



COMPANY UPDATE / TARGET PRICE CHANGE

Key Metrics

GLAD - NASDAQ (as of 08/03/17)	\$9.87
Price Target	NA
52-Week Range	\$7.33-\$10.12
Shares Outstanding (mm)	25.5
Market Cap. (\$mm)	\$252
3-Mo. Average Daily Volume (000)	112.4
Institutional Ownership	16.3%
Total Debt/Equity	64.9%
TTM ROE	15.8%
Net Asset Value Per Share	\$8.33
Price/Net Asset Value	118.5%
Dividend Yield	8.5%
Price/LTM Net Investment Income	7.3x

Net Investment Income Per Share FY 9/30

	2016A	Prior 2017E	Curr. 2017E	Prior 2018E	Curr. 2018E
1Q	\$0.21	\$0.21 A	\$0.21 A	\$0.21	\$0.21
2Q	\$0.21	\$0.21 A	\$0.21 A	\$0.21	\$0.21
3Q	\$0.21	\$0.21	\$0.21 A	\$0.21	\$0.21
4Q	\$0.21	\$0.21	\$0.21	\$0.21	\$0.21
Year	\$0.84	\$0.84	\$0.84	\$0.84	\$0.84
P/NII	11.8x		11.7x		11.8x

Numbers may not add due to rounding

Net Asset Value Per Share FY 9/30

	2016A	Prior 2017E	Curr. 2017E	Prior 2018E	Curr. 2018E
1Q	\$8.38	\$8.36 A	\$8.36 A	\$8.33	\$9.26
2Q	\$7.92	\$8.33 A	\$8.22 A	\$8.33	\$9.27
3Q	\$7.95	\$8.33	\$8.38 A	\$8.33	\$9.27
4Q	\$8.62	\$8.33	\$9.26	\$8.33	\$9.27

Company Description: Headquartered in McLean, Virginia, Gladstone Capital Corporation operates as a business development company which requires the company to pay out at least 90% of earnings to shareholders. GLAD provides cash flow-based loans to privately held lower middle market businesses based in the U.S.

Gladstone Capital Corp.

GLAD -- NASDAQ – Neutral – 3

F3Q17 Review – Reaffirming Neutral Rating

- **Earnings Update:** F3Q17 net investment income per share of \$0.21 was in line with our estimate and the Street consensus.
- **Operating Highlights:** Total investment income rose \$0.8 million linked-quarter (LQ) to \$9.6 million as a \$1.0 million increase in interest income more than offset a \$0.2 million decline in other income. Results were in line with expectations.

Net investment income was flat at \$5.4 million LQ as the lift in total investment income was offset by a similar increase in total expenses.

Net asset value per share grew \$0.05 sequentially to \$8.38 primarily resulting from \$0.8 million of unrealized depreciation.

GLAD invested \$29.0 million in three new portfolio companies and \$6.8 million in existing companies during the quarter. We had projected \$42.5 million in investment production.

The company received \$3.1 million in repayments in F3Q17, down substantially from \$14.5 million in F2Q17 and \$34.0 million in the year-ago quarter.

Debt investments in two portfolio companies were on nonaccrual status at quarter-end with an aggregate cost basis of \$27.9 million, or 7.6% of the cost basis of all debt investments. Nonaccrual assets at March 31, 2017 were \$24.4 million or 7.2% debt investments at cost.

- **Estimates & Valuation:** We are retaining our FY2017 and FY2018 net investment income per share estimates at \$0.84. We reaffirm our Neutral rating.

Note Important Disclosures on pages 6-7

Note Analyst Certification on page 6

OTHER KEY TAKEAWAYS

- With solid investment production, limited payoffs and improved valuation marks, investments at FV rose 8.3% sequentially
- The weighted average yield on interest-bearing investments increased to 11.4% in F3Q17 from 11.3% in the prior quarter.
- Approximately 89% of debt investments were variable rate at quarter-end, all of which contain interest rate floors. The weighted average LIBOR floor on these assets is approximately 1.3%.
- The increase in total expenses were primarily driven by an increase in the base management fee and interest expense, coupled with a decrease in the incentive fee waiver.
- Borrowings from GLAD's line of credit increased \$26.0 million to \$82.2 million LQ. The credit limit under the facility is \$170.0 million.
- The debt-to-equity ratio rose to 0.66X at quarter-end from 0.55X at the end of F2Q17.
- GLAD issued 362,600 shares of common stock at a blended price of \$9.89 through an at-the-market program. Gross proceeds were \$3.6 million. The company indicated that it intends to continue such offerings, noting they are accretive to NAV at its current share price.

The following chart provides information regarding the company's investment portfolio. Total net depreciation for the portfolio was 14.9% at quarter-end versus 16.4% at March 31, 2017. Hilliard Lyons does not project any changes in the valuation of the portfolio.

PORTFOLIO HOLDINGS

HOLDINGS SUMMARY @ JUNE 30, 2017							
Company	Product	Fair Value		App. Portfolio	Cost of Portfolio	FV Portfolio	
		Cost (000)	6/30/17				(Dep.)
Control Investments							
1	Defiance Integrated Technologies	Automobile	\$ 6,645	\$ 11,055	\$ 4,410	1.64%	3.20%
2	PIC 360, LLC	Machinery	\$ 4,001	\$ 4,173	\$ 172	0.99%	1.21%
3	Sunshine Media Holdings	Printing & Publishing	\$ 29,969	\$ 5,073	\$ (24,896)	7.38%	1.47%
Affiliate Investments							
4	Edge Adhesives Holdings, Inc.	Diversified/Conglomerate Manufacturing	\$ 10,316	\$ 7,106	\$ (3,210)	2.54%	2.06%
5	FedCap Partners, LLC	Private Equity Fund-Aerospace & Defense	\$ 1,634	\$ 1,562	\$ (72)	0.40%	0.45%
6	Lignetics, Inc.	Diversified Natural Resources	\$ 19,955	\$ 18,746	\$ (1,209)	4.92%	5.43%
7	LWO Acquisitions Company	Diversified/Conglomerate Manufacturing	\$ 14,416	\$ 11,323	\$ (3,093)	3.55%	3.28%
8	Targus Cayman HoldCo Limited	Textiles & Leather	\$ 4,896	\$ 3,304	\$ (1,592)	1.21%	0.96%
Non-Control Investments							
9	AG Transportation Holdings, LLC	Cargo Transport	\$ 14,244	\$ 13,065	\$ (1,179)	3.51%	3.78%
10	Alloy Die Casting Co	Diversified/Conglomerate Manufacturing	\$ 7,910	\$ 3,993	\$ (3,917)	1.95%	1.16%
11	B+T Group Acquisition Inc.	Telecommunications	\$ 7,799	\$ 7,314	\$ (485)	1.92%	2.12%
12	Belnick, Inc.	Home & Office Furnishings, Housewares	\$ 10,000	\$ 10,025		2.46%	2.90%
13	Canopy Safety Brands, LLC	Personal & Non-Durable Products	\$ 7,350	\$ 7,145	\$ (205)	1.81%	2.07%
14	Chinese Yellow Pages Company	Printing & Publishing	\$ 107	\$ -	\$ (107)	0.03%	0.00%
15	Drumcree LLC	Broadcasting and Entertainment	\$ 6,177	\$ 6,192	\$ 15	1.52%	1.79%
16	Flight Fit N Fun LLC	Leisure, Amusement, Motion Pic. Ent.	\$ 8,500	\$ 8,247	\$ (253)	2.09%	2.39%
17	Francis Drilling Fluids, Ltd.	Oil and Gas	\$ 24,778	\$ 8,319	\$ (16,459)	6.10%	2.41%
18	Funko Acquisition Holdings, LLC	Personal & Non-Durable Products	\$ 167	\$ 245	\$ 78	0.04%	0.07%
19	GFRC Holdings, LLC	Buildings and Real Estate	\$ 3,130	\$ 2,974	\$ (156)	0.77%	0.86%
20	HB Capital Resources, Ltd.	Diversified Conglomerate Service	\$ 22,000	\$ 22,000	\$ -	5.42%	6.37%
21	IA Tech, LLC	Diversified/Conglomerate Service	\$ 23,000	\$ 23,518	\$ 518	5.67%	6.81%
22	Leeds Novamark Capital I, L.P.	Private Equity Fund - Health, Edu, Childcare	\$ 1,414	\$ 1,303	\$ (111)	0.35%	0.38%
23	Meridian Rack & Pinion, Inc.	Automobile	\$ 5,589	\$ 4,155	\$ (1,434)	1.38%	1.20%
24	Merlin International	Healthcare, Education, Childcare	\$ 10,000	\$ 10,112	\$ 112	2.46%	2.93%
25	The Mochi Ice Cream Company	Beverage, Food, and Tobacco	\$ 7,200	\$ 7,491	\$ 291	1.77%	2.17%
26	NetFortis Corp.	Telecommunications	\$ 24,001	\$ 24,120	\$ 119	5.91%	6.98%
27	Precision Acquisition Group Hldgs, Inc	Machinery	\$ 795	\$ 789	\$ (6)	0.20%	0.23%
28	Sea Link International	Automobile	\$ 5,240	\$ 5,214	\$ (26)	1.29%	1.51%
29	Travel Sentry, Inc.	Diversified/Conglomerate Service	\$ 8,902	\$ 9,047	\$ 145	2.19%	2.62%
30	Triple H Food Processors	Beverage, Food, and Tobacco	\$ 7,250	\$ 7,618	\$ 368	1.79%	2.20%
31	TWS Acquisition Corporation	Healthcare, Education, Childcare	\$ 9,432	\$ 9,598	\$ 166	2.32%	2.78%
32	United Flexible, Inc.	Diversified/Conglomerate Manufacturing	\$ 18,501	\$ 18,202	\$ (299)	4.56%	5.27%
33	Vacation Rental Pros Prop. Mgt.	Hotels, Motels, Inns, and gaming	\$ 7,091	\$ 7,091	\$ -	1.75%	2.05%
34	Vision Government Solutions	Diversified/Conglomerate Service	\$ 12,050	\$ 11,110	\$ (940)	2.97%	3.22%
35	WadeCo Specialties Inc.	Oil and Gas	\$ 20,864	\$ 21,208	\$ 344	5.14%	6.14%
Syndicated Investments							
36	DataPipe, Inc.	Diversified/conglomerate service	\$ 1,962	\$ 2,005	\$ 43	0.48%	0.58%
37	Keystone Acquisiiton Corp.	Diversified/conglomerate service	\$ 3,921	\$ 3,960	\$ 39	0.97%	1.15%
38	Ldiscovery, LLC	Diversified/conglomerate service	\$ 4,810	\$ 4,700	\$ (110)	1.19%	1.36%
39	Medical Solutions Holdings, Inc.	Healthcare, Education, Childcare	\$ 2,955	\$ 3,000	\$ 45	0.73%	0.87%
40	NetSmart Technologies	Healthcare, Education, Childcare	\$ 3,607	\$ 3,642	\$ 35	0.89%	1.05%
41	New Trident Holdcorp, Inc.	Healthcare, Education, Childcare	\$ 3,984	\$ 2,700	\$ (1,284)	0.98%	0.78%
42	Edmentum Ultimate Holdings, LLC	Healthcare, Education, Childcare	\$ 5,877	\$ 3,249	\$ (2,628)	1.45%	0.94%
43	PSC Industrial Holdings Corp.	Oil and Gas	\$ 3,450	\$ 3,010	\$ (440)	0.85%	0.87%
44	SourceHOV LLC	Finance	\$ 4,879	\$ 4,781	\$ (98)	1.20%	1.38%
45	The Active Network Inc.	Electronics	\$ 519	\$ 517	\$ (2)	0.13%	0.15%
46	Vertellus Specialties Inc.	Chemicals, Plastics and Rubber	\$ 4,117	\$ 1,363	\$ (2,754)	1.01%	0.39%
47	W3, Co.	Oil and Gas	\$ 499	\$ 139	\$ (360)	0.12%	0.04%
		Total	\$ 405,903	\$ 345,503	\$ (60,400) depre./cost	-14.88%	
		Number of Portfolio Companies	47	\$ 7,351	Average Investment Size FV		

Source: Company, Hilliard Lyons estimates; Nonaccrual assets: if the portfolio company's debt is on nonaccrual the entire investment is listed here

SUITABILITY

Our suitability rating on GLAD is 3 on our scale of 1 to 4 (1 = most conservative, 4 = most aggressive). Factors contributing to our suitability rating include the company's market capitalization, liquidity and trading volume, diversity of revenues and the geographic diversification of its footprint.

RISKS AND CONSIDERATIONS

Gladstone Capital is exposed to various risks including:

- **Economic Risk** – A widespread economic downturn could weaken the credit quality of GLAD's portfolio companies which could lead to higher than expected write downs and limit future growth opportunities in the small and medium sized companies GLAD invests in.
- **Interest Rate Risk** - A rise in interest rates could place stress on GLAD's portfolio companies and eventually affect their ability to pay. Additionally, as interest rates rise, GLAD's high dividend may lose appeal and lead to lower demand for the stock.
- **Investment Criteria Risk** - Failure to invest in securities that will support the dividend and future growth of GLAD could eventually lead to dividend cuts.
- **Sector Rotation** – The share price of the company's common stock may be vulnerable to any sector rotation that might occur.

GLOSSARY

Regulated Investment Company (RIC): As regarded by the Internal Revenue Service. By following a few requirements, the most important of which is paying out at least 90% of taxable income (ordinary income plus short-term capital gains), the company does not pay federal income tax. This *avoids double taxation*. A typical company distributes common dividends out of net income (after-tax). Taxes are paid again by the shareholder upon receipt of a dividend. Sometimes a RIC will report income taxes paid. Any amount of taxable income greater than 90% but less than 98% not paid to shareholders is subject to a 4% excise tax and a 35% rate on any taxable income retained. There may be some instances where it is in the RIC's best interest to retain income in spite of paying the taxes.

Business Development Company (BDC): Structure provided in the Investment Company Act of 1940. Basic requirements: 1) Qualifying assets – 70% of total assets must be small private U.S. companies. 2) Asset coverage – assets must cover the company's borrowings by at least 200% or debt to equity cannot exceed 1. 3) Significant managerial assistance – BDCs must offer to provide guidance to its portfolio companies.

Non-Diversified Company: May have investments exceeding 5% of total assets or an equity interest in a company exceeding 10%.

	GLADSTONE CAPITAL CORPORATION										GLAD.NEUTRAL		
	12/31/16	3/31/17	6/30/17	9/30/17	12/31/17	3/31/18	6/30/18	9/30/18	12/31/18	3/31/19	FY 2016 A	FY 2017 E	FY 2018 E
\$ Thousands, Except for Per Share Data													
Income Statement Analysis													
Investment Income:													
Total Interest Income	8,633	8,588	9,629	10,009	10,177	10,173	10,344	10,824		34,895	35,216	36,859	41,519
Total Other Income	1,341	205	3	500	950	950	950	950		3,163	3,893	2,049	3,800
Total Investment Income	9,974	8,793	9,632	10,509	11,127	11,123	11,294	11,774		38,058	39,109	38,908	45,319
Expenses:													
Base Management Fee	1,378	1,359	1,480	1,544	1,584	1,586	1,607	1,633		6,888	5,685	5,761	6,420
Incentive Fee	2,933	1,070	1,116	1,223	1,315	1,306	1,339	1,401		4,083	4,514	4,702	5,361
Administration Fee	300	286	272	287	314	330	319	349		1,033	1,182	1,155	1,313
Interest Expense	556	587	904	869	922	935	930	1,007		3,828	2,899	2,916	3,794
Dividends on Preferred Stock	1,029	1,029	1,029	1,029	1,029	1,029	1,029	1,029		4,116	4,116	4,117	4,118
Other General and Administrative	910	623	727	920	974	973	988	1,030		3,294	3,531	3,180	3,965
Expenses Before Credits from Advisor	5,466	4,954	5,528	5,881	6,136	6,170	6,213	6,450		23,242	21,928	21,830	24,970
Portfolio Company Fee Credit	(649)	(434)	(261)	(249)	(255)	(257)	(259)	(263)		(1,399)	(783)	(1,583)	(1,035)
Senior Syndicated Loan Fee Waiver	(13)	(9)	(100)	(100)	(15)	(15)	(15)	(15)		(118)	(92)	(137)	(60)
Incentive Fee Waiver	(37)	(1,077)	(914)	(585)	(902)	(419)	(373)	(210)		(1,367)	(1,429)	(2,613)	(1,304)
Total Expenses	4,767	3,434	4,253	5,032	5,566	5,478	5,566	5,962		20,358	19,624	17,487	22,571
Net Investment Income	5,207	5,359	5,379	5,477	5,561	5,645	5,729	5,813		17,700	19,485	21,421	22,747
Realized & Unrealized Gain (Loss):	(3,448)	45.00	(23.00)	-	-	-	-	-		(34,176)	7,154	(3,426)	-
Total Net Realized Gain/(Loss)	(843)	(748)	807	-	-	-	-	-		24,960	(15,271)	(784)	-
Net Dec./Inc. in Net Assets from Operations	916	4,656	6,163	5,477	5,561	5,645	5,729	5,813		8,484	11,368	17,211	22,747
Balance Sheet													
Assets:													
Total Investments At Cost	348,988	374,906	405,903	417,064	424,082	422,698	428,893	434,731		410,244	381,801	417,064	434,731
Unrealized Gain/(Loss)	(60,742)	(61,389)	(60,400)	(60,400)	(60,400)	(60,400)	(60,400)	(60,400)		(44,353)	(59,687)	(60,400)	(60,400)
Total Investments At Fair Value	288,246	313,517	345,503	356,664	363,682	362,298	368,493	374,331		365,891	322,114	356,664	374,331
Cash & Cash Equivalents	5,780	5,014	7,002	7,002	7,002	7,002	7,002	7,002		3,808	6,152	7,002	7,002
Other Assets	10,626	10,106	8,840	8,840	8,840	8,840	8,840	8,840		12,783	8,912	8,840	8,840
Total Assets	304,652	328,637	361,345	372,506	379,524	378,140	384,335	390,173		382,482	337,178	372,506	390,173
Liabilities & Shareholders' Equity:													
Borrowings At Fair Value (\$170M Line)	27,987	53,989	59,624	67,047	70,310	65,151	67,552	69,578		127,300	71,300	67,047	69,578
Maturity Redeemable Preferred Stock	59,448	59,536	59,536	59,536	59,536	59,536	59,536	59,536		61,000	61,000	59,536	59,536
Total Borrowings	87,435	113,525	119,160	126,583	129,846	124,687	127,088	129,114		188,300	132,300	126,583	129,114
Other Liabilities	3,832	2,442	2,502	2,502	2,502	2,502	2,502	2,502		2,738	3,671	2,503	2,503
Total Liabilities	91,267	115,967	144,362	129,086	132,348	127,189	129,590	131,617		191,038	135,971	129,086	131,617
Shareholders' Equity (Net Assets)	213,385	212,670	216,983	243,419	247,176	250,952	254,744	258,556		191,444	201,207	243,419	258,556
Total Liabilities & Shareholders' Equity	304,652	328,637	361,345	372,506	379,524	378,140	384,335	390,173		382,482	337,178	372,506	390,173
Share & Per Share Data:													
Common Shares Outstanding (000)	25,518	25,880	25,880	26,280	26,680	27,080	27,480	27,880		21,132	23,344	26,280	27,880
Average Diluted Shares (000)	24,431	25,576	25,880	26,080	26,480	26,880	27,280	27,680		21,067	23,202	25,492	27,080
Net Investment Income Per Share	0.21	0.21	0.21	0.21	0.21	0.21	0.21	0.21		0.84	0.84	0.84	0.84
Dividends	0.21	0.21	0.21	0.21	0.21	0.21	0.21	0.21		0.84	0.84	0.84	0.84
Net Investment Income Payout Ratio	99%	100%	101%	100%	100%	100%	100%	100%		100%	100%	100%	100%
Earnings Per Share	0.04	0.18	0.24	0.21	0.21	0.21	0.21	0.21		0.40	0.49	0.68	0.84
Net Asset Value Per Share	8.36	8.22	8.38	9.26	9.26	9.27	9.27	9.27		9.06	8.62	9.26	9.27
Performance Ratios: %													
Interest Income / Avg. Investments at Cost	9.37%	9.62%	9.65%	9.65%	9.60%	9.74%	9.74%	9.95%		8.81%	9.22%	9.57%	9.76%
Interest Expense / Avg. Borrowings	2.01%	2.37%	3.12%	2.89%	2.85%	2.96%	2.96%	3.12%		2.42%	2.18%	2.57%	2.98%
Total Expenses / Total Investment Income	47.79%	39.06%	44.16%	47.88%	50.02%	49.25%	49.28%	50.63%		53.48%	50.18%	44.94%	49.81%
Annualized Total Expenses / Avg. Assets	-0.74%	-0.46%	-0.26%	-0.24%	-0.24%	-0.24%	-0.24%	-0.24%		5.72%	5.82%	5.13%	6.46%
Return on Avg. Assets	0.30%	1.42%	1.71%	1.47%	1.47%	1.49%	1.49%	1.49%		2.22%	3.37%	4.62%	5.83%
Return on Avg. Equity	0.43%	2.19%	2.84%	2.25%	2.25%	2.25%	2.25%	2.25%		4.43%	5.65%	7.07%	8.80%
Balance Sheet Ratios													
Assets/Equity	1.43x	1.55x	1.67x	1.53x	1.54x	1.51x	1.51x	1.51x		2.00x	1.68x	1.53x	1.51x
Total Debt to Equity	0.43x	0.56x	0.67x	0.53x	0.54x	0.51x	0.51x	0.51x		0.98x	0.68x	0.53x	0.51x
Net Debt to Equity	0.38x	0.51x	0.52x	0.49x	0.50x	0.47x	0.47x	0.47x		0.96x	0.63x	0.49x	0.47x

Source: Company reports and Hilliard Lyons estimates.

Additional information is available upon request.

Analyst Certification

I, Andrew W. Stapp, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

Gladstone Commercial Corp. (GOOD-\$20.83), Gladstone Investment Corp. (GAIN-\$9.63), and Gladstone Land Corp. (LAND-\$11.04) share the same management and board as Gladstone Capital Corp.

Hilliard Lyons acted as a manager or co-manager of an offering of securities of Gladstone Capital Corp. in the past 12 months.

Hilliard Lyons has received investment banking compensation from Gladstone Capital Corp. in the past 12 months.

Investment Ratings

Buy - We believe the stock has significant total return potential in the coming 12 months.

Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.

Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.

Underperform - We believe the stock is vulnerable to a price set back in the next 12 months.

Suitability Ratings

1 - A large cap, core holding with a solid history

2 - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks

3 - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage

4 - Speculative, due to small size, inconsistent profitability, erratic revenue, volatility, low trading volume or a narrow customer or product base



Rating	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	36	29%	14%	86%
Hold/Neutral	79	63%	5%	95%
Sell	10	8%	0%	100%

As of 7 July 2017

Other Disclosures

Opinions expressed are subject to change without notice and do not take into account the particular investment objectives, financial situation or needs of individual investors. Employees of J.J.B. Hilliard, W.L. Lyons, LLC or its affiliates may, at times, release written or oral commentary, technical analysis or trading strategies that differ from the opinions expressed here.

J.J.B. Hilliard, W.L. Lyons, LLC is a multi-disciplined financial services firm that regularly seeks investment banking assignments and compensation from issuers for services including, but not limited to, acting as an underwriter in an offering or financial advisor in a merger or acquisition, or serving as placement agent in private transactions.

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