

GLADSTONE INVESTMENT CORPORATION\DE

Form 10-K

May 21, 2012

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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 March 31, 2012

OR

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

Commission file number 814-00704

GLADSTONE INVESTMENT CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of

incorporation or organization)

83-0423116
(I.R.S. Employer

Identification No.)

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1521 Westbranch Drive, Suite 200

McLean, Virginia
(Address of principal executive offices)

22102
(Zip Code)

(703) 287-5800

(Registrant's telephone number, including area code)

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

(Title of Each Class)	(Name of Exchange on which Registered)
Common Stock, \$0.001 par value per share	NASDAQ Global Select Market
7.125% Series A Cumulative Term Preferred Stock, \$0.001 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 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 and posted on its corporate Website, 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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 10-K or any amendment to this Form 10-K.

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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 definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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 12 b-2 of the Exchange Act). YES NO

The aggregate market value of the voting stock held by non-affiliates of the Registrant on September 30, 2011, based on the closing price on that date of \$6.80 on the NASDAQ Global Select Market, was \$131,241,547. For the purposes of calculating this amount only, all directors and executive officers of the Registrant have been treated as affiliates. There were 22,080,133 shares of the Registrant's Common Stock, \$0.001 par value, outstanding as of May 21, 2012.

Documents Incorporated by Reference. Portions of the Registrant's Proxy Statement relating to the Registrant's 2012 Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K as indicated herein.

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GLADSTONE INVESTMENT CORPORATION

FORM 10-K FOR THE FISCAL YEAR ENDED

MARCH 31, 2012

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All statements contained herein, other than historical facts, may constitute forward-looking statements. These statements may relate to, among other things, future events or our future performance or financial condition. In some cases, you can identify forward-looking statements by terminology such as may, might, believe, will, provided, anticipate, future, could, growth, plan, intend, expect, should, would, if, seek, possible, potential, likely or the negative of such terms or comparable terminology. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others: (1) further adverse changes 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, George Stelljes III or David Dullum; (4) changes in our business strategy; (5) availability, terms 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; and (8) those factors described in the Risk Factors section of this Form 10-K. We caution readers not to place undue reliance on any such forward-looking statement. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, after the date of this Form 10-K.

PART I

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

ITEM 1. BUSINESS**Overview**

We invest primarily in subordinated loans, mezzanine debt, preferred stock, common stock and warrants to purchase common stock of small and medium-sized companies, generally located in the United States, in connection with buyouts and other recapitalizations. When we invest in buyouts we typically do so with the management teams of the particular companies and with other buyout funds. We also sometimes invest in senior secured loans and, to a much lesser extent, senior and subordinated syndicated loans. Our investment objective is to generate both current income and capital gains through these debt and equity instruments.

We were incorporated under the General Corporation Laws of the State of Delaware on February 18, 2005. On June 22, 2005 we completed an initial public offering and commenced operations. We operate as a closed-end, non-diversified management investment company and have elected to be treated as a business development company (BDC) under the Investment Company Act of 1940, as amended (the 1940 Act). For federal income tax purposes, we have elected to be treated as a regulated investment company (RIC) under Subchapter M of the Internal Revenue Code of 1986, as amended (the Code). In order 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 seek to achieve returns through current income generated from senior, subordinated and mezzanine debt, and capital gains from the sale of preferred stock, common stock and warrants to purchase common stock that we purchase in connection with buyouts and recapitalizations of small and mid-sized companies with established management teams. We seek to make investments that generally range between \$10 million and \$40 million each, although this investment size may vary proportionately as the size of our capital base changes. Typically, our investments mature in no more than seven years and accrue interest at fixed or variable rates with floors in place. We invest as either the lead investor or a co-investor with other buyout funds and the 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 to be investing alone.

We expect that our target portfolio over time will primarily include the following three categories of investments in private companies:

Subordinated Debt and Mezzanine Debt. We anticipate that, over time, much of the capital that we invest will be in the form of subordinated or mezzanine debt. Most of our mezzanine and subordinated loans are collateralized by a subordinated lien on some or all of the assets of the borrower. We structure most of our mezzanine and subordinated loans with variable interest rates, but some are fixed rate loans. In either event, we structure the loans at rates of interest that provide us with significant current interest income and generally have interest rate floors to protect against declining interest rates. Our subordinated and mezzanine loans typically have maturities of five to seven years and provide for interest-only payments in the early years, with amortization of principal deferred to

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the later years of the loans. In some cases, we may enter into loans that, by their terms, convert into equity or additional debt securities or defer payments of interest for the first few years after our investment. Our loans generally include a success fee component that is usually paid upon exit when a business is sold.

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This fee enhances the overall yield of the loan. Our subordinated and mezzanine debt investments may also include equity features, such as warrants or options to buy a significant common stock ownership interest in the portfolio company. If a portfolio company appreciates in value, we may achieve additional investment returns from any equity interests we hold. If we are a minority interest holder, we may structure the warrants to provide provisions protecting our rights as a minority-interest holder, such as the right to sell the warrants back to the company upon the occurrence of specified events. In most cases, we obtain registration rights for these equity interests, which may include demand and co-registration rights.

Preferred Stock, Warrants to Purchase Common Stock and Common Stock. We also acquire preferred stock, common stock or warrants to purchase common stock, or a combination of the three, in connection with a buyout or recapitalization. These investments are generally in combination with an investment in one of our debt products. With respect to our investments in preferred stock, common stock or warrants to purchase common stock, we target an investment return substantially higher than our investments in loans. However, we can offer no assurance that we can achieve such a return with respect to any investment or our portfolio as a whole. The features of the preferred stock we receive vary by transaction but may include priority distribution rights, superior voting rights, redemption rights, liquidation preferences and other provisions intended to protect our interests. Generally speaking, warrants to purchase common stock and common stock do not have any current income and its value is realized, if at all, upon the sale of the business or following the company's initial public offering.

Senior Secured Debt. We may provide senior secured acquisition financing for some portfolio companies. We typically structure these senior secured loans to have terms of three to five years, and they may provide for limited principal payments in the first few years of the term of the loan. We generally obtain security interests in the assets of our portfolio companies that will serve as collateral in support of the repayment of these senior loans. This collateral usually takes the form of first priority liens on the assets of the portfolio company. The interest rates on our senior secured loans are generally variable rates based on the London Interbank Offered Rate (LIBOR).

Investment Concentrations

As of March 31, 2012, we had investments in 17 portfolio companies in 12 states and 11 different industries with an aggregate fair value of \$225.7 million, of which SOG Specialty Knives and Tools, LLC (SOG), Acme Cryogenics, Inc. (Acme), and Venyu Solutions, Inc. (Venyu), collectively, comprised approximately \$81.7 million, or 36.2%, of our total investment portfolio, at fair value. The following table outlines our investments by security type at March 31, 2012 and 2011:

	March 31, 2012				March 31, 2011			
	Cost	Fair Value						
Senior term debt	\$ 110,475	41.5%	\$ 94,886	42.0%	\$ 64,566	32.8%	\$ 58,627	38.2%
Senior subordinated term debt	80,461	30.2	70,661	31.3	74,602	37.8	62,806	41.0
Common equity/equivalents	71,084	26.6	46,669	20.7	52,922	26.8	25,398	16.6
Preferred equity	4,375	1.7	13,436	6.0	5,102	2.6	6,454	4.2
Total investments	\$ 266,395	100.0%	\$ 225,652	100.0%	\$ 197,192	100.0%	\$ 153,285	100.0%

Investments at fair value consisted of the following industry classifications at March 31, 2012 and 2011:

	March 31, 2012		March 31, 2011	
	Fair Value	Percentage of Total Investments	Fair Value	Percentage of Total Investments
Chemicals, Plastics, and Rubber	\$ 46,793	20.7%	\$ 19,906	13.0%
Machinery (Nonagriculture, Nonconstruction, Nonelectronic)	30,770	13.6	10,431	6.8
Leisure, Amusement, Motion Pictures, Entertainment	30,096	13.3		
Diversified/Conglomerate Manufacturing	29,017	12.9	12,746	8.3

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Containers, Packaging, and Glass	24,332	10.8	29,029	19.0
Electronics	23,330	10.3	25,012	16.3
Cargo Transport	13,017	5.8	13,183	8.6
Oil and Gas	9,684	4.3	4,931	3.2
Buildings and Real Estate	9,277	4.1	10,120	6.6
Aerospace and Defense	6,713	3.0	6,659	4.4
Home and Office Furnishings, Housewares, and Durable Consumer Products	2,623	1.2	8,627	5.6
Automobile			7,560	4.9
Printing and Publishing			3,073	2.0
Telecommunications			1,499	1.0
Diversified/Conglomerate Service			509	0.3
Total Investments	\$ 225,652	100.0%	\$ 153,285	100.0%

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The investments, at fair value, were included in the following geographic regions of the U.S. as of March 31, 2012 and 2011:

	March 31, 2012		March 31, 2011	
	Fair Value	Percentage of Total Investments	Fair Value	Percentage of Total Investments
South	\$ 128,902	57.1%	\$ 92,172	60.1%
West	59,112	26.2	12,746	8.3
Northeast	30,924	13.7	38,126	24.9
Midwest	6,714	3.0	10,241	6.7
Total Investments	\$ 225,652	100.0%	\$ 153,285	100.0%

The geographic region indicates the location of the headquarters for our portfolio companies. A portfolio company may have other business locations in other geographic regions.

Our Investment Adviser and Administrator

Gladstone Management Corporation (our Adviser) is our affiliate and investment adviser and is led by a management team which has extensive experience in our line of business. Our Adviser also has an affiliate, Gladstone Administration, LLC (our Administrator), which employs our chief financial officer and treasurer, chief compliance officer, internal counsel and their respective staffs. Our Adviser and Administrator also provide investment advisory and administrative services, respectively, to our affiliates, Gladstone Capital Corporation (Gladstone Capital), a publicly-traded BDC and RIC; Gladstone Commercial Corporation (Gladstone Commercial), a publicly-traded real estate investment trust; Gladstone Land Corporation, a private agricultural real estate company owned by David Gladstone; Gladstone Lending Corporation (Gladstone Lending), a private corporation that was formed primarily to invest in first- and second-lien term loans and that has filed a registration statement on Form N-2 with the Securities and Exchange Commission (SEC) but has not yet commenced operations; and Gladstone Partners Fund, L.P., a private partnership fund that was formed primarily to co-invest with us and Gladstone Capital but has not yet commenced operations. Each of our directors and executive officers, other than Messrs. Mead and Watson, is also a director or executive officer, or both, of Gladstone Capital and Gladstone Commercial, each of which is also externally managed by our Adviser. Mr. Watson is also an executive officer of Gladstone Capital. In the future, our Adviser and Administrator may provide investment advisory and administrative services, respectively, to other funds, both public and private.

We have been externally managed by our Adviser pursuant to an investment advisory and administrative agreement since our inception. Our Adviser was organized as a corporation under the laws of the State of Delaware on July 2, 2002, and is a registered investment adviser under the Investment Advisers Act of 1940, as amended. Our Adviser is headquartered in McLean, Virginia, a suburb of Washington, D.C., and our Adviser also has offices in several other states.

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

To originate investments, our Adviser's investment professionals use an extensive referral network comprised primarily of private equity sponsors, venture capitalists, leveraged buyout funds, investment bankers, attorneys, accountants, commercial bankers and business brokers. Our 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, David Dullum, 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) from the Adviser's investment committee, which is composed of David Gladstone (our chairman and chief executive officer), Terry Lee Brubaker (our co-vice chairman, chief operating officer and secretary) and George Stelljes III (our co-vice chairman and chief investment officer), to the prospective company. If this LOI is issued, then Gladstone Securities, LLC (Gladstone Securities), a broker-dealer registered with the Financial Industry Regulatory Authority (FINRA) and an affiliate of ours, will conduct a thorough due diligence investigation and create a detailed business analysis summarizing the prospective portfolio company's historical financial statements, industry, competitive position and management team and analyzing its conformity to our general investment criteria. The investment professionals then present this investment profile to our 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.

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Value-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 value-and-income orientation. In seeking value, we focus on companies in which we can invest at relatively low multiples of earnings before interest, taxes, depreciation and amortization (EBITDA) and that have positive operating cash flow at the time of investment. In seeking income, we seek to invest in companies that generate relatively high and stable cash flow to provide some assurance that they will be able to service their debt and pay any required distributions on preferred stock. Typically, we do not expect to invest in start-up companies or companies with speculative business plans.

Experienced Management. We generally require that our portfolio companies have experienced management teams. We also require the portfolio companies to have in place proper incentives to induce management to succeed and to act in concert with our interests as investors, including having significant equity or other interests in the financial performance of their companies.

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

Exit Strategy. We seek to invest in companies that we believe will provide a stable stream of cash flow that is sufficient to repay the loans we make to them while reinvesting for the growth of their respective businesses. We target such internally generated cash flow to allow our portfolio companies to pay interest on, and repay the principal of, our investments. This is a major factor in our investment thesis and evaluation of risk. In addition, we also seek to invest in companies whose business models and expected future cash flows offer attractive possibilities for capital appreciation on any equity interests we may obtain or retain. These capital appreciation possibilities include strategic acquisitions by other industry participants or financial buyers, initial public offerings of common stock, or other capital market transactions.

Liquidation Value of Assets. The prospective liquidation value of the assets, if any, collateralizing loans in which we invest is an important factor in our investment analysis. We emphasize both tangible assets, such as accounts receivable, inventory, equipment, and real estate, and intangible assets, such as intellectual property, customer lists, networks, and databases, although the relative weight we place on these asset classes will vary by company and industry.

Extensive Due Diligence

Our Adviser and Gladstone Securities conducts what we believe are extensive due diligence investigations of our prospective portfolio companies and investment opportunities. Our due diligence investigation of a prospective portfolio company will begin with a review of publicly available information followed by in depth business analysis, including, but not limited to, some or all of the following:

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

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

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

review of all loan documents;

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

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

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

We also rely on the long-term relationships that our Adviser's investment professionals have with ve