to participate, if you so choose, along with your proxy materials.

Please visit our website at www.GladstoneCapital.com for further information. While you are on the website, please sign up for our email notices to keep up to date on all of our affiliated companies' activities.

Thank you for your continued support.

David Gladstone
Chairman of the Board and Chief Executive Officer

Terry L. Brubaker
Vice Chairman of the Board and Chief Operating Officer

Robert L. Marcotte
President