PROSPECT CAPITAL CORP
Form N-2
January 08, 2010

Table of Contents

As filed with the Securities and Exchange Commission on January 8, 2010

Registration No. 333-

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form N-2

þ **REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933**
o **PRE-EFFECTIVE AMENDMENT NO.**
o **POST-EFFECTIVE AMENDMENT NO.**

PROSPECT CAPITAL CORPORATION
(Exact Name of Registrant as Specified in Charter)

10 East 40th Street, 44th Floor
New York, NY 10016
(Address of Principal Executive Offices)

Registrant s Telephone Number, Including Area Code: (212) 448-0702
John F. Barry III
Brian H. Oswald
c/o Prospect Capital Management LLC
10 East 40th Street, 44th Floor
New York, NY 10016
(212) 448-0702
(Name and Address of Agent for Service)

Copies of information to:

Richard T. Prins
Skadden, Arps, Slate, Meagher & Flom LLP
4 Times Square
New York, NY 10036
(212) 735-3000

Approximate Date of Proposed Public Offering: As soon as practicable after the effective date of this Registration Statement.

If any securities being registered on this form will be offered on a delayed or continuous basis in reliance on Rule 415 under the Securities Act of 1933, other than securities offered in connection with a distribution reinvestment plan, check the following box. þ

It is proposed that this filing will become effective (check appropriate box):

þ when declared effective pursuant to section 8(c).

If appropriate, check the following box:

o This post-effective amendment designates a new effective date for a previously filed post-effective amendment registration statement.

o This form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act and the Securities Act registration statement number of the earlier effective registration statement for the same offering is .

CALCULATION OF REGISTRATION FEE UNDER THE SECURITIES ACT OF 1933

Title of Securities Being Registered	**Amount Being Registered**	**Proposed Maximum Offering Price per Unit**	**Proposed Maximum Aggregate Offering Price(1)**	**Amount of Registration Fee**
Common Stock, $.001 par value per share(2)				
Preferred Stock(2)				
Debt Securities(3)				
Warrants(4)				
Total	$ 500,000,000		$ 500,000,000(5)	$ 35,650(1)

(1) Estimated solely for the purpose of calculating the registration fee. Pursuant to Rule 457(o) of the rules and regulations under the Securities Act of 1933, which permits the registration fee to be calculated on the basis of the maximum offering price of all the securities listed, the table does not specify by each class information as to the amount to be registered, proposed maximum offering price per unit or proposed maximum aggregate offering price. $4,529.36 of the registration fee was previously paid in relation to $147,536,001 of the $500,000,000 of securities remaining issuable under the Registrant s registration statement on Form N-2 filed June 15, 2007 (File No. 333-143819), which will be included in this registration statement upon its being declared effective.

(2) Subject to Note 5 below, there is being registered hereunder an indeterminate principal amount of common stock or preferred stock as may be sold, from time to time.

(3) Subject to Note 5 below, there is being registered hereunder an indeterminate principal amount of debt securities as may be sold, from time to time. If any debt securities are issued at an original issue discount, then the offering price shall be in such greater principal amount as shall result in an aggregate price to investors not to exceed $500,000,000.

(4) Subject to Note 5 below, there is being registered hereunder an indeterminate principal amount of warrants as may be sold, from time to time, representing rights to purchase common stock, preferred stock or debt securities.

(5) In no event will the aggregate offering price of all securities issued from time to time pursuant to this registration statement exceed $500,000,000.

Table of Contents

SUBJECT TO COMPLETION

$500,000,000

PROSPECT CAPITAL CORPORATION

Common Stock
Preferred Stock
Debt Securities
Warrants

We may offer, from time to time, in one or more offerings or series, together or separately, up to $500,000,000 of our common stock, preferred stock, debt securities or rights to purchase shares of common stock, preferred stock or debt securities, collectively, the Securities, to provide us with additional capital. Securities may be offered at prices and on terms to be disclosed in one or more supplements to this prospectus. You should read this prospectus and the applicable prospectus supplement carefully before you invest in our Securities.

We may offer shares of common stock at a discount to net asset value per share in certain circumstances. Sales of common stock at prices below net asset value per share dilute the interests of existing stockholders, have the effect of reducing our net asset value per share and may reduce our market price per share.

Our Securities may be offered directly to one or more purchasers, or through agents designated from time to time by us, or to or through underwriters or dealers. The prospectus supplement relating to the offering will identify any agents or underwriters involved in the sale of our Securities, and will disclose any applicable purchase price, fee, commission or discount arrangement between us and our agents or underwriters or among our underwriters or the basis upon which such amount may be calculated. See Plan of Distribution. We may not sell any of our Securities through agents, underwriters or dealers without delivery of the prospectus and a prospectus supplement describing the method and terms of the offering of such Securities. Our common stock is traded on The NASDAQ Global Select Market under the symbol PSEC. As of January 7, 2010, the last reported sales price for our common stock was $12.35.

Prospect Capital Corporation, or the Company, is a company that lends to and invests in middle market privately-held companies. Prospect Capital Corporation, a Maryland corporation, has been organized as a closed-end investment company since April 13, 2004 and has filed an election to be treated as a business development company under the Investment Company Act of 1940, as amended, or the 1940 Act, and is a non-diversified investment company within the meaning of the 1940 Act.

Prospect Capital Management LLC, our investment adviser, manages our investments and Prospect Administration LLC, our administrator, provides the administrative services necessary for us to operate.

Investing in our Securities involves a heightened risk of total loss of investment and is subject to risks. Before buying any Securities, you should read the discussion of the material risks of investing in our Securities in Risk Factors beginning on page 14 of this prospectus.

This prospectus contains important information about us that you should know before investing in our Securities. Please read it before making an investment decision and keep it for future reference. We file annual, quarterly and current reports, proxy statements and other information about us with the Securities and Exchange Commission, or the SEC. You may make inquiries or obtain this information free of charge by writing to Prospect Capital Corporation at 10 East 40th Street, 44th Floor, New York, NY 10016, or by calling collect at 212-448-0702. Our Internet address is http://www.prospectstreet.com. You may also obtain information about us from our website and the SEC s website (http://www.sec.gov).

The SEC has not approved or disapproved of these securities or determined if this prospectus supplement or the accompanying prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

This prospectus may not be used to consummate sales of securities unless accompanied by a prospectus supplement.

The date of this Prospectus is , 2010

TABLE OF CONTENTS

ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we have filed with the SEC, using the shelf registration process. Under the shelf registration process, we may offer, from time to time on a delayed basis, up to $500,000,000 of our common stock, preferred stock, debt securities or warrants representing rights to purchase shares of our common stock, preferred stock or debt securities on the terms to be determined at the time of the offering. The Securities may be offered at prices and on terms described in one or more supplements to this prospectus. This prospectus provides you with a general description of the Securities that we may offer. Each time we use this prospectus to offer Securities, we will provide a prospectus supplement that will contain specific information about the terms of that offering. The prospectus supplement may also add, update or change information contained in this prospectus. Please carefully read this prospectus and any prospectus supplement together with any exhibits and the additional information described under the heading Available Information and the section under the heading Risk Factors before you make an investment decision.

Table of Contents

PROSPECTUS SUMMARY

The following summary contains basic information about this offering. It does not contain all the information that may be important to an investor. For a more complete understanding of this offering, we encourage you to read this entire document and the documents to which we have referred.

Information contained or incorporated by reference in this prospectus may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, which are statements about the future that may be identified by the use of forward-looking terminology such as may, will, expect, intend, plans, anticipate, continue or the negative thereof or other variations thereon or comparable terminology. These forward-looking statements do not meet the safe harbor for forward-looking statements pursuant to Section 27A of the Securities Act of 1933, as amended, or the Securities Act. The matters described in Risk Factors and certain other factors noted throughout this prospectus and in any exhibits to the registration statement of which this prospectus is a part, constitute cautionary statements identifying important factors with respect to any such forward-looking statements, including certain risks and uncertainties, that could cause actual results to differ materially from those in such forward-looking statements. The Company reminds all investors that no forward-looking statement can be relied upon as an accurate or even mostly accurate forecast because humans cannot forecast the future.

The terms we, us, our, and Company refer to Prospect Capital Corporation; Prospect Capital Management or t Investment Adviser refers to Prospect Capital Management LLC, our investment adviser; Prospect Administration or the Administrator refers to Prospect Administration LLC, our administrator; and Prospect refers to Prospect Capital Management LLC, its affiliates and its predecessor companies.

The Company

We are a financial services company that lends to and invests in middle market privately-held companies.

We were originally organized under the name Prospect Street Energy Corporation and we changed our name to Prospect Energy Corporation in June 2004. We changed our name again to Prospect Capital Corporation in May 2007 and at the same time terminated our policy of investing at least 80% of our net assets in energy companies. While we expect to be less focused on the energy industry in the future, we will continue to have significant holdings in the energy and energy related industries. On December 2, 2009, we completed our previously announced acquisition of Patriot Capital Funding, Inc., or Patriot, under the Agreement and Plan of Merger, dated as of August 3, 2009, by and among, us and Patriot. Pursuant to the terms of the merger agreement, we acquired Patriot for approximately $200 million comprised of our common stock and cash to repay all of Patriot s outstanding debt, which amounted to $107.3 million. In the merger, each outstanding share of Patriot common stock was converted into the right to receive 0.363992 shares of common stock of Prospect, representing 8,444,068 shares of the Company s common stock, and the payment of cash in lieu of fractional shares of Prospect common stock of less than $200 resulting from the application of the foregoing exchange ratio.

We have been organized as a closed-end investment company since April 13, 2004 and have filed an election to be treated as a business development company under the 1940 Act. We are a non-diversified company within the meaning of the 1940 Act. Our headquarters are located at 10 East 40th Street, 44th Floor, New York, NY 10016, and our telephone number is (212) 448-0702.

The Investment Adviser

Prospect Capital Management, an affiliate of the Company, manages our investment activities. Prospect Capital Management is an investment adviser that has been registered under the Investment Advisers Act of 1940, or the Advisers Act, since March 31, 2004. Under an investment advisory and management agreement between us and Prospect Capital Management, or the Investment Advisory Agreement, we have agreed to pay Prospect Capital Management investment advisory fees, which will consist of an annual base management fee based on our gross assets, which we define as total assets without deduction for any liabilities, as well as a two-part incentive fee based on our performance.

Table of Contents

The Offering

We may offer, from time to time, in one or more offerings or series, together or separately, up to $500,000,000 of our Securities, which we expect to use initially to maintain balance sheet liquidity, involving repayment of debt under our credit facility, investment in high quality short-term debt instruments or a combination thereof, and thereafter to make long-term investments in accordance with our investment objectives.

Our Securities may be offered directly to one or more purchasers, through agents designated from time to time by us, or to or through underwriters or dealers. The prospectus supplement relating to a particular offering will disclose the terms of that offering, including the name or names of any agents or underwriters involved in the sale of our Securities by us, the purchase price, and any fee, commission or discount arrangement between us and our agents or underwriters or among our underwriters, or the basis upon which such amount may be calculated. See Plan of Distribution. We may not sell any of our Securities through agents, underwriters or dealers without delivery of a prospectus supplement describing the method and terms of the offering of our Securities.

We may offer shares of common stock at a discount to net asset value per share at prices approximating market value less selling expenses upon approval of our directors, including a majority of our independent directors, in certain circumstances. See Sales of Common Stock Below Net Asset Value in this prospectus and in the prospectus supplement, if applicable. Sales of common stock at prices below net asset value per share dilute the interests of existing stockholders, have the effect of reducing our net asset value per share and may reduce our market price per share. We will not offer shares of common stock at a discount to net asset value through a rights offering under this prospectus.

Set forth below is additional information regarding the offering of our Securities:

Use of proceeds	Unless otherwise specified in a prospectus supplement, we intend to use the net proceeds from selling Securities pursuant to this prospectus initially to maintain balance sheet liquidity, involving repayment of debt under our credit facility, investments in high quality short-term debt instruments or a combination thereof, and thereafter to make long-term investments in accordance with our investment objective. See Use of Proceeds.
Distributions	We have paid quarterly distributions to the holders of our common stock and generally intend to continue to do so. The amount of the quarterly distributions is determined by our Board of Directors and is based on our estimate of our investment company taxable income and net short-term capital gains. Certain amounts of the quarterly distributions may from time to time be paid out of our capital rather than from earnings for the quarter as a result of our deliberate planning or accounting reclassifications. Distributions in excess of our current or accumulated earnings or profits constitute a return of capital and will reduce the stockholder s adjusted tax basis in such stockholder s common stock. After the adjusted basis is reduced to zero, these distributions will constitute capital gains to such stockholders. Certain additional amounts may be deemed as distributed to stockholders for income tax purposes. Other types of Securities will likely pay distributions in accordance with their terms. See Price Range of Common Stock, Distributions and Material U.S. Federal Income Tax Considerations.

Taxation	We have qualified and elected to be treated for U.S. Federal income tax purposes as a regulated investment company, or a RIC, under Subchapter M of the Internal Revenue Code of 1986, or the Code. As a RIC, we generally do not have to pay corporate-level U.S. Federal income taxes on any ordinary income or capital gains that we

	distribute to our stockholders as dividends. To maintain our qualification as a RIC and obtain RIC tax treatment, we must maintain specified source-of-income and asset diversification requirements and distribute annually at least 90% of our ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any. See Distributions and Material U.S. Federal Income Tax Considerations.
Dividend reinvestment plan	We have a dividend reinvestment plan for our stockholders. This is an opt out dividend reinvestment plan. As a result, when we declare a dividend, the dividends are automatically reinvested in additional shares of our common stock, unless a stockholder specifically opts out of the dividend reinvestment plan so as to receive cash dividends. Stockholders who receive distributions in the form of stock are subject to the same U.S. Federal, state and local tax consequences as stockholders who elect to receive their distributions in cash. See Dividend Reinvestment Plan.
The NASDAQ Global Select Market Symbol	PSEC
Anti-takeover provisions	Our charter and bylaws, as well as certain statutory and regulatory requirements, contain provisions that may have the effect of discouraging a third party from making an acquisition proposal for us. These anti-takeover provisions may inhibit a change in control in circumstances that could give the holders of our common stock the opportunity to realize a premium over the market price of our common stock. See Description Of Our Capital Stock.
Management arrangements	Prospect Capital Management serves as our investment adviser. Prospect Administration serves as our administrator. For a description of Prospect Capital Management, Prospect Administration and our contractual arrangements with these companies, see Management Management Services Investment Advisory Agreement, and Management Management Services Administration Agreement.
Risk factors	Investment in our Securities involves certain risks relating to our structure and investment objective that should be considered by prospective purchasers of our Securities. In addition, investment in our Securities involves certain risks relating to investing in the energy sector, including but not limited to risks associated with commodity pricing, regulation, production, demand, depletion and expiration, weather, and valuation. We have a limited operating history upon which you can evaluate our business. In addition, as a business development company, our portfolio primarily includes securities issued by privately-held companies. These investments generally involve a high degree of business and financial risk, and are less liquid than public securities. We are required to mark the carrying value of our investments to fair value on a quarterly basis, and economic events, market conditions and events affecting individual portfolio companies can result in quarter-to-quarter mark-downs and mark-ups of the value of individual investments that collectively can

materially affect our net asset value, or NAV. Also, our determinations of fair value of privately-held securities may differ materially from the

Table of Contents

values that would exist if there was a ready market for these investments. A large number of entities compete for the same kind of investment opportunities as we do. Moreover, our business requires a substantial amount of capital to operate and to grow and we seek additional capital from external sources. In addition, the failure to qualify as a RIC eligible for pass-through tax treatment under the Code on income distributed to stockholders could have a materially adverse effect on the total return, if any, obtainable from an investment in our Securities. See Risk Factors and the other information included in this prospectus for a discussion of factors you should carefully consider before deciding to invest in our Securities.

Plan of distribution

We may offer, from time to time, up to $500,000,000 of our common stock, preferred stock, debt securities or rights to purchase shares of our common stock, preferred stock or debt securities on the terms to be determined at the time of the offering. Securities may be offered at prices and on terms described in one or more supplements to this prospectus directly to one or more purchasers, through agents designated from time to time by us, or to or through underwriters or dealers. The supplement to this prospectus relating to the offering will identify any agents or underwriters involved in the sale of our Securities, and will set forth any applicable purchase price, fee and commission or discount arrangement or the basis upon which such amount may be calculated. We may not sell Securities pursuant to this prospectus without delivering a prospectus supplement describing the method and terms of the offering of such Securities. For more information, see Plan of Distribution.

Fees and Expenses

The following tables are intended to assist you in understanding the costs and expenses that an investor in this offering will bear directly or indirectly. We caution you that some of the percentages indicated in the table below are estimates and may vary. In these tables, we assume that we have borrowed $210 million under our credit facility, which is the maximum amount available under the credit facility. Except where the context suggests otherwise, whenever this prospectus contains a reference to fees or expenses paid by you or us or that we will pay fees or expenses, the Company will pay such fees and expenses out of our net assets and, consequently, you will indirectly bear such fees or expenses as an investor in the Company. However, you will not be required to deliver any money or otherwise bear personal liability or responsibility for such fees or expenses.

Stockholder transaction expenses:	
Sales load (as a percentage of offering price)(1)	5.00%
Offering expenses borne by us (as a percentage of offering price)(2)	0.50%
Dividend reinvestment plan expenses(3)	None
Total stockholder transaction expenses (as a percentage of offering price)(4)	5.50%
Annual expenses (as a percentage of net assets attributable to common stock)(4):	
Combined base management fee (2.72%)(5) and incentive fees payable under Investment Advisory Agreement (20% of realized capital gains and 20% of pre-incentive fee net investment income) (2.03%)(6)	4.75%
Interest payments on borrowed funds	2.07%(7)

Other expenses	1.61%(8)
Total annual expenses	8.43%(6)(8)

Table of Contents

Example

The following table demonstrates the projected dollar amount of cumulative expenses we would pay out of net assets and that you would indirectly bear over various periods with respect to a hypothetical investment in our common stock. In calculating the following expense amounts, we have assumed we would have borrowed all $210 million available under our line of credit, that our annual operating expenses would remain at the levels set forth in the table above and that we would pay the stockholder costs shown in the table above.

	1 Year	3 Years	5 Years	10 Years
You would pay the following expenses on a $1,000 investment, assuming a 5% annual return	$ 115.48	$ 233.92	$ 349.06	$ 623.11

While the example assumes, as required by the SEC, a 5% annual return, our performance will vary and may result in a return greater or less than 5%. The income incentive fee under our Investment Advisory Agreement with Prospect Capital Management would be zero at the 5% annual return assumption, as required by the SEC for this table, since no incentive fee is paid until the annual return exceeds 7%. This illustration assumes that we will not realize any capital gains computed net of all realized capital losses and unrealized capital depreciation in any of the indicated time periods. If we achieve sufficient returns on our investments, including through the realization of capital gains, to trigger an incentive fee of a material amount, our expenses, and returns to our investors after such expenses, would be higher. In addition, while the example assumes reinvestment of all dividends and distributions at NAV, participants in our dividend reinvestment plan will receive a number of shares of our common stock, determined by dividing the total dollar amount of the dividend payable to a participant by the market price per share of our common stock at the close of trading on the valuation date for the dividend. See Dividend Reinvestment Plan for additional information regarding our dividend reinvestment plan.

This example and the expenses in the table above should not be considered a representation of our future expenses. Actual expenses (including the cost of debt, if any, and other expenses) may be greater or less than those shown.

(1) In the event that the Securities to which this prospectus relates are sold to or through underwriters, a corresponding prospectus supplement will disclose the estimated applicable sales load.

(2) The related prospectus supplement will disclose the estimated amount of offering expenses, the offering price and the estimated offering expenses borne by us as a percentage of the offering price.

(3) The expenses of the dividend reinvestment plan are included in other expenses.

(4) The related prospectus supplement will disclose the offering price and the total stockholder transaction expenses as a percentage of the offering price.

(5) Our base management fee is 2% of our gross assets (which include any amount borrowed, i.e., total assets without deduction for any liabilities). Although no plans are in place to borrow the full amount under our line of credit, assuming that we borrowed $210 million, the 2% management fee of gross assets equals approximately 2.72% of net assets. See Management Management Services Investment Advisory Agreement and footnote 6 below.

(6) The incentive fee payable to our Investment Adviser under the Investment Advisory Agreement is based on our performance and will not be paid unless we achieve certain goals. Under the assumption of a 5% return required in the example, no incentive fee would be payable. The incentive fee consists of two parts. The first part, the income incentive fee, which is payable quarterly in arrears, will equal 20% of the excess, if any, of our pre-incentive fee net investment income that exceeds a 1.75% quarterly (7% annualized) hurdle rate, subject to a catch up provision measured as of the end of each calendar quarter. In the three months ended September 30, 2009, we paid an incentive fee of $3.08 million (see calculation below). We expect the incentive fees we pay to increase to the extent we earn greater interest and dividend income through our investments in portfolio companies and, to a lesser extent, realize capital gains upon the sale of warrants or other equity investments in our portfolio companies and to decrease if our interest and dividend income and capital gains decrease. The catch-up provision requires us to pay 100% of our pre-incentive fee net investment income with respect to that portion of such income, if any, that exceeds the hurdle rate but is less than 125% of the quarterly hurdle rate in any calendar quarter (8.75% annualized assuming an annualized hurdle rate of 7%). The catch-up provision

Table of Contents

is meant to provide Prospect Capital Management with 20% of our pre-incentive fee net investment income as if a hurdle rate did not apply when our pre-incentive fee net investment income exceeds 125% of the quarterly hurdle rate in any calendar quarter (8.75% annualized assuming an annualized hurdle rate of 7%). The income incentive fee will be computed and paid on income that may include interest that is accrued but not yet received in cash. If interest income is accrued but never paid, the Board of Directors would decide to write off the accrual in the quarter when the accrual is determined to be uncollectible. The write off would cause a decrease in interest income for the quarter equal to the amount of the prior accrual. The Investment Adviser is not under any obligation to reimburse us for any part of the incentive fee it received that was based on accrued income that we never receive as a result of a default by an entity on the obligation that resulted in the accrual of such income. Our pre-incentive fee net investment income used to calculate the income incentive fee is also included in the amount of our gross assets used to calculate the 2% base management fee (see footnote 5 above). The second part of the incentive fee, the capital gains incentive fee, will equal 20% of our realized capital gains, if any, during a particular year computed net of all realized capital losses and unrealized capital depreciation.

Examples of how the incentive fee is calculated are as follows:

Assuming pre-incentive fee net investment income of 0.55%, there would be no income incentive fee because such income would not exceed the hurdle rate of 1.75%.

Assuming pre-incentive fee net investment income of 2%, the income incentive fee would be as follows:

= 100% × (2%-1.75%)

= 0.25%

Assuming pre-incentive fee net investment income of 2.30%, the income incentive fee would be as follows:

= (100% × (catch-up : 2.1875%-1.75%)) + (20% × (2.30%-2.1875%))

= (100% × 0.4375%) + (20% × 0.1125%) = 0.4375% + 0.0225% = 0.46%

Assuming net realized capital gains of 6% and realized capital losses and unrealized capital depreciation of 1%, the capital gains incentive fee would be as follows:

= 20% × (6%-1%)

= 20% × 5% = 1%

The following is a calculation of the most recently paid incentive fee paid in September 2009 (for the quarter ended September 30, 2009) (in thousands):

Prior Quarter Net Asset Value (adjusted for stock offerings during the quarter)	$ 588,960
Quarterly Hurdle Rate	1.75%
Current Quarter Hurdle	$ 10,307
125% of the Quarterly Hurdle Rate	2.1875%
125% of the Current Quarter Hurdle	$ 12,884

Current Quarter Pre Incentive Fee Net Investment Income	$ 15,398
Incentive Fee Catch-Up	$ 2,577
Incentive Fee 20% in excess of 125% of the Current Quarter Hurdle	$ 503
Total Current Quarter Incentive Fee	$ 3,080

Table of Contents

For a more detailed discussion of the calculation of the two-part incentive fee, see Management Management Services Investment Advisory Agreement.

(7) The table above assumes that we have borrowed all $210 million available under our line of credit, although no plans are in place to borrow the full amount under our line of credit. The table below shows our estimated annual expenses as a percentage of net assets attributable to common stock, assuming that we did not incur any indebtedness.

Base management fee	2.03%
Incentive fees payable under Investment Advisory Agreement (20% of realized capital gains and 20% of pre-incentive fee net investment income)	2.03%
Interest payments on borrowed funds	None
Other expenses	2.99%
Total annual expenses (estimated)	7.05%

(8) Other expenses is based on our annualized expenses during our quarter ended September 30, 2009 representing all of our estimated recurring operating expenses (except fees and expenses reported in other items of this table) that are deducted from our operating income and reflected as expenses in our Statement of Operations. The estimate of our overhead expenses, including payments under an administration agreement with Prospect Administration, or the Administration Agreement, based on our projected allocable portion of overhead and other expenses incurred by Prospect Administration in performing its obligations under the Administration Agreement. Other expenses does not include non-recurring expenses. See Management Management Services Administration Agreement.

Table of Contents

SELECTED CONDENSED FINANCIAL DATA OF PROSPECT

You should read the condensed financial information below with the Financial Statements and Notes thereto included in this prospectus. Financial information for the twelve months ended June 30, 2009, 2008, 2007, 2006 and 2005 has been derived from the audited financial statements for that period. The selected consolidated financial data at and for the three months ended September 30, 2009 and 2008 have been derived from unaudited financial data, but in the opinion of our management, reflects all adjustments (consisting only of normal recurring adjustments) that are necessary to present fairly the results for such interim periods. Interim results at and for the three months ended September 30, 2009 are not necessarily indicative of the results that may be expected for the year ending June 30, 2010. Certain reclassifications have been made to the prior period financial information to conform to the current period presentation. See Management s Discussion and Analysis of Financial Condition and Results of Operations starting on page 31 for more information.

	For the Three Months Ended September 30		For the Year/Period Ended June 30,				
	2009	2008	2009	2008	2007	2006	200
	(In thousands except data relating to shares, per share and number of portfolio companies)						
nance Data:							
income	$ 14,835	$ 17,556	$ 62,926	$ 59,033	$ 30,084	$ 13,268	$
d income	6,218	4,723	22,793	12,033	6,153	3,601	
come	464	13,520	14,762	8,336	4,444		
vestment	21,517	35,799	100,481	79,402	40,681	16,869	
and credit expenses	(1,374)	(1,508)	(6,161)	(6,318)	(1,903)	(642)	
ent advisory	(6,289)	(8,698)	(26,705)	(20,199)	(11,226)	(3,868)	(
xpenses	(1,536)	(2,091)	(8,452)	(7,772)	(4,421)	(3,801)	(
penses	(9,199)	(12,297)	(41,318)	(34,289)	(17,550)	(8,311)	(
estment	12,318	23,502	59,163	45,113	23,131	8,558	
l and ed gains	(18,696)	(9,504)	(24,059)	(17,522)	(6,403)	4,338	
ease in net om ns	$ (6,378)	$ 13,998	$ 35,104	$ 27,591	$ 16,728	$ 12,896	$
re Data:							

ease in net om ns(1)	$ (0.13)	$ 0.47	$ 1.11	$ 1.17	$ 1.06	$ 1.83	$
tions per share	$ (0.41)	$ (0.40)	$ (1.62)	$ (1.59)	$ (1.54)	$ (1.12)	$
weighted utstanding eriod	49,804,906	29,520,379	31,559,905	23,626,642	15,724,095	7,056,846	7,05
nd ies Data:							
ents	$ 510,798	$ 549,303	$ 547,168	$ 497,530	$ 328,222	$ 133,969	$ 5
sets	104,697	38,415	119,857	44,248	48,280	4,511	4
sets	615,495	587,718	667,025	541,778	376,502	138,480	10
drawn on cility		131,667	124,800	91,167		28,500	
owed to parties	7,321	9,669	6,713	6,641	4,838	745	
abilities	928	14,643	2,916	14,347	71,616	965	
bilities	8,249	155,979	134,429	112,155	76,454	30,210	
ts	$ 607,246	$ 431,739	$ 532,596	$ 429,623	$ 300,048	$ 108,270	10
ent Activity							
ortfolio ies at nd	29	31(2)	30	29(2)	24(2)	15	
ions	$ 6,066	$ 70,456	$ 98,305	$ 311,947	$ 167,255	$ 83,625	$ 7
payments, r disposals	$ 24,241	$ 10,949	$ 27,007	$ 127,212	$ 38,407	$ 9,954	$ 3
d-Average end of)	15.7%	15.5%	13.7%	15.5%	17.1%	17.0%	

(1) Per share data is based on average weighted shares for the period.

(2) Includes a net profits interest in Charlevoix Energy Trading LLC (Charlevoix), remaining after loan was paid.

(3) Includes dividends from certain equity investments.

Table of Contents

SELECTED FINANCIAL DATA OF PATRIOT

You should read this selected consolidated financial data in conjunction with the consolidated financial statements and notes thereto of Patriot included elsewhere in this document. The selected consolidated financial data at and for the fiscal years ended December 31, 2008, 2007, 2006, 2005 and 2004 have been derived from Patriot s audited financial statements. The selected consolidated financial data at and for the nine months ended September 30, 2009 and 2008 have been derived from unaudited financial data, but in the opinion of Patriot s management, reflects all adjustments (consisting only of normal recurring adjustments) that are necessary to present fairly the results for such interim periods. Interim results at and for the nine months ended September 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009. No financial statements will be prepared for any periods subsequent to September 30, 2009. Certain reclassifications have been made to the prior period financial information to conform to the current period presentation.

	For the Nine Months Ended September 30,		Year Ended December 31,				
	2009	**2008**	**2008**	**2007**	**2006**	**2005**	
ement							
income:							
ne	$ 23,928,878	$ 30,562,567	$ 40,140,087	$ 37,147,275	$ 25,387,709	$ 13,035,673	$
	592,680	816,253	1,409,613	1,280,361	270,176	366,830	
nent	121,161	749,704	749,704	534,901	848,449	46,839	
nent	24,642,719	32,128,524	42,299,404	38,962,537	26,506,334	13,449,342	
n expense	2,508,241	3,440,278	3,973,030	5,410,075	3,877,525	2,481,761	
es(1)						554,796	
nse(2)	6,768,583	5,774,508	8,158,473	7,421,596	4,332,582	3,517,989	
fees	4,169,297	1,011,119	1,635,519	887,021	1,045,613	730,550	
penalty(3)						3,395,335	
e expense	2,427,985	2,140,238	2,807,113	2,498,724	2,229,970	1,041,030	
es	15,874,106	12,366,143	16,574,135	16,217,416	11,485,690	11,721,461	
nt income	8,768,613	19,762,381	25,725,269	22,745,121	15,020,644	1,727,881	
gain (loss) ts	(32,919,325)	22,138	(882,588)	91,601	(3,262,966)		
d) on	(4,082,847)	(20,367,281)	(39,992,921)	(3,637,706)	3,817,931	(2,965,175)	

d gain rest rate	3,097,384	34,772	(2,335,019)	(775,326)	12,961		
loss)	$ (33,904,788)	$ (20,310,371)	$ (17,485,259)	$ 18,423,690	$ 15,588,570	$ (1,237,294)	$
s) per	$ (1.20)	$ (0.03)	$ (0.84)	$ 0.99	$ 1.10	$ (0.17)	$
s) per .	$ (1.20)	$ (0.03)	$ (0.84)	$ 0.98	$ 1.10	$ (0.17)	$
erage nding,	20,943,734	20,682,167	20,713,540	18,670,904	14,145,200	7,253,632	
erage nding,	20,943,734	20,682,167	20,713,540	18,830,213	14,237,952	7,253,632	
et Data:							
nents	$ 257,432,323	$ 331,073,227	$ 322,370,748	$ 384,725,753	$ 257,812,235	$ 138,302,852	$ 6
	272,914,882	366,277,459	354,262,646	398,378,808	271,086,364	151,007,186	7
tstanding	112,706,453	154,200,000	162,600,000	164,900,000	98,380,000	21,650,000	4
s equity	155,930,479	201,589,072	180,117,170	221,597,684	164,108,629	127,152,365	2
ue per re	$ 7.44	$ 9.74	$ 8.65	$ 10.73	$ 10.37	$ 10.48	$
erage yield tments(4)	11.1%	12.4%	12.1%	12.4%	13.4%	13.5%	
rtfolio	29	36	35	36	26	15	
mployees	11	14	13	14	11	9	

(1) On July 27, 2005, Patriot terminated the consulting agreements pursuant to which these fees were incurred.

(2) Patriot s capital structure at December 31, 2004 reflected a higher percentage of leverage than it is permitted to incur as a business development company. Patriot used a portion of the net proceeds it received from its initial public offering to repay all of its outstanding indebtedness, including the $3.4 million prepayment penalty, at the time of its initial public offering. Patriot is generally only allowed to borrow amounts such that its asset coverage, as defined in the 1940 Act, equals at least 200% after such borrowing.

(3) The prepayment penalty was incurred in connection with the repayment in full and termination of Patriot s $120.0 million financing agreement.

(4) Computed using actual interest income earned for the fiscal year, including amortization of deferred financing fees and original issue discount, divided by the weighted average fair value of debt investments.

Table of Contents

UNAUDITED SELECTED PRO FORMA CONSOLIDATED FINANCIAL DATA

The following tables set forth unaudited pro forma condensed consolidated financial data for Prospect and Patriot as a consolidated entity, giving effect to the merger as if it had occurred on the dates indicated and after giving effect to certain transactions that occurred subsequent to September 30, 2009. The unaudited pro forma condensed consolidated operating data are presented as if the merger had been completed on July 1, 2008. The unaudited pro forma condensed consolidated balance sheet data at September 30, 2009 is presented as if the merger had occurred as of that date. In the opinion of management, all adjustments necessary to reflect the effect of these transactions have been made. The merger has been accounted for in accordance with the acquisition method of accounting as detailed in Accounting Standards Codification (ASC) 805, Business Combinations (ASC 805). Certain items in the pro forma financial statements are accounted for on a tentative basis while the accounting for Patriot as of the acquisition date is finalized.

The unaudited pro forma condensed consolidated financial data should be read together with the respective historical audited and unaudited consolidated financial statements and financial statement notes of Patriot and Prospect in this document. The unaudited pro forma condensed consolidated financial data are presented for comparative purposes only and do not necessarily indicate what the future operating results or financial position of Prospect will be following completion of the merger. The unaudited pro forma condensed consolidated financial data does not include adjustments to reflect any cost savings or other operational efficiencies that may be realized as a result of the merger of Patriot and Prospect or any future merger related restructuring or integration expenses.

		For the Three Months Ended September 30, 2009 (In thousands except data relating to earnings per share)
Performance Data:		
Interest and dividend income	$	28,853
Fee income		138
Other income		576
Total investment income		29,567
Interest expense		(2,371)
Base management and income incentive fees		(8,036)
General and administrative expenses		(5,483)
Total expenses		(15,890)
Net investment income		13,677
Realized and unrealized gains (losses)		(24,579)
Net income	$	(10,902)

Per Share Data:		
Earnings per share	$	(0.19)
Average weighted shares outstanding for the period		58,249

		At Sept. 30, 2009
Assets and Liabilities Data:		
Investment securities	$	717,924
Cash		26,725
Other assets		14,877
Total assets		759,526
Borrowings		60,000
Other liabilities		14,173
Total liabilities		74,173
Net assets	$	685,353

Table of Contents

UNAUDITED PRO FORMA PER SHARE DATA

The following selected unaudited pro forma per share information for the year ended June 30, 2009 and the three months ended September 30, 2009 reflects the merger and related transactions as if they had occurred on July 1, 2008. The unaudited pro forma combined net asset value per common share outstanding reflects the merger and related transactions as if they had occurred on September 30, 2009 and certain other transactions that occurred subsequent to September 30, 2009.

Such unaudited pro forma combined per share information is based on the historical financial statements of Prospect and Patriot and on publicly available information and certain assumptions and adjustments as discussed in the section entitled Unaudited Pro Forma Condensed Consolidated Financial Statements. This unaudited pro forma combined per share information is provided for illustrative purposes only and is not necessarily indicative of what the operating results or financial position of Prospect or Patriot would have been had the merger and related transactions been completed at the beginning of the periods or on the dates indicated, nor are they necessarily indicative of any future operating results or financial position. The following should be read in connection with the section entitled Unaudited Pro Forma Condensed Consolidated Financial Statements and other information included in or incorporated by reference into this document.

	Comparative per Share Data			
	Prospect	Patriot	Pro Forma Combined- Prospect	Per Equivalent Patriot Share(3)
Year ended June 30, 2009:				
Income from continuing operations per share	$ 1.11	$ (1.81)	$ (0.07)	$ (0.03)
Distributions per share declared to date(1)	$ 1.6175	$ 0.58	$ 1.6175	$ 0.59
Average weighted shares outstanding for the period (in thousands)	31,560	20,847	53,588	
Three months ended September 30, 2009:				
Income from continuing operations per share	$ (0.13)	$ (0.23)	$ (0.19)	$ (0.07)
Distributions per share declared to date(1)	$ 0.4075	$ 0.00	$ 0.4075	$ 0.15
Average weighted shares outstanding for the period (in thousands)	49,805	20,950	58,249	
At September 30, 2009:				
Net asset value per share(2)	$ 11.11	$ 7.44	$ 10.82	$ 3.94

(1) The historical distributions declared per share for Prospect and Patriot is computed by dividing the distributions declared for the year ended June 30, 2009 and the three months ended September 30, 2009 by their respective historical weighted average shares outstanding. The pro forma combined distributions declared are the distributions per share as declared by Prospect.

(2) The historical net asset value per share for Prospect and Patriot as of September 30, 2009 are as previously reported by the companies. The pro forma combined net asset value per share as of September 30, 2009 is computed by dividing the pro forma combined net assets by the pro forma combined number of shares

outstanding. In addition, the pro forma combined net asset value per share as of September 30, 2009 reflects the write down of the fair value of Patriot s investments at September 30, 2009 to Prospect s determination of the fair value of these investments, Prospect, in conjunction with an independent valuation agent, has determined that a fair value of Patriot s investments at September 30, 2009 that approximates the total purchase price paid by Prospect to acquire Patriot in connection with the merger transaction, which is approximately $50.4 million lower than the fair value of those investments as previously determined by Patriot, is appropriate.

(3) The Patriot equivalent pro forma per share amount is calculated by multiplying the combined pro forma share amounts by the common stock exchange ratio of 0.363992.

RISK FACTORS

Investing in our Securities involves a high degree of risk. You should carefully consider the risks described below, together with all of the other information included in this prospectus, before you decide whether to make an investment in our Securities. The risks set forth below are not the only risks we face. If any of the adverse events or conditions described below occur, our business, financial condition and results of operations could be materially adversely affected. In such case, our NAV, and the trading price of our common stock could decline, or the value of our preferred stock, debt securities, and warrants, if any are outstanding, may decline, and you may lose all or part of your investment.

Risks Relating To Our Business

Our financial condition and results of operations will depend on our ability to manage our future growth effectively.

Prospect Capital Management has been registered as an investment adviser since March 31, 2004, and we have been organized as a closed-end investment company since April 13, 2004. Our ability to achieve our investment objective depends on our ability to grow, which depends, in turn, on our Investment Adviser s ability to continue to identify, analyze, invest in and monitor companies that meet our investment criteria. Accomplishing this result on a cost-effective basis is largely a function of our Investment Adviser s structuring of investments, its ability to provide competent, attentive and efficient services to us and our access to financing on acceptable terms. As we continue to grow, Prospect Capital Management will need to continue to hire, train, supervise and manage new employees. Failure to manage our future growth effectively could have a materially adverse effect on our business, financial condition and results of operations.

We are dependent upon Prospect Capital Management s key management personnel for our future success.

We depend on the diligence, skill and network of business contacts of the senior management of our Investment Adviser. We also depend, to a significant extent, on our Investment Adviser s access to the investment professionals and the information and deal flow generated by these investment professionals in the course of their investment and portfolio management activities. The senior management team of the Investment Adviser evaluates, negotiates, structures, closes, monitors and services our investments. Our success depends to a significant extent on the continued service of the senior management team, particularly John F. Barry III and M. Grier Eliasek. The departure of any of the senior management team could have a materially adverse effect on our ability to achieve our investment objective. In addition, we can offer no assurance that Prospect Capital Management will remain our investment adviser or that we will continue to have access to its investment professionals or its information and deal flow.

We operate in a highly competitive market for investment opportunities.

A large number of entities compete with us to make the types of investments that we make in target companies. We compete with other business development companies, public and private funds, commercial and investment banks and commercial financing companies. Additionally, because competition for investment opportunities generally has increased among alternative investment vehicles, such as hedge funds, those entities have begun to invest in areas they have not traditionally invested in, including investments in middle-market companies. As a result of these new entrants, competition for investment opportunities at middle-market companies has intensified, a trend we expect to continue.

Many of our existing and potential 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 could allow them to consider a wider variety of investments and establish more or fuller relationships with borrowers and sponsors than us. Furthermore, many of our competitors are not subject to the regulatory restrictions that the 1940 Act imposes on us as a business development company. We cannot assure you that the competitive pressures we face will not have a materially adverse effect on our business, financial condition and results of operations. Also, as a result of existing and increasing competition and our competitors ability to provide a total package solution, 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 primarily based on the interest rates that we offer, and we believe that some of our competitors make loans with interest rates that are 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. If we match our competitors pricing, terms and structure, we may experience decreased net interest income and increased risk of credit loss.

Most of our portfolio investments are recorded at fair value as determined in good faith by our Board of Directors and, as a result, there is uncertainty as to the value of our portfolio investments.

A large percentage of our portfolio investments consist of securities of privately held companies. Hence, market quotations are generally not readily available for determining the fair values of such investments. The determination of fair value, and thus the amount of unrealized losses we may incur in any year, is to a degree subjective, and the Investment Adviser has a conflict of interest in making the determination. We value these securities quarterly at fair value as determined in good faith by our Board of Directors based on input from our Investment Adviser, a third party independent valuation firm and our audit committee. Our Board of Directors utilizes the services of an independent valuation firm to aid it in determining the fair value of any securities. The types of factors that may be considered in determining the fair values of our investments include the nature and realizable value of any collateral, the portfolio company s ability to make payments and its earnings, the markets in which the portfolio company does business, comparison to publicly traded companies, discounted cash flow, current market interest rates and other relevant factors. Because such valuations, and particularly valuations of private securities and private companies, are inherently uncertain, the valuations may fluctuate significantly over short periods of time due to changes in current market conditions. The determinations of fair value by our Board of Directors may differ materially from the values that would have been used if an active market and market quotations existed for these investments. Our net asset value could be adversely affected if the determinations regarding the fair value of our investments were materially higher than the values that we ultimately realize upon the disposal of such securities.

Senior securities, including debt, expose us to additional risks, including the typical risks associated with leverage.

We currently use our revolving credit facility to leverage our portfolio and we expect in the future to borrow from and issue senior debt securities to banks and other lenders and may securitize certain of our portfolio investments.

With certain limited exceptions, as a BDC we are only allowed to borrow amounts such that our asset coverage, as defined in the 1940 Act, is at least 200% after such borrowing. The amount of leverage that we employ will depend on our Investment Adviser s and our Board of Directors assessment of market conditions and other factors at the time of any proposed borrowing. There is no assurance that a leveraging strategy will be successful. Leverage involves risks and special considerations for stockholders, including:

- A likelihood of greater volatility in the net asset value and market price of our common stock;
- Diminished operating flexibility as a result of asset coverage or investment portfolio composition requirements required by lenders or investors that are more stringent than those imposed by the 1940 Act;
- The possibility that investments will have to be liquidated at less than full value or at inopportune times to comply with debt covenants or to pay interest or dividends on the leverage;

Increased operating expenses due to the cost of leverage, including issuance and servicing costs;

Convertible or exchangeable securities issued in the future may have rights, preferences and privileges more favorable than those of our common stock; and

Subordination to lenders superior claims on our assets as a result of which lenders will be able to receive proceeds available in the case of our liquidation before any proceeds are distributed to our stockholders.

For example, the amount we may borrow under our revolving credit facility is determined, in part, by the fair value of our investments. If the fair value of our investments declines, we may be forced to sell investments at a loss to maintain compliance with our borrowing limits. Other debt facilities we may enter into in the future may contain similar provisions. Any such forced sales would reduce our net asset value and also make it difficult for the net asset value to recover.

Illustration. The following table illustrates the effect of leverage on returns from an investment in our common stock assuming various annual returns, net of expenses. The calculations in the table below are hypothetical and actual returns may be higher or lower than those appearing below. The calculation assumes (i) $667.0 million in total assets, (ii) an average cost of funds of 7.0%, (iii) $124.8 million in debt outstanding and (iv) $532.6 million of shareholders equity.

Assumed Return on Our Portfolio (net of expenses)	**(10)%**	**(5)%**	**0%**	**5%**	**10%**
Corresponding Return to Stockholder	(14.2)%	(7.9)%	(1.6)%	4.6%	10.9%

Our Investment Adviser and our Board of Directors in their best judgment nevertheless may determine to use leverage if they expect that the benefits to our stockholders of maintaining the leveraged position will outweigh the risks.

Changes in interest rates may affect our cost of capital and net investment income.

A significant portion of the debt investments we make bears interest at fixed rates and the value of these investments could be negatively affected by increases in market interest rates. In addition, as the interest rate on our revolving credit facility is at a variable rate based on an index, an increase in interest rates would make it more expensive to use debt to finance our investments. As a result, a significant increase in market interest rates could both reduce the value of our portfolio investments and increase our cost of capital, which would reduce our net investment income.

We need to raise additional capital to grow because we must distribute most of our income.

We need additional capital to fund growth in our investments. A reduction in the availability of new capital could limit our ability to grow. We must distribute at least 90% of our ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, to our shareholders to maintain our RIC status. As a result, such earnings are not available to fund investment originations. We have sought additional capital by borrowing from financial institutions and may issue debt securities or additional equity securities. If we fail to obtain funds from such sources or from other sources to fund our investments, we could be limited in our ability to grow, which may have an adverse effect on the value of our common stock. In addition, as a business development company, we are generally required to maintain a ratio of total assets to total borrowings of at least 200%, which may restrict our ability to borrow in certain circumstances.

The lack of liquidity in our investments may adversely affect our business.

We generally make investments in private companies. Substantially all of these securities are subject to legal and other restrictions on resale or are otherwise less liquid than publicly traded securities. The illiquidity of our investments may make it difficult for us to sell such investments if the need arises. In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the value at which we have previously recorded our investments. In addition, we may face other restrictions on our ability to liquidate an investment in a portfolio company to the extent that we or our Investment Adviser has material non-public information regarding such portfolio company.

We may experience fluctuations in our quarterly results.

We could experience fluctuations in our quarterly operating results due to a number of factors, including the interest or dividend rates payable on the debt or equity securities we hold, the default rate on debt securities, the

Table of Contents

level of our expenses, variations in and the timing of the recognition of realized and unrealized gains or losses, the degree to which we encounter competition in our markets, the seasonality of the energy industry, weather patterns, changes in energy prices and general economic conditions. As a result of these factors, results for any period should not be relied upon as being indicative of performance in future periods.

Our most recent net asset value was calculated on September 30, 2009 and our NAV when calculated effective December 31, 2009 may be higher or lower.

Our most recently estimated NAV per share is $10.82 on an as adjusted basis solely to give effect to our payment of the October dividend recorded on ex-dividend date of October 6, 2009 and issuance of common shares on October 19, 2009 in connection with our dividend reinvestment plan and December 2, 2009 in connection with our merger with Patriot Capital Funding, Inc., versus $11.11 determined by us as of September 30, 2009. NAV as of December 31, 2009 may be higher or lower than $10.82 based on potential changes in valuations and earnings for the quarter then ended. We have subsequently declared distributions of $25.9 million for the second quarter of the fiscal year ending June 30, 2010. We have not adjusted the NAV for such dividend as the net income for such period has not yet been determined. Our Board of Directors has not yet determined the fair value of portfolio investments subsequent to September 30, 2009. Our Board of Directors determines the fair value of our portfolio investments on a quarterly basis in connection with the preparation of quarterly financial statements and based on input from an independent valuation firm, our Investment Advisor and the audit committee of our Board of Directors.

Potential conflicts of interest could impact our investment returns.

Our executive officers and directors, and the executive officers of our Investment Adviser, Prospect Capital Management, may serve as officers, directors or principals of entities that operate in the same or related lines 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 our best interests or those of our stockholders. Nevertheless, it is possible that new investment opportunities that meet our investment objective may come to the attention of one of these entities in connection with another investment advisory client or program, and, if so, such opportunity might not be offered, or otherwise made available, to us. However, as an investment adviser, Prospect Capital Management has a fiduciary obligation to act in the best interests of its clients, including us. To that end, if Prospect Capital Management or its affiliates manage any additional investment vehicles or client accounts in the future, Prospect Capital Management will endeavor to allocate investment opportunities in a fair and equitable manner over time so as not to discriminate unfairly against any client. If Prospect Capital Management chooses to establish another investment fund in the future, when the investment professionals of Prospect Capital Management identify an investment, they will have to choose which investment fund should make the investment.

In the course of our investing activities, under the Investment Advisory Agreement we pay base management and incentive fees to Prospect Capital Management, and reimburse Prospect Capital Management for certain expenses it incurs. As a result of the Investment Advisory Agreement, there may be times when the senior management team of Prospect Capital Management has interests that differ from those of our stockholders, giving rise to a conflict.

Prospect Capital Management receives a quarterly income incentive fee based, in part, on our pre-incentive fee net investment income, if any, for the immediately preceding calendar quarter. This income incentive fee is subject to a fixed quarterly hurdle rate before providing an income incentive fee return to the Investment Adviser. This fixed hurdle rate was determined when then current interest rates were relatively low on a historical basis. Thus, if interest rates rise, it would become easier for our investment income to exceed the hurdle rate and, as a result, more likely that our Investment Adviser will receive an income incentive fee than if interest rates on our investments remained constant or decreased. Subject to the receipt of any requisite stockholder approval under the 1940 Act, our Board of Directors may adjust the hurdle rate by amending the Investment Advisory Agreement.

The income incentive fee payable by us is computed and paid on income that may include interest that has been accrued but not yet received in cash. If a portfolio company defaults on a loan that has a deferred interest feature, it is possible that interest accrued under such loan that has previously been included in the calculation of the income incentive fee will become uncollectible. If this happens, our Investment Adviser is not required to reimburse us for any such income incentive fee payments. If we do not have sufficient liquid assets to pay this incentive fee or distributions to stockholders on such accrued income, we may be required to liquidate assets in order to do so. This fee structure could give rise to a conflict of interest for our Investment Adviser to the extent that it may encourage the Investment Adviser to favor debt financings that provide for deferred interest, rather than current cash payments of interest.

We have entered into a royalty-free license agreement with Prospect Capital Management. Under this agreement, Prospect Capital Management agrees to grant us a non-exclusive license to use the name Prospect Capital. Under the license agreement, we have the right to use the Prospect Capital name for so long as Prospect Capital Management or one of its affiliates remains our Investment Adviser. In addition, we rent office space from Prospect Administration, an affiliate of Prospect Capital Management, and pay Prospect Administration our allocable portion of overhead and other expenses incurred by Prospect Administration in performing its obligations as Administrator under the Administration Agreement, including rent and our allocable portion of the costs of our chief financial officer and chief compliance officer and their respective staffs. This may create conflicts of interest that our Board of Directors monitors.

Our incentive fee could induce Prospect Capital Management to make speculative investments.

The incentive fee payable by us to Prospect Capital Management may create an incentive for our Investment Adviser to make investments on our behalf that are more speculative or involve more risk than would be the case in the absence of such compensation arrangement. The way in which the incentive fee payable is determined (calculated as a percentage of the return on invested capital) may encourage the Investment Adviser to use leverage to increase the return on our investments. Increased use of leverage and this increased risk of replacement of that leverage at maturity, would increase the likelihood of default, which would disfavor holders of our common stock. Similarly, because the Investment Adviser will receive an incentive fee based, in part, upon net capital gains realized on our investments, the Investment Adviser may invest more than would otherwise be appropriate in companies whose securities are likely to yield capital gains, as compared to income producing securities. Such a practice could result in our investing in more speculative securities than would otherwise be the case, which could result in higher investment losses, particularly during economic downturns.

The incentive fee payable by us to Prospect Capital Management could create an incentive for our Investment Adviser to invest on our behalf in instruments, such as zero coupon bonds, that have a deferred interest feature. Under these investments, we would accrue interest income over the life of the investment but would not receive payments in cash on the investment until the end of the term. Our net investment income used to calculate the income incentive fee, however, includes accrued interest. For example, accrued interest, if any, on our investments in zero coupon bonds will be included in the calculation of our incentive fee, even though we will not receive any cash interest payments in respect of payment on the bond until its maturity date. Thus, a portion of this incentive fee would be based on income that we may not have yet received in cash in the event of default may never receive.

Changes in 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 U.S. Federal levels. These laws and regulations, as well as their interpretation, may be changed from time to time. Accordingly, changes in these laws or regulations could have a materially adverse effect on our business. For additional information regarding the regulations we are subject to, see Regulation.

Recent developments may increase the risks associated with our business and an investment in us.

The U.S. financial markets have been experiencing a high level of volatility, disruption and distress, which was exacerbated by the failure of several major financial institutions in the last few months of 2008. In addition, the U.S. economy has been in a recession, the aftermath of which may be severe and prolonged. Similar conditions have occurred in the financial markets and economies of numerous other countries and could worsen, both in the U.S. and globally. These conditions have raised the level of many of the risks described in this document and could have an adverse effect on our portfolio companies as well as on our business, financial condition, results of operations, dividend payments, credit facility, access to capital, valuation of our assets, NAV and our stock price.

Risks Relating To Our Operation As A Business Development Company

Our Investment Adviser and its senior management team have limited experience managing a business development company under the 1940 Act.

The 1940 Act imposes numerous constraints on the operations of business development companies. For example, business development companies are, with narrow exceptions, required to invest at least 70% of their total assets in securities of certain privately held, thinly traded or distressed U.S. companies, cash, cash equivalents, U.S. government securities and other high quality debt investments that mature in one year or less. Our Investment Adviser s and its senior management team s limited experience in managing a portfolio of assets under such constraints may hinder their ability to take advantage of attractive investment opportunities and, as a result, achieve our investment objective. In addition, our investment strategies differ in some ways from those of other investment funds that have been managed in the past by investment professionals.

A failure on our part to maintain our status as a business development company would significantly reduce our operating flexibility.

If we do not continue to qualify as a business development company, we might be regulated as a registered closed-end investment company under the 1940 Act; our failure to qualify as a BDC would make us subject to additional regulatory requirements, which may significantly decrease our operating flexibility by limiting our ability to employ leverage.

If we fail to qualify as a RIC, we will have to pay corporate-level taxes on our income, and our income available for distribution would be reduced.

To maintain our qualification for federal income tax purposes as a RIC under Subchapter M of the Code, and obtain RIC tax treatment, we must meet certain source of income, asset diversification and annual distribution requirements.

The source of income requirement is satisfied if we derive at least 90% of our annual gross income from interest, dividends, payments with respect to certain securities loans, gains from the sale or other disposition of securities or options thereon or foreign currencies, or other income derived with respect to our business of investing in such securities or currencies, and net income from interests in qualified publicly traded partnerships, as defined in the Code.

The annual distribution requirement for a RIC is satisfied if we distribute at least 90% of our ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, to our stockholders on an annual basis. Because we use debt financing, we are subject to certain asset coverage ratio requirements under the 1940 Act and financial covenants that could, under certain circumstances, restrict us from making distributions necessary to qualify for RIC tax treatment. If we are unable to obtain cash from other sources, we may fail to qualify for RIC tax treatment and, thus, may be subject to corporate-level income tax.

To maintain our qualification as a RIC, we must also meet certain asset diversification requirements at the end of each calendar quarter. Failure to meet these tests may result in our having to dispose of certain investments quickly in order to prevent the loss of RIC status. Because most of our investments are in private companies, any such dispositions could be made at disadvantageous prices and may result in substantial losses.

If we fail to qualify as a RIC for any reason or become 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 of our distributions. Such a failure would have a materially adverse effect on us and our stockholders. For additional information regarding asset coverage ratio and RIC requirements, see Regulation Senior Securities and Material U.S. Federal Income Tax Considerations .

Table of Contents

Regulations governing our operation as a business development company affect our ability to raise, and the way in which we raise, additional capital.

We have incurred indebtedness under our revolving credit facility and, in the future, may issue preferred stock and/or borrow additional money from banks or other financial institutions, which we refer to collectively as senior securities, up to the maximum amount permitted by the 1940 Act. Under the provisions of the 1940 Act, we are permitted, as a BDC, to incur indebtedness or issue senior securities only in amounts such that our asset coverage, as defined in the 1940 Act, equals at least 200% after each issuance of senior securities. If the value of our assets declines, we may be unable to satisfy this test, which would prohibit us from paying dividends and could prohibit us from qualifying as a RIC. If we cannot satisfy this test, we may be required to sell a portion of our investments or sell additional shares of common stock at a time when such sales may be disadvantageous in order to repay a portion of our indebtedness. In addition, issuance of additional common stock could dilute the percentage ownership of our current stockholders in us.

As a BDC regulated under provisions of the 1940 Act, we are not generally able to issue and sell our common stock at a price below the current net asset value per share. If our common stock trades at a discount to net asset value, this restriction could adversely affect our ability to raise capital. We may, however, sell our common stock, or warrants, options or rights to acquire our common stock, at a price below the current net asset value of our common stock in certain circumstances, including if (i)(1) the holders of a majority of our shares (or, if less, at least 67% of a quorum consisting of a majority of our shares) and a similar majority of the holders of our shares who are not affiliated persons of us approve the sale of our common stock at a price that is less than the current net asset value, and (2) a majority of our Directors who have no financial interest in the transaction and a majority of our independent Directors (a) determine that such sale is in our and our stockholders best interests and (b) in consultation with any underwriter or underwriters of the offering, make a good faith determination as of a time either immediately prior to the first solicitation by us or on our behalf of firm commitments to purchase such shares, or immediately prior to the issuance of such shares, that the price at which such shares are to be sold is not less than a price which closely approximates the market value of such shares, less any distributing commission or discount or if (ii) a majority of the number of the beneficial holders of our common stock entitled to vote at the annual meeting, without regard to whether a majority of such shares are voted in favor of the proposal, approve the sale of our common stock at a price that is less than the current net asset value per share. At our 2008 annual meeting of stockholders held February 12, 2009, and our 2009 annual meeting of stockholders held on December 11, 2009, we obtained the first method of approval from our shareholders. See If we sell common stock at a discount to our net asset value per share, stockholders who do not participate in such sale will experience immediate dilution in an amount that may be material discussed below.

To generate cash for funding new investments, we pledged a substantial portion of our portfolio investments under our revolving credit facility. These assets are not available to secure other sources of funding or for securitization. Our ability to obtain additional secured or unsecured financing on attractive terms in the future is uncertain.

Alternatively, we may securitize our future loans to generate cash for funding new investments. To securitize loans, we may create a wholly owned subsidiary and contribute a pool of loans to such subsidiary. This could include the sale of interests in the loans by the subsidiary on a non-recourse basis to purchasers who we would expect to be willing to accept a lower interest rate to invest in investment grade loan pools. We would retain a portion of the equity in the securitized pool of loans. An inability to successfully securitize our loan portfolio could limit our ability to grow our business and fully execute our business strategy, and could decrease our earnings, if any. Moreover, the successful securitization of our loan portfolio exposes us to a risk of loss for the equity we retain in the securitized pool of loans and might expose us to losses because the residual loans in which we do not sell interests may tend to be those that are riskier and more likely to generate losses. A successful securitization may also impose financial and operating covenants that restrict our business activities and may include limitations that could hinder our ability to finance additional loans and investments or to make the distributions required to maintain our status as a RIC under

Subchapter M of the Code. The 1940 Act may also impose restrictions on the structure of any securitizations.

Table of Contents

Our common stock may trade at a discount to our net asset value per share.

Common stock of BDCs, like that of closed-end investment companies, frequently trades at a discount to current net asset value, which could adversely affect the ability to raise capital. In the past, our common stock has traded at a discount to our net asset value. However, we have been able to periodically raise capital pursuant to authority granted by our stockholders at our 2008 and 2009 annual meetings to sell an unlimited number of shares of our common stock at any level of discount from net asset value during the 12 month period following such approval. The risk that our common stock may continue to trade at a discount to our net asset value is separate and distinct from the risk that our net asset value per share may decline.

If we sell common stock at a discount to our net asset value per share, stockholders who do not participate in such sale will experience immediate dilution in an amount that may be material.

At our 2008 annual meeting of stockholders held on February 12, 2009 and our 2009 annual meeting of stockholders held on December 11, 2009, our stockholders approved our ability to sell an unlimited number of shares of our common stock at any level of discount from net asset value per share during the 12 month period following such approval in accordance with the exception described above in Regulations governing our operation as a business development company affect our ability to raise, and the way in which we raise, additional capital. The issuance or sale by us of shares of our common stock at a discount to net asset value poses a risk of dilution to our stockholders. In particular, stockholders who do not purchase additional shares at or below the discounted price in proportion to their current ownership will experience an immediate decrease in net asset value per share (as well as in the aggregate net asset value of their shares if they do not participate at all). These stockholders will also experience a disproportionately greater decrease in their participation in our earnings and assets and their voting power than the increase we experience in our assets, potential earning power and voting interests from such issuance or sale. They may also experience a reduction in the market price of our common stock. For additional information and hypothetical examples of these risks, see Sales of Common Stock Below Net Asset Value and the prospectus supplement pursuant to which such sale is made.

We may have difficulty paying our required distributions if we recognize income before or without receiving cash representing such income.

For U.S. Federal income tax purposes, we include in income certain amounts that we have not yet received in cash, such as original issue discount, which may arise if we receive warrants in connection with the making of a loan or possibly in other circumstances, or payment-in-kind interest, which represents contractual interest added to the loan balance and due at the end of the loan term. Such original issue discount, which could be significant relative to our overall investment activities, or increases in loan balances as a result of payment-in-kind arrangements, are included in our taxable income before we receive any corresponding cash payments. We also may be required to include in taxable income certain other amounts that we do not receive in cash. While we focus primarily on investments that will generate a current cash return, our investment portfolio currently includes, and we may continue to invest in, securities that do not pay some or all of their return in periodic current cash distributions.

The income incentive fee payable by us is computed and paid on income that may include interest that has been accrued but not yet received in cash. If a portfolio company defaults on a loan that is structured to provide accrued interest, it is possible that accrued interest previously used in the calculation of the income incentive fee will become uncollectible.

Since in some cases we may recognize taxable income before or without receiving cash representing such income, we may have difficulty meeting the tax requirement to distribute at least 90% of our ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, to maintain RIC tax treatment.

Accordingly, we may have to sell some of our investments at times we would not consider advantageous, raise additional debt or equity capital or reduce new investment originations to meet these distribution requirements. If we are not able to obtain cash from other sources, we may fail to qualify for RIC treatment and thus become subject to corporate-level income tax. See Regulation Senior Securities and Material U.S. Federal Income Tax Considerations .

Table of Contents

Our ability to enter into transactions with our affiliates is restricted.

We are prohibited under the 1940 Act from knowingly participating in certain transactions with our affiliates without the prior approval of our independent directors. Any person that owns, directly or indirectly, 5% or more of our outstanding voting securities is our affiliate for purposes of the 1940 Act and we are generally prohibited from buying or selling any security or other property from or to such affiliate, absent the prior approval of our independent directors. The 1940 Act also prohibits joint transactions with an affiliate, which could include investments in the same portfolio company (whether at the same or different times), without prior approval of our independent directors. We are prohibited from buying or selling any security or other property from or to our Investment Adviser and its affiliates and persons with whom we are in a control relationship, or entering into joint transactions with any such person, absent the prior approval of the SEC.

The Company may be unable to realize the benefits anticipated by the merger with Patriot or may take longer than anticipated to achieve such benefits.

On December 2, 2009, we completed our previously announced acquisition of Patriot under the Agreement and Plan of Merger, dated as of August 3, 2009, by and among, us and Patriot. The realization of certain benefits anticipated as a result of the merger will depend in part on the integration of Patriot s investment portfolio with the Company and the successful inclusion of Patriot s investment portfolio in the Company s financing operations. There can be no assurance that Patriot s business can be operated profitably or integrated successfully into the Company s operations in a timely fashion or at all. The dedication of management resources to such integration may detract attention from the day-to-day business of the Company and there can be no assurance that there will not be substantial costs associated with the transition process or that there will not be other material adverse effects as a result of these integration efforts. Such effects, including but not limited to, incurring unexpected costs or delays in connection with such integration and failure of Patriot s investment portfolio to perform as expected, could have a material adverse effect on the financial results of the Company.

Risks Relating To Our Investments

We may not realize gains or income from our investments.

We seek to generate both current income and capital appreciation. However, the securities we invest in may not appreciate and, in fact, may decline in value, and the issuers of debt securities we invest in may default on interest and/or principal payments. Accordingly, we may not be able to realize gains from our investments, and any gains that we do realize may not be sufficient to offset any losses we experience. See Business Our Investment Objective and Policies .

Our portfolio is concentrated in a limited number of portfolio companies, particularly those in the energy industry, which subject us to a risk of significant loss if any of these companies defaults on its obligations under any of the securities that we hold or if the energy industry experiences a downturn.

As of January 7, 2010, we had invested in a number of companies in the energy and energy related industries. A consequence of this lack of diversification is that the aggregate returns we realize may be significantly and adversely affected if a small number of such investments perform poorly or if we need to write down the value of any one investment. Beyond our income tax diversification requirements, we do not have fixed guidelines for diversification, and our investments are concentrated in relatively few portfolio companies. In addition, to date we have concentrated on making investments in the energy industry. While we expect to be less focused on the energy and energy related industries in the future, we anticipate that we will continue to have significant holdings in the energy and energy related industries. As a result, a downturn in the energy industry could materially and adversely affect us.

The energy industry is subject to many risks.

We have a significant concentration in the energy industry. Our definition of energy, as used in the context of the energy industry, is broad, and different sectors in the energy industry may be subject to variable risks and economic pressures. As a result, it is difficult to anticipate the impact of changing economic and political conditions on our portfolio companies and, as a result, our financial results. The revenues, income (or losses) and valuations of energy companies can fluctuate suddenly and dramatically due to any one or more of the following factors:

Commodity Pricing Risk. Energy companies in general are directly affected by energy commodity prices, such as the market prices of crude oil, natural gas and wholesale electricity, especially for those that own the underlying energy commodity. In addition, the volatility of commodity prices can affect other energy companies due to the impact of prices on the volume of commodities transported, processed, stored or distributed and on the cost of fuel for power generation companies. The volatility of commodity prices can also affect energy companies ability to access the capital markets in light of market perception that their performance may be directly tied to commodity prices. Historically, energy commodity prices have been cyclical and exhibited significant volatility. Although we generally prefer risk controls, including appropriate commodity and other hedges, by certain of our portfolio companies, if available, some of our portfolio companies may not engage in hedging transactions to minimize their exposure to commodity price risk. For those companies that engage in such hedging transactions, they remain subject to market risks, including market liquidity and counterparty creditworthiness. In addition, such companies may also still have exposure to market prices if such companies do not produce volumes or other contractual obligations in accordance with such hedging contracts.

Regulatory Risk. The profitability of energy companies could be adversely affected by changes in the regulatory environment. The businesses of energy companies are heavily regulated by federal, state and local governments in diverse ways, such as the way in which energy assets are constructed, maintained and operated and the prices energy companies may charge for their products and services. Such regulation can change over time in scope and intensity. For example, a particular by-product of an energy process may be declared hazardous by a regulatory agency, which can unexpectedly increase production costs. Moreover, many state and federal environmental laws provide for civil penalties as well as regulatory remediation, thus adding to the potential liability an energy company may face. In addition, the deregulation of energy markets and the unresolved regulatory issues related to some power markets such as California create uncertainty in the regulatory environment as rules and regulations may be adopted on a transitional basis. We cannot assure you that the deregulation of energy markets will continue and if it continues, whether its impact on energy companies profitability will be positive.

Production Risk. The profitability of energy companies may be materially impacted by the volume of crude oil, natural gas or other energy commodities available for transporting, processing, storing, distributing or power generation. A significant decrease in the production of natural gas, crude oil, coal or other energy commodities, due to the decline of production from existing facilities, import supply disruption, depressed commodity prices, political events, OPEC actions or otherwise, could reduce revenue and operating income or increase operating costs of energy companies and, therefore, their ability to pay debt or dividends.

Demand Risk. A sustained decline in demand for crude oil, natural gas, refined petroleum products and electricity could materially affect revenues and cash flows of energy companies. Factors that could lead to a decrease in market demand include a recession or other adverse economic conditions, an increase in the market price of the underlying commodity, higher taxes or other regulatory actions that increase costs, or a shift in consumer demand for such products.

Depletion and Exploration Risk. A portion of any one energy company s assets may be dedicated to natural gas, crude oil and/or coal reserves and other commodities that naturally deplete over time. Depletion could have a materially adverse impact on such company s ability to maintain its revenue. Further, estimates of energy reserves may not be accurate and, even if accurate, reserves may not be fully utilized at reasonable costs. Exploration of energy resources, especially of oil and gas, is inherently risky and requires large amounts of capital.

Weather Risk. Unseasonable extreme weather patterns could result in significant volatility in demand for energy and power. In addition, hurricanes, storms, tornados, floods, rain, and other significant weather events could disrupt supply and other operations at our portfolio companies as well as customers or suppliers to such companies. This volatility may create fluctuations in earnings of energy companies.

Table of Contents

Operational Risk. Energy companies are subject to various operational risks, such as failed drilling or well development, unscheduled outages, underestimated cost projections, unanticipated operation and maintenance expenses, failure to obtain the necessary permits to operate and failure of third-party contractors (for example, energy producers and shippers) to perform their contractual obligations. In addition, energy companies employ a variety of means of increasing cash flow, including increasing utilization of existing facilities, expanding operations through new construction, expanding operations through acquisitions, or securing additional long-term contracts. Thus, some energy companies may be subject to construction risk, acquisition risk or other risk factors arising from their specific business strategies.

Competition Risk. The progress in deregulating energy markets has created more competition in the energy industry. This competition is reflected in risks associated with marketing and selling energy in the evolving energy market and a competitor s development of a lower-cost energy or power source, or of a lower cost means of operations, and other risks arising from competition.

Valuation Risk. Since mid-2001, excess power generation capacity in certain regions of the United States has caused substantial decreases in the market capitalization of many energy companies. While such prices have recovered to some extent, we can offer no assurance that such decreases in market capitalization will not recur, or that any future decreases in energy company valuations will be insubstantial or temporary in nature.

Terrorism Risk. Since the September 11th attacks, the United States government has issued public warnings indicating that energy assets, specifically those related to pipeline infrastructure, production facilities and transmission and distribution facilities, might be specific targets of terrorist activity. The continued threat of terrorism and related military activity will likely increase volatility for prices of natural gas and oil and could affect the market for products and services of energy companies. In addition, any future terrorist attack or armed conflict in the United States or elsewhere may undermine economic conditions in the United States in general.

Financing Risk. Some of our portfolio companies rely on the capital markets to raise money to pay their existing obligations. Their ability to access the capital markets on attractive terms or at all may be affected by any of the risks associated with energy companies described above, by general economic and market conditions or by other factors. This may in turn affect their ability to satisfy their obligations with us.

Our investments in prospective portfolio companies may be risky and we could lose all or part of our investment.

Some of our portfolio companies have relatively short or no operating histories. These companies are and will be subject to all of the business risk and uncertainties associated with any new business enterprise, including the risk that these companies may not reach their investment objective and the value of our investment in them may decline substantially or fall to zero.

In addition, investment in the middle market companies that we are targeting involves a number of other significant risks, including:

these companies may have limited financial resources and may be unable to meet their obligations under their securities that we hold, which may be accompanied by a deterioration in the value of their securities or of any collateral with respect to any securities and a reduction in the likelihood of our realizing on any guarantees we may have obtained in connection with our investment;

they may have shorter operating histories, narrower product lines and smaller market shares than larger businesses, which tend to render them more vulnerable to competitors actions and market conditions, as well as general economic downturns;

because many of these companies are privately held companies, public information is generally not available about these companies. As a result, we will depend on the ability of our Investment Adviser to obtain adequate information to evaluate these companies in making investment decisions. If our Investment

Adviser is unable to uncover all material information about these companies, it may not make a fully informed investment decision, and we may lose money on our investments;

they are more likely to depend on the management talents and efforts of a small group of persons; therefore, the death, disability, resignation or termination of one or more of these persons could have a materially adverse impact on our portfolio company and, in turn, on us;

they may have less predictable operating results, may from time to time be parties to litigation, may be engaged in changing businesses with products subject to a risk of obsolescence and may require substantial additional capital to support their operations, finance expansion or maintain their competitive position; and

they may have difficulty accessing the capital markets to meet future capital needs.

In addition, our executive officers, directors and our Investment Adviser could, in the ordinary course of business, be named as defendants in litigation arising from proposed investments or from our investments in the portfolio companies.

Economic recessions or downturns could impair our portfolio companies and harm our operating results.

The U.S. financial markets have been experiencing a high level of volatility, disruption and distress, which was exacerbated by the failure of several major financial institutions in the last few months of 2008. In addition, the U.S. economy has been in a recession, the aftermath of which may be severe and prolonged. Similar conditions have occurred in the financial markets and economies of numerous other countries and could worsen, both in the U.S. and globally. Our portfolio companies will generally be affected by the conditions and overall strength of the national, regional and local economies, including interest rate fluctuations, changes in the capital markets and changes in the prices of their primary commodities and products. These factors also impact the amount of residential, industrial and commercial growth in the energy industry. Additionally, these factors could adversely impact the customer base and customer collections of our portfolio companies.

As a result, many of our portfolio companies may be susceptible to economic slowdowns or recessions and may be unable to repay our loans or meet other obligations during these periods. Therefore, our non-performing assets are likely to increase, and the value of our portfolio is likely to decrease, during these periods. Adverse economic conditions also may decrease the value of collateral securing some of our loans and the value of our equity investments. Economic slowdowns or recessions could lead to financial losses in our portfolio and a decrease in revenues, net income and assets. Unfavorable economic conditions also could increase our funding costs, limit our access to the capital markets or result in a decision by lenders not to extend credit to us. These events could prevent us from increasing investments and harm our operating results.

A portfolio company s failure to satisfy financial or operating covenants imposed by us or other lenders could lead to defaults and, potentially, termination of its loans and foreclosure on its secured assets, which could trigger cross-defaults under other agreements and jeopardize a portfolio company s ability to meet its obligations under the debt or equity securities that we hold. We may incur expenses to the extent necessary to seek recovery upon default or to negotiate new terms, which may include the waiver of certain financial covenants, with a defaulting portfolio company. In addition, if one of our portfolio companies were to go bankrupt, even though we may have structured our interest as senior debt or preferred equity, 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 or equity holding and subordinate all or a portion of our claim to those of other creditors.

The lack of liquidity in our investments may adversely affect our business.

We make investments in private companies. A portion of these investments may be subject to legal and other restrictions on resale, transfer, pledge or other disposition or will otherwise be less liquid than publicly traded securities. The illiquidity of our investments may make it difficult for us to sell such investments if the need arises. In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the value at which we have previously recorded our investments. In addition, we face other restrictions on our ability to liquidate an investment in a business entity to the extent that we or our Investment Adviser has or could be deemed to have material non-public information regarding such business entity.

Table of Contents

We may have limited access to information about privately held companies in which we invest.

We invest primarily in privately-held companies. Generally, little public information exists about these companies, and we are required to rely on the ability of our Investment Adviser s investment professionals to obtain adequate information to evaluate the potential returns from investing in these companies. These companies and their financial information are not subject to the Sarbanes-Oxley Act and other rules that govern public companies. If we are unable to uncover all material information about these companies, we may not make a fully informed investment decision, and we may lose money on our investment.

We may not be in a position to control a portfolio investment when we are a debt or minority equity investor and its management may make decisions that could decrease the value of our investment.

We make both debt and minority equity investments in portfolio companies. As a result, we are subject to the risk that a portfolio company may make business decisions with which we disagree, and the management of such company, as representatives of the holders of their common equity, may take risks or otherwise act in ways that do not serve our interests. As a result, a portfolio company may make decisions that could decrease the value of our portfolio holdings.

Our portfolio companies may incur debt or issue equity securities that rank equally with, or senior to, our investments in such companies.

We may invest in mezzanine debt and dividend-paying equity securities issued by our portfolio companies. Our portfolio companies usually have, or may be permitted to incur, other debt, or issue other equity securities, that rank equally with, or senior to, the securities in which we invest. By their terms, such instruments may provide that the holders are entitled to receive payment of dividends, interest or principal on or before the dates on which we are entitled to receive payments in respect of the securities in which we invest. Also, in the event of insolvency, liquidation, dissolution, reorganization or bankruptcy of a portfolio company, holders of securities 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. After repaying the senior security holders, the portfolio company may not have any remaining assets to use for repaying its obligation to us. In the case of securities ranking equally with securities in which we invest, we would have to share on an equal basis any distributions with other security holders in the event of an insolvency, liquidation, dissolution, reorganization or bankruptcy of the relevant portfolio company.

We may not be able to fully realize the value of the collateral securing our debt investments.

Although a substantial amount of our debt investments are protected by holding security interests in the assets of the portfolio companies, we may not be able to fully realize the value of the collateral securing our investments due to one or more of the following factors:

- our debt investments are primarily made in the form of mezzanine loans, therefore our liens on the collateral, if any, are subordinated to those of the senior secured debt of the portfolio companies, if any. As a result, we may not be able to control remedies with respect to the collateral;

- the collateral may not be valuable enough to satisfy all of the obligations under our secured loan, particularly after giving effect to the repayment of secured debt of the portfolio company that ranks senior to our loan;

- bankruptcy laws may limit our ability to realize value from the collateral and may delay the realization process;

- our rights in the collateral may be adversely affected by the failure to perfect security interests in the collateral;

the need to obtain regulatory and contractual consents could impair or impede how effectively the collateral would be liquidated and could affect the value received; and

Table of Contents

some or all of the collateral may be illiquid and may have no readily ascertainable market value. The liquidity and value of the collateral could be impaired as a result of changing economic conditions, competition, and other factors, including the availability of suitable buyers.

Our investments in foreign securities may involve significant risks in addition to the risks inherent in U.S. investments.

Our investment strategy contemplates potential investments in securities of foreign companies. Investing in foreign companies may expose us to additional risks not typically associated with investing in U.S. companies. These risks include changes in exchange control regulations, political and social instability, expropriation, imposition of foreign taxes, less liquid markets and less available information than is generally the case in the United States, higher transaction costs, less government supervision of exchanges, brokers and issuers, less developed bankruptcy laws, difficulty in enforcing contractual obligations, lack of uniform accounting and auditing standards and greater price volatility.

Although currently most of our investments are, and we expect that most of our investments will be, U.S. dollar-denominated, investments that are denominated in a foreign currency will be subject to the risk that the value of a particular currency will change in relation to one or more other currencies. Among the factors that may affect currency values are trade balances, the level of short-term interest rates, differences in relative values of similar assets in different currencies, long-term opportunities for investment and capital appreciation, and political developments.

We may expose ourselves to risks if we engage in hedging transactions.

We may employ hedging techniques to minimize certain investment risks, such as fluctuations in interest and currency exchange rates, but we can offer no assurance that such strategies will be effective. If we engage in hedging transactions, we may expose ourselves to risks associated with such transactions. We may utilize instruments such as forward contracts, currency options and interest rate swaps, caps, collars and floors to seek to hedge against fluctuations in the relative values of our portfolio positions from changes in currency exchange rates and market interest rates. Hedging against a decline in the values of our portfolio positions does not eliminate the possibility of fluctuations in the values of such positions or prevent losses if the values of such positions decline. However, such hedging can establish other positions designed to gain from those same developments, thereby offsetting the decline in the value of such portfolio positions. Such hedging transactions may also limit the opportunity for gain if the values of the portfolio positions should increase. Moreover, it may not be possible to hedge against an exchange rate or interest rate fluctuation that is so generally anticipated that we are not able to enter into a hedging transaction at an acceptable price.

The success of our hedging transactions depends on our ability to correctly predict movements, currencies and interest rates. Therefore, while we may enter into such transactions to seek to reduce currency exchange rate and interest rate risks, unanticipated changes in currency exchange rates or interest rates may result in poorer overall investment performance than if we had not engaged in any such hedging transactions. The degree of correlation between price movements of the instruments used in a hedging strategy and price movements in the portfolio positions being hedged may vary. Moreover, for a variety of reasons, we may not seek to establish a perfect correlation between such hedging instruments and the portfolio holdings being hedged. Any such imperfect correlation may prevent us from achieving the intended hedge and expose us to risk of loss. In addition, it may not be possible to hedge fully or perfectly against currency fluctuations affecting the value of securities denominated in non-U.S. currencies.

Our Board of Directors may change our operating policies and strategies without prior notice or stockholder approval, the effects of which may be adverse to us and could impair the value of our stockholders investment.

Our Board of Directors has the authority to modify or waive our current operating policies and our strategies without prior notice and without stockholder approval. We cannot predict the effect any changes to our current operating policies and strategies would have on our business, financial condition, and value of our common stock.

Table of Contents

However, the effects might be adverse, which could negatively impact our ability to pay dividends and cause stockholders to lose all or part of their investment.

Risks Relating To Our Securities

Investing in our securities may involve a high 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 volatility or loss of principal. Our investments in portfolio companies may be speculative and aggressive, and therefore, an investment in our shares may not be suitable for someone with low risk tolerance.

The market price of our securities may fluctuate significantly.

The market price and liquidity of the market for our securities may be significantly affected by numerous factors, some of which are beyond our control and may not be directly related to our operating performance. These factors include:

- significant volatility in the market price and trading volume of securities of business development companies or other companies in the energy industry, which are not necessarily related to the operating performance of these companies;
- changes in regulatory policies or tax guidelines, particularly with respect to RICs or business development companies;
- loss of RIC qualification;
- changes in earnings or variations in operating results;
- changes in the value of our portfolio of investments;
- any shortfall in revenue or net income or any increase in losses from levels expected by investors or securities analysts;
- departure of one or more of Prospect Capital Management s key personnel;
- operating performance of companies comparable to us;
- changes in prevailing interest rates;
- litigation matters;
- general economic trends and other external factors; and
- loss of a major funding source.

Sales of substantial amounts of our securities in the public market may have an adverse effect on the market price of our securities.

As of January 7, 2010, we have 63,349,746 shares of common stock outstanding. Sales of substantial amounts of our securities or the availability of such securities for sale could adversely affect the prevailing market price for our securities. If this occurs and continues it could impair our ability to raise additional capital through the sale of securities should we desire to do so.

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

We have made and intend to continue to make distributions on a quarterly basis to our stockholders out of assets legally available for distribution. 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 or year-to-year increases in cash distributions. In addition, due to the asset coverage test applicable to us as a business development company, we may be limited in our ability to make distributions.

Table of Contents

Provisions of the Maryland General Corporation Law and of our charter and bylaws could deter takeover attempts and have an adverse impact on the price of our common stock.

Our charter and bylaws and the Maryland General Corporation Law contain provisions that may have the effect of delaying, deferring or preventing a transaction or a change in control that might involve a premium price for our stockholders or otherwise be in their best interest. These provisions may prevent shareholders from being able to sell shares of its common stock at a premium over the current of prevailing market prices.

Our charter provides for the classification of our Board of Directors into three classes of directors, serving staggered three-year terms, which may render a change of control or removal of our incumbent management more difficult. Furthermore, any and all vacancies on our Board of Directors will be filled generally only by the affirmative vote of a majority of the remaining directors in office, even if the remaining directors do not constitute a quorum, and any director elected to fill a vacancy will serve for the remainder of the full term until a successor is elected and qualifies.

Our Board of Directors is authorized to create and issue new series of shares, to classify or reclassify any unissued shares of stock into one or more classes or series, including preferred stock and, without stockholder approval, to amend our charter to increase or decrease the number of shares of common stock that we have authority to issue, which could have the effect of diluting a stockholder s ownership interest. Prior to the issuance of shares of common stock of each class or series, including any reclassified series, our Board of Directors is required by our governing documents to set the terms, preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms or conditions of redemption for each class or series of shares of stock.

Our charter and bylaws also provide that our Board of Directors has the exclusive power to adopt, alter or repeal any provision of our bylaws, and to make new bylaws. The Maryland General Corporation Law also contains certain provisions that may limit the ability of a third party to acquire control of us, such as:

- The Maryland Business Combination Act, which, subject to certain limitations, prohibits certain business combinations between us and an interested stockholder (defined generally as any person who beneficially owns 10% or more of the voting power of the common stock or an affiliate thereof) for five years after the most recent date on which the stockholder becomes an interested stockholder and, thereafter, imposes special minimum price provisions and special stockholder voting requirements on these combinations; and

- The Maryland Control Share Acquisition Act, which provides that control shares of a Maryland corporation (defined as shares of common stock which, when aggregated with other shares of common stock controlled by the stockholder, entitles the stockholder to exercise one of three increasing ranges of voting power in electing directors, as described more fully below) acquired in a control share acquisition (defined as the direct or indirect acquisition of ownership or control of control shares) have no voting rights except to the extent approved by stockholders by the affirmative vote of at least two-thirds of all the votes entitled to be cast on the matter, excluding all interested shares of common stock.

The provisions of the Maryland Business Combination Act will not apply, however, if our Board of Directors adopts a resolution that any business combination between us and any other person will be exempt from the provisions of the Maryland Business Combination Act. Although our Board of Directors has adopted such a resolution, there can be no assurance that this resolution will not be altered or repealed in whole or in part at any time. If the resolution is altered or repealed, the provisions of the Maryland Business Combination Act may discourage others from trying to acquire control of us.

As permitted by Maryland law, our bylaws contain a provision exempting from the Maryland Control Share Acquisition Act any and all acquisitions by any person of our common stock. Although our bylaws include such a provision, such a provision may also be amended or eliminated by our Board of Directors at any time in the future, provided that we will notify the Division of Investment Management at the SEC prior to amending or eliminating this provision.

We may in the future choose to pay dividends in our own stock, in which case our shareholders may be required to pay tax in excess of the cash they receive.

We may distribute taxable dividends that are payable in part in our stock. Under IRS Revenue Procedure 2010-12, which extended and modified Revenue Procedure 2009-15, up to 90% of any such taxable dividend for 2009, 2010, and 2011 could be payable in our stock. The IRS has also issued (and where Revenue Procedure 2009-15 or 2010-12 is not currently applicable, the IRS continues to issue) private letter rulings on cash/stock dividends paid by regulated investment companies and real estate investment trusts using a 20% cash standard (instead of the 10% cash standard of Revenue Procedures 2009-15 and 2010-12) if certain requirements are satisfied. Taxable stockholders receiving such dividends would be required to include the full amount of the dividend as ordinary income (or as long-term capital gain to the extent such distribution is properly designated as a capital gain dividend) to the extent of its current and accumulated earnings and profits for United States federal income tax purposes. As a result, a U.S. stockholder may be required to pay tax with respect to such dividends in excess of any cash received. If a U.S. stockholder sells the stock it receives as a dividend in order to pay this tax, it may be subject to transaction fees (e.g. broker fees or transfer agent fees) and the sales proceeds may be less than the amount included in income with respect to the dividend, depending on the market price of our stock at the time of the sale. Furthermore, with respect to non-U.S. stockholders, we may be required to withhold U.S. tax with respect to such dividends, including in respect of all or a portion of such dividend that is payable in stock. In addition, if a significant number of our stockholders determine to sell shares of its stock in order to pay taxes owed on dividends, it may put downward pressure on the trading price of our stock. It is unclear whether and to what extent we will be able to pay dividends in cash and our stock (whether pursuant to Revenue Procedure 2009-15 or 2010-12, a private letter ruling, or otherwise).

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(All figures in this section are in thousands except share, per share and other data)

The following discussion should be read in conjunction with our financial statements and related notes and other financial information appearing elsewhere in this prospectus. In addition to historical information, the following discussion and other parts of this prospectus contain forward-looking information that involves risks and uncertainties. Our actual results could differ materially from those anticipated by such forward-looking information due to the factors discussed under Risk Factors and Forward-Looking Statements appearing elsewhere herein.

Note on Forward Looking Statements

Some of the statements in this report constitute forward-looking statements, which relate to future events or our future performance or financial condition. The forward-looking statements contained herein involve risks and uncertainties, including statements as to:

- our future operating results;
- our business prospects and the prospects of our portfolio companies;
- the impact of investments that we expect to make;
- our contractual arrangements and relationships with third parties;
- the dependence of our future success on the general economy and its impact on the industries in which we invest;
- the ability of our portfolio companies to achieve their objectives;
- our expected financings and investments;
- the adequacy of our cash resources and working capital; and
- the timing of cash flows, if any, from the operations of our portfolio companies.

We generally use words such as anticipates, believes, expects, intends and similar expressions to identify forward-looking statements. Our actual results could differ materially from those projected in the forward-looking statements for any reason, including the factors set forth in Risk Factors and elsewhere in this prospectus. These forward-looking statements do not meet the safe harbor for forward-looking statements pursuant to Section 27A of the Securities Act.

We have based the forward-looking statements included in this report on information available to us on the date of this report, and we assume no obligation to update any such forward-looking statements. 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 in the future may file with the Securities and Exchange Commission (SEC), including any annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K.

General

We are a financial services company that primarily lends to and invests in middle market privately-held companies. We are a closed-end investment company that has filed an election to be treated as a business development company under the Investment Company Act of 1940, or the 1940 Act. We invest primarily in senior and subordinated debt and equity of companies in need of capital for acquisitions, divestitures, growth, development, project financing and recapitalization. We work with the management teams or financial sponsors to seek investments with historical cash flows, asset collateral or contracted pro-forma cash flows.

Table of Contents

We seek to be a long-term investor with our portfolio companies. Since the fiscal year ended June 30, 2007, we have invested primarily in industries related to the industrial/energy economy. Since then, we have widened our strategy to focus in other sectors of the economy and continue to diversify our portfolio holdings.

Patriot Acquisition

On August 3, 2009, we announced that we had entered into a definitive agreement to acquire Patriot Capital Funding, Inc. (Patriot). On December 2, 2009, we consummated the transaction and acquired the outstanding shares of Patriot common stock for approximately $201,083. This purchase price was calculated based upon a price of Prospect common stock of $10.99 per share, $970 for the purchase of restricted stock from the former employees of Patriot and repayment of the debt outstanding at closing of $107,313. The holders of Patriot s common stock received 0.363992 shares of our common stock. This resulted in approximately 8.4 million shares of common stock being issued by us. In connection with the transaction, we repaid all the outstanding borrowings of Patriot, in compliance with the merger agreement. We, in conjunction with an independent valuation agent, have determined that the fair value of the assets is approximately $4,194 in excess of the purchase price and have recorded a gain on the consummation of the transaction for this amount.

On December 2, 2009, Patriot made a final dividend equal to its undistributed net ordinary income and capital gains of $0.38 per share. In accordance with a recent IRS revenue procedure, the dividend was paid 10% in cash and 90% in newly issued shares of Patriot s common stock. The exchange ratio was adjusted to give effect to the tax distribution.

Market Conditions

In 2008 and 2009, the financial services industry has been negatively affected by turmoil in the global capital markets. What began in 2007 as a deterioration of credit quality in subprime residential mortgages has spread rapidly to other credit markets. Market liquidity and credit quality conditions are significantly weaker today than two years ago.

We believe that Prospect Capital is well positioned to navigate through these adverse market conditions. As a business development company, we are limited to a maximum 1 to 1 debt to equity ratio, and as of September 30, 2009, we had $89,391 available under our credit facility, of which zero was outstanding. As we make additional investments that are eligible to be pledged under the credit facility, we will generate additional availability. The revolving period for the extended credit facility continues until June 25, 2010, with an amortization running to June 25, 2011.

We also continue to generate liquidity through public and private stock offerings. On July 7, 2009 we completed a public stock offering for 5,175,000 shares of our common stock at $9.00 per share, raising $46,575 of gross proceeds. On August 20, 2009 and September 24, 2009, we issued 3,449,686 shares and 2,807,111 shares, respectively, of our common stock at $8.50 and $9.00 per share, respectively, in private stock offerings, raising $29,322, and $25,264 of gross proceeds, respectively. Concurrent with the sale of these shares, we entered into a registration rights agreement in which we granted the purchasers certain registration rights with respect to the shares. Under the terms and conditions of the registration rights agreement, we will use our reasonable best efforts to file with the SEC within sixty (60) days a post-effective amendment to the registration statement on Form N-2 and will also use our reasonable best efforts to cause such post-effective amendment to be declared effective by the SEC within one hundred twenty (120) days. Under the registration rights agreement, we may be obligated to make liquidated damages payments to holders upon certain events.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reported period. Changes in the economic environment, financial markets and any other parameters used in determining these estimates could cause actual results to differ.

Table of Contents

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with GAAP. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Changes in the economic environment, financial markets and any other parameters used in determining such estimates could cause actual results to differ materially. In addition to the discussion below, our critical accounting policies are further described in the notes to the financial statements.

Basis of Consolidation

Under the 1940 Act rules, the regulations pursuant to Article 6 of Regulation S-X, and the American Institute of Certified Public Accountants Audit and Accounting Guide for Investment Companies, we are precluded from consolidating any entity other than another investment company or an operating company which provides substantially all of its services and benefits to us. Our September 30, 2009 and June 30, 2009 financial statements include our accounts and the accounts of Prospect Capital Funding, LLC, our only wholly-owned, closely-managed subsidiary that is also an investment company. All intercompany balances and transactions have been eliminated in consolidation.

Investment Classification

We are a non-diversified company within the meaning of the 1940 Act. We classify our investments by level of control. As defined in the 1940 Act, control investments are those where there is the ability or power to exercise a controlling influence over the management or policies of a company. Control is generally deemed to exist when a company or individual possesses or has the right to acquire within 60 days or less, a beneficial ownership of 25% or more of the voting securities of an investee company. Affiliated investments and affiliated companies are defined by a lesser degree of influence and are deemed to exist through the possession outright or via the right to acquire within 60 days or less, beneficial ownership of 5% or more of the outstanding voting securities of another person.

Investments are recognized when we assume an obligation to acquire a financial instrument and assume the risks for gains or losses related to that instrument. Investments are derecognized when we assume an obligation to sell a financial instrument and forego the risks for gains or losses related to that instrument. Specifically, we record all security transactions on a trade date basis. Investments in other, non-security financial instruments are recorded on the basis of subscription date or redemption date, as applicable. Amounts for investments recognized or derecognized but not yet settled are reported as Receivables for investments sold and Payables for investments purchased, respectively, in the Consolidated Statements of Assets and Liabilities.

Investment Valuation

Our Board of Directors has established procedures for the valuation of our investment portfolio. These procedures are detailed below.

Investments for which market quotations are readily available are valued at such market quotations.

For most of our investments, market quotations are not available. With respect to investments for which market quotations are not readily available or when such market quotations are deemed not to represent fair value, our Board of Directors has approved a multi-step valuation process each quarter, as described below:

1) Each portfolio company or investment is reviewed by our investment professionals with the independent valuation firm engaged by our Board of Directors;

2) the independent valuation firm conducts independent appraisals and makes their own independent assessment;

3) the audit committee of our Board of Directors reviews and discusses the preliminary valuation of our Investment Adviser and that of the independent valuation firm; and

4) the Board of Directors discusses the valuations and determines the fair value of each investment in our portfolio in good faith based on the input of our Investment Adviser, the independent valuation firm and the audit committee.

In September 2006, the Financial Accounting Standards Board (FASB) issued Accounting Standards Codification (ASC or Codification) 820, *Fair Value Measurements and Disclosures* (ASC 820). ASC 820 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. We adopted ASC 820 on a prospective basis beginning in the quarter ended September 30, 2008.

ASC 820 classifies the inputs used to measure these fair values into the following hierarchy:

Level 1: Quoted prices in active markets for identical assets or liabilities, accessible by the Company at the measurement date.

Level 2: Quoted prices for similar assets or liabilities in active markets, or quoted prices for identical or similar assets or liabilities in markets that are not active, or other observable inputs other than quoted prices.

Level 3: Unobservable inputs for the asset or liability.

In all cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to each investment.

The changes to generally accepted accounting principles from the application of ASC 820 relate to the definition of fair value, framework for measuring fair value, and the expanded disclosures about fair value measurements. ASC 820 applies to fair value measurements already required or permitted by other standards.

In accordance with ASC 820, the fair value of our investments is defined as the price that we would receive upon selling an investment in an orderly transaction to an independent buyer in the principal or most advantageous market in which that investment is transacted.

In April 2009, the FASB issued ASC 820-10-65, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (ASC 820-10-65). This update provides further clarification for ASC 820 in markets that are not active and provides additional guidance for determining when the volume of trading level of activity for an asset or liability has significantly decreased and for identifying circumstances that indicate a transaction is not orderly. ASC 820-10-65 is effective for interim and annual reporting periods ending after June 15, 2009. The adoption of ASC 820-10-65 for the three months ended September 30, 2009, did not have any effect on our net asset value, financial position or results of operations as there was no change to the fair value measurement principles set forth in ASC 820.

Federal and State Income Taxes

We have elected to be treated as a regulated investment company and intend to continue to comply with the requirements of the Internal Revenue Code of 1986 (the Code), applicable to regulated investment companies. We are required to distribute at least 90% of our investment company taxable income and intend to distribute (or retain through a deemed distribution) all of our investment company taxable income and net capital gain to stockholders; therefore, we have made no provision for income taxes. The character of income and gains that we will distribute is determined in accordance with income tax regulations that may differ from GAAP. Book and tax basis differences relating to stockholder dividends and distributions and other permanent book and tax differences are reclassified to paid-in capital.

If we do not distribute (or are not deemed to have distributed) at least 98% of our annual taxable income in the calendar year earned, we will generally be required to pay an excise tax equal to 4% of the amount by which 98% of our annual taxable income exceeds the distributions from such taxable income for the year. To the extent that we determine that our estimated current year annual taxable income will be in excess of estimated current year dividend distributions from such taxable income, we accrue excise taxes, if any, on estimated excess taxable income as taxable income is earned using an annual effective excise tax rate. The annual effective excise tax rate is determined by dividing the estimated annual excise tax by the estimated annual taxable income.

We adopted FASB ASC 740, *Income Taxes* (ASC 740). ASC 740 provides guidance for how uncertain tax positions should be recognized, measured, presented, and disclosed in the financial statements. ASC 740 requires the evaluation of tax positions taken or expected to be taken in the course of preparing our tax returns to determine whether the tax positions are more-likely-than-not of being sustained by the applicable tax authority. Tax positions not deemed to meet the more-likely-than-not threshold are recorded as a tax benefit or expense in the current year. Adoption of ASC 740 was applied to all open tax years as of July 1, 2007. The adoption of ASC 740 did not have an effect on our net asset value, financial condition or results of operations as there was no liability for unrecognized tax benefits and no change to our beginning net asset value. As of September 30, 2009 and for the three months then ended, we did not have a liability for any unrecognized tax benefits. Management s determinations regarding ASC 740 may be subject to review and adjustment at a later date based upon factors including, but not limited to, an on-going analysis of tax laws, regulations and interpretations thereof.

Revenue Recognition

Realized gains or losses on the sale of investments are calculated using the specific identification method.

Interest income, adjusted for amortization of premium and accretion of discount, is recorded on an accrual basis. Origination, closing and/or commitment fees associated with investments in portfolio companies are accreted into interest income over the respective terms of the applicable loans. Upon the prepayment of a loan or debt security, any prepayment penalties and unamortized loan origination, closing and commitment fees are recorded as interest income.

Loans are placed on non-accrual status when principal or interest payments are past due 90 days or more or when there is reasonable doubt that principal or interest will be collected. Unpaid accrued interest is generally reversed when a loan is placed on non-accrual status. Interest payments received on non-accrual loans may be recognized as income or applied to principal depending upon management s judgment. Non-accrual loans are restored to accrual status when past due principal and interest is paid and in management s judgment, are likely to remain current. As of September 30, 2009, approximately 5.7% of our net assets are in non-accrual status.

Dividend income is recorded on the ex-dividend date.

Structuring fees and similar fees are recognized as income as earned, usually when paid. Structuring fees, excess deal deposits, net profits interests and overriding royalty interests are included in other income.

Statement of Assets and Liabilities Overview

During the three months ended September 30, 2009, net assets have increased by $74,650 from $532,596 as of June 30, 2009 to $607,246 as of September 30, 2009. This net increase in assets primarily resulted from $97,675 of capital share transactions, offset by $19,548 in dividends declared to our stockholders. During this three month period we recognized net investment income of $12,318 and a decrease in net assets due to changes in unrealized depreciation of investments of $18,696. The result was the $6,378 decrease in net assets resulting from operations.

The aggregate fair value of our portfolio investments was $510,798 and $547,168 as of September 30, 2009 and June 30, 2009, respectively. During the three months ended September 30, 2009, our net cost of investments decreased by $17,674, or 3.3%, primarily from the repayment of two investments. At September 30, 2009, we were invested in 29 long-term portfolio investments.

Investment Activity

During the three months ended September 30, 2009, we completed follow-on investments in existing portfolio companies, totaling approximately $4,599 and recorded PIK interest of $1,467, resulting in gross investment originations of $6,066. The more significant of these follow-on investments are described briefly in the following:

On July 1, 2009, we made a follow-on secured debt investment of $1,093 in Iron Horse Coiled Tubing, Inc. (Iron Horse) in support of the build out of additional equipment.

During the three months ended September 30, 2009, we provided additional fundings of $2,961 to Yatesville Coal Holdings, Inc. (Yatesville) to fund ongoing operations.

During the three months ended September 30, 2009, we closed-out two positions which are briefly described below.

On August 31, 2009, C&J Cladding, LLC (C&J) repaid the $3,150 loan receivable to us and we received an additional 5% prepayment penalty totaling $158. We continue to hold warrants for common units in this investment.

On September 4, 2009, Peerless Manufacturing Co. repaid the $20,000 loan receivable to us.

During the three months ended September 30, 2009, we also received principal amortization payments of $1,091 on several loans.

On September 30, 2008, we settled our net profits interests (NPIs) in IEC Systems LP (IEC) and Advanced Rig Services LLC (ARS) with the companies for a combined $12,576. IEC and ARS originally issued the NPIs to us when we loaned a combined $25,600 to IEC and ARS on November 20, 2007. In conjunction with the NPI realization, we recognized other income of $12,576 simultaneously reinvested the $12,576 as incremental senior secured debt in IEC and ARS. The incremental debt will amortize over the period ending November 20, 2010.

The following is a quarter-by-quarter summary of our investment activity:

Quarter-End	**Acquisitions(1)**	**Dispositions(2)**
September 30, 2009	$ 6,066	$ 24,241
June 30, 2009	7,929	3,148
March 31, 2009	6,356	10,782
December 31, 2008	13,564	2,128
September 30, 2008	70,456	10,949
June 30, 2008	118,913	61,148
March 31, 2008	31,794	28,891
December 31, 2007	120,846	19,223
September 30, 2007	40,394	17,949
June 30, 2007	130,345	9,857
March 31, 2007	19,701	7,731
December 31, 2006	62,679	17,796
September 30, 2006	24,677	2,781
June 30, 2006	42,783	5,752
March 31, 2006	15,732	901
December 31, 2005		3,523
September 30, 2005	25,342	
June 30, 2005	17,544	
March 31, 2005	7,332	
December 31, 2004	23,771	32,083
September 30, 2004	30,371	
Since inception	$ 816,595	$ 258,883

(1) Includes new deals, additional fundings, refinancings and PIK interest.

(2) Includes scheduled principal payments, prepayments and refinancings.

Investment Holdings

As of September 30, 2009, we continue to pursue our investment strategy. Despite our name change to Prospect Capital Corporation and the termination of our policy to invest at least 80% of our net assets in energy companies in May 2007, we currently have a concentration of investments in companies in the energy and energy related industries. Some of the companies in which we invest have relatively short or no operating histories. These companies are and will be subject to all of the business risk and uncertainties associated with any new business enterprise, including the risk that these companies may not reach their investment objective or the value of our investment in them may decline substantially or fall to zero.

Our portfolio had an annualized current yield of 15.7% and 15.5% across all our long-term debt and certain equity investments as of September 30, 2009 and September 30, 2008, respectively. At September 30, 2009, this yield includes interest from all of our long-term investments as well as dividends from Gas Solutions Holdings, Inc. (GSHI) and NRG Manufacturing, Inc. (NRG). We expect the current yield to decline over time as we increase the size of the portfolio. Monetization of other equity positions that we hold is not included in this yield calculation. In each of our portfolio companies, we hold equity positions, ranging from minority interests to majority stakes, which we expect over time to contribute to our investment returns. Some of these equity positions include features such as contractual minimum internal rates of returns, preferred distributions, flip structures and other features expected to generate additional investment returns, as well as contractual protections and preferences over junior equity, in addition to the yield and security offered by our cash flow and collateral debt protections.

We classify our investments by level of control. As defined in the 1940 Act, control investments are those where there is the ability or power to exercise a controlling influence over the management or policies of a company. Control is generally deemed to exist when a company or individual possesses or has the right to acquire within 60 days or less, a beneficial ownership of 25% or more of the voting securities of an investee company. Affiliated investments and affiliated companies are defined by a lesser degree of influence and are deemed to exist through the possession outright or via the right to acquire within 60 days or less, beneficial ownership of 5% or more of the outstanding voting securities of another person.

As of September 30, 2009, we own controlling interests in Ajax Rolled Ring & Machine (Ajax), C&J, Change Clean Energy Holdings, Inc. (CCEHI), GSHI, Integrated Contract Services, Inc. (ICS), Iron Horse, NRG, R-V Industries, Inc. (R-V), and Yatesville. We also own affiliated interests in Appalachian Energy Holdings, LLC (AEH) and Biotronic NeuroNetwork (Biotronic).

The following is a summary of our investment portfolio by level of control:

	September 30, 2009				June 30, 2009			
Level of Control	**Cost**	**Percent of Portfolio**	**Fair Value**	**Percent of Portfolio**	**Cost**	**Percent of Portfolio**	**Fair Value**	**Percent of Portfolio**
Control	$ 188,886	31.5%	$ 198,043	33.2%	$ 187,105	29.7%	$ 206,332	31.9%
Affiliate	33,555	5.6%	31,790	5.3%	33,544	5.3%	32,254	5.0%
Non-control/Non-affiliate	291,309	48.7%	280,965	47.2%	310,775	49.3%	308,582	47.8%
Money Market Funds	85,143	14.2%	85,143	14.3%	98,735	15.7%	98,735	15.3%
Total Portfolio	$ 598,893	100.0%	$ 595,941	100.0%	$ 630,159	100.0%	$ 645,903	100.0%

The following is our investment portfolio presented by type of investment at September 30, 2009 and June 30, 2009, respectively:

September 30, 2009 **June 30, 2009**

Level of Control	Cost	Percent of Portfolio	Fair Value	Percent of Portfolio	Cost	Percent of Portfolio	Fair Value	Percent of Portfolio
Money Market Funds	$ 85,143	14.2%	$ 85,143	14.3%	$ 98,735	15.7%	$ 98,735	15.3%
Senior Secured Debt	230,158	38.4%	213,394	35.8%	232,534	36.9%	220,993	34.2%
Subordinated Secured Debt	235,638	39.4%	167,839	28.2%	251,292	39.9%	194,547	30.1%
Subordinated Unsecured Debt	15,125	2.5%	16,410	2.8%	15,065	2.4%	16,331	2.5%
Preferred Stock	10,432	1.7%	5,202	0.9%	10,432	1.6%	4,139	0.7%
Common Stock	16,606	2.8%	88,234	14.8%	16,310	2.6%	89,278	13.8%
Membership Interests	3,031	0.5%	6,846	1.1%	3,031	0.5%	7,270	1.1%
Overriding Royalty Interests		0.0%	3,187	0.5%		0.0%	3,483	0.5%
Net Profit Interests		0.0%	2,087	0.3%		0.0%	2,561	0.4%
Warrants	2,760	0.5%	7,599	1.3%	2,760	0.4%	8,566	1.4%
Total Portfolio	$ 598,893	100.0%	$ 595,941	100.0%	$ 630,159	100.0%	$ 645,903	100.0%

Table of Contents

The following is our investment portfolio presented by geographic location of the investment at September 30, 2009 and June 30, 2009, respectively:

	September 30, 2009				June 30, 2009			
Level of Control	Cost	Percent of Portfolio	Fair Value	Percent of Portfolio	Cost	Percent of Portfolio	Fair Value	Percent of Portfolio
Canada	$ 20,521	3.4%	$ 12,908	2.2%	$ 19,344	3.1%	$ 12,606	2.0%
Midwest US	77,712	13.0%	84,082	14.1%	77,681	12.3%	84,097	13.0%
Northeast US	45,999	7.7%	43,968	7.4%	44,875	7.1%	47,049	7.3%
Southeast US	168,156	28.1%	94,812	15.9%	164,652	26.1%	101,710	15.7%
Southwest US	155,423	25.9%	227,608	38.2%	178,993	28.4%	253,615	39.3%
Western US	45,939	7.7%	47,420	7.9%	45,879	7.3%	48,091	7.4%
Money Market Funds	85,143	14.2%	85,143	14.3%	98,735	15.7%	98,735	15.3%
Total Portfolio	$ 598,893	100.0%	$ 595,941	100.0%	$ 630,159	100.0%	$ 645,903	100.0%

The following is our investment portfolio presented by industry sector of the investment at September 30, 2009 and June 30, 2009, respectively:

	September 30, 2009				June 30, 2009			
Level of Control	Cost	Percent of Portfolio	Fair Value	Percent of Portfolio	Cost	Percent of Portfolio	Fair Value	Percent of Portfolio
Biomass Power	$ 2,826	0.5%	$ 2,530	0.4%	$ 2,530	0.4%	$ 2,530	0.4%
Construction Services	5,028	0.8%	1,123	0.2%	5,017	0.8%	2,408	0.4%
Contracting	16,652	2.8%	5,971	1.0%	16,652	2.6%	5,000	0.8%
Financial Services	25,554	4.3%	23,365	3.9%	25,424	4.0%	23,073	3.6%
Food Products	27,459	4.6%	29,730	5.0%	27,413	4.4%	29,416	4.6%
Gas Gathering and Processing	35,003	5.8%	85,187	14.3%	35,003	5.6%	85,187	13.2%
Healthcare	57,683	9.6%	61,530	10.3%	57,535	9.1%	60,293	9.3%
Manufacturing	71,053	11.9%	87,136	14.6%	90,978	14.4%	110,929	17.2%
Metal Services	580	0.1%	3,067	0.5%	3,302	0.5%	7,133	1.1%
Mining and Coal Production	51,850	8.7%	10,994	1.8%	48,890	7.8%	13,097	2.0%
Oil and Gas Production	104,437	17.4%	101,019	17.0%	104,183	16.5%	104,806	16.2%
Oilfield Fabrication	33,292	5.6%	33,957	5.7%	34,247	5.4%	34,931	5.4%
Pharmaceuticals	11,951	2.0%	11,684	2.0%	11,949	2.0%	11,452	1.8%
Production Services	20,521	3.4%	12,908	2.2%	19,344	3.1%	12,606	1.9%
Retail	15,440	2.6%	4,236	0.7%	14,623	2.3%	6,272	1.0%
Shipping Vessels	7,241	1.2%	6,469	1.1%	7,160	1.1%	7,381	1.1%

Specialty Minerals	15,814	2.6%	18,162	3.0%	15,814	2.5%	18,924	2.9%
Technical Services	11,366	1.9%	11,730	2.0%	11,360	1.8%	11,730	1.8%
Money Market Funds	85,143	14.2%	85,143	14.3%	98,735	15.7%	98,735	15.3%
Total Portfolio	$ 598,893	100.0%	$ 595,941	100.0%	$ 630,159	100.0%	$ 645,903	100.0%

Investment Valuation

In determining the fair value of our portfolio investments at September 30, 2009, the Audit Committee considered valuations from the independent valuation firm and from management having an aggregate range of $485,934 to $532,023, excluding money market investments.

In determining the range of value for debt instruments, management and the independent valuation firm generally shadow rated the investment and then based upon the range of ratings, determined appropriate yields to maturity for a loan rated as such. A discounted cash flow analysis was then prepared using the appropriate yield to maturity as the discount rate, yielding the ranges. For equity investments, the enterprise value was determined by applying EBITDA multiples for similar recent investment sales. For stressed equity investments, a liquidation analysis was prepared.

The Board of Directors looked at several factors in determining where within the range to value the asset including: recent operating and financial trends for the asset, independent ratings obtained from third parties and comparable multiples for recent sales of companies within the industry. The composite of all these analysis, applied to each investment, was a total valuation of $510,798, excluding money market investments.

Our investments are generally lower middle market companies, outside of the financial sector, with less than $30,000 of annual EBITDA. We believe our market has experienced less volatility than others because we believe there are more buy and hold investors who own these less liquid investments. In addition, the middle market relies on less leverage than the large capitalization marketplace, which we believe will result in less financial distress.

During the three months ended September 30, 2009, there has been a general improvement in the markets in which we operate and market rates of interest demanded for middle market loans have decreased. As a result, many of our debt investments have seen an increase in value. The fair value is limited on the high side to the loans par value, plus any prepayment penalties that would be imposed. Many of the debt investments in this category have not seen a significant change in value as they were previously valued at or near par value. These investments include: American Gilsonite Company, Biotronic, Castro Cheese Company, Inc., H&M Oil & Gas, LLC, IEC/ARS, Maverick Healthcare, LLC, NRG Manufacturing, Inc., Qualitest Pharmaceuticals, Inc., Regional Management Corp., Resco, Shearer s Foods, Inc., Stryker Energy, LLC, TriZetto Group and Unitek.

Six debt investments were made to companies that are not performing in line with budget expectations as of September 30, 2009 and have seen a diminution of value since June 30, 2009 (Ajax, AEH, Conquest Cherokee, LLC, Deb Shops, Inc., Freedom Marine Services LLC, and Iron Horse). For these assets, we have increased the market interest rates to take into account the increased credit risk and general changes in current interest rates for similar assets to determine their fair value.

Four portfolio companies (C&J, Diamondback, Miller and R-V) are equity investments for which the previously outstanding debt has been repaid.

Control investments offer increased risk and reward over straight debt investments. Operating results and changes in market multiples can result in dramatic changes in values from quarter to quarter. Significant downturns in operations can further result in our looking to recoveries on sales of assets rather than the enterprise value of the investment. Several control investments in our portfolio are under enhanced scrutiny by our senior management and our Board of Directors and are discussed below.

Gas Solutions Holdings, Inc.

GSHI is an investment that we made in September 2004 in which we own 100% of the equity. GSHI is a midstream gathering and processing business located in East Texas. GSHI has improved its operations and we have experienced an increase in revenue, gross margin, and EBITDA (the later two metrics on both an absolute and a percentage of revenues basis) over the past five years.

During the past two years, we have been in discussions with multiple interested purchasers for Gas Solutions. While we wish to unlock the value in Gas Solutions, we do not wish to enter into any agreement at any time that does not recognize the long term value we see in Gas Solutions. As a well hedged midstream asset, which will generate predictable and consistent cash flows to us, Gas Solutions is a valuable asset that we wish to sell at a value-maximizing price, or not at all. We continue discussions with interested parties, but have a patient approach toward the process. In addition, a sale of the assets, rather than the stock of GSHI, might result in a significant tax liability at the GSHI level which will need to be paid prior to any distribution to us.

In early May 2008, Gas Solutions II Ltd purchased a series of propane puts at $0.10 out of the money and at prices of $1.53 per gallon and $1.394 per gallon covering the periods May 1, 2008, through April 30, 2009, and May 1, 2009, through April 30, 2010, respectively. These hedges were executed at close to the highest market propane prices ever achieved on an historical basis; such hedges preserve the upside of Gas Solutions II Ltd to benefit from potential future increases in commodity prices. GSHI generated approximately $26,172 of EBITDA for the fiscal year ending December 31, 2008, an increase of 67% from 2007 results. Despite the volatility in commodity prices over the last year, GSHI generated approximately $26,955 of EBITDA for the twelve months ending September 30, 2009.

In determining the value of GSHI, we have utilized several valuation techniques to determine the value of the investment. These techniques offer a wide range of values. Our Board of Directors has determined the value to be $85,187 for our debt and equity positions at September 30, 2009 based upon a combination of a discounted cash flow analysis, a public comparables analysis and review of recent indications of interest. At September 30, 2009 and June 30, 2009, GSHI was valued $50,184 above its amortized cost.

Integrated Contract Services, Inc.

ICS is an investment that we made in April 2007. Prior to January 2009, ICS owned the assets of ESA Environmental Specialists, Inc. (ESA) and 100% of the stock of The Healing Staff (THS). ESA originally defaulted under our contract governing our investment in ESA, prompting us to commence foreclosure actions with respect to certain ESA assets in respect of which we have a priority lien. In response to our actions, ESA filed voluntarily for reorganization under the bankruptcy code on August 1, 2007. On September 20, 2007 the U.S. Bankruptcy Court approved a Section 363 Asset Sale from ESA to us. To complete this transaction, we contributed our ESA debt to a newly-formed entity, ICS, and provided funds for working capital on October 9, 2007. In return for the ESA debt, we received senior secured debt in ICS of equal amount to our ESA debt, preferred stock of ICS, and 49% of the ICS common stock. ICS subsequently ceased operations and assigned the collateral back to us. ICS is in default of both payment and financial covenants. During September and October 2007, we provided $1,170 to THS for working capital.

In January 2009, we foreclosed on the real and personal property of ICS. Through this foreclosure process, we gained 100% ownership of THS and certain ESA assets. Based upon an analysis of the liquidation value of the ESA assets and the enterprise value of THS, our Board of Directors affirmed the fair value of our investment in ICS at $5,971 at September 30, 2009, a reduction of $10,681 from its amortized cost, compared to the $11,652 unrealized loss recorded at June 30, 2009.

Yatesville Coal Holdings, Inc.

All of our coal holdings have been consolidated under common management in Yatesville. Yatesville began to show improvement after the consolidation of the coal holdings, but the company exhausted its permitted reserves in December 2008 and has not had any meaningful revenue stream since. Yatesville s management continues to pursue additional mine permits and received its first new permit in March 2009 for approximately 650,000 tons. Yatesville has elected not to begin production from its new permit and is investigating alternative revenue streams. These actions have been complicated and impacted by an environment where coal prices are depressed from historical norms. We continue to evaluate strategies for Yatesville such as partnering with and investing in other coal operators in Central Appalachia in order to increase the scale, scope and efficiency of Yatesville s reserve development activities. During the three months ended September 30, 2009, we provided additional funding of $2,961 to Yatesville to fund ongoing operations including new permitting. Our Board of Directors, upon recommendation from senior management, has set the value of the Yatesville investment at $10,994 at September 30, 2009, a reduction of $40,856 from its amortized cost, compared to the $35,793 unrealized loss recorded at June 30, 2009.

Change Clean Energy Holdings Inc. and Change Clean Energy, Inc., f/k/a Worcester Energy Partners, Inc.

Change Clean Energy, Inc. (CCEI) is an investment that we originated in September 2005 which owns and operated a bio-mass energy plant. In March 2009 CCEI ceased operations temporarily as it was not economically feasible to make a profit based on the cost of materials and the price being paid for electricity. During that quarter, we determined that it was appropriate to institute foreclosure proceedings against the co-borrowers of our debt to take full control of the assets. In anticipation of such proceedings CCEHI was established and on March 11, 2009, the foreclosure was completed and the assets were assigned to a wholly owned subsidiary of CCEHI. During the three months ended September 30, 2009, we provided additional funding of $296 to CCEHI to fund ongoing operations. CCEI currently has no material operations. At June 30, 2009 we determined that the impairment at both

Table of Contents

CCEI and CCEHI was other than temporary and recognized a realized loss of $41,134, which was the amount by which the amortized cost exceeded the fair value. At September 30, 2009, our Board of Directors, under recommendation from senior management, has reaffirmed the value of the CCEHI investment at $2,530, a reduction of $296 from its amortized cost.

Capitalization

Our investment activities are capital intensive and the availability and cost of capital is a critical component of our business. We capitalize our business with a combination of debt and equity. Our debt is currently consists of a revolving credit facility availing us of the ability to borrow debt subject to borrowing base determinations and our equity capital is currently comprised entirely of common equity.

On June 25, 2009, we completed a first closing on an expanded $250,000 syndicated revolving credit facility (the Facility). The new Facility, for which five lenders have closed on $195,000 to date, includes an accordion feature which allows the Facility to accept up to an aggregate total of $250,000 of commitments for which we continue to solicit additional commitments from other lenders for the additional $55,000. The revolving period of the Facility extends through June 2010, with an additional one year amortization period after the completion of the revolving period. As of September 30, 2009 and June 30, 2009, we had zero and $124,800 of borrowings outstanding under our credit facility, respectively.

Interest on borrowings under the credit facility is one-month Libor plus 400 basis points, subject to a minimum Libor floor of 200 basis points after that date. The maintenance of this facility requires us to pay a fee for the amount not drawn upon. This fee assessed at the rate of 100 basis points per annum. The following table shows the facility amounts and outstanding borrowings at September 30, 2009 and June 30, 2009:

	As of September 30, 2009		As of June 30, 2009	
	Facility Amount	Amount Outstanding	Facility Amount	Amount Outstanding
Revolving Credit Facility	$ 195,000	$	$ 175,000	$ 124,800

The following table shows the contractual maturity of our revolving credit facility at September 30, 2009:

	Payments Due by Period		
	Less Than 1 Year	1-3 Years	More Than 3 Years
Credit Facility Payable	$	$	$

During the quarter ended September 30, 2009, we completed public and private offerings and raised $97,675 of additional equity by issuing 11,431,797 shares of our common stock below net asset value diluting shareholder value by $0.75 per share. The following table shows the calculation of net asset value per share as of September 30, 2009 and June 30, 2009:

	As of September 30, 2009		As of June 30, 2009	
Net Assets	$	607,246	$	532,596
Shares of common stock outstanding		54,672,155		42,943,084
Net asset value per share	$	11.11	$	12.40

At September 30, 2009, we had 54,672,155 of our common stock issued and outstanding.

Results of Operations

For the three months ended September 30, 2009 and September 30, 2008, the net (decrease) increase in net assets resulting from operations was ($6,378) and $13,998, respectively, representing ($0.13) and $0.47 per share, respectively. We experienced a net realized and unrealized loss of ($18,696) or approximately ($0.38) per share in the three months ended September 30, 2009. This compares with the net realized and unrealized loss of ($9,504) during the three months ended September 30, 2008 or approximately ($0.33) per share.

While we seek to maximize gains and minimize losses, our investments in portfolio companies can expose our capital to risks greater than those we may anticipate as these companies are typically not issuing securities rated investment grade, have limited resources, have limited operating history, are generally private companies with limited operating information available and are likely to depend on a small core of management talents. Changes in any of these factors can have a significant impact on the value of the portfolio company.

Investment Income

We generate revenue in the form of interest income on the debt securities that we own, dividend income on any common or preferred stock that we own, and amortized loan origination fees on the structuring of new deals. Our investments, if in the form of debt securities, will typically have a term of one to ten years and bear interest at a fixed or floating rate. To the extent achievable, we will seek to collateralize our investments by obtaining security interests in our portfolio companies assets. We also may acquire minority or majority equity interests in our portfolio companies, which may pay cash or in-kind dividends on a recurring or otherwise negotiated basis. In addition, we may generate revenue in other forms including prepayment penalties and possibly consulting fees. Any such fees generated in connection with our investments are recognized as earned.

Investment income consists of interest income, including accretion of loan origination fees and prepayment penalty fees, dividend income and other income, including net profits interest, overriding royalties interest and structuring fees. The following table details the various components of investment income and the related levels of debt investments for the three months ended September 30, 2009 and September 30, 2008:

	For the Three Months Ended September 30	
	2009	2008
Interest income	$ 14,835	$ 17,556
Dividend income	6,218	4,723
Other income	464	13,520
Total investment income	$ 21,517	$ 35,799
Average debt principal of investments	$ 497,161	$ 493,487
Weighted-average interest rate earned	11.84%	14.11%

Total investment income has decreased for the three months ended September 30, 2009 from the amount reported for the three months ended September 30, 2008 primarily due to a decrease in other income.

Income from other sources decrease from $13,520 for the three months ended September 30, 2008 to $464 for the three months ended September 30, 2009. This $12,899 decrease is primarily due to the settlement of our net profit interests in IEC/ARS for $12,576 during the three months ended September 30, 2008.

While average principal balances of debt investments have increased from $493,487 for the three months ended September 30, 2008 to $497,161 for the three months ended September 30, 2009, the weighted-average interest rate earned decreased from 14.11% to 11.84%. During the three month period ended September 30, 2009, interest of

$4,448 was foregone on non-accrual debt investments compared to $1,989 of forgone interest for the three months ended September 30, 2008. Without these adjustments, the weighted average interest rates earned on debt investments would have been 15.39% and 15.71% for the three months ended September 30, 2009 and 2008, respectively.

Dividend income has grown from $4,723 to $6,218 for the three months ended September 30, 2008 and September 30, 2009, respectively. The increase in dividend income is attributable to dividends received from our investment in GSHI. We received dividends from GSHI of $4,000 and $6,000 during the three months ended September 30, 2008 and September 30, 2009, respectively.

Table of Contents

Operating Expenses

Our primary operating expenses consist of investment advisory fees (base management and income incentive fees), credit facility costs, legal and professional fees and other operating and overhead-related expenses. These expenses include our allocable portion of overhead under the Administration Agreement with Prospect Administration under which Prospect Administration provides administrative services and facilities for us. Our investment advisory fees compensate our Investment Adviser for its work in identifying, evaluating, negotiating, closing and monitoring our investments. We bear all other costs and expenses of our operations and transactions in accordance with our Administration Agreement with Prospect Administration. Operating expenses were $9,199 and $12,297 for the three months ended September 30, 2009 and September 30, 2008, respectively.

The base management fee was $3,209 and $2,823 for the three months ended September 30, 2009 and September 30, 2008, respectively. The increase in this expense for the three months ended September 30, 2009 is directly related to our growth in total assets. For the three months ended September 30, 2009 and September 30, 2008, we incurred $3,080 and $5,875, respectively, of income incentive fees. The $2,795 decrease in the income incentive fee for the respective three-month period is driven by a decrease in pre- management fee net investment income from $29,377 for the three months ended September 30, 2008 to $15,398 for the three months ended September 30, 2009, primarily the result of the settlement of net profits interest in IEC/ARS in the 2008 period. No capital gains incentive fee has yet been incurred pursuant to the Investment Advisory Agreement.

During the three months ended September 30, 2009, we incurred $1,374 of expenses related to our credit facility. This compares with expenses of $1,518 incurred during the three months ended September 30, 2008. These expenses are related directly to the leveraging capacity put into place for each of those periods and the levels of indebtedness actually undertaken during those quarters. The table below describes the various credit facility expenses and the related indicators of leveraging capacity and indebtedness during these periods.

	For the Three Months Ended September 30,	
	2009	**2008**
Interest expense	$ 127	$ 1,230
Amortization of deferred financing costs	824	180
Commitment and other fees	423	108
Total	$ 1,374	$ 1,518
Weighted-average debt outstanding	$ 8,398	$ 115,419
Weighted-average interest rate incurred	6.00%	4.27%
Facility amount at beginning of period	$ 195,000	$ 200,000

The increase in our interest rate incurred is primarily due to an increase of 150 basis points in our current borrowing rate effective June 25, 2009.

As our asset base has grown and we have added complexity to our capital raising activities, due, in part, to our assumption of the sub-administration role from Vastardis, we have commensurately increased the size of our administrative and financial staff, accounting for a significant increase in the overhead allocation from Prospect Administration. Over the last year, Prospect Administration has added several additional staff members, including a senior finance professional, a controller, two corporate counsels and other finance professionals. As our portfolio continues to grow, we expect to continue to increase the size of our administrative and financial staff on a basis that provides increasing returns to scale. However, initial investments in administrative and financial staff may not provide returns to scale immediately, perhaps not until the portfolio increases to a greater size. Other allocated expenses from Prospect Administration have, as expected, increased alongside with the increase in staffing and asset base.

Legal costs decreased significantly from $597 for the three months ended September 30, 2008 to zero for the three months ended September 30, 2009 as there were legal matters in the prior year that are no longer active.

43

Net Investment Income, Net Realized (Loss) Gains, (Decrease) Increase in Net Assets from Net Change in Unrealized Depreciation/Appreciation and Net (Decrease) Increase in Net Assets Resulting from Operations

Net realized (loss) gains were zero and $1,645 for the three months ended September 30, 2009 and September 30, 2008, respectively. The net realized gain of $1,645 for the three months ended September 30, 2008 was due primarily to the sale of the warrants related to Deep Down, Inc.

Net decrease in net assets from changes in unrealized appreciation/depreciation was $18,696 and $11,149 for the three months ended September 30, 2009 and September 30, 2008, respectively. For the three months ended September 30, 2009, the $18,696 decrease in net assets from the net change in unrealized appreciation/depreciation was driven primarily by write-downs of our investments in Ajax, AEH, C&J, Conquest, Deb Shops, and Yatesville. For the three months ended September 30, 2008, the $11,149 decrease in net assets from the net change in unrealized appreciation/depreciation was driven by significant write-downs in our investments in CCEI, Deb Shops, Iron Horse and by the disposition of Deep Down, Inc. which had been previously valued above cost. These instances of unrealized depreciation were partially offset by unrealized appreciation in C&J, GSHI, and Yatesville.

Financial Condition, Liquidity and Capital Resources

For the three months ended September 30, 2009 and September 30, 2008, our operating activities provided (used) $41,503 and ($27,785) of cash, respectively. Financing activities (used) provided ($44,425) and $28,499 of cash during the three months ended September 30, 2009 and September 30, 2008, respectively, which included the payments of dividends of $16,647 and $11,845, during the three months ended September 30, 2009 and September 30, 2008, respectively.

Our primary uses of funds have been to add to our investments in our portfolio companies, to add new companies to our investment portfolio, and to make cash distributions to holders of our common stock.

We have and may continue to fund a portion of our cash needs through borrowings from banks, issuances of senior securities or secondary offerings. We may also securitize a portion of our investments in mezzanine or senior secured loans or other assets. Our objective is to put in place such borrowings in order to enable us to expand our portfolio. At September 30, 2009, we had zero outstanding borrowings on our $195,000 revolving credit facility.

On September 6, 2007, our Registration Statement on Form N-2 was declared effective by the SEC. At September 30, 2009, under the Registration Statement, we had remaining availability to issue up to approximately $147,500 of our equity securities over the next 11 months.

We also continue to generate liquidity through public and private stock offerings. On July 7, 2009 we completed a public stock offering for 5,175,000 shares of our common stock at $9.00 per share, raising $46,575 of gross proceeds. On August 20, 2009 and September 24, 2009, we issued 3,449,686 shares and 2,807,111 shares, respectively, of our common stock at $8.50 and $9.00 per share, respectively, in private stock offerings, raising $29,322, and $25,264 of gross proceeds, respectively. Concurrent with the sale of these shares, we entered into a registration rights agreement in which we granted the purchasers certain registration rights with respect to the shares. Under the terms and conditions of the registration rights agreement, we will use our reasonable best efforts to file with the SEC within sixty (60) days a post-effective amendment to the registration statement on Form N-2 and will also use our reasonable best efforts to cause such post-effective amendment to be declared effective by the SEC within one hundred twenty (120) days. Under the registration rights agreement, we may be obligated to make liquidated damages payments to holders upon certain events.

On August 3, 2009, we announced that we had entered into a definitive agreement to acquire Patriot, for which will issue stock, draw down on our revolving credit facility and use available cash and cash equivalents on hand, $92,163 as of September 30, 2009, to repay all Patriot debt outstanding, anticipated to be $110,500 when the acquisition closes.

Table of Contents

Off-Balance Sheet Arrangements

At September 30, 2009, we did not have any off-balance sheet liabilities or other contractual obligations that are reasonably likely to have a current or future material effect on our financial condition, other than those which originate from 1) the investment advisory and management agreement and the administration agreement and 2) the portfolio companies.

Developments Since the End of the Fiscal Quarter

On October 19, 2009, we issued 233,523 shares of our common stock in connection with the dividend reinvestment plan.

On December 2, 2009, we completed our previously announced acquisition of Patriot under the Agreement and Plan of Merger, dated as of August 3, 2009, by and among, us and Patriot. Pursuant to the terms of the merger agreement, we acquired Patriot for approximately $200 million comprised of our common stock and cash to repay all of Patriot s outstanding debt, which amounted to $107.3 million. In the merger, each outstanding share of Patriot common stock was converted into the right to receive 0.363992 shares of common stock of Prospect, representing 8,444,068 shares of the Company s common stock, and the payment of cash in lieu of fractional shares of Prospect common stock of less than $200 resulting from the application of the foregoing exchange ratio.

On December 17, 2009, we declared a dividend for our second fiscal quarter (for the fiscal year ending June 30, 2010) of $0.40875 per share. The ex-dividend date is Tuesday, December 29, 2009, the record date is Thursday, December 31, 2009 and the payment date is Monday, January 25, 2010.

On January 6, 2010, we announced a $15 million increase in total commitments on our revolving credit facility, increasing the facility size from $195 million to $210 million.

REPORT OF MANAGEMENT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining adequate internal control over financial reporting, and for performing an assessment of the effectiveness of internal control over financial reporting as of June 30, 2009. 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. The Company s internal control over financial reporting includes those policies and procedures that (i) pertain to 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.

Management performed an assessment of the effectiveness of the Company s internal control over financial reporting as of June 30, 2009 based upon criteria in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on our assessment, management determined that the Company s internal control over financial reporting was effective as of June 30, 2009 based on the criteria on Internal Control Integrated Framework issued by COSO. There were no changes in our internal control over financial reporting during the quarter ended June 30, 2009 that have materially affected, or are reasonably likely to affect, our internal control over financial reporting.

Our management s assessment of the effectiveness of our internal control over financial reporting as of June 30, 2009 has been audited by BDO Seidman LLP, an independent registered public accounting firm, as stated in their report which appears in the 10-K.

USE OF PROCEEDS

Unless otherwise specified in a prospectus supplement, we intend to use the net proceeds from selling Securities pursuant to this prospectus initially to maintain balance sheet liquidity, involving repayment of debt under our credit facility, investments in high quality short-term debt instruments or a combination thereof, and thereafter to make long-term investments in accordance with our investment objective. A supplement to this prospectus relating to each offering will provide additional detail, to the extent known at the time, regarding the use of the proceeds from such offering including any intention to utilize proceeds to pay expenses in order to avoid sales of long-term assets.

We anticipate that substantially all of the net proceeds of an offering of Securities pursuant to this prospectus will be used for the above purposes within six months, depending on the availability of appropriate investment opportunities consistent with our investment objective and market conditions. In addition, we expect that there will be several offerings pursuant to this prospectus; we expect that substantially all of the proceeds from all offerings will be used within three years. Pending our new investments, we plan to invest a portion of net proceeds in cash equivalents, U.S. government securities and other high-quality debt investments that mature in one year or less from the date of investment and other general corporate purposes. The management fee payable by us will not be reduced while our assets are invested in such securities. See Regulation Temporary Investments for additional information about temporary investments we may make while waiting to make longer-term investments in pursuit of our investment objective.

FORWARD-LOOKING STATEMENTS

Our annual report on Form l0-K for the year ended June 30, 2009, any of our quarterly reports on Form 10-Q or current reports on Form 8-K, or any other oral or written statements made in press releases or otherwise by or on behalf of Prospect Capital Corporation including this prospectus may contain forward looking statements within the meaning of the Section 21E of the Securities Exchange Act of 1934, as amended, which involve substantial risks and uncertainties. Forward looking statements predict or describe our future operations, business plans, business and investment strategies and portfolio management and the performance of our investments and our investment management business. These forward-looking statements are not historical facts, but rather are based on current

Table of Contents

expectations, estimates and projections about our industry, our beliefs, and our assumptions. Words such as intends, intend, intended, goal, estimate, estimates, expects, expect, expected, project, projected, project anticipates, anticipated, should, could, may, will, designed to, foreseeable future, believe, believes variations of these words and similar expressions are intended to identify forward-looking statements. Our actual results or outcomes may differ materially from those anticipated. Readers are cautioned not to place undue reliance on these forward looking statements, which speak only as of the date the statement was made. We undertake no obligation to publicly update or revise any forward looking statements, whether as a result of new information, future events or otherwise. These forward-looking statements do not meet the safe harbor for forward-looking statements pursuant to Section 27A of the Securities Act. These statements are not guarantees of future performance and are subject to risks, uncertainties, and other factors, some of which are beyond our control and difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements, including without limitation:

- our future operating results,
- our business prospects and the prospects of our portfolio companies,
- the impact of investments that we expect to make,
- the dependence of our future success on the general economy and its impact on the industries in which we invest,
- the ability of our portfolio companies to achieve their objectives,
- difficulty in obtaining financing or raising capital, especially in the current credit and equity environment,
- the level and volatility of prevailing interest rates and credit spreads, magnified by the current turmoil in the credit markets,
- adverse developments in the availability of desirable loan and investment opportunities whether they are due to competition, regulation or otherwise,
- a compression of the yield on our investments and the cost of our liabilities, as well as the level of leverage available to us,
- our regulatory structure and tax treatment, including our ability to operate as a business development company and a regulated investment company;
- the adequacy of our cash resources and working capital;
- the timing of cash flows, if any, from the operations of our portfolio companies;
- the ability of our investment adviser to locate suitable investments for us and to monitor and administer our investments,
- authoritative generally accepted accounting principles or policy changes from such standard-setting bodies as the Financial Accounting Standards Board, the Securities and Exchange Commission, Internal Revenue Service, the New York Stock Exchange, and other authorities that we are subject to, as well as their counterparts in any foreign jurisdictions where we might do business; and

the risks, uncertainties and other factors we identify in Risk Factors and elsewhere in this prospectus and in our filings with the SEC.

Although we believe that the assumptions on which these forward-looking statements are based are reasonable, any of those assumptions could prove to be inaccurate, and as a result, the forward-looking statements based on those assumptions also could be inaccurate. Important assumptions include our ability to originate new loans and investments, certain margins and levels of profitability and the availability of additional capital. In light of these and other uncertainties, the inclusion of a projection or forward-looking statement in this prospectus should not be regarded as a representation by us that our plans and objectives will be achieved. These risks and uncertainties include those described or identified in Risk Factors and elsewhere in this prospectus. You should not place undue reliance on these forward-looking statements, which apply only as of the date of this prospectus.

Table of Contents

DISTRIBUTIONS

We have paid and intend to continue to distribute quarterly distributions to our stockholders out of assets legally available for distribution. Our distributions, if any, will be determined by our Board of Directors. Certain amounts of the quarterly distributions may from time to time be paid out of our capital rather than from earnings for the quarter as a result of our deliberate planning or by accounting reclassifications.

In order to maintain RIC tax treatment, we must distribute at least 90% of our ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, out of the assets legally available for distribution. In order to avoid certain excise taxes imposed on RICs, we are required to distribute with respect to each calendar year by January 31 of the following year an amount at least equal to the sum of

- 98% of our ordinary income for the calendar year,
- 98% of our capital gains in excess of capital losses for the one-year period ending on October 31 of the calendar year, and
- any ordinary income and net capital gains for preceding years that were not distributed during such years.

In December 2008, our Board of Directors elected to retain excess profits generated in the quarter ended September 30, 2008 and pay a 4% excise tax on such retained earnings. This tax of $533,000 was paid in the quarter ending March 31, 2009.

In addition, although we currently intend to distribute realized net capital gains (which we define as net long-term capital gains in excess of short-term capital losses), if any, at least annually, out of the assets legally available for such distributions, we may decide in the future to retain such capital gains for investment. In such event, the consequences of our retention of net capital gains are as described under Material U.S. Federal Income Tax Considerations. We can offer no assurance that we will achieve results that will permit the payment of any cash distributions and, if we issue senior securities, we may be prohibited from making distributions if doing so causes us to fail to maintain the asset coverage ratios stipulated by the 1940 Act or if distributions are limited by the terms of any of our borrowings.

We maintain an opt out dividend reinvestment plan for our common stockholders. As a result, if we declare a dividend, then stockholders cash dividends will be automatically reinvested in additional shares of our common stock, unless they specifically opt out of the dividend reinvestment plan so as to receive cash dividends. See Dividend Reinvestment Plan. To the extent prudent and practicable, we intend to declare and pay dividends on a quarterly basis.

With respect to the dividends paid to stockholders, income from origination, structuring, closing, commitment and other upfront fees associated with investments in portfolio companies were treated as taxable income and accordingly, distributed to stockholders. For the fiscal year ended June 30, 2009, we declared total dividends of approximately $56.1 million. For the first quarter of the fiscal year ending June 30, 2010, we paid total distributions of approximately $22.3 million and have declared distributions of $25.9 million for the second quarter of the same fiscal year.

Tax characteristics of all distributions will be reported to stockholders, as appropriate, on Form 1099-DIV after the end of the year. Our ability to pay distributions could be affected by future business performance, liquidity, capital needs, alternative investment opportunities and loan covenants.

Table of Contents

The following table lists the quarterly distributions per share since shares of our common stock began being regularly quoted on The NASDAQ Global Select Market:

Date Declared	Record Date	Payment Date	Per Share	Amount
11/11/2004	12/10/2004	12/30/2004	$ 0.100	$ 705,510
2/9/2005	3/11/2005	3/31/2005	$ 0.125	$ 881,888
4/21/2005	6/10/2005	6/30/2005	$ 0.150	$ 1,058,265
9/15/2005	9/22/2005	9/29/2005	$ 0.200	$ 1,411,020
12/12/2005	12/22/2005	12/29/2005	$ 0.280	$ 1,975,428
3/15/2006	3/24/2006	3/31/2006	$ 0.300	$ 2,116,530
6/14/2006	6/23/2006	6/30/2006	$ 0.340	$ 2,401,060
7/31/2006	9/22/2006	9/29/2006	$ 0.380	$ 4,858,879
12/15/2006	12/29/2006	1/5/2007	$ 0.385	$ 7,263,926
3/14/2007	3/23/2007	3/30/2007	$ 0.3875	$ 7,666,837
6/14/2007	6/22/2007	6/29/2007	$ 0.390	$ 7,752,900
9/6/2007	9/19/2007	9/28/2007	$ 0.3925	$ 7,830,008
12/18/2007	12/28/2007	1/7/2008	$ 0.395	$ 9,369,850
3/6/2008	3/31/2008	4/16/2008	$ 0.400	$ 10,468,455
6/19/2008	6/30/2008	7/16/2008	$ 0.40125	$ 11,845,052
9/16/2008	9/30/2008	10/16/2008	$ 0.4025	$ 11,881,953
12/19/2008	12/31/2008	1/20/2008	$ 0.40375	$ 11,966,313
3/24/2009	3/31/2009	4/20/2009	$ 0.405	$ 12,670,882
6/23/2009	7/8/2009	7/20/2009	$ 0.40625	$ 19,547,972
9/28/2009	10/8/2009	10/19/2009	$ 0.4075	$ 22,278,903
12/17/2009	12/31/2009	1/25/2010	$ 0.40875	$ 25,894,209
Total Declared				$ 181,845,840

SENIOR SECURITIES

Information about our senior securities is shown in the following table for the periods ended June 30, 2009, 2008, 2007, 2006, 2005 and 2004 unless otherwise noted. The information for the years ended June 30, 2009, 2008, 2007, 2006, 2005 and 2004 has been derived from our financial statements which have been audited by BDO Seidman, LLP. The indicates information which the SEC expressly does not require to be disclosed for certain types of senior securities.

Class and Year	Total Amount Outstanding(1)	Asset Coverage per Unit(2)	Involuntary Liquidating Preference Per Unit(3)	Average Market Value Per Unit(4)
Credit Facility				

Fiscal 2009 (as of June 30, 2009)	$ 124,800	$ 5,268	N/A
Fiscal 2008 (as of June 30, 2007)	91,167	5,712	N/A
Fiscal 2007 (as of June 30, 2007)		N/A	N/A
Fiscal 2006 (as of June 30, 2006)	28,500	4,799	N/A
Fiscal 2005 (as of June 30, 2005)		N/A	N/A
Fiscal 2004 (as of June 30, 2004)		N/A	N/A

(1) Total amount of each class of senior securities outstanding at the end of the period presented (in 000 s).

(2) The asset coverage ratio for a class of senior securities representing indebtedness is calculated as our consolidated total assets, less all liabilities and indebtedness not represented by senior securities, divided by senior securities representing indebtedness. This asset coverage ratio is multiplied by $1,000 to determine the Asset Coverage Per Unit.

(3) The amount to which such class of senior security would be entitled upon the involuntary liquidation of the issuer in preference to any security junior to it.

(4) Not applicable, as senior securities are not registered for public trading.

Table of Contents

PRICE RANGE OF COMMON STOCK

Our common stock is quoted on The NASDAQ Global Select Market under the symbol PSEC. The following table sets forth, for the periods indicated, our net asset value per share of common stock and the high and low sales prices per share of our common stock as reported on The NASDAQ Global Select Market. Our common stock historically trades at prices both above and below its NAV. There can be no assurance, however, that such premium or discount, as applicable, to NAV will be maintained.

	NAV(1)	Stock Price High(2)	Low(2)	Premium (Discount) of High to NAV	Premium (Discount) of Low to NAV	Dividend Declared
Twelve Months Ending June 30, 2005						
First quarter	$ 13.67	$ 15.45	$ 14.42	13.0%	5.5%	
Second quarter	13.74	15.15	11.63	10.3%	(15.4)%	$ 0.100
Third quarter	13.74	13.72	10.61	(0.1)%	(22.8)%	0.125
Fourth quarter	14.59	13.47	12.27	(7.7)%	(15.9)%	0.150
Twelve Months Ending June 30, 2006						
First quarter	$ 14.60	$ 13.60	$ 11.06	(6.8)%	(24.2)%	$ 0.200
Second quarter	14.69	15.46	12.84	5.2%	(12.6)%	0.280
Third quarter	14.81	16.64	15.00	12.4%	1.3%	0.300
Fourth quarter	15.31	17.07	15.83	11.5%	3.4%	0.340
Twelve Months Ending June 30, 2007						
First quarter	$ 14.86	$ 16.77	$ 15.30	12.9%	3.0%	$ 0.380
Second quarter	15.24	18.79	15.60	23.3%	2.4%	0.385
Third quarter	15.18	17.68	16.40	16.5%	8.0%	0.3875
Fourth quarter	15.04	18.68	16.91	24.2%	12.4%	0.390
Twelve Months Ending June 30, 2008						
First quarter	$ 15.08	$ 18.68	$ 14.16	23.9%	(6.1)%	$ 0.3925
Second quarter	14.58	17.17	11.22	17.8%	(23.0)%	0.395
Third quarter	14.15	16.00	13.55	13.1%	(4.2)%	0.400
Fourth quarter	14.55	16.12	13.18	10.8%	(9.4)%	0.40125
Twelve Months Ending June 30, 2009						
First quarter	$ 14.63	$ 14.24	$ 11.12	(2.7)%	(24.0)%	$ 0.4025
Second quarter	14.43	13.08	6.29	(9.4)%	(56.4)%	0.40375
Third quarter	14.19	12.89	6.38	(9.2)%	(55.0)%	0.405
Fourth quarter	12.40	10.48	7.95	(15.5)%	(35.9)%	0.40625
Twelve Months Ending June 30, 2010						

First quarter	11.11	$ 10.99	$ 8.82	(1.1)%	(20.6)%	$ 0.4075
Second quarter	(3)(4)	$ 12.31	$ 9.93	(4)	(4)	$ 0.40875
Third quarter (to 1/7/10)	(3)(4)	$ 12.35	$ 12.00	(4)	(4)	(5)

(1) Net asset value per share is determined as of the last day in the relevant quarter and therefore may not reflect the net asset value per share on the date of the high or low sales price. The NAVs shown are based on outstanding shares at the end of each period.

(2) The High/Low Stock Price is calculated as of the closing price on a given day in the applicable quarter.

(3) Our most recently determined NAV per share was $11.11 as of September 30, 2009 ($10.82 on an as adjusted basis solely to give effect to dividends paid on October 19, 2009 and in connection with our merger with Patriot on December 2, 2009). NAV as of December 31, 2009 may be higher or lower than $10.82 based on potential changes in valuations as of December 31, 2009.

(4) NAV has not yet been finally determined for any day after September 30, 2009.

(5) The dividend for the third quarter of 2010 will be declared in March 2010.

On January 7, 2010, the last reported sales price of our common stock was $12.35 per share. As of January 7, 2010, we had approximately 72 stockholders of record.

BUSINESS

General

We are a financial services company that primarily lends to and invests in middle market privately-held companies. We are a closed-end investment company that has filed an election to be treated as a business development company under the Investment Company Act of 1940, or the 1940 Act. We invest primarily in senior and subordinated debt and equity of companies in need of capital for acquisitions, divestitures, growth, development, project financing and recapitalization. We work with the management teams or financial sponsors to seek investments with historical cash flows, asset collateral or contracted pro-forma cash flows.

On July 27, 2004, we completed our initial public offering, or IPO, and sold 7 million shares of common stock at a price of $15.00 per share, less underwriting discounts and commissions totaling $1.05 per share. An additional 55,000 shares were issued through the exercise of an over-allotment option with respect to the IPO on August 27, 2004. Since the IPO and the exercise of the related over-allotment option, we have made eleven other share offerings and six related over-allotment options resulting in the issuance of 43,493,836 shares at prices ranging from $7.75 to $17.70. The most recent offering was completed on September 24, 2009 pursuant to which the Company sold 2,807,111 at an unregistered direct price of $9.00 per share.

On December 2, 2009, we completed our previously announced acquisition of Patriot under the Agreement and Plan of Merger, dated as of August 3, 2009, by and among, us and Patriot. Pursuant to the terms of the merger agreement, we acquired Patriot for approximately $200 million comprised of our common stock and cash to repay all of Patriot s outstanding debt, which amounted to $107.3 million. In the merger, each outstanding share of Patriot common stock was converted into the right to receive 0.363992 shares of common stock of Prospect, representing 8,444,068 shares of the Company s common stock, and the payment of cash in lieu of fractional shares of Prospect common stock of less than $200 resulting from the application of the foregoing exchange ratio.

Our headquarters are located at 10 East 40th Street, 44th Floor, New York, NY 10016, and our telephone number is (212) 448-0702. Our investment adviser is Prospect Capital Management LLC.

Our Investment Objective and Policies

Our investment objective is to generate both current income and long-term capital appreciation through debt and equity investments. We focus on making investments in private companies, and many of our investments are in energy companies. We are a non-diversified company within the meaning of the 1940 Act.

Typically, we concentrate on making investments in companies with annual revenues of less than $500 million and enterprise values of less than $250 million. Our typical investment involves a secured loan of less than $50 million with some form of equity participation. From time to time, we acquire controlling interests in companies in conjunction with making secured debt investments in such companies. In most cases, companies in which we invest are privately held at the time we invest in them. We refer to these companies as target or middle market companies and these investments as middle market investments.

We seek to maximize returns and protect risk for our investors by applying rigorous analysis to make and monitor our investments. While the structure of our investments varies, we can invest in senior secured debt, senior unsecured debt, subordinated secured debt, subordinated unsecured debt, mezzanine debt, convertible debt, convertible preferred equity, preferred equity, common equity, warrants and other instruments, many of which generate current yield. Our investments primarily range between approximately $5 million and $50 million each, although this investment size may vary as the size of our capital base changes.

While our primary focus is to seek current income through investment in the debt and/or dividend-paying equity securities of eligible privately-held, thinly-traded or distressed companies and long-term capital appreciation by acquiring accompanying warrants, options or other equity securities of such companies, we may invest up to 30% of the portfolio in opportunistic investments in order to seek enhanced returns for stockholders. Such investments may include investments in the debt and equity instruments of broadly-traded public companies. We expect that these public companies generally will have debt securities that are non-investment grade. Within this 30% basket, we may also invest in debt and equity securities of companies located outside of the United States.

Table of Contents

Our investments may include other equity investments, such as warrants, options to buy a minority interest in a portfolio company, or contractual payment rights or rights to receive a proportional interest in the operating cash flow or net income of such company. When determined by our Investment Adviser to be in our best interest, we may acquire a controlling interest in a portfolio company. Any warrants we receive with our debt securities may require only a nominal cost to exercise, and thus, as a portfolio company appreciates in value, we may achieve additional investment return from this equity interest. We have structured, and will continue to structure, some warrants to include provisions protecting our rights as a minority-interest or, if applicable, controlling-interest holder, as well as puts, or rights to sell such securities back to the company, upon the occurrence of specified events. In many cases, we obtain registration rights in connection with these equity interests, which may include demand and piggyback registration rights.

We plan to hold many of our investments to maturity or repayment, but will sell our investments earlier if a liquidity event takes place, such as the sale or recapitalization of a portfolio company, or if we determine a sale of one or more of our investments to be in our best interest.

We have qualified and elected to be treated for U.S. Federal income tax purposes as a Registered Investment Company (RIC) under Subchapter M of the Code. As a RIC, we generally do not have to pay corporate-level U.S. Federal income taxes on any ordinary income or capital gains that we distribute to our stockholders as dividends. To continue to qualify as a RIC, we must, among other things, meet certain source-of-income and asset diversification requirements (as described below). In addition, to qualify for RIC tax treatment we must distribute to our stockholders, for each taxable year, at least 90% of our investment company taxable income, which is generally our ordinary income plus the excess of our realized net short-term capital gains over our realized net long-term capital losses.

For a discussion of the risks inherent in our portfolio investments, see Risk Factors Risks Relating to our Investments.

Industry Sectors

We have invested significantly in industrial and energy related companies. However, we continue to widen our focus in other sectors of the economy to diversify our portfolio holdings. The energy industry consists of companies in the direct energy value chain as well as companies that sell products and services to, or acquire products and services from, the direct energy value chain. In this prospectus, we refer to all of these companies as energy companies and assets in these companies as energy assets. The categories of energy companies in this chain are described below. The direct energy value chain broadly includes upstream businesses, midstream businesses and downstream businesses:

Upstream businesses find, develop and extract energy resources, including natural gas, crude oil and coal, which are typically from geological reservoirs found underground or offshore, and agricultural products.

Midstream businesses gather, process, refine, store and transmit energy resources and their by products in a form that is usable by wholesale power generation, utility, petrochemical, industrial and gasoline customers.

Downstream businesses include the power and electricity segment as well as businesses that process, refine, market or distribute hydrocarbons or other energy resources, such as customer-ready natural gas, propane and gasoline, to end-user customers.

Ongoing Relationships with Portfolio Companies

Monitoring

Prospect Capital Management monitors our portfolio companies on an ongoing basis. Prospect Capital Management will continue to monitor the financial trends of each portfolio company to determine if it is meeting its business plan and to assess the appropriate course of action for each company.

Prospect Capital Management employs several methods of evaluating and monitoring the performance and value of our investments, which may include, but are not limited to, the following:

- Assessment of success in adhering to the portfolio company s business plan and compliance with covenants;
- Regular contact with portfolio company management and, if appropriate, the financial or strategic sponsor, to discuss financial position, requirements and accomplishments;
- Attendance at and participation in board meetings of the portfolio company; and
- Review of monthly and quarterly financial statements and financial projections for the portfolio company.

Investment Valuation

Our Board of Directors has established procedures for the valuation of our investment portfolio. These procedures are detailed below.

Investments for which market quotations are readily available are valued at such market quotations.

For most of our investments, market quotations are not available. With respect to investments for which market quotations are not readily available or when such market quotations are deemed not to represent fair value, our Board of Directors has approved a multi-step valuation process each quarter, as described below:

1) each portfolio company or investment is reviewed by our investment professionals with the independent valuation firm engaged by our Board of Directors;

2) the independent valuation firm conducts independent appraisals and makes their own independent assessment;

3) the audit committee of our Board of Directors reviews and discusses the preliminary valuation of our Investment Adviser and that of the independent valuation firm; and

4) the Board of Directors discusses the valuations and determines the fair value of each investment in our portfolio in good faith based on the input of our Investment Adviser, the independent valuation firm and the audit committee.

Investments are valued utilizing a market approach, an income approach, or both approaches, as appropriate. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities (including a business). The income approach uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present value amount (discounted) calculated based on an appropriate discount rate. The measurement is based on the net present value indicated by current market expectations about those future amounts. In following these approaches, the types of factors that we may take into account in fair value pricing our investments include, as relevant: available current market data, including relevant and applicable market trading and transaction comparables, applicable market yields and multiples, security covenants, call protection provisions, information rights, the nature and realizable value of any collateral, the portfolio company s ability to make payments, its earnings and discounted cash flows, the markets in which the portfolio company does business, comparisons of financial ratios of peer companies that are public, M&A comparables, the principal market and enterprise values, among other factors.

In September 2006, the Financial Accounting Standards Board (FASB) issued Accounting Standards Codification (ASC or Codification) 820, *Fair Value Measurements and Disclosures* (ASC 820). ASC 820 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. We adopted ASC 820 on a prospective basis beginning in the quarter ended September 30, 2008.

ASC 820 classifies the inputs used to measure these fair values into the following hierarchy:

Level 1: Quoted prices in active markets for identical assets or liabilities, accessible by the Company at the measurement date.

Table of Contents

Level 2: Quoted prices for similar assets or liabilities in active markets, or quoted prices for identical or similar assets or liabilities in markets that are not active, or other observable inputs other than quoted prices.

Level 3: Unobservable inputs for the asset or liability.

In all cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to each investment.

The changes to generally accepted accounting principles from the application of ASC 820 relate to the definition of fair value, framework for measuring fair value, and the expanded disclosures about fair value measurements. ASC 820 applies to fair value measurements already required or permitted by other standards.

In accordance with ASC 820, the fair value of our investments is defined as the price that we would receive upon selling an investment in an orderly transaction to an independent buyer in the principal or most advantageous market in which that investment is transacted.

In April 2009, the FASB issued ASC 820-10-65, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (ASC 820-10-65). This update provides further clarification for ASC 820 in markets that are not active and provides additional guidance for determining when the volume of trading level of activity for an asset or liability has significantly decreased and for identifying circumstances that indicate a transaction is not orderly. ASC 820-10-65 is effective for interim and annual reporting periods ending after June 15, 2009. The adoption of ASC 820-10-65 for the three months ended September 30, 2009, did not have any effect on our net asset value, financial position or results of operations as there was no change to the fair value measurement principles set forth in ASC 820.

For a discussion of the risks inherent in determining the value of securities for which readily available market values do not exist, see Risk Factors Risks relating to our business Most of our portfolio investments are recorded at fair value as determined in good faith by our Board of Directors and, as a result, there is uncertainty as to the value of our portfolio investments.

Valuation of Other Financial Assets and Financial Liabilities

In February 2007, FASB issued SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115 . SFAS 159 permits an entity to elect fair value as the initial and subsequent measurement attribute for many of assets and liabilities for which the fair value option has been elected and similar assets and liabilities measured using another measurement attribute. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those years. We have adopted this statement on July 1, 2008 and have elected not to value some assets and liabilities at fair value as would be permitted by SFAS 159.

The Investment Adviser

Prospect Capital Management manages our investments as our investment adviser. Prospect Capital Management is a Delaware limited liability corporation that has been registered as an investment adviser under the Advisers Act since March 31, 2004. Prospect Capital Management is led by John F. Barry III and M. Grier Eliasek, two senior executives with significant investment advisory and business experience. Both Messrs. Barry and Eliasek spend a significant amount of their time in their roles at Prospect Capital Management working on the Company s behalf. The principal executive offices of Prospect Capital Management are 10 East 40th Street, 44th Floor, New York, NY 10016. We depend on the diligence, skill and network of business contacts of the senior management of our Investment Adviser. We also depend, to a significant extent, on our Investment Adviser s investment professionals and the information and deal flow generated by those investment professionals in the course of their investment and portfolio management activities. The Investment Adviser s senior management team evaluates, negotiates, structures, closes, monitors and services our investments. Our future success depends to a significant extent on the continued service of the senior management team, particularly John F. Barry III and M. Grier Eliasek. The departure of any of the senior managers of our Investment Adviser could have a materially

Table of Contents

adverse effect on our ability to achieve our investment objective. In addition, we can offer no assurance that Prospect Capital Management will remain our Investment Adviser or that we will continue to have access to its investment professionals or its information and deal flow. Under our Investment Advisory Agreement, we pay Prospect Capital Management investment advisory fees, which consist of an annual base management fee based on our gross assets as well as a two-part incentive fee based on our performance. Mr. Barry currently controls Prospect Capital Management. See Management Management Services Board of Directors approval of the Investment Advisory Agreement.

As a business development company, we offer, and must provide upon request, managerial assistance to certain of our portfolio companies. This assistance could involve, among other things, monitoring the operations of our portfolio companies, participating in board and management meetings, consulting with and advising officers of portfolio companies and providing other organizational and financial guidance. We may receive fees for these services. Such fees would not qualify as good income for purposes of the 90% income test that we must meet each year to qualify as a RIC. Prospect Administration provides such managerial assistance on our behalf to portfolio companies when we are required to provide this assistance.

Staffing

Mr. John F. Barry III, our chairman and chief executive officer, Mr. Grier Eliasek, our chief operating officer and president, and Mr. Brian H. Oswald, our chief financial officer, chief compliance officer, treasurer and secretary, comprise our senior management. Over time, we expect to add additional officers and employees. Messrs. Barry and Eliasek each also serves as an officer of Prospect Administration and performs his respective functions under the terms of the Administration Agreement. Our day-to-day investment operations are managed by Prospect Capital Management. In addition, we reimburse Prospect Administration for our allocable portion of expenses incurred by it in performing its obligations under the Administration Agreement, including rent and our allocable portion of the costs of our Chief Executive Officer, President, Chief Financial Officer, Chief Operating Officer, Chief Compliance Officer, Treasurer and Secretary and their respective staffs. See Management Management Services Administration Agreement.

Properties

We do not own any real estate or other physical properties materially important to our operation. Our corporate headquarters are located at 10 East 40th Street, 44th Floor, New York, NY 10016, where we occupy an office space pursuant to the Administration Agreement.

Legal Proceedings

On December 6, 2004, Dallas Gas Partners, L.P. (DGP) served us with a complaint filed November 30, 2004 in the U.S. District for the Southern District of Texas, Galveston Division. DGP alleges that DGP was defrauded and that we breached our fiduciary duty to DGP and tortiously interfered with DGP s contract to purchase Gas Solutions, Ltd. (a subsidiary of our portfolio company, GSHI) in connection with our alleged agreement in September 2004 to loan DGP funds with which DGP intended to buy Gas Solutions, Ltd. for approximately $26 million. The complaint sought relief not limited to $100 million. On November 30, 2005, U.S. Magistrate Judge John R. Froeschner of the U.S. District Court for the Southern District of Texas, Galveston Division, issued a recommendation that the court grant our Motion for Summary Judgment dismissing all claims by DGP. On February 21, 2006, U.S. District Judge Samuel Kent of the U.S. District Court for the Southern District of Texas, Galveston Division issued an order granting our Motion for Summary Judgment dismissing all claims by DGP, against us. On May 16, 2007, the Court also granted us summary judgment on DGP s liability to us on our counterclaim for DGP s breach of a release and covenant not to sue. On January 4, 2008, the Court, Judge Melinda Harmon presiding, granted our motion to dismiss all DGP s claims asserted against certain of our officers and affiliates. On August 20, 2008, Judge Harmon entered a Final Judgment dismissing all of DGP s claims. DGP appealed to the U.S. Court of Appeals for the Fifth Circuit, which affirmed the Final Judgment on June 24, 2009. DGP has moved for rehearing. Our damage claims against DGP remain pending.

In May 2006, based in part on unfavorable due diligence and the absence of investment committee approval, we declined to extend a loan for $10 million to a potential borrower (plaintiff). Plaintiff was subsequently sued by its own attorney in a local Texas court for plaintiff s failure to pay fees owed to its attorney. In December 2006, plaintiff filed a cross-action against us and certain of our affiliates (the defendants) in the same local Texas court, alleging, among other things, tortious interference with contract and fraud. We petitioned the United States District Court for the Southern District of New York (the District Court) to compel arbitration and to enjoin the Texas action. In February 2007, our motions were granted. Plaintiff appealed that decision. On July 24, 2008, the Second Circuit Court of Appeals affirmed the judgment of the District Court. The arbitration commenced in July 2007 and concluded in late November 2007. Post-hearing briefings were completed in February 2008. On April 14, 2008, the arbitrator rendered an award in our favor, rejecting all of plaintiff s claims. On April 18, 2008, we filed a petition before the District Court to confirm the award. On October 8, 2008, the District Court granted the Company s petition to confirm the award, confirmed the awards and subsequently entered judgment thereon in favor of the Company in the amount of $2.3 million. After filing a defective notice of appeal to the United States Court of Appeals for the Second Circuit on November 5, 2008, plaintiff s counsel resubmitted a new notice of appeal on January 9, 2009. The plaintiff subsequently requested that the Company agree to stipulate to the withdrawal of plaintiff s appeal to the Second Circuit. Such a stipulation was filed with the Second Circuit on or about April 14, 2009. Based on this stipulation, the Second Circuit issued a mandate terminating the appeal, which was transmitted to the District Court on April 23, 2009. Post-judgment discovery against plaintiff is continuing and we have filed a motion for sanctions against plaintiff s counsel. Argument for the motion for sanctions was held on November 19, 2009 and a decision from the court is pending.

We are involved in various investigations, claims and legal proceedings that arise in the ordinary course of our business. These matters may relate to intellectual property, employment, tax, regulation, contract or other matters. The resolution of such matters that may arise out of these investigations, claims and proceedings will be subject to various uncertainties and, even if such matters are without merit, could result in the expenditure of significant financial and managerial resources.

We are not aware of any other material pending legal proceeding, and no such material proceedings are contemplated to which we are a party or of which any of our property is subject.

Management

Our business and affairs are managed under the direction of our Board of Directors. Our Board of Directors currently consists of five directors, three of whom are not interested persons of the Company as defined in Section 2(a)(19) of the 1940 Act. We refer to these individuals as our independent directors. Our Board of Directors elects our officers to serve for a one-year term and until their successors are duly elected and qualify, or until their earlier removal or resignation.

Board Of Directors And Executive Officers

Under our charter, our directors are divided into three classes. Directors are elected for a staggered term of three years each, with a term of office of one of the three classes of directors expiring each year. At each annual meeting of our stockholders, the successors to the class of directors whose terms expire at such meeting are 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. Each director holds office for the term to which he or she is elected and until his or her successor is duly elected and qualifies.

Directors and Executive Officers

Our directors and executive officers and their positions are set forth below. The address for each director and executive officer is c/o Prospect Capital Corporation, 10 East 40th Street, 44th Floor, New York, NY 10016.

Table of Contents

Independent Directors

Name and Age	Position(s) Held with the Company	Term of Office(1) and Length of Time Served	Principal Occupation(s) During Past 5 Years	Number of Portfolios in Fund Complex Overseen by Director	Other Directorships Held by Director(2)
Graham D.S. Anderson, 45	Director	Class I Director since September 2008; Term expires 2011	General Partner of Euclid SR Partners from 2000 to present. From 1996 to 2000, Mr. Anderson was a General Partner of Euclid Partners, the predecessor to Euclid SR Partners.	One	None
Eugene S. Stark, 51	Director	Class III Director since September 2008; Term expires 2010	Principal Financial Officer, Chief Compliance Officer and Vice President Administration of General American Investors Company, Inc. from May 2005 to present. Prior to his role with General American Investors Company, Inc., Mr. Stark served as the Chief Financial Officer of Prospect Capital Corporation from January 2005 to April 2005. From May 1987 to December 2004 Mr. Stark served as Senior Vice President and Vice President with Prudential Financial, Inc.	One	None
Andrew C. Cooper, 48	Director	Class II Director since February 2009; Term expires 2012	Mr. Cooper is an entrepreneur, who over the last 11 years has founded, built, run and sold three companies. He is Co-Chief Executive Officer of Unison Site Management, Inc., a specialty finance company focusing on cell site easements, and Executive Director of Brand Asset Digital, a digital media marketing and distribution company. Prior to that, Mr. Cooper focused on venture capital and investment banking for Morgan Stanley for 14 years.	One	Unison Site Management, LLC, Brand Asset Digital, LLC and Aquatic Energy, LLC

(1) Our Board of Directors is divided into three classes of directors serving staggered three-year terms. Mr. Anderson is a Class I director with a term that will expire in 2011, Mr. Eliasek and Mr. Cooper are Class II directors with terms that will expire in 2012 and Mr. Barry and Mr. Stark are Class III directors with terms that will expire in 2010.

(2) No director otherwise serves as a director of an investment company subject to the 1940 Act.

Table of Contents

Interested Directors

Name and Age	Position(s) Held with the Company	Term of Office(1) and Length of Time Served	Principal Occupation(s) During Past 5 Years	Number of Portfolios in Fund Complex Overseen by Director	Other Directorships Held by Director(2)
John F. Barry III,(3) 57	Director, Chairman of the Board of Directors, and Chief Executive Officer	Class III Director since June 2004; Term expires 2010	Chairman and Chief Executive Officer of the Company; Managing Director and Chairman of the Investment Committee of Prospect Capital Management and Prospect Administration since June 2004; Managing Director of Prospect Capital Management.	One	None
M. Grier Eliasek,(3) 36	Director, President and Chief Operating Officer	Class II Director since June 2004; Term expires 2012	President and Chief Operating Officer of the Company, Managing Director of Prospect Capital Management and Prospect Administration	One	None

(1) Our Board of Directors is divided into three classes of directors serving staggered three-year terms. Mr. Anderson is a Class I director with a term that will expire in 2011, Mr. Eliasek and Mr. Cooper are Class II directors with terms that will expire in 2012 and Mr. Barry and Mr. Stark are Class III directors with terms that will expire in 2010.

(2) No director otherwise serves as a director of an investment company subject to the 1940 Act.

(3) Messrs. Barry and Eliasek are each considered an interested person under the 1940 Act by virtue of serving as one of our officers and having a relationship with Prospect Capital Management.

Information about Executive Officers who are not Directors

Name and Age	Position(s) Held with the Company	Term of Office and Length of Time Served	Principal Occupation(s) During Past Five Years
Brian H. Oswald, 48			

Chief Financial Officer, Chief Compliance Officer, Treasurer and Secretary	November 2008 to present as Chief Financial Officer and October 2008 to present as Chief Compliance Officer	Joined Prospect Administration as Managing Director in June 2008. Previously Managing Director in Structured Finance Group at GSC Group (2006 to 2008) and Chief Financial Officer at Capital Trust, Inc. (2003 to 2005)

Independent Directors

Graham D.S. Anderson. Mr. Anderson has served as General Partner of Euclid SR Partners from 1996 to present. Mr. Anderson currently serves as a member of the Board of Directors of Acurian, Inc. (a clinical trial recruitment company), FatWire Software Corp. (a web content management company), iJet Risk Management (an operational risk management information company), Plateau Systems Limited (a human capital management software company) and SkinMedica Inc. (a dermatology and cosmeceuticals company).

Andrew C. Cooper. Mr. Cooper has 24 years of experience in growth company management, venture investing and investment banking. He has a wide range of operational, marketing, technology, and debt and equity capital raising expertise. Mr. Cooper is an entrepreneur, who over the last 11 years has founded, built, run and sold three companies. Prior to that, Mr. Cooper focused on venture capital and investment banking for Morgan Stanley for 14 years. He is Co-Chief Executive Officer of Unison Site Management, Inc., a specialty finance company focusing on cell site easements, and Executive Director of Brand Asset Digital, a digital media marketing and distribution company. His current Board appointments include Unison Site Management, LLC, Brand Asset Digital, LLC and Aquatic Energy, LLC.

Table of Contents

Eugene S. Stark. Mr. Stark has served as Principal Financial Officer, Chief Compliance Officer and Vice President Administration of General American Investors Company, Inc. from May 2005 to present. Prior to his role with General American Investors Company, Inc., Mr. Stark served as the Chief Financial Officer of Prospect Capital Corporation from January 2005 to April 2005. From May 1987 to December 2004 Mr. Stark served as Senior Vice President (division level) and Vice President (corporate level) with Prudential Financial, Inc. in various financial management positions. Mr. Stark serves as a member of the Board of Directors of Prospect Capital Funding LLC, a wholly-owned subsidiary of the Company, and sits on the Board of Trustees and is a Member of the Finance Committee of Mount Saint Mary Academy.

Interested Directors

John F. Barry III. Mr. Barry is chairman and chief executive officer of the Company and is a control person of Prospect Capital Management and a managing director of Prospect Administration. Mr. Barry is chairman of Prospect s investment committee and has been an officer of Prospect since 1990. In addition to overseeing Prospect, Mr. Barry has served on the boards of directors of twelve private and public Prospect portfolio companies. Mr. Barry has served on the board of advisors of USEC Inc., a publicly-traded energy company. Mr. Barry has served as chairman and chief executive officer of Bondnet Trading Systems. From 1988 to 1989, Mr. Barry managed the investment bank of L.F. Rothschild & Company, focusing on private equity and debt financings for energy and other companies. From 1983 to 1988, Mr. Barry was a senior investment and merchant banker at Merrill Lynch & Co., where he was a founding member of the project finance group, executing more than $4 billion in energy and other financings. From 1979 to 1983, Mr. Barry was a corporate securities attorney at Davis Polk & Wardwell, where he advised energy companies and their commercial and investment bankers. From 1978 to 1979, Mr. Barry served as law clerk to Circuit Judge, formerly Chief Judge, J. Edward Lumbard of the U.S. Court of Appeals for the Second Circuit in New York City. Mr. Barry is chairman of the board of directors of the Mathematics Foundation of America, a non-profit foundation which enhances opportunities in mathematics education for students from diverse backgrounds. Mr. Barry received his JD cum laude from Harvard Law School, where he was an editor of the Harvard Law Review, and his Bachelor of Arts magna cum laude from Princeton University, where he was a University Scholar.

M. Grier Eliasek. Mr. Eliasek is president and chief operating officer of the Company and a managing director of Prospect Capital Management and Prospect Administration. At the Company, Mr. Eliasek is responsible for various administrative and investment management functions and leads and supervises other Prospect professionals in origination and assessment of investments. Mr. Eliasek has served as a senior investment professional at Prospect since 1999. Prior to joining Prospect, Mr. Eliasek assisted the chief financial officer of Amazon.com in 1999 in corporate strategy, customer acquisition, and new product launches. From 1995 to 1998, Mr. Eliasek served as a consultant with Bain & Company, a global strategy consulting firm, where he managed engagements for companies in several different industries. At Bain, Mr. Eliasek analyzed new lines of businesses, developed market strategies, revamped sales organizations and improved operational performance. Mr. Eliasek received his MBA from Harvard Business School. Mr. Eliasek received his Bachelor of Science in Chemical Engineering with Highest Distinction from the University of Virginia, where he was a Jefferson Scholar and a Rodman Scholar.

Executive Officer

Brian H. Oswald. Mr. Oswald is chief financial officer, chief compliance officer, secretary and treasurer of the Company. He began his career at KPMG Peat Marwick, where he held various positions over his ten-year tenure, finishing as a Senior Manager in the financial institutions group. During his time at KPMG, he served as the reviewing senior manager for several initial public offerings of financial institutions. After KPMG, Mr. Oswald served as the Executive Vice President and President of Gloversville Federal Savings and Loan Association, served as the Director of Financial Reporting and Subsidiary Accounting for River Bank America and served as the Corporate Controller for Magic Solutions, Inc. In each of these positions, Mr. Oswald instituted significant operational changes and was instrumental in raising additional equity for River Bank America. From 2003 to 2005, Mr. Oswald led Capital Trust, Inc., a self-managed finance and investment management REIT which specializes in credit-sensitive structured financial products, as Chief Financial Officer. From 1997 to 2003, he served as Chief Accounting Officer for Capital Trust. Prior to joining the Company, Mr. Oswald spent two years with the Structured

Finance Division of GSC Group, serving as Managing Director of Finance for this asset management company. At GSC, Mr. Oswald managed the finances for a REIT, two hedge funds and thirteen CDOs. Mr. Oswald joined the Administrator on June 16, 2008. Mr. Oswald holds a B.A. degree in Accounting from Moravian College. He is a licensed Certified Public Accountant in the States of New York and Pennsylvania, and is a Certified Management Accountant. Mr. Oswald also serves as a board member of RMJ Laboratories, Inc.

For information on the investment professionals of Prospect Capital Management, see Business The Investment Adviser Staffing.

Committees of the Board of Directors

Our Board of Directors has established an Audit Committee and a Nominating and Corporate Governance Committee. For the fiscal year ended June 30, 2009, our Board of Directors held twenty-two Board of Director meetings, eleven Audit Committee meetings, and five Nominating and Corporate Governance Committee meeting. All directors attended at least 75% of the aggregate number of meetings of the Board of Directors and of the respective committees on which they served. We require each director to make a diligent effort to attend all board and committee meetings, as well as each annual meeting of stockholders.

The Audit Committee. The Audit Committee operates pursuant to a charter approved by the Board of Directors. The charter sets forth the responsibilities of the Audit Committee, which include selecting or retaining each year an independent registered public accounting firm, or the independent accountants, to audit the accounts and records of the Company; reviewing and discussing with management and the independent accountants the annual audited financial statements of the Company, including disclosures made in management s discussion and analysis, and recommending to the Board of Directors whether the audited financial statements should be included in the Company s annual report on Form 10-K; reviewing and discussing with management and the independent accountants the Company s quarterly financial statements prior to the filings of its quarterly reports on Form 10-Q; pre-approving the independent accountants engagement to render audit and/or permissible non-audit services; and evaluating the qualifications, performance and independence of the independent accountants. The Audit Committee is presently composed of three persons: Messrs. Anderson, Cooper and Stark, each of whom is not an interested person as defined in the 1940 Act and is considered independent under the Marketplace Rules of the NASDAQ Stock Market LLC. The Company s Board of Directors has determined that Mr. Stark is an audit committee financial expert as that term is defined under Item 407 of Regulation S-K and Mr. Stark serves as the Chairman of the Audit Committee. The Audit Committee may delegate its pre-approval responsibilities to one or more of its members. The member(s) to whom such responsibility is delegated must report, for informational purposes only, any pre-approval decisions to the Audit Committee at its next scheduled meeting. Messrs. Stark, Anderson and Cooper were added to the Audit Committee concurrent with their election to the Board of Directors on September 4, 2008, September 15, 2008 and February 12, 2009, respectively.

The function of the Audit Committee is oversight. Our management is primarily responsible for maintaining appropriate systems for accounting and financial reporting principles and policies and internal controls and procedures that provide for compliance with accounting standards and applicable laws and regulations. The independent accountants are primarily responsible for planning and carrying out a proper audit of our annual financial statements in accordance with generally accepted accounting standards. The independent accountants are accountable to the Board of Directors and the Audit Committee, as representatives of our stockholders. The Board of Directors and the Audit Committee have the ultimate authority and responsibility to select, evaluate and, where appropriate, replace our independent accountants (subject, if applicable, to stockholder ratification).

In fulfilling their responsibilities, it is recognized that members of the Audit Committee are not our full-time employees or management and are not, and do not represent themselves to be, accountants or auditors by profession.

As such, it is not the duty or the responsibility of the Audit Committee or its members to conduct field work or other types of auditing or accounting reviews or procedures, to determine that the financial statements are complete and accurate and are in accordance with generally accepted accounting principles, or to set auditor independence standards. Each member of the Audit Committee is entitled to rely on (a) the integrity of those persons within and outside us and management from which it receives information; (b) the accuracy of the financial and other information provided to the Audit Committee absent actual knowledge to the contrary (which is required to be promptly reported to the Board of Directors); and (c) statements made by our officers and employees, our Investment Adviser or other third parties as to any information technology, internal audit and other non-audit services provided by the independent accountants to us.

The Nominating and Corporate Governance Committee. The Nominating and Corporate Governance Committee, or the Nominating and Governance Committee, is responsible for selecting qualified nominees to be elected to the Board of Directors by stockholders; selecting qualified nominees to fill any vacancies on the Board of Directors or a committee thereof; developing and recommending to the Board of Directors a set of corporate governance principles applicable to the Company; overseeing the evaluation of the Board of Directors and management; and undertaking such other duties and responsibilities as may from time to time be delegated by the Board of Directors to the Nominating and Governance Committee. The Nominating and Governance Committee is presently composed of three persons: Messrs. Anderson, Cooper and Stark, each of whom is not an interested person as defined in Section 2(a)(19) of the 1940 Act and Mr. Anderson serves as the Chairman of the Nominating and Governance Committee. Messrs. Stark, Anderson and Cooper were added to the Nominating and Governance Committee concurrent with their election to the Board of Directors on September 4, 2008, September 15, 2008 and February 12, 2009, respectively.

The Nominating and Governance Committee will consider stockholder recommendations for possible nominees for election as directors when such recommendations are submitted in accordance with the Company s bylaws and any applicable law, rule or regulation regarding director nominations. Nominations should be sent to the Corporate Secretary, c/o Prospect Capital Corporation, 10 East 40th Street, 44th Floor, New York, New York 10016. When submitting a nomination to the Company for consideration, a stockholder must provide all information that would be required under applicable SEC rules to be disclosed in connection with election of a director, including the following minimum information for each director nominee: full name, age and address; principal occupation during the past five years; current directorships on publicly held companies and investment companies; number of shares of our common stock owned, if any; and, a written consent of the individual to stand for election if nominated by the Board of Directors and to serve if elected by the stockholders. Criteria considered by the Nominating and Governance Committee in evaluating the qualifications of individuals for election as members of the Board of Directors include compliance with the independence and other applicable requirements of the Marketplace Rules of NASDAQ and the 1940 Act and all other applicable laws, rules, regulations and listing standards, the criteria, policies and principles set forth in the Nominating and Corporate Governance Committee Charter, and the ability to contribute to the effective management of the Company, taking into account our needs and such factors as the individual s experience, perspective, skills, expertise and knowledge of the industries in which the Company operates, personal and professional integrity, character, business judgment, time availability in light of other commitments, dedication and conflicts of interest. The Nominating and Governance Committee also may consider such other factors as it may deem to be in our best interests and those of our stockholders. The Board of Directors also believes it is appropriate for certain key members of our management to participate as members of the Board of Directors.

Corporate Governance

Corporate Governance Guidelines. Upon the recommendation of the Nominating and Governance Committee, the Board of Directors has adopted Corporate Governance Guidelines on behalf of the Company. These Corporate Governance Guidelines address, among other things, the following key corporate governance topics: director responsibilities; the size, composition, and membership criteria of the Board of Directors; composition and responsibilities of directors serving on committees of the Board of Directors; director access to officers, employees, and independent advisors; director orientation and continuing education; director compensation; and an annual performance evaluation of the Board of Directors.

Code of Conduct. We have adopted a code of conduct which applies to, among others, our senior officers, including our Chief Executive Officer and Chief Financial Officer, as well as all of our employees. Our code of conduct is an exhibit to our Annual Report on Form 10-K filed with the SEC, and can be accessed via the Internet site of the SEC at http://www.sec.gov. We intend to disclose amendments to or waivers from a required provision of the code of conduct on Form 8-K.

Table of Contents

Code of Ethics. We, Prospect Capital Management and Prospect Administration have each adopted a code of ethics pursuant to Rule 17j-1 under the 1940 Act that establishes procedures for personal investments and restricts certain personal securities transactions. Personnel subject to each code may invest in securities for their personal investment accounts, including securities that may be purchased or held by us, so long as such investments are made in accordance with the code s requirements.

Internal Reporting and Whistle Blower Protection Policy. The Company s Audit Committee has established guidelines and procedures regarding the receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters, collectively, Accounting Matters, and the confidential, anonymous submission by our employees of concerns regarding questionable accounting or auditing matters. Persons with complaints or concerns regarding Accounting Matters may submit their complaints to our Chief Compliance Officer, or CCO. Persons who are uncomfortable submitting complaints to the CCO, including complaints involving the CCO, may submit complaints directly to our Audit Committee Chairman. Complaints may be submitted on an anonymous basis.

The CCO may be contacted at: Prospect Capital Corporation, Chief Compliance Officer, 10 East 40th Street, 44th Floor, New York, New York 10016.

The Audit Committee Chairman may be contacted at: Prospect Capital Corporation, Audit Committee Chairman, 10 East 40th Street, 44th Floor, New York, New York 10016.

Independent Directors

The Board of Directors, in connection with the 1940 Act and the applicable Marketplace Rules of NASDAQ, has considered the independence of members of the Board of Directors who are not employed by Prospect Capital Management and has concluded that Messrs. Anderson, Cooper and Stark are not interested persons as defined by the 1940 Act and therefore qualify as independent directors under the standards promulgated by the Marketplace Rules of NASDAQ. In reaching this conclusion, the Board of Directors concluded that Messrs. Anderson, Cooper and Stark had no relationships with Prospect Capital Management or any of its affiliates, other than their positions as directors of the Company and, if applicable, investments in us that are on the same terms as those of other stockholders.

Proxy Voting Policies And Procedures

We have delegated our proxy voting responsibility to Prospect Capital Management. The guidelines are reviewed periodically by Prospect Capital Management and our non-interested directors, and, accordingly, are subject to change. See Regulation Proxy Voting Policies and Procedures.

Table of Contents

Compensation of Directors and Officers

The following table sets forth information regarding the compensation received by the directors and executive officers from the Company for the fiscal year ended June 30, 2009. No compensation is paid to the interested directors by the Company.

Name and Position	Aggregate Compensation from the Company	Pension or Retirement Benefits Accrued as Part of the Company s Expenses(1)	Total Compensation Paid to Director/ Officer
Interested Directors			
John F. Barry(2)	None	None	None
M. Grier Eliasek(2)	None	None	None
Independent Directors			
Graham D.S. Anderson(3)	$ 67,750	None	$ 67,750
Andrew C. Cooper(4)	$ 32,381	None	$ 32,381
Eugene S. Stark(5)	$ 70,500	None	$ 70,500
Executive Officers			
William E. Vastardis(6,7)		None	
Brian H. Oswald(2)	None	None	None

(1) We do not have a bonus, profit sharing or retirement plan, and directors do not receive any pension or retirement benefits.

(2) We have not paid, and we do not intend to pay, any annual cash compensation to our executive officers for their services as executive officers. Messrs. Barry and Eliasek are compensated by Prospect Capital Management from the income Prospect Capital Management receives under the management agreement between Prospect Capital Management and us. Mr. Oswald is compensated by Prospect Administration from the income Prospect Administration receives under the Administration Agreement.

(3) Mr. Anderson joined our Board of Directors on September 15, 2008.

(4) Mr. Cooper joined our Board of Directors on February 12, 2009.

(5) Mr. Stark joined our Board of Directors on September 4, 2008.

(6) Mr. Vastardis is no longer employed by the Company, but served as Chief Compliance Officer from January 4, 2005 through September 30, 2008, and served as Chief Financial Officer and Treasurer from April 30, 2005 through November 11, 2008. Mr. Vastardis served as Secretary from April 30, 2005 through June 6, 2008.

(7) The compensation of William E. Vastardis for his service as Chief Financial Officer and Treasurer of the Company was paid by Vastardis Fund Services LLC, formerly our sub-administrator. Vastardis Fund Services

was in turn paid by the Company at a monthly minimum rate of $33,333.33 or annual fees on gross assets of 0.20% on the first $250 million, 0.15% on the next $250 million, 0.10% on the next $250 million, 0.075% on the next $250 million and 0.05% over one billion. The compensation of William E. Vastardis for his service as Chief Compliance Officer of the Company was paid by Vastardis Compliance Services LLC. Vastardis Compliance Services LLC was in turn paid by the Company at a monthly rate of $6,250. In addition, the Company paid Vastardis Compliance Services LLC for certain other services at the rate of $270 per hour. Both Vastardis Fund Services LLC and Vastardis Compliance Services LLC determined the compensation to be paid to Mr. Vastardis with respect to the Company based on a case-by-case evaluation of the time and resources that is required to fulfill his duties to the Company. For the fiscal year ending June 30, 2009, the Company paid Vastardis Compliance Services LLC $25,000 for services rendered by Mr. Vastardis as Chief Compliance Officer. For the fiscal year ending June 30, 2009, the Company paid Vastardis Fund Services LLC approximately $827,083 for services required to be provided by Prospect Administration, including, but not limited to, (a) clerical, bookkeeping and record keeping services, (b) conducting relations with custodians, depositories, transfer agents and other third-party service providers and (c) furnishing reports to Prospect Administration and the Board of Directors of the Company of its performance of obligations. In addition, the fees paid to Vastardis Fund Service LLC cover the services rendered by Mr. Vastardis as our Chief Financial Officer and Treasurer.

Table of Contents

Effective July 1, 2008, the independent directors received an annual fee of $90,000 plus reimbursement of any reasonable out-of-pocket expenses incurred. The chairman of the Audit Committee received an additional annual cash retainer of $7,500 and the chairman of the Nominating and Corporate Governance Committee received an additional annual cash retainer of $5,000. Effective September 15, 2008, the independent directors who do not serve on any committees of the board receive an annual fee of $11,250.

Effective October 1, 2008, the independent directors who serve on a committee of the Board receive an annual fee of $85,000 plus reimbursement of any reasonable out-of-pocket expenses incurred and committee chairmen no longer receive any additional compensation.

Effective January 12, 2009, the independent directors who serve on both committees of the Board receive an annual fee of $85,000 plus reimbursement of any reasonable out-of-pocket expenses incurred, the independent directors who serve on one committee of the Board receive an annual fee of $60,000 plus reimbursement of any reasonable out-of-pocket expenses incurred and the independent directors who do not serve on any committees of the board receive an annual fee of $11,250. No compensation was paid to directors who are interested persons of the Company as defined in 1940 Act. In addition, the Company purchases directors and officers liability insurance on behalf of the directors and officers. Through September 30, 2009, each of the three independent directors has been paid $21,250 for the fiscal year ending June 30, 2010.

Management Services

Investment Advisory Agreement

We have entered into the Investment Advisory Agreement with Prospect Capital Management under which the Investment Adviser, subject to the overall supervision of our Board of Directors, manages the day-to-day operations of, and provides investment advisory services to, us. Under the terms of the Investment Advisory Agreement, our Investment Adviser: (i) determines the composition of our portfolio, the nature and timing of the changes to our portfolio and the manner of implementing such changes, (ii) identifies, evaluates and negotiates the structure of the investments we make (including performing due diligence on our prospective portfolio companies); and (iii) closes and monitors investments we make.

Prospect Capital Management s services under the Investment Advisory Agreement are not exclusive, and it is free to furnish similar services to other entities so long as its services to us are not impaired. For providing these services the Investment Adviser receives a fee from us, consisting of two components: a base management fee and an incentive fee. The base management fee is calculated at an annual rate of 2% on our gross assets (including amounts borrowed). For services rendered under the Investment Advisory Agreement, the base management fee is payable quarterly in arrears. The base management fee is calculated based on the average value of our gross assets at the end of the two most recently completed calendar quarters and appropriately adjusted for any share issuances or repurchases during the current calendar quarter. Base management fees for any partial month or quarter are appropriately prorated.

The incentive fee has two parts. The first part, the income incentive fee, is calculated and payable quarterly in arrears based on our pre-incentive fee net investment income for the immediately preceding calendar quarter. For this purpose, pre-incentive fee net investment income means interest income, dividend income and any other income (including any other fees (other than fees for providing managerial assistance), such as commitment, origination, structuring, diligence and consulting fees and other fees that we receive from portfolio companies) accrued during the calendar quarter, minus our operating expenses for the quarter (including the base management fee, expenses payable under the Administration Agreement described below, and any interest expense and dividends paid on any issued and outstanding preferred stock, but excluding the incentive fee). Pre-incentive fee net investment income includes, in the case of investments with a deferred interest feature (such as original issue discount, debt instruments with payment in kind interest and zero coupon securities), accrued income that we have not yet received in cash. Pre-incentive fee net investment income does not include any realized capital gains, realized capital losses or unrealized capital appreciation or depreciation. Pre-incentive fee net investment income, expressed as a rate of return on the value of our net assets at the end of the immediately preceding calendar quarter, is compared to a hurdle rate of 1.75% per quarter (7% annualized).

The net investment income used to calculate this part of the incentive fee is also included in the amount of the gross assets used to calculate the 2% base management fee. We pay the Investment Adviser an income incentive fee with respect to our pre-incentive fee net investment income in each calendar quarter as follows:

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

100.00% 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 125.00% of the quarterly hurdle rate in any calendar quarter (8.75% annualized assuming a 7.00% annualized hurdle rate); and

20.00% of the amount of our pre-incentive fee net investment income, if any, that exceeds 125.00% of the quarterly hurdle rate in any calendar quarter (8.75% annualized assuming a 7.00% annualized hurdle rate).

These calculations are appropriately prorated for any period of less than three months and adjusted for any share issuances or repurchases during the current quarter.

The second part of the incentive fee, the capital gains incentive fee, is determined and payable in arrears as of the end of each calendar year (or upon termination of the Investment Advisory Agreement, as of the termination date), and equals 20% of our realized capital gains for the calendar year, if any, computed net of all realized capital losses and unrealized capital depreciation at the end of such year. In determining the capital gains incentive fee payable to the Investment Adviser, we calculate the aggregate realized capital gains, aggregate realized capital losses and aggregate unrealized capital depreciation, as applicable, with respect to each investment that has been in our portfolio. For the purpose of this calculation, an investment is defined as the total of all rights and claims which may be asserted against a portfolio company arising out of our participation in the debt, equity, and other financial instruments issued by that company. Aggregate realized capital gains, if any, equals the sum of the differences between the aggregate net sales price of each investment and the aggregate cost basis of such investment when sold or otherwise disposed. Aggregate realized capital losses equal the sum of the amounts by which the aggregate net sales price of each investment is less than the aggregate cost basis of such investment when sold or otherwise disposed. Aggregate unrealized capital depreciation equals the sum of the differences, if negative, between the aggregate valuation of each investment and the aggregate cost basis of such investment as of the applicable calendar year-end. At the end of the applicable calendar year, the amount of capital gains that serves as the basis for our calculation of the capital gains incentive fee involves netting aggregate realized capital gains against aggregate realized capital losses on a since-inception basis and then reducing this amount by the aggregate unrealized capital depreciation. If this number is positive, then the capital gains incentive fee payable is equal to 20% of such amount, less the aggregate amount of any capital gains incentive fees paid since inception.

The total base management fees earned by and paid to Prospect Capital Management during the twelve months ended June 30, 2009, June 30, 2008 and June 30, 2007 were $11.9 million, $8.9 million and $5.4 million, respectively. The total base management fees earned by and paid to Prospect Capital Management for the three months ended September 30, 2009 and September 30, 2008 were $3.2 million and $2.8 million, respectively.

The income incentive fees were $14.8 million, $11.3 million and $5.8 million for the twelve months ended June 30, 2009, June 30, 2008 and June 30, 2007, respectively. No capital gains incentive fees were earned for the twelve months ended June 30, 2009, June 30, 2008 and June 30, 2007. The total income incentive fees for the three months ended September 30, 2009 and September 30, 2008 were $3.1 million and $5.9 million, respectively.

The total investment advisory fees were $26.7 million, $20.2 million and $11.2 million for the twelve months ended June 30, 2009, June 30, 2008 and June 30, 2007, respectively. The total investment advisory fees for the three months ended September 30, 2009 and September 30, 2008 were $6.3 million and $8.7 million, respectively.

Because of the structure of the incentive fee, it is possible that we may have to pay an incentive fee in a quarter where we incur a loss. For example, if we receive pre-incentive fee net investment income in excess of the hurdle rate for a quarter, we will pay the applicable income incentive fee even if we have incurred negative total return in that quarter due to realized or unrealized losses on our investments.

Examples of Quarterly Incentive Fee Calculation

Example 1: Income Incentive Fee(*):

Alternative 1

Assumptions

Investment income (including interest, dividends, fees, etc.) = 1.25%

Hurdle rate(1) = 1.75%

Base management fee(2) = 0.50%

Other expenses (legal, accounting, custodian, transfer agent, etc.)(3) = 0.20%

(*) The hypothetical amount of pre-incentive fee net investment income shown is based on a percentage of total net assets.

(1) Represents 7% annualized hurdle rate

(2) Represents 2% annualized base management fee.

(3) Excludes organizational and offering expenses.

Pre-incentive fee net investment income (investment income   (base management fee + other expenses)) = 0.55%

Pre-incentive net investment income does not exceed hurdle rate, therefore there is no income incentive fee.

Alternative 2

Assumptions

Investment income (including interest, dividends, fees, etc.) = 2.70%

Hurdle rate(1) = 1.75%

Base management fee(2) = 0.50%

Other expenses (legal, accounting, custodian, transfer agent, etc.)(3) = 0.20%

Pre-incentive fee net investment income (investment income   (base management fee + other expenses)) = 2%

Pre-incentive net investment income exceeds hurdle rate, therefore there is an income incentive fee payable by us to our Investment Adviser.

Income incentive Fee

= 100% × Catch Up + the greater of 0% AND (20% × (pre-incentive fee net investment income − 2.1875%)
= (100% × (2% − 1.75%)) + 0%
= 100% × 0.25% + 0%
= 0.25%

Alternative 3

Assumptions

Investment income (including interest, dividends, fees, etc.) = 3%

Hurdle rate(1) = 1.75%

Base management fee(2) = 0.50%

Other expenses (legal, accounting, custodian, transfer agent, etc.)(3) = 0.20%

Pre-incentive fee net investment income (investment income (base management fee + other expenses)) = 2.30%

Table of Contents

Pre-incentive net investment income exceeds hurdle rate, therefore there is an income incentive fee payable by us to our Investment Adviser.

Income incentive Fee = 100% × Catch Up + the greater of 0% AND (20% × (pre-incentive fee net investment income − 2.1875%)
= (100% × (2.1875% − 1.75%)) + the greater of 0% AND (20% × (2.30% − 2.1875%))
= (100% × 0.4375%) + (20% × 0.1125%)
= 0.4375% + 0.0225%
= 0.46%

Example 2: Capital Gains Incentive Fee:

Alternative 1

Assumptions

Year 1: $20 million investment made

Year 2: Fair market value, or FMV of investment determined to be $22 million

(1) Represents 7% annualized hurdle rate.

(2) Re presents 2% annualized base management fee.

(3) Excludes organizational and offering expenses.

Year 3: FMV of investment determined to be $17 million

Year 4: Investment sold for $21 million

The impact, if any, on the capital gains portion of the incentive fee would be:

Year 1: No impact

Year 2: No impact

Year 3: Decrease base amount on which the second part of the incentive fee is calculated by $3 million (unrealized capital depreciation)

Year 4: Increase base amount on which the second part of the incentive fee is calculated by $4 million ($1 million of realized capital gain and $3 million reversal in unrealized capital depreciation)

Alternative 2

Assumptions

Year 1: $20 million investment made

Year 2: FMV of investment determined to be $17 million

Year 3: FMV of investment determined to be $17 million

Year 4: FMV of investment determined to be $21 million

Year 5: FMV of investment determined to be $18 million

Year 6: Investment sold for $15 million

The impact, if any, on the capital gains portion of the incentive fee would be:

Year 1: No impact

Year 2: Decrease base amount on which the second part of the incentive fee is calculated by $3 million (unrealized capital depreciation)

Year 3: No impact

Year 4: Increase base amount on which the second part of the incentive fee is calculated by $3 million (reversal in unrealized capital depreciation)

Year 5: Decrease base amount on which the second part of the incentive fee is calculated by $2 million (unrealized capital depreciation)

Year 6: Decrease base amount on which the second part of the incentive fee is calculated by $3 million ($5 million of realized capital loss offset by a $2 million reversal in unrealized capital depreciation)

Alternative 3

Assumptions

Year 1: $20 million investment made in company A, or Investment A, and $20 million investment made in company B, or Investment B

Year 2: FMV of Investment A is determined to be $21 million, and Investment B is sold for $18 million

Year 3: Investment A is sold for $23 million

The impact, if any, on the capital gains portion of the incentive fee would be:

Year 1: No impact

Year 2: Decrease base amount on which the second part of the incentive fee is calculated by $2 million (realized capital loss on Investment B)

Year 3: Increase base amount on which the second part of the incentive fee is calculated by $3 million (realized capital gain on Investment A)

Alternative 4

Assumptions

Year 1: $20 million investment made in company A, or Investment A, and $20 million investment made in company B, or Investment B

Year 2: FMV of Investment A is determined to be $21 million, and FMV of Investment B is determined to be $17 million

Year 3: FMV of Investment A is determined to be $18 million, and FMV of Investment B is determined to be $18 million

Year 4: FMV of Investment A is determined to be $19 million, and FMV of Investment B is determined to be $21 million

Year 5: Investment A is sold for $17 million, and Investment B is sold for $23 million

The impact, if any, on the capital gains portion of the incentive fee would be:

Year 1: No impact

Year 2: Decrease base amount on which the second part of the incentive fee is calculated by $3 million (unrealized capital depreciation on Investment B)

Year 3: Decrease base amount on which the second part of the incentive fee is calculated by $1 million ($2 million in unrealized capital depreciation on Investment A and $1 million recovery in unrealized capital depreciation on Investment B)

Year 4: Increase base amount on which the second part of the incentive fee is calculated by $3 million ($1 million recovery in unrealized capital depreciation on Investment A and $2 million recovery in unrealized capital depreciation on Investment B)

Year 5: Increase base amount on which the second part of the incentive fee is calculated by $1 million ($3 million realized capital gain on Investment B offset by $3 million realized capital loss on Investment A plus a $1 million reversal in unrealized capital depreciation on Investment A from Year 4)

Payment of our expenses

All investment professionals of the Investment Adviser and its staff, when and to the extent engaged in providing investment advisory and management services, and the compensation and routine overhead expenses of such personnel allocable to such services, will be provided and paid for by the Investment Adviser. We bear all other costs and expenses of our operations and transactions, including those relating to: organization and offering; calculation of our net asset value (including the cost and expenses of any independent valuation firm); expenses incurred by Prospect Capital Management payable to third parties, including agents, consultants or other advisers (such as independent valuation firms, accountants and legal counsel), in monitoring our financial and legal affairs and in monitoring our investments and performing due diligence on our prospective portfolio companies; interest payable on debt, if any, and dividends payable on preferred stock, if any, incurred to finance our investments; offerings of our debt, our preferred shares, our common stock and other securities; investment advisory fees; fees payable to third parties, including agents, consultants or other advisors, relating to, or associated with, evaluating and making investments; transfer agent and custodial fees; registration fees; listing fees; taxes; independent directors fees and expenses; costs of preparing and filing reports or other documents with the SEC; the costs of any reports, proxy statements or other notices to stockholders, including printing costs; our allocable portion of the fidelity bond, directors and officers/errors and omissions liability insurance, and any other insurance premiums; direct costs and expenses of administration, including auditor and legal costs; and all other expenses incurred by us, by our Investment Adviser or by Prospect Administration in connection with administering our business, such as our allocable portion of overhead under the Administration Agreement, including rent and our allocable portion of the costs of our chief compliance officer and chief financial officer and his staff, including the internal legal staff.

Duration and termination

The Investment Advisory Agreement was originally approved by our Board of Directors on June 23, 2004 and was recently re-approved by the Board of Directors on June 17, 2009 for an additional one-year term expiring June 24, 2010. Unless terminated earlier as described below, it will remain in effect from year to year thereafter if approved annually by our Board of Directors or by the affirmative vote of the holders of a majority of our outstanding voting securities, including, in either case, approval by a majority of our directors who are not interested persons. The Investment Advisory Agreement will automatically terminate in the event of its assignment. The Investment Advisory Agreement may be terminated by either party without penalty upon not more than 60 days written notice to the other. See Risk factors Risks Relating to Our Business We are dependent upon Prospect Capital Management s key management personnel for our future success.

Administration Agreement

We have also entered into an Administration Agreement with Prospect Administration under which Prospect Administration, among other things, provides (or arranges for the provision of) administrative services and facilities for us. For providing these services, we reimburse Prospect Administration for our allocable portion of overhead incurred by Prospect Administration in performing its obligations under the Administration Agreement, including rent and our allocable portion of the costs of our chief compliance officer and chief financial officer and his staff, including the internal legal staff. Under this agreement, Prospect Administration furnishes us with office facilities, equipment and clerical, bookkeeping and record keeping services at such facilities. Prospect Administration also performs, or oversees the performance of, our required administrative services, which include, among other things, being responsible for the financial records that we are required to maintain and preparing reports to our stockholders and reports filed with the Securities and Exchange Commission, or the SEC. In addition, Prospect Administration assists us in determining and publishing our net asset value, overseeing the preparation and filing of our tax returns and the printing and dissemination of reports to our stockholders, and generally oversees the payment of our expenses and the performance of administrative and professional services rendered to us by others. Under the Administration Agreement, Prospect Administration also provides on our behalf managerial assistance to those portfolio companies to which we are required to provide such assistance. The Administration Agreement may be terminated by either party without penalty upon 60 days written notice to the other party. Prospect Administration is a wholly owned subsidiary of our Investment Adviser.

Prospect Administration previously engaged Vastardis Fund Services LLC (Vastardis) to serve as our sub-administrator to perform certain services required of Prospect Administration. On April 30, 2009 we gave a 60-day notice to Vastardis of termination of our agreement for Vastardis to provide sub-administration services effective June 30, 2009. We entered into a new consulting services agreement for the period from July 1, 2009 until the filing of our Form 10-K for the year ended June 30, 2009. We paid Vastardis a total of $30,000 for services rendered in conjunction with preparation of Form 10-K under the new agreement. All administration services were assumed by Prospect Administration effective September 14, 2009.

We reimbursed Prospect Administration $2.9 million, $2.1 million and $0.5 million for the twelve months ended June 30, 2009, June 30, 2008 and June 30, 2007, respectively, for services it provided to the Company at cost.

Indemnification

The Investment Advisory Agreement provides that, absent willful misfeasance, bad faith or gross negligence in the performance of its duties or by reason of the reckless disregard of its duties and obligations, Prospect Capital Management and its officers, managers, agents, employees, controlling persons, members and any other person or entity affiliated with it are entitled to indemnification from us for any damages, liabilities, costs and expenses (including reasonable attorneys fees and amounts reasonably paid in settlement) arising from the rendering of Prospect Capital Management s services under the Investment Advisory Agreement or otherwise as our investment adviser.

The Administration Agreement provides that, absent willful misfeasance, bad faith or negligence in the performance of its duties or by reason of the reckless disregard of its duties and obligations, Prospect Administration and its officers, managers, partners, agents, employees, controlling persons, members and any other person or entity affiliated with it are entitled to indemnification from us for any damages, liabilities, costs and expenses (including reasonable attorneys fees and amounts reasonably paid in settlement) arising from the rendering of Prospect Administration s services under the Administration Agreement or otherwise as our administrator.

Under the sub-administration agreement (which, as described above, was terminated as of June 30, 2009), Vastardis and its officers, partners, agents, employees, controlling persons, members, and any other person or entity affiliated with Vastardis, are not liable to the Administrator or to us for any action taken or omitted to be taken by Vastardis in connection with the performance of any of its duties or obligations or otherwise as sub-administrator for the Administrator on our behalf. The agreement also provides that, absent willful misfeasance, bad faith or negligence in the performance of Vastardis duties or by reason of the reckless disregard of Vastardis duties and obligations, Vastardis and its officers, partners, agents, employees, controlling persons, members, and any other person or entity affiliated with Vastardis are entitled to indemnification from the Administrator and us. All damages, liabilities, costs and expenses (including reasonable attorneys fees and amounts reasonably paid in settlement) incurred in or by reason of any pending, threatened or completed action, suit, investigation or other proceeding (including an action or suit by or in the right of the Administrator or us or our security holders) arising out of or otherwise based upon the performance of any of Vastardis duties or obligations under the agreement or otherwise as sub-administrator for the Administrator on our behalf.

Board of Directors approval of the Investment Advisory Agreement

On June 17, 2009, our Board of Directors voted unanimously to renew the Investment Advisory Agreement for the 12-month period ending June 24, 2010. In its consideration of the Investment Advisory Agreement, the Board of Directors focused on information it had received relating to, among other things: (a) the nature, quality and extent of the advisory and other services to be provided to us by Prospect Capital Management; (b) comparative data with respect to advisory fees or expense ratios paid by other business development companies with similar investment objectives; (c) our projected operating expenses; (d) the projected profitability of Prospect Capital Management and any existing and potential sources of indirect income to Prospect Capital Management or Prospect Administration from their relationships with us and the profitability of those relationships; (e) information about the services to be performed and the personnel performing such services under the Investment Advisory Agreement; (f) the organizational capability and financial condition of Prospect Capital Management and its affiliates and (g) the possibility of obtaining similar services from other third party service providers or through an internally managed

Table of Contents

structure. In approving the renewal of the Investment Advisory Agreement, the Board of Directors, including all of the directors who are not interested persons, considered the following:

Nature, Quality and Extent of Services. The Board of Directors considered the nature, extent and quality of the investment selection process employed by Prospect Capital Management. The Board of Directors also considered Prospect Capital Management s personnel and their prior experience in connection with the types of investments made by us. The Board of Directors concluded that the services to be provided under the Investment Advisory Agreement are generally the same as those of comparable business development companies described in the available market data.

Investment Performance. The Board of Directors reviewed our investment performance as well as comparative data with respect to the investment performance of other externally managed business development companies. The Board of Directors concluded that Prospect Capital Management was delivering results consistent with our investment objective and that our investment performance was satisfactory when compared to comparable business development companies.

The reasonableness of the fees paid to Prospect Capital Management. The Board of Directors considered comparative data based on publicly available information on other business development companies with respect to services rendered and the advisory fees (including the management fees and incentive fees) of other business development companies as well as our projected operating expenses and expense ratio compared to other business development companies. The Board of Directors, on behalf of the Company, also considered the profitability of Prospect Capital Management. Based upon its review, the Board of Directors concluded that the fees to be paid under the Investment Advisory Agreement are reasonable compared to other business development companies.

Economies of Scale. The Board of Directors considered information about the potential of Prospect Capital Management to realize economies of scale in managing our assets, and determined that at this time there were not economies of scale to be realized by Prospect Capital Management.

Based on the information reviewed and the discussions detailed above, the Board of Directors (including all of the directors who are not interested persons) concluded that the investment advisory fee rates and terms are fair and reasonable in relation to the services provided and approved the renewal of the Investment Advisory Agreement with Prospect Capital Management as being in the best interests of the Company and its stockholders.

Portfolio Managers

The following individuals function as portfolio managers primarily responsible for the day-to-day management of our portfolio. Our portfolio managers are not responsible for day-to-day management of any other accounts. For a description of their principal occupations for the past five years, see above.

Name	Position	Length of Service with Company (Years)
John F. Barry	Chairman and Chief Executive Officer	5
M. Grier Eliasek	President and Chief Operating Officer	5

Mr. Eliasek receives no compensation from the Company. Mr. Eliasek receives a salary and bonus from Prospect Capital Management that takes into account his role as a senior officer of the Company and of Prospect Capital

Management, his performance and the performance of each of Prospect Capital Management and the Company. Mr. Barry receives no compensation from the Company. Mr. Barry, as the sole member of Prospect Capital Management, receives a salary and/or bonus from Prospect Capital Management and is entitled to equity distributions after all other obligations of Prospect Capital Management are met.

The following table sets forth the dollar range of our common stock beneficially owned by each of the portfolio managers described above as of June 30, 2009.

Name	Aggregate Dollar Range of Common Stock Beneficially Owned by Prospect Capital Management
John F. Barry	Over $100,000
M. Grier Eliasek	Over $100,000

Managerial Assistance

As a business development company, we offer, and must provide upon request, managerial assistance to certain of our portfolio companies. This assistance could involve, among other things, monitoring the operations of our portfolio companies, participating in board and management meetings, consulting with and advising officers of portfolio companies and providing other organizational and financial guidance. We billed $846,000, $1,027,000, and $505,000 of managerial assistance fees for the years ended June 30, 2009, June 30, 2008, and June 30, 2007, respectively, of which $60,000 and $380,000 remains on the consolidated statement of assets and liabilities as of June 30, 2009, and June 30, 2008, respectively. These fees are paid to the Administrator so we simultaneously accrue a payable to the Administrator for the same amounts, which remain on the consolidated statements of assets and liabilities.

License Agreement

We entered into a license agreement with Prospect Capital Management, pursuant to which Prospect Capital Management agreed to grant us a nonexclusive, royalty free license to use the name Prospect Capital. Under this agreement, we have a right to use the Prospect Capital name, for so long as Prospect Capital Management or one of its affiliates remains our investment adviser. Other than with respect to this limited license, we have no legal right to the Prospect Capital name. This license agreement will remain in effect for so long as the Investment Advisory Agreement with our Investment Adviser is in effect.

CERTAIN RELATIONSHIPS AND TRANSACTIONS

We have entered into the Investment Advisory Agreement with Prospect Capital Management. Our Chairman of the Board of Directors is the sole member of and controls Prospect Capital Management. Our senior management may in the future also serve as principals of other investment managers affiliated with Prospect Capital Management that may in the future manage investment funds with investment objectives similar to ours. In addition, our executive officers and directors and the principals of Prospect Capital Management may serve as officers, directors or principals of entities that operate in the same or related lines of business as we do or of investment funds managed by affiliates. Accordingly, we may not be given the opportunity to participate in certain investments made by investment funds managed by advisers affiliated with Prospect Capital Management. However, our Investment Adviser and other members of the affiliated present and predecessor companies of Prospect Capital Management intend to allocate investment opportunities in a fair and equitable manner consistent with our investment objectives and strategies so that we are not disadvantaged in relation to any other client. See Risk Factors Risks Relating To Our Business Potential conflicts of interest could impact our investment returns.

In addition, pursuant to the terms of the Administration Agreement, Prospect Administration provides, or arranges to provide, the Company with the office facilities and administrative services necessary to conduct our day-to-day operations. Prospect Capital Management is the sole member of and controls Prospect Administration.

We have no intention of investing in any portfolio company in which Prospect Capital Management or any affiliate currently has an investment.

Table of Contents

CONTROL PERSONS AND PRINCIPAL STOCKHOLDERS

As of January 7, 2010, there were no persons that owned 25% or more of our outstanding voting securities, and we believe no person should be deemed to control us, as such term is defined in the 1940 Act.

The following table sets forth, as of January 7, 2010, certain ownership information with respect to our common stock for those persons who directly or indirectly own, control or hold with the power to vote, 5% or more of our outstanding common stock and all officers and directors, as a group. Unless otherwise indicated, we believe that the beneficial owners set forth in the tables below have sole voting and investment power.

Name and Address	Type of Ownership	Shares Owned	Percentage of Common Stock Outstanding(1)
Prospect Capital Management LLC(2)	Record and beneficial	936,912	1.48%
All officers and directors as a group (6 persons)(3)	Record and beneficial	1,789,185	2.82%

(1) Does not reflect shares of common stock reserved for issuance upon any exercise of any underwriters overallotment option.

(2) John F. Barry is a control person of Prospect Capital Management.

(3) Represents shares of common stock held by Prospect Capital Management. Because John F. Barry controls Prospect Capital Management, he may be deemed to be the beneficial owner of shares of our common stock held by Prospect Capital Management. The address for all officers and directors is c/o Prospect Capital Corporation, 10 East 40th Street, 44th Floor, New York, NY 10016.

The following table sets forth the dollar range of our equity securities beneficially owned by each of our directors and officers as of December 31, 2009. We are not part of a family of investment companies as that term is defined in the 1940 Act.

Name of Director or Officer	Dollar Range of Equity Securities in the Company(1)
Independent Directors	
Graham D.S. Anderson	$50,001 $100,000
Andrew C. Cooper	None
Eugene S. Stark	$50,001 $100,000
Interested Directors	
John F. Barry III(2)	Over $100,000
M. Grier Eliasek	Over $100,000
Officer	

Brian H. Oswald	$50,001 $100,000

(1) Dollar ranges are as follows: none, $1-$10,000, $10,001-$50,000, $50,001-$100,000 or over $100,000.

(2) Represents an indirect beneficial ownership in shares of our common stock, that are beneficially owned directly by Prospect Capital Management, by reason of Mr. Barry s position as a control person of Prospect Capital Management.

Table of Contents

PORTFOLIO COMPANIES

The following is a listing of our portfolio companies at September 30, 2009. Values are as of September 30, 2009.

The portfolio companies are presented in three categories: companies more than 25% owned are portfolio companies in which Prospect directly or indirectly owns more than 25% of the outstanding voting securities of such portfolio company and, therefore, such portfolio company is presumed to be controlled by us under the 1940 Act; companies owned 5% to 25% are portfolio companies where Prospect directly or indirectly owns 5% to 25% of the outstanding voting securities of such portfolio company and/or holds one or more seats on the portfolio company s Board of Directors and, therefore, such portfolio company is deemed to be an affiliated person with us under the 1940 Act; companies less than 5% owned are portfolio companies where Prospect directly or indirectly owns less than 5% of the outstanding voting securities of such portfolio company and where it has no other affiliations with such portfolio company. As of September 30, 2009, Prospect owned 100% of the fully diluted common equity of GSHI, 100% of the common equity of CCEHI, 49% of the fully diluted common equity of Integrated, 79.83% of the fully diluted common equity of Iron Horse, 80% of the fully diluted common equity of NRG, 74.51% of the fully diluted equity of R-V, 78.11% of the fully diluted common equity of Ajax and 100% of the fully diluted common equity of Yatesville. Prospect makes available significant managerial assistance to its portfolio companies. Prospect generally requests and may receive rights to observe the meetings of its portfolio companies Boards of Directors.

ne of Portfolio pany	Nature of its Principal Business (Location)	Title and Class of Securities Held	Collateral Held	Investment Structure	Equity Securities Held, at Fair Value (In millions)	Loa a Fa Va (I milli
panies more than owned						
Rolled Ring and hine	Manufacturing (South Carolina)	Senior secured debt, subordinated secured debt, preferred stock and common equity	First priority lien on substantially all assets	Common shares; Preferred shares; Senior secured note Tranche A, 10.50% due 4/01/2013; Subordinated secured note Tranche B, 11.50% plus 6.00% PIK due 4/01/2013	0.0	2
Cladding LLC	Metal services (Texas)	Warrants	N/A loan repaid	Warrants, common shares, expiring 3/30/2014	0.0	
nge Clean Energy ings, Inc	Biomass power (Maine)	Common equity	First priority lien on substantially all assets	Common shares	2.5	
					55.2	3

Solutions Holdings,	Gas gathering and processing (Texas)	Senior and junior secured debt and common equity	First priority lien on substantially all assets	Common shares; Senior secured note, 18.00% due 12/22/2018; Junior secured note, 18.00% due 12/23/2018		
grated Contract ices, Inc.	Contracting (North Carolina)	Senior and junior secured debt, preferred stock and common equity	First priority lien on substantially all assets	Common shares; Preferred shares; Senior and junior secured notes, 7.00% plus 7.00% PIK plus 6.00% default interest, in non-accrual status effective 10/09/2007 past due; Senior demand note, 15.00% due 12/31/2009	0.0	
Horse Coiled ng, Inc.	Production services (Alberta, Canada)	Senior secured debt, bridge loan and common equity	First priority lien on substantially all assets	Common shares; Senior secured note, 15.00% due 12/31/2009; Bridge loan, 15.00% plus 3.00% PIK due 12/31/2009	0.0	1
G Manufacturing,	Manufacturing (Texas)	Senior secured debt and common equity	First priority lien on substantially all assets	Common shares; Senior secured note, 16.50% due 8/31/2011	19.0	1
Industries, Inc.	Manufacturing (Pennsylvania)	Warrants and common equity	N/A loan repaid	Common shares; Warrants, common shares, expiring 6/30/2017	15.7	
sville Coal Holdings,	Mining and coal production (Kentucky)	Senior and junior secured debt and common equity	First priority lien on substantially all assets	Common shares; Senior secured note, 15.75% due 12/31/2010, in non-accrual status effective 1/01/2009; Junior secured note, 15.75% due 12/31/2010, in non-accrual status effective 1/01/2009	0.0	1
npanies 5% to 25% ed						
alachian Energy ings LLC	Construction services (West Virginia)	Senior secured debt, warrants and preferred units	First priority lien on substantially all assets	Preferred units; Warrants, common shares, expiring 2/13/2016, 6/17/2018, 11/30/2018; Senior secured note Tranche A, 14.00% plus 3.00%	0.0	

				PIK plus 3.00% default interest non-accrual status effective 11/01/2008 due 1/31/2011; Senior secured note Tranche B, 14.00% plus 3.00% PIK 3.00% default interest non-accrual status effective 11/01/2008, past due		
ronic NeuroNetwork	Healthcare (Michigan)	Senior secured debt and preferred stock	First priority lien on substantially all assets	Preferred shares; Senior secured note, 11.50%, 1.00% PIK due 2/21/2013	3.7	2

74

Table of Contents

ame of Portfolio ompany	Nature of its Principal Business (Location)	Title and Class of Securities Held	Collateral Held	Investment Structure	Equity Securities Held, at Fair Value (In millions)	Loans at Fair Value (In million
ompanies less han 5% owned						
merican Gilsonite ompany	Specialty minerals (Utah)	Senior subordinated secured debt and membership interests	Second priority lien on substantially all assets	Membership interests; Senior subordinated secured note, 12.00% plus 3.00% PIK due 3/14/2013	3.1	15.1
astro Cheese ompany, Inc.	Food products (Texas)	Junior secured debt	Second priority lien on substantially all assets	Junior secured note, 11.00% plus 2.00% PIK due 2/28/2013	0.0	7.6
onquest Cherokee LC	Oil and gas production (Tennessee)	Senior secured debt, net profit interest and overriding royalty interest	First priority lien on substantially all assets	Overriding royalty interest, 5.00%; net profits interest, 10.00% Senior secured note, 13.00% , in non-accrual status effective 4/01/2009 plus 4.00% default interest, past due	0.3	5.0
eb Shops, Inc.	Retail (Pennsylvania)	Second lien debt	Second priority lien on substantially all assets	Second lien note, 1.00% plus 13.00% PIK due 10/23/2014	0.0	4.2
iamondback perating LP	Oil and gas production (Oklahoma)	Net profit interest	N/A-Loan repaid.	Net profit interest, 15.00%	0.4	0.0
reedom Marine ervices LLC	Shipping vessels (Louisiana)	Subordinated secured debt and net profit interest	Second priority lien on substantially all assets	Net profit interest, 22.50%; Subordinated secured note, 12.00% plus 4.00% PIK due 12/31/2011	0.0	6.5
&M Oil & Gas LC	Oil and gas production (Texas)	Senior secured debt and net profit interest	First priority lien on substantially all assets	Net profit interest, 8.00%; Senior secured note, 13.00% due 6/30/2010	1.5	49.3
EC Systems P/Advanced Rig ervices LLC. ARS)	Oilfield fabrication (Texas)	Senior secured debt	First priority lien on substantially all assets	Senior secured notes 12.00% plus 3.00% PIK due 11/20/2012	0.0	34.0

laverick ealthcare LLC	Healthcare (Arizona)	Second lien debt, preferred units and common units	Second priority lien on substantially all assets	Common units; Preferred units; Second lien debt, 12.50% plus 3.50% PIK due 4/30/2014	1.5	12.9
liller Petroleum, ıc.	Oil and gas production (Tennessee)	Warrants	N/A loan repaid	Warrants, expiring 5/04/2010 through 9/30/2014	0.3	0.0
ualitest harmaceuticals, ıc.	Pharmaceuticals (Alabama)	Second lien debt	Second priority lien on substantially all assets	Second lien debt, 8.10% due 4/30/2015	0.0	11.7
egional lanagement Corp.	Financial services (South Carolina)	Second lien debt	Second priority lien on substantially all assets	Second lien debt, 12.00% plus 2.00% PIK due 6/29/2012	0.0	23.4
esco Products, ıc.	Manufacturing (Pennsylvania)	Second lien debt	Second priority lien on substantially all assets	Second lien debt, 8.37% due 6/22/2014	0.0	9.8
hearer s Foods, ıc.	Food products (Ohio)	Second lien debt and membership interests	Common equity; Second priority lien on substantially all assets	Membership interests; Second lien debt, 14.00% due 10/31/2013	3.8	18.4
tryker Energy LC	Oil and gas production (Ohio)	Subordinated secured revolving credit facility and overriding royalty interest	Second priority lien on substantially all assets	Overriding royalty interest, 3.50%; Subordinated secured revolving credit facility, 12.00% due 12/01/2011	2.8	28.5
riZetto Group	Healthcare (California)	Subordinated unsecured debt	Unsecured	Subordinated unsecured note, 12.00% plus 1.50% PIK due 10/01/2016	0.0	16.4
nitek	Technical services (Pennsylvania)	Second lien debt	Second priority lien on substantially all assets	Second lien debt, 13.08% due 12/31/2013	0.0	11.7
Vind River esources Corp. nd Wind River II orp.	Oil and gas production (Utah)	Senior secured debt and net profit interest	First priority lien on substantially all assets	Net profit interest, 5.00%; Senior secured note, 13.00% plus 3.00% default interest, in non-accrual status effective 12/01/2008 due 7/31/2010	0.1	12.7

Table of Contents

DETERMINATION OF NET ASSET VALUE

The net asset value per share of our outstanding shares of common stock will be determined quarterly by dividing the value of total assets minus liabilities by the total number of shares outstanding.

In calculating the value of our total assets, we will value investments for which market quotations are readily available at such market quotations. Short-term investments which mature in 60 days or less, such as U.S. Treasury bills, are valued at amortized cost, which approximates market value. The amortized cost method involves recording a security at its cost (i.e., principal amount plus any premium and less any discount) on the date of purchase and thereafter amortizing/accreting that difference between the principal amount due at maturity and cost assuming a constant yield to maturity as determined at the time of purchase. Short-term securities which mature in more than 60 days are valued at current market quotations by an independent pricing service or at the mean between the bid and ask prices obtained from at least two brokers or dealers (if available, or otherwise by a principal market maker or a primary market dealer). Investments in money market mutual funds are valued at their net asset value as of the close of business on the day of valuation.

Most of the investments in our portfolio do not have market quotations which are readily available, meaning the investments do not have actively traded markets. Debt and equity securities for which market quotations are not readily available are valued with the assistance of an independent valuation service using a documented valuation policy and a valuation process that is consistently applied under the direction of our Board of Directors. For a discussion of the risks inherent in determining the value of securities for which readily available market values do not exist, see Risk Factors Risks Relating to Our Business Most of our portfolio investments are recorded at fair value as determined in good faith by our Board of Directors and, as a result, there is uncertainty as to the value of our portfolio investments.

The factors that may be taken into account in valuing such investments include, as relevant, the portfolio company s ability to make payments, its estimated earnings and projected discounted cash flows, the nature and realizable value of any collateral, the financial environment in which the portfolio company operates, comparisons to securities of similar publicly traded companies, changes in interest rates for similar debt instruments and other relevant factors. Due to the inherent uncertainty of determining the fair value of investments that do not have readily available market quotations, the fair value of these investments may differ significantly from the values that would have been used had such market quotations existed for such investments, and any such differences could be material.

As part of the fair valuation process, the independent valuation firm engaged by the Board of Directors performs a review of each debt and equity investment and provides a range of values for each investment, which, along with management s valuation recommendations, is reviewed by the Audit Committee. Management and the independent valuation firm may adjust their preliminary evaluations to reflect comments provided by the Audit Committee. The Audit Committee reviews the final valuation report and management s valuation recommendations and makes a recommendation to the Board of Directors based on its analysis of the methodologies employed and the various weights that should be accorded to each portion of the valuation as well as factors that the independent valuation firm and management may not have included in their evaluation processes. The Board of Directors then evaluates the Audit Committee recommendations and undertakes a similar analysis to determine the fair value of each investment in the portfolio in good faith.

Determination of fair values involves subjective judgments and estimates not susceptible to substantiation by auditing procedures. Accordingly, under current accounting standards, the notes to our financial statements will refer to the uncertainty with respect to the possible effect of such valuations, and any change in such valuations, on our financial statements.

SALES OF COMMON STOCK BELOW NET ASSET VALUE

At our 2008 annual meeting of stockholders held on February 12, 2009 and our 2009 annual meeting of stockholders held on December 11, 2009, our stockholders approved our ability to sell an unlimited number of shares of our common stock at any level of discount from net asset value (NAV) per share during the twelve-month period following such approval. In order to sell shares pursuant to this authorization a majority of our directors who have no financial interest in the sale and a majority of our independent directors must (a) find that the sale is in our best interests and in the best interests of our stockholders, and (b) in consultation with any underwriter or underwriters of the offering, make a good faith determination as of a time either immediately prior to the first solicitation by us or on our behalf of firm commitments to purchase such shares, or immediately prior to the issuance of such shares, that the price at which such shares are to be sold is not less than a price which closely approximates the market value of such shares, less any distributing commission or discount. We are permitted to sell shares of common stock below NAV per share in rights offerings although we will not do so under this prospectus. Any offering of common stock below NAV per share will be designed to raise capital for investment in accordance with our investment objective.

In making a determination that an offering below NAV per share is in our and our stockholders best interests, our Board of Directors would consider a variety of factors, including:

The effect that an offering below NAV per share would have on our stockholders, including the potential dilution they would experience as a result of the offering;

The amount per share by which the offering price per share and the net proceeds per share are less than the most recently determined NAV per share;

The relationship of recent market prices of par common stock to NAV per share and the potential impact of the offering on the market price per share of our common stock;

Whether the estimated offering price would closely approximate the market value of our shares;

The potential market impact of being able to raise capital during the current financial market difficulties;

The nature of any new investors anticipated to acquire shares in the offering;

The anticipated rate of return on and quality, type and availability of investments; and

The leverage available to us.

Our Board of Directors would also consider the fact that sales of common stock at a discount will benefit our Advisor as the Advisor will earn additional investment management fees on the proceeds of such offerings, as it would from the offering of any other securities of the Company or from the offering of common stock at premium to NAV per share.

We will not sell shares under a prospectus supplement to the registration statement or current post-effective amendment thereto of which this prospectus forms a part (the current registration statement) if the cumulative dilution to our NAV per share from offerings under the current registration statement exceeds 15%. This limit would be measured separately for each offering pursuant to the current amendment by calculating the percentage dilution or accretion to aggregate NAV from that offering and then summing the percentage from each offering. For example, if our most recently determined NAV at the time of the first offering is $10.82 and we have 64 million shares outstanding, sale of 16 million shares at net proceeds to us of $5.41 per share (a 50% discount) would produce dilution of 10.00%. If we subsequently determined that our NAV per share increased to $11.00 on the then 70 million shares outstanding and then made an additional offering, we could, for example, sell approximately an additional 8.888 million shares at net proceeds to us of $5.50 per share, which would produce dilution of 5.00%, before we would reach the aggregate 15% limit. If we file a new post-effective amendment, the threshold would reset.

Sales by us of our common stock at a discount from NAV pose potential risks for our existing stockholders whether or not they participate in the offering, as well as for new investors who participate in the offering.

The following three headings and accompanying tables will explain and provide hypothetical examples on the impact of an offering at a price less than NAV per share on three different set of investors:

- existing shareholders who do not purchase any shares in the offering;
- existing shareholders who purchase a relatively small amount of shares in the offering or a relatively large amount of shares in the offering; and
- new investors who become shareholders by purchasing shares in the offering.

Table of Contents

Impact On Existing Stockholders Who Do Not Participate in the Offering

Our existing stockholders who do not participate in an offering below NAV per share or who do not buy additional shares in the secondary market at the same or lower price we obtain in the offering (after expenses and commissions) face the greatest potential risks. These stockholders will experience an immediate decrease (often called dilution) in the NAV of the shares they hold and their NAV per share. These stockholders will also experience a disproportionately greater decrease in their participation in our earnings and assets and their voting power than the increase we will experience in our assets, potential earning power and voting interests due to the offering. These shareholders may also experience a decline in the market price of their shares, which often reflects to some degree announced or potential increases and decreases in NAV per share. This decrease could be more pronounced as the size of the offering and level of discounts increases.

The following chart illustrates the level of NAV dilution that would be experienced by a nonparticipating stockholder in three different hypothetical offerings of different sizes and levels of discount from NAV per share. It is not possible to predict the level of market price decline that may occur.

The examples assume that the issuer has 64,000,000 common shares outstanding, $767,480,000 in total assets and $75,0000,000 in total liabilities. The current NAV and NAV per share are thus $692,480,000 and $10.82. The chart illustrates the dilutive effect on Stockholder A of (1) an offering of 3,200,000 shares (5% of the outstanding shares) at $10.28 per share after offering expenses and commission (a 5% discount from NAV), (2) an offering of 6,400,000 shares (10% of the outstanding shares) at $9.74 per share after offering expenses and commissions (a 10% discount from NAV) and (3) an offering of 12,800,000 shares (20% of the outstanding shares) at $8.66 per share after offering expenses and commissions (a 20% discount from NAV). The prospectus supplement pursuant to which any discounted offering is made will include a chart based on the actual number of shares in such offering and the actual discount to the most recently determined NAV, as applicable.

		Example 1 5% Offering at 5% Discount		**Example 2 10% Offering at 10% Discount**		**Example 3 20% Offering at 20% Discount**	
	Prior to Sale Below NAV	**Following Sale**	**% Change**	**Following Sale**	**% Change**	**Following Sale**	**% Change**
fering Price							
ce per Share to Public		$ 10.82		$ 10.25		$ 9.11	
t Proceeds per Share to uer		$ 10.28		$ 9.74		$ 8.66	
crease to NAV							
tal Shares Outstanding	64,000,000	67,200,000	5.00%	70,400,000	10.00%	76,800,000	20.00%
V per Share	$ 10.82	$ 10.79	(0.24)%	$ 10.72	(0.91)%	$ 10.46	(3.33)
lution to nparticipating ockholder							
ares Held by ockholder A	64,000	64,000	0.00%	64,000	0.00%	64,000	0.00%
rcentage Held by ockholder A	0.10%	0.10%	(4.76)%	0.09%	(9.09)%	0.08%	(16.67)
	$ 692,480	$ 690,831	(0.24)%	$ 686,185	(0.91)%	$ 669,397	(3.33)

tal NAV Held by ockholder A											
tal Investment by ockholder A (Assumed be $10.82 per Share)	$	692,480	$	692,480		$	692,480		$	692,480	
tal Dilution to ockholder A (Total AV Less Total vestment)			$	(1,649)		$	(6,295)		$	(23,083)	
AV per Share Held by ockholder A			$	10.79		$	10.72		$	10.46	
vestment per Share ld by Stockholder A ssumed to be $10.82 r Share on Shares Held or to Sale)	$	10.82	$	10.82		$	10.82		$	10.82	
lution per Share Held Stockholder A (NAV r Share Less Investment r Share)			$	(0.03)		$	(0.10)		$	(0.36)	
rcentage Dilution to ockholder A (Dilution r Share Divided by vestment per Share)					(0.24)%			(0.91)%			(3.33)

78

Impact On Existing Stockholders Who Do Participate in the Offering

Our existing stockholders who participate in an offering below NAV per share or who buy additional shares in the secondary market at the same or lower price as we obtain in the offering (after expenses and commissions) will experience the same types of NAV dilution as the nonparticipating stockholders, albeit at a lower level, to the extent they purchase less than the same percentage of the discounted offering as their interest in our shares immediately prior to the offering. The level of NAV dilution will decrease as the number of shares such stockholders purchase increases. Existing stockholders who buy more than such percentage will experience NAV dilution but will, in contrast to existing stockholders who purchase less than their proportionate share of the offering, experience an increase (often called accretion) in NAV per share over their investment per share and will also experience a disproportionately greater increase in their participation in our earnings and assets and their voting power than our increase in assets, potential earning power and voting interests due to the offering. The level of accretion will increase as the excess number of shares such stockholder purchases increases. Even a stockholder who overparticipates will, however, be subject to the risk that we may make additional discounted offerings in which such stockholder does not participate, in which case such a stockholder will experience NAV dilution as described above in such subsequent offerings. These shareholders may also experience a decline in the market price of their shares, which often reflects to some degree announced or potential increases and decreases in NAV per share. This decrease could be more pronounced as the size of the offering and level of discounts increases.

The following chart illustrates the level of dilution and accretion in the hypothetical 20% discount offering from the prior chart (Example 3) for a stockholder that acquires shares equal to (1) 50% of its proportionate share of the offering (i.e., 6,400 shares, which is 0.05% of an offering of 12,800,000 shares) rather than its 0.10% proportionate share and (2) 150% of such percentage (i.e. 19,200 shares, which is 0.15% of an offering of 12,800,000 shares rather than its 0.10% proportionate share). The prospectus supplement pursuant to which any discounted offering is made will include a chart for these examples based on the actual number of shares in such offering and the actual discount from the most recently determined NAV per share, as applicable. It is not possible to predict the level of market price decline that may occur.

		50% Participation		150% Participation	
	Prior to Sale Below NAV	**Following Sale**	**% Change**	**Following Sale**	**% Change**
Offering Price					
Price per Share to Public		$ 9.11		$ 9.11	
Net Proceeds per Share to Issuer		$ 8.66		$ 8.66	
Decrease/Increase to NAV					
Total Shares Outstanding	64,000,000	76,800,000	20.00%	76,800,000	20.00%
NAV per Share	$ 10.82	$ 10.46	(3.33)%	$ 10.46	(3.33)%
Dilution/Accretion to Participating Stockholder					
Shares Held by Stockholder A	64,000	70,400	10.00%	83,200	30.00%
Percentage Held by Stockholder A	0.10%	0.09%	(8.33)%	0.11%	8.33%
Total NAV Held by Stockholder A	$ 692,480	$ 736,337	6.33%	$ 870,216	25.67%
Total Investment by Stockholder A (Assumed to be $10.82 per		$ 750,794		$ 867,422	

Share on Shares held Prior to Sale)										
Total Dilution/Accretion to Stockholder A (Total NAV Less Total Investment)			$	(14,457)			$	2,794		
NAV per Share Held by Stockholder A			$	10.46			$	10.46		
Investment per Share Held by Stockholder A (Assumed to Be $10.82 on Shares Held Prior to Sale)	$	10.82	$	10.67	(1.44)%		$	10.43	(3.64)%	
Dilution/Accretion per Share Held by Stockholder A (NAV per Share Less Investment per Share)			$	(0.21)			$	0.03		
Percentage Dilution/Accretion to Stockholder A (Dilution/Accretion per Share Divided by Investment per Share)					(1.93)%				0.32%	

Table of Contents

Impact On New Investors

Investors who are not currently stockholders and who participate in an offering below NAV but whose investment per share is greater than the resulting NAV per share due to selling compensation and expenses paid by the issuer will experience an immediate decrease, albeit small, in the NAV of their shares and their NAV per share compared to the price they pay for their shares. Investors who are not currently stockholders and who participate in an offering below NAV per share and whose investment per share is also less than the resulting NAV per share due to selling compensation and expenses paid by the issuer being significantly less than the discount per share will experience an immediate increase in the NAV of their shares and their NAV per share compared to the price they pay for their shares. These investors will experience a disproportionately greater participation in our earnings and assets and their voting power than our increase in assets, potential earning power and voting interests. These investors will, however, be subject to the risk that we may make additional discounted offerings in which such new stockholder does not participate, in which case such new stockholder will experience dilution as described above in such subsequent offerings. These investors may also experience a decline in the market price of their shares, which often reflects to some degree announced or potential increases and decreases in NAV per share. This decrease could be more pronounced as the size of the offering and level of discounts increases.

The following chart illustrates the level of dilution or accretion for new investors that would be experienced by a new investor in the same hypothetical 5%, 10% and 20% discounted offerings as described in the first chart above. The illustration is for a new investor who purchases the same percentage (0.10%) of the shares in the offering as Stockholder A in the prior examples held immediately prior to the offering. The prospectus supplement pursuant to which any discounted offering is made will include a chart for these examples based on the actual number of shares in such offering and the actual discount from the most recently determined NAV per share, as applicable. It is not possible to predict the level of market price decline that may occur.

		Example 1 5% Offering at 5% Discount		**Example 2 10% Offering at 10% Discount**		**Example 3 20% Offering at 20% Discount**	
	Prior to Sale Below NAV	**Following Sale**	**% Change**	**Following Sale**	**% Change**	**Following Sale**	**% Change**
ffering Price							
ice per Share to Public		$ 10.82		$ 10.25		$ 9.11	
et Proceeds per Share to suer		$ 10.28		$ 9.74		$ 8.66	
ecrease/Increase to AV							
otal Shares Outstanding	64,000,000	67,200,000	5.00%	70,400,000	10.00%	76,800,000	20.00%
AV per Share	$ 10.82	$ 10.79	(0.24)%	$ 10.72	(0.91)%	$ 10.46	(3.33)
ilution/Accretion to ew Investor A							
ares Held by Investor	0	3,200		6,400		12,800	
rcentage Held by vestor A	0.00%	0.00%		0.01%		0.02%	
tal NAV Held by vestor A	$ 0	$ 34,542		$ 68,618		$ 133,879	
		$ 34,624		$ 65,603		$ 116,528	

otal Investment by vestor A (At Price to blic)						
otal Dilution/Accretion Investor A (Total NAV ss Total Investment)		$ (82)		$ 3,015		$ 17,251
AV per Share Held by vestor A		$ 10.79		$ 10.72		$ 10.46
vestment per Share eld by Investor A	$ 0	$ 10.82		$ 10.25		$ 9.11
ilution/Accretion per are Held by Investor A AV per Share Less vestment per Share)		$ (0.03)		$ 0.47		$ 1.35
rcentage ilution/Accretion to vestor A ilution/Accretion per are Divided by vestment per Share)			(0.24)%		4.60%	14.79%

80

DIVIDEND REINVESTMENT PLAN

We have adopted a dividend reinvestment plan that provides for reinvestment of our distributions on behalf of our stockholders, unless a stockholder elects to receive cash as provided below. As a result, when our Board of Directors authorizes, and we declare, a cash dividend, then our stockholders who have not opted out of our dividend reinvestment plan will have their cash dividends automatically reinvested in additional shares of our common stock, rather than receiving the cash dividends.

No action is required on the part of a registered stockholder to have their cash dividend reinvested in shares of our common stock. A registered stockholder may elect to receive an entire dividend in cash by notifying the plan administrator and our transfer agent and registrar, in writing so that such notice is received by the plan administrator no later than the record date for dividends to stockholders. The plan administrator sets up an account for shares acquired through the plan for each stockholder who has not elected to receive dividends in cash and hold such shares in non-certificated form. Upon request by a stockholder participating in the plan, the plan administrator will, instead of crediting shares to the participant s account, issue a certificate registered in the participant s name for the number of whole shares of our common stock and a check for any fractional share. Such request by a stockholder must be received three days prior to the dividend payable date in order for that dividend to be paid in cash. If such request is received less than three days prior to the dividend payable date, then the dividends are reinvested and shares are repurchased for the stockholder s account; however, future dividends are paid out in cash on all balances. Those stockholders whose shares are held by a broker or other financial intermediary may receive dividends in cash by notifying their broker or other financial intermediary of their election.

We primarily use newly issued shares to implement the plan, whether our shares are trading at a premium or at a discount to net asset value. However, we reserve the right to purchase shares in the open market in connection with our implementation of the plan. The number of shares to be issued to a stockholder is determined by dividing the total dollar amount of the dividend payable to such stockholder by the market price per share of our common stock at the close of regular trading on The NASDAQ Global Select Market on the valuation date for such dividend. If we use newly-issued shares to implement the plan, the valuation date will not be earlier than the last day that stockholders have the right to elect to receive cash in lieu of shares. Market price per share on that date will be the closing price for such shares on The NASDAQ Global Select Market or, if no sale is reported for such day, at the average of their reported bid and asked prices. The number of shares of our common stock to be outstanding after giving effect to payment of the dividend cannot be established until the value per share at which additional shares will be issued has been determined and elections of our stockholders have been tabulated. Stockholders who do not elect to receive dividends in shares of common stock may experience accretion to the net asset value of their shares if our shares are trading at a premium at the time we issue new shares under the plan and dilution if our shares are trading at a discount. The level of accretion or discount would depend on various factors, including the proportion of our stockholders who participate in the plan, the level of premium or discount at which our shares are trading and the amount of the dividend payable to a stockholder.

There are no brokerage charges or other charges to stockholders who participate in the plan. The plan administrator s fees under the plan are paid by us. If a participant elects by written notice to the plan administrator to have the plan administrator sell part or all of the shares held by the plan administrator in the participant s account and remit the proceeds to the participant, the plan administrator is authorized to deduct a $15 transaction fee plus a $0.10 per share brokerage commissions from the proceeds.

Stockholders who receive dividends in the form of stock are subject to the same U.S. Federal, state and local tax consequences as are stockholders who elect to receive their dividends in cash. A stockholder s basis for determining gain or loss upon the sale of stock received in a dividend from us will be equal to the total dollar amount of the dividend payable to the stockholder. Any stock received in a dividend will have a new holding period for tax purposes commencing on the day following the day on which the shares are credited to the U.S. stockholder s account.

Participants may terminate their accounts under the plan by notifying the plan administrator via its website at www.amstock.com or by filling out the transaction request form located at the bottom of their statement and sending it to the plan administrator at American Stock Transfer & Trust Company, P.O. Box 922, Wall Street Station, New York, NY 10269-0560 or by calling the plan administrator s Interactive Voice Response System at (888) 888-0313.

The plan may be terminated by us upon notice in writing mailed to each participant at least 30 days prior to any payable date for the payment of any dividend by us. All correspondence concerning the plan should be directed to the plan administrator by mail at American Stock Transfer & Trust Company, 59 Maiden Lane, New York, NY 10007 or by telephone at (718) 921-8200.

Stockholders who purchased their shares through or hold their shares in the name of a broker or financial institution should consult with a representative of their broker or financial institution with respect to their participation in our dividend reinvestment plan. Such holders of our stock may not be identified as our registered stockholders with the plan administrator and may not automatically have their cash dividend reinvested in shares of our common stock by the administrator.

MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS

The following discussion is a general summary of the material U.S. Federal income tax considerations applicable to us and to an investment in our shares. This summary does not purport to be a complete description of the income tax considerations applicable to us or our investors on such an investment. For example, we have not described tax consequences that we assume to be generally known by investors or certain considerations that may be relevant to certain types of holders subject to special treatment under U.S. Federal income tax laws, including stockholders subject to the alternative minimum tax, tax-exempt organizations, insurance companies, dealers in securities, pension plans and trusts, financial institutions, U.S. stockholders (as defined below) whose functional currency is not the U.S. dollar, persons who mark-to-market our shares and persons who hold our shares as part of a straddle, hedge or conversion transaction. This summary assumes that investors hold our common stock as capital assets (within the meaning of the Code). The discussion is based upon the Code, Treasury regulations, and administrative and judicial interpretations, each as of the date of this prospectus and all of which are subject to change, possibly retroactively, which could affect the continuing validity of this discussion. We have not sought and will not seek any ruling from the Internal Revenue Service, or the IRS, regarding this offering. This summary does not discuss any aspects of U.S. estate or gift tax or foreign, state or local tax. It does not discuss the special treatment under U.S. Federal income tax laws that could result if we invested in tax-exempt securities or certain other investment assets.

A U.S. stockholder is a beneficial owner of shares of our common stock that is for U.S. Federal income tax purposes:

- a citizen or individual resident of the United States;
- a corporation, or other entity treated as a corporation for U.S. Federal income tax purposes, created or organized in or under the laws of the United States or any state thereof or the District of Columbia;
- an estate, the income of which is subject to U.S. Federal income taxation regardless of its source; or
- a trust if (1) a U.S. court is able to exercise primary supervision over the administration of such trust and one or more U.S. persons have the authority to control all substantial decisions of the trust or (2) it has a valid election in place to be treated as a U.S. person.

A Non-U.S. stockholder is a beneficial owner of shares of our common stock that is not a partnership and is not a U.S. stockholder.

If a partnership (including an entity treated as a partnership for U.S. Federal income tax purposes) holds shares of our common stock, the tax treatment of a partner in the partnership will generally depend upon the status of the partner and the activities of the partnership. A prospective stockholder that is a partner of a partnership holding shares of our common stock should consult its tax advisors with respect to the purchase, ownership and disposition of shares of our common stock.

Tax matters are very complicated and the tax consequences to an investor of an investment in our shares will depend on the facts of his, her or its particular situation. We encourage investors to consult their own tax advisors

Table of Contents

regarding the specific consequences of such an investment, including tax reporting requirements, the applicability of U.S. Federal, state, local and foreign tax laws, eligibility for the benefits of any applicable tax treaty and the effect of any possible changes in the tax laws.

Election To Be Taxed As A RIC

As a business development company, we have qualified and elected to be treated as a RIC under Subchapter M of the Code. As a RIC, we generally are not subject to corporate-level U.S. Federal income taxes on any ordinary income or capital gains that we distribute to our stockholders as dividends. To qualify as a RIC, we must, among other things, meet certain source-of-income and asset diversification requirements (as described below). In addition, to obtain RIC tax treatment, we must distribute to our stockholders, for each taxable year, at least 90% of our investment company taxable income, which is generally our ordinary income plus the excess of realized net short-term capital gains over realized net long-term capital losses, or the Annual Distribution Requirement.

Taxation As A RIC

Provided that we qualify as a RIC and satisfy the Annual Distribution Requirement, we will not be subject to U.S. Federal income tax on the portion of our investment company taxable income and net capital gain (which we define as net long-term capital gains in excess of net short-term capital losses) we timely distribute to stockholders. We will be subject to U.S. Federal income tax at the regular corporate rates on any income or capital gain not distributed (or deemed distributed) to our stockholders.

We will be subject to a 4% non-deductible U.S. Federal excise tax on certain undistributed income of RICs unless we distribute in a timely manner an amount at least equal to the sum of (1) 98% of our ordinary income for each calendar year, (2) 98% of our capital gain net income for the one-year period ending October 31 in that calendar year and (3) any income realized, but not distributed, in preceding years.

In December 2008, our Board of Directors elected to retain excess profits generated in the quarter ended September 30, 2008 and pay a 4% excise tax on such retained earnings. We paid $533,000 for the excise tax with the filing of our tax return in March 2009.

In order to qualify as a RIC for U.S. Federal income tax purposes, we must, among other things:

- qualify to be treated as a business development company or be registered as a management investment company under the 1940 Act at all times during each taxable year;

- derive in each taxable year at least 90% of our gross income from dividends, interest, payments with respect to certain securities loans, gains from the sale or other disposition of stock or other securities or currencies or other income derived with respect to our business of investing in such stock, securities or currencies and net income derived from an interest in a qualified publicly traded partnership (as defined in the Code) or the 90% Income Test; and

- diversify our holdings so that at the end of each quarter of the taxable year:

  - at least 50% of the value of our assets consists of cash, cash equivalents, U.S. Government securities, securities of other RICs, and other securities if such other securities of any one issuer do not represent more than 5% of the value of our assets or more than 10% of the outstanding voting securities of the issuer (which for these purposes includes the equity securities of a qualified publicly traded partnership); and no more than 25% of the value of our assets is invested in the securities, other than U.S. Government securities or securities of other RICs, (i) of one issuer (ii) of two or more issuers that are controlled, as determined under applicable tax rules, by us and that are engaged in the same or similar or related trades or businesses or (iii) of one or more qualified publicly traded partnerships, or the diversification tests.

To the extent that we invest in entities treated as partnerships for U.S. Federal income tax purposes (other than a qualified publicly traded partnership), we generally must include the items of gross income derived by the partnerships for purposes of the 90% Income Test, and the income that is derived from a partnership (other than a qualified publicly traded partnership) will be treated as qualifying income for purposes of the 90% Income Test only to the extent that such income is attributable to items of income of the partnership which would be qualifying income if realized by us directly. In addition, we generally must take into account our proportionate share of the assets held by partnerships (other than a qualified publicly traded partnership) in which we are a partner for purposes of the diversification tests.

In order to meet the 90% Income Test, we may establish one or more special purpose corporations to hold assets from which we do not anticipate earning dividend, interest or other qualifying income under the 90% Income Test. Any such special purpose corporation would generally be subject to U.S. Federal income tax, and could result in a reduced after-tax yield on the portion of our assets held there.

We may be required to recognize taxable income in circumstances in which we do not receive cash. For example, if we hold debt obligations that are treated under applicable tax rules as having original issue discount (such as debt instruments with payment-in-kind interest or, in certain cases, increasing interest rates or issued with warrants), we must include in income each year a portion of the original issue discount that accrues over the life of the obligation, regardless of whether cash representing such income is received by us in the same taxable year. Because any original issue discount accrued will be included in our investment company taxable income for the year of accrual, we may be required to make a distribution to our stockholders in order to satisfy the Annual Distribution Requirement, even though we will not have received any corresponding cash amount.

Gain or loss realized by us from warrants acquired by us as well as any loss attributable to the lapse of such warrants generally will be treated as capital gain or loss. Such gain or loss generally will be long-term or short-term, depending on how long we held a particular warrant.

Although we do not presently expect to do so, we are authorized to borrow funds and to sell assets in order to satisfy distribution requirements. However, under the 1940 Act, we are not permitted to make distributions to our stockholders while our debt obligations and other senior securities are outstanding unless certain asset coverage tests are met. See Regulation Senior Securities. Moreover, our ability to dispose of assets to meet our distribution requirements may be limited by (1) the illiquid nature of our portfolio and/or (2) other requirements relating to our status as a RIC, including the diversification tests. If we dispose of assets in order to meet the Annual Distribution Requirement or to avoid the excise tax, we may make such dispositions at times that, from an investment standpoint, are not advantageous.

If we fail to satisfy the Annual Distribution Requirement or otherwise fail to qualify as a RIC in any taxable year, we will be subject to tax in that year on all of our taxable income, regardless of whether we make any distributions to our stockholders. In that case, all of such income will be subject to corporate-level U.S. Federal income tax, reducing the amount available to be distributed to our stockholders. See Failure To Obtain RIC Tax Treatment.

As a regulated investment company, we are not allowed to carry forward or carry back a net operating loss for purposes of computing our investment company taxable income in other taxable years. Certain of our investment practices may be subject to special and complex U.S. Federal income tax provisions that may, among other things, (i) disallow, suspend or otherwise limit the allowance of certain losses or deductions, (ii) convert lower taxed long-term capital gain and qualified dividend income into higher taxed short-term capital gain or ordinary income, (iii) convert an ordinary loss or a deduction into a capital loss (the deductibility of which is more limited), (iv) cause us to recognize income or gain without a corresponding receipt of cash, (v) adversely affect the time as to when a purchase or sale of stock or securities is deemed to occur, (vi) adversely alter the characterization of certain complex financial transactions, and (vii) produce income that will not be qualifying income for purposes of the 90% Income Test. We will monitor our transactions and may make certain tax elections in order to mitigate the effect of these provisions.

As described above, to the extent that we invest in equity securities of entities that are treated as partnerships for U.S. Federal income tax purposes, the effect of such investments for purposes of the 90% Income Test and the diversification tests will depend on whether or not the partnership is a qualified publicly traded partnership (as defined in the Code). If the partnership is a qualified publicly traded partnership, the net income derived from such investments will be qualifying income for purposes of the 90% Income Test and will be securities for purposes of the diversification tests. If the partnership, however, is not treated as a qualified publicly traded partnership, then the consequences of an investment in the partnership will depend upon the amount and type of income and assets of the partnership allocable to us. The income derived from such investments may not be qualifying income for purposes of the 90% Income Test and, therefore, could adversely affect our qualification as a RIC. We intend to monitor our investments in equity securities of entities that are treated as partnerships for U.S. Federal income tax purposes to prevent our disqualification as a RIC.

We may invest in preferred securities or other securities the U.S. Federal income tax treatment of which may not be clear or may be subject to recharacterization by the IRS. To the extent the tax treatment of such securities or the income from such securities differs from the expected tax treatment, it could affect the timing or character of income recognized, requiring us to purchase or sell securities, or otherwise change our portfolio, in order to comply with the tax rules applicable to RICs under the Code.

Taxation Of U.S. Stockholders

Distributions by us generally are taxable to U.S. stockholders as ordinary income or capital gains. Distributions of our investment company taxable income (which is, generally, our ordinary income plus realized net short-term capital gains in excess of realized net long-term capital losses) will be taxable as ordinary income to U.S. stockholders to the extent of our current or accumulated earnings and profits, whether paid in cash or reinvested in additional common stock. For taxable years beginning on or before December 31, 2010, to the extent such distributions paid by us to noncorporate stockholders (including individuals) are attributable to dividends from U.S. corporations and certain qualified foreign corporations, such distributions generally will be eligible for taxation at rates applicable to long term capital gains (currently a maximum tax rate of 15%) *provided* that we properly designate such distribution as derived from qualified dividend income and certain holding period and other requirements are satisfied. In this regard, it is not anticipated that a significant portion of distributions paid by us will be attributable to qualified dividends and, therefore, generally will not qualify for the long term capital gains. Distributions of our net capital gains (which is generally our realized net long-term capital gains in excess of realized net short-term capital losses) properly designated by us as capital gain dividends will be taxable to a U.S. stockholder as long-term capital gains (currently at a maximum rate of 15% in the case of individuals, trusts or estates), regardless of the U.S. stockholder s holding period for his, her or its common stock and regardless of whether paid in cash or reinvested in additional common stock. Distributions in excess of our current and accumulated earnings and profits first will reduce a U.S. stockholder s adjusted tax basis in such stockholder s common stock and, after the adjusted basis is reduced to zero, will constitute capital gains to such U.S. stockholder.

Although we currently intend to distribute any long-term capital gains at least annually, we may in the future decide to retain some or all of our long-term capital gains, but designate the retained amount as a deemed distribution. In that case, among other consequences, we will pay tax on the retained amount, each U.S. stockholder will be required to include his, her or its proportionate share of the deemed distribution in income as if it had been actually distributed to the U.S. stockholder, and the U.S. stockholder will be entitled to claim a credit equal to his, her or its allocable share of the tax paid thereon by us. The amount of the deemed distribution net of such tax will be added to the U.S. stockholder s tax basis for his, her or its common stock. Since we expect to pay tax on any retained capital gains at our regular corporate tax rate, and since that rate is in excess of the maximum rate currently payable by individuals on long-term capital gains, the amount of tax that individual stockholders will be treated as having paid and for which they will receive a credit will exceed the tax they owe on the retained net capital gain. Such excess generally may be claimed as a credit against the U.S. stockholder s other U.S. Federal income tax obligations or may be refunded to the extent it exceeds a stockholder s liability for U.S. Federal income tax. A stockholder that is not subject to U.S. Federal income tax or otherwise required to file a U.S. Federal income tax return would be required to file a U.S. Federal income tax return on the appropriate form in order to claim a refund for the taxes we paid. In order to utilize the deemed distribution approach, we must provide written notice to our stockholders prior to the expiration of 60 days after the close of the relevant taxable year. We cannot treat any of our investment company taxable income as a deemed distribution.

For purposes of determining (1) whether the Annual Distribution Requirement is satisfied for any year and (2) the amount of capital gain dividends paid for that year, we may, under certain circumstances, elect to treat a dividend that is paid during the following taxable year as if it had been paid during the taxable year in question. If we make such an election, the U.S. stockholder will still be treated as receiving the dividend in the taxable year in which the distribution is made. However, any dividend declared by us in October, November or December of any calendar year, payable to stockholders of record on a specified date in any such month and actually paid during January of the following year, will be treated as if it had been received by our U.S. stockholders on December 31 of the year in which the dividend was declared.

If an investor purchases shares of our common stock shortly before the record date of a distribution, the price of the shares will include the value of the distribution and the investor will be subject to tax on the distribution even though it represents a return of his, her or its investment.

A U.S. stockholder generally will recognize taxable gain or loss if the stockholder sells or otherwise disposes of his, her or its shares of our common stock. Any gain arising from such sale or disposition generally will be treated as long-term capital gain or loss if the stockholder has held his, her or its shares for more than one year. Otherwise, it would be classified as short-term capital gain or loss. However, any capital loss arising from the sale or disposition of shares of our common stock held for six months or less will be treated as long-term capital loss to the extent of the amount of capital gain dividends received, or undistributed capital gain deemed received, with respect to such shares. In addition, all or a portion of any loss recognized upon a disposition of shares of our common stock may be disallowed if other substantially identical shares are purchased (whether through reinvestment of distributions or otherwise) within 30 days before or after the disposition. The ability to otherwise deduct capital losses may be subject to other limitations under the code.

In general, individual U.S. stockholders currently are subject to a maximum U.S. Federal income tax rate of 15% on their net capital gain, or the excess of realized net long-term capital gain over realized net short-term capital loss for a taxable year, including a long-term capital gain derived from an investment in our shares. Such rate is lower than the maximum rate on ordinary income currently payable by individuals. Corporate U.S. stockholders currently are subject to U.S. Federal income tax on net capital gain at the maximum 35% rate also applied to ordinary income. Noncorporate stockholders with net capital losses for a year (which we define as capital losses in excess of capital gains) generally may deduct up to $3,000 of such losses against their ordinary income each year; any net capital losses of a noncorporate stockholder in excess of $3,000 generally may be carried forward and used in subsequent years as provided in the Code. Corporate stockholders generally may not deduct any net capital losses for a year, but may carry back such losses for three years or carry forward such losses for five years.

We will send to each of our U.S. stockholders, as promptly as possible after the end of each calendar year, a notice detailing, on a per share and per distribution basis, the amounts includible in such U.S. stockholder s taxable income for such year as ordinary income and as long-term capital gain. In addition, the U.S. Federal tax status of each year s distributions generally will be reported to the IRS (including the amount of dividends, if any, eligible for the 15% maximum rate). Distributions may also be subject to additional state, local and foreign taxes depending on a U.S. stockholder s particular situation. Dividends distributed by us generally will not be eligible for the dividends-received deduction or the preferential rate applicable to qualifying dividends.

We may be required to withhold U.S. Federal income tax, or backup withholding, currently at a rate of 28% (until January 1, 2011 when a higher rate of 31% will apply absent Congressional action) from all taxable distributions to any noncorporate U.S. stockholder (1) who fails to furnish us with a correct taxpayer identification number or a certificate that such stockholder is exempt from backup withholding, or (2) with respect to whom the IRS notifies us that such stockholder has failed to properly report certain interest and dividend income to the IRS and to respond to notices to that effect. An individual s taxpayer identification number is his or her social security number. Backup withholding is not an additional tax, and any amount withheld may be refunded or credited against the U.S. stockholder s U.S. Federal income tax liability, *provided* that proper information is timely provided to the IRS.

Taxation Of Non-U.S. Stockholders

Whether an investment in the shares is appropriate for a Non-U.S. stockholder will depend upon that person s particular circumstances. An investment in the shares by a Non-U.S. stockholder may have adverse tax consequences. Non-U.S. stockholders should consult their tax advisers before investing in our common stock.

Distributions of our investment company taxable income to Non-U.S. stockholders that are not effectively connected with a U.S. trade or business carried on by the Non-U.S. stockholder, will generally be subject to withholding of U.S. Federal income tax at a rate of 30% (or lower rate provided by an applicable treaty) to the extent of our current and accumulated earnings and profits. However, effective for taxable years beginning before January 1, 2010, we generally will not be required to withhold any amounts with respect to distributions of (i) U.S.-source interest income that would not have been subject to withholding of U.S. Federal income tax if they had been earned directly by a Non-U.S. stockholder, and (ii) net short-term capital gains in excess of net long-term capital losses that would not have been subject to withholding of U.S. Federal income tax if they had been earned directly by a Non-U.S. stockholder, in each case only to the extent that such distributions are properly designated by us as interest-related dividends or short-term capital gain dividends, as the case may be, and certain other requirements are met.

Actual or deemed distributions of our net capital gains to a Non-U.S. stockholder, and gains realized by a Non-U.S. stockholder upon the sale of our common stock, that are not effectively connected with a U.S. trade or business carried on by the Non-U.S. stockholder, will generally not be subject to U.S. Federal withholding tax and generally will not be subject to U.S. Federal income tax unless the Non-U.S. stockholder is a nonresident alien individual and is physically present in the United States for more than 182 days during the taxable year and meets certain other requirements. However, withholding of U.S. Federal income tax at a rate of 30% on capital gains of nonresident alien individuals who are physically present in the United States for more than the 182 day period only applies in exceptional cases because any individual present in the United States for more than 182 days during the taxable year is generally treated as a resident for U.S. income tax purposes; in that case, he or she would be subject to U.S. income tax on his or her worldwide income at the graduated rates applicable to U.S. citizens, rather than the 30% U.S. Federal withholding tax.

If we distribute our net capital gains in the form of deemed rather than actual distributions (which we may do in the future), a Non-U.S. stockholder will be entitled to a U.S. Federal income tax credit or tax refund equal to the stockholder s allocable share of the tax we pay on the capital gains deemed to have been distributed. In order to obtain the refund, the Non-U.S. stockholder must obtain a U.S. taxpayer identification number and file a U.S. Federal income tax return even if the Non-U.S. stockholder would not otherwise be required to obtain a U.S. taxpayer identification number or file a U.S. Federal income tax return. Accordingly, investment in the shares may not be appropriate for a Non-U.S. stockholder.

Distributions of our investment company taxable income and net capital gains (including deemed distributions) to Non-U.S. stockholders, and gains realized by Non-U.S. stockholders upon the sale of our common stock that is effectively connected with a U.S. trade or business carried on by the Non-U.S. stockholder (or if an income tax treaty applies, attributable to a permanent establishment in the United States), will be subject to U.S. Federal income tax at the graduated rates applicable to U.S. citizens, residents and domestic corporations. Corporate Non-U.S. stockholders may also be subject to an additional branch profits tax at a rate of 30% imposed by the Code (or lower rate provided by an applicable treaty). In the case of a non-corporate Non-U.S. stockholder, we may be required to withhold U.S. Federal income tax from distributions that are otherwise exempt from withholding tax (or taxable at a reduced rate) unless the Non-U.S. stockholder certifies his or her foreign status under penalties of perjury or otherwise establishes an exemption.

The tax consequences to a Non-U.S. stockholder entitled to claim the benefits of an applicable tax treaty may differ from those described herein. Non-U.S. stockholders are advised to consult their own tax advisers with respect to the particular tax consequences to them of an investment in our shares.

A Non-U.S. stockholder who is a nonresident alien individual may be subject to information reporting and backup withholding of U.S. Federal income tax on dividends unless the Non-U.S. stockholder provides us or the dividend paying agent with an IRS Form W-8BEN (or an acceptable substitute form) or otherwise meets documentary evidence requirements for establishing that it is a Non-U.S. stockholder or otherwise establishes an exemption from backup withholding.

Non-U.S. persons should consult their own tax advisors with respect to the U.S. Federal income tax and withholding tax, and state, local and foreign tax consequences of an investment in the shares.

Table of Contents

Failure To Obtain RIC Tax Treatment

If we were unable to obtain tax treatment as a RIC, we would 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 they be required to be made. Distributions would generally be taxable to our stockholders as ordinary dividend income (currently eligible for the 15% maximum rate) 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 tax basis, and any remaining distributions would be treated as a capital gain.

The discussion set forth herein does not constitute tax advice, and potential investors should consult their own tax advisors concerning the tax considerations relevant to their particular situation.

DESCRIPTION OF OUR CAPITAL STOCK

The following description is based on relevant portions of the Maryland General Corporation Law and on our charter and bylaws. This summary is not necessarily complete, and we refer you to the Maryland General Corporation Law and our charter and bylaws for a more detailed description of the provisions summarized below.

Capital Stock

Our authorized capital stock consists of 100,000,000 shares of stock, par value $0.001 per share, all of which is initially classified as common stock. Our common stock is traded on The NASDAQ Global Select Market under the symbol PSEC. There are no outstanding options or warrants to purchase our stock. No stock has been authorized for issuance under any equity compensation plans. Under Maryland law, our stockholders generally are not personally liable for our debts or obligations.

Under our charter, our Board of Directors is authorized to classify and reclassify any unissued shares of stock into other classes or series of stock, and to authorize the issuance of such shares, without obtaining stockholder approval. As permitted by the Maryland General Corporation Law, our charter provides that the Board of Directors, without any action by our stockholders, may amend the charter from time to time to increase or decrease the aggregate number of shares of stock or the number of shares of stock of any class or series that we have authority to issue.

The below table sets forth each class of our outstanding securities as of January 7, 2010:

(1) Title of Class	(2) Amount Authorized	(3) Amount Held by the Company or for its Account	(4) Amount Outstanding Exclusive of Amount Shown Under(3)
Common Stock	100,000,000	0	63,349,746

Common Stock

All shares of our common stock have equal rights as to earnings, assets, dividends and voting and, when they are issued, will be duly authorized, validly issued, fully paid and nonassessable. Distributions may be paid to the holders of our common stock if, as and when authorized by our Board of Directors and declared by us out of funds legally available therefor. Shares of our common stock have no preemptive, conversion or redemption rights and are freely transferable, except where their transfer is restricted by U.S. Federal and state securities laws or by contract. In the event of a liquidation, dissolution or winding up of us, each share of our common stock would be entitled to share ratably in all of our assets that are legally available for distribution after we pay all debts and other liabilities and subject to any preferential rights of holders of our preferred stock, if any preferred stock is outstanding at such time. Each share of our common stock is entitled to one vote on all matters submitted to a vote of stockholders, including the election of directors. Except as provided with respect to any other class or series of stock, the holders of our common stock will possess exclusive voting power. There is no cumulative voting in the election of directors, which means that prior to the issuance of preferred stock holders of a majority of the outstanding shares of common stock will elect all of our directors, and holders of less than a majority of such shares will be unable to elect any director.

Table of Contents

Preferred Stock

Our charter authorizes our Board of Directors to classify and reclassify any unissued shares of stock into other classes or series of stock, including preferred stock. Prior to issuance of shares of each class or series, the Board of Directors is required by Maryland law and by our charter to set the terms, preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms or conditions of redemption for each class or series. Thus, the Board of Directors could authorize the issuance of shares of preferred stock with terms and conditions which could have the effect of delaying, deferring or preventing a transaction or a change in control that might involve a premium price for holders of our common stock or otherwise be in their best interest. You should note, however, that any issuance of preferred stock must comply with the requirements of the 1940 Act. The 1940 Act requires, among other things, that (1) immediately after issuance and before any dividend or other distribution (other than in shares of stock) is made with respect to our common stock and before any purchase of common stock is made, such preferred stock together with all other senior securities must not exceed an amount equal to 50% of our total assets after deducting the amount of such dividend, distribution or purchase price, as the case may be, and (2) the holders of shares of preferred stock, if any are issued, must be entitled as a class to elect two directors at all times and to elect a majority of the directors if dividends on such preferred stock become in arrears by two years or more until all arrears are cured. Certain matters under the 1940 Act require the separate vote of the holders of any issued and outstanding preferred stock. For example, holders of preferred stock would vote separately from the holders of common stock on a proposal to operate other than as an investment company. We believe that the availability for issuance of preferred stock will provide us with increased flexibility in structuring future financings and acquisitions.

Limitation On Liability Of Directors And Officers; Indemnification And Advance Of Expenses

Maryland law permits a Maryland corporation to include in its charter a provision limiting the liability of its directors and officers to the corporation and its stockholders for money damages except for liability resulting from (a) actual receipt of an improper benefit or profit in money, property or services or (b) active and deliberate dishonesty established by a final judgment as being material to the cause of action. Our charter contains such a provision which eliminates directors and officers liability to the maximum extent permitted by Maryland law, subject to the requirements of the 1940 Act.

Our charter authorizes us, to the maximum extent permitted by Maryland law and subject to the requirements of the 1940 Act, to obligate ourselves to indemnify any present or former director or officer or any individual who, while serving as a director or officer and at our request, serves or has served another corporation, real estate investment trust, partnership, joint venture, trust, employee benefit plan or other enterprise as a director, officer, partner or trustee, from and against any claim or liability to which that person may become subject or which that person may incur by reason of his or her service in any such capacity and to pay or reimburse their reasonable expenses in advance of final disposition of a proceeding. Our bylaws obligate us, to the maximum extent permitted by Maryland law and subject to the requirements of the 1940 Act, to indemnify any present or former director or officer or any individual who, while serving as a director or officer and at our request, serves or has served another corporation, real estate investment trust, partnership, joint venture, trust, employee benefit plan or other enterprise as a director, officer, partner or trustee and who is made, or threatened to be made, a party to the proceeding by reason of his or her service in any such capacity from and against any claim or liability to which that person may become subject or which that person may incur by reason of his or her service in any such capacity and to pay or reimburse their reasonable expenses in advance of final disposition of a proceeding. The charter and bylaws also permit us to indemnify and advance expenses to any person who served a predecessor of us in any of the capacities described above and any of our employees or agents or any employees or agents of our predecessor. In accordance with the 1940 Act, we will not indemnify any person for any liability to which such person would be subject by reason of such person s willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his or her office.

Maryland law requires a corporation (unless its charter provides otherwise, which our charter does not) to indemnify a director or officer who has been successful, on the merits or otherwise, in the defense of any proceeding to which he or she is made, or threatened to be made, a party by reason of his or her service in that capacity. Maryland law permits a corporation to indemnify its present and former directors and officers, among others, against judgments, penalties, fines, settlements and reasonable expenses actually incurred by them in connection with any proceeding to which they may be made, or threatened to be made, a party by reason of their service in those or other capacities unless it is established that (a) the act or omission of the director or officer was material to the matter giving rise to the proceeding and (1) was committed in bad faith or (2) was the result of active and deliberate dishonesty, (b) the director or officer actually received an improper personal benefit in money, property or services or (c) in the case of any criminal proceeding, the director or officer had reasonable cause to believe that the act or omission was unlawful. However, under Maryland law, a Maryland corporation may not indemnify for an adverse judgment in a suit by or in the right of the corporation or for a judgment of liability on the basis that a personal benefit was improperly received, unless in either case a court orders indemnification, and then only for expenses. In addition, Maryland law permits a corporation to advance reasonable expenses to a director or officer upon the corporation s receipt of (a) a written affirmation by the director or officer of his or her good faith belief that he or she has met the standard of conduct necessary for indemnification by the corporation and (b) a written undertaking by him or her or on his or her behalf to repay the amount paid or reimbursed by the corporation if it is ultimately determined that the standard of conduct was not met.

Our insurance policy does not currently provide coverage for claims, liabilities and expenses that may arise out of activities that a present or former director or officer of us has performed for another entity at our request. There is no assurance that such entities will in fact carry such insurance. However, we note that we do not expect to request our present or former directors or officers to serve another entity as a director, officer, partner or trustee unless we can obtain insurance providing coverage for such persons for any claims, liabilities or expenses that may arise out of their activities while serving in such capacities.

Provisions Of The Maryland General Corporation Law And Our Charter And Bylaws

Anti-takeover Effect

The Maryland General Corporation Law and our charter and bylaws contain provisions that could make it more difficult for a potential acquiror to acquire us by means of a tender offer, proxy contest or otherwise. These provisions are expected to discourage certain coercive takeover practices and inadequate takeover bids and to encourage persons seeking to acquire control of us to negotiate first with our Board of Directors. These provisions could have the effect of depriving stockholders of an opportunity to sell their shares at a premium over prevailing market prices by discouraging a third party from seeking to obtain control of us. We believe that the benefits of these provisions outweigh the potential disadvantages of discouraging any such acquisition proposals because, among other things, the negotiation of such proposals may improve their terms.

Control Share Acquisitions

The Maryland General Corporation Law under the Control Share Act provides that control shares of a Maryland corporation acquired in a control share acquisition have no voting rights except to the extent approved by a vote of two-thirds of the votes entitled to be cast on the matter. Shares owned by the acquiror, by officers or by directors who are employees of the corporation are excluded from shares entitled to vote on the matter. Control shares are voting shares of stock which, if aggregated with all other shares of stock owned by the acquiror or in respect of which the acquiror is able to exercise or direct the exercise of voting power (except solely by virtue of a revocable proxy), would entitle the acquiror to exercise voting power in electing directors within one of the following ranges of voting power:

- one-tenth or more but less than one-third,
- one-third or more but less than a majority, or

a majority or more of all voting power.

The requisite stockholder approval must be obtained each time an acquiror crosses one of the thresholds of voting power set forth above. Control shares do not include shares the acquiring person is then entitled to vote as a result of having previously obtained stockholder approval. A control share acquisition means the acquisition of control shares, subject to certain exceptions.

A person who has made or proposes to make a control share acquisition may compel the Board of Directors of the corporation to call a special meeting of stockholders to be held within 50 days of demand to consider the voting rights of the shares. The right to compel the calling of a special meeting is subject to the satisfaction of certain conditions, including an undertaking to pay the expenses of the meeting. If no request for a meeting is made, the corporation may itself present the question at any stockholders meeting.

If voting rights are not approved at the meeting or if the acquiring person does not deliver an acquiring person statement as required by the statute, then the corporation may repurchase for fair value any or all of the control shares, except those for which voting rights have previously been approved. The right of the corporation to repurchase control shares is subject to certain conditions and limitations, including, as provided in our bylaws, compliance with the 1940 Act. Fair value is determined, without regard to the absence of voting rights for the control shares, as of the date of the last control share acquisition by the acquiror or of any meeting of stockholders at which the voting rights of the shares are considered and not approved. If voting rights for control shares are approved at a stockholders meeting and the acquiror becomes entitled to vote a majority of the shares entitled to vote, all other stockholders may exercise appraisal rights. The fair value of the shares as determined for purposes of appraisal rights may not be less than the highest price per share paid by the acquiror in the control share acquisition.

The Control Share Act does not apply (a) to shares acquired in a merger, consolidation or share exchange if the corporation is a party to the transaction or (b) to acquisitions approved or exempted by the charter or bylaws of the corporation.

Our bylaws contain a provision exempting from the Control Share Act any and all acquisitions by any person of our shares of stock. There can be no assurance that such provision will not be amended or eliminated at any time in the future. However, we will notify the Division of Investment Management at the SEC prior to amending our bylaws to be subject to the Control Share Act and will make such amendment only if the Board of Directors determines that it would be in our best interests.

Business Combinations

Under Maryland law, business combinations between a Maryland corporation and an interested stockholder or an affiliate of an interested stockholder are prohibited for five years after the most recent date on which the interested stockholder becomes an interested stockholder. These business combinations include a merger, consolidation, share exchange or, in circumstances specified in the statute, an asset transfer or issuance or reclassification of equity securities. An interested stockholder is defined as:

- any person who beneficially owns 10% or more of the voting power of the corporation s shares; or
- an affiliate or associate of the corporation who, at any time within the two-year period prior to the date in question, was the beneficial owner of 10% or more of the voting power of the then outstanding voting stock of the corporation.

A person is not an interested stockholder under this statute if the Board of Directors approved in advance the transaction by which he otherwise would have become an interested stockholder. However, in approving a transaction, the Board of Directors may provide that its approval is subject to compliance, at or after the time of approval, with any terms and conditions determined by the Board of Directors.

After the five-year prohibition, any business combination between the Maryland corporation and an interested stockholder generally must be recommended by the Board of Directors of the corporation and approved by the affirmative vote of at least:

80% of the votes entitled to be cast by holders of outstanding shares of voting stock of the corporation; and

two-thirds of the votes entitled to be cast by holders of voting stock of the corporation other than shares held by the interested stockholder with whom or with whose affiliate the business combination is to be effected or held by an affiliate or associate of the interested stockholder.

These super-majority vote requirements do not apply if the corporation s common stockholders receive a minimum price, as defined under Maryland law, for their shares in the form of cash or other consideration in the same form as previously paid by the interested stockholder for its shares.

The statute permits various exemptions from its provisions, including business combinations that are exempted by the Board of Directors before the time that the interested stockholder becomes an interested stockholder. Our Board of Directors has adopted a resolution that any business combination between us and any other person is exempted from the provisions of the Business Combination Act, *provided* that the business combination is first approved by the Board of Directors, including a majority of the directors who are not interested persons as defined in the 1940 Act. This resolution, however, may be altered or repealed in whole or in part at any time. If this resolution is repealed, or the Board of Directors does not otherwise approve a business combination, the statute may discourage others from trying to acquire control of us and increase the difficulty of consummating any offer.

Conflict with 1940 Act

Our bylaws provide that, if and to the extent that any provision of the Maryland General Corporation Law, including the Control Share Act (if we amend our bylaws to be subject to such Act) and the Business Combination Act, or any provision of our charter or bylaws conflicts with any provision of the 1940 Act, the applicable provision of the 1940 Act will control.

Classified Board of Directors

Our Board of Directors is divided into three classes of directors serving staggered three-year terms. The current terms of the first, second and third classes will expire in 2011, 2012 and 2010 respectively, and in each case, until their successors are duly elected and qualify. Each year one class of directors will be elected to the Board of Directors by the stockholders. A classified board may render a change in control of us or removal of our incumbent management more difficult. We believe, however, that the longer time required to elect a majority of a classified Board of Directors will help to ensure the continuity and stability of our management and policies.

Election of Directors

Our charter and bylaws provide that the affirmative vote of the holders of a majority of the outstanding shares of stock entitled to vote in the election of directors will be required to elect a director. Under the charter, our Board of Directors may amend the bylaws to alter the vote required to elect directors.

Number of Directors; Vacancies; Removal

Our charter provides that the number of directors will be set only by the Board of Directors in accordance with our bylaws. Our bylaws provide that a majority of our entire Board of Directors may at any time increase or decrease the number of directors. However, unless our bylaws are amended, the number of directors may never be less than three nor more than eight. Our charter provides that, at such time as we have three independent directors and our common stock is registered under the Exchange Act of 1934, as amended, or the Exchange Act, we elect to be subject to the provision of Subtitle 8 of Title 3 of the Maryland General Corporation Law regarding the filling of vacancies on the Board of Directors. Accordingly, at such time, except as may be provided by the Board of Directors in setting the terms of any class or series of preferred stock, any and all vacancies on the Board of Directors may be filled only by the affirmative vote of a majority of the remaining directors in office, even if the remaining directors do not constitute a quorum, and any director elected to fill a vacancy will serve for the remainder of the full term of the directorship in which the vacancy occurred and until a successor is elected and qualifies, subject to any applicable requirements of the 1940 Act.

Our charter provides that a director may be removed only for cause, as defined in our charter, and then only by the affirmative vote of at least two-thirds of the votes entitled to be cast in the election of directors.

Action by Stockholders

The Maryland General Corporation Law provides that stockholder action can be taken only at an annual or special meeting of stockholders or (unless the charter provides for stockholder action by less than unanimous written consent, which our charter does not) by unanimous written consent in lieu of a meeting. These provisions, combined with the requirements of our bylaws regarding the calling of a stockholder-requested special meeting of stockholders discussed below, may have the effect of delaying consideration of a stockholder proposal until the next annual meeting.

Advance Notice Provisions for Stockholder Nominations and Stockholder Proposals

Our bylaws provide that with respect to an annual meeting of stockholders, nominations of persons for election to the Board of Directors and the proposal of business to be considered by stockholders may be made only (1) pursuant to our notice of the meeting, (2) by the Board of Directors or (3) by a stockholder who is entitled to vote at the meeting and who has complied with the advance notice procedures of the bylaws. With respect to special meetings of stockholders, only the business specified in our notice of the meeting may be brought before the meeting. Nominations of persons for election to the Board of Directors at a special meeting may be made only (1) pursuant to our notice of the meeting, (2) by the Board of Directors or (3) *provided* that the Board of Directors has determined that directors will be elected at the meeting, by a stockholder who is entitled to vote at the meeting and who has complied with the advance notice provisions of the bylaws.

The purpose of requiring stockholders to give us advance notice of nominations and other business is to afford our Board of Directors a meaningful opportunity to consider the qualifications of the proposed nominees and the advisability of any other proposed business and, to the extent deemed necessary or desirable by our Board of Directors, to inform stockholders and make recommendations about such qualifications or business, as well as to provide a more orderly procedure for conducting meetings of stockholders. Although our bylaws do not give our Board of Directors any power to disapprove stockholder nominations for the election of directors or proposals recommending certain action, they may have the effect of precluding a contest for the election of directors or the consideration of stockholder proposals if proper procedures are not followed and of discouraging or deterring a third party from conducting a solicitation of proxies to elect its own slate of directors or to approve its own proposal without regard to whether consideration of such nominees or proposals might be harmful or beneficial to us and our stockholders.

Calling of Special Meetings of Stockholders

Our bylaws provide that special meetings of stockholders may be called by our Board of Directors and certain of our officers. Additionally, our bylaws provide that, subject to the satisfaction of certain procedural and informational requirements by the stockholders requesting the meeting, a special meeting of stockholders will be called by the secretary of the corporation upon the written request of stockholders entitled to cast not less than a majority of all the votes entitled to be cast at such meeting.

Approval of Extraordinary Corporate Action; Amendment of Charter and Bylaws

Under Maryland law, a Maryland corporation generally cannot dissolve, amend its charter, merge, sell all or substantially all of its assets, engage in a share exchange or engage in similar transactions outside the ordinary course of business, unless approved by the affirmative vote of stockholders entitled to cast at least two-thirds of the votes entitled to be cast on the matter. However, a Maryland corporation may provide in its charter for approval of these matters by a lesser percentage, but not less than a majority of all of the votes entitled to be cast on the matter. Our charter generally provides for approval of charter amendments and extraordinary transactions by the stockholders entitled to cast at least a majority of the votes entitled to be cast on the matter.

Our charter also provides that certain charter amendments and any proposal for our conversion, whether by merger or otherwise, from a closed-end company to an open-end company or any proposal for our liquidation or dissolution requires the approval of the stockholders entitled to cast at least 80 percent of the votes entitled to be cast on such matter. However, if such amendment or proposal is approved by at least two-thirds of our continuing directors (in addition to approval by our Board of Directors), such amendment or proposal may be approved by a majority of the votes entitled to be cast on such a matter. The continuing directors are defined in our charter as our current directors as well as those directors whose nomination for election by the stockholders or whose election by the directors to fill vacancies is approved by a majority of the continuing directors then on the Board of Directors.

Our charter and bylaws provide that the Board of Directors will have the exclusive power to make, alter, amend or repeal any provision of our bylaws.

No Appraisal Rights

Except with respect to appraisal rights arising in connection with the Control Share Act discussed above, as permitted by the Maryland General Corporation Law, our charter provides that stockholders will not be entitled to exercise appraisal rights.

DESCRIPTION OF OUR PREFERRED STOCK

In addition to shares of common stock, our charter authorizes the issuance of preferred stock. If we offer preferred stock under this prospectus, we will issue an appropriate prospectus supplement. We may issue preferred stock from time to time in one or more series, without stockholder approval. Our Board of Directors is authorized to fix for any series of preferred stock the number of shares of such series and the designation, relative powers, preferences and rights, and the qualifications, limitations or restrictions of such series; except that, such an issuance must adhere to the requirements of the 1940 Act, Maryland law and any other limitations imposed by law.

The 1940 Act requires, among other things, that (1) immediately after issuance and before any distribution is made with respect to common stock, the liquidation preference of the preferred stock, together with all other senior securities, must not exceed an amount equal to 50% of our total assets (taking into account such distribution) and (2) the holders of shares of preferred stock, if any are issued, must be entitled as a class to elect two directors at all times and to elect a majority of the directors if dividends on the preferred stock are in arrears by two years or more.

For any series of preferred stock that we may issue, our Board of Directors will determine and the prospectus supplement relating to such series will describe:

- the designation and number of shares of such series;
- the rate and time at which, and the preferences and conditions under which, any dividends will be paid on shares of such series, the cumulative nature of such dividends and whether such dividends have any participating feature;
- any provisions relating to convertibility or exchangeability of the shares of such series;
- the rights and preferences, if any, of holders of shares of such series upon our liquidation, dissolution or winding up of our affairs;
- the voting powers of the holders of shares of such series;
- any provisions relating to the redemption of the shares of such series;
- any limitations on our ability to pay dividends or make distributions on, or acquire or redeem, other securities while shares of such series are outstanding;

any conditions or restrictions on our ability to issue additional shares of such series or other securities;

if applicable, a discussion of certain U.S. Federal income tax considerations; and

any other relative power, preferences and participating, optional or special rights of shares of such series, and the qualifications, limitations or restrictions thereof.

All shares of preferred stock that we may issue will be identical and of equal rank except as to the particular terms thereof that may be fixed by our Board of Directors, and all shares of each series of preferred stock will be identical and of equal rank except as to the dates from which cumulative dividends thereon will be cumulative.

DESCRIPTION OF OUR DEBT SECURITIES

We may issue debt securities in one or more series which, if publicly offered, will be under an indenture to be entered into between us and a trustee. The specific terms of each series of debt securities we publicly offer will be described in the particular prospectus supplement relating to that series. For a complete description of the terms of a particular series of debt securities, you should read both this prospectus and the prospectus supplement relating to that particular series.

The prospectus supplement, which will accompany this prospectus, will describe the particular series of debt securities being offered by including:

- the designation or title of the series of debt securities;
- the total principal amount of the series of debt securities;
- the percentage of the principal amount at which the series of debt securities will be offered;
- the date or dates on which principal will be payable;
- the rate or rates (which may be either fixed or variable) and/or the method of determining such rate or rates of interest, if any;
- the date or dates from which any interest will accrue, or the method of determining such date or dates, and the date or dates on which any interest will be payable;
- the terms for redemption, extension or early repayment, if any;
- the currencies in which the series of debt securities are issued and payable;
- the provision for any sinking fund;
- any restrictive covenants;
- any events of default;
- whether the series of debt securities are issuable in certificated form;
- any provisions for defeasance or covenant defeasance;
- any special U.S. Federal income tax implications, including, if applicable, U.S. Federal income tax considerations relating to original issue discount;
- any provisions for convertibility or exchangeability of the debt securities into or for any other securities;
- whether the debt securities are subject to subordination and the terms of such subordination;
- the listing, if any, on a securities exchange;

the name and address of the trustee; and

any other terms.

The debt securities may be secured or unsecured obligations. Under the provisions of the 1940 Act, we are permitted, as a business development company, to issue debt only in amounts such that our asset coverage, as defined in the 1940 Act, equals at least 200% after each issuance of debt. Unless the prospectus supplement states otherwise, principal (and premium, if any) and interest, if any, will be paid by us in immediately available funds.

DESCRIPTION OF OUR WARRANTS

We may issue warrants to purchase shares of our common stock, preferred stock or debt securities from time to time. Such warrants may be issued independently or together with one of our Securities and may be attached or separate from such securities. We will issue each series of warrants under a separate warrant agreement to be entered into between us and a warrant agent. The warrant agent will act solely as our agent and will not assume any obligation or relationship of agency for or with holders or beneficial owners of warrants.

Table of Contents

A prospectus supplement will describe the particular terms of any series of warrants we may issue, including the following:

- the title of such warrants;
- the aggregate number of such warrants;
- the price or prices at which such warrants will be issued;
- the currency or currencies, including composite currencies, in which the price of such warrants may be payable;
- the number of shares of common stock, preferred stock or debt securities issuable upon exercise of such warrants;
- the price at which and the currency or currencies, including composite currencies, in which the shares of common stock, preferred stock or debt securities purchasable upon exercise of such warrants may be purchased;
- the date on which the right to exercise such warrants will commence and the date on which such right will expire;
- whether such warrants will be issued in registered form or bearer form;
- if applicable, the minimum or maximum amount of such warrants which may be exercised at any one time;
- if applicable, the number of such warrants issued with each share of common stock, preferred stock or debt securities;
- if applicable, the date on and after which such warrants and the related shares of common stock, preferred stock or debt securities will be separately transferable;
- information with respect to book-entry procedures, if any;
- if applicable, a discussion of certain U.S. Federal income tax considerations; and
- any other terms of such warrants, including terms, procedures and limitations relating to the exchange and exercise of such warrants.

We and the warrant agent may amend or supplement the warrant agreement for a series of warrants without the consent of the holders of the warrants issued thereunder to effect changes that are not inconsistent with the provisions of the warrants and that do not materially and adversely affect the interests of the holders of the warrants.

Under the 1940 Act, we may generally only offer warrants *provided* that (1) the warrants expire by their terms within ten years; (2) the exercise or conversion price is not less than the current market value at the date of issuance; (3) our stockholders authorize the proposal to issue such warrants, and our Board of Directors approves such issuance on the basis that the issuance is in our best interests and the best interest of our stockholders; and (4) if the warrants are accompanied by other securities, the warrants are not separately transferable unless no class of such warrants and the securities accompanying them has been publicly distributed. The 1940 Act also provides that the amount of our voting securities that would result from the exercise of all outstanding warrants at the time of issuance may not exceed 25% of our outstanding voting securities.

REGULATION

We are a closed-end, non-diversified investment company that has filed an election to be treated as a business development company under the 1940 Act and has elected to be treated as a RIC under Subchapter M of the Code. The 1940 Act contains prohibitions and restrictions relating to transactions between business development companies and their affiliates (including any investment advisers or sub-advisers), principal underwriters and affiliates of those affiliates or underwriters and requires that a majority of the directors be persons other than interested persons, as that term is 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 business development company unless approved by a majority of our outstanding voting securities.

We may invest up to 100% of our assets in securities acquired directly from issuers in privately negotiated transactions. With respect to such securities, we may, for the purpose of public resale, be deemed an underwriter as that term is defined in the Securities Act. Our intention is to not write (sell) or buy put or call options to manage risks associated with the publicly-traded securities of our portfolio companies, except that we may enter into hedging transactions to manage the risks associated with interest rate and other market fluctuations. However, in connection with an investment or acquisition financing of a portfolio company, we may purchase or otherwise receive warrants to purchase the common stock of the portfolio company. Similarly, in connection with an acquisition, we may acquire rights to require the issuers of acquired securities or their affiliates to repurchase them under certain circumstances. We also do not intend to acquire securities issued by any investment company that exceed the limits imposed by the 1940 Act. Under these limits, except with respect to money market funds we generally cannot acquire more than 3% of the voting stock of any registered investment company, invest more than 5% of the value of our total assets in the securities of one investment company or invest more than 10% of the value of our total assets in the securities of more than one investment company. With regard to that portion of our portfolio invested in securities issued by investment companies, it should be noted that such investments subject our stockholders indirectly to additional expenses. None of these policies are fundamental and may be changed without stockholder approval.

Qualifying Assets

Under the 1940 Act, a business development company 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 represent at least 70% of the company s total assets. The principal categories of qualifying assets relevant to our business are the following:

(1) Securities purchased in transactions not involving any public offering from the issuer of such securities, which issuer (subject to certain limited exceptions) is an eligible portfolio company, or from any person who is, or has been during the preceding 13 months, an affiliated person of an eligible portfolio company, or from any other person, subject to such rules as may be prescribed by the SEC. An eligible portfolio company is defined in the 1940 Act and rules adopted pursuant thereto as any issuer which:

(a) is organized under the laws of, and has its principal place of business in, the United States;

(b) is not an investment company (other than a small business investment company wholly owned by the business development company) or a company that would be an investment company but for exclusions under the 1940 Act for certain financial companies such as banks, brokers, commercial finance companies, mortgage companies and insurance companies; and

(c) satisfies any of the following:

1. does not have any class of securities with respect to which a broker or dealer may extend margin credit;

2. is controlled by a business development company or a group of companies including a business development company and the business development company has an affiliated person who is a director of the eligible portfolio company;

3. is a small and solvent company having total assets of not more than $4 million and capital and surplus of not less than $2 million;

4. does not have any class of securities listed on a national securities exchange; or

5. has a class of securities listed on a national securities exchange, but has an aggregate market value of outstanding voting and non-voting common equity of less than $250 million.

(2) Securities in companies that were eligible portfolio companies when we made our initial investment if certain other requirements are satisfied.

Table of Contents

(3) Securities of any eligible portfolio company which we control.

(4) Securities purchased in a private transaction from a U.S. issuer that is not an investment company or from an affiliated person of the issuer, or in transactions incident thereto, if the issuer is in bankruptcy and subject to reorganization or if the issuer, immediately prior to the purchase of its securities was unable to meet its obligations as they came due without material assistance other than conventional lending or financing agreements.

(5) Securities of an eligible portfolio company purchased from any person in a private transaction if there is no ready market for such securities and we already own 60% of the outstanding equity of the eligible portfolio company.

(6) Securities received in exchange for or distributed on or with respect to securities described in (1) through (4) above, or pursuant to the exercise of warrants or rights relating to such securities.

(7) Cash, cash equivalents, U.S. government securities or high-quality debt securities maturing in one year or less from the time of investment.

In addition, a business development company must have been organized and have its principal place of business in the United States and must be operated for the purpose of making investments in the types of securities described in (1), (2), (3) or (4) above.

Managerial Assistance to Portfolio Companies

In order to count portfolio securities as qualifying assets for the purpose of the 70% test, the business development company must either control the issuer of the securities or must offer to make available to the issuer of the securities (other than small and solvent companies described above) significant managerial assistance; except that, where the business development company 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. Making available significant managerial assistance means, among other things, any arrangement whereby the business development company, 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.

Temporary Investments

Pending investment in other types of qualifying assets, as described above, our investments may consist of cash, cash equivalents, including money market funds, U.S. government securities or high quality debt securities maturing in one year or less from the time of investment, which we refer to, collectively, as temporary investments, so that 70% of our assets are qualifying assets. Typically, we will invest in money market funds, U.S. treasury bills or in repurchase agreements that are fully collateralized by cash or securities issued by the U.S. government or its agencies. A repurchase agreement involves the purchase by an investor, such as us, of a specified security and the simultaneous agreement by the seller to repurchase it at an agreed upon future date and at a price which is greater than the purchase price by an amount that reflects an agreed-upon interest rate. There is no percentage restriction on the proportion of our assets that may be invested in such repurchase agreements. However, if more than 25% of our total assets constitute repurchase agreements from a single counterparty, we would not meet the diversification tests in order to qualify as a RIC for U.S. Federal income tax purposes. Thus, we do not intend to enter into repurchase agreements with a single counterparty in excess of this limit. Our Investment Adviser will monitor the creditworthiness of the counterparties with which we enter into repurchase agreement transactions.

Senior Securities

We are permitted, under specified conditions, to issue multiple classes of indebtedness and one class of stock senior to our common stock if our asset coverage, as defined in the 1940 Act, is at least equal to 200% immediately after each such issuance. In addition, while any preferred stock or public debt securities remain outstanding, we must make provisions to prohibit any distribution to our stockholders or the repurchase of such securities or shares unless we meet the applicable asset coverage ratios after giving effect to such distribution or repurchase. We may

Table of Contents

also borrow amounts up to 5% of the value of our total assets for temporary or emergency purposes without regard to asset coverage. For a discussion of the risks associated with leverage, see Risk Factors.

Code of Ethics

We, Prospect Capital Management and Prospect Administration have each adopted a code of ethics pursuant to Rule 17j-1 under the 1940 Act that establishes procedures for personal investments and restricts certain personal securities transactions. Personnel subject to each code may invest in securities for their personal investment accounts, including securities that may be purchased or held by us, so long as such investments are made in accordance with the code s requirements. For information on how to obtain a copy of each code of ethics, see Available Information.

Investment Concentration

Our investment objective is to generate both current income and long-term capital appreciation through debt and equity investments. While we are diversifying the portfolio, many of our existing investments are in the energy and energy related industries.

Compliance Policies and Procedures

We and our Investment Adviser have adopted and implemented written policies and procedures reasonably designed to prevent violation of the U.S. Federal securities laws, and are required to review these compliance policies and procedures annually for their adequacy and the effectiveness of their implementation, and to designate a Chief Compliance Officer to be responsible for administering the policies and procedures. Brian H. Oswald serves as our Chief Compliance Officer.

Proxy Voting Policies and Procedures

We have delegated our proxy voting responsibility to Prospect Capital Management. The Proxy Voting Policies and Procedures of Prospect Capital Management are set forth below. The guidelines are reviewed periodically by Prospect Capital Management and our independent directors, and, accordingly, are subject to change.

Introduction. As an investment adviser registered under the Advisers Act, Prospect Capital Management has a fiduciary duty to act solely in the best interests of its clients. As part of this duty, Prospect Capital Management recognizes that it must vote client securities in a timely manner free of conflicts of interest and in the best interests of its clients.

These policies and procedures for voting proxies for Prospect Capital Management s Investment Advisory clients are intended to comply with Section 206 of, and Rule 206(4)-6 under, the Advisers Act.

Proxy policies. These policies are designed to be responsive to the wide range of subjects that may be the subject of a proxy vote. These policies are not exhaustive due to the variety of proxy voting issues that Prospect Capital Management may be required to consider. In general, Prospect Capital Management will vote proxies in accordance with these guidelines unless: (1) Prospect Capital Management has determined to consider the matter on a case-by-case basis (as is stated in these guidelines), (2) the subject matter of the vote is not covered by these guidelines, (3) a material conflict of interest is present, or (4) Prospect Capital Management might find it necessary to vote contrary to its general guidelines to maximize stockholder value and vote in its clients best interests. In such cases, a decision on how to vote will be made by the Proxy Voting Committee (as described below). In reviewing proxy issues, Prospect Capital Management will apply the following general policies:

Elections of directors. In general, Prospect Capital Management will vote in favor of the management-proposed slate of directors. If there is a proxy fight for seats on the Board of Directors or Prospect Capital Management determines that there are other compelling reasons for withholding votes for directors, the Proxy Voting Committee will determine the appropriate vote on the matter. Prospect Capital Management believes that directors have a duty to respond to stockholder actions that have received significant stockholder support. Prospect Capital Management may withhold votes for directors that fail to act on key issues such as failure to

Table of Contents

implement proposals to declassify boards, failure to implement a majority vote requirement, failure to submit a rights plan to a stockholder vote and failure to act on tender offers where a majority of stockholders have tendered their shares. Finally, Prospect Capital Management may withhold votes for directors of non-U.S. issuers where there is insufficient information about the nominees disclosed in the proxy statement.

Appointment of auditors. Prospect Capital Management believes that the Company remains in the best position to choose the auditors and will generally support management s recommendation.

Changes in capital structure. Changes in a company s charter, articles of incorporation or by-laws may be required by state or U.S. Federal regulation. In general, Prospect Capital Management will cast its votes in accordance with the Company s management on such proposal. However, the Proxy Voting Committee will review and analyze on a case-by-case basis any proposals regarding changes in corporate structure that are not required by state or U.S. Federal regulation.

Corporate restructurings, mergers and acquisitions. Prospect Capital Management believes proxy votes dealing with corporate reorganizations are an extension of the investment decision. Accordingly, the Proxy Voting Committee will analyze such proposals on a case-by-case basis.

Proposals affecting the rights of stockholders. Prospect Capital Management will generally vote in favor of proposals that give stockholders a greater voice in the affairs of the Company and oppose any measure that seeks to limit those rights. However, when analyzing such proposals, Prospect Capital Management will weigh the financial impact of the proposal against the impairment of the rights of stockholders.

Corporate governance. Prospect Capital Management recognizes the importance of good corporate governance in ensuring that management and the Board of Directors fulfill their obligations to the stockholders. Prospect Capital Management favors proposals promoting transparency and accountability within a company.

Anti-takeover measures. The Proxy Voting Committee will evaluate, on a case-by-case basis, proposals regarding anti-takeover measures to determine the measure s likely effect on stockholder value dilution.

Stock splits. Prospect Capital Management will generally vote with the management of the Company on stock split matters.

Limited liability of directors. Prospect Capital Management will generally vote with management on matters that would affect the limited liability of directors.

Social and corporate responsibility. The Proxy Voting Committee may review and analyze on a case-by-case basis proposals relating to social, political and environmental issues to determine whether they will have a financial impact on stockholder value. Prospect Capital Management may abstain from voting on social proposals that do not have a readily determinable financial impact on stockholder value.

Proxy voting procedures. Prospect Capital Management will generally vote proxies in accordance with these guidelines. In circumstances in which (1) Prospect Capital Management has determined to consider the matter on a case-by-case basis (as is stated in these guidelines), (2) the subject matter of the vote is not covered by these guidelines, (3) a material conflict of interest is present, or (4) Prospect Capital Management might find it necessary to vote contrary to its general guidelines to maximize stockholder value and vote in its clients best interests, the Proxy Voting Committee will vote the proxy.

Proxy voting committee. Prospect Capital Management has formed a proxy voting committee to establish general proxy policies and consider specific proxy voting matters as necessary. In addition, members of the committee may contact the management of the Company and interested stockholder groups as necessary to discuss proxy issues. Members of the committee will include relevant senior personnel. The committee may also evaluate proxies where we face a potential conflict of interest (as discussed below). Finally, the committee monitors adherence to guidelines, and reviews the policies contained in this statement from time to time.

Conflicts of interest. Prospect Capital Management recognizes that there may be a potential conflict of interest when it votes a proxy solicited by an issuer that is its advisory client or a client or customer of one of our affiliates or with whom it has another business or personal relationship that may affect how it votes on the

Table of Contents

issuer s proxy. Prospect Capital Management believes that adherence to these policies and procedures ensures that proxies are voted with only its clients best interests in mind. To ensure that its votes are not the product of a conflict of interests, Prospect Capital Management requires that: (i) anyone involved in the decision making process (including members of the Proxy Voting Committee) disclose to the chairman of the Proxy Voting Committee any potential conflict that he or she is aware of and any contact that he or she has had with any interested party regarding a proxy vote; and (ii) employees involved in the decision making process or vote administration are prohibited from revealing how Prospect Capital Management intends to vote on a proposal in order to reduce any attempted influence from interested parties.

Proxy voting. Each account s custodian will forward all relevant proxy materials to Prospect Capital Management, either electronically or in physical form to the address of record that Prospect Capital Management has provided to the custodian.

Proxy recordkeeping. Prospect Capital Management must retain the following documents pertaining to proxy voting:

- copies of its proxy voting polices and procedures;
- copies of all proxy statements;
- records of all votes cast by Prospect Capital Management;
- copies of all documents created by Prospect Capital Management that were material to making a decision how to vote proxies or that memorializes the basis for that decision; and
- copies of all written client requests for information with regard to how Prospect Capital Management voted proxies on behalf of the client as well as any written responses provided.

All of the above-referenced records will be maintained and preserved for a period of not less than five years from the end of the fiscal year during which the last entry was made. The first two years of records must be maintained at our office.

Proxy voting records. Clients may obtain information about how Prospect Capital Management voted proxies on their behalf by making a written request for proxy voting information to: Compliance Officer, Prospect Capital Management LLC, 10 East 40th Street, 44th Floor, New York, NY 10016.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 imposes a variety of regulatory requirements on publicly-held companies. In addition to our Chief Executive and Chief Financial Officers required certifications as to the accuracy of our financial reporting, we are also required to disclose the effectiveness of our disclosure controls and procedures as well as report on our assessment of our internal controls over financial reporting, the latter of which must be audited by our independent registered public accounting firm.

The Sarbanes-Oxley Act also requires us to continually review our policies and procedures to ensure that we remain in compliance with all rules promulgated under the Act.

CUSTODIAN, TRANSFER AND DIVIDEND PAYING AGENT AND REGISTRAR

Our Securities are held under a custody agreement by U.S. Bank National Association. The address of the custodian is: 1555 North Rivercenter Drive, MK-WI-5302, Milwaukee, WI 53212, Attention: Mutual Fund Custody Account Administrator, facsimile: (866) 350-1430. American Stock Transfer & Trust Company acts as our transfer agent, dividend paying agent and registrar. The principal business address of American Stock Transfer & Trust Company is 59 Maiden Lane, New York, NY 10007, telephone number: (718) 921-8200.

Table of Contents

BROKERAGE ALLOCATION AND OTHER PRACTICES

Since we generally acquire and dispose of our investments in privately negotiated transactions, we infrequently use brokers in the normal course of our business. The aggregate amount of brokerage commissions paid by us during the three most recent fiscal years is $105,613. Subject to policies established by our Board of Directors, Prospect Capital Management is primarily responsible for the execution of the publicly-traded securities portion of our portfolio transactions and the allocation of brokerage commissions.

Prospect Capital Management does not expect to execute transactions through any particular broker or dealer, but seeks to obtain the best net results for the Company, taking into account such factors as price (including the applicable brokerage commission or dealer spread), size of order, difficulty of execution, and operational facilities of the firm and the firm s risk and skill in positioning blocks of securities. While Prospect Capital Management generally seeks reasonably competitive trade execution costs, the Company will not necessarily pay the lowest spread or commission available. Subject to applicable legal requirements, Prospect Capital Management may select a broker based partly upon brokerage or research services provided to it and the Company and any other clients. In return for such services, we may pay a higher commission than other brokers would charge if Prospect Capital Management determines in good faith that such commission is reasonable in relation to the services provided.

PLAN OF DISTRIBUTION

We may sell the Securities pursuant to this prospectus and a prospectus supplement in any of four ways (or in any combination): (a) through underwriters or dealers; (b) directly to a limited number of purchasers or to a single purchaser, including existing stockholders in a rights offering; (c) through agents; or (d) directly to our stockholders and others through the issuance of transferable or non-transferable rights to our stockholders. In the case of a rights offering, the applicable prospectus supplement will set forth the number of shares of our common stock issuable upon the exercise of each right and the other terms of such rights offering. We will not sell shares of common stock in a rights offering at a price below NAV per share under this prospectus. Any underwriter or agent involved in the offer and sale of the Securities will also be named in the applicable prospectus supplement. The Securities may be sold at-the-market to or through a market maker or into an existing trading market for the securities, on an exchange or otherwise. The prospectus supplement will set forth the terms of the offering of such securities, including:

- the name or names of any underwriters or agents and the amounts of Securities underwritten or placed by each of them;
- the offering price of the Securities and the proceeds to us and any discounts, commissions or concessions allowed or reallowed or paid to underwriters or agents; and
- any securities exchanges on which the Securities may be listed.

In addition, pursuant to the terms of certain applicable registration rights agreements entered into by us or that we may enter into in the future, certain of our stockholders may resell shares of our common stock under this prospectus and as described in any related prospectus supplement.

We may use Securities to acquire investments in companies, the terms of which will be further disclosed in a prospectus supplement if such stock is issued in an offering hereunder.

Any offering price and any discounts or concessions allowed or reallowed or paid to underwriters or agents may be changed from time to time.

We may sell our common stock, or warrants, options or rights to acquire our common stock, at a price below the current net asset value of our common stock in certain circumstances, including if (i)(1) the holders of a majority of our shares (or, if less, at least 67% of a quorum consisting of a majority of our shares) and a similar majority of the holders of our shares who are not affiliated persons of us approve the sale of our common stock at a price that is less than the current net asset value, and (2) a majority of our Directors who have no financial interest in the transaction and a majority of our independent Directors (a) determine that such sale is in our and our stockholders best interests and (b) in consultation with any underwriter or underwriters of the offering, make a good faith determination as of a time either immediately prior to the first solicitation by us or on our behalf of firm commitments to purchase such shares, or immediately prior to the issuance of such shares, that the price at which such shares are to be sold is not less than a price which closely approximates the market value of such shares, less any distributing commission or discount or if (ii) a majority of the number of the beneficial holders of our common stock entitled to vote at the annual meeting, without regard to whether a majority of such shares are voted in favor of the proposal, approve the sale of our common stock at a price that is less than the current net asset value per share.

If underwriters are used in the sale of any Securities, Securities acquired by the underwriters for their own account may be resold from time to time in one or more transactions, including negotiated transactions, at a fixed public offering price or at varying prices determined at the time of sale. The Securities may be either offered to the public through underwriting syndicates represented by managing underwriters, or directly by underwriters. Generally, any obligations by the underwriters to purchase the Securities will be subject to certain conditions precedent.

The maximum commission or discount to be received by any FINRA member or independent broker-dealer will not exceed 8%. In connection with any rights offering to our stockholders, we may also enter into a standby underwriting arrangement with one or more underwriters pursuant to which the underwriter(s) will purchase our common stock remaining unsubscribed for after the rights offering.

We may sell the Securities through agents from time to time. The prospectus supplement will name any agent involved in the offer or sale of the Securities and any commissions we pay to them. Generally, any agent will be acting on a best efforts basis for the period of its appointment.

Agents, dealers and underwriters may be entitled to indemnification by us against certain civil liabilities, including liabilities under the Securities Act or to contribution with respect to payments which the agents or underwriters may be required to make in respect thereof. Agents, dealers and underwriters may be customers of, engage in transactions with, or perform services for us in the ordinary course of business.

We may enter into derivative transactions with third parties, or sell Securities outside of this prospectus to third parties in privately negotiated transactions. If the applicable prospectus supplement indicates, in connection with those derivatives, the third parties may sell Securities covered by this prospectus and the applicable prospectus supplement, including in short sale transactions. If so, the third party may use Securities pledged by us or borrowed from us or others to settle those sales or to close out any related open borrowings of stock, and may use securities received from us in settlement of those derivatives to close out any related open borrowings of stock. The third party in such sale transactions will be an underwriter and, if not identified in this prospectus, will be identified in the applicable prospectus supplement (or a post-effective amendment). We or one of our affiliates may loan or pledge Securities to a financial institution or other third party that in turn may sell the securities using this prospectus. Such financial institution or third party may transfer its short position to investors in our Securities or in connection with a simultaneous offering of other Securities offered by this prospectus or otherwise.

In order to comply with the securities laws of certain states, if applicable, the Securities offered hereby will be sold in such jurisdictions only through registered or licensed brokers or dealers. In addition, in certain states, the Securities may not be sold unless they have been registered or qualified for sale in the applicable state or an exemption from the registration or qualification requirements is available and is complied with.

LEGAL MATTERS

Certain legal matters regarding the securities offered by this prospectus will be passed upon for the Company by Skadden, Arps, Slate, Meagher & Flom LLP, New York, NY, and Venable LLP as special Maryland counsel.

INDEPENDENT REGISTERED ACCOUNTING FIRM

BDO Seidman, LLP is the independent registered public accounting firm of the Company.

Table of Contents

AVAILABLE INFORMATION

We have filed with the SEC a registration statement on Form N-2, together with all amendments and related exhibits, under the Securities Act, with respect to our Securities offered by this prospectus. The registration statement contains additional information about us and the Securities being registered by this prospectus. We file with or submit to the SEC annual, quarterly and current periodic reports, proxy statements and other information meeting the informational requirements of the Exchange Act. This information and the information specifically regarding how we voted proxies relating to portfolio securities for the period ended June 30, 2009, are available free of charge by contacting us at 10 East 40th Street, 44th floor, New York, NY 10016 or by telephone at toll-free (888) 748-0702. You may inspect and copy these reports, proxy statements and other information, as well as the registration statement and related exhibits and schedules, at the Public Reference Room of the SEC at 100 F Street NE, Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at (202) 551-8090 or by calling 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements and other information filed electronically by us with the SEC which are available on the SEC s Internet site at http://www.sec.gov. Copies of these reports, proxy and information statements and other information may be obtained, after paying a duplicating fee, by electronic request at the following E-mail address: publicinfo@sec.gov, or by writing the SEC s Public Reference Section, Washington, D.C. 20549-0102.

INDEX TO FINANCIAL STATEMENTS

PROSPECT CAPITAL CORPORATION

PATRIOT CAPITAL FUNDING INC.

AUDITED FINANCIAL STATEMENTS

Table of Contents

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

UNAUDITED PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

On December 2, 2009 we acquired the outstanding shares of Patriot common stock. The holders of Patriot s common stock received 0.363992 shares of our common stock. This resulted in approximately 8.4 million shares of common stock being issued by us. In connection with the transaction, we repaid all the outstanding borrowings of Patriot, in compliance with the merger agreement. The unaudited pro forma condensed combined financial information has been derived from and should be read in conjunction with the historical consolidated combined financial statements and the related notes of both Patriot and ours, which are included elsewhere in this document.

The following unaudited pro forma condensed combined financial information and explanatory notes illustrate the effect of the merger on our financial position and results of operations based upon the companies respective historical financial positions and results of operations under the acquisition method of accounting with us treated as the acquirer. Under this method of accounting, the assets and liabilities of Patriot will be recorded by us at their estimated fair values as of the date the merger is completed. The unaudited pro forma condensed combined financial information of ours and Patriot reflects the unaudited combined condensed balance sheet as of September 30, 2009 and the unaudited combined condensed income statements for the year ended June 30, 2009 and the three months ended September 30, 2009, updated where more timely information is available. The condensed consolidated balance sheet as of September 30, 2009 assumes the acquisition took place on that date. The condensed consolidated statements of income for the year ended June 30, 2009 and the three months ended September 30, 2009 assumes the acquisition took place on July 1, 2008. The unaudited pro forma condensed combined balance sheet also reflects the impact of certain transactions that occurred subsequent to September 30, 2009. Certain items in the pro forma financial statements are accounted for on a tentative basis while the accounting for Patriot as of the acquisition date is finalized.

The unaudited pro forma condensed combined financial information is presented for illustrative purposes only and does not indicate the financial results of the combined companies had the companies actually been combined at the beginning of each period presented, nor the impact of possible business model changes. The unaudited pro forma condensed combined financial information also does not consider any potential impacts of current market conditions on revenues, expense efficiencies, asset dispositions, and share repurchases, among other factors. In addition, as explained in more detail in the accompanying notes to the unaudited pro forma condensed combined financial information, the allocation of the pro forma purchase price reflected in the unaudited pro forma condensed combined financial information is subject to adjustment and may vary significantly from the actual purchase price allocation that will be recorded upon completion of the merger.

Table of Contents

PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES

PRO FORMA CONDENSED CONSOLIDATED BALANCE SHEET
September 30, 2009

	Prospect	Pro Forma Patriot (A)	Pro Forma Adjustments	Pro Forma
		(In thousands) Unaudited		
ASSETS AND LIABILITIES DATA				
Investment Securities	$ 510,798	$ 257,477	$ (50,351)(C)	$ 717,924
Cash	92,163	1,697	(19,822)(B)	26,725
			(47,313)(C)	
Other Assets	12,534	2,343		14,877
Total Assets	615,495	261,517	(117,486)	759,526
Borrowings		107,313	(107,313)(C)	60,000
			60,000(C)	
Other Liabilities	8,249	5,924		14,173
Total Liabilities	8,249	113,237	(47,313)	74,173
Net Assets	$ 607,246	$ 148,280	(19,822)(B)	$ 685,353
			(50,351)(C)	

See accompanying notes to unaudited pro forma condensed combined financial statements.

Table of Contents

PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES

PRO FORMA CONDENSED CONSOLIDATED INCOME STATEMENT
Three Months Ended September 30, 2009

	Three Months Ended September 30, 2009 Prospect	Patriot	Pro Forma Adjustments	Pro Forma
	(In thousands, except per share data) Unaudited			
Performance Data				
Interest and Dividend Income	$ 21,053	$ 7,800	$ (D)	$ 28,853
Fee Income		138		138
Other Income	464	112		576
Total Investment Income	21,517	8,050		29,567
Interest Expense	(1,374)	(2,405)	(1,408)(E)	(2,371)
Base Management Fees	(3,209)		(1,408)(F)	(4,617)
Income Incentive Fees	(3,080)		(339)(G)	(3,419)
General and Administrative Expenses	(1,536)	(4,497)	550(H)	(5,483)
Total Expenses	(9,199)	(6,902)	211	(15,890)
Net Investment Income	12,318	1,148	211	13,677
Realized Gain/(Loss)		(20,906)		(20,906)
Unrealized Gain/(Loss)	(18,696)	15,023		(3,673)
Net Realized and Unrealized Gain/(Loss)	(18,696)	(5,883)		(24,579)
Net Income	$ (6,378)	$ (4,735)	$ 211	$ (10,902)
Average Shares Outstanding	49,805	20,951	(12,507)(I)	58,249
Earnings Per Share	$ (0.13)	$ (0.23)		$ (0.19)

See accompanying notes to unaudited pro forma condensed combined financial statements.

Table of Contents

PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES

PRO FORMA CONDENSED CONSOLIDATED INCOME STATEMENT
Year Ended June 30, 2009

	Year Ended June 30, 2009 Prospect	Patriot	Pro Forma Adjustments	Pro Forma
	(In thousands, except per share data) Unaudited			
Performance Data				
Interest and Dividend Income	$ 85,719	$ 35,146	$ (D)	$ 120,865
Fee Income		1,508		1,508
Other Income	14,762	338		15,100
Gain on Patriot Acquisition			4,159	4,159
Total Investment Income	100,481	36,992	4,159	141,632
Interest Expense	(6,161)	(8,537)	3,469(E)	(11,229)
Base Management Fees	(11,915)		(6,825)(F)	(18,740)
Income Incentive Fees	(14,790)		(3,680)(G)	(19,470)
General and Administrative Expenses	(8,452)	(8,314)	2,453(H)	(14,313)
Total Expenses	(41,318)	(16,851)	(5,583)	(63,752)
Net Investment Income	59,163	20,141	(1,424)	77,880
Realized Gain/(Loss)	(39,078)	(12,462)		(51,540)
Unrealized Gain/(Loss)	15,019	(45,334)		(30,315)
Net Realized and Unrealized Gain/(Loss)	(24,059)	(57,796)		(81,855)
Net Income	$ 35,104	$ (37,655)	$ (1,424)	$ (3,975)
Average Shares Outstanding	31,560	20,847	1,181(I)	53,588
Earnings Per Share	$ 1.11	$ (1.81)		$ (0.07)

See accompanying notes to unaudited pro forma condensed combined financial statements.

Prospect Capital Corporation and Subsidiaries

Pro Forma Schedule of Investments
Unaudited
As of September 30, 2009

Company (Industry)	Description	Investment	Prospect Cost	Prospect Fair Value	Pro Forma Patriot Cost	Pro Forma Patriot Fair Value	Pro Forma Prospect(1) Cost	Pro Forma Prospect(1) Fair Value
			(In thousands, except share data)					
Control investments:								
Ajax Rolled Ring & Machine *(Manufacturing)*	Manufacturer of seamless rolled rings	Senior Secured Note Tranche A (10.5%, due 4/13)	$ 21,377	$ 21,377			$ 21,377	$ 21,377
		Subordinated Secured Note Tranche B (17.5%, due 4/13)(2)	11,855	8,192			11,855	8,192
		Series A Convertible Preferred Shares (6,143 shares)	6,057				6,057	
		Unrestricted Common Shares (6 shares)						
Aylward Enterprises, LLC *(Machinery)*	Manufacturer of packaging equipment	Revolving Line of Credit (5.3%, due 2/12)(3)			3,956	3,956	3,956	3,956
		Senior Secured Term Loan A (6.0%, due 2/12)(3)			8,020	1,301	8,020	1,301
		Senior Subordinated Debt (22.0%, due 8/12)(2)(3)			6,747		6,747	
		Subordinated Member Note (8.0%, due 2/13)(2)(3)			148		148	
		Membership Interest			1,250		1,250	

		(1,250,000 units)						
C&J Cladding LLC *(Metal Services)*	Cladding services for deep-strata and sub-sea drilling components	Warrants (400 warrants, expiring 3/14)	580	3,067			580	3,067
Change Clean Energy Holdings, Inc. (CCEHI) *(Biomass Power)*	Owner of non-operating wood fired biomass power plant	Common Shares (1,000 shares)	2,826	2,530			2,826	2,530
Fischbein, LLC	Designer and manufacturer of packaging equipment	Senior Subordinated Debt (16.5%, due 5/13)(2)			3,609	3,609	3,609	3,609
(Machinery)		Membership Interest Class A (2,800,000 units)			2,800	2,739	2,800	2,739
Gas Solutions Holdings, Inc.	Owner and operator of a gas gathering and processing	Senior Secured Note (18.0%, due 12/18)	25,000	25,000			25,000	25,000
(Gas Gathering and Distribution)	system	Junior Secured Note (18.0%, due 12/18)	5,000	5,000			5,000	5,000
		Common Shares (100 shares)	5,003	55,187			5,003	55,187
Integrated Contract Services, Inc.	Provider of contract management services	Senior Demand Note (15.0%, due 6/09)	1,170	1,170			1,170	1,170
(Contracting)		Senior Secured Note (14.0% plus 6.0% default interest, past due)(2)(3)	800	800			800	800
		Junior Secured Note (14.0% plus 6.0% default interest, past due)(2)(3)	14,003	4,001			14,003	4,001
		Series A Preferred shares (10 shares)						

Common Stock (49 shares)	679	679

Table of Contents

Prospect Capital Corporation and Subsidiaries

Pro Forma Schedule of Investments
Unaudited
As of September 30, 2009 (Continued)

pany stry)	Description	Investment	Prospect Cost	Prospect Fair Value	Pro Forma Patriot Cost	Pro Forma Patriot Fair Value	Pro Forma Prospect(1) Cost	Pro Forma Prospect(1) Fai Valu
			(In thousands, except share data)					
Horse Coiled ng, Inc. *luction Services)*	Provider of fracing services to oil and gas producers	Bridge Loan (18.0%, due 12/09)(2)	$ 11,003	$ 10,695			$ 11,003	$ 10,
		Senior Secured Note (15.0% due 12/09)	9,250	2,213			9,250	2,
		Common Shares (1,781 shares)	268				268	
Manufacturing, *ufacturing)*	Manufacturer and fabricator of steel structures and vessels	Senior Secured Note (16.5%, due 8/11)	13,080	13,080			13,080	13,
		Common shares (1,000 shares)	2,317	19,015			2,317	19,
a Corporation *e & Office ishings, ewares & ble)*	Manufacturer and marketer of professional high-grade fiberglass-handled striking and digging tools	Revolving Line of Credit (9.3%, due 9/12)(3)			1,082	1,082	1,082	1,
		Senior Secured Term Loan A (10.0%, due 9/12)(3)			5,108	5,108	5,108	5,
		Senior Subordinated Debt (15.0%, due 3/13)(2)(3)			3,143	387	3,143	
		Preferred Stock Class A (475 shares)			565		565	
					1,132		1,132	

		Preferred Stock Class B (1,045 shares)						
		Common Stock (1,140,584 shares)			80		80	
ndustries, Inc. *ufacturing)*	Manufacturer of custom equipment	Warrants (200,000 warrants, expiring 6/17)	1,682	4,220			1,682	4,
		Common Shares (545,107 shares)	5,086	11,502			5,086	11,
mp r Trailer pany, Inc. *mobile)*	Manufacturer of side dump trailers	Revolving Line of Credit (7.3%, due 1/11)			934	934	934	
		Senior Secured Term Loan A (7.3%, due 1/11)			2,037	1,450	2,037	1,
		Senior Secured Term Loan B (8.8%, due 1/11)			2,302		2,302	
		Senior Secured Term Loan C (16.5%, due 7/11)(2)			2,254		2,254	
		Senior Secured Term Loan D (7.3%, due 7/11)			1,700		1,700	
		Preferred Stock (49,635.5 shares)			166		166	
		Common Stock (64,050 shares)						
ville Coal ngs, Inc. *ng and Coal* *uction)*	Mining operation of coal	Senior Secured Note (15.7%, due 12/10)(3)	10,000	10,000			10,000	10,
		Junior Secured Note (15.7%, due 12/10)(3)	41,423	994			41,423	
		Common Stock (1,000 shares)	427				427	
Control tments			$ 188,886	$ 198,043	$ 47,033	$ 20,566	$ 235,919	$ 218,

Table of Contents

Prospect Capital Corporation and Subsidiaries

Pro Forma Schedule of Investments
Unaudited
As of September 30, 2009 (Continued)

ny ry)	Description	Investment	Prospect Cost	Prospect Fair Value	Pro Forma Patriot Cost	Pro Forma Patriot Fair Value	Pro Form Prospect(Cost	
			(In thousands, except share data)					
investments:								
hian Energy Holdings LLC *uction Services)*	Acquirer and operator of small and medium sized energy services companies	Senior Secured Debt Tranche A (17.0% plus 3.0% default interest, due 1/11)(2)(3)	$ 1,897	$ 1,123			$ 1,897	$
		Senior Secured Debt Tranche B (17.0% plus 3.0% default interest, past due)(2)(3)	1,960				1,960	
		Series C Preferred Equity (500 units)	500				500	
		Series B Preferred Equity (241 units)	241				241	
		Series A Preferred Equity (200 units)	82				82	
		Warrants (25,000 warrants, expiring 11/18)						
		Warrants (6,025 warrants, expiring 6/18)	172				172	
		Warrants (6,065 warrants, expiring 2/16)	176				176	
c Neuro Network *are, Education & re)*	Provider of neurophysiological monitoring services to surgeons	Senior Secured Note (12.5%, due 2/13)(2)	26,227	27,014			26,227	
		Preferred Shares (9,925.455 shares)	2,300	3,653			2,300	

aft Incorporated *& Leather)*	Supplier of spiritwear and campus apparel	Revolving Line of Credit (9.0%, due 9/13)	778	778	778
		Senior Secured Term Loan A (9.5%, due 9/13)	4,278	4,278	4,278
		Senior Secured Term Loan B (10.0%, due 9/13)	4,875	4,875	4,875
		Senior Secured Term Loan C (18.5%, due 3/14)(2)	6,831	6,831	6,831
		Preferred Stock (1,000,000 shares)	1,106	761	1,106
		Common Stock (10,000 shares)			
oldings, LLC *& Leather)*	Manufacturer and distributor of specialty pet products	Revolving Line of Credit (10.5%, due 1/12)	1,490	1,490	1,490
		Senior Secured Term Loan A (10.5%, due 1/12)	3,667	3,667	3,667
		Senior Secured Term Loan B (12.0%, due 1/12)	446	446	446
		Senior Secured Term Loan C (18.0%, due 3/12)(2)	4,626	4,346	4,626
		Membership Interest Class A (730.02 units)	730		730
		Membership Interest Common (199,795.08 units)			
LC(3) *fied/Conglomerate Service)*	Provider of tuition management services	Membership Interest Class B (1,218 units)	1,281		1,281
		Membership Interest Class D (1 unit)	290		290

Table of Contents

Prospect Capital Corporation and Subsidiaries

Pro Forma Schedule of Investments
Unaudited
As of September 30, 2009 (Continued)

			Prospect		Pro Forma Patriot		Pro Forma Prospect(1	
ny try)	Description	Investment	Cost	Fair Value	Cost	Fair Value	Cost	F V
			(In thousands, except share data)					
elmets Holdings, LLC(5)	Manufacturer of protective headgear	Senior Secured Term Loan A (4.3%, due 12/13)			$ 3,988	$ 3,494	$ 3,988	$
al & Nondurable Consumer ts)		Senior Secured Term Loan B (4.9%, due 12/13)			7,356	6,443	7,356	
		Senior Subordinated Debt Series A (15.0%, due 6/14)(2)			7,072	6,026	7,072	
		Senior Subordinated Debt Series B (15.0%, due 6/14)(2)			1,307	1,116	1,307	
		Common Stock (20,000 shares)			2,000	1,402	2,000	
ffiliate Investments			$ 33,555	$ 31,790	$ 52,121	$ 45,953	$ 85,676	$ 7
ntrol/non-affiliate investments:								
CO, Inc.	Distributor of specialty chemicals and contract application services	Revolving Line of Credit (10.3%, due 7/11)			789	789	789	
ical)		Senior Secured Term Loan A (10.3%, due 6/11)			7,436	7,436	7,436	

		Common Stock (5,000 shares)			500	187	500	
t Fasteners International, LLC *nery)*	Distributor of fasteners and related hardware for use in aerospace, electronics and defense industries	Senior Secured Term Loan (4.0%, due 11/12)			5,208	5,004	5,208	
		Junior Secured Term Loan (14.0%, due 5/13)(2)			5,335	5,268	5,335	
		Convertible Preferred Stock (32,000 shares)			241	392	241	
an Gilsonite Company *lty Minerals)*	Miner and distributor of Gilsonite	Senior Subordinated Note (15.0%, due 3/13)(2)	14,783	15,078			14,783	1
		Membership Interest Units in AGCPEP, LLC (99.9999)%	1,031	3,084			1,031	
Defense Group, Inc. *pace & Defense)*	Diversified defense company	Common Stock (4,000 shares)			463	146	463	
ead General Insurance Agency, *surance)*	Insurance agency and program specialist	Junior Secured Term Loan (12.8%, due 2/13)(2)			5,052	3,826	5,052	
Inc. *g, Steel, Iron & Nonprecious*	Manufacturer of pre-fabricated metal building systems	Revolving Line of Credit (8.0%, due 5/10)			797	797	797	
		Senior Secured Term Loan B (11.5%, due 5/10)			1,609	1,609	1,609	
		Senior Secured Term Loan C (19.0%, due			8,348	2,155	8,348	

5/10)(2) Common Stock Warrants (33,750 warrants)	18	18

F-10

Table of Contents

Prospect Capital Corporation and Subsidiaries

Pro Forma Schedule of Investments
Unaudited
As of September 30, 2009 (Continued)

ompany (ndustry)	Description	Investment	Prospect Cost	Prospect Fair Value	Pro Forma Patriot Cost	Pro Forma Patriot Fair Value	Pro Forma Prospect(1) Cost	Pro Forma Prospect(1) Fair Value
			(In thousands, except share data)					
aleel + Hayden, LLC *Personal & Nondurable onsumer Products)*	Provider of proprietary branded professional skincare and cosmetic products to physicians and spa communities	Junior Secured Term Loan B (9.8%, due 11/11)			$ 9,868	$ 9,868	$ 9,868	$ 9,868
		Senior Subordinated Debt (16.5%, due 11/12)			6,202	6,264	6,202	6,264
		Common Stock (7,500 shares)			750	689	750	689
		Options in Mineral Fusion Natural Brands, LLC (11,662 options)						
astro Cheese ompany, Inc. *Food Products)*	Manufacturer, packager and distributor of cheese products	Junior Secured Note (13.0%, due 2/13)(2)	7,459	7,608			7,459	7,608
onquest Cherokee, LC *Oil and Gas roduction)*	Developer of gas reserves	Senior Secured Note (13.0% plus 4.0% default interest, past due)(3)	10,441	4,963			10,441	4,963
		Overriding Royalty Interests		362				362
S Operating, LLC	Provider of maintenance, repair and	Revolving Line of Credit (10.5%, due 1/13)			196	196	196	196

uildings & Real state)	replacement of HVAC, electrical, plumbing, and foundation repair	Senior Secured Term Loan A (9.5%, due 7/12)			1,502	1,502	1,502	1,502
		Senior Subordinated Debt (16.5%, due 1/13)(2)			2,717	2,717	2,717	2,717
opernicus Group *Healthcare, ducation & Childcare)*	Provider of clinical trial review services	Revolving Line of Credit (11.5%, due 10/13)			134	134	134	134
		Senior Secured Term Loan A (11.5%, due 10/13)			7,327	7,327	7,327	7,327
		Senior Subordinated Debt (18.0%, due 4/14)			12,387	10,855	12,387	10,855
		Preferred Stock Series A (1,000,000 shares)			1,000	558	1,000	558
ustom Direct, Inc. *Printing & Publishing)*	Direct marketer of checks and other financial products and services	Senior Secured Term Loan (3.0%, due 12/13)			1,569	1,382	1,569	1,382
		Junior Secured Term Loan (6.3%, due 12/14)			2,000	1,150	2,000	1,150
eb Shops, Inc. *(Retail)*	Apparel retailer	Second Lien Debt (8.7%, due 10/14)	15,440	4,236			15,440	4,236
iamondback perating, LP *(Oil and as Production)*	Oil and gas drilling	Net Profits Interest (15.0% payable on Equity distributions)		438				438

Prospect Capital Corporation and Subsidiaries

Pro Forma Schedule of Investments
Unaudited
As of September 30, 2009 (Continued)

Company (Industry)	Description	Investment	Prospect Cost	Prospect Fair Value	Pro Forma Patriot Cost	Pro Forma Patriot Fair Value	Pro Forma Prospect(1) Cost	Pro Forma Prospect(1) Fair Value
			(In thousands, except share data)					
Dover Saddlery, Inc. *(Retail Stores)*	Equestrian products catalog retailer	Common Stock (30,974 shares)			$ 148	$ 67	$ 148	$ 67
EXL Acquisition Corp.	Manufacturer of lab testing supplies	Senior Secured Term Loan A (3.9%, due 3/11)			2,150	1,993	2,150	1,993
(Electronics)		Senior Secured Term Loan B (4.2%, due 3/12)			4,165	3,859	4,165	3,859
		Senior Secured Term Loan C (4.7%, due 3/12)			2,562	2,373	2,562	2,373
		Senior Secured Term Loan D (15.0%, due 3/12)			6,127	6,127	6,127	6,127
		Common Stock Class A (2,475 shares)			2	403	2	403
		Common Stock Class B (25 shares)			298	304	298	304
Fairchild Industrial Products, Co.	Manufacturer of industrial controls and power transmission products	Preferred Stock Class A (378.4 shares)			373	380	373	380
(Electronics)					122	260	122	260

		Common Stock Class B (27.5 shares)						
Freedom Marine Services LLC *(Shipping Vessels)*	Operator of offshore supply vessels	Subordinated Secured Note (16.0%, due 12/11)(2)	7,241	6,469			7,241	6,469
		Net Profits Interest (22.5% payable on Equity distributions)						
H&M Oil & Gas, LLC *(Oil and Gas Production)*	Developer of oil and gas holdings	Senior Secured Note (13.0%, due 6/10)	49,661	49,284			49,661	49,284
		Net Profits Interest (8.0% payable on Equity distributions)		1,519				1,519
Hudson Products Holdings, Inc. *(Mining, Steel, Iron & Nonprecious Metals)*	Manufactures and designs air-cooled heat exchanger equipment	Senior Secured Term Loan (8.0%, due 8/15)			7,229	6,125	7,229	6,125
IEC Systems LP (IEC)/ Advanced Rig Services LLC *(ARS) (Oilfield Fabrication)*	Provider of electrical and rig-up services	ARS senior Secured Note (15.0%, due 11/12)(2)	12,482	12,731			12,482	12,731
		IEC senior Secured Note (15.0%, due 11/12)(2)	20,810	21,226			20,810	21,226
Impact Products, LLC *(Machinery)*	Distributor of janitorial supplies	Junior Secured Term Loan (6.3%, due 9/12)			8,793	8,526	8,793	8,526
		Senior Subordinated Debt (15.0%,			5,524	5,524	5,524	5,524

		due 9/12)				
Label Corp Holdings, Inc. *(Printing & Publishing)*	Manufacturer of prime labels	Senior Secured Term Loan (7.9%, due 8/14)	5,590	5,019	5,590	5,019

Table of Contents

Prospect Capital Corporation and Subsidiaries

Pro Forma Schedule of Investments
Unaudited
As of September 30, 2009 (Continued)

Company (Industry)	Description	Investment	Prospect Cost	Prospect Fair Value	Pro Forma Patriot Cost	Pro Forma Patriot Fair Value	Pro Forma Prospect(1) Cost	Pro Forma Prospect(1) Fair Value
			(In thousands, except share data)					
LHC Holdings Corp. *(Healthcare, Education & Childcare)*	Provider of home healthcare services	Senior Secured Term Loan A (4.3%, due 11/12)			$ 3,245	$ 2,898	$ 3,245	$ 2,898
		Senior Subordinated Debt (14.5%, due 5/13)			4,526	4,526	4,526	4,526
		Membership Interest (125,000 units)			125	182	125	182
Mac & Massey Holdings, LLC *(Grocery)*	Broker and distributor of ingredients to manufacturers of food products	Senior Subordinated Debt (15.8%, due 2/13)(2)			8,280	8,280	8,280	8,280
		Common Stock (250 shares)			235	470	235	470
Maverick Healthcare, LLC *(Healthcare, Education & Childcare)*	Provider of home healthcare products and services	Second Lien Debt (13.5%, due 4/14)(2)	12,779	12,904			12,779	12,904
		Preferred Units (1,250,000 units)	1,252	1,549			1,252	1,549
		Common Units (1,250,000 units)						
Miller Petroleum, Inc.	Developer of oil and gas holdings	Warrants (15,811,856 warrants, expiring 5/10 to 6/14)	150	312			150	312

(Oil and Gas Production)								
Northwestern Management Services, LLC *(Healthcare, Education & Childcare)*	Provider of dental services	Revolving Line of Credit (5.8%, due 12/12)			118	118	118	118
		Senior Secured Term Loan A (4.3%, due 12/12)			5,013	4,697	5,013	4,697
		Senior Secured Term Loan B (4.8%, due 12/12)			1,219	1,142	1,219	1,142
		Junior Secured Term Loan (15.0%, due 6/13)(2)			2,885	2,785	2,885	2,785
		Common Stock (500 shares)			500	451	500	451
Prince Mineral Company, Inc. *(Metals & Minerals)*	Manufacturer of pigments	Junior Secured Term Loan (5.5%, due 12/12)			11,079	11,079	11,079	11,079
		Senior Subordinated Debt (14.0%, due 7/13)(2)			12,033	12,033	12,033	12,033
Qualitest Pharmaceuticals, Inc. *(Pharmaceuticals)*	Manufacturer of generic prescription pharmaceuticals	Second Lien Debt (8.1%, due 4/15)	11,951	11,684			11,951	11,684
Quartermaster, Inc. *(Retail)*	Retailer of uniforms and tactical equipment to law enforcement and security professionals	Revolving Line of Credit (5.9%, due 12/10)			2,988	2,988	2,988	2,988
		Senior Secured Term Loan A (5.7%, due 12/10)			2,256	2,256	2,256	2,256
		Senior Secured Term Loan B (7.0%, due 12/10)			2,515	2,515	2,515	2,515
		Senior Secured Term Loan C			3,460	3,460	3,460	3,460

		(15.0%, due 12/11)(2)				
Regional Management Corp. *(Financial Services)*	Provider of non-prime consumer installment loans	Second Lien Debt (14.0%, due 6/12)(2)	25,554	23,365	25,554	23,365
Resco Products, Inc. *(Manufacturing)*	Manufacturer of refractory products	Second Lien Debt (8.67%, due 6/14)	9,599	9,750	9,599	9,750

Prospect Capital Corporation and Subsidiaries

Pro Forma Schedule of Investments
Unaudited
As of September 30, 2009 (Continued)

npany ustry)	Description	Investment	Prospect Cost	Prospect Fair Value	Pro Forma Patriot Cost	Pro Forma Patriot Fair Value	Pro Forma Prospect(1) Cost	Pro Forma Prospect(1) Fair Value
			(In thousands, except share data)					
-M Corporation *omobile)*	Manufacturer of doors, ramps and bulk heads for	Senior Secured Term Loan A (3.0%, due 2/13)			$ 5,699	$ 5,190	$ 5,699	$ 5,1
	fire trucks and food transportation	Senior Secured Term Loan B (4.5%, due 5/13)			8,239	7,500	8,239	7,5
		Senior Subordinated Debt (15.0%, due 8/13)			7,132	7,132	7,132	7,1
rrer s Foods, Inc. *od Products)*	Manufacturer of snack foods	Second Lien Debt (14.0%, due 10/13)	18,000	18,360			18,000	18,3
		Membership Interest Units in Mistral Chip Holdings, LLC (2,000 units)	2,000	3,762			2,000	3,7
ker Energy, LLC *and Gas Production)*	Developer of oil and gas holdings	Subordinated Secured Revolving Credit Facility (12.0%, due 12/11)	29,185	28,468			29,185	28,4
		Overriding Royalty		2,825				2,8

		Interests						
etto Group	Developer of software for healthcare payers	Subordinated Unsecured Note (13.5%, due 10/16)(2)	15,125	16,410			15,125	16,4
althcare, Education & dcare)								
ek	Outsourced satellite and cable installation services	Second Lien Debt (13.1%, due 12/13)	11,366	11,730			11,366	11,7
hnical Services)								
d River Resources o. and Wind River II o.	Developer of oil and gas holdings	Senior Secured Note (13.0% plus 3.0% default interest, due 7/10)(3)	15,000	12,718			15,000	12,7
and Gas Production)		Net Profits Interest (5.0% payable on Equity distributions)		130				1
l -Control/Non-Affiliate stments			$ 291,309	$ 280,965	$ 206,078	$ 190,913	$ 497,387	$ 471,8
Forma Adjustments: nges in loan balances equent to ember 30, 2009					45	45	45	
ected Fair Value ermination Adjustment								(50,3
l Investments			$ 513,750	$ 510,798	$ 305,277	$ 257,477	$ 819,027	$ 717,9

Prospect Capital Corporation and Subsidiaries

Pro Forma Schedule of Investments
Unaudited
As of September 30, 2009 (Continued)

(1) Upon consummation of the merger and in accordance with the acquisition method of accounting as detailed in Accounting Standards Codification (ASC) 805, Business Combinations (ASC 805), Prospect is required to determine the fair value of each of Patriot s investments and record such fair value as the cost basis and initial fair value of each such investment in Prospect s financial statements. In this regard, Prospect s management, in conjunction with the assistance of an independent valuation firm had preliminarily determined that the aggregate fair value of Patriot s investments approximated the purchase price to be paid by Prospect to acquire Patriot in connection with the merger. Since the signing of the merger agreement, there has been an increase in the value of the investments being acquired and as such, Prospect expects to recognize a gain of $4.2 million in conjunction with the acquisition of Patriot. As a result, the adjustment for the write-down of the assets to fair value on December 2, 2009 has been reflected in a single line item below entitled Expected Fair Value Determination Adjustment. However, a final determination of the fair value of Patriot s investments will be made after the merger is completed and, as a result, the actual amount of this adjustment may vary from the preliminary amount set forth herein. Thus, the information set forth in the columns below reflect historical amounts and have not been individually adjusted to reflect the write down of the fair value of Patriot s investments to conform to Prospect s preliminary determination of the fair value of such investments.

(2) Interest rate includes payment-in-kind (PIK) interest.

(3) Loan is on non-accrual status.

See accompanying notes to unaudited pro forma condensed combined financial statements.

PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Unaudited
(In thousands, except share and per share data)

Note 1 Basis of Pro Forma Presentation

The unaudited pro forma condensed combined financial information related to the merger is included as of and for the three months ended September 30, 2009 and for the year ended June 30, 2009. On December 2, 2009, Prospect acquired Patriot for approximately $201,083. This purchase price was calculated based upon a price of Prospect common stock of $10.99 per share, $970 for the purchase of restricted stock from the former employees of Patriot and repayment of the debt outstanding at closing of $107,313.

On December 2, 2009, Patriot made a final dividend equal to its undistributed net ordinary income and capital gains of $0.38 per share. In accordance with a recent IRS revenue procedure, the dividend was paid 10% in cash and 90% in newly issued shares of Patriot s common stock. The exchange ratio was adjusted to give effect to the tax distribution. The pro forma adjustments included herein reflect the conversion of Patriot common stock into Prospect common stock using an exchange ratio of 0.363992 of a share of Prospect common stock, with 8,444,068 shares of Prospect common stock being issued to the holders of the Patriot shares.

The merger will be accounted for as an acquisition of Patriot by Prospect in accordance with acquisition method of accounting as detailed in Accounting Standards Codification (ASC) 805, Business Combinations (ASC 805). The fair value of the consideration paid is allocated to the assets acquired and liabilities assumed based on their fair values as the date of acquisition. As described in more detail in FAS 141(R), goodwill, if any, is recognized as of the acquisition date, for the excess of the consideration transferred over the fair value of identifiable net assets acquired. If the total acquisition date fair value of the identifiable net assets acquired exceeds the fair value of the consideration transferred, the excess is recognized as a gain. In connection with the merger of Patriot and Prospect, the estimated fair value of the net assets acquired is anticipated to equal the purchase price and based on Prospect s preliminary purchase price allocation; no gain will be recorded by Prospect in the period the merger is completed.

Under the 1940 Act rules, the regulations pursuant to Article 6 of Regulation S-X and the American Institute of Certified Public Accountants Audit and Accounting Guide for Investment Companies, we are precluded from consolidating any entity other than another investment company or an operating company which provides substantially all of its services and benefits to us. Our financial statements include our accounts and the accounts of Prospect Capital Funding, LLC, our only wholly-owned, closely-managed subsidiary that is also an investment company. All intercompany balances and transactions have been eliminated in consolidation.

In determining the value of the assets to be acquired, ASC 820 Fair Value Measurements and Disclosures (ASC 820), was utilized. Under ASC 820, investments are valued utilizing a market approach, an income approach, or both approaches, as appropriate. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities (including a business). The income approach uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present value amount (discounted) calculated based on an appropriate discount rate. The measurement is based on the net present value indicated by current market expectations about those future amounts. In following these approaches, the types of factors that Prospect may take into account in fair value pricing its investments include, as relevant: available current market data, including relevant and applicable market trading and transaction comparables, applicable market yields and multiples, security covenants, call protection provisions, information rights, the nature and realizable value of any collateral, the portfolio company s ability to make payments, its earnings and discounted cash flows, the markets in which the portfolio company does business, comparisons of financial ratios of peer companies that are public, M&A comparables, the principal market and enterprise values, among other factors.

PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Unaudited
(In thousands, except share and per share data) (Continued)

ASC 820 classifies the inputs used to measure these fair values into the following hierarchy:

Level 1: Quoted prices in active markets for identical assets or liabilities, accessible by Prospect at the measurement date.

Level 2: Quoted prices for similar assets or liabilities in active markets, or quoted prices for identical or similar assets or liabilities in markets that are not active, or other observable inputs other than quoted prices.

Level 3: Unobservable inputs for the asset or liability.

In all cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level of input that is significant to the fair value measurement. Prospect s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to each investment. ASC 820 applies to fair value measurements already required or permitted by other standards. In accordance with ASC 820, the fair value of Prospect s investments is defined as the price that it would receive upon selling an investment in an orderly transaction to an independent buyer in the principal or most advantageous market in which that investment is transacted. Substantially all of the assets held by Prospect and Patriot are level 3 assets.

Certain other transactions which affect the purchase price and the ability to consummate the transaction but occurred subsequent to September 30, 2009 have been adjusted for in the unaudited condensed pro forma balance sheet. These include common stock issuances and debt repayments by Prospect and loan repayments received and settlements by Patriot. Prospect does not anticipate any realignment of the portfolio other than repayments by borrowers.

The unaudited pro forma condensed combined financial information includes preliminary estimated adjustments to record the assets and liabilities of Patriot at their respective estimated fair values and represents management s estimates based on available information. The pro forma adjustments included herein may be revised as additional information becomes available and as additional analyses are performed. The final allocation of the purchase price will be determined after the merger is completed and after completion of a final analysis to determine the estimated fair values of Patriot s assets and liabilities. Accordingly, the final purchase accounting adjustments and integration charges may be materially different from the pro forma adjustments presented in the document. Increases or decreases in the estimated fair values of the net assets, commitments, and other items of Patriot as compared to the information shown in the document may change the amount of the purchase price allocated to goodwill or recognized as income in accordance with ASC 805.

The unaudited pro forma condensed combined financial information is presented in this document is for illustrative purposes only and does not necessarily indicate the results of operations or the combined financial position that would have resulted had the merger been completed at the beginning of the applicable period presented, nor the impact of possible business model changes as a result of current market conditions which may impact revenues, expense efficiencies, asset dispositions, share repurchases and other factors. Additionally, the unaudited pro forma condensed combined financial information is not indicative of the results of operations in future periods or the future financial position of the combined company.

Note 2   Preliminary Purchase Accounting Allocations

The unaudited pro forma condensed combined financial information for the merger includes the unaudited pro forma condensed combined balance sheet as of September 30, 2009 assuming the merger was completed on September 30, 2009. The unaudited pro forma condensed combined income statements for the year ended June 30, 2009 and the three months ended September 30, 2009 were prepared assuming the merger was completed on July 1, 2008.

Table of Contents

PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Unaudited
(In thousands, except share and per share data) (Continued)

The unaudited pro forma condensed combined financial information reflects the issuance of 8,444,068 shares of Prospect common stock.

The merger will be accounted for using the purchase method of accounting; accordingly, Prospect s cost to acquire Patriot will be allocated to the assets and liabilities of Patriot at their respective estimated fair values estimated by Prospect as of the acquisition date. Accordingly, the pro forma purchase price has been allocated to the assets acquired and the liabilities assumed based on their estimated fair values as summarized in the following table:

Cash (to repay Patriot Debt)	$ 107,313
Cash (to fund purchase of restricted stock from former Patriot employees)	970
Common Stock issued	92,800
Total Purchase Price	201,083
Assets acquired:	
Investments	207,126
Cash and cash equivalents	1,697
Other assets	2,343
Assets acquired	211,166
Other Liabilities assumed	(5,924)
Net assets acquired	205,242
Gain on Patriot acquisition	4,159

Note 3 Preliminary Pro Forma Adjustments

The preliminary pro forma purchase accounting allocation included in the unaudited pro forma condensed combined financial information is as follows:

A To reflect Patriot s September 30, 2009 balance sheet, updated for estimated changes subsequent to September 30, 2009 to the acquisition date:

	PCAP Historical Sept. 30,	Pro Forma	Pro Forma PCAP Sept. 30, 2009 as

	2009	Adjustments(AA)	Adjusted
Investment Securities	$ 257,432	$ 45	$ 257,477
Cash and cash equivalents	5,062	(3,365)	1,697
Other Assets	10,421	(8,078)	2,343
Total Assets	$ 272,915	$ (11,398)	$ 261,517
Borrowings	$ 112,706	$ (5,393)	$ 107,313
Other Liabilities	4,278	1,646	5,924
Total Liabilities	116,984	(3,747)	113,237
Net Assets	155,931	(7,651)	148,280
	$ 272,915	$ (11,398)	$ 261,517

PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Unaudited
(In thousands, except share and per share data) (Continued)

(AA) Primarily the result of payments received from certain investments and the recognition of certain income related to such investments subsequent to September 30, 2009 and the use of the proceeds and cash on hand to repay outstanding borrowings and the recording of additional liabilities incurred by Patriot.

B To record the Prospect cash distribution paid on October 19, 2009.

C To reflect the acquisition of Patriot by the issuance of 8,444,068 shares of Prospect common stock and the payment of $107,313 to repay Patriot outstanding borrowings and $970 to purchase restricted stock from the former employees of Patriot. Below reflects the allocation of purchase price on the basis of the fair value of assets acquired and liabilities assumed:

Components of Purchase Price:

	Pro Forma Patriot September 30, 2009 As Adjusted	Pro Forma Adjustments	Pro Forma
Cash (to repay Patriot Debt)	$ 107,313	$	$ 107,313
Cash (to fund purchase of restricted stock from former Patriot employees)	970		970
Common Stock issued (AA)	92,800		92,800
Total Purchase Price	201,083		201,083
Assets acquired:			
Investments	257,477	(50,351)(BB)	207,126
Cash and cash equivalents	1,697		1,697
Other assets	2,343		2,343
Total assets acquired	261,517	(50,351)	211,166
Other liabilities assumed	(5,924)		(5,924)
Net assets acquired	$ 255,593	$ (50,351)	205,242
Gain on Patriot acquisition			$ 4,159

(AA) To reflect the issuance of 8,444,068 shares of Prospect common stock at an assumed price of $10.99 per share.

(BB) To reflect the write down of Patriot s fair value of its investments to Prospect s determination of fair value. Prospect is working in conjunction with an independent valuation agent and expects that the fair value of the investment portfolio will approximate the purchase price, which is approximately $50,351 less than the value determined by Patriot. Patriot s fair values, some of which have been determined in conjunction with an independent valuation agent, were derived utilizing different market assumptions than those utilized by Prospect.

D The purchase price of the investments being acquired from Patriot is below the amortized cost of such investments. As a result, subsequent to the acquisition date Prospect will record the accretion to par value in interest income over the term of the investment. Interest income has not been adjusted to reflect the accretion to par value for the periods presented. The accretion for the first 12 months after acquisition is estimated to be approximately $17,000.

E To reflect the reduction of Patriot interest expense for the year ended June 30, 2009 as though the repayment of the $107,313 occurred on July 1, 2008 and the reduction in interest cost for the three months ended

PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Unaudited
(In thousands, except share and per share data) (Continued)

September 30, 2009 and twelve months ended June 30, 2009 for the decrease in the cost of borrowing as the amount outstanding was reduced and the Prospect credit facility bears a lower rate of interest than the Patriot credit facility.

F Base management fees were computed based on 2% of Average Assets per Prospect s investment advisory agreement with Prospect Capital Management, LLC.

G Incentive management fees were recomputed based on the formula in Prospect s investment advisory agreement with Prospect Capital Management, LLC.

H Adjustments to general and administrative expenses were made to reflect investment professionals being retained by Prospect Capital Management, LLC and covered by the management fees.

I Weighted average shares have been adjusted to reflect the following:

	Year Ended June 30, 2009	Three Months Ended September 30, 2009
Prospect Weighted Average Shares Outstanding	31,560	49,805
Estimated shares issued to fund the repayment of Patriots Debt (reflected as outstanding for the period presented) for the year ended June 30, 2009	13,854	
Estimated shares issued in connection with the Merger, including any shares issued in satisfaction of any restricted stock agreements (reflected as outstanding for the period presented)	8,444	8,444
Prospect Adjusted Weighted Average Shares Outstanding	53,588	58,249

Table of Contents

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES
September 30, 2009 and June 30, 2009

	September 30, 2009 (Unaudited)	June 30, 2009 (Audited)
	(In thousands, except share and per share data)	
Assets (Note 9)		
Investments at fair value (cost of $513,750 and $531,424, respectively, Note 3) Control investments (cost of $188,886 and $187,105, respectively)	$ 198,043	$ 206,332
Affiliate investments (cost of $33,555 and $33,544, respectively)	31,790	32,254
Non-control/Non-affiliate investments (cost of $291,309 and $310,775, respectively)	280,965	308,582
Total investments at fair value	510,798	547,168
Investments in money market funds	85,143	98,735
Cash	7,020	9,942
Receivables for:		
Interest, net	4,652	3,562
Dividends	7	28
Other	314	571
Prepaid expenses	780	68
Deferred financing costs, net	6,781	6,951
Total Assets	615,495	667,025
Liabilities		
Credit facility payable (Note 9)		124,800
Due to Prospect Administration (Note 7)	157	842
Due to Prospect Capital Management (Note 7)	5,874	5,871
Accrued expenses	1,447	2,381
Other liabilities	771	535
Total Liabilities	8,249	134,429
Net Assets	$ 607,246	$ 532,596
Components of Net Assets		
Common stock, par value $0.001 per share (100,000,000 and 100,000,000 common shares authorized, respectively; 54,672,155 and 42,943,084 issued and outstanding, respectively)	$ 55	$ 43
Paid-in capital in excess of par	646,271	545,707
Undistributed net investment income	16,922	24,152

Accumulated realized losses on investments		(53,050)		(53,050)
Unrealized (depreciation) appreciation on investments		(2,952)		15,744
Net Assets	$	607,246	$	532,596
Net Asset Value Per Share	$	11.11	$	12.40

See notes to consolidated financial statements.

Table of Contents

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS
For The Three Months Ended September 30, 2009 and 2008

	For Three Months Ended September 30, 2009	September 30, 2008
	(Unaudited) (In thousands, except share and per share data)	
Investment Income		
Interest income:		
Control investments (Net of foreign withholding tax of $32 and $47, respectively)	$ 4,591	$ 6,722
Affiliate investments	849	560
Non-control/non-affiliate investments	9,395	10,274
Total interest income	14,835	17,556
Dividend income:		
Control investments	6,200	4,584
Money market funds	18	139
Total dividend income	6,218	4,723
Other income: (Note 4)		
Control/affiliate investments		744
Non-control/non-affiliate investments	464	12,776
Total other income	464	13,520
Total Investment Income	21,517	35,799
Operating Expenses		
Investment advisory fees:		
Base management fee (Note 7)	3,209	2,823
Income incentive fee (Note 7)	3,080	5,875
Total investment advisory fees	6,289	8,698
Interest and credit facility expenses	1,374	1,518
Sub-administration fees (including former Chief Financial Officer and Chief Compliance Officer)		250
Legal fees		597
Valuation services	120	160
Audit, compliance and tax related fees	262	177

Allocation of overhead from Prospect Administration (Note 7)		840		588
Insurance expense		63		61
Directors fees		64		81
Other general and administrative expenses		187		167
Total Operating Expenses		9,199		12,297
Net Investment Income		12,318		23,502
Net realized gain on investments				1,645
Net change in unrealized depreciation on investments		(18,696)		(11,149)
Net (Decrease) Increase in Net Assets Resulting from Operations	$	(6,378)	$	13,998
Net (decrease) increase in net assets resulting from operations per share:	$	(0.13)	$	0.47
Dividends declared per share:	$	0.41	$	0.40

See notes to consolidated financial statements.

Table of Contents

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS
For The Three Months Ended September 30, 2009 and 2008

	For the Three Months Ended September 30, 2009	For the Three Months Ended September 30, 2008
	(Unaudited) (In thousands, except share data)	
Increase in Net Assets from Operations:		
Net investment income	$ 12,318	$ 23,502
Net realized gain on investments		1,645
Net change in unrealized depreciation on investments	(18,696)	(11,149)
Net (Decrease) Increase in Net Assets Resulting from Operations	(6,378)	13,998
Dividends to Shareholders:	(19,548)	(11,882)
Capital Share Transactions:		
Net proceeds from capital shares sold	98,833	
Less: Offering costs of public share offerings	(1,158)	
Reinvestment of dividends	2,901	
Net Increase in Net Assets Resulting from Capital Share Transactions	100,576	
Total Increase in Net Assets:	74,650	2,116
Net assets at beginning of period	532,596	429,623
Net Assets at End of Period	$ 607,246	$ 431,739
Capital Share Activity:		
Shares sold	11,431,797	
Shares issued through reinvestment of dividends	297,274	
Net increase in capital share activity	11,729,071	
Shares outstanding at beginning of period	42,943,084	29,520,379
Shares Outstanding at End of Period	54,672,155	29,520,379

See notes to consolidated financial statements.

Table of Contents

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS
For The Three Months Ended September 30, 2009 and 2008

	For the Three Months Ended September 30, 2009	For the Three Months Ended September 30, 2008
	(Unaudited) (In thousands, except share data)	
Cash Flows from Operating Activities:		
Net (decrease) increase in net assets resulting from operations	$ (6,378)	$ 13,998
Net realized gain on investments		(1,645)
Net change in unrealized depreciation on investments	18,696	11,149
Accretion of original issue discount on investments	(501)	(1,770)
Amortization of deferred financing costs	823	180
Gain on settlement of net profits interest		(12,576)
Change in operating assets and liabilities:		
Payments for purchases of investments	(4,599)	(57,460)
Payment-In-Kind interest	(1,467)	(420)
Proceeds from sale of investments and collection of investment principal	24,241	10,949
Purchases of cash equivalents	(124,998)	(9,999)
Sales of cash equivalents	124,998	9,999
Net investments in money market funds	13,592	4,342
Increase in interest receivable	(1,090)	(1,422)
Decrease in dividends receivable	21	4,018
Decrease in loan principal receivable		8
Increase in receivable for managerial assistance		(2)
Increase in receivable for potential deal expenses		(303)
Decrease (increase) in other receivables	257	(45)
Increase in prepaid expenses	(712)	(73)
(Decrease) increase in due to Prospect Administration	(685)	343
Increase in due to Prospect Capital Management	3	2,685
Decrease in accrued expenses	(934)	(110)
Increase in other liabilities	236	369
Net Cash Provided By (Used In) Operating Activities:	41,503	(27,785)
Cash Flows from Financing Activities:		
Borrowings under credit facility		47,500
Payments under credit facility	(124,800)	(7,000)
Financing costs paid and deferred	(653)	(156)
Net proceeds from issuance of common stock	98,833	
Offering costs from issuance of common stock	(1,158)	
Dividends paid	(16,647)	(11,845)
Net Cash Provided By Financing Activities:	(44,425)	28,499

Total (Decrease) Increase in Cash		(2,922)		714
Cash balance at beginning of period		9,942		555
Cash Balance at End of Period	$	7,020	$	1,269
Cash Paid For Interest	$	348	$	1,250
Non-Cash Financing Activity:				
Amount of shares issued in connection with dividend reinvestment plan	$	2,901	$	

See notes to consolidated financial statements.

F-24

Table of Contents

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

CONSOLIDATED SCHEDULE OF INVESTMENTS
September 30, 2009 and June 30, 2009

		September 30, 2009				
Portfolio Investments(1)	**Locale/ Industry**	**Par Value/ Shares/ Ownership%**	**Cost**	**Fair Value(2)**	**% of Net Assets**
		(In thousands, except share data)			
Control Investments (25.00% or greater of voting control)					
Ajax Rolled Ring & Machine	South Carolina/ Manufacturing				
Unrestricted common shares (7 total unrestricted common shares issued and outstanding and 681.86 restricted common shares issued and outstanding)		6	$	$	0.0%
Series A convertible preferred shares (7,182.6 total preferred shares issued and outstanding)		6,142.6	6,057		0.0%
Subordinated secured note Tranche B, 11.50% plus 6.00% PIK, 4/01/2013(3),(4)		$ 11,855	11,855	8,192	1.3%
Senior secured note Tranche A, 10.50%, 4/01/2013(3),(5)		$ 21,377	21,377	21,377	3.5%
Total			39,289	29,569	4.8%
C&J Cladding LLC	Texas/Metal Services				
Warrant, common units, expiring 3/30/2014 (1,000 total company units outstanding)		400	580	3,067	0.5%
Change Clean Energy Holdings, Inc. (CCEHI)(7)	Maine/Biomass Power				
CCEHI common shares (1,000 total common shares issued and outstanding)		1,000	2,826	2,530	0.4%
Gas Solutions Holdings, Inc.(3),(8)	Texas/Gas Gathering and Processing				
Common shares (100 total common shares outstanding)		100	5,003	55,187	9.1%
Junior secured note, 18.00%, 12/23/2018		$ 5,000	5,000	5,000	0.8%
Senior secured note, 18.00%, 12/22/2018		$ 25,000	25,000	25,000	4.1%

Total	35,003	85,187	14.0%

See notes to consolidated financial statements.

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

CONSOLIDATED SCHEDULE OF INVESTMENTS
September 30, 2009 and June 30, 2009 (Continued)

		September 30, 2009			
Portfolio Investments(1)	**Locale/Industry**	**Par Value/ Shares/ Ownership%**	**Cost**	**Fair Value(2)**	**% of Net Assets**
		(In thousands, except share data)			
Integrated Contract Services, Inc.(9)	North Carolina/ Contracting				
Common stock (100 total common shares outstanding)		49	$ 679	$	0.0%
Series A preferred shares (10 total Series A preferred shares outstanding)		10			0.0%
Junior secured note, stated rate 7.00% plus 7.00% PIK plus 6.00% default interest, in non-accrual status effective 10/09/2007, past due		$ 14,003	14,003	4,001	0.7%
Senior secured note, stated rate 7.00% plus 7.00% PIK plus 6.00% default interest, in non-accrual status effective 10/09/2007, past due		$ 800	800	800	0.1%
Senior demand note, 15.00%, 12/31/09(10)		$ 1,170	1,170	1,170	0.2%
Total			16,652	5,971	1.0%
Iron Horse Coiled Tubing, Inc.	Alberta, Canada/ Production Services				
Common shares (2,231 total class A common shares outstanding)		1,781	268		0.0%
Senior secured note, 15.00%, 12/31/2009		$ 9,250	9,250	2,213	0.4%
Bridge loan, 15.00% plus 3.00% PIK, 12/31/2009		$ 11,003	11,003	10,695	1.8%
Total			20,521	12,908	2.2%
NRG Manufacturing, Inc.	Texas/Manufacturing				
Common shares (1,000 total common shares issued and outstanding)		800	2,317	19,015	3.1%
Senior secured note, 16.50%, 8/31/2011(3),(11)		$ 13,080	13,080	13,080	2.2%

Total			15,397	32,095	5.3%
R-V Industries, Inc.	Pennsylvania/ Manufacturing				
Common shares (1,000,000 total common shares issued and outstanding)		545,107	5,086	11,502	1.9%
Warrants, common shares, expiring 6/30/2017 (1,000,000 total common shares outstanding)		200,000	1,682	4,220	0.7%
Total			6,768	15,722	2.6%
Yatesville Coal Holdings, Inc.(12)	Kentucky/Mining and Coal Production				
Common stock (1,000 total common shares outstanding)		1,000	427		0.0%
Junior secured note, 15.75%, in non-accrual status effective 1/01/2009, matures 12/31/2010		$ 41,423	41,423	994	0.2%
Senior secured note, 15.75%, in non-accrual status effective 1/01/2009, matures 12/31/2010		$ 10,000	10,000	10,000	1.6%
Total			51,850	10,994	1.8%
Total Control Investments			188,886	198,043	32.6%

See notes to consolidated financial statements.

Table of Contents

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

CONSOLIDATED SCHEDULE OF INVESTMENTS
September 30, 2009 and June 30, 2009 (Continued)

Portfolio Investments(1)	Locale/Industry	Par Value/ Shares/ Ownership%	Cost	Fair Value(2)	% of Net Assets
		September 30, 2009 (In thousands except share data)			
Affiliate Investments (5.00% to 24.99% of voting control)					
Appalachian Energy Holdings LLC(13)	West Virginia/ Construction Services				
Warrants Class A common units, expiring 2/13/2016 (86,843 total fully-diluted class A common units outstanding)		6,065	$ 176	$	0.0%
Warrants Class A common units, expiring 6/17/2018 (86,843 total fully-diluted class A common units outstanding)		6,025	172		0.0%
Warrants Class A common units, expiring 11/30/2018 (86,843 total fully-diluted class A common units outstanding)		25,000			0.0%
Series A preferred equity (1,075 total series A preferred equity units outstanding)		200	82		0.0%
Series B preferred equity (794 total series B preferred equity units outstanding)		241	241		0.0%
Series C preferred equity (500 total series C preferred equity units outstanding)		500	500		0.0%
Senior Secured Debt Tranche B, 14.00% plus 3.00% PIK plus 3.00% default interest, non-accrual status effective 11/01/2008, past due		$ 2,087	1,960		0.0%
Senior Secured Debt Tranche A, 14.00% plus 3.00% PIK plus 3.00% default interest, non-accrual status effective 11/01/2008, matures 1/31/2011		$ 2,034	1,897	1,123	0.2%
Total			5,028	1,123	0.2%
Biotronic NeuroNetwork	Michigan/ Healthcare				
Preferred shares (85,000 total preferred shares outstanding)(14)		9,925.455	2,300	3,653	0.6%
		$ 26,227	26,227	27,014	4.4%

Senior secured note, 11.50% plus 1.00% PIK, 2/21/2013(3),(15)						
Total				28,527	30,667	5.0%
Total Affiliate Investments				33,555	31,790	5.2%
Non-control/Non-affiliate Investments (less than 5.00% of voting control)						
American Gilsonite Company	Utah/Specialty Minerals					
Membership interest units in AGC/PEP, LLC(16)			99.9999%	1,031	3,084	0.5%
Senior subordinated note, 12.00% plus 3.00% PIK, 3/14/2013(3)		$	14,783	14,783	15,078	2.5%
Total				15,814	18,162	3.0%
Castro Cheese Company, Inc.(3)	Texas/Food Products					

F-27

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

CONSOLIDATED SCHEDULE OF INVESTMENTS
September 30, 2009 and June 30, 2009 (Continued)

Portfolio Investments(1)	Locale/Industry	Par Value/ Shares/ Ownership%	Cost	Fair Value(2)	% of Net Assets
		September 30, 2009 (In thousands except share data)			
Junior secured note, 11.00% plus 2.00% PIK, 2/28/2013		$ 7,577	$ 7,459	$ 7,608	1.2%
Conquest Cherokee, LLC(17)	Tennessee/Oil and Gas Production				
Overriding Royalty Interests				362	0.1%
Net profits interest, 10.00% payable on equity distributions					0.0%
Senior secured note, 13.00%, in non-accrual status effective 4/01/2009 plus 4.00% default interest, past due(18)		$ 10,450	10,441	4,963	0.8%
Total			10,441	5,325	0.9%
Deb Shops, Inc.	Pennsylvania/ Retail				
Second lien debt, 1.00% plus 13.00% PIK, 10/23/2014		$ 15,805	15,440	4,236	0.7%
Diamondback Operating, LP	Oklahoma/Oil and Gas Production				
Net profits interest, 15.00% payable on equity distributions(20)				438	0.1%
Freedom Marine Services LLC(3),(21)	Louisiana/ Shipping Vessels				
Net profits interest, 22.50% payable on equity distributions					0.0%
Subordinated secured note, 12.00% plus 4.00% PIK, 12/31/2011(22)		$ 7,309	7,241	6,469	1.1%
Total			7,241	6,469	1.1%

H&M Oil & Gas, LLC(21)	Texas/Oil and Gas Production					
Net profits interest, 8.00% payable on equity distributions					1,519	0.3%
Senior secured note, 13.00%, 6/30/2010(23)		$	49,661	49,661	49,284	8.1%
Total				49,661	50,803	8.4%
IEC Systems LP (IEC)/Advanced Rig Services LLC (ARS)(3),(24)	Texas/Oilfield Fabrication					
IEC senior secured note, 12.00% plus 3.00% PIK, 11/20/2012		$	20,810	20,810	21,226	3.5%
ARS senior secured note, 12.00% plus 3.00% PIK, 11/20/2012		$	12,482	12,482	12,731	2.1%
Total				33,292	33,957	5.6%
Maverick Healthcare, LLC	Arizona/ Healthcare					
Common units (79,000,000 total class A common units outstanding)			1,250,000			0.0%

F-28

Table of Contents

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

CONSOLIDATED SCHEDULE OF INVESTMENTS
September 30, 2009 and June 30, 2009 (Continued)

		September 30, 2009			
Portfolio Investments(1)	**Locale/Industry**	**Par Value/ Shares/ Ownership%**	**Cost**	**Fair Value(2)**	**% of Net Assets**
		(In thousands except share data)			
Preferred units (79,000,000 total preferred units outstanding)		1,250,000	$ 1,252	$ 1,549	0.3%
Second lien debt, 12.50% plus 3.50% PIK, 4/30/2014(3)		$ 12,779	12,779	12,904	2.1%
Total			14,031	14,453	2.4%
Miller Petroleum, Inc.(25)	Tennessee/Oil and Gas Production				
Warrants, common shares, expiring 5/04/2010 to 9/30/2014 (18,324,356 total common shares outstanding)		2,026,606	150	312	0.1%
Qualitest Pharmaceuticals, Inc.(3),(26)	Alabama/ Pharmaceuticals				
Second lien debt, 8.10%, 4/30/2015		$ 12,000	11,951	11,684	1.9%
Regional Management Corp.(3)	South Carolina/ Financial Services				
Second lien debt, 12.00% plus 2.00% PIK, 6/29/2012		$ 25,554	25,554	23,365	3.8%
Resco Products, Inc.(3),(27)	Pennsylvania/ Manufacturing				
Second lien debt, 8.37%, 6/22/2014		$ 9,750	9,599	9,750	1.6%
Shearer s Foods, Inc.	Ohio/Food Products				
Membership interest units in Mistral Chip Holdings, LLC (45,300 total membership units outstanding)(28)		2,000	2,000	3,762	0.6%
Second lien debt, 14.00%, 10/31/2013(3)		$ 18,000	18,000	18,360	3.0%
Total			20,000	22,122	3.6%
Stryker Energy, LLC(29)					

	Ohio/Oil and Gas Production					
Overriding Royalty Interests					2,825	0.5%
Subordinated secured revolving credit facility, 12.00%, 12/01/2011(3),(30)		$	29,500	29,185	28,468	4.7%
Total				29,185	31,293	5.2%
TriZetto Group(3)	California/ Healthcare					
Subordinated unsecured note, 12.00% plus 1.50% PIK, 10/01/2016		$	15,262	15,125	16,410	2.7%
Unitek(3),(31)	Pennsylvania/ Technical Services					
Second lien debt, 13.08%, 12/31/2013		$	11,500	11,366	11,730	1.9%
Wind River Resources Corp. and Wind River II Corp.(21)	Utah/Oil and Gas Production					
Net profits interest, 5.00% payable on equity distributions					130	0.0%

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

CONSOLIDATED SCHEDULE OF INVESTMENTS
September 30, 2009 and June 30, 2009 (Continued)

		September 30, 2009			
Portfolio Investments(1)	**Locale/Industry**	**Par Value/ Shares/ Ownership%**	**Cost**	**Fair Value(2)**	**% of Net Assets**
		(In thousands except share data)			
Senior secured note, stated rate 13.00% plus 3.00% default interest, in non-accrual status effective 12/01/2008, matures 7/31/2010(32)		$ 15,000	$ 15,000	$ 12,718	2.1%
Total			15,000	12,848	2.1%
Total Non-control/Non-affiliate Investments			291,309	280,965	46.3%
Total Portfolio Investments			513,750	510,798	84.1%
Money Market Funds					
Fidelity Institutional Money Market Funds Government Portfolio (Class I)		61,864,980	61,865	61,865	10.2%
Fidelity Institutional Money Market Funds Government Portfolio (Class I)(3)		23,278,164	23,278	23,278	3.8%
Total Money Market Funds			85,143	85,143	14.0%
Total Investments			$ 598,893	$ 595,941	98.1%

See notes to consolidated financial statements.

Table of Contents

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

CONSOLIDATED SCHEDULE OF INVESTMENTS
September 30, 2009 and June 30, 2009 (Continued)

Portfolio Investments(1)	Locale/ Industry	Par Value/ Shares/ Ownership%	Cost	June 30, 2009 Fair Value(2)	% of Net Assets
		(In thousands except share data)			
Control Investments (25.00% or greater of voting control)					
Ajax Rolled Ring & Machine	South Carolina/ Manufacturing				
Unrestricted common shares (7 total unrestricted common shares issued and outstanding and 681.85 restricted common shares issued and outstanding)		6	$	$	0.0%
Series A convertible preferred shares (7,192.6 total preferred shares issued and outstanding)		6,142.6	6,057		0.0%
Subordinated secured note Tranche B, 11.50% plus 6.00% PIK, 4/01/2013(3),(4)		$ 11,675	11,675	10,151	1.9%
Senior secured note Tranche A, 10.50%, 4/01/2013(3),(5)		$ 21,487	21,487	21,487	4.0%
Total			39,219	31,638	5.9%
C&J Cladding LLC	Texas/Metal Services				
Warrant, common units, expiring 3/30/2014 (1,000 total company units outstanding)		400	580	3,825	0.7%
Senior secured note, 14.00%, 3/30/2012(3),(6)		$ 3,150	2,722	3,308	0.6%
Total			3,302	7,133	1.3%
Change Clean Energy Holdings, Inc. (CCEHI)(7)	Maine/ Biomass Power				
CCEHI common shares (1,000 total common shares issued and outstanding)		1,000	2,530	2,530	0.5%
Gas Solutions Holdings, Inc.(3),(8)					

	Texas/Gas Gathering and Processing					
Common shares (100 total common shares outstanding)			100	5,003	55,187	10.4%
Junior secured note, 18.00%, 12/23/2018		$	5,000	5,000	5,000	0.9%
Senior secured note, 18.00%, 12/22/2018		$	25,000	25,000	25,000	4.7%
Total				35,003	85,187	16.0%
Integrated Contract Services, Inc.(9)	North Carolina/ Contracting					
Common stock (100 total common shares outstanding)			49	679		0.0%
Series A preferred shares (10 total Series A preferred shares outstanding)			10			0.0%
Junior secured note, stated rate 7.00% plus 7.00% PIK plus 6.00% default interest, in non-accrual status effective 10/09/2007, past due		$	14,003	14,003	3,030	0.6%

Table of Contents

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

CONSOLIDATED SCHEDULE OF INVESTMENTS
September 30, 2009 and June 30, 2009 (Continued)

Portfolio Investments(1)	Locale/ Industry	Par Value/ Shares/ Ownership%	Cost	Fair Value(2)	% of Net Assets
			June 30, 2009		
		(In thousands except share data)			
Senior secured note, stated rate 7.00% plus 7.00% PIK plus 6.00% default interest, in non-accrual status effective 10/09/2007, past due		$ 800	$ 800	$ 800	0.1%
Senior demand note, 15.00%, 6/30/2009(10)		$ 1,170	1,170	1,170	0.2%
Total			16,652	5,000	0.9%
Iron Horse Coiled Tubing, Inc.	Alberta, Canada/ Production Services				
Common shares (2,231 total class A common shares outstanding)		1,781	268		0.0%
Senior secured note, 15.00%, 12/31/2009		$ 9,250	9,250	3,004	0.6%
Bridge loan, 15.00% plus 3.00% PIK, 12/31/2009		$ 9,826	9,826	9,602	1.8%
Total			19,344	12,606	2.4%
NRG Manufacturing, Inc.	Texas/ Manufacturing				
Common shares (1,000 total common shares issued and outstanding)		800	2,317	19,294	3.6%
Senior secured note, 16.50%, 8/31/2011(3),(11)		$ 13,080	13,080	13,080	2.5%
Total			15,397	32,374	6.1%
R-V Industries, Inc.	Pennsylvania/ Manufacturing				
Common shares (750,000 total common shares issued and outstanding)		545,107	5,086	12,267	2.3%
		200,000	1,682	4,500	0.8%

Warrants, common shares, expiring 6/30/2017 (200,000 total common shares outstanding)						
Total				6,768	16,767	3.1%
Yatesville Coal Holdings, Inc.(12)	Kentucky/ Mining and Coal Production					
Common stock (1,000 total common shares outstanding)			1,000	427		0.0%
Junior secured note, 15.72%, in non-accrual status effective 1/01/2009, matures 12/31/2010		$	38,463	38,463	3,097	0.6%
Senior secured note, 15.72%, in non-accrual status effective 1/01/2009, matures 12/31/2010		$	10,000	10,000	10,000	1.9%
Total				48,890	13,097	2.5%
Total Control Investments				187,105	206,332	38.7%

See notes to consolidated financial statements.

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

CONSOLIDATED SCHEDULE OF INVESTMENTS
September 30, 2009 and June 30, 2009 (Continued)

		June 30, 2009						
Portfolio Investments(1)	**Locale/ Industry**		**Par Value/ Shares/ Ownership%**		**Cost**		**Fair Value(2)**	**% of Net Assets**
		(In thousands except share data)						
Affiliate Investments (5.00% to 24.99% of voting control)								
Appalachian Energy Holdings LLC(13)	West Virginia/ Construction Services							
Warrants Class A common units, expiring 2/13/2016 (86,843 total fully-diluted class A common units outstanding)			6,065	$	176	$		0.0%
Warrants Class A common units, expiring 6/17/2018 (86,843 total fully-diluted class A common units outstanding)			6,025		172			0.0%
Warrants Class A common units, expiring 11/30/2018 (86,843 total fully-diluted class A common units outstanding)			25,000					0.0%
Series A preferred equity (1,075 total series A preferred equity units outstanding)			200		82			0.0%
Series B preferred equity (794 total series B preferred equity units outstanding)			241		241			0.0%
Series C preferred equity (500 total series C preferred equity units outstanding)			500		500			0.0%
Senior Secured Debt Tranche B, 14.00% plus 3.00% PIK plus 3.00% default interest, non-accrual status effective 11/01/2008, past due		$	2,050		1,955		356	0.1%
Senior Secured Debt Tranche A, 14.00% plus 3.00% PIK plus 3.00% default interest, non-accrual status effective 11/01/2008, matures 1/31/2011		$	1,997		1,891		2,052	0.4%
Total					5,017		2,408	0.5%
Biotronic NeuroNetwork	Michigan/ Healthcare							
Preferred shares (85,000 total preferred shares outstanding)(14)			9,925.455		2,300		2,839	0.5%
		$	26,227		26,227		27,007	5.1%

Senior secured note, 11.50% plus 1.00% PIK, 2/21/2013(3),(15)						
Total				28,527	29,846	5.6%
Total Affiliate Investments				33,544	32,254	6.1%
Non-control/Non-affiliate Investments (less than 5.00% of voting control)						
American Gilsonite Company	Utah/Specialty Minerals					
Membership interest units in AGC PEP, LLC(16)			99.9999%	1,031	3,851	0.7%
Senior subordinated note, 12.00% plus 3.00% PIK, 3/14/2013(3)		$	14,783	14,783	15,073	2.8%
Total				15,814	18,924	3.5%
Castro Cheese Company, Inc.(3)	Texas/Food Products					

F-33

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

CONSOLIDATED SCHEDULE OF INVESTMENTS
September 30, 2009 and June 30, 2009 (Continued)

		June 30, 2009			
Portfolio Investments(1)	**Locale/ Industry**	**Par Value/ Shares/ Ownership%**	**Cost**	**Fair Value(2)**	**% of Net Assets**
		(In thousands except share data)			
Junior secured note, 11.00% plus 2.00% PIK, 2/28/2013		$ 7,538	$ 7,413	$ 7,637	1.4%
Conquest Cherokee, LLC(17)	Tennessee/Oil and Gas Production				
Overriding Royalty Interests				565	0.1%
Senior secured note, 13.00%, in non-accrual status effective 4/01/2009 plus 4.00% default interest, past due(18)		$ 10,200	10,191	6,855	1.3%
Total			10,191	7,420	1.4%
Deb Shops, Inc.(19)	Pennsylvania/ Retail				
Second lien debt, 8.67%, 10/23/2014		$ 15,000	14,623	6,272	1.2%
Diamondback Operating, LP	Oklahoma/Oil and Gas Production				
Net profits interest, 15.00% payable on equity distributions(20)				458	0.1%
Freedom Marine Services LLC(3),(21)	Louisiana/ Shipping Vessels				
Net profits interest, 22.50% payable on equity distributions				229	0.0%
Subordinated secured note, 12.00% plus 4.00% PIK, 12/31/2011(22)		$ 7,234	7,160	7,152	1.4%
Total			7,160	7,381	1.4%
H&M Oil & Gas, LLC(3),(21)	Texas/Oil and Gas Production				
Net profits interest, 8.00% payable on equity distributions				1,682	0.3%

Senior secured note, 13.00%, 6/30/2010(23)		$	49,688	49,688	49,697	9.3%
Total				49,688	51,379	9.6%
IEC Systems LP (IEC)/Advanced Rig Services LLC (ARS)(3),(24)	Texas/Oilfield Fabrication					
IEC senior secured note, 12.00% plus 3.00% PIK, 11/20/2012		$	21,411	21,411	21,839	4.1%
ARS senior secured note, 12.00% plus 3.00% PIK, 11/20/2012		$	12,836	12,836	13,092	2.5%
Total				34,247	34,931	6.6%
Maverick Healthcare, LLC	Arizona/ Healthcare					
Common units (79,000,000 total class A common units outstanding)			1,250,000			0.0%
Preferred units (79,000,000 total preferred units outstanding)			1,250,000	1,252	1,300	0.2%

Table of Contents

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

CONSOLIDATED SCHEDULE OF INVESTMENTS
September 30, 2009 and June 30, 2009 (Continued)

		June 30, 2009			
Portfolio Investments(1)	**Locale/ Industry**	**Par Value/ Shares/ Ownership%**	**Cost**	**Fair Value(2)**	**% of Net Assets**
		(In thousands except share data)			
Second lien debt, 12.00% plus 1.50% PIK, 4/30/2014(3)		$ 12,691	$ 12,691	$ 12,816	2.4%
Total			13,943	14,116	2.6%
Miller Petroleum, Inc.(25)	Tennessee/Oil and Gas Production				
Warrants, common shares, expiring 5/04/2010 to 6/30/2014 (15,811,856 total common shares outstanding)		1,935,523	150	241	0.1%
Peerless Manufacturing Co.(3)	Texas/ Manufacturing				
Subordinated secured note, 11.50% plus 3.50% PIK, 4/29/2013		$ 20,000	20,000	20,400	3.8%
Qualitest Pharmaceuticals, Inc.(3),(26)	Alabama/ Pharmaceuticals				
Second lien debt, 8.10%, 4/30/2015		$ 12,000	11,949	11,452	2.2%
Regional Management Corp.(3)	South Carolina/ Financial Services				
Second lien debt, 12.00% plus 2.00% PIK, 6/29/2012		$ 25,424	25,424	23,073	4.3%
Resco Products, Inc.(3),(27)	Pennsylvania/ Manufacturing				
Second lien debt, 8.67%, 6/22/2014		$ 9,750	9,594	9,750	1.8%
Shearer s Foods, Inc.	Ohio/Food Products				
Membership interest units in Mistral Chip Holdings, LLC (45,300 total membership		2,000	2,000	3,419	0.6%

units outstanding)(28)						
Second lien debt, 14.00%, 10/31/2013(3)		$	18,000	18,000	18,360	3.5%
Total				20,000	21,779	4.1%
Stryker Energy, LLC(29)	Ohio/Oil and Gas Production					
Overriding Royalty Interests					2,918	0.6%
Subordinated secured revolving credit facility, 12.00%, 12/01/2011(3),(30)		$	29,500	29,154	29,554	5.5%
Total				29,154	32,472	6.1%
TriZetto Group(3)	California/ Healthcare					
Subordinated unsecured note, 12.00% plus 1.50% PIK, 10/01/2016		$	15,205	15,065	16,331	3.1%
Unitek(3),(31)	Pennsylvania/ Technical Services					

Table of Contents

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

CONSOLIDATED SCHEDULE OF INVESTMENTS
September 30, 2009 and June 30, 2009 (Continued)

				June 30, 2009	
Portfolio Investments(1)	**Locale/ Industry**	**Par Value/ Shares/ Ownership%**	**Cost**	**Fair Value(2)**	**% of Net Assets**
		(In thousands except share data)			
Second lien debt, 13.08%, 12/31/2013		$ 11,500	$ 11,360	$ 11,730	2.2%
Wind River Resources Corp. and Wind River II Corp.(21)	Utah/Oil and Gas Production				
Net profits interest, 5.00% payable on equity distributions				192	0.0%
Senior secured note, stated rate 13.00% plus 3.00% default interest, in non-accrual status effective 12/01/2008, matures 7/31/2010(32)		$ 15,000	15,000	12,644	2.4%
Total			15,000	12,836	2.4%
Total Non-control/Non-affiliate Investments			310,775	308,582	57.9%
Total Portfolio Investments			531,424	547,168	102.7%
Money Market Funds					
Fidelity Institutional Money Market Funds Government Portfolio (Class I)		94,752,972	94,753	94,753	17.8%
Fidelity Institutional Money Market Funds Government Portfolio (Class I)(3)		3,982,278	3,982	3,982	0.7%
Total Money Market Funds			98,735	98,735	18.5%
Total Investments			$ 630,159	$ 645,903	121.2%

See notes to consolidated financial statements.

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

CONSOLIDATED SCHEDULE OF INVESTMENTS
September 30, 2009 and June 30, 2009 (Continued)

Endnote Explanations for the Consolidated Schedule of Investments as of September 30, 2009 and June 30, 2009

(1) The securities in which Prospect Capital Corporation (we , us or our) has invested were acquired in transactions that were exempt from registration under the Securities Act of 1933, as amended, or the Securities Act. These securities may be resold only in transactions that are exempt from registration under the Securities Act.

(2) Fair value is determined by or under the direction of our Board of Directors (see Note 2).

(3) Security, or portion thereof, is held as collateral for the credit facility with Rabobank Nederland (see Note 11). The market values of these investments at September 30, 2009 and June 30, 2009 were $373,911 and $434,069, respectively; they represent 62.7% and 67.2% of total investments at fair value, respectively.

(4) Interest rate is the greater of 11.5% or 3-month LIBOR plus 8.5%; rate reflected is as of the reporting date September 30, 2009 or June 30, 2009, as applicable.

(5) Interest rate is the greater of 10.5% or 3-month LIBOR plus 7.5%; rate reflected is as of the reporting date September 30, 2009 or June 30, 2009, as applicable.

(6) Interest rate is the greater of 14.0% or 12-Month LIBOR plus 7.5%; rate reflected is as of June 30, 2009.

(7) There are several entities involved in the Biomass investment. We own 100 shares of common stock in Worcester Energy Holdings, Inc. (WEHI), representing 100% of the issued and outstanding common stock. WEHI, in turn, owns 51 membership certificates in Biochips LLC (Biochips), which represents a 51% ownership stake.

We own 282 shares of common stock in Worcester Energy Co., Inc. (WECO), which represents 51% of the issued and outstanding common stock. We own directly 1,665 shares of common stock in Change Clean Energy Inc. (CCEI), f/k/a Worcester Energy Partners, Inc., which represents 51% of the issued and outstanding common stock and the remaining 49% is owned by WECO. CCEI owns 100 shares of common stock in Precision Logging and Landclearing, Inc. (Precision), which represents 100% of the issued and outstanding common stock.

During the quarter ended March 31, 2009, we created two new entities in anticipation of the foreclosure proceedings against the co-borrowers (WECO, CCEI and Biochips) Change Clean Energy Holdings, Inc. (CCEHI) and DownEast Power Company, LLC (DEPC). We own 1,000 shares of CCEHI, representing 100% of the issued and outstanding stock, which in turn, owns a 100% of the membership interests in DEPC.

On March 11, 2009, we foreclosed on the assets formerly held by CCEI and Biochips with a successful credit bid of $6,000 to acquire the assets. The assets were subsequently assigned to DEPC.

WECO, CCEI and Biochips are joint borrowers on the term note issued to Prospect Capital. Effective July 1, 2008, this loan was placed on non-accrual status.

Biochips, WECO, CCEI, Precision and WEHI currently have no material operations and no significant assets. As of June 30, 2009, our Board of Directors assessed a fair value of $0 for all of these equity positions and the loan position. We determined that the impairment of both CCEI and CCEHI as of June 30, 2009 was other than temporary and recorded a realized loss for the amount that the amortized cost exceeds the fair value at June 30, 2009. Our Board of Directors set the value of the remaining CCEHI investment at $2,530 as of September 30, 2009 and June 30, 2009.

(8) Gas Solutions Holdings, Inc. is a wholly-owned investment of us.

(9) Entity was formed as a result of the debt restructuring of ESA Environmental Specialist, Inc. In early 2009, we foreclosed on the two loans on non-accrual status and purchased the underlying personal and real property. We own 1,000 shares of common stock in The Healing Staff (THS), f/k/a Lisamarie

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

CONSOLIDATED SCHEDULE OF INVESTMENTS
September 30, 2009 and June 30, 2009 (Continued)

Fallon, Inc. representing 100% ownership. We own 1,500 shares of Vets Securing America, Inc. (VSA), representing 100% ownership. VSA is a holding company for the real property of Integrated Contract Services, Inc. (ICS) purchased during the foreclosure process.

(10) Loan is with THS an affiliate of ICS.

(11) Interest rate is the greater of 16.5% or 12-Month LIBOR plus 11.0%; rate reflected is as of the reporting date September 30, 2009 or June 30, 2009, as applicable.

(12) On June 30, 2008, we consolidated our holdings in four coal companies into Yatesville Coal Holdings, Inc. (Yatesville), and consolidated the operations under one management team. In the transaction, the debt that we held of C&A Construction, Inc. (C&A), Genesis Coal Corp. (Genesis), North Fork Collieries LLC (North Fork) and Unity Virginia Holdings LLC (Unity) were exchanged for newly issued debt from Yatesville, and our ownership interests in C&A, E&L Construction, Inc. (E&L), Whymore Coal Company Inc. (Whymore), Genesis and North Fork were exchanged for 100% of the equity of Yatesville. This reorganization allows for a better utilization of the assets in the consolidated group.

At September 30, 2009 and at June 30, 2009, Yatesville owned 100% of the membership interest of North Fork. In addition, Yatesville held a $9,272 and $8,062, respectively, note receivable from North Fork as of those two respective dates.

At September 30, 2009 and at June 30, 2009, Yatesville owned 90% and 87%, respectively, of the common stock of Genesis and held a note receivable of $20,880 and $20,802, respectively, as of those two respective dates.

Yatesville held a note receivable of $4,261 from Unity at September 30, 2009 and at June 30, 2009.

There are several entities involved in Yatesville s investment in Whymore at June 30, 2009. As of June 30, 2009, Yatesville owned 10,000 shares of common stock or 100% of the equity and held a $14,973 senior secured debt receivable from C&A, which owns the equipment. Yatesville owned 10,000 shares of common stock or 100% of the equity of E&L, which leases the equipment from C&A, employs the workers, is listed as the operator with the Commonwealth of Kentucky, mines the coal, receives revenues and pays all operating expenses. Yatesville owned 4,900 shares of common stock or 49% of the equity of Whymore, which applies for and holds permits on behalf of E&L. Yatesville also owned 4,285 Series A convertible preferred shares in each of C&A, E&L and Whymore. Whymore and E&L are guarantors under the C&A credit agreement with Yatesville.

In August 2009, Yatesville sold its 49% ownership interest in the common shares of Whymore to the 51% holder of the Whymore common shares (Whymore Purchaser). All reclamation liability was transferred to the Whymore Purchaser. In September 2009, Yatesville completed an auction for all of its equipment.

(13) There are several entities involved in the Appalachian Energy Holdings LLC (AEH) investment. We own warrants, the exercise of which will permit us to purchase 37,090 Class A common units of AEH at a nominal

cost and in near-immediate fashion. We own 200 units of Series A preferred equity, 241 units of Series B preferred equity, and 500 units of Series C preferred equity of AEH. The senior secured notes are with C&S Operating LLC and East Cumberland L.L.C., both operating companies owned by AEH.

(14) On a fully diluted basis represents, 11.677% of voting common shares.

(15) Interest rate is the greater of 11.5% or 6-month LIBOR plus 7.0%; rate reflected is as of the reporting date September 30, 2009 or June 30, 2009, as applicable.

(16) We own 99.9999% of AGC/PEP, LLC. AGC/PEP, LLC owns 2,038 out of a total of 83,694 shares (including 4,510 vested an unvested management options) of American Gilsonite Holding Company which owns 100% of American Gilsonite Company.

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

CONSOLIDATED SCHEDULE OF INVESTMENTS
September 30, 2009 and June 30, 2009 (Continued)

(17) In addition to the stated returns, we hold overriding royalty interests on which we receive payment based upon operations of the borrower and net profits interest of 10.00% on equity distributions which will be realized upon sale of the borrower or a sale of the interests.

(18) Interest rate is the greater of 13.0% or 12-Month LIBOR plus 7.5% not to exceed 14.50%; rate reflected is as of the reporting date September 30, 2009 or June 30, 2009, as applicable.

(19) Interest rate is 3-Month LIBOR plus 8.0%; rate reflected is as of June 30, 2009.

(20) In January 2009, our loan was repaid in full and we retained a 15.0% net profits interest payable on equity distributions.

(21) In addition to the stated returns, we also hold net profits interest which will be realized upon sale of the borrower or a sale of the interests.

(22) Interest rate is the greater of 12.0% or 3-Month LIBOR plus 6.11%; rate reflected is as of the reporting date September 30, 2009 or June 30, 2009, as applicable.

(23) Interest rate is the greater of 13.0% or 12-Month LIBOR plus 7.5%; rate reflected is as of the reporting date September 30, 2009 or June 30, 2009, as applicable.

(24) Interest rate is the greater of 12.0% or 12-month LIBOR plus 6.0%; rate reflected is as of the reporting date September 30, 2009 or June 30, 2009, as applicable.

(25) Total common shares outstanding of 18,324,356 as of September 15, 2009 from Miller Petroleum, Inc. s Quarterly Report on Form 10-Q filed on September 21, 2009 as applicable to our September 30, 2009 reporting date. Total common shares outstanding of 15,811,856 as of March 11, 2009 from Miller s Quarterly Report on Form 10-Q filed on March 16, 2009.

(26) Interest rate is 3-Month LIBOR plus 7.5%; rate reflected is as of the reporting date June 30, 2009 or June 30, 2008, as applicable.

(27) Interest rate is 3-Month LIBOR plus 8.0%; rate reflected is as of the reporting date September 30, 2009 or June 30, 2009, as applicable.

(28) Mistral Chip Holdings, LLC owns 45,300 shares out of 50,500 total shares outstanding of Chip Holdings, Inc., the parent company of Shearer s Foods, Inc., before adjusting for management options.

(29) In addition to the stated returns, we also hold overriding royalty interests on which we receive payment based upon operations of the borrower.

(30)

Interest rate is the greater of 12.0% or 12-Month LIBOR plus 7.0%; rate reflected is as of the reporting date June 30, 2009 or June 30, 2008, as applicable.

(31) Interest rate is the greater of 13.08% or 3-Month LIBOR plus 7.25%; rate reflected is as of the reporting date September 30, 2009 or June 30, 2009, as applicable.

(32) Interest rate is the greater of 13.0% or 12-month LIBOR plus 7.5% not to exceed 14.0%; rate reflected is as of the reporting date September 30, 2009 or June 30, 2009, as applicable.

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2009
(Unaudited)
(In thousands, except share and per share data)

Note 1. Organization

References herein to we , us or our refer to Prospect Capital Corporation and its subsidiary unless the context specifically requires otherwise.

We were formerly known as Prospect Energy Corporation, a Maryland corporation. We were organized on April 13, 2004 and were funded in an initial public offering (IPO), completed on July 27, 2004. We are a closed-end investment company that has filed an election to be treated as a Business Development Company (BDC), under the Investment Company Act of 1940 (the 1940 Act). As a BDC, we have qualified and have elected to be treated as a regulated investment company (RIC), under Subchapter M of the Internal Revenue Code. We invest primarily in senior and subordinated debt and equity of companies in need of capital for acquisitions, divestitures, growth, development, project financings, recapitalizations, and other purposes.

On May 15, 2007, we formed a wholly-owned subsidiary, Prospect Capital Funding, LLC, a Delaware limited liability company, for the purpose of holding certain of our loan investments in the portfolio which are used as collateral for our credit facility.

Note 2. Significant Accounting Policies

The following are significant accounting policies consistently applied by us:

Basis of Presentation

The accompanying interim financial statements, which are not audited, have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 6 or 10 of Regulation S-X, as appropriate. The financial results of our portfolio investments are not consolidated in the interim financial statements.

Use of Estimates

The preparation of GAAP financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reported period. Changes in the economic environment, financial markets, creditworthiness of our portfolio companies and any other parameters used in determining these estimates could cause actual results to differ, and these differences could be material.

Basis of Consolidation

Under the 1940 Act rules, the regulations pursuant to Article 6 of Regulation S-X and the American Institute of Certified Public Accountants Audit and Accounting Guide for Investment Companies, we are precluded from consolidating any entity other than another investment company or an operating company which provides substantially all of its services and benefits to us. Our financial statements include our accounts and the accounts of Prospect Capital Funding, LLC, our only wholly-owned, closely-managed subsidiary that is also an investment company. All intercompany balances and transactions have been eliminated in consolidation.

Investment Classification

We are a non-diversified company within the meaning of the 1940 Act. We classify our investments by level of control. As defined in the 1940 Act, control investments are those where there is the ability or power to exercise a

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2009
(Unaudited)
(In thousands, except share and per share data) (Continued)

controlling influence over the management or policies of a company. Control is generally deemed to exist when a company or individual possesses or has the right to acquire within 60 days or less, a beneficial ownership of 25% or more of the voting securities of an investee company. Affiliated investments and affiliated companies are defined by a lesser degree of influence and are deemed to exist through the possession outright or via the right to acquire within 60 days or less, beneficial ownership of 5% or more of the outstanding voting securities of another person.

Investments are recognized when we assume an obligation to acquire a financial instrument and assume the risks for gains or losses related to that instrument. Investments are derecognized when we assume an obligation to sell a financial instrument and forego the risks for gains or losses related to that instrument. Specifically, we record all security transactions on a trade date basis. Investments in other, non-security financial instruments are recorded on the basis of subscription date or redemption date, as applicable. Amounts for investments recognized or derecognized but not yet settled are reported as receivables for investments sold and payables for investments purchased, respectively, in the Consolidated Statements of Assets and Liabilities.

Investment Valuation

Our Board of Directors has established procedures for the valuation of our investment portfolio. These procedures are detailed below.

Investments for which market quotations are readily available are valued at such market quotations.

For most of our investments, market quotations are not available. With respect to investments for which market quotations are not readily available or when such market quotations are deemed not to represent fair value, our Board of Directors has approved a multi-step valuation process each quarter, as described below:

1) Each portfolio company or investment is reviewed by our investment professionals with the independent valuation firm;

2) the independent valuation firm engaged by our Board of Directors conducts independent appraisals and makes their own independent assessment;

3) the audit committee of our Board of Directors reviews and discusses the preliminary valuation of our Investment Adviser and that of the independent valuation firm; and

4) the Board of Directors discusses valuations and determines the fair value of each investment in our portfolio in good faith based on the input of our Investment Adviser, the respective independent valuation firm and the audit committee.

Investments are valued utilizing a market approach, an income approach, or both approaches, as appropriate. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities (including a business). The income approach uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present value amount (discounted) calculated based on an appropriate discount rate. The measurement is based on the net present value indicated by current market expectations about those future amounts. In following these approaches, the types of factors that we may take into account in fair value pricing our investments include, as relevant: available current market data, including relevant and applicable market trading and transaction comparables, applicable market yields and multiples, security covenants, call protection provisions, information rights, the nature and realizable value of any collateral, the portfolio company s ability to make payments, its earnings and discounted cash flows, the markets in which the portfolio company does business, comparisons of financial ratios of peer companies that are public, M&A comparables, the principal market and enterprise values, among other factors.

Table of Contents

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2009
(Unaudited)
(In thousands, except share and per share data) (Continued)

In September 2006, the Financial Accounting Standards Board (FASB) issued Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures* (ASC 820). ASC 820 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. We adopted ASC 820 on a prospective basis beginning in the quarter ended September 30, 2008.

ASC 820 classifies the inputs used to measure these fair values into the following hierarchy:

Level 1: Quoted prices in active markets for identical assets or liabilities, accessible by us at the measurement date.

Level 2: Quoted prices for similar assets or liabilities in active markets, or quoted prices for identical or similar assets or liabilities in markets that are not active, or other observable inputs other than quoted prices.

Level 3: Unobservable inputs for the asset or liability.

In all cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to each investment. The changes to GAAP from the application of ASC 820 relate to the definition of fair value, framework for measuring fair value, and the expanded disclosures about fair value measurements. ASC 820 applies to fair value measurements already required or permitted by other standards. In accordance with ASC 820, the fair value of our investments is defined as the price that we would receive upon selling an investment in an orderly transaction to an independent buyer in the principal or most advantageous market in which that investment is transacted.

In April 2009, the FASB issued ASC Subtopic 820-10-65, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (ASC 820-10). This update provides further clarification for ASC 820 in markets that are not active and provides additional guidance for determining when the volume of trading level of activity for an asset or liability has significantly decreased and for identifying circumstances that indicate a transaction is not orderly. ASC 820-10-65 is effective for interim and annual reporting periods ending after June 15, 2009. The adoption of ASC 820-10-65 for the three months ended September 30, 2009, did not have any effect on our net asset value, financial position or results of operations as there was no change to the fair value measurement principles set forth in ASC 820.

Valuation of Other Financial Assets and Financial Liabilities

In February 2007, FASB issued ASC Subtopic 820-10-05-1, *The Fair Value Option for Financial Assets and Financial Liabilities* (ASC 820-10-05-1). ASC 820-10-05-1 permits an entity to elect fair value as the initial and subsequent measurement attribute for many of assets and liabilities for which the fair value option has been elected and similar assets and liabilities measured using another measurement attribute. We adopted this statement on July 1, 2008 and have elected not to value other assets and liabilities at fair value as would be permitted by ASC 820-10-05-1.

Revenue Recognition

Realized gains or losses on the sale of investments are calculated using the specific identification method.

Interest income, adjusted for amortization of premium and accretion of discount, is recorded on an accrual basis. Origination, closing and/or commitment fees associated with investments in portfolio companies are accreted into interest income over the respective terms of the applicable loans. Upon the prepayment of a loan or debt

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2009
(Unaudited)
(In thousands, except share and per share data) (Continued)

security, any prepayment penalties and unamortized loan origination, closing and commitment fees are recorded as interest income.

Dividend income is recorded on the ex-dividend date.

Structuring fees and similar fees are recognized as income as earned, usually when paid. Structuring fees, excess deal deposits, net profits interests and overriding royalty interests are included in other income.

Loans are placed on non-accrual status when principal or interest payments are past due 90 days or more or when there is reasonable doubt that principal or interest will be collected. Accrued interest is generally reversed when a loan is placed on non-accrual status. Interest payments received on non-accrual loans may be recognized as income or applied to principal depending upon management s judgment. Non-accrual loans are restored to accrual status when past due principal and interest is paid and in management s judgment, are likely to remain current.

Federal and State Income Taxes

We have elected to be treated as a regulated investment company and intend to continue to comply with the requirements of the Internal Revenue Code of 1986 (the Code), applicable to regulated investment companies. We are required to distribute at least 90% of our investment company taxable income and intend to distribute (or retain through a deemed distribution) all of our investment company taxable income and net capital gain to stockholders; therefore, we have made no provision for income taxes. The character of income and gains that we will distribute is determined in accordance with income tax regulations that may differ from GAAP. Book and tax basis differences relating to stockholder dividends and distributions and other permanent book and tax differences are reclassified to paid-in capital.

If we do not distribute (or are not deemed to have distributed) at least 98% of our annual taxable income in the calendar year it is earned, we will generally be required to pay an excise tax equal to 4% of the amount by which 98% of our annual taxable income exceeds the distributions from such taxable income for the year. To the extent that we determine that our estimated current year annual taxable income will be in excess of estimated current year dividend distributions from such taxable income, we accrue excise taxes, if any, on estimated excess taxable income as taxable income is earned using an annual effective excise tax rate. The annual effective excise tax rate is determined by dividing the estimated annual excise tax by the estimated annual taxable income.

We adopted FASB ASC 740, *Income Taxes* (ASC 740). ASC 740 provides guidance for how uncertain tax positions should be recognized, measured, presented, and disclosed in the financial statements. ASC 740 requires the evaluation of tax positions taken or expected to be taken in the course of preparing our tax returns to determine whether the tax positions are more-likely-than-not of being sustained by the applicable tax authority. Tax positions not deemed to meet the more-likely-than-not threshold are recorded as a tax benefit or expense in the current year. Adoption of ASC 740 was applied to all open tax years as of July 1, 2007. The adoption of ASC 740 did not have an effect on our net asset value, financial condition or results of operations as there was no liability for unrecognized tax benefits and no change to our beginning net asset value. As of September 30, 2009 and for the three months then ended, we did not have a liability for any unrecognized tax benefits. Management s determinations regarding ASC 740 may be subject to review and adjustment at a later date based upon factors including, but not limited to, an on-going analysis of tax laws, regulations and interpretations thereof.

Dividends and Distributions

Dividends and distributions to common stockholders are recorded on the ex-dividend date. The amount, if any, to be paid as a dividend is approved by our Board of Directors each quarter and is generally based upon our

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2009
(Unaudited)
(In thousands, except share and per share data) (Continued)

management s estimate of our earnings for the quarter. Net realized capital gains, if any, are distributed at least annually.

Financing Costs

We record origination expenses related to our credit facility as deferred financing costs. These expenses are deferred and amortized as part of interest expense using the effective interest method over the stated life of the facility.

We record registration expenses related to shelf filings as prepaid assets. These expenses consist principally of Securities and Exchange Commission (SEC) registration fees, legal fees and accounting fees incurred. These prepaid assets will be charged to capital upon the receipt of an equity offering proceeds or charged to expense if no offering completed.

Guarantees and Indemnification Agreements

We follow FASB ASC 460, Guarantees (ASC 460).ASC 460 elaborates on the disclosure requirements of a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also requires a guarantor to recognize, at the inception of a guarantee, for those guarantees that are covered by ASC 460, the fair value of the obligation undertaken in issuing certain guarantees. ASC 460 did not have a material effect on the financial statements. Refer to Note 3, Note 7 and Note 10 for further discussion of guarantees and indemnification agreements.

Per Share Information

Net increase or decrease in net assets resulting from operations per common share are calculated using the weighted average number of common shares outstanding for the period presented. Diluted net increase or decrease in net assets resulting from operations per share are not presented as there are no potentially dilutive securities outstanding.

Reclassifications

Certain reclassifications have been made in the presentation of prior consolidated financial statements to conform to the presentation as of and for the three months ended September 30, 2009.

Recent Accounting Pronouncements

In March 2008, the FASB issued ASC 815, *Derivatives and Hedging* (ASC 815). ASC 815 is intended to improve financial reporting for derivative instruments by requiring enhanced disclosure that enables investors to understand how and why the entity uses derivatives, how derivatives are accounted for, and how derivatives affect an entity s results of operations, financial position, and cash flows. ASC 815 is effective for interim and annual periods beginning after November 15, 2008. For the three months ended September 30, 2009, our adoption of ASC 815 did not impact results of operations or financial condition.

In May 2009, the FASB issued ASC 855, *Subsequent Events* (ASC 855). ASC 855 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The standard, which includes a new required disclosure of the date through which an entity has evaluated subsequent events, is effective for interim or annual periods ending after June 15, 2009. We evaluated all events or transactions that occurred after September 30, 2009 up through January 8,

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2009
(Unaudited)
(In thousands, except share and per share data) (Continued)

2010. During this period, we did not have any material recognizable subsequent events other than those disclosed in our financial statements.

In June 2009, the FASB issued ASC 105, *Generally Accepted Accounting Principles* (ASC 105), which establishes the FASB Codification which supersedes all existing accounting standard documents and will become the single source of authoritative non-governmental U.S. GAAP. All other accounting literature not included in the Codification will be considered non-authoritative. The Codification did not change GAAP but reorganizes the literature. ASC 105 is effective for interim and annual periods ending after September 15, 2009. We have conformed our financial statements and related Notes to the new Codification for the quarter ended September 30, 2009.

In August 2009, the FASB issued Accounting Standards Update ASU 2009-05, *Measuring Liabilities at Fair Value, to amend FASB Accounting Standards Codification ASC 820, Fair Value Measurements and Disclosures* (ASC 820), to clarify how entities should estimate the fair value of liabilities. ASC 820, as amended, includes clarifying guidance for circumstances in which a quoted price in an active market is not available, the effect of the existence of liability transfer restrictions, and the effect of quoted prices for the identical liability, including when the identical liability is traded as an asset. The amended guidance in ASC 820 on measuring liabilities at fair value is effective for the first interim or annual reporting period beginning after August 28, 2009, with earlier application permitted. Our management does not believe that the adoption of the amended guidance in ASC 820 will have a significant effect on our financial statements.

Note 3. Portfolio Investments

At September 30, 2009, we had invested in 29 long-term portfolio investments, which had an amortized cost of $513,750 and a fair value of $510,798 and at June 30, 2009, we had invested in 30 long-term portfolio investments, which had an amortized cost of $531,424 and a fair value of $547,168.

As of September 30, 2009, we own controlling interests in Ajax Rolled Ring & Machine (Ajax), C&J Cladding, LLC (C&J), Change Clean Energy Holdings, Inc. (CCEHI), Gas Solutions Holdings, Inc. (GSHI), Integrated Contract Services, Inc. (ICS), Iron Horse Coiled Tubing, Inc. (Iron Horse), NRG Manufacturing, Inc. (NRG), R-V Industries, Inc. (R-V), and Yatesville Coal Holdings, Inc. (Yatesville). We also own an affiliated interest in Appalachian Energy Holdings, LLC (AEH) and Biotronic NeuroNetwork (Biotronic).

The fair values of our portfolio investments as of September 30, 2009 disaggregated into the three levels of the ASC 820 valuation hierarchy are as follows:

	Quoted Prices in Active Markets	Significant Other Observable	Significant Unobservable

	for Identical Securities (Level 1)	Inputs (Level 2)	Inputs (Level 3)	Total
Investments at fair value				
Control investments	$	$	$ 198,043	$ 198,043
Affiliate investments			31,790	31,790
Non-control/non-affiliate investments			280,965	280,965
			510,798	510,798
Investments in money market funds		85,143		85,143
Total assets reported at fair value	$	$ 85,143	$ 510,798	$ 595,941

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2009
(Unaudited)
(In thousands, except share and per share data) (Continued)

The aggregate values of Level 3 portfolio investments changed during the three months ended September 30, 2009 as follows:

	Fair Value Measurements Using Unobservable Inputs (Level 3)			
	Control Investments	Affiliate Investments	Non-Control/ Non-Affiliate Investments	Total
Fair value as of June 30, 2009	$ 206,332	$ 32,254	$ 308,582	$ 547,168
Total realized losses				
Change in unrealized depreciation	(9,484)	(475)	(7,751)	(17,710)(1)
Purchases, issuances, settlements and other, net	1,195	11	(19,866)	(18,660)
Transfers within Level 3				
Transfers in (out) of Level 3				
Fair value as of September 30, 2009	$ 198,043	$ 31,790	$ 280,965	$ 510,798

(1) Relates to assets held at September 30, 2009.

At September 30, 2009 and June 30, 2009, five loan investments were on non-accrual status: AEH, Conquest Cherokee, LLC (Conquest), ICS, Wind River Resources Corp. and Wind River II Corp. (Wind River), and Yatesville. The loan principal of these loans amounted to $95,797 and $92,513 as of September 30, 2009 and June 30, 2009, respectively. The fair values of these investments represent approximately 5.7% and 7.3% of our net assets as of September 30, 2009 and June 30, 2009, respectively. For the three months ended September 30, 2009 and September 30, 2008, the income foregone as a result of not accruing interest on non-accrual debt investments amounted to $4,448 and $1,989, respectively. At September 30, 2009, we held one asset on which payment of interest was past-due more than 90 days for which we continue to accrue interest. The principal balance of such loan is $20,253 and the accrued interest receivable is $1,237 at September 30, 2009. We expect full repayment of principal and interest on this loan.

GSHI has indemnified us against any legal action arising from its investment in Gas Solutions, LP. We have incurred approximately $2,093 from the inception of the investment in GSHI through September 30, 2009 for fees associated with a legal action, and GSHI has reimbursed us for the entire amount. Of the $2,093 reimbursement, $277 was reflected as dividend income: control investments in the Consolidated Statements of Operations for the three months ended September 30, 2008. There were no such legal fees incurred or reimbursed for the three months ended September 30, 2009. Additionally, certain other expenses incurred by us which are attributable to GSHI have been reimbursed by GSHI and are reflected as dividend income: control investments in the Consolidated Statements of

Operations. For the three months ended September 30, 2009 and September 30, 2008, such reimbursements totaled as $1,231 and $1,620, respectively.

The original cost basis of debt placements and equity securities acquired totaled to approximately $6,066 and $70,456 during the three months ended September 30, 2009 and September 30, 2008, respectively. Debt repayments and sales of equity securities with a cost basis of approximately $24,241 and $10,949 were received during the three months ended September 30, 2009 and September 30, 2008, respectively.

Table of Contents

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2009
(Unaudited)
(In thousands, except share and per share data) (Continued)

Note 4. Other Investment Income

Other investment income consists of structuring fees, overriding royalty interests, settlement of net profit interests, deal deposits, administrative agent fee, and other miscellaneous and sundry cash receipts. Income from such sources for the three months ended September 30, 2009 and September 30, 2008 were as follows:

Income Source	For the Three Months Ended September 30, 2009	For the Three Months Ended September 30, 2008
Structuring and amendment fees	$ 405	$ 687
Overriding royalty interests	44	158
Settlement of net profits interests		12,576
Deal deposit		82
Administrative agent fee	15	17