

PROSPECT CAPITAL CORP  
Form N-2/A  
October 11, 2011

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As filed with the Securities and Exchange Commission on October 7, 2011

Registration No. 333-176637

## U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

### FORM N-2

✓ REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

✓ PRE-EFFECTIVE AMENDMENT NO. 1

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

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**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. ✓

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

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- o 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, \$.001 par value per share(2)				
Debt Securities(3)				
Warrants(4)				
Units(5)				
<b>Total</b>	\$750,000,000		\$750,000,000(6)	\$63,301(7)

- (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 (the "Securities Act"), 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. Pursuant to Rule 415(a)(6) under the Securities Act, this registration statement covers a total of \$530,675,000 of unsold securities that had previously been registered under the registrant's registration statement on Form N-2, initially filed with the Securities and Exchange Commission (the "SEC") on November 19, 2010 (No. 333-170724) (the "Prior Registration Statement") and that are being carried forward to this registration statement. The Prior Registration Statement initially registered securities for a maximum aggregate offering price of \$750,000,000 and of that amount the registrant has previously sold common stock for an aggregate offering price of \$219,325,000, leaving a balance of unsold securities with an aggregate offering price of \$530,675,000. In connection with the registration of securities on the Prior Registration Statement, the registrant paid a registration fee of \$37,837 covering such unsold securities and which registration fee is being carried forward to this registration statement and will continue to be applied to such unsold securities pursuant to Rule 415(a)(6). Pursuant to Rule 415(a)(6), the offering of the unsold securities registered under the Prior Registration Statement will be deemed terminated as of the date of effectiveness of this registration statement. If the registrant sells any of such unsold securities pursuant to the Prior Registration Statement after the date of the initial filing, and prior to the date of effectiveness, of this registration statement, the registrant will file a pre-effective amendment to this registration statement which will reduce the number of such unsold securities included on this registration statement.
- (2) Subject to Note 6 below, there is being registered hereunder an indeterminate principal amount of common stock or preferred stock as may be sold, from time to time separately or as units in combination with other securities registered hereunder.
- (3) Subject to Note 6 below, there is being registered hereunder an indeterminate principal amount of debt securities as may be sold, from time to time separately or as units in combination with other securities registered hereunder. 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 \$750,000,000.
- (4) Subject to Note 6 below, there is being registered hereunder an indeterminate principal amount of warrants as may be sold, from time to time separately or as units in combination with other securities registered hereunder, representing rights to purchase common stock, preferred stock or debt securities.
- (5) Subject to Note 6 below, there is being registered hereunder an indeterminate number of units. Each unit may consist of a combination of any one or more securities being registered hereunder and may also include securities being issued by third parties, including the U.S. Treasury.
- (6) In no event will the aggregate offering price of all securities issued from time to time pursuant to this registration statement exceed \$750,000,000.

(7)

Previously paid.

**THE REGISTRANT HEREBY AMENDS THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY ITS EFFECTIVE DATE UNTIL THE REGISTRANT SHALL FILE A FURTHER AMENDMENT WHICH SPECIFICALLY STATES THAT THE REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(A) OF THE SECURITIES ACT OF 1933 OR UNTIL THE REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATES AS THE COMMISSION, ACTING PURSUANT TO SAID SECTION 8(A), MAY DETERMINE.**

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**The information in this preliminary prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission has been declared effective. This preliminary prospectus is not an offer to sell nor does it seek an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.**

**SUBJECT TO COMPLETION, DATED OCTOBER 7, 2011**

**\$750,000,000**

## **PROSPECT CAPITAL CORPORATION**

**Common Stock  
Preferred Stock  
Debt Securities  
Warrants  
Units**

We may offer, from time to time, in one or more offerings or series, together or separately, up to \$750,000,000 of our common stock, preferred stock, debt securities, warrants representing rights to purchase shares of common stock, preferred stock or debt securities, or units comprised of any combination of the foregoing, 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, or warrants, options or rights to acquire 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. At our 2010 annual meeting, held on December 10, 2010, our stockholders approved our ability to sell or otherwise issue an unlimited number of shares of our common stock at any level of discount from net asset value per share for a period of twelve months, expiring on December 10, 2011. We are currently seeking stockholder approval at our 2011 annual meeting, to be held on December 8, 2011, to continue for an additional year our ability to issue shares of common stock below net asset value, subject to the condition that the maximum number of shares salable below net asset value pursuant to this authority in any particular offering that could result in such dilution is limited to 25% of our then outstanding common stock immediately prior to each such offering.

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 October 6, 2011, the last reported sales price for our common stock was \$8.71.

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 10 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 212-448-0702. Our Internet address is <http://www.prospectstreet.com>. Information contained on our website is not incorporated by reference into this prospectus and you should not consider information contained on our website to be a part of this prospectus. 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 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 \_\_\_\_\_, 2011

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**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 \$750,000,000 of our common stock, preferred stock, debt securities or warrants representing rights to purchase shares of our common stock, preferred stock or debt securities, or units comprised of any combination of the foregoing, 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.



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**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," "estimate" or "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," "Prospect," and "Company" refer to Prospect Capital Corporation; "Prospect Capital Management" or the "Investment Adviser" refers to Prospect Capital Management LLC, our investment adviser; and "Prospect Administration" or the "Administrator" refers to Prospect Administration LLC, our administrator.*

**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. From our inception to the fiscal year ended June 30, 2007, we invested primarily in industries related to the industrial/energy economy. Since then, we have widened our strategy to focus on other sectors of the economy and continue to broaden our portfolio holdings.

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.

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**The Offering**

We may offer, from time to time, in one or more offerings or series, together or separately, up to \$750,000,000 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 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 upon approval of our directors, including a majority of our independent directors, in certain circumstances. At our 2010 annual meeting, held on December 10, 2010, our stockholders approved our ability to sell or otherwise issue an unlimited number of shares of our common stock at any level of discount from net asset value per share for a period of twelve months, expiring on December 10, 2011. We are currently seeking stockholder approval at our 2011 annual meeting, to be held on December 8, 2011, to continue for an additional year our ability to issue shares of common stock below net asset value, subject to the condition that the maximum number of shares salable below net asset value pursuant to this authority in any particular offering that could result in such dilution is limited to 25% of our then outstanding common stock immediately prior to each such offering. Similarly, our stockholders approved our ability to issue warrants, options or rights to acquire our common stock at our 2008 annual meeting of stockholders for an unlimited time period and in accordance with the 1940 Act which provides that the conversion or exercise price of such warrants, options or rights may be less than net asset value per share at the date such securities are issued or at the date such securities are converted into or exercised for shares of our common stock. 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 have no current intention of engaging in a rights offering, although we reserve the right to do so in the future.

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."

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**Distributions**

In June 2010, our Board of Directors approved a change in dividend policy from quarterly distributions to monthly distributions. Since that time, we have paid monthly distributions to the holders of our common stock and generally intend to continue to do so. The amount of the monthly 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 monthly distributions may from time to time be paid out of our capital rather than from earnings for the month 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."

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**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 "Business Management Services Investment Advisory Agreement," and "Business 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. 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 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 \$750,000,000 of our common stock, preferred stock, debt securities or warrants representing rights to purchase shares of our common stock, preferred stock or debt securities, or units comprised of any combination of the foregoing, 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."

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**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 \$400 million under our credit facility, which is the maximum amount available under the credit facility. We do not intend to issue preferred stock during the year. 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.

<b>Stockholder transaction expenses:</b>	
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%
<b>Annual expenses (as a percentage of net assets attributable to common stock)(4):</b>	
Management fees(5)	3.35%
Incentive fees payable under Investment Advisory Agreement (20% of realized capital gains and 20% of pre-incentive fee net investment income)(6)	2.11%
Total advisory fees	5.46%
Interest payments on the credit facility	1.53%
Interest payments on the 2010 Notes(7)	0.84%
Interest payments on the 2011 Notes(8)	0.85%
Total interest expense	3.22%
Acquired Fund Fees and Expenses(9)	0.01%
Other expenses(10)	1.52%
Total annual expenses(6)(10)	10.21%

**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 \$400 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 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	\$ 131.54	\$ 277.56	\$ 414.68	\$ 721.98

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 is unlikely to be material assuming a 5% annual return and is not included in the example. If we achieve sufficient returns on our

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investments, including through the realization of capital gains, to trigger an incentive fee of a material amount, our distributions to our common stockholders and our expenses would likely be higher. In addition, while the example assumes reinvestment of all dividends and other 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 distribution 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 distribution. 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 \$400 million, the 2% management fee of gross assets equals approximately 3.35% of net assets. See "Business Management Services Investment Advisory Agreement" and footnote 6 below.
- (6) Based on the incentive fee paid during our fiscal year ended June 30, 2011, all of which consisted of an income incentive fee. For a more detailed discussion of the calculation of the two-part incentive fee, see "Management Services Investment Advisory Agreement" in this prospectus.
- (7) On December 21, 2010, the Company issued \$150 million in aggregate principal amount of 6.25% Convertible Senior Notes due 2015, which we refer to as the 2010 Notes. See "Business General" and "Risk Factors Risks Related to our Business" for more detail on the 2010 Notes.
- (8) On February 18, 2011, the Company issued \$172.5 million in aggregate principal amount of 5.5% Convertible Senior Notes due 2016, which we refer to as the 2011 Notes. See "Business General" and "Risk Factors Risks Related to our Business" for more detail on the 2011 Notes. The 2011 Notes and the 2010 Notes are referred to collectively as the Notes.
- (9) The Company's stockholders indirectly bear the expenses of underlying investment companies in which the Company invests. This amount includes the fees and expenses of investment companies in which the Company is invested in as of June 30, 2011. When applicable, fees and expenses are based on historic fees and expenses for the investment companies and for those investment companies with little or no operating history, fees and expenses are based on expected fees and expenses stated in the investment companies' prospectus or other similar communication without giving effect to any performance. Future fees and expenses for certain investment companies may be substantially higher or lower because certain fees and expenses are based on the performance of the investment companies, which may fluctuate over time. The amount of the Company's



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average net assets used in calculating this percentage was based on net assets of approximately \$1.1 billion as of June 30, 2011.

- (10) "Other expenses" are based on estimated amounts for the current fiscal year. The amount shown above represents annualized expenses during our three months ended June 30, 2011 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 "Business Management Services Administration Agreement."



Table of Contents**SELECTED CONDENSED FINANCIAL DATA**

You should read the condensed consolidated financial information below with the Consolidated Financial Statements and notes thereto included in this prospectus. Financial information below for the years ended June 30, 2011, 2010, 2009, 2008 and 2007 has been derived from the financial statements that were audited by our independent registered public accounting firm. 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 33 for more information.

	For the Year/Period Ended June 30,				
	2011	2010	2009	2008	2007
(in thousands except data relating to shares, per share and number of portfolio companies)					
<b>Performance Data:</b>					
Interest income	\$ 134,454	\$ 86,518	\$ 62,926	\$ 59,033	\$ 30,084
Dividend income	15,092	15,366	22,793	12,033	6,153
Other income	19,930	12,675	14,762	8,336	4,444
<b>Total investment income</b>	<b>169,476</b>	<b>114,559</b>	<b>100,481</b>	<b>79,402</b>	<b>40,681</b>
Interest and credit facility expenses	(17,598)	(8,382)	(6,161)	(6,318)	(1,903)
Investment advisory expense	(46,051)	(30,727)	(26,705)	(20,199)	(11,226)
Other expenses	(11,606)	(8,260)	(8,452)	(7,772)	(4,421)
<b>Total expenses</b>	<b>(75,255)</b>	<b>(47,369)</b>	<b>(41,318)</b>	<b>(34,289)</b>	<b>(17,550)</b>
Net investment income	94,221	67,190	59,163	45,113	23,131
Realized and unrealized gains (losses)	24,017	(47,565)	(24,059)	(17,522)	(6,403)
Net increase in net assets from operations	\$ 118,238	\$ 19,625	\$ 35,104	\$ 27,591	\$ 16,728
<b>Per Share Data:</b>					
Net increase in net assets from operations(1)	\$ 1.38	\$ 0.33	\$ 1.11	\$ 1.17	\$ 1.06
Distributions declared per share	\$ (1.21)	\$ (1.33)	\$ (1.62)	\$ (1.59)	\$ (1.54)
Average weighted shares outstanding for the period	85,978,757	59,429,222	31,559,905	23,626,642	15,724,095
<b>Assets and Liabilities Data:</b>					
Investments	\$ 1,463,010	\$ 748,483	\$ 547,168	\$ 497,530	\$ 328,222
Other assets	86,307	84,212	119,857	44,248	48,280
<b>Total assets</b>	<b>1,549,317</b>	<b>832,695</b>	<b>667,025</b>	<b>541,778</b>	<b>376,502</b>
Amount drawn on credit facility	84,200	100,300	124,800	91,167	
2010 Notes	150,000				
2011 Notes	172,500				
Amount owed to related parties	7,918	9,300	6,713	6,641	4,838
Other liabilities	20,342	11,671	2,916	14,347	71,616
<b>Total liabilities</b>	<b>434,960</b>	<b>121,271</b>	<b>134,429</b>	<b>112,155</b>	<b>76,454</b>
<b>Net assets</b>	<b>\$ 1,114,357</b>	<b>\$ 711,424</b>	<b>\$ 532,596</b>	<b>\$ 429,623</b>	<b>\$ 300,048</b>
<b>Investment Activity Data:</b>					
No. of portfolio companies at period end	72	58	30	29(2)	24(2)

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Acquisitions	\$	953,337	\$	364,788(3)	\$	98,305	\$	311,947	\$	167,255
Sales, repayments, and other disposals	\$	285,562	\$	136,221	\$	27,007	\$	127,212	\$	38,407
Weighted-Average Yield at end of period(4)		12.8%		14.2%		13.7%		15.5%		17.1%

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- (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 \$207,126 of acquired portfolio investments from Patriot Acquisition.
- (4) Includes dividends from certain equity investments.

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**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, warrants, and units, if any are outstanding, may decline, and you may lose all or part of your investment.*

**Risks Relating To Our Business**

***We may suffer credit losses.***

Investment in small and middle-market companies is highly speculative and involves a high degree of risk of credit loss. These risks are likely to increase during volatile economic periods, such as the US and many other economies have recently been experiencing. See "Risks Related to Our Investments."

***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,

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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.

In addition, decreases in the market values or fair values of our investments are recorded as unrealized depreciation. Unprecedented declines in prices and liquidity in the corporate debt markets experienced during the recent financial crises resulted in significant net unrealized depreciation in our portfolio in the past. The effect of all of these factors on our portfolio reduced our NAV by increasing net unrealized depreciation in our portfolio. Depending on market conditions, we could incur substantial realized losses and may continue to suffer additional unrealized losses in future periods, which could have a material adverse impact on our business, financial condition and results of operations.

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***Senior securities, including debt, expose us to additional risks, including the typical risks associated with leverage and could adversely affect our business, financial condition and results of operations.***

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. We also have the Notes outstanding, which are a form of leverage and are senior in payment to our common stock.

With certain limited exceptions, as a business development company, or 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 the following, any of which could adversely affect our business, financial condition and result of operations:

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;

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 will be distributed to our stockholders;

Making it more difficult for us to meet our payment and other obligations under the Notes and our other outstanding debt;

The occurrence of an event of default if we fail to comply with the financial and/or other restrictive covenants contained in our debt agreements, including the credit agreement and each indenture governing the Notes, which event of default could result in all or some of our debt becoming immediately due and payable;

Reduced availability of our cash flow to fund investments, acquisitions and other general corporate purposes, and limiting our ability to obtain additional financing for these purposes;

The risk of increased sensitivity to interest rate increases on our indebtedness with variable interest rates, including borrowings under our amended senior credit facility; and

Reduced flexibility in planning for, or reacting to, and increasing our vulnerability to, changes in our business, the industry in which we operate and the general economy.

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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 NAV and also make it difficult for the net asset value to recover. 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.

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In addition, our ability to meet our payment and other obligations of the Notes and our credit facility depends on our ability to generate significant cash flow in the future. This, to some extent, is subject to general economic, financial, competitive, legislative and regulatory factors as well as other factors that are beyond our control. We cannot assure you that our business will generate cash flow from operations, or that future borrowings will be available to us under our existing credit facility or otherwise, in an amount sufficient to enable us to meet our payment obligations under the Notes and our other debt and to fund other liquidity needs. If we are not able to generate sufficient cash flow to service our debt obligations, we may need to refinance or restructure our debt, including the Notes, sell assets, reduce or delay capital investments, or seek to raise additional capital. If we are unable to implement one or more of these alternatives, we may not be able to meet our payment obligations under the Notes and our other debt.

*Illustration.* The following table illustrates the effect of leverage on returns from an investment in our common stock assuming various annual returns, net of interest expense. The calculations in the table below are hypothetical and actual returns may be higher or lower than those appearing below. The calculation assumes (i) \$1.5 billion in total assets, (ii) an average cost of funds of 5.88%, (iii) \$400 million in debt outstanding and (iv) \$1.1 billion of stockholders' equity.

Assumed Return on Our Portfolio (net of expenses)	(10)%	(5)%	0%	5%	10%
Corresponding Return to Stockholder	(15.77)%	(8.96)%	(2.14)%	4.68%	11.50%

The assumed portfolio return is required by regulation of the SEC and is not a prediction of, and does not represent, our projected or actual performance. Actual returns may be greater or less than those appearing in the table.

***The Notes present other risks to holders of our common stock, including the possibility that the Notes could discourage an acquisition of the Company by a third party and accounting uncertainty.***

Certain provisions of the Notes could make it more difficult or more expensive for a third party to acquire us. Upon the occurrence of certain transactions constituting a fundamental change, holders of the Notes will have the right, at their option, to require us to repurchase all of their Notes or any portion of the principal amount of such Notes in integral multiples of \$1,000. We may also be required to increase the conversion rate or provide for conversion into the acquirer's capital stock in the event of certain fundamental changes. These provisions could discourage an acquisition of us by a third party.

The accounting for convertible debt securities is subject to frequent scrutiny by the accounting regulatory bodies and is subject to change. We cannot predict if or when any such change could be made and any such change could have an adverse impact on our reported or future financial results. Any such impacts could adversely affect the market price of our common stock.

***We fund a portion of our investments with borrowed money, which magnifies the potential for gain or loss on amounts invested and may increase the risk of investing in us.***

Borrowings and other types of financing, also known as leverage, magnify the potential for gain or loss on amounts invested and, therefore, increase the risks associated with investing in our securities. Our lenders have fixed dollar claims on our assets that are superior to the claims of our common stockholders or any preferred stockholders. If the value of our assets increases, then leveraging would cause the net asset value to increase more sharply than it would have had we not leveraged. Conversely, if the value of our assets decreases, leveraging would cause net asset value to decline more sharply than it otherwise would have had we not leveraged. Similarly, any increase in our income in excess of consolidated interest payable on the borrowed funds would cause our net income to increase more than it would without the leverage, while any decrease in our income would cause net income to decline more sharply than it would have had we not borrowed. Such a decline could negatively affect

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our ability to make common stock dividend payments. Leverage is generally considered a speculative investment technique.

***We may in the future determine to fund a portion of our investments with preferred stock, which would magnify the potential for gain or loss and the risks of investing in us in the same way as our borrowings.***

Preferred stock, which is another form of leverage, has the same risks to our common stockholders as borrowings because the dividends on any preferred stock we issue must be cumulative. Payment of such dividends and repayment of the liquidation preference of such preferred stock must take preference over any dividends or other payments to our common stockholders, and preferred stockholders are not subject to any of our expenses or losses and are not entitled to participate in any income or appreciation in excess of their stated preference.

***In addition to regulatory restrictions that restrict our ability to raise capital, our credit facility contains various covenants which, if not complied with, could accelerate repayment under the facility, thereby materially and adversely affecting our liquidity, financial condition and results of operations.***

The agreement governing our credit facility requires us to comply with certain financial and operational covenants. These covenants include:

restrictions on the level of indebtedness that we are permitted to incur in relation to the value of our assets;

restrictions on our ability to incur liens; and

maintenance of a minimum level of stockholders' equity.

As of June 30, 2011, we were in compliance with these covenants. However, our continued compliance with these covenants depends on many factors, some of which are beyond our control. Accordingly, there are no assurances that we will continue to comply with the covenants in our credit facility. Failure to comply with these covenants would result in a default under this facility which, if we were unable to obtain a waiver from the lenders thereunder, could result in an acceleration of repayments under the facility and thereby have a material adverse impact on our business, financial condition and results of operations.

***Failure to extend our existing credit facility, the revolving period of which is currently scheduled to expire on June 13, 2012, could have a material adverse effect on our results of operations and financial position and our ability to pay expenses and make distributions.***

The revolving period for our credit facility with a syndicate of lenders is currently scheduled to terminate on June 13, 2012. If the credit facility is not renewed or extended by the participant banks by June 13, 2012, we will not be able to make further borrowings under the facility after such date and the outstanding principal balance on that date will be due and payable on June 13, 2013. At June 30, 2011 we had outstanding borrowings of \$84.2 million under our credit facility. Interest on borrowings under the credit facility is one-month LIBOR plus 325 basis points, subject to a minimum LIBOR floor of 100 basis points. Additionally, the lenders charge a fee on the unused portion of the credit facility equal to either 75 basis points if at least half of the credit facility is used or 100 basis points otherwise. If we are unable to extend our facility or find a new source of borrowing on acceptable terms, we will be required to pay down the amounts outstanding under the facility during the one-year term-out period through one or more of the following: (1) principal collections on our securities pledged under the facility, (2) at our option, interest collections on our securities pledged under the facility and cash collections on our securities not pledged under the facility, or (3) possible liquidation of some or all of our loans and other assets, any of which could have a material adverse effect on our results of operations and financial position and may force us to decrease or stop paying certain expenses and



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making distributions until the facility is repaid. In addition, our stock price could decline significantly, we would be restricted in our ability to acquire new investments and, in connection with our year-end audit, our independent registered accounting firm could raise an issue as to our ability to continue as a going concern.

***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 and other senior securities 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 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 NAV was calculated as of June 30, 2011 and our NAV when calculated as of September 30, 2011 may be higher or lower.***

Our most recently estimated NAV per share is \$10.04 on an as adjusted basis solely to give effect to distributions with record dates of July 29, 2011, August 31, 2011 and September 30, 2011, our

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issuance of common stock on July 22, 2011, August 26, 2011 and September 23, 2011 in connection with our dividend reinvestment plan, and our issuance of 1,500,000 shares of common stock on July 18, 2011 in connection with the option granted with the June 21, 2011 offering of 10,000,000 shares which were delivered June 24, 2011, versus \$10.36 determined by us as of June 30, 2011. NAV per share as of September 30, 2011, may be higher or lower than \$10.04 based on potential changes in valuations and earnings for the quarter then ended. Our Board of Directors has not yet determined the fair value of portfolio investments at any date subsequent to June 30, 2011. 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 Adviser 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

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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.

***We may be obligated to pay our investment adviser incentive compensation even if we incur a loss.***

Our investment adviser is entitled to incentive compensation for each fiscal quarter based, in part, on our pre-incentive fee net investment income if any, for the immediately preceeding calendar quarter above a performance threshold for that quarter. Accordingly, since the performance threshold is based on a percentage of our net asset value, decreases in our net asset value make it easier to achieve the performance threshold. Our pre-incentive fee net investment income for incentive compensation purposes excludes realized and unrealized capital losses or depreciation that we may incur in the fiscal quarter, even if such capital losses or depreciation result in a net loss on our statement of operations for that quarter. Thus, we may be required to pay Prospect Capital Management incentive compensation for a fiscal quarter even if there is a decline in the value of our portfolio or we incur a net loss for that quarter.

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***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 material adverse effect on our business. For additional information regarding the regulations we are subject to, see "Regulation."

***Foreign and domestic political risk may adversely affect our business.***

We are exposed to political risk to the extent that Prospect Capital Management, on its behalf and subject to its investment guidelines, transacts in securities in the U.S. and foreign markets. The governments in any of these jurisdictions could impose restrictions, regulations or other measures, which may have a material adverse impact on our strategy.

***Capital markets have recently been in a period of disruption and instability. These market conditions have materially and adversely affected debt and equity capital markets in the United States and abroad, which have had, and may in the future have, a negative impact on our business and operations.***

The U.S. and foreign capital markets have recently been in a period of disruption as evidenced by a lack of liquidity in the debt capital markets, significant write-offs in the financial services sector, the re-pricing of credit risk in the broadly syndicated credit market and the failure of certain major financial institutions. Despite actions of the United States federal government and foreign governments, these events contributed to worsening general economic conditions that materially and adversely impacted the broader financial and credit markets and reduced the availability of debt and equity capital for the market as a whole and financial services firms in particular. While these conditions appear to be improving, they could continue for a prolonged period of time or worsen in the future. In addition, while these conditions persist, we and other companies in the financial services sector may have to access, if available, alternative markets for debt and equity capital in order to grow. Equity capital may be difficult to raise because subject to some limited exceptions, as a BDC, we are generally not able to issue additional shares of our common stock at a price less than net asset value without first obtaining approval for such issuance from our stockholders and our independent directors. At our annual meeting of stockholders held on December 10, 2010, subject to certain determinations required to be made by our Board of Directors, our stockholders approved our ability to sell or otherwise issue shares of our common stock at a price below its then current net asset value per share for a twelve month period expiring on the anniversary of the date of stockholder approval. We are currently seeking stockholder approval at our 2011 annual meeting, to be held on December 8, 2011, to continue for an additional year our ability to issue shares of common stock below net asset value, subject to the condition that the maximum number of shares salable below net asset value pursuant to this authority in any particular offering that could result in such dilution is limited to 25% of our then outstanding common stock immediately prior to each such offering. In addition, our ability to incur indebtedness or issue other senior securities (including by issuing preferred stock) is limited by applicable regulations such that our asset coverage, as defined in the 1940 Act, must equal at least 200% immediately after each time we incur indebtedness or issue other senior securities. The debt capital that will be available, if at all, may be at a higher cost and on less favorable terms and conditions in the future. Any inability to raise capital could have a negative effect on our business, financial condition and results of operations.

Moreover, recent market conditions have made, and may in the future make, it difficult to extend the maturity of or refinance our existing indebtedness and any failure to do so could have a material adverse effect on our business. The illiquidity of our investments may make it difficult for us to sell such investments if required. As a result, we may realize significantly less than the value at which we have recorded our investments.

Given the recent extreme volatility and dislocation in the capital markets, many BDCs have faced, and may in the future face, a challenging environment in which to raise capital. Recent significant

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changes in the capital markets affecting our ability to raise capital have affected the pace of our investment activity. In addition, significant changes in the capital markets, including the recent extreme volatility and disruption, has had, and may in the future have, a negative effect on the valuations of our investments and on the potential for liquidity events involving our investments. An inability to raise capital, and any required sale of our investments for liquidity purposes, could have a material adverse impact on our business, financial condition or results of operations.

**Risks Relating To Our Operation As A Business Development Company**

*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 and issue common stock.

*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 would 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".

*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 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

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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 distributing 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, as required 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".

***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 through the issuance of the Notes 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 our annual meeting, without regard to whether a majority of such shares are voted in favor of the proposal, approve the sale of our

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common stock at a price that is less than the current net asset value per share. At our 2010 annual meeting of stockholders held on December 10, 2010, we obtained the first method of approval from our shareholders to sell an unlimited number of shares of common stock at any discount to net asset value per share for a period of twelve months, expiring on December 10, 2011. We are currently seeking stockholder approval at our 2011 annual meeting, to be held on December 8, 2011, to continue for an additional year our ability to issue shares of common stock below net asset value, subject to the condition that the maximum number of shares salable below net asset value pursuant to this authority in any particular offering that could result in such dilution is limited to 25% of our then outstanding common stock immediately prior to each such offering. We will not sell shares of common stock under a prospectus supplement to the registration statement (the "current registration statement") if the cumulative dilution to our NAV per share from offerings under the current registration statement exceeds 15%. 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. See " Securitization of our assets subjects us to various risks."

***Securitization of our assets subjects us to various risks.***

We may securitize assets to generate cash for funding new investments. We refer to the term securitize to describe a form of leverage under which a company (sometimes referred to as an "originator" or "sponsor") transfers income producing assets to a single-purpose, bankruptcy-remote subsidiary (also referred to as a "special purpose entity" or SPE), which is established solely for the purpose of holding such assets and entering into a structured finance transaction. The SPE then issues notes secured by such assets. The special purpose entity may issue the notes in the capital markets either publicly or privately to a variety of investors, including banks, non-bank financial institutions and other investors. There may be a single class of notes or multiple classes of notes, the most senior of which carries less credit risk and the most junior of which may carry substantially the same credit risk as the equity of the SPE.

An important aspect of most debt securitization transactions is that the sale and/or contribution of assets into the SPE be considered a true sale and/or contribution for accounting purposes and that a reviewing court would not consolidate the SPE with the operations of the originator in the event of the originator's bankruptcy based on equitable principles. Viewed as a whole, a debt securitization seeks to lower risk to the note purchasers by isolating the assets collateralizing the securitization in an SPE that is not subject to the credit and bankruptcy risks of the originator. As a result of this perceived reduction of risk, debt securitization transactions frequently achieve lower overall leverage costs for originators as compared to traditional secured lending transactions.

In accordance with the above description, to securitize loans, we may create a wholly owned subsidiary and contribute a pool of our assets to such subsidiary. The SPE may be funded with, among other things, whole loans or interests from other pools and such loans may or may not be rated. The SPE would then sell its notes to purchasers who we would expect to be willing to accept a lower interest rate and the absence of any recourse against us to invest in a pool of income producing assets to which none of our creditors would have access. We would retain all or a portion of the equity in the SPE. An inability to successfully securitize portions of our portfolio or otherwise leverage our portfolio through secured and unsecured borrowings could limit our ability to grow our business and fully execute our business strategy, and could decrease our earnings, if any. However, the successful

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securitization of portions of our portfolio exposes us to a risk of loss for the equity we retain in the SPE and might expose us to greater risk on our remaining portfolio because the assets we retain 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.

Interests we hold in the SPE, if any, will be subordinated to the other interests issued by the SPE. As such, we will only receive cash distributions on such interests if the SPE has made all cash interest and other required payments on all other interests it has issued. In addition, our subordinated interests will likely be unsecured and rank behind all of the secured creditors, known or unknown, of the SPE, including the holders of the senior interests it has issued. Consequently, to the extent that the value of the SPE's portfolio of assets has been reduced as a result of conditions in the credit markets, or as a result of defaults, the value of the subordinated interests we retain would be reduced. Securitization imposes on us the same risks as borrowing except that our risk in a securitization is limited to the amount of subordinated interests we retain, whereas in a borrowing or debt issuance by us directly we would be at risk for the entire amount of the borrowing or debt issuance.

Generally, we would expect the SPE not to be consolidated with us and in that event our only interest will be the value of our retained subordinated interest and the income allocated to us, which may be more or less than the cash we receive from the SPE, and none of the SPE's liabilities will be reflected as our liabilities. If the assets of the SPE are not consolidated with our assets and liabilities, then our interest in the SPE may be deemed not to be a qualifying asset for purposes of determining whether 70% of our assets are qualifying assets and the leverage incurred by such SPE may or may not be treated as borrowings by us for purposes of the requirement that we not issue senior securities in an amount in excess of our net assets.

We may also engage in transactions utilizing SPEs and securitization techniques where the assets sold or contributed to the SPE remain on our balance sheet for accounting purposes. If, for example, we sell the assets to the SPE with recourse or provide a guarantee or other credit support to the SPE, its assets will remain on our balance sheet. Consolidation would also generally result if we, in consultation with the SEC, determine that consolidation would result in a more accurate reflection of our assets, liabilities and results of operations. In these structures, the risks will be essentially the same as in other securitization transactions but the assets will remain our assets for purposes of the limitations described above on investing in assets that are not qualifying assets and the leverage incurred by the SPE will be treated as borrowings incurred by us for purposes of our limitation on the issuance of senior securities.

Our Investment Adviser may have conflicts of interest with respect to potential securitizations in as much as securitizations that are not consolidated may reduce our assets for purposes of determining its investment advisory fee although in some circumstances our investment adviser may be paid certain fees for managing the assets of the SPE so as to reduce or eliminate any potential bias against securitizations.

***Our ability to invest in public companies may be limited in certain circumstances.***

As a BDC, we must not acquire any assets other than "qualifying assets" specified in the 1940 Act unless, at the time the acquisition is made, at least 70% of our total assets are qualifying assets (with certain limited exceptions). Subject to certain exceptions for follow-on investments and distressed companies, an investment in an issuer that has outstanding securities listed on a national securities exchange may be treated as qualifying assets only if such issuer has a market capitalization that is less than \$250 million at the time of such investment.



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***Price declines and illiquidity in the corporate debt markets have adversely affected, and may in the future adversely affect, the fair value of our portfolio investments, reducing our net asset value through increased net unrealized depreciation.***

As a BDC, we are required to carry our investments at market value or, if no market value is ascertainable, at fair value as determined in good faith by or under the direction of our Board of Directors. As part of the valuation process, the types of factors that we may take into account in determining the fair value of our investments include, as relevant and among other factors: 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, merger and acquisition comparables, our principal market (as the reporting entity) and enterprise values. Decreases in the market values or fair values of our investments are recorded as unrealized depreciation. Unprecedented declines in prices and liquidity in the corporate debt markets resulted in significant net unrealized depreciation in our portfolio in the past. The effect of all of these factors on our portfolio has reduced our net asset value by increasing net unrealized depreciation in our portfolio. Depending on market conditions, we could incur substantial realized losses and may suffer additional unrealized losses in future periods, which could have a material adverse impact on our business, financial condition and results of operations.

***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. 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 2010 annual meeting of stockholders held on December 10, 2010, 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 the December 10, 2010 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." We are currently seeking stockholder approval at our 2011 annual meeting, to be held on December 8, 2011, to continue for an additional year our ability to issue shares of common stock below net asset value, subject to the condition that the maximum number of shares salable below net asset value pursuant to this authority in any particular offering that could result in such dilution is limited to 25% of our then outstanding common stock immediately prior to each such offering. 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. In addition, such sales may adversely affect the price at which our common stock trades. 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 have sold shares of our common stock

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at prices below net asset value per share and may continue to do so to the future. For additional information, see "Recent Sales of Common Stock Below Net Asset Value" in the prospectus supplement pursuant to which such sale is made, if applicable.

***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.

**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 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;

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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;

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

increased taxes, regulatory expense or the costs of changes to the way they conduct business due to the effects of climate change may adversely affect their business, financial structure or prospects.

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. and foreign 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. Despite actions of the United States federal government and foreign governments, these events contributed to worsening general economic conditions that materially and adversely impacted the broader financial and credit markets and reduced the availability of debt and equity capital for the market as a whole and financial services firms in particular. While these conditions appear to be improving, they could continue for a prolonged period of time or worsen in the future 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.

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

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re-characterize our debt or equity holding and subordinate all or a portion of our claim to those of other creditors.

***Our portfolio contains a limited number of portfolio companies, which subjects us to a greater risk of significant loss if any of these companies defaults on its obligations under any of its debt securities.***

A consequence of the limited number of investments in our portfolio is that the aggregate returns we realize may be significantly adversely affected if one or more of our significant portfolio company investments perform poorly or if we need to write down the value of any one significant investment. Beyond our income tax diversification requirements, we do not have fixed guidelines for diversification, and our portfolio could contain relatively few portfolio companies.

***Our failure to make follow-on investments in our portfolio companies could impair the value of our portfolio.***

Following an initial investment in a portfolio company, we may make additional investments in that portfolio company as "follow-on" investments, in order to: (1) increase or maintain in whole or in part our equity ownership percentage; (2) exercise warrants, options or convertible securities that were acquired in the original or subsequent financing or (3) attempt to preserve or enhance the value of our investment.

We may elect not to make follow-on investments, may be constrained in our ability to employ available funds, or otherwise may lack sufficient funds to make those investments. We have the discretion to make any follow-on investments, subject to the availability of capital resources. The failure to make follow-on investments may, in some circumstances, jeopardize the continued viability of a portfolio company and our initial investment, or may result in a missed opportunity for us to increase our participation in a successful operation. Even if we have sufficient capital to make a desired follow-on investment, we may elect not to make a follow-on investment because we may not want to increase our concentration of risk, because we prefer other opportunities, or because we are inhibited by compliance with BDC requirements or the desire to maintain our tax status.

***We may be unable to invest the net proceeds raised from offerings on acceptable terms, which would harm our financial condition and operating results.***

Until we identify new investment opportunities, we intend to either invest the net proceeds of future offerings in interest-bearing deposits or other short-term instruments or use the net proceeds from such offerings to reduce then-outstanding obligations under our credit facility. We cannot assure you that we will be able to find enough appropriate investments that meet our investment criteria or that any investment we complete using the proceeds from an offering will produce a sufficient return.

***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.

***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

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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 may be made in the form of mezzanine loans, therefore our liens on the collateral, if any, may be 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

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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 including those located in emerging market countries. 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. Such risks are more pronounced in emerging market countries.

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. The Company has no current intention of engaging in any of the hedging transaction described above, although it reserves the right to do so in the future.

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***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. 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 and is highly speculative.***

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.



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***In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has, from time to time, been brought against that company.***

If our stock price fluctuates significantly, we may be the target of securities litigation in the future. Securities litigation could result in substantial costs and divert management's attention and resources from our business.

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

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.

***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 stockholders from being able to sell shares of our 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

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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. 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. 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. It is the view of the staff of the SEC that opting into the Maryland Control Share Acquisition Act would be acting in a manner inconsistent with section 18(i) of the 1940 Act.

***We may in the future choose to pay dividends in our own stock, in which case our stockholders 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, up to 90% of any such taxable dividend could be payable in our stock for dividends paid on or before December 31, 2012 with respect to any taxable year ending on or before December 31, 2011. The IRS has also issued private letter rulings on cash/stock dividends paid by regulated investment companies and real estate investment trusts 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 our 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.

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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 our 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 2010-12, a private letter ruling, or otherwise).

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**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 consolidated financial statements and related notes and other financial information appearing elsewhere in this offering memorandum or incorporated by reference into this offering memorandum. In addition to historical information, the following discussion and other parts of this offering memorandum 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 section of the offering memorandum 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 offering memorandum. 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 herein on information available to us on the date of this document, 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 SEC, including any annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K.

**Overview**

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

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acquisitions, divestitures, growth, development 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.

We seek to be a long-term investor with our portfolio companies. From our July 27, 2004 inception to the fiscal year ended June 30, 2007, we 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 reduce our exposure to the energy industry, and our holdings in the energy and energy related industries now represent less than 20% of our investment portfolio.

The aggregate value of our portfolio investments was \$1,463,010 and \$748,483 as of June 30, 2011 and June 30, 2010, respectively. During the fiscal year ended June 30, 2011, our net cost of investments increased by \$706,975, or 97.0%, as a result of twenty-eight new investments, twelve follow-on investments and revolver advances of \$943,703, accrued of payment-in-kind interest of \$9,634 and accretion of purchase discount of \$23,035, while we received full repayment on fourteen investments, sold three investments and received several partial prepayments and revolver repayments totaling of \$269,397.

Compared to the end of the fiscal year ended June 30, 2010, our net assets increased by \$402,933 or 56.6% during the year ended June 30, 2011, from \$711,424 to \$1,114,357. This increase resulted from the issuance of new shares of our common stock (less offering costs) in the amount of \$379,929, dividend reinvestments of \$10,934, and another \$118,238 from operations. These increases, in turn, were offset by \$106,167 in dividend distributions to our stockholders. The \$118,238 increase in net assets resulting from operations is net of the following: net investment income of \$94,221, net realized gain on investments of \$16,465, and an increase in net assets due to changes in net unrealized appreciation of investments of \$7,552.

**Market Opportunity**

We believe that current market conditions present attractive opportunities for us to invest in middle-market companies; specifically:

We believe that the dislocation in the credit markets that began in 2007 resulted in reduced competition, a widening of interest spreads, increased fees and generally more conservative capital structures and deal terms. These previous market conditions may continue to create favorable opportunities to invest at attractive risk-adjusted returns.

We believe that many senior lenders have, in recent years, de-emphasized their service and product offerings to middle-market businesses in favor of lending to large corporate clients and managing capital markets transactions. In addition, commercial and investment banks are limited in their ability to underwrite and syndicate bank loans and high yield securities for middle-market issuers as they seek to build capital and reduce leverage, resulting in opportunities for alternative funding sources and therefore higher new-issue market opportunities.

We believe there is a large pool of un-invested private equity capital for middle-market businesses. We expect private equity firms will seek to leverage their investments by combining equity capital with senior secured loans and mezzanine debt from other sources.

A high volume of senior secured and high yield debt was originated in the calendar years 2004 through 2007 and will come due in the near term and, accordingly, we believe that new financing opportunities will increase as many companies seek to refinance this indebtedness.

To capitalize on these opportunities, expansion of the capital base has been and may continue to be necessary. We have demonstrated our continuing access to capital markets in several equity and debt transactions during the year ended June 30, 2011, From July 1, 2010 to December 15, 2010, we raised

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\$181,946 of equity capital through our at the market program. On December 21, 2010 and February 18, 2011, we issued \$150,000 and \$172,500, respectively, of senior convertible notes. On April 7, 2011, we completed a public stock offering for 9,000,000 shares of our common stock raising \$102,600 of gross proceeds. On June 24, 2011, we completed a public stock offering for 10,000,000 shares of our common stock at \$10.15 per share, raising \$101,500 of gross proceeds. On July 18, 2011, the underwriter exercised its option to purchase an additional 1,500,000 shares of our common stock.

The preparation of financial statements in conformity with 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.

**Fourth Quarter Highlights**

*Investment Transactions*

On April 18, 2011, we made a \$13,000 secured debt investment to support the acquisition of New Meatco Provisions, LLC ("Meatco"), a leading food distributor, by Annex Capital Management. The second lien note bears interest in cash at the greater of 12.0% or Libor plus 9.0% and interest in kind of 4.0% and has a final maturity on April 18, 2016.

On April 18, 2011, Unitek Acquisition, Inc. ("Unitek") repaid the \$11,500 loan receivable to us.

On April 26, 2011, we made a senior secured follow-on investment of \$11,000 in ICON Health & Fitness, Inc ("ICON"). The first lien note bears interest in cash at 11.875% and has a final maturity on October 15, 2016.

On May 2, 2011, we sold our membership interests in Fischbein, LLC ("Fischbein") realizing a gain of \$9,893 on the sale and received a repayment of the loan that was outstanding. We subsequently made a \$3,334 senior secured second-lien term loan and invested \$875 in the common equity of Fischbein with the new ownership group. The second lien note bears interest in cash at 12.0% and interest in kind of 2.0% and has a final maturity on October 31, 2016.

On May 3, 2011, we made a debt investment of \$25,000 to support the acquisition of Byrider Systems Acquisition Corp. ("Byrider"), a leading used car sales and finance business, by Altamont Capital Partners. The second lien note bears interest in cash at 12.0% and interest in kind of 2.0% and has a final maturity on November 3, 2016.

On May 6, 2011, we made a \$34,450 investment in NMMB Holdings, Inc. ("NMMB"), an advertising media buying business, of which \$31,750 was funded at closing. \$24,250 is structured as senior secured debt, \$2,800 as subordinated debt and \$4,400 as controlling equity. The loans bear interest in cash at 14.0% and 15.0%, respectively, and have a final maturity on May 6, 2016. The \$3,000 revolver, of which \$300 was drawn at closing, bears interest in cash at the greater of 10.50% or Libor plus 8.50% and has a final maturity on May 6, 2016.

On May 6, 2011, we provided \$15,000 in secured second-lien acquisition financing for Mood Media Corporation ("Mood Media"), a company in the in-store media industry. The second lien note bears interest in cash at the greater of 10.25% or Libor plus 8.75% and has a final maturity on November 6, 2018.

On May 6, 2011, we provided \$15,000 in secured second-lien financing for the recapitalization of Potters Holdings II, L.P. ("Potters"), a leading company in the engineered glass materials industry. The second lien note bears interest in cash at the greater of 10.25% or Libor plus 8.50% and has a final maturity on November 6, 2017.

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On May 25, 2011, we provided \$24,000 in secured first-lien financing to Targus Group International, Inc. ("Targus"), the leading global supplier of notebook carrying cases and accessories. The first lien note bears interest in cash at the greater of 11.0% or Libor plus 9.50% and has a final maturity on May 25, 2016.

On May 31, 2011, we provided \$35,000 in secured second-lien financing to Springs Window Fashions, LLC ("Springs Window"), a leading designer and manufacturer of high-quality window treatments. The second lien note bears interest in cash at the greater of 11.25% or Libor plus 9.25% and has a final maturity on November 30, 2017.

On May 31, 2011, Label Corp Holdings Inc ("Label Corp") repaid the \$5,749 loan receivable to us.

On June 3, 2011, Prince Mineral Company, Inc. ("Prince") repaid the \$23,540 loan receivable to us and we recognized \$10,463 of accelerated purchase discount accretion.

On June 16, 2011, we made a senior secured debt investment of \$26,500 to support the acquisition of ST Products, LLC ("STP"), a leading North American producer of precision redrawn, small diameter, thin wall copper, and specialty alloy tubes. The first lien note bears interest in cash at the greater of 12.0% or Libor plus 9.00% and has a final maturity date on June 16, 2016.

On June 21, 2011, we provided \$25,000 in secured second lien financing for the recapitalization of U.S. HealthWorks Holding Company, Inc. ("U.S.H."), a leading company in the occupational medical services industry. The second lien note bears interest in cash at the greater of 10.50% or Libor plus 9.00% and has a final maturity on June 15, 2017.

On June 30, 2011, we made a senior secured debt investment of \$82,500 in CRT MIDCO, LLC ("CRT"), a market-leading specialty media buying business, of which \$75,000 was funded at closing. The first lien notes bear interest in cash at the greater of 10.50% or Libor plus 7.50% and have a final maturity on June 30, 2017. The revolver, which was undrawn at closing of \$7,500, bears interest in cash at the greater of 10.50% or Libor plus 7.50% and has a final maturity on June 30, 2012.

On June 30, 2011 we provided \$5,000 in secured second lien financing for the acquisition of Pre-Paid Legal Services, Inc. ("Pre-Paid Legal"), a top company in the professional services subscription market. The second lien notes bear interest in cash at the greater of 11.00% or Libor plus 9.50% and has a final maturity on December 31, 2016.

### *Equity Issuance*

On April 7, 2011, we completed a public stock offering for 9,000,000 shares of our common stock raising \$102,600 of gross proceeds and \$102,164 of net proceeds.

On June 24, 2011, we completed a public stock offering for 10,000,000 shares of our common stock at \$10.15 per share, raising \$101,500 of gross proceeds and \$100,173 of net proceeds. On July 18, 2011, the underwriter exercised its option to purchase an additional 1,500,000 shares of our common stock, raising an additional \$15,225 of gross proceeds and \$15,060 of net proceeds.

On April 29, 2011, May 31, 2011 and June 24, 2011, we issued 76,377, 78,689 and 92,813 shares of our common stock in connection with the dividend reinvestment plan, respectively.

### *Dividend*

On May 9, 2011, we announced the declaration of monthly dividends in the following amounts and with the following dates:

\$0.101225 per share for May 2011 to holders of record on May 31, 2011 with a payment date of June 24, 2011;



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\$0.101250 per share for June 2011 to holders of record on June 30, 2011 with a payment date of July 22, 2011;

\$0.101275 per share for July 2011 to holders of record on July 29, 2011 with a payment date of August 26, 2011;

\$0.101300 per share for August 2011 to holders of record on August 31, 2011 with a payment date of September 23, 2011.

*Credit Facility*

On April 21, 2011, we announced an increase in commitments to our credit facility of \$40,000. The commitments to the credit facility stood at \$325,000 at June 30, 2011.

**Patriot Acquisition**

On December 2, 2009, we acquired the outstanding shares of Patriot Capital Funding, Inc. ("Patriot") common stock for \$201,083. Under the terms of the merger agreement, Patriot common shareholders received 0.363992 shares of our common stock for each share of Patriot common stock, resulting in 8,444,068 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.

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 final income distribution. The merger has been accounted for as an acquisition of Patriot by Prospect Capital Corporation ("Prospect") in accordance with acquisition method of accounting as detailed in Accounting Standards Codification ("ASC" or "Codification") 805, *Business Combinations* ("ASC 805"). The fair value of the consideration paid was allocated to the assets acquired and liabilities assumed based on their fair values as the date of acquisition. As described in more detail in ASC 805, goodwill, if any, would have been recognized as of the acquisition date, if the consideration transferred exceeded the fair value of identifiable net assets acquired. As of the acquisition date, the fair value of the identifiable net assets acquired exceeded the fair value of the consideration transferred, and we recognized the excess as a gain. A preliminary gain of \$5,714 was recorded by Prospect in the quarter ended December 31, 2009 related to the acquisition of Patriot, which was revised in the fourth quarter of the fiscal year ended June 30, 2010, to \$7,708, when we settled severance accruals related to certain members of Patriot's top management, and finalized during the first quarter of the fiscal year ended June 30, 2011, to \$8,632, when we settled the remaining severance accruals related to the last two members of Patriot's top management. Under ASC 805, the adjustments to our preliminary estimates were reflected in the three months ended December 31, 2009 (See Note 14 to our consolidated financial statements.). The acquisition of Patriot was negotiated in July 2009 with the purchase agreement being signed on August 3, 2009. Between July 2009 and December 2, 2009, our valuation of certain of the investments acquired from Patriot increased due to market improvement, which resulted in the recognition of the gain at closing.

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The 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(1)	92,800
Total purchase price	201,083
Assets acquired:	
Investments(2)	207,126
Cash and cash equivalents	1,697
Other assets	3,859
Assets acquired	212,682
Other liabilities assumed	(2,967)
Net assets acquired	209,715
Gain on Patriot acquisition(3)	\$ 8,632

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- (1) The value of the shares of common stock exchanged with the Patriot common shareholders was based upon the closing price of our common stock on December 2, 2009, the price immediately prior to the closing of the transaction.
- (2) The fair value of Patriot's investments was determined by the Board of Directors in conjunction with an independent valuation agent. This valuation resulted in a purchase price which was \$98,150 below the amortized cost of such investments. For those assets which are performing, Prospect will record the accretion to par value in interest income over the remaining term of the investment.
- (3) The gain has been determined after the final payments of certain liabilities were settled.

During the year ended June 30, 2011, we recognized \$22,084 of interest income due to purchase discount accretion from the assets acquired from Patriot. Included in the \$22,084 is \$4,912 of normal accretion, \$12,035 of accelerated accretion resulting from the repayment of Impact Products, LLC ("Impact Products"), Label Corp and Prince and \$4,968 of accelerated accretion resulting from the recapitalization of our debt investments in Arrowhead General Insurance Agency, Inc. ("Arrowhead"), The Copernicus Group, Inc. ("Copernicus"), Fischbein and Northwestern Management Services, LLC ("Northwestern"). The restructured loans for Arrowhead, Copernicus, Fischbein and Northwestern were issued at market terms comparable to other industry transactions. In accordance with ASC 320-20-35 the cost basis of the new loan was recorded at par value, which precipitated the acceleration of original purchase discount from the loan repayment which was recognized as interest income.

During the period from the acquisition of Patriot on December 2, 2009 to June 30, 2010, we recognized \$18,795 of interest income due to purchase discount accretion from the assets acquired from Patriot. Included in this amount \$4,579 of normal accretion and \$14,216 of accelerated accretion resulting from the early repayments of four loans, three revolving lines of credit, sale of one investment position and restructuring of our loans to Aircraft Fasteners International, LLC ("AFI"), EXL Acquisition Corp. ("EXL"), LHC Holdings Corp. ("LHC"), Prince, ROM Acquisition Corporation ("ROM"). The revised terms were more favorable than the original terms and increased the present value of the future cash flows. In accordance with ASC 320-20-35 the cost basis of the new loans were recorded at par value, which precipitated the acceleration of original purchase discount from the loan repayment which was recognized as interest income.

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**Investment Holdings**

As of June 30, 2011, we continue to pursue our investment strategy. In May 2007, we changed our name to "Prospect Capital Corporation" and the terminated of our policy to invest at least 80% of our net assets in energy companies. Since that time, we have reduced our exposure to the energy industry, and our holdings in the energy and energy related industries now represent less than 20% of our investment portfolio.

At June 30 2011, approximately \$1,463,010 or 131.3% of our net assets are invested in 72 long-term portfolio investments and 5.4% of our net assets invested in money market funds.

During the year ended June 30, 2011, we originated \$953,337 of new investments. Our origination efforts recently have focused primarily on secured lending and reducing the risk in the portfolio, including a higher percentage of first lien loans than in prior periods, though we also continue to close selected junior debt and equity investments. In addition to targeting investments senior in corporate capital structures with our new originations, we have also increased our origination business mix of third party private equity sponsor owned companies, which tend to have more third party equity capital supporting our debt investments than non sponsor transactions. Our portfolio's annualized current yield decreased from 14.2% as of June 30, 2010 to 12.8% as of June 30, 2011 across all long-term debt and certain equity investments. We expect Prospect's current asset yield may decline modestly over the next few quarters as we increase the size of the portfolio while reducing credit risk. Monetization of other equity positions that we hold is not included in this yield calculation. In many 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 June 30, 2011, we own controlling interests in AIRMALL USA, Inc. ("AIRMALL"), Ajax Rolled Ring & Machine, Inc. ("Ajax"), AWCNC, LLC, Borga, Inc. ("Borga"), C&J Cladding LLC, Change Clean Energy Holdings, Inc. ("CCEHI"), Freedom Marine Services LLC ("Freedom Marine"), Gas Solutions Holdings, Inc. ("GSHI"), Integrated Contract Services, Inc. ("ICS"), Iron Horse Coiled Tubing, Inc. ("Iron Horse"), Manx Energy, Inc. ("Manx"), NMMB, NRG Manufacturing, Inc. ("NRG"), Nupla Corporation ("Nupla"), R-V Industries, Inc. ("R-V") and Yatesville Coal Holdings, Inc. ("Yatesville"). We also own an affiliated interest in BNN Holdings Corp. f/k/a Biotronic NeuroNetwork ("Biotronic"), Boxercraft Incorporated ("Boxercraft"), Smart, LLC, and Sport Helmets Holdings, LLC ("Sport Helmets").

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The following is a summary of our investment portfolio by level of control at June 30, 2011 and June 30, 2010, respectively:

Level of Control	June 30, 2011				June 30, 2010			
	Cost	Percent of Portfolio	Fair Value	Percent of Portfolio	Cost	Percent of Portfolio	Fair Value	Percent of Portfolio
Control	\$ 262,301	18.0%	\$ 310,072	20.4%	\$ 185,720	23.3%	\$ 195,958	24.0%
Affiliate	56,833	3.9%	72,337	4.7%	65,082	8.2%	73,740	9.0%
Non-control/Non-affiliate	16,600	74.1%	1,080,601	71.0%	477,957	59.9%	478,785	58.6%
Money Market Funds	59,903	4.0%	59,903	3.9%	68,871	8.6%	68,871	8.4%
<b>Total Portfolio</b>	<b>\$ 1,495,637</b>	<b>100.0%</b>	<b>\$ 1,522,913</b>	<b>100.0%</b>	<b>\$ 797,630</b>	<b>100.0%</b>	<b>\$ 817,354</b>	<b>100.0%</b>

The following is our investment portfolio presented by type of investment at June 30, 2011 and June 30, 2010, respectively:

Type of Investment	June 30, 2011				June 30, 2010			
	Cost	Percent of Portfolio	Fair Value	Percent of Portfolio	Cost	Percent of Portfolio	Fair Value	Percent of Portfolio
Money Market Funds	\$ 59,903	4.0%	\$ 59,903	3.9%	\$ 68,871	8.6%	\$ 68,871	8.4%
Revolving Line of Credit	7,144	0.5%	7,278	0.5%	4,754	0.6%	5,017	0.6%
Senior Secured Debt	822,582	55.0%	789,981	51.9%	313,755	39.4%	287,470	35.2%
Subordinated Secured Debt	491,188	32.9%	448,675	29.5%	333,453	41.8%	313,511	38.4%
Subordinated Unsecured Debt	54,687	3.7%	55,336	3.6%	30,209	3.8%	30,895	3.8%
Preferred Stock	31,979	2.1%	25,454	1.7%	16,969	2.1%	5,872	0.7%
Common Stock	19,865	1.3%	116,076	7.6%	20,243	2.5%	77,131	9.4%
Membership Interests	6,128	0.4%	15,392	1.0%	6,964	0.9%	17,730	2.2%
Overriding Royalty Interests		%	2,168	0.1%		%	2,768	0.3%
Net Profit Interests		%		%		%	1,020	0.1%
Warrants	2,161	0.1%	2,650	0.2%	2,412	0.3%	7,069	0.9%
<b>Total Portfolio</b>	<b>\$ 1,495,637</b>	<b>100.0%</b>	<b>\$ 1,522,913</b>	<b>100.0%</b>	<b>\$ 797,630</b>	<b>100.0%</b>	<b>\$ 817,354</b>	<b>100.0%</b>

The following is our investment portfolio presented by geographic location of the investment at June 30, 2011 and June 30, 2010, respectively:

Geographic Location	June 30, 2011				June 30, 2010			
	Cost	Percent of Portfolio	Fair Value	Percent of Portfolio	Cost	Percent of Portfolio	Fair Value	Percent of Portfolio
Canada	\$ 74,239	5.0%	\$ 75,207	4.9%	\$ 21,002	2.6%	\$ 12,054	1.5%
Ireland	14,908	1.0%	15,000	1.0%	14,903	1.9%	15,000	1.8%
Netherlands		%		%	1,397	0.2%	1,233	0.2%
Midwest US	358,540	24.0%	340,251	22.3%	170,869	21.5%	167,571	20.5%

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Northeast US	242,039	16.1%	234,628	15.4%	61,813	7.7%	62,727	7.7%
Southeast US	234,528	15.7%	208,226	13.7%	193,420	24.2%	171,144	20.9%
Southwest US	189,436	12.7%	266,004	17.5%	179,641	22.6%	235,945	28.9%
Western US	322,044	21.5%	323,694	21.3%	85,714	10.7%	82,809	10.1%
Money Market Funds	59,903	4.0%	59,903	3.9%	68,871	8.6%	68,871	8.4%
Total Portfolio	\$ 1,495,637	100.0%	\$ 1,522,913	100.0%	\$ 797,630	100.0%	\$ 817,354	100.0%

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The following is our investment portfolio presented by industry sector of the investment at June 30, 2011 and June 30, 2010, respectively:

Industry	June 30, 2011				June 30, 2010			
	Cost	Percent of Portfolio	Fair Value	Percent of Portfolio	Cost	Percent of Portfolio	Fair Value	Percent of Portfolio
Aerospace and Defense	\$ 56		%\$ 35		%\$ 56		%\$ 38	%
Automobile / Auto Finance	41,924	2.8%	42,444	2.8%	19,017	2.4%	18,615	2.3%
Biomass Power	2,540	0.2%		%	2,383	0.3%		%
Business Services	6,604	0.4%	6,787	0.4%	12,060	1.5%	12,132	1.5%
Chemicals	25,277	1.7%	25,277	1.7%	1,397	0.2%	1,233	0.2%
Commercial Services	34,625	2.3%	34,625	2.3%		%		%
Consumer Services	68,286	4.6%	68,286	4.5%		%		%
Contracting	18,220	1.2%	1,767	0.1%	16,652	2.1%	4,542	0.6%
Durable Consumer Products	141,779	9.5%	144,362	9.5%	20,000	2.5%	20,000	2.4%
Ecological	141	%	194	%	141	%	340	%
Electronics	588	%	1,374	0.1%	25,777	3.2%	25,629	3.1%
Financial Services		%		%	25,814	3.2%	25,592	3.1%
Food Products	144,503	9.7%	146,498	9.6%	53,681	6.7%	60,882	7.4%
Gas Gathering and Processing	42,003	2.8%	105,406	6.9%	37,503	4.7%	93,096	11.4%
Healthcare	156,396	10.5%	163,657	10.7%	89,026	11.2%	93,593	11.5%
Home and Office Furnishings, Housewares and Durable	1,916	0.1%	6,109	0.4%	14,112	1.8%	17,232	2.1%
Insurance	86,850	5.8%	87,448	5.7%	5,811	0.7%	5,952	0.7%
Machinery	13,179	0.9%	13,171	0.9%	15,625	2.0%	17,776	2.2%
Manufacturing	114,113	7.6%	136,039	8.9%	74,961	9.4%	64,784	7.9%
Media	121,302	8.1%	121,300	8.0%		%		%
Metal Services and Minerals	580	%	4,699	0.3%	19,252	2.4%	33,620	4.1%
Mining, Steel, Iron and Non-Precious Metals and Coal								
Production	1,448	0.1%		%	1,130	0.1%	808	0.1%
Oil and Gas Production	124,662	8.3%	70,923	4.7%	122,034	15.3%	96,988	11.9%
Oilfield Fabrication	23,076	1.5%	23,076	1.5%	30,429	3.8%	30,429	3.7%
Personal and Nondurable Consumer Products	15,147	1.0%	23,403	1.5%	14,387	1.8%	20,049	2.5%
Pharmaceuticals		%		%	11,955	1.5%	12,000	1.5%
		%		%	5,222	0.7%	5,284	0.6%

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Printing and Publishing								
Production Services	14,387	1.0%	15,357	1.0%	21,002	2.6%	12,054	1.5%
Property Management	52,420	3.5%	51,726	3.4%		%		%
Retail	14,669	1.0%	145	0.0%	14,669	1.8%	2,148	0.3%
Shipping Vessels	11,303	0.8%	3,079	0.2%	10,040	1.3%	3,583	0.4%
Software & Computer Services	37,890	2.5%	38,000	2.5%	14,903	1.9%	15,000	1.8%
Specialty Minerals	30,169	2.0%	34,327	2.3%	15,814	2.1%	18,463	2.3%
Technical Services		%		%	11,387	1.4%	11,615	1.4%
Textiles and Leather	12,931	0.9%	15,632	1.0%	22,519	2.8%	25,006	3.1%
Transportation	76,750	5.2%	77,864	5.2%		%		%
Money Market Funds	59,903	4.0%	59,903	3.9%	68,871	8.6%	68,871	8.4%
Total Portfolio	\$ 1,495,637	100.0%	\$ 1,522,913	100.0%	\$ 797,630	100.0%	\$ 817,354	100.0%

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**Portfolio Investment Activity**

During the year ended June 30, 2011, we acquired \$863,784 of new investments, completed follow-on investments in existing portfolio companies, totaling approximately \$71,935, funded \$7,984 of revolver advances, and recorded PIK interest of \$9,634, resulting in gross investment originations of \$953,337. The more significant of these investments are described briefly in the following:

On July 14, 2010, we made a senior secured investment of \$38,000 in Progrexion Holdings, Inc. ("Progrexion"), a leading consumer credit enhancement services company. The \$36,000 first lien note bears interest in cash at the greater of 11.0% or Libor plus 9.0% and has a final maturity on December 31, 2014. The \$2,000 revolver, of which \$1,400 was funded at closing, bears interest in cash at the greater of 11.0% or Libor plus 9.0% and has a final maturity on June 30, 2011.

On July 23, 2010, we made a secured debt investment of \$21,000 in SonicWALL, Inc. ("SonicWALL"), a global leader in network security and data protection for small, mid-sized, and large enterprise organizations. On September 30, 2010, we made a follow-on secured debt investment of \$2,000 in SonicWALL. The second lien notes bear interest in cash at the greater of 12.0% or Libor plus 2.0% and have a final maturity on January 23, 2017.

On July 30, 2010, we invested \$42,500 of debt and \$9,920 of equity in AIRMALL, a leading developer and manager of airport retail operations. The \$30,000 first lien note bears interest in cash at the greater of 12.0% or Libor plus 9.0% and has a final maturity on June 30, 2015. The \$12,500 subordinate note bears interest in cash at 12.0% and interest in kind of 6.0% and has a final maturity on December 31, 2015.

On July 30, 2010, we invested \$20,000 in Northwestern, a leading dental practice management company in the Southeast Florida market. The first lien note bears interest in cash at the greater of 10.50% or Libor plus 7.50% and has a final maturity on July 30, 2015.

On September 30, 2010, we made a follow-on secured debt investment of \$4,500 in GSHI to support the acquisition of a gathering pipeline system in Texas. The follow-on junior secured note bears interest in cash at 18.0% and has a final maturity on December 12, 2016.

On October 12, 2010, we made a senior secured debt investment of \$32,500 in ICON, a leading manufacturer and marketer of branded health and fitness equipment. The first lien note bears interest in cash at 11.875% and has a final maturity on October 15, 2016.

On November 12, 2010, we made a senior subordinated debt investment of \$15,000 in American Importing Company, Inc and Ann's House of Nuts Inc, collectively Snacks Holding Corporation, a leading manufacturer and marketer of dried fruits and trail mixes. The note bears interest in cash at 12.0% and interest in kind of 1.0% and has a final maturity on November 12, 2017.

On November 29, 2010, we made a senior subordinated debt investment of \$14,000 in Royal Adhesives & Sealants, LLC ("Royal"), a leading producer of proprietary, high-performance adhesives and sealants. On December 13, 2010, we made a follow-on senior subordinated debt investment of \$11,000 in Royal, an Arsenal Capital Partners portfolio company, in connection with Arsenal's acquisition of Para-Chem Southern and the creation of a leading adhesives, sealants, and coatings platform. The note bears interest in cash at 12.0% and interest in kind of 2.0% and has a final maturity on November 29, 2016.

On December 10, 2010, we made a \$30,000 secured second-lien financing to American Gilsonite Company ("American Gilsonite") for a dividend recapitalization. After the financing, we received a \$2,098 dividend as a result of our equity holdings in American Gilsonite and repayment of the loan that was outstanding. The second lien note bears interest in cash at the greater of



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12.0% or Libor plus 10.0% and interest in kind of 2.50% and has a final maturity on March 10, 2016.

On December 23, 2010, we made a second lien secured debt investment of \$15,300 in JHH Holdings, Inc., a leading provider of home healthcare services in Texas. The second lien note bears interest in cash at the greater of 12.0% or Libor plus 10.0% and interest in kind of 2.50% and has a final maturity on June 23, 2016.

On December 23, 2010, we made a senior secured investment of \$18,333 in VPSI, Inc., a leading market share transportation services company. The first lien note bears interest in cash at the greater of 12.0% or Libor plus 10.0% and has a final maturity on December 23, 2015.

On January 6, 2011, we made a senior secured term loan investment of \$30,000 to support the acquisition of Progressive Logistics Services, LLC ("Progressive") by a middle market private equity firm. The first lien notes bear interest in cash at the greater of 8.50% or Libor plus 6.50% and the greater of 14.50% or Libor plus 12.50%, respectively, and have a final maturity on January 6, 2016.

On January 10, 2011, we made a senior secured debt investment of \$20,000 to support the acquisition of Endeavor House by Pinnacle Treatment Centers, Inc. ("Pinnacle"). The \$19,000 first lien note bears interest in cash at the greater of 11.0% or Libor plus 8.0% and has a final maturity on January 10, 2016. The \$1,000 revolver, which was unfunded at closing, bears interest in cash at the greater of 8.0% or Libor plus 5.0% and has a final maturity on January 10, 2016.

On January 21, 2011, we provided senior secured credit facilities of \$28,200 to support the acquisition of Stauber Performance Ingredients, Inc. ("Stauber"), by ICV Partners. The \$25,700 first lien note bears interest in cash at the greater of 10.50% or Libor plus 7.50% and has a final maturity on January 21, 2016. The \$2,500 revolver, of which \$750 was funded at closing, bears interest in cash at the greater of 10.50% or Libor plus 7.50% and has a final maturity on January 21, 2016.

On January 31, 2011, we made a senior secured term investment of \$7,500 to support the recapitalization of Empire Today, LLC, which is the second largest independent provider of carpet and hard surface flooring to consumers in the residential replacement flooring industry. The first lien note bears interest in cash at 11.375% and has a final maturity on February 1, 2017.

On February 3, 2011, we made a senior secured debt investment of \$22,000 to support the recapitalization of Medical Security Card Company, LLC, a pharmacy services company. The \$20,500 first lien note bears interest in cash at the greater of 11.25% or Libor plus 8.75% and has a final maturity on February 1, 2016. The \$1,500 revolver, which was unfunded at closing, bears interest in cash at the greater of 9.50% or Libor plus 7.0% and has a final maturity on February 1, 2016.

On February 4, 2011, we made a secured second-lien debt investment of \$45,000 to support the refinancing of Clearwater Seafoods LP, a leading premium seafood company based in Nova Scotia, Canada. The second lien note bears interest in cash at 12.0% and has a final maturity on February 4, 2016.

On February 9, 2011, we made a senior secured debt investment of \$23,500 to support the recapitalization of Copernicus. After the financing we received a repayment of the loan that was previously outstanding. \$11,250 of the first lien notes bear interest in cash at the greater of 8.0% or Libor plus 5.0% and \$11,250 of the first lien notes bear interest in cash at the greater of 14.0% or Libor plus 11.0%, respectively, and both have a final maturity on February 6, 2016. The \$1,000 revolver, which was unfunded at closing, bears interest in cash at the greater of 8.0% or Libor plus 5.0% and has a final maturity on February 9, 2016.

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On March 2, 2011, we made a senior secured first-lien debt investment of \$14,000 to support the acquisition of Out Rage, LLC, a market leader in the bowhunting equipment industry. The \$12,500 first lien note bears interest in cash at the greater of 11.0% or Libor plus 8.0% and has a final maturity on March 2, 2015. The \$1,500 revolver, which was unfunded at closing, bears interest in cash at the greater of 11.0% or Libor plus 8.0% and has a final maturity on March 2, 2015.

On March 4, 2011, we made a \$27,000 secured second-lien term loan to Arrowhead. After the financing we received a repayment of the loan that was previously outstanding. The second lien note bears interest in cash at the greater of 11.25% or Libor plus 9.50% and has a final maturity on September 30, 2017.

On March 18, 2011, we closed a \$60,000 first-lien senior secured facility for SG Acquisition, Inc. ("Safe-Guard"), the leading third-party administrator of ancillary finance and insurance products and services for new, used, and leased motor vehicles. \$30,000 of the first lien notes bear interest in cash at the greater of 8.50% or Libor plus 6.50% and \$30,000 of the first lien notes bear interest in cash at the greater of 14.50% or Libor plus 12.50%, respectively, and both have a final maturity on March 18, 2016.

On March 31, 2011, we funded a \$53,000 first-lien senior secured credit facility, funded \$1,435 of a \$5,000 commitment on a revolving line of credit and invested \$1,500 in common equity to support the acquisition of Cargo Airport Services USA, LLC ("CAS") by ICV Partners. The \$53,000 first lien note bears interest in cash at the greater of 11.50% or Libor plus 8.50% and has a final maturity on March 31, 2016. The \$5,000 revolver, of which \$1,435 was funded at closing, bears interest in cash at the greater of 11.50% or Libor plus 8.50% and has a final maturity on March 31, 2012.

On March 31, 2011, we provided a net \$32,770 in first-lien senior secured financing for the recapitalization of Progrexion focused on the consumer credit information sector. The first lien note bears interest in cash at the greater of 10.75% or Libor plus 8.75% and has a final maturity on December 31, 2014.

On April 18, 2011, we made a \$13,000 secured debt investment to support the acquisition of Meatco, a leading food distributor, by Annex Capital Management. The second lien note bears interest in cash at the greater of 12.0% or Libor plus 9.0% and interest in kind of 4.0% and has a final maturity on April 18, 2016.

On April 26, 2011, we made a senior secured follow-on investment of \$11,000 in ICON. The first lien note bears interest in cash at 11.875% and has a final maturity on October 15, 2016.

On May 2, 2011, we sold our membership interests in Fischbein realizing a gain of \$9,893 on the sale and received a repayment of the loan that was outstanding. We subsequently made a \$3,334 senior secured second-lien term loan and invested \$875 in the common equity of Fischbein with the new ownership group. The second lien note bears interest in cash at 12.0% and interest in kind of 2.0% and has a final maturity on October 31, 2016.

On May 3, 2011, we made a debt investment of \$25,000 to support the acquisition of Byrider, a leading used car sales and finance business, by Altamont Capital Partners. The second lien note bears interest in cash at 12.0% and interest in kind of 2.0% and has a final maturity on November 3, 2016.

On May 6, 2011, we made a \$34,450 investment in NMMB, an advertising media buying business, of which \$31,750 was funded at closing. \$24,250 is structured as senior secured debt, \$2,800 as subordinated debt and \$4,400 as controlling equity. The loans bear interest in cash at 14.0% and 15.0%, respectively, and have a final maturity on May 6, 2016. The \$3,000 revolver, of

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which \$300 was drawn at closing, bears interest in cash at the greater of 10.50% or Libor plus 8.50% and has a final maturity on May 6, 2016.

On May 6, 2011, we provided \$15,000 in secured second-lien acquisition financing to Mood Media, a company in the in-store media industry. The second lien note bears interest in cash at the greater of 10.25% or Libor plus 8.75% and has a final maturity on November 6, 2018.

On May 6, 2011, we provided \$15,000 in secured second-lien financing for the recapitalization of Potters, a leading company in the engineered glass materials industry. The second lien note bears interest in cash at the greater of 10.25% or Libor plus 8.50% and has a final maturity on November 6, 2017.

On May 25, 2011, we provided \$24,000 in secured first-lien financing to Targus, the leading global supplier of notebook carrying cases and accessories. The first lien note bears interest in cash at the greater of 11.0% or Libor plus 9.50% and has a final maturity on May 25, 2016.

On May 31, 2011, we provide \$35,000 in secured second-lien financing to Springs Window, a leading designer and manufacturer of high-quality window treatments. The second lien note bears interest in cash at the greater of 11.25% or Libor plus 9.25% and has a final maturity on November 30, 2017.

On June 16, 2011, we made a senior secured debt investment of \$26,500 to support the acquisition of STP, a leading North American producer of precision redrawn, small diameter, thin wall copper, and specialty alloy tubes. The first lien note bears interest in cash at the greater of 12.0% or Libor plus 9.00% and has a final maturity date on June 16, 2016.

On June 21, 2011, we provided \$25,000 in secured second lien financing for the recapitalization of U.S.H., a leading company in the occupational medical services industry. The second lien note bears interest in cash at the greater of 10.50% or Libor plus 9.00% and has a final maturity on June 15, 2017.

On June 30, 2011, we made a senior secured debt investment of \$82,500 in CRT, a market-leading specialty media buying business, of which \$75,000 was funded at closing. The \$75,000 first lien notes bear interest in cash at the greater of 10.50% or Libor plus 7.50% and have a final maturity on June 30, 2017. The \$7,500 revolver, which was unfunded at closing, bears interest in cash at the greater of 10.50% or Libor plus 7.50% and has a final maturity on June 30, 2012.

On June 30, 2011 we also provided \$5,000 in secured second lien financing for the acquisition of Pre-Paid Legal, a top company in the professional services subscription market. The second lien notes bear interest in cash at the greater of 11.00% or Libor plus 9.50% and have a final maturity on December 31, 2016.

During the year ended June 30, 2011, we closed-out seventeen positions which are briefly described below.

On July 30, 2010, Northwestern repaid the \$8,500 loan receivable to us.

On August 26, 2010, Regional Management Corporation ("RMC") repaid the \$25,814 loan receivable to us.

On September 1, 2010, Impact Products repaid the \$12,848 loan receivable to us.

On September 23, 2010, Roll Coater Acquisition Corp. repaid the \$6,268 loan receivable to us.

On September 29, 2010, we sold our common stock in LyondellBasell Industries N.V. for \$1,803, realizing a gain of \$527.

On October 29, 2010, Castro Cheese Company, Inc. repaid the \$7,732 loan receivable to us.

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On November 3, 2010, TriZetto Group repaid the \$15,492 loan receivable to us.

On December 1, 2010, Qualitest Pharmaceuticals, Inc. repaid the \$12,000 loan receivable to us.

On December 10, 2010, American Gilsonite repaid the \$14,783 loan receivable to us.

On December 15, 2010, we sold Sidump'r Trailer Company, Inc. and received \$430 net proceeds.

In December 2010, we exercised our warrants in Miller Petroleum, Inc. ("Miller") and received 2,013,814 shares of Miller common stock and sold 1,397,510 of these shares at \$3.95 net proceeds per share, realizing a gain of \$5,415. We sold the remaining 616,304 shares of Miller common stock on January 10, 2011, realizing \$4.23 of net proceeds per share and an additional gain of \$2,561 on this sale and a total gain of \$7,976 on settlement of the investment.

On January 24, 2011, Maverick Healthcare LLC repaid the \$13,122 loan receivable to us.

On March 11, 2011, EXL repaid the \$22,988 loan receivable to us and we sold our 2,500 shares of EXL common stock.

On March 31, 2011, KTPS Holdings, LLC repaid the \$8,414 loan receivable to us. A portion of the loan receivable was repaid at a discount, for which we realized a loss of \$549.

On April 18, 2011, Unitek repaid the \$11,500 loan receivable to us.

On May 31, 2011, Label Corp repaid the \$5,749 loan receivable to us.

On June 3, 2011, Prince repaid the \$23,540 loan receivable to us and we recognized \$10,463 of accelerated purchase discount accretion.

During the year ended June 30, 2011, we also received principal amortization payments of \$16,996 on several loans, and \$24,450 of partial prepayments related to AIRMALL, AFI, Ajax, EXL, Fischbein, Iron Horse, LHC, Nupla, Northwestern, Progrexion, ROM, Seaton Corp and Stauber.

During the year ended June 30, 2011, we recognized \$22,084 of interest income due to purchase discount accretion from the assets acquired from Patriot. Included in the \$22,084 is \$4,912 of normal accretion, \$12,035 of accelerated accretion resulting from the repayment of Impact Products, Label Corp and Prince, and \$4,968 of accelerated accretion resulting from the recapitalization of our debt investments in Arrowhead, Copernicus, Fischbein and Northwestern. The restructured loans for Arrowhead, Copernicus, Fischbein and Northwestern were issued at market terms comparable to other industry transactions. In accordance with ASC 320-20-35 the cost basis of the new loan was recorded at par value, which precipitated the acceleration of original purchase discount from the loan repayment which was recognized as interest income. We expect to recognize \$836 of normal accretion during the three months ended September 30, 2011.

During the period from the acquisition of Patriot on December 2, 2009 to June 30, 2010, we recognized \$18,795 of interest income due to purchase discount accretion from the assets acquired from Patriot. Included in this amount \$4,579 of normal accretion and \$14,216 of accelerated accretion resulting from the early repayments of four loans, three revolving lines of credit, sale of one investment position and restructuring of our loans to AFI, EXL, LHC, Prince and ROM. The revised terms were more favorable than the original terms and increased the present value of the future cash flows. In accordance with ASC 320-20-35 the cost basis of the new loans were recorded at par value, which precipitated the acceleration of original purchase discount from the loan repayment which was recognized as interest income.

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

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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 and simultaneously reinvested the \$12,576 as incremental senior secured debt in IEC and ARS. The incremental debt amortized over the period ending November 20, 2010.

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

<b>Quarter-End</b>	<b>Acquisitions(1)</b>	<b>Dispositions(2)</b>
June 30, 2011	\$ 312,301	\$ 62,367
March 31, 2011	359,152	76,494
December 31, 2010	140,933	62,915
September 30, 2010	140,951	67,621
June 30, 2010	88,973	39,883
March 31, 2010	59,311	26,603
December 31, 2009(3)	210,438	45,494
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	\$ 2,128,654	\$ 640,260

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

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

(3) The \$210,438 of acquisitions for the quarter ended December 31, 2009 includes \$207,126 of portfolio investments acquired from Patriot.

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**Investment Valuation**

In determining the fair value of our portfolio investments at June 30, 2011 the Audit Committee considered valuations from the independent valuation firm and from management having an aggregate range of \$1,435,916 to \$1,548,301, 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 \$1,463,010, excluding money market investments.

Our portfolio companies are generally lower middle market companies, outside of the financial sector, with less than \$50,000 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.

During the year ended June 30, 2011, there has been a general improvement in the markets in which we operate, and market rates of interest negotiated for middle market loans have decreased.

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.

*Ajax Rolled Ring & Machine, Inc.*

We acquired a controlling equity interest in Ajax in a recapitalization of Ajax that was closed on April 4, 2008. We funded \$22,000 of senior secured term debt, \$11,500 of subordinated term debt and \$6,300 of equity as of that closing. During the fiscal year ended June 30, 2010, we funded an additional \$3,530 of secured subordinated debt to refinance a third-party revolver provider and provide working capital. Ajax repaid \$3,461 of this secured subordinated debt during the quarter ended September 30, 2010. As of June 30, 2011, we control 77.68% of the fully-diluted common and preferred equity. The principal balance of our senior debt to Ajax was \$20,607 and new debt was \$15,035 as of June 30, 2011.

Ajax forges seamless steel rings sold to various customers. The rings are used in a range of industrial applications, including in construction equipment and wind power turbines. Ajax's business is cyclical, and the business experienced a significant decline in 2009 in light of the global macroeconomic crisis. Ajax has seen significant improvement in operating results in 2010 with EBITDA increasing over 100% from that generated in 2009.

The Board of Directors increased the fair value of our investment in Ajax to \$33,877 as of June 30, 2011, a reduction of \$7,822 from its amortized cost, compared to the \$13,006 unrealized depreciation recorded at June 30, 2010.

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*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 biomass energy plant. In March 2009, CCEI ceased operations, as the business became uneconomic based on the cost of materials and the price being received for the electricity generated. During that quarter, we instituted foreclosure proceedings against the co-borrowers of our debt. In anticipation of such proceedings, CCEHI was established. On March 11, 2009, the foreclosure was completed and the assets were assigned to a wholly owned subsidiary of CCEHI. During the year ended June 30, 2010, 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 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. During the years ended June 30, 2011 and June 30, 2010, we made follow-on investments of \$316 and \$554, respectively, in CCEHI for professional services related to ongoing litigations and plant security. At June 30, 2011, our Board of Directors, under recommendation from senior management, has set the value of the CCEHI investment with no value, a reduction of \$2,540 from its amortized cost after the recognized loss recorded in 2009.

*Freedom Marine Services, LLC*

Freedom Marine is an investment that we initially funded in October 2006. We acquired a controlling interest in the company on October 1, 2009 as part of a broader restructuring of the company and subsequently provided additional funding to support ongoing operations. During the year ended June 30, 2011, we provided additional funding of \$944 to Freedom Marine in order to provide needed liquidity and pay dry docking expenses. As of June 30, 2011, we control 86.78% of the fully-diluted equity.

Freedom Marine is an owner-operator of three offshore supply vessels operating out of Houma, Louisiana. The three vessels are leased out to various oil and gas industry participants operating in the Gulf of Mexico. Freedom Marine's business were significantly impacted by the 2010 Gulf of Mexico oil spill. Offshore activity levels remain depressed and the company has been EBITDA negative since October 2010.

Based upon an analysis of the liquidation value of the vessels and the enterprise value of Freedom Marine, our Board of Directors determined the fair value of our investment in Freedom Marine to be \$3,079 at June 30, 2011, a reduction of \$8,224 from its amortized cost, compared to the \$6,457 unrealized loss recorded at June 30, 2010.

*Gas Solutions Holdings, Inc.*

GSHI is an investment that we completed 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 experienced an increase in revenue, gross margin, and EBITDA over the past year given the increase in plant volumes and natural gas liquids prices.

GSHI continues to focus on plant projects and seeking new opportunities to help the company grow beyond its existing footprint. On September 30, 2010, we made a follow-on secured debt investment of \$4,500 to GSHI to support the acquisition of an additional gathering pipeline system in Texas.

In April 2010, GSHI purchased a series of propane puts with strike prices of \$1.00 per gallon and \$0.95 per gallon covering the periods May 1, 2010, through April 30, 2011, and May 1, 2011, through April 30, 2012, respectively. GSHI hedged approximately 85% of its exposure to natural

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gas liquids based on plant volumes at the time of entering into the puts. In March 2011, GSHI purchased propane puts with strike prices of \$0.95 per gallon covering the period May 1, 2012, through April 30, 2013, hedging approximately 100% of its exposure to natural gas liquids based on projected plant volumes. These hedges will reduce the volatility on earnings associated with lower prices of natural gas liquids without limiting the upside from higher prices, helping GSHI to continue to generate sufficient cash flow to make interest and dividend payments. GSHI has experienced a growth of approximately 34% in revenue and 40% in EBITDA when comparing 2010 results to 2009 results. GSHI has experienced a growth of approximately 36% in revenue and 60% in EBITDA when comparing results for the six months ended June 30, 2011 to June 30, 2010. As GSHI continues to fill the excess capacity at the plant, operating results will continue to improve.

In determining the value of GSHI, we have utilized two valuation techniques to determine the value of the investment. Our Board of Directors has determined the value to be \$105,406 for our debt and equity positions at June 30, 2011 based upon a combination of a discounted cash flow analysis and a public comparables analysis. At June 30, 2011 and June 30, 2010, GSHI was valued \$63,403 and \$55,593 above its amortized cost, respectively.

*Integrated Contract Services, Inc.*

ICS is an investment that we entered into 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. THS provides outsourced medical staffing and security staffing services to governmental and commercial enterprises. In November 2009, THS was informed that the U.S. Air Force would not exercise its option to renew its contract. THS continues to solicit new contracts to replace the revenue lost when the Air Force contract ended. As part of its strategy to recovery from the loss of the Air Force contract, in 2010 THS started a new business, Vets Securing America, Inc. ("VSA"), to provide out-sourced security guards staffed primarily using retired military veterans. During the year ended June 30, 2011, we made follow-on secured debt investments of \$1,708 to support the ongoing operations of THS and VSA.

Based upon an analysis of the liquidation value of the ESA assets and the enterprise value of THS/VSA, our Board of Directors determined the fair value of our investment in ICS to be \$1,767 at June 30, 2011, a reduction of \$16,453 from its amortized cost, compared to the \$12,110 unrealized loss recorded at June 30, 2010.

*Iron Horse Coiled Tubing, Inc.*

Iron Horse is an investment that we completed in April 2006. Iron Horse had been a provider of coiled tubing subcontractor services prior to making a strategic decision in late 2007 to directly



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service natural gas and oil producers in the Western Canadian Sedimentary Basin ("WCSB") as a fracturing services provider. As a result of the business transition, the Company's 2008 financial performance declined significantly from 2007 levels. Iron Horse completed its transition from a subcontractor to a direct service provider in 2009, but natural gas prices declined to trough levels due to the recession and heightened natural gas inventory levels. Since November 2009, Iron Horse has experienced increased activity in the WCSB and is now completing wells for a diversified base of large and small producers in the WCSB.

Prior to December 31, 2007, we owned 8.5% of the common stock in Iron Horse. On December 31, 2007, we received an additional 50.3% of the common stock in Iron Horse, which increased our total ownership to 58.8%. Through a series of subsequent loans that were used to construct equipment and facilitate the transition from a subcontractor to a direct service provider, we secured an additional 21.0% of the common stock in Iron Horse in September 2008, which increased our total ownership to 79.8% of the common stock in Iron Horse.

Effective January 1, 2010, we restructured our senior secured and bridge loans to Iron Horse and we reorganized Iron Horse's management structure. Our loans were replaced with three new tranches of senior secured debt and our total ownership of Iron Horse decreased to 70.4% on a fully-diluted basis. Our fully-diluted equity ownership will incrementally decrease as debt tranches are repaid. There was no change to fair value at the time of restructuring. In 2010, Iron Horse returned to profitability reporting EBITDA of over \$12,000 for the year ended December 31, 2010. Revenues were up almost 500% from 2009 to 2010 and Iron Horse repaid \$6,615 of this senior secured debt during the year ended June 30, 2011. These repayments decreased our ownership to 57.8% on a fully-diluted basis. As Iron Horse has shown an ability to continue to service the interest and principal payments as they come due, we returned Iron Horse to accrual status in December 2010.

The Board of Directors increased the fair value of our investment in Iron Horse to \$15,357 as of June 30, 2011, a premium of \$970 above its amortized cost, compared to the \$8,948 unrealized depreciation recorded at June 30, 2010.

*Manx Energy, Inc.*

On January 19, 2010, we modified the terms of our senior secured debt in Appalachian Energy Holdings LLC ("AEH") and Coalbed LLC ("Coalbed") in conjunction with the formation of Manx, a new entity consisting of the assets of AEH, Coalbed and Kinley Exploration. The assets of the three companies were combined under new common management. We funded \$2,800 at closing to Manx to provide for working capital. A portion of our loans to AEH and Coalbed was exchanged for Manx preferred equity, while our AEH equity interest was converted into Manx common stock. There was no change to fair value at the time of restructuring, and we continue to fully reserve any income accrued for Manx. During the year ended June 30, 2011, we made a follow-on secured debt investments of \$750 in Manx to support ongoing operations.

The Board of Directors wrote-down the fair value of our investment in Manx to \$1,312 as of June 30, 2011, a reduction of \$17,707 from its amortized cost, compared to the \$13,584 unrealized loss recorded at June 30, 2010.

*Yatesville Coal Holdings, Inc.*

All of our coal holdings have been consolidated under the Yatesville entity. Yatesville delivered improved operating results after the consolidation of the coal holdings, but the company mined through all of its permitted reserves by December 2008 and has not produced meaningful revenues since then. We continue to evaluate strategies for Yatesville, such as soliciting indications of interest regarding a transaction involving part or all of recoverable reserves. During the quarter

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ended December 31, 2009, we discontinued operations at Yatesville. At December 31, 2009, our Board of Directors determined that, consistent with the decision to discontinue operations, the impairment of Yatesville was other than temporary, and we recorded a realized loss of \$51,228, which was the amount that the amortized cost exceeded the fair value at December 31, 2009. During the years ended June 30, 2011 and June 30, 2010, we made follow-on investments of \$555 and \$3,471, respectively, in Yatesville for professional services related to ongoing litigations. At June 30, 2011, our Board of Directors, under recommendation from senior management, has set the value of the Yatesville investment with no value, a reduction of \$1,448 from its amortized cost after the recognized depreciation.

Equity positions in the portfolio are susceptible to potentially significant changes in value, both increases as well as decreases, due to changes in operating results. Four of our portfolio companies have experienced such volatility due to improved operating results GSHI, Iron Horse, NRG and R-V. NRG and GSHI experienced meaningful increases in valuation during the year ended June 30, 2011, NRG due to overall industry stabilization and increased backlog resulting from a new product line, and GSHI due to improved operating results. The value of our equity position in NRG has increased to \$32,403 as of June 30, 2011, a premium of \$30,086 to its amortized cost, compared to the \$4,714 unrealized gain recorded at June 30, 2010. The value of our equity position in GSHI has increased to \$68,406 as of June 30, 2011, a premium of \$63,403 to its amortized cost, compared to the \$55,593 unrealized gain recorded at June 30, 2010. Eight of the other controlled investments have been valued at discounts to the original investment. Six of the control investments are valued at premiums to the original investment amounts, including Iron Horse for which our unrealized gain increased by \$9,918 during the year ended June 30, 2011 due to improved operating results. Overall, at June 30, 2011, the control investments are valued at \$47,771 above their amortized cost.

We hold four affiliate investments at June 30, 2011. The affiliate investments reported strong operating results with valuations increasing for three investments Biotronic, Boxercraft and Sport Helmets. Biotronic experienced the most meaningful increase in valuation. Biotronic completed a significant acquisition in November 2010, which is driving the operating results and the increase in the value of the investment. All affiliate investments are valued at amortized cost or higher. Overall, at June 30, 2011, affiliate investments are valued \$15,504 above their amortized cost.

With the Non-control/Non-affiliate investments, generally, there is less volatility related to our total investments because our equity positions tend to be smaller than with our control/affiliate investments, and debt investments are generally not as susceptible to large swings in value as equity investments. For debt investments, the fair value is limited on the high side to each loan's par value, plus any prepayment premia that could be imposed. Many of the debt investments in this category have not experienced a significant change in value, as they were previously valued at or near par value. The exception to this categorization relates to investments which were acquired in the Patriot Acquisition, many of which were acquired at significant discounts to par value, and any changes in operating results or interest rates can have a significant effect on the value of such investments. H&M Oil & Gas, LLC ("H&M"), Shearer's Food's, Inc. ("Shearer's") and Stryker Energy, LLC ("Stryker"), experienced decreases in valuations due to declines in their operating results. At June 30, 2011, H&M was placed on non-accrual status due to the inability of the company to service its debt. The remaining investments did not experience significant changes in operations or valuation. During the year ended June 30, 2011, we recognized \$22,084 of interest income due to purchase discount accretion from the assets acquired from Patriot. Included in the \$22,084 is \$4,912 of normal accretion, \$12,035 of accelerated accretion resulting from the repayment of Impact Products, Label Corp and Prince, and \$4,968 of accelerated accretion resulting from the recapitalization of our debt investments in Arrowhead, Copernicus, Fischbein and Northwestern. The restructured loans for Arrowhead, Copernicus, Fischbein and Northwestern were issued at market terms comparable to other industry transactions. In accordance with ASC 320-20-35 the cost basis of the new loan was recorded at par value, which precipitated the

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acceleration of original purchase discount from the loan repayment which was recognized as interest income.

**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 currently consists of a revolving credit facility availing us of the ability to borrow debt subject to borrowing base determinations and Senior Convertible Notes which we issued in December 2010 and February 2011 and our equity capital is currently comprised entirely of common equity. The following table shows the Revolving Credit Facility and Senior Convertible Notes amounts and outstanding borrowings at June 30, 2011 and June 30, 2010:

	As of June 30, 2011		As of June 30, 2010	
	Facility Amount	Amount Outstanding	Facility Amount	Amount Outstanding
Revolving Credit Facility	\$ 325,000	\$ 84,200	\$ 210,000	\$ 100,300
Senior Convertible Notes	\$ 322,500	\$ 322,500	\$	\$

The following table shows the contractual maturity of our Revolving Credit Facility and Senior Convertible Notes at June 30, 2011:

	Payments Due By Period		
	Less Than 1 Year	1 - 3 Years	More Than 3 Years
Revolving Credit Facility	\$	\$ 84,200	\$
Senior Convertible Notes	\$	\$	\$ 322,500

We have and expect to continue to fund a portion of our cash needs through borrowings from banks, issuances of senior securities, including secured, unsecured and convertible debt securities and preferred stock, or issuances of common equity. For flexibility, we maintain a universal shelf registration statement that allows for the public offering and sale of our debt securities, common stock, preferred stock and warrants to purchase such securities in an amount up to \$750,000 less issuances to date. We may from time to time issue securities pursuant to the shelf registration statement or otherwise pursuant to private offerings. The issuance of debt or equity securities will depend on future market conditions, funding needs and other factors and there can be no assurance that any such issuance will occur or be successful.

*Revolving Credit Facility*

On June 25, 2009, we completed a first closing on an expanded \$250,000 syndicated revolving credit facility (the "Facility"). The Facility included an accordion feature which allowed the Facility to accept up to an aggregate total of \$250,000 of commitments for which we had \$210,000 of commitments from six lenders when the Facility was renegotiated. The revolving period of the Facility extended through June 2010, with an additional one year amortization period after the completion of the revolving period.

On June 11, 2010, we closed an extension and expansion of our revolving credit facility with a syndicate of lenders ("Syndicated Facility"). The lenders have extended current commitments of \$400,000 under the Syndicated Facility as detailed in the *Recent Developments*. As we make additional investments which are eligible to be pledged under the Syndicated Facility, we will generate additional availability to the extent such investments are eligible to be placed into the borrowing base. The revolving period of the Syndicated Facility extends through June 2012, with an additional one year

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amortization period (with distributions allowed) after the completion of the revolving period. During such one year amortization period, all principal payments on the pledged assets will be applied to reduce the balance. At the end of the one year amortization period, the remaining balance will become due if required by the lenders.

As of June 30, 2011 and June 30, 2010, we had the ability to borrow up to \$255,673 and \$180,678, respectively, under our Syndicated Facility based on the assets pledged as collateral at that time, of which \$84,200 and \$100,300 was drawn, respectively. The Syndicated Facility requires us to pledge assets as collateral in order to borrow under the credit facility. At June 30, 2011, the investments used as collateral for the Syndicated Facility had an aggregate market value of \$700,321, which represents 62.8% of net assets. Prospect Capital Funding, LLC, our wholly-owned subsidiary, holds \$631,915 of these investments at market value as of June 30, 2011. The release of any assets from Prospect Capital Funding, LLC requires the approval of Rabobank as facility agent.

The borrowings under the Syndicated Facility bore interest at a rate of one-month Libor plus 250 basis points prior to June 25, 2009, which increased to one-month Libor plus 400 basis points, subject to a minimum Libor floor of 200 basis points for the period from June 26, 2009 to June 10, 2010. Beginning June 11, 2010, interest on borrowings decreased under the Syndicated Facility is one-month Libor plus 325 basis points, subject to a minimum Libor floor of 100 basis points. The maintenance of this facility requires us to pay a fee for the amount not drawn upon. Prior to June 25, 2009, this fee was assessed at the rate of 37.5 basis points per annum of the amount of that unused portion. For the period from June 26, 2010 to June 10, 2010, this rate increased to 100 basis points per annum. After June 11, 2010, the lenders charge a fee on the unused portion of the credit facility equal to either 75 basis points if at least half of the credit facility is used or 100 basis points otherwise.

Concurrent with the extension of our Syndicated Facility, in June 2010, we wrote off \$759 of the unamortized debt issue costs associated with the original credit facility, in accordance with ASC 470-50, *Debt Modifications and Extinguishments*.

*Senior Convertible Notes*

On December 21, 2010, we issued \$150,000 in aggregate principal amount of our 6.25% senior convertible notes due 2015 ("2010 Notes") for net proceeds following underwriting expenses of approximately \$145,200. Interest on the 2010 Notes is paid semi-annually in arrears on June 15 and December 15, at a rate of 6.25% per year, commencing June 15, 2011. The 2010 Notes mature on December 15, 2015 unless converted earlier. The 2010 Notes are convertible into shares of common stock at an initial conversion rate and conversion rate at June 30, 2011 of 88.0902 and 88.0932 shares of common stock, respectively, per \$1,000 principal amount of 2010 Notes, which is equivalent to a conversion price of approximately \$11.35 per share of common stock, subject to adjustment in certain circumstances. The conversion rate for the 2010 Notes will be increased if monthly cash dividends paid to common shares exceed the rate of \$0.101125 cents per share, subject to adjustment.

On February 18, 2011, we issued \$172,500 in aggregate principal amount of our 5.50% senior convertible notes due 2016 ("2011 Notes") for net proceeds following underwriting expenses of approximately \$167,325. Interest on the 2011 Notes is paid semi-annually in arrears on February 15 and August 15, at a rate of 5.50% per year, commencing August 15, 2011. The 2011 Notes mature on August 15, 2016 unless converted earlier. The 2011 Notes are convertible into shares of common stock at an initial conversion rate and conversion rate at June 30, 2011 of 78.3699 and 78.3717 shares, respectively, of common stock per \$1,000 principal amount of 2011 Notes, which is equivalent to a conversion price of approximately \$12.76 per share of common stock, subject to adjustment in certain circumstances. The conversion rate for the 2011 Notes will be increased when monthly cash dividends paid to common shares exceed the rate of \$0.101150 per share.

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In no event will the total number of shares of common stock issuable upon conversion exceed 96.8992 per \$1,000 principal amount of the 2010 Notes (the "conversion rate cap"), except that, to the extent we receive written guidance or a no-action letter from the staff of the Securities and Exchange Commission (the "Guidance") permitting us to adjust the conversion rate in certain instances without regard to the conversion rate cap and to make the 2010 Notes convertible into certain reference property in accordance with certain reclassifications, business combinations, asset sales and corporate events by us without regard to the conversion rate cap, we will make such adjustments without regard to the conversion rate cap and will also, to the extent that we make any such adjustment without regard to the conversion rate cap pursuant to the Guidance, adjust the conversion rate cap accordingly. We will use our commercially reasonable efforts to obtain such Guidance as promptly as practicable.

Prior to obtaining the Guidance, we will not engage in certain transactions that would result in an adjustment to the conversion rate increasing the conversion rate beyond what it would have been in the absence of such transaction unless we have engaged in a reverse stock split or share combination transaction such that in our reasonable best estimation, the conversion rate following the adjustment for such transaction will not be any closer to the conversion rate cap than it would have been in the absence of such transaction.

Upon conversion, unless a holder converts after a record date for an interest payment but prior to the corresponding interest payment date, the holder will receive a separate cash payment with respect to the Notes surrendered for conversion representing accrued and unpaid interest to, but not including the conversion date. Any such payment will be made on the settlement date applicable to the relevant conversion on the 2010 Notes and 2011 Notes (collectively, "Senior Convertible Notes").

No holder of Senior Convertible Notes will be entitled to receive shares of our common stock upon conversion to the extent (but only to the extent) that such receipt would cause such converting holder to become, directly or indirectly, a beneficial owner (within the meaning of Section 13(d) of the Securities Exchange Act of 1934 and the rules and regulations promulgated thereunder) of more than 5.0% of the shares of our common stock outstanding at such time. The 5.0% limitation shall no longer apply following the effective date of any fundamental change. We will not issue any shares in connection with the conversion or redemption of the Notes which would equal or exceed 20% of the shares outstanding at the time of the transaction in accordance with NASDAQ rules.

Subject to certain exceptions, holders may require us to repurchase, for cash, all or part of their Notes upon a fundamental change at a price equal to 100% of the principal amount of the Notes being repurchased plus any accrued and unpaid interest up to, but excluding, the fundamental change repurchase date. In addition, upon a fundamental change that constitutes a non-stock change of control we will also pay holders an amount in cash equal to the present value of all remaining interest payments (without duplication of the foregoing amounts) on such Senior Convertible Notes through and including the maturity date.

In connection with the issuance of the Senior Convertible Notes, we incurred \$10,562 of fees which are being amortized over the term of the facility in accordance with ASC 470-50, *Debt Modifications and Extinguishments*, of which \$9,845 remains to be amortized.

During the year ended June 30, 2011, we recorded \$17,598 of interest costs and amortization of financing costs as interest expense.

During the year ended June 30, 2011, we raised \$277,766 of additional equity, net of offering costs, by issuing 28,494,476 shares of our common stock below net asset value diluting shareholder value by

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\$0.16 per share. The following table shows the calculation of net asset value per share as of June 30, 2011 and June 30, 2010:

	As of June 30, 2011		As of June 30, 2010
Net Assets	\$ 1,114,357	\$	711,424
Shares of common stock outstanding	107,606,690		69,086,862
Net asset value per share	\$ 10.36	\$	10.30

At June 30, 2011, we had 107,606,690 of our common stock issued and outstanding.

**Results of Operations**

Net increase in net assets resulting from operations for the years ended June 30, 2011, 2010 and 2009 was \$118,238, \$19,625 and \$35,104, respectively, representing \$1.38, \$0.33 and \$1.11 per weighted average share, respectively. The primary driver of the variability in the results is the recognition of realized gains and losses and changes in unrealized gains and losses in the investment portfolio. During the year ended June 30, 2011, we experienced net unrealized and realized gains of \$24,017, or approximately \$0.28 per weighted average share, primarily from significant write-ups of our investments in Ajax, Biotronic GSHI, Iron Horse, NRG and Sport Helmets, and our sale of our common equity in Fischbein and Miller, for which we realized gains of \$9,893 and \$7,977, respectively. These instances of realized and unrealized appreciation were partially offset by unrealized depreciation in H&M, Shearer's and Stryker. During the year ended June 30, 2010, we experienced net unrealized and realized losses of \$47,565 or approximately \$0.80 per weighted average share due primarily to the impairment of Yatesville (See Investment Valuations for further discussion.). The \$51,228 realized loss for Yatesville was partially offset by write-ups of our investments in Ajax, Freedom Marine, H&M, Manx, NRG, and R-V. During the year ended June 30, 2009, we experienced net unrealized and realized losses of \$24,059 or approximately \$0.76 per weighted average share. The \$41,134 realized loss for CCEHI and \$21,099 unrealized write-down of our investment in Yatesville was partially offset by write-ups of our investments in GSHI and NRG.

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. These companies are typically not issuing securities rated investment grade, have limited resources, have limited operating history, have concentrated product lines or customers, 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, fees generated from 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, which consists of interest income, including accretion of loan origination fees and prepayment penalty fees, dividend income and other income, including settlement of net profits interests, overriding royalty interests and structuring fees, was \$169,476, \$114,559, and \$100,481 for the years ended June 30, 2011, June 30, 2010 and June 30, 2009, respectively. During the year ended

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June 30, 2011, the primary driver of the increase in investment income is the deployment of additional capital in revenue-producing assets through increased origination, for which we recognized an increase of \$16,107 in structuring fee income, and \$44,685 in cash and payment-in-kind interest income. This \$44,685 of interest income excludes purchase discount accretion from the assets acquired from Patriot and is the result of a larger income producing investment portfolio. These increases were partially offset by a \$4,650 decline in dividend income from GSHI as well as a decline, year over year, related to the one-time gain of \$8,632 in the fiscal year ended June 30, 2010, recorded upon acquiring Patriot. The primary driver of the increase from the fiscal year ended June 30, 2009 to the fiscal year ended June 30, 2010 is the acquisition of additional assets from Patriot and other new investments which increased interest income for the second half of the year. This increase is partially offset by a decline in dividend income from GSHI.

The following table describes the various components of investment income and the related levels of debt investments:

	Year Ended June 30, 2011	Year Ended June 30, 2010	Year Ended June 30, 2009
Interest income	\$ 134,454	\$ 86,518	\$ 62,926
Dividend income	15,092	15,366	22,793
Other income	19,930	12,675	14,762
 Total investment income	 \$ 169,476	 \$ 114,559	 \$ 100,481
 Average debt principal of investments	 \$ 980,557	 \$ 615,638	 \$ 523,189
 Weighted-average interest rate earned	 13.7%	 14.1%	 12.0%

Average interest income producing assets have increased from \$523,189 for the year ended June 30, 2009 to \$615,638 for the year ended June 30, 2010 and \$980,557 for the year ended June 30, 2011. The average yield on interest bearing assets increased from 12.0% for the year ended June 30, 2009 to 14.1% for the year ended June 30, 2010 and 13.7% for the year ended June 30, 2011. This increase in annual returns is primarily the accelerated accretion on the assets acquired from Patriot on which we recognized \$17,172 and \$14,216 during the years ended June 30, 2011 and June 30, 2010, respectively. Without these adjustments, the weighted average interest rates earned on debt investments would have been 12.0% and 11.7% for the years ended June 30, 2011 and 2010, respectively. Generally, interest returns have remained relatively stable over the three year period, but we have seen a decrease in interest rates on loans issued during our fourth fiscal quarter ended June 30, 2011.

Investment income is also generated from dividends and other income. Dividend income decreased from \$15,366 for the year ended June 30, 2010 to \$15,092 for the year ended June 30, 2011. The decrease in dividend income is primarily attributable to a decrease in the level of dividends received from our investment in GSHI. We received dividends from GSHI of \$9,850 and \$14,500 during the years ended June 30, 2011 and June 30, 2010, respectively. The decrease in dividends from GSHI is primarily the a consequence of GSHI distributing dividends in excess of their current earnings in 2009, as GSHI had accumulated excess earnings and profits available for distribution. GSHI remains profitable and has increased its EBITDA in 2010 in comparison with 2009. We anticipate that GSHI may be able to increase its dividends in the future as the result of organic growth and add-on acquisitions. This decrease was offset by a \$4,178 increase in dividends received from American Gilsonite and NRG during the year ended June 30, 2011.

Other income has come primarily from structuring fees, overriding royalty interests, and settlement of net profits interests. Comparing the year ended June 30, 2010 to the year ended June 30, 2011, income from other sources, excluding the \$8,632 gain on the Patriot acquisition, increased from \$4,043 to \$19,930. This \$15,887 increase is primarily due to \$18,494 of structuring fees recognized during the year ended June 30, 2011 primarily from the AIRMALL, CAS, CRT, Progrexion, Safe-Guard, Springs

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Window and NMMB originations, in comparison to \$2,388 of structuring fees recognized during the year ended June 30, 2010.

Comparing the year ended June 30, 2009 to the year ended June 30, 2010, income from other sources, excluding the \$8,632 gain on the Patriot acquisition, decreased from \$14,762 to \$4,043. This decrease in other income is largely due to the settlement of our net profit interests in IEC/ARS for \$12,576 during the year ended June 30, 2009. During the year ended June 30, 2009, structuring fees of \$1,274 were received primarily related to Biotronic and GSHI, in comparison to \$2,388 of structuring fees recognized during the year ended June 30, 2010.

**Operating Expenses**

Our primary operating expenses consist of investment advisory fees (base and 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 \$75,255, \$47,369 and \$41,318 for the years ended June 30, 2011, June 30, 2010 and June 30, 2009, respectively.

The base investment advisory expenses were \$22,496, \$13,929 and \$11,915 for the years ended June 30, 2011, June 30, 2010 and June 30, 2009, respectively. These increases are directly related to our growth in total assets. \$23,555, \$16,798 and \$14,790 in income incentive fees were earned for the years ended June 30, 2011, June 30, 2010 and June 30, 2009, respectively. The increases have occurred as net interest income has increased due primarily to an increase in the asset base. No capital gains incentive fee has yet been incurred pursuant to the Investment Advisory Agreement.

During the years ended June 30, 2011, June 30, 2010 and June 30, 2009, we incurred \$17,598, \$8,382 and \$6,161, respectively, of expenses related to our Syndicated Facility and Senior Convertible Notes. These expenses are related directly to the leveraging capacity put into place for each of those years and the levels of indebtedness actually undertaken in those years. The table below describes the various expenses of our Syndicated Facility and Senior Convertible Notes and the related indicators of leveraging capacity and indebtedness during these years.

	Year Ended June 30, 2011	Year Ended June 30, 2010	Year Ended June 30, 2009
Interest expense	\$ 9,861	\$ 1,338	\$ 5,075
Amortization of deferred financing costs	5,366	5,297	759
Commitment and other fees	2,371	1,747	327
Total	\$ 17,598	\$ 8,382	\$ 6,161
Weighted average debt outstanding	\$ 176,277	\$ 23,147	\$ 132,013
Weighted average interest rate	5.59%	5.78%	3.84%
Facility amount at beginning of year	\$ 210,000	\$ 175,000	\$ 200,000

The increase in interest expense for the year ended June 30, 2011 is due to the issuance of Senior Convertible Notes on December 21, 2010 and February 18, 2011 for which we incurred \$8,374 of interest expense. The increase in our interest rate incurred for the year ended June 30, 2010 is primarily due to an increase of 150 basis points in our borrowing rate effective June 25, 2009 and the concurrent introduction of a Libor floor at 200 basis points. This increase was partially amended on June 11, 2010 with the closing of our current facility. The borrowing rate and Libor floor decreased by 75 basis points and 100 basis points, respectively.



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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 Fund Services LLC ("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 two years, Prospect Administration has increased staffing levels along with costs passed through. The allocation of overhead expense from Prospect Administration were \$2,856, \$3,361 and \$4,979 for the years ended June 30, 2009, 2010 and 2011, respectively. 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 will continue to increase along with the increase in staffing and asset base.

Total operating expenses, net of management fees, interest costs and allocation of overhead from Prospect Administration ("Other Operating Expenses"), were \$6,627, \$4,899 and \$5,596 for the years ended June 30, 2011, 2010 and 2009, respectively. The increase in Other Operating Expenses during the year ended June 30, 2011 when compared to the year ended June 30, 2010 is primarily the result of a \$1,058 increase in costs expensed in connection with abandoned originations and portfolio company acquisitions, an \$818 increase in administrative expenses incurred to support of our growing portfolio and a \$589 increase in unreimbursed legal and consulting fees incurred related to the management of loans. These increases were offset by the non-recurrence of the costs incurred in connection with the merger discussions with Allied Capital Corporation ("Allied") expensed in the 2010 period. The decrease in Other Operating Expenses during the year ended June 30, 2010 when compared to the year ended June 30, 2009 is primarily the result operating efficiencies realized upon the termination of the sub-administration agreement and no excise taxes being paid in 2010 offset by the costs incurred in connection with merger discussions with Allied expensed in the 2010 period.

**Net Investment Income**

Net investment income represents the difference between investment income and operating expenses. Our net investment income was \$94,221, \$67,190 and \$59,163 for the years ended June 30, 2011, June 30, 2010 and June 30, 2009, respectively, or \$1.10 per share, \$1.13 per share and \$1.87 per share, respectively. The \$27,031 increase for the year ended June 30, 2011 is primarily due to increases of \$47,936 and \$7,255 in interest income and other income, respectively, due to the increased size of our portfolio for which we have recognized additional interest income and structuring fees. The \$27,031 increase is offset by an increase in operating expenses of \$27,886, primarily due to a \$15,324 increase in advisory fees due to the growing size of our portfolio and related income, and \$9,216 of additional interest and credit facility expenses. The per share decrease for the year ended June 30, 2011 is primarily due to a decrease in dividends from existing equity investments along with new equity investments in the portfolio which have not yet declared any dividends and the non-recurring nature of the gain from the Patriot Acquisition during the year ended June 30, 2010 offset by an increase in structuring fees collected in the fiscal year ended June 30, 2011.

The \$8,027 increase in net investment income for the year ended June 30, 2010 in comparison to the year ended June 30, 2009 is primarily due to an increase in investment income of \$14,078. This \$14,078 is due to a \$23,592 increase in interest income offset by decreases in dividend income from GSHI and other income. Income from other sources, excluding the \$8,632 gain on the Patriot acquisition, decreased from \$14,762 to \$4,043. This decrease in other income is largely due to the settlement of our net profit interests in IEC/ARS for \$12,576 during the year ended June 30, 2009. The per share decrease for the year ended June 30, 2010 is primarily result of our increasing our asset mix in financings with private equity sponsors. We believe that such financings offer less risk, and

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consequently lower yields, due, in part, to lesser risk to our capital resulting from larger equity at risk underneath our capital.

**Net Realized Gains (Losses), Increase (Decrease) in Net Assets from Net Changes in Unrealized Appreciation/Depreciation**

Net realized gains (losses) were \$16,465, (\$51,545) and (\$39,078) for the years ended June 30, 2011, June 30, 2010 and June 30, 2009, respectively. The net realized gain for the year ended June 30, 2011 was due primarily to gains from the sales of our common equity in Fischbein and Miller of \$9,893 and \$7,977, respectively. The net realized loss of \$51,545 for the year ended June 30, 2010 was due primarily to the impairment of Yatesville. (See Investment Valuations for further discussion.) On June 30, 2009, we determined that the impairment of the CCEHI investment was other than temporarily impaired and recognized a realized loss of \$41,134 for the amount by which the amortized cost exceeded the current fair value. This loss was partially offset by realized gains of \$423 and \$1,641 from sales of the Arctic warrants and Deep Down, Inc. ("Deep Down") common stock, respectively.

Net increase in net assets from changes in unrealized appreciation was \$7,552, \$3,980 and \$15,019 for the years ended June 30, 2011, June 30, 2010 and June 30, 2009, respectively, or \$0.09 per share, \$0.07 per share and \$0.48 per share, respectively. For the year ended June 30, 2011, the \$7,552 increase in net assets from the net change in unrealized appreciation was driven by significant write-ups of \$54,916 related to our investments in Ajax, Biotronic, GSHI, Iron Horse, NRG and Sport Helmets. These instances of unrealized appreciation were partially offset by unrealized depreciation of approximately \$35,689 related to our investments in H&M, ICS, Manx, Shearer's, Stryker, and \$10,840 related to the repayment of Prince. For the year ended June 30, 2010, the net unrealized appreciation was driven by \$25,184 of write-ups in our investments in Fischbein, GSHI, Prince, Shearer's, and RMC, and by the disposition of previously written-down investment in Yatesville mentioned above with an unrealized net appreciation of \$35,471, which, in turn, were offset by \$56,954 of write-downs in our investments in Deb Shops, Inc. ("Deb Shops"), Freedom Marine, H&M, Manx, NRG, R-V and Wind River Resources Corp. and Wind River II Corp. For the year ended June 30, 2009, the net unrealized appreciation was driven by significant write-ups of our investments in American Gilsonite, GSHI, NRG, R-V, Shearer's and Stryker, and by the disposition of previously written-down investment in CCEI mentioned above, which, in turn, were offset by significant write-downs our investments in Ajax, AEH, Conquest Cherokee, LLC, Deb Shops, Iron Horse and Yatesville as well as the elimination of the unrealized appreciation resulting from the sale of Deep Down mentioned above.

**Financial Condition, Liquidity and Capital Resources**

For the years ended June 30, 2011, June 30, 2010 and June 30, 2009, our operating activities (used) provided (\$581,609), \$54,838 and (\$74,000) of cash, respectively. Investing activities used \$106,586 for the acquisition of Patriot for the year ended June 30, 2010. There were no investing activities for the years ended June 30, 2011 and June 30, 2009. Financing activities provided cash flows of \$582,020, \$42,887 and \$83,387 for the years ended June 30, 2011, June 30, 2010 and June 30, 2009, respectively. Dividends paid were \$91,247, \$82,908 and \$43,257 for the years ended June 30, 2011, June 30, 2010 and June 30, 2009, respectively.

Our primary uses of funds have been to continue to invest in our investments in portfolio companies, to add new companies to our investment portfolio, acquire Patriot, repay outstanding borrowings and to make cash distributions to holders of our common stock.

Our primary sources of funds have been issuances of debt and equity. 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

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expand our portfolio. During the year ended June 30, 2011, we borrowed \$465,900 and made repayments totaling \$482,000 under our revolving credit facility. As of June 30, 2011, we had \$84,200 outstanding borrowings on our revolving credit facility and \$322,500 outstanding on our Senior Convertible notes (See Note 6 to our consolidated financial statements).

On March 16, 2011, our Registration Statement on Form N-2 was declared effective by the SEC. Under this Shelf Registration Statement, we can issue up to \$547,000 of additional equity securities as of June 30, 2011.

Over the past three years, we have been active in completing 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 filed with the SEC a post-effective amendment to the registration statement on Form N-2 on November 6, 2009. Such amendment was declared effective by the SEC on November 9, 2009.

On December 2, 2009 we acquired the outstanding shares of Patriot common stock for approximately \$201,083. Under the terms of the merger agreement, Patriot common shareholders received 0.363992 shares of our common stock for each share of Patriot common stock, resulting in 8,444,068 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.

On March 17, 2010, we established an at-the-market program through which we could sell, from time to time and at our discretion, 8,000,000 shares of our common stock. Through this program we issued 5,251,400 shares of our common stock at an average price of \$11.50 per share, raising \$60,378 of gross proceeds, from March 23, 2010 through June 30, 2010 and \$26,799 from July 1, 2010 to July 21, 2010.

On July 19, 2010, we established a second at-the-market program, as we had sold all the shares authorized in the original at-the-market program. We engaged three broker-dealers to act as potential agents and sell our common stock directly into the market over a period of time. We paid a 2% commission to the broker-dealer on shares sold. Through this program we issued 6,000,000 shares of our common stock at an average price of \$9.73 per share, raising \$58,403 of gross proceeds, from July 22, 2010 through September 28, 2010.

On September 24, 2010, we established a third at-the-market program, as we had sold all the shares authorized in the preceding at-the-market programs, through which we could sell, from time to time and at our discretion, 6,000,000 shares of our common stock. We engaged three broker-dealers to act as potential agents and sell our common stock directly into the market over a period of time. We currently pay a 2% commission to the broker-dealer on shares sold. Through this program we issued 302,400 shares of our common stock at an average price of \$9.87 per share, raising \$2,986 of gross proceeds, from September 29, 2010 through September 30, 2010. During the period from October 1, 2010 to November 3, 2010, we continued this program and issued an additional 4,929,556 shares of our common stock at an average price of \$9.86 per share, raising \$48,611 of gross proceeds.

On November 10, 2010, we established a fourth at-the-market program, through which we could sell, from time to time and at our discretion, 9,750,000 shares of our common stock. We engaged four broker-dealers to act as potential agents and sell our common stock directly into the market over a period of time. We pay a 2% commission to the broker-dealer on shares sold. Through this program we

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issued 4,513,920 shares of our common stock at an average price of \$10.00 per share, raising \$45,147 of gross proceeds, from November 16, 2010 through December 15, 2010.

On April 7, 2011, we completed a public stock offering for 9,000,000 shares of our common stock raising \$102,600 of gross proceeds.

On June 24, 2011, we completed a public stock offering for 10,000,000 shares of our common stock at \$10.15 per share, raising \$101,500 of gross proceeds.

Our Board of Directors, pursuant to the Maryland General Corporation Law, executed Articles of Amendment to increase the number of shares authorized for issuance from 100,000,000 to 200,000,000 in the aggregate. The amendment became effective August 31, 2010.

**Off-Balance Sheet Arrangements**

At June 30, 2011, 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.

**Recent Developments**

On July 1, 2011, we made a senior secured follow-on investment of \$2,500 in Boxercraft to support the acquisition of Jones & Mitchell, a supplier of college-licensed apparel.

On July 8, 2011, we made a secured senior lien investment of \$39,000 to support the recapitalization of Totes Isotoner Corporation.

On July 11, 2011, we announced an increase in commitments to our credit facility of \$50,000 to \$375,000 raising the total commitments in the aggregate.

On July 18, 2011, we issued 1,500,000 shares in connection with the exercise of an overallotment option granted with the June 21, 2011 offering of 10,000,000 shares which were delivered June 24, 2011, raising an additional \$15,225 of gross proceeds and \$15,060 of net proceeds.

On July 22, 2011, we issued 102,890 shares of our common stock in connection with the dividend reinvestment plan.

On August 5, 2011, we made a senior secured follow-on investment of \$3,850 in ROM to support the acquisition of Havis Lighting Solutions, a supplier of products primarily used by emergency response and police vehicles.

On August 9, 2011, we provided a \$15,000 term loan to support the acquisition of Nobel Learning Communities, Inc., a leading national operator of private schools.

On August 9, 2011, we made an investment of \$32,116 to purchase 66% of the unrated subordinated notes in Babson CLO Ltd. 2011-I.

On August 24, 2011, we announced the declaration of monthly dividends in the following amounts and with the following dates:

\$0.101325 per share for September 2011 to holders of record on September 30, 2011 with a payment date of October 25, 2011; and

\$0.101350 per share for October 2011 to holders of record on October 31, 2011 with a payment date of November 22, 2011.

On August 24, 2011, our Board of Directors approved a share repurchase plan under which we may repurchase up to \$100,000 of our common stock at prices below our net asset value.



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On August 26, 2011, we issued 106,869 shares of our common stock in connection with the dividend reinvestment plan.

On September 1, 2011, we announced an increase in commitments to our credit facility of \$25,000 to \$400,000 raising the total commitments in the aggregate to the maximum of the accordion feature of the credit facility.

On September 7, 2011, we provided \$11,800 million in additional senior secured financing to an existing portfolio company to acquire a leading manufacturer of personal safety products for the transportation and industrial markets.

On September 16, 2011, we acted as the facility agent and lead lender of a syndication of lenders that collectively provided \$132,500 in senior secured financing to support the financing of a leading logistics company, to which we funded \$90,500. This company provides a broad array of logistics services to a diverse group of blue chip customers in the grocery, food service, retail, and specialty automotive industries.

On September 23, 2011, we issued 100,634 shares of our common stock in connection with the dividend reinvestment plan.

On September 29, 2011, we made a senior secured loan of \$23,000 to support the recapitalization of Anchor Hocking, LLC ("Anchor"), a company controlled by affiliates of Monomoy Capital Partners. Prospect served as facility agent in a \$45,000 term loan financing for Anchor.

**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 accounting principles generally accepted in the United States of America ("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 June 30, 2011 and June 30, 2010 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.

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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.

Effective July 1, 2008, we adopted the Financial Accounting Standards Board ("FASB") 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.

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.

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*

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*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 year ended June 30, 2011, 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.

In January 2010, the FASB issued Accounting Standards Update 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements* ("ASC 2010-06"). ASU 2010-06 amends ASC 820-10 and clarifies and provides additional disclosure requirements related to recurring and non-recurring fair value measurements and employers' disclosures about postretirement benefit plan assets. ASU 2010-06 is effective December 15, 2009, except for the disclosure about purchase, sales, issuances and settlements in the roll forward of activity in level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 (or July 1, 2011 for us) and for interim periods within those fiscal years. We do not believe that the adoption of the amended guidance in ASC 820-10 will have a significant effect on our financial statements.

*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 at least 98% of our annual income and 98.2% of our capital gains 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 ordinary income and 98.2% of our capital gains 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.

If we fail to satisfy the Annual Distribution Requirement or otherwise fail to qualify as a RIC in any taxable year, 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 we be required to make distributions. Distributions would generally be taxable to our individual and other non-corporate taxable stockholders as ordinary dividend income eligible for the reduced maximum rate for taxable years beginning before 2013 (but not for taxable years beginning thereafter, unless the relevant provisions are extended by legislation) to the extent of our current and accumulated earnings and profits, provided certain holding period and other requirements are met. Subject to certain limitations under the Code, corporate distributions would be eligible for the dividends-received deduction. To qualify again to be taxed as a RIC in a subsequent year, we would be required to distribute to our shareholders our accumulated earnings and profits attributable to non-RIC years reduced by an interest charge of 50% of such earnings and profits payable by us as an additional tax. In addition, if we failed to qualify as a RIC for a period greater than two taxable years, then, in order to qualify as a RIC in a subsequent



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year, we would be required to elect to recognize and pay tax on any net built-in gain (the excess of aggregate gain, including items of income, over aggregate loss that would have been realized if we had been liquidated) or, alternatively, be subject to taxation on such built-in gain recognized for a period of ten years.

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 June 30, 2011 and for the year 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 June 30, 2011, approximately 4.8% 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.

*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 or distribution is approved by our Board of Directors each quarter and is generally based upon our 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 and the Senior Convertible Notes as deferred financing costs. These expenses are deferred and amortized as part of interest expense using

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the straight-line method for our revolving credit facility and the effective interest method for our Senior Convertible Notes, over the respective expected life.

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 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.

*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. In accordance with ASC 946, *Financial Services Investment Companies*, convertible securities are not considered in the calculation of net assets per share.

*Recent Accounting Pronouncements*

In January 2010, the FASB issued Accounting Standards Update 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements* ("ASC 2010-06"). ASU 2010-06 amends ASC 820-10 and clarifies and provides additional disclosure requirements related to recurring and non-recurring fair value measurements and employers' disclosures about postretirement benefit plan assets. ASU 2010-06 is effective December 15, 2009, except for the disclosure about purchase, sales, issuances and settlements in the roll forward of activity in level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 (or July 1, 2011 for us) and for interim periods within those fiscal years. We do not believe that the adoption of the amended guidance in ASC 820-10 will have a significant effect on our financial statements.

In February 2011, the FASB issued Accounting Standards Update 2011-02, *Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring* ("ASU 2011-02"). ASU 2011-02 clarifies which loan modifications constitute troubled debt restructurings. It is intended to assist creditors in determining whether a modification of the terms of a receivable meets the criteria to be considered a troubled debt restructuring, both for purposes of recording an impairment loss and for disclosure of troubled debt restructurings. In evaluating whether a restructuring constitutes a troubled debt restructuring, a creditor must separately conclude that both of the following exist: (a) the restructuring constitutes a concession; and (b) the debtor is experiencing financial difficulties. ASU 2011-02 provides guidance to clarify whether the creditor has granted a concession and whether a debtor is experiencing financial difficulties. The new guidance is effective for interim and annual periods beginning on or after June 15, 2011, and applies retrospectively to restructurings occurring on or after the beginning of the fiscal year of adoption or July 1, 2011 for us. We do not believe that the adoption of the amended guidance in ASU 2011-02 will have a significant effect on our financial statements.

In May 2011, the FASB issued Accounting Standards Update 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* ("ASU 2011-04"). ASU 2011-04 amends Accounting Standards Codification Topic 820, "Fair Value

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Measurements" ("ASC 820") by: (1) clarifying that the highest-and-best-use and valuation-premise concepts only apply to measuring the fair value of non-financial assets; (2) allowing a reporting entity to measure the fair value of the net asset or net liability position in a manner consistent with how market participants would price the net risk position, if certain criteria are met; (3) providing a framework for considering whether a premium or discount can be applied in a fair value measurement; (4) providing that the fair value of an instrument classified in a reporting entity's shareholders' equity is estimated from the perspective of a market participant that holds the identical item as an asset; and (5) expanding the qualitative and quantitative fair value disclosure requirements. The expanded disclosures include, for Level 3 items, a description of the valuation process and a narrative description of the sensitivity of the fair value to changes in unobservable inputs and interrelationships between those inputs if a change in those inputs would result in a significantly different fair value measurement. ASU 2011-4 also requires disclosures about the highest-and-best-use of a non-financial asset when this use differs from the asset's current use and the reasons for such a difference. In addition, this ASU amends Accounting Standards Codification 820, "Fair Value Measurements," to require disclosures to include any transfers between Level 1 and Level 2 of the fair value hierarchy. These amendments are effective for fiscal years beginning after December 15, 2011 and for interim periods within those fiscal years. The amendments of ASU 2011-04, when adopted, are not expected to have a material impact on our consolidated financial statements.

**QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are subject to financial market risks, including changes in interest rates and equity price risk. Some of the loans in our portfolio have floating interest rates.

We may hedge against interest rate fluctuations by using standard hedging instruments such as futures, options and forward contracts subject to the requirements of the 1940 Act. While hedging activities may insulate us against adverse changes in interest rates, they may also limit our ability to participate in the benefits of higher interest rates with respect to our portfolio of investments. During the twelve months ended June 30, 2011, we did not engage in hedging activities.

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**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, 2011. 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, 2011 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, 2011 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, 2011 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, 2011 has been audited by our 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 10-K for the year ended June 30, 2011, 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

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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 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," "projections," "plans," "seeks," "anticipates," "anticipated," "should," "could," "may," "will," "designed to," "foreseeable future," "believe," "believes" and "scheduled" and 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 SEC, Internal Revenue Service, NASDAQ, and other authorities that we are subject to, as well as their counterparts in any foreign jurisdictions where we might do business; and

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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.

### **DISTRIBUTIONS**

We have paid and intend to continue to distribute monthly 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 monthly distributions may from time to time be paid out of our capital rather than from earnings for the period 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. In order to avoid certain excise taxes imposed on RICs, we are required to distribute during each calendar year an amount at least equal to the sum of

98% of our ordinary income for the calendar year,

98.2% 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. We paid \$533,000 for the excise tax with the filing of our tax return in March 2009. No such election was made in December 2009 or 2010.

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 will 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. Stockholders who receive distributions 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 distributions in cash. See "Dividend Reinvestment Plan." The tax consequences of distributions to

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stockholders are described under the label "Material U.S. Federal Income Tax Considerations." To the extent prudent and practicable, we intend to declare and pay dividends on a monthly basis.

With respect to the distributions 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. During the fiscal year ended June 30, 2009, we recorded total distributions of approximately \$36.5 million. For the fiscal year ended June 30, 2010, we recorded total distributions of approximately \$101.0 million. On June 18, 2010, we announced a change in dividend policy from quarterly to monthly dividends. During the fiscal year ended June 30, 2011, we recorded total distributions of approximately \$106.2 million.

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.



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The following table reflects the distributions per share that we have declared on our common stock to date. In June 2010, we changed our distribution policy from a quarterly payment to a monthly payment.

Declaration Date	Record Date	Pay Date	Rate	Amount (In thousands)
8/24/2011	10/31/2011	11/22/2011	\$ 0.101350	*
8/24/2011	9/30/2011	10/25/2011	0.101325	\$ 11,087
5/9/2011	8/31/2011	9/23/2011	0.101300	11,074
5/9/2011	7/29/2011	8/26/2011	0.101275	11,060
5/9/2011	6/30/2011	7/22/2011	0.101250	10,896
5/9/2011	5/31/2011	6/24/2011	0.101225	9,871
2/8/2011	4/29/2011	5/31/2011	0.101200	9,861
2/8/2011	3/31/2011	4/29/2011	0.101175	8,940
2/8/2011	2/28/2011	3/31/2011	0.101150	8,930
11/8/2010	1/31/2011	2/28/2011	0.101125	8,919
11/8/2010	12/31/2010	1/31/2011	0.101000	8,900
11/8/2010	11/30/2010	12/31/2010	0.100875	8,668
8/26/2010	10/29/2010	11/30/2010	0.100750	8,347
8/26/2010	9/30/2010	10/29/2010	0.100625	7,889
6/18/2010	8/31/2010	9/30/2010	0.100500	7,620
6/18/2010	7/30/2010	8/31/2010	0.100250	7,330
6/18/2010	6/30/2010	7/30/2010	0.100000	6,909
3/18/2010	3/31/2010	4/23/2010	0.410000	26,403
12/17/2009	12/31/2009	1/25/2010	0.408750	25,894
9/28/2009	10/8/2009	10/19/2009	0.407500	22,279
6/23/2009	7/8/2009	7/20/2009	0.406250	19,548
3/24/2009	3/31/2009	4/20/2009	0.405000	12,671
12/19/2008	12/31/2008	1/19/2009	0.403750	11,966
9/16/2008	9/30/2008	10/16/2008	0.402500	11,882
6/19/2008	6/30/2008	7/16/2008	0.401250	11,845
3/6/2008	3/31/2008	4/16/2008	0.400000	10,468
12/8/2007	12/28/2007	1/7/2008	0.395000	9,370
9/6/2007	9/19/2007	9/28/2007	0.392500	7,830
6/14/2007	6/22/2007	6/29/2007	0.390000	7,753
3/14/2007	3/23/2007	3/30/2007	0.387500	7,667
12/15/2006	12/29/2006	1/5/2007	0.385000	7,264
7/31/2006	9/22/2006	9/29/2006	0.380000	4,858
6/14/2006	6/23/2006	6/30/2006	0.340000	2,401
3/15/2006	3/24/2006	3/31/2006	0.300000	2,117
12/12/2005	12/22/2005	12/29/2005	0.280000	1,975
9/15/2005	9/22/2005	9/29/2005	0.200000	1,411
4/21/2005	6/10/2005	6/30/2005	0.150000	1,058
2/9/2005	3/11/2005	3/31/2005	0.125000	882
11/11/2004	12/10/2004	12/30/2004	0.100000	706
Since Inception			\$	354,549

\*  
Not yet determinable

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Information about our senior securities is shown in the following table as of each fiscal year ended June 30 since the Company commenced operations and as of June 30, 2011.

<b>Credit Facility</b>	<b>Total Amount Outstanding(1)</b>	<b>Asset Coverage per Unit(2)</b>	<b>Involuntary Liquidating Preference per Unit(3)</b>	<b>Average Market Value per Unit(4)</b>
Fiscal 2011 (as of June 30, 2011)	\$ 84,200	\$ 18,065		
Fiscal 2010 (as of June 30, 2010)	100,300	8,093		
Fiscal 2009 (as of June 30, 2009)	124,800	5,268		
Fiscal 2008 (as of June 30, 2008)	91,167	5,712		
Fiscal 2007 (as of June 30, 2007)		N/A		
Fiscal 2006 (as of June 30, 2006)	28,500	4,799		
Fiscal 2005 (as of June 30, 2005)		N/A		
Fiscal 2004 (as of June 30, 2004)		N/A		

**2010 Notes**

Fiscal 2011 (as of June 30, 2011)	\$ 150,000	\$ 10,140		
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**2011 Notes**

Fiscal 2011 (as of June 30, 2011)	\$ 172,500	\$ 8,818		
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**All Senior Securities**

Fiscal 2011 (as of June 30, 2011)	\$ 406,700	\$ 3,740		
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(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) This column is inapplicable.

(4) This column is inapplicable.

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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 NAV 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 per share. There can be no assurance, however, that such premium or discount, as applicable, to NAV per share will be maintained. Common stock of business development companies, like that of closed-end investment companies, frequently trades at a discount to current NAV per share. In the past, our common stock has traded at a discount to our NAV per share. The risk that our common stock may continue to trade at a discount to our NAV per share is separate and distinct from the risk that our NAV per share may decline.

	NAV(1)	Stock Price High(2)	Low(2)	Premium (Discount) of High to NAV	Premium (Discount) of Low to NAV	Dividend Declared
<b>Twelve Months Ending June 30, 2008</b>						
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
<b>Twelve Months Ending June 30, 2009</b>						
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
<b>Twelve Months Ending June 30, 2010</b>						
First quarter	\$ 11.11	\$ 10.99	\$ 8.82	(1.1)%	(20.6)%	\$ 0.4075
Second quarter	10.10	12.31	9.93	21.9%	(1.7)%	0.40875
Third quarter	10.12	13.20	10.45	30.4%	3.3%	0.410
Fourth quarter	10.30	12.20	9.65	18.4%	(6.3)%	0.10
<b>Twelve Months Ending June 30, 2011</b>						
First quarter	\$ 10.24	\$ 10.00	\$ 9.18	(2.3)%	(10.4)%	\$ 0.301375
Second quarter	10.25	10.86	9.69	6.0%	(5.5)%	0.302625
Third quarter	10.33	12.33	10.72	19.4%	3.8%	0.303450
Fourth quarter	10.36	12.18	9.95	17.6%	(4.0)%	0.303675
<b>Twelve Months Ending June 30, 2012</b>						
First quarter	(3)(4)	\$ 10.18	\$ 7.41	(4)	(4)	0.303900(5)
Second quarter (to October 6, 2011)	(3)(4)	\$ 8.71	\$ 7.99	(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 of our common stock 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.

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- (3) Our most recently estimated NAV per share is \$10.04 on an as adjusted basis solely to give effect to distributions with record dates of July 29, 2011, August 31, 2011 and September 30, 2011, our issuance of common shares on July 22, 2011, August 26, 2011 and September 23, 2011 in connection with our dividend reinvestment plan, and our issuance of 1,500,000 shares of common stock on July 18, 2011 in connection with the option granted with the June 21, 2011 offering of 10,000,000 shares which were delivered June 24, 2011, versus \$10.36 determined by us as of June 30, 2011. NAV per share as of September 30, 2011, may be higher or lower than \$10.04 based on potential changes in valuations and earnings for the quarter then ended.
- (4) NAV has not yet been finally determined for any day after June 30, 2011.
- (5) In June 2010, we changed our distribution policy from a quarterly payment to a monthly payment.
- In May 2011, we announced the declaration of four additional monthly distributions as follows:
- \$0.101275 per share for July 2011 to holders of record on July 29, 2011 with a payment date of August 26, 2011; and
- \$0.101300 per share for August 2011 to holders of record on August 31, 2011 with a payment date of September 23, 2011.
- In August 2011, we announced the declaration of two additional monthly distributions as follows:
- \$0.101325 per share for September 2011 to holders of record on September 30, 2011 with a payment date of October 25, 2011; and
- \$0.101350 per share for October 2011 to holders of record on October 31, 2011 with a payment date of November 22, 2011.
- On October 6, 2011, the last reported sales price of our common stock was \$8.71 per share.
- As of October 6, 2011, we had approximately 75 stockholders of record.

The below table sets forth each class of our outstanding securities as of October 6, 2011.

<b>Title of Class</b>	<b>Amount Authorized</b>	<b>Amount Held by Registrant or for its Account</b>	<b>Amount Outstanding</b>
Common Stock	200,000,000	0	109,417,083

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**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 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.

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.

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 19 other common stock share offerings and seven related over-allotment options resulting in the issuance of 90,546,823 shares at prices ranging from \$7.75 to \$17.70. We issued the 2010 Notes on December 21, 2010 and the 2011 Notes on February 18, 2011.

*Notes*

On December 21, 2010 and February 18, 2011, the Company issued the 2010 Notes and the 2011 Notes, respectively. We refer to the 2010 Notes and the 2011 Notes collectively as the Notes. The Notes were issued only to qualified institutional investors under Rule 144A of the 1933 Act. The 2010 Notes mature on December 15, 2015 and the 2011 Notes mature on August 15, 2016, in each case unless previously converted in accordance with their terms. The Notes will be general unsecured obligations of the Company, rank equally in right of payment with the Company's existing and future senior unsecured debt, and rank senior in right of payment to any potential subordinated debt, should any be issued in the future. The Company may not redeem the Notes prior to maturity. The net proceeds from the offerings of the Notes were approximately \$322.5 million which was used initially to maintain balance sheet liquidity, including repayment of debt under the Company's credit facility, investments in high quality short-term debt instruments or a combination thereof, and to make long-term investments in accordance with the Company's investment objective.

The interest rate on the 2010 Notes is 6.25% per year, payable semiannually in arrears on June 15 and December 15 of each year, commencing June 15, 2011. Holders may convert their 2010 Notes at any time on or prior to the close of business on the business day immediately preceding the maturity date at an initial conversion rate of 88.0902 shares of common stock per \$1,000 principal amount of 2010 Notes (equivalent to an initial conversion price of approximately \$11.35 per share). The conversion rate is subject to adjustment in certain events and in no event will the total number of shares of common stock issuable upon conversion exceed 96.8992 per \$1,000 principal amount of the 2010 Notes, or the "conversion rate cap," except that, to the extent the Company receives written guidance or a no-action letter from the staff of the SEC permitting it to adjust the conversion rate in certain instances without regard to the conversion rate cap, and to make the 2010 Notes convertible into certain reference property in accordance with certain reclassifications, business combinations, asset sales and corporate events of the Company without regard to the conversion rate cap it will make such adjustments without regard to the conversion rate cap and will also, to the extent that it makes any such adjustment without regard to the conversion rate cap pursuant to such written guidance or a no-action, adjust the conversion rate cap accordingly. Prior to obtaining the previously mentioned written guidance or no-action letter from the staff of the SEC, the Company will not engage in certain

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transactions that would result in an adjustment to the conversion rate increasing the conversion rate beyond what it would have been in the absence of such transaction unless the Company has engaged in a reverse stock split or share combination transaction such that in our reasonable best estimation, the conversion rate following the adjustment for such transaction will not be any closer to the conversion rate cap than it would have been in the absence of such transaction. At June 30, 2011, the 2010 Notes are convertible into 88.0932 shares of common stock, as adjusted for monthly cash dividends paid in excess of \$0.101125 per share after closing.

The interest rate on the 2011 Notes is 5.50% per year, payable semiannually in arrears on February 15 and August 15 of each year, commencing August 15, 2011. Holders may convert their 2011 Notes at any time on or prior to the close of business on the business day immediately preceding the maturity date at an initial conversion rate of 78.3699 shares of common stock per \$1,000 principal amount of 2011 Notes (equivalent to an initial conversion price of approximately \$12.76 per share). The conversion rate is subject to adjustment in certain events. At June 30, 2011, the 2011 Notes are convertible into 78.3717 shares of common stock, as adjusted for monthly cash dividends paid in excess of \$0.101150 per share after closing.

If the Company undergoes a "fundamental change" as described in the indenture for each of the Notes, holders may require the Company to repurchase all or part of their Notes at a price equal to 100% of the principal amount of the Notes, plus accrued and unpaid interest (including additional interest, if any).

Under each indenture governing the Notes, there are certain events of default, the occurrence of which may lead to the Notes being due and payable immediately. An event of default under an indenture could have a material adverse effect on our business, financial conditions and results of operations.

**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. We are a non-diversified company within the meaning of the 1940 Act.

We invest primarily in first and second lien senior loans and mezzanine debt, which in some cases includes an equity component. First and second lien senior loans generally are senior debt instruments that rank ahead of subordinated debt of a given portfolio company. These loans also have the benefit of security interests on the assets of the portfolio company, which may rank ahead of or be junior to other security interests. Mezzanine debt is subordinated to senior loans and is generally unsecured. Our investments have generally ranged between \$5 million and \$75 million each, although the investment size may be more or less than this range. Our investment sizes are expected to grow as our capital base expands.

We also 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. 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

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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 have and may make additional investments in debt and equity securities of companies located outside of the United States.

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**

While our original investments were concentrated in industrial and energy related companies, we continue to widen our focus in other sectors of the economy to diversify our portfolio holdings. Our portfolio is now well diversified into 36 industry categories with no individual industry comprising more than 10.7% of the portfolio on either a cost or fair value basis.

**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.

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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 shadow bond approach, a market approach, an income approach, a liquidation approach, or a combination of approaches, as appropriate. The shadow bond and market approaches use 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*



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("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 and six months ended December 31, 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.

In January 2010, the FASB issued Accounting Standards Update 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements* ("ASC 2010-06"). ASU 2010-06 amends ASC 820-10 and clarifies and provides additional disclosure requirements related to recurring and non-recurring fair value measurements and employers' disclosures about postretirement benefit plan assets. ASU 2010-06 is effective for interim and annual reporting periods beginning after December 15, 2009. Our management does not believe that the adoption of the amended guidance in ASC 820-10 will have a significant effect on our financial statements.

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 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

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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 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 ASC 820-10-05-1.

***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 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.

**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 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, which we define as total assets without deduction for any liabilities, as well as a two-part incentive fee based on our performance. Mr. Barry currently controls Prospect Capital Management. See "Business Management Services Board of Directors approval of the Investment Advisory Agreement."

**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

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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 "Business 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**

From time to time, we may become 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 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.

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**Independent Directors**

<b>Name and Age</b>	<b>Position(s) Held with the Company</b>	<b>Term of Office(1) and Length of Time Served</b>	<b>Principal Occupation(s) During Past 5 Years</b>	<b>Number of Portfolios in Fund Complex Overseen by Director</b>	<b>Other Directorships Held by Director(2)</b>
William J. Grempe, 68	Director	Class II Director from 2006 to 2009; Class I Director since April 2010; Term expires 2011	Mr. Grempe was responsible for traditional banking services, credit and lending, private equity and corporate cash management with Merrill Lynch & Co. from 1999 to present.	One	None
Eugene S. Stark, 53	Director	Class III Director since September 2008; Term expires 2013	Principal Financial Officer, Chief Compliance Officer and Vice President Administration of General American Investors Company, Inc. from May 2005 to present.	One	None
Andrew C. Cooper, 49	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.	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. Grempe 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 2013.
- (2) No director otherwise serves as a director of an investment company subject to the 1940 Act.

**Interested Directors**

<b>Name and Age</b>	<b>Position(s) Held with the Company</b>	<b>Term of Office(1) and Length of Time Served</b>	<b>Principal Occupation(s) During Past 5 Years</b>	<b>Number of Portfolios in Fund Complex Overseen by Director</b>	<b>Other Directorships Held by Director(2)</b>
John F. Barry III, 59(3)	Director, Chairman of the Board of Directors, and Chief Executive Officer	Class III Director since June 2004; Term expires 2013	Chairman and Chief Executive Officer of the Company; Managing Director of Prospect Capital Management and Prospect Administration since June 2004; Managing Director of affiliated companies of Prospect Capital Management and Prospect Administration.	One	None
M. Grier Eliasek, 38(3)	Director, 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. Grempe 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 2013.
- (2)

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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.

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**Information about Executive Officers who are not Directors**

<b>Name and Age</b>	<b>Position(s) Held with the Company</b>	<b>Term of Office and Length of Time Served</b>	<b>Principal Occupation(s) During Past Five Years</b>
Brian H. Oswald, 50	Chief Financial Officer, Chief Compliance Officer, Treasurer and Secretary	November 2008 to present as Chief Financial Officer, Treasurer and Secretary 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).

*Board Leadership Structure*

The Board of Directors believes that the combined position of Chief Executive Officer of the Company and Chairman of the Board of Directors of the Company is a superior model that results in greater efficiency regarding management of the Company, reduced confusion due to the elimination of the need to transfer substantial information quickly and repeatedly between a chief executive officer and chairman, and business advantages to the Company arising from the specialized knowledge acquired from the duties of the dual roles. The need for efficient decision making is particularly acute in the line of business of the Company, whereby multiple factors including market factors, interest rates and innumerable other financial metrics change on an ongoing and daily basis. The Board of Directors has not identified a lead independent director of the Board of Directors of the Company in as much as the Board consists of only five individuals.

*Director Independence*

On an annual basis, each member of our Board of Directors is required to complete an independence questionnaire designed to provide information to assist the Board of Directors in determining whether the director is independent. Our Board of Directors has determined that each of our directors, other than Messrs. Barry and Eliasek, is independent under the 1940 Act.

*Role of the Chairman and Chief Executive Officer*

As Chairman of the Board of Directors and Chief Executive Officer, Mr. Barry assumes a leading role in mid- and long-term strategic planning and supports major transaction initiatives of the Company. Mr. Barry also manages the day-to-day operations of the Company, with the support of the other executive officers. As Chief Executive Officer, Mr. Barry has general responsibility for the implementation of the policies of the Company, as determined by the Board of Directors, and for the management of the business and affairs of the Company. The Board of Directors has determined that its leadership structure, in which the majority of the directors are not affiliated with the Company, Prospect Capital Management or Prospect Administration, is appropriate in light of the services that Prospect Capital Management and Prospect Administration and their affiliates provide to the Company and the potential conflicts of interest that could arise from these relationships.

*Experience, Qualifications, Attributes and/or Skills that Led to the Board's Conclusion that such Members Should Serve as Director of the Company*

The Board believes that, collectively, the directors have balanced and diverse experience, qualifications, attributes and skills, which allow the Board to operate effectively in governing the Company and protecting the interests of its stockholders. Below is a description of the various experiences, qualifications, attributes and/or skills with respect to each director considered by the Board.

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*John F. Barry III*

The Board benefits from Mr. Barry's years of experience in the investment banking and the financial advisory industries, as well as his service on multiple boards for various companies. In addition to overseeing the Company, Mr. Barry has served on the boards of directors of private and public companies, including financial services, financial technology and energy companies. Mr. Barry also managed an investment bank, focusing on private equity and debt financing for energy and other companies, and was the founding member of the project finance group at Merrill Lynch & Co. The Board also benefits from Mr. Barry's past experience as a corporate securities lawyer at a premiere United States law firm, advising energy companies and their commercial and investment bankers. Mr. Barry is also 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's longstanding service as Chairman and Chief Executive Officer of the Company and as a Managing Director of Prospect Capital Management and Prospect Administration provide him with a specific understanding of the Company, its operation, and the business and regulatory issues facing the Company.

*M. Grier Eliasek*

Mr. Eliasek brings to the Board business leadership and experience and knowledge of senior loan, mezzanine, bridge loan, private equity and venture capital investments, as well as a knowledge of diverse management practices. Mr. Eliasek is the President and Chief Operating Officer of the Company and a Managing Director of Prospect Capital Management and Prospect Administration. He is also responsible for leading the origination and assessment of investments for the Company. Mr. Eliasek serves on the board of directors of Gas Solutions Holdings, Inc., a gas gathering and processing company in East Texas, which helps provide the Company's Board with an in-depth knowledge of the management of companies in which the Company invests. The Board also benefits from Mr. Eliasek's experience as a consultant with Bain & Company, a global strategy consulting firm, where he managed engagements for companies in several different industries, by providing the Company with unique views on investment and management issues. At Bain & Company, Mr. Eliasek analyzed new lines of businesses, developed market strategies, revamped sales organizations, and improved operational performance for Bain & Company clients. Mr. Eliasek's longstanding service as Director, President and Chief Operating Officer of the Company and as a Managing Director of Prospect Capital Management and Prospect Administration provide him with a specific understanding of the Company, its operation, and the business and regulatory issues facing the Company.

*Andrew C. Cooper*

Mr. Cooper's over 25 years of experience in venture capital management, venture capital investing and investment banking provides the Board with a wealth of leadership, business investing and financial experience. Mr. Cooper's experience as the co-founder, director and former co-CEO of Unison Site Management LLC, a leading cellular site owner with 2,000 plus cell sites which generate more than \$40 million in annual cash flow, and as co-founder, CFO and VP of business development for Avesta Technologies, an enterprise, information and technology management software company bought by Visual Networks in 2000, provides the Board with the benefit of leadership and experience in finance and management. Mr. Cooper also serves on the board of Brand Asset Digital, Aquatic Energy and the Madison Square Boys and Girls Club of New York. Further, Mr. Cooper's time as a director of CSG Systems, Protection One Alarm, LionBridge Technologies and Weblink Wireless, provides the Board with a wealth of experience and an in-depth understanding of management practices. Mr. Cooper's knowledge of financial and accounting matters qualifies him to serve on the Company's Audit Committee and his independence from the Company, Prospect Capital Management and Prospect

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Administration enhances his service as a member of the Nominating and Corporate Governance Committee.

*William J. Grep*

Mr. Grep brings to the Board a broad and diverse knowledge of business and finance as a result of his career as an investment banker, spanning over 30 years working in corporate finance and originating and executing transactions and advisory assignments for energy and utility related clients. Since 1999, Mr. Grep has been responsible for traditional banking services, credit and lending, private equity and corporate cash management with Merrill Lynch & Co.. From 1996 to 1999, he served at Wachovia as senior vice president, managing director and co-founder of the utilities and energy investment banking group, responsible for origination, structuring, negotiation and successful completion of transactions utilizing investment banking, capital markets and traditional commercial banking products. From 1989 to 1996, Mr. Grep was the managing director of global power and project finance at JPMorgan Chase & Co., and from 1970 to 1989, Mr. Grep was with Merrill Lynch & Co., starting out as an associate in the mergers and acquisitions department, then in 1986 becoming the senior vice president, managing director and head of the regulated industries group. Mr. Grep's knowledge of financial and accounting matters qualifies him to serve on the Company's Audit Committee and his independence from the Company, Prospect Capital Management and Prospect Administration enhances his service as a member of the Nominating and Corporate Governance Committee.

*Eugene S. Stark*

Mr. Stark brings to the Board over 20 years of experience in directing the financial and administrative functions of investment management organizations. The Board benefits from his broad experience in financial management; SEC reporting and compliance; strategic and financial planning; expense, capital and risk management; fund administration; due diligence; acquisition analysis; and integration activities. Since May 2005, Mr. Stark's position as the Principal Financial Officer, Chief Compliance Officer and Vice President of Administration at General American Investors Company, Inc., where he is responsible for operations, compliance, and financial functions, allows him to provide the Board with added insight into the management practices of other financial companies. From January to April of 2005, Mr. Stark was the Chief Financial Officer of the Company, prior to which he worked at Prudential Financial, Inc. between 1987 and 2004. His many positions within Prudential include 10 years as Vice President and Fund Treasurer of Prudential Mutual Funds, 4 years as Senior Vice President of Finance of Prudential Investments, and 2 years as Senior Vice President of Finance of Prudential Amenities. Mr. Stark is also a Certified Public Accountant. Mr. Stark's knowledge of financial and accounting matters qualifies him to serve on the Company's Audit Committee and his independence from the Company, Prospect Capital Management and Prospect Administration enhances his service as a member of the Nominating and Corporate Governance Committee. Mr. Stark is also a member of Mount Saint Mary Academy's Finance Committee.

*Means by Which the Board of Directors Supervises Executive Officers*

The Board of Directors is regularly informed on developments and issues related to the Company's business, and monitors the activities and responsibilities of the executive officers in various ways.

At each regular meeting of the Board of Directors, the executive officers report to the Board of Directors on developments and important issues. Each of the executive officers, as applicable, also provide regular updates to the members of the Board of Directors regarding the Company's business between the dates of regular meetings of the Board of Directors.



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Executive officers and other members of Prospect Capital Management, at the invitation of the Board of Directors, regularly attend portions of meetings of the Board of Directors and its committees to report on the financial results of the Company, its operations, performance and outlook, and on areas of the business within their responsibility, including risk management and management information systems, as well as other business matters.

*The Board's Role in Risk Oversight*

The Company's Board of Directors performs its risk oversight function primarily through (a) its two standing committees, which report to the entire Board of Directors and are comprised solely of independent directors and (b) monitoring by the Company's Chief Compliance Officer, or CCO, in accordance with its compliance policies and procedures.

As set forth in the descriptions regarding the Audit Committee and the Nominating and Governance Committee, the Audit Committee and the Nominating and Governance Committee assist the Board of Directors in fulfilling its risk oversight responsibilities. The Audit Committee's risk oversight responsibilities include 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; 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 Nominating and Governance Committee's risk oversight responsibilities include 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; and overseeing the evaluation of the Board of Directors and management. Both the Audit Committee and the Nominating and Governance Committee consist solely of independent directors.

The Company's Board of Directors also performs its risk oversight responsibilities with the assistance of the Chief Compliance Officer. The Company's Chief Compliance Officer prepares a written report annually discussing the adequacy and effectiveness of the compliance policies and procedures of the Company and certain of its service providers. The Chief Compliance Officer's report, which is reviewed by the Board of Directors, addresses at a minimum (a) the operation of the compliance policies and procedures of the Company and certain of its service providers since the last report; (b) any material changes to such policies and procedures since the last report; (c) any recommendations for material changes to such policies and procedures as a result of the Chief Compliance Officer's annual review; and (d) any compliance matter that has occurred since the date of the last report about which the Board of Directors would reasonably need to know to oversee the Company's compliance activities and risks. In addition, the Chief Compliance Officer meets separately in executive session with the independent directors at least once each year.

The Company believes that its Board of Director's role in risk oversight is effective and appropriate given the extensive regulation to which it is already subject as a business development company, or BDC, under the 1940 Act. Specifically, as a BDC the Company must comply with certain regulatory requirements that control certain types of risk in its business and operations. For example, the Company's ability to incur indebtedness is limited such that its asset coverage must equal at least 200% immediately after each time it incurs indebtedness, the Company generally has to invest at least 70% of its total assets in "qualifying assets." In addition, the Company elected to be treated as a regulated investment company, or RIC, under Subchapter M of the Internal Revenue Code, as amended. As a RIC, the Company must, among other things, meet certain income source and asset diversification requirements.

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The Company believes that the extent of its Board of Directors' (and its committees') role in risk oversight complements its Board's leadership structure because it allows the Company's independent directors to exercise oversight of risk without any conflict that might discourage critical review through the two fully independent board committees, auditor and independent valuation providers, and otherwise.

The Company believes that a board's roles in risk oversight must be evaluated on a case by case basis and that the Board of Directors' practices concerning risk oversight is appropriate. However, the Company continually re-examines the manners in which the Board administers its oversight function on an ongoing basis to ensure that they continue to meet the Company's needs.

**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, 2011, our Board of Directors held seventeen Board of Director meetings, eight Audit Committee meetings, and one Nominating and Corporate Governance Committee meetings. 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. Two directors attended last year's annual meeting of stockholders in person.

*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 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. Cooper, Grempe and Stark, each of whom is not an "interested person" as defined in the 1940 Act and is considered independent under applicable NASDAQ rules, with Mr. Stark serving as chairman of the committee. The 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. 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. Cooper, Grempe and Stark were added to the Audit Committee concurrent with their election to the Board of Directors on February 12, 2009, April 1, 2010 and September 4, 2008, 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).

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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 shall be 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 shall 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 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 takes into consideration the educational, professional and technical backgrounds and diversity of each nominee when evaluating such nominees to be elected to the Board of Directors. The Nominating and Governance Committee does not have a formal policy with respect to diversity. The Nominating and Governance Committee is presently composed of three persons: Messrs. Cooper, Grempp and Stark, each of whom is not an "interested person" as defined in the 1940 Act and is considered independent under applicable NASDAQ rules, with Mr. Grempp serving as chairman of the committee. Messrs. Cooper, Grempp and Stark were added to the Nominating and Governance Committee concurrent with their election to the Board of Directors on February 12, 2009, April 1, 2010 and September 4, 2008, 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 Commission 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 NASDAQ rules 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

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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.

*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. Cooper, Grempe 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. Cooper, Grempe 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.

Table of Contents**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."

**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, 2011. 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
<b>Interested Directors</b>			
John F. Barry III(2)	None	None	None
M. Grier Eliasek(2)	None	None	None
<b>Independent Directors</b>			
Andrew C. Cooper(3)	\$ 85,000	None	\$ 85,000
William J. Grempp(4)	\$ 85,000	None	\$ 85,000
Eugene S. Stark(5)	\$ 85,000	None	\$ 85,000
<b>Executive Officers</b>			
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 from the income Prospect Administration receives under the administration agreement.

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

(4) Mr. Grempp joined our Board of Directors on April 1, 2010.

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

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 per director plus reimbursement of any out-of-pocket expenses incurred. All independent directors currently serve on both committees. 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.

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**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, 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 June 30, 2011, we paid an incentive fee of \$7.5 million (see calculation below). 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).

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 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

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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.

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 actual transfer or sale of assets by Prospect to a SPE established by Prospect and consolidated with Prospect is disregarded for purposes of calculating the incentive fee.

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The following is a calculation of the most recently paid incentive fee paid in July 2011 (for the quarter ended June 30, 2011) (in thousands):

Prior Quarter Net Asset Value (adjusted for stock offerings during the quarter)	\$ 1,013,469
Quarterly Hurdle Rate	1.75%
Current Quarter Hurdle	\$ 17,736
125% of the Quarterly Hurdle Rate	2.1875%
125% of the Current Quarter Hurdle	\$ 22,170
Current Quarter Pre Incentive Fee Net Investment Income	\$ 37,737
Incentive Fee "Catch-Up"	\$ 4,434
Incentive Fee 20% in excess of 125% of the Current Quarter Hurdle	\$ 3,113
Total Current Quarter Incentive Fee	\$ 7,547

The total base management fees earned by and paid to Prospect Capital Management during the twelve months ended June 30, 2011, June 30, 2010 and June 30, 2009 were \$22.5 million, \$13.9 million and \$11.9 million, respectively.

The income incentive fees were \$23.6 million, \$16.8 million and \$14.8 million for the twelve months ended June 30, 2011, June 30, 2010 and June 30, 2009, respectively. No capital gains incentive fees were earned for the twelve months ended June 30, 2011, June 30, 2010 and June 30, 2009.

The total investment advisory fees were \$46.1 million, \$30.7 million and \$26.7 million for the twelve months ended June 30, 2011, June 30, 2010 and June 30, 2009, 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.

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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%

(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)) = 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 =  $100\% \times \text{"Catch Up" + the greater of } 0\% \text{ AND } (20\% \times (\text{pre-incentive fee net investment income} - 2.1875\%))$   
=  $(100\% \times (2\% - 1.75\%)) + 0\%$   
=  $100\% \times 0.25\% + 0\%$   
= 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%

(1) Represents 7% annualized hurdle rate.

(2) Represents 2% annualized base management fee.

(3) Excludes organizational and offering expenses.

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

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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 =  $100\% \times \text{"Catch Up"} + \text{the greater of } 0\% \text{ AND } (20\% \times (\text{pre-incentive fee net investment income} - 2.1875\%))$   
=  $(100\% \times (2.1875\% - 1.75\%)) + \text{the greater of } 0\% \text{ AND } (20\% \times (2.30\% - 2.1875\%))$   
=  $(100\% \times 0.4375\%) + (20\% \times 0.1125\%)$   
=  $0.4375\% + 0.0225\%$   
=  $0.46\%$

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

*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

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*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

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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*

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*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)

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*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 advisers, 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 May 9, 2011 for an additional one-year term expiring June 24, 2012. 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."



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***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.

We reimbursed Prospect Administration \$5.0 million, \$3.4 million and \$2.9 million for the twelve months ended June 30, 2011, June 30, 2010 and June 30, 2009, 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.

***Board of Directors approval of the Investment Advisory Agreement***

On May 9, 2011, our Board of Directors voted unanimously to renew the Investment Advisory Agreement for the 12-month period ending June 24, 2012. 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

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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 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 III	Chairman and Chief Executive Officer	6
M. Grier Eliasek	President and Chief Operating Officer	6

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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, 2011.

Name	Aggregate Dollar Range of Common Stock Beneficially Owned by Prospect Capital Management
John F. Barry III	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 \$1,325,000, \$892,000 and \$846,000 of managerial assistance fees for the years ended June 30, 2011, June 30, 2010 and June 30, 2009, respectively, of which \$128,000 and \$247,000 remains on the consolidated statement of assets and liabilities as of June 30, 2011 and June 30, 2010, 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

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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.

**CONTROL PERSONS AND PRINCIPAL STOCKHOLDERS**

As of October 6, 2011, 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 October 6, 2011, 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.

<b>Name and Address</b>	<b>Type of Ownership</b>	<b>Shares Owned</b>	<b>Percentage of Common Stock Outstanding(1)</b>
Zazove Associates, LLC(2)	Record and Beneficial	10,315,483	9.4%
All officers and directors as a group (6 persons)	Record and beneficial	2,869,999	2.6%

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

(2) Based upon a Schedule 13G filed with the SEC on February 28, 2011 by Zazove Associates LLC. According to the Schedule 13G, all of the shares beneficially owned by Zazove Associates LLC represent shares issuable upon the conversion of the Notes. Notwithstanding the percentage of common stock noted, each of the Notes contain a provision that limits the holders of the Notes from converting the Notes to shares of common stock of the Company to the extent such conversion would cause the holder to become a beneficial owner of more than 5.0% of the Company's outstanding common stock at the time of conversion. Percentage of common stock outstanding included the conversion of these shares in the total outstanding.

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The following table sets forth the dollar range of our equity securities beneficially owned by each of our directors and officers as of June 30, 2011. 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)
<b>Independent Directors</b>	
William J. Gremp	\$10,001 - \$50,000
Andrew C. Cooper	None
Eugene S. Stark	\$50,001 - \$100,000
<b>Interested Directors</b>	
John F. Barry III(2)	Over \$100,000
M. Grier Eliasek	Over \$100,000
<b>Officer</b>	
Brian H. Oswald	Over \$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.

**PORTFOLIO COMPANIES**

The following is a listing of our portfolio companies at June 30, 2011. Values are as of June 30, 2011.

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 June 30, 2011, Prospect owned 100.00% of the fully diluted common equity of GSHI, 100.00% of the common equity of CCEHI, 100% of the equity of Airmall, 100% of the common equity of Borga, 40% of the fully diluted equity of C&J, 49.00% of the fully diluted common equity of Integrated, 57.8% of the fully diluted common equity of Iron Horse, 100.00% of the members unit of AWCNC, LLC, 100.00% of the common equity of Coalbed, Inc., 100.00% of the fully diluted equity of Freedom Marine Holdings Inc., 95.0% of the fully diluted preferred equity of NMMB Holdings, Inc., 90.7% of the fully diluted equity of Nupla Corporation, 80.00% of the fully diluted common equity of NRG, 74.1% of the fully diluted equity of R-V, 77.7% of the fully diluted equity of Ajax and 100.0% 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.

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Name of Portfolio Company	Nature of its Principal Business (Location)	Title and Class of Securities Held	Collateral Held	Investment Structure	Equity Securities Held, at Fair Value (In millions of \$)	Loans, at Fair Value (In millions of \$)
<b>Companies more than 25% owned</b>						
Airmail USA, Inc.	Property management (Pennsylvania)	Senior secured debt, senior subordinated debt, convertible preferred stock and common equity	First priority lien on substantially all assets	Common shares; convertible preferred shares; senior secured term loan, 12% due 6/30/2015; senior subordinated term loan, 12.00% plus 6.00% PIK, due 12/31/2015	9.2	42.5
Ajax Rolled Ring and Machine, Inc.	Manufacturing (South Carolina)	Senior secured debt, subordinated secured debt, convertible preferred stock and common equity	First priority lien on substantially all assets	Common shares; Convertible 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	33.9
AWCNC, LLC	Machinery (North Carolina)	Members Units	N/A	Members units	0.0	0.0
Borga, Inc.	Manufacturing (California)	Revolving line of credit, senior secured debt, warrants and common equity	First priority lien on all assets and pledge of all stock	Warrants; common shares; Revolving line of credit, 5.00% plus 3.00% default interest, in non-accrual status effective 03/02/2010, past due; Senior secured Term Loan B, 8.50% plus 3.00% default interest, in non-accrual status effective 03/02/2010, past due; Senior secured Term Loan C, 12.00% plus 4.00% PIK plus 3.00% default interest, in non-accrual status effective 03/02/2010, past due	0.0	1.7
C&J Cladding LLC	Metal services and Minerals (Texas)	Membership Interests	N/A	Membership Interests	4.7	0.0
Change Clean Energy Holdings, Inc.	Biomass power (Maine)	Common equity	First priority lien on substantially all assets	Common shares	0.0	0.0
Freedom Marine Services 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, in non-accrual status effective 10/1/2010, due 12/31/2011	0.0	3.1
Gas Solutions Holdings, Inc.	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 12/11/2016; Junior secured note, 18.00% due 12/12/2016	68.4	37.0
Integrated Contract Services, Inc.	Contracting (North Carolina)	Secured promissory note, 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%, in	0.0	1.8

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Iron Horse Coiled Tubing, Inc.	Production services (Alberta, Canada)	Senior secured debt and common equity	First priority lien on substantially all assets	non-accrual status effective 11/1/2010 past due; Secured promissory note, 15%, in non-accrual status effective 12/22/2010, due 3/21/2012-4/10/2013	1.7	13.7
				Common shares; Senior secured note, tranche 2, zero coupon, due 12/31/2016; senior secured note tranche 3, 2% due 12/31/2016		

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Name of Portfolio Company	Nature of its Principal Business (Location)	Title and Class of Securities Held	Collateral Held	Investment Structure	Equity Securities Held, at Fair Value (In millions of \$)	Loans, at Fair Value (In millions of \$)
Manx Energy, Inc.	Oil and Gas production (Kansas)	Senior secured debt, preferred stock and common equity	First priority lien on substantially all assets	Common shares; Preferred shares senior secured note (AEH), 8% in non-accrual status effective 1/19/2010, due 1/19/2013; senior secured note (Coalbed), 8%, in non-accrual status effective 1/19/2010, due 1/19/2013; senior secured note (Manx), 13.00%, in non-accrual status effective 1/19/2010, due 1/19/2013	0.0	1.3
NMMB Holdings, Inc.	Media (New York)	Preferred stock, revolving line of credit, senior term debt and senior subordinated debt	First priority lien on substantially all assets	Preferred shares; revolving line of credit, 10.50% due 5/6/2014, senior term loan, 14.00% due 5/6/2016; senior subordinated term loan, 15.00% due 5/6/2016	4.4	27.1
NRG Manufacturing, Inc.	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	32.4	13.1
Nupla Corporation	Home & Office Furnishings, Housewares & Durable (California)	Revolving line of credit, senior secured debt, senior subordinated debt, preferred stock and common equity	First priority lien on substantially all assets	Common shares; Preferred shares; Revolving line of credit, 7.25% plus 2.00% default interest due 9/04/2012; Senior secured Term Loan A, 8.00% plus 2.00% default interest due 9/04/2012; Senior subordinated debt, 15% PIK, in non-accrual status effective 4/01/2009 due 3/04/2013	0.0	6.1
R-V Industries, Inc.	Manufacturing (Pennsylvania)	Warrants and common equity	N/A loan repaid	Common shares; Warrants, expiring 6/30/2017	5.9	2.2
Yatesville Coal Holdings, Inc.	Mining, Steel, Iron and Non-Precious Metals and Coal Production (Kentucky)	Senior and junior secured debt and common equity	First priority lien on substantially all assets	Common shares; Senior secured note, in non-accrual status effective 1/01/2009 due 12/31/2010; Junior secured note, in non-accrual status effective 1/01/2009 due 12/31/2010	0.0	0.0



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Name of Portfolio Company	Nature of its Principal Business (Location)	Title and Class of Securities Held	Collateral Held	Investment Structure	Equity Securities Held, at Fair Value (In millions of \$)	Loans, at Fair Value (In millions of \$)
<b>Companies 5% to 25% owned</b>						
Biotronic NeuroNetwork	Healthcare (Michigan)	Senior secured debt and preferred stock	First priority lien on substantially all assets	Preferred shares; Senior secured note, 11.50% plus 1.00% PIK due 2/21/2013	7.0	27.0
Boxercraft Incorporated	Textiles & Leather (Georgia)	Senior secured debt, subordinated secured debt and common equity	First priority lien on substantially all assets	Common shares; Preferred shares; Senior secured Term Loan A, 9.50% due 9/16/2013; Senior secured Term Loan B, 10.00% due 9/16/2013; Subordinated secured term loan, 12.00% plus 6.50% PIK due 3/16/2014	0.4	15.2
Smart, LLC	Diversified / Conglomerate Service (New York)	Membership interests	N/A	Membership interests	0.0	0.0
Sports Helmets Holdings, LLC	Personal & Nondurable Consumer Products (New York)	Revolving line of credit, senior secured debt, senior subordinated debt and common equity	First priority lien on all assets and stock	Common shares; Revolving line of credit, 4.00% due 12/14/2013; Senior secured Term Loan A, 4.00% due 12/14/2013; Senior secured Term Loan B, 4.50% due 12/14/2013; Senior subordinated debt Series A, 12.00% plus 3.00% PIK due 6/14/2014; Senior subordinated debt Series B, 10.00% plus 5.00% PIK due 6/14/2014	4.3	18.4
<b>Companies less than 5% owned</b>						
ADAPCO, Inc.	Ecological (Florida)	Common equity	N/A	Common shares	0.2	0.0
Aircraft Fasteners International, LLC	Machinery (California)	Revolving line of credit, senior and junior secured debt and convertible preferred stock	First priority lien on all assets and stock	Convertible preferred shares; Revolving line of credit, 9.5% due 11/01/2012; Senior secured Term Loan, 9.5% due 11/01/2012; Junior secured Term Loan, 12.00% plus 6% PIK due 5/01/2013	0.3	8.5
Allied Defense Group, Inc.	Aerospace & Defense (Virginia)	Common equity	N/A	Common shares	0.0	0.0
American Gilsonite Company	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 2.50% PIK due 3/10/2016	4.1	30.2
Arrowhead General Insurance Agency, Inc.	Insurance (California)	Junior secured debt	Second perfected priority lien on substantially all assets	Junior secured Term Loan, 11.25% due 9/30/2017	0.0	27.0
Byrider Systems Acquisition Corp.	Auto Finance (Indiana)	Senior subordinated debt	Subordinated lien on substantially all assets	Senior subordinated note, 12.00% plus 2.00% PIK due 11/3/2016	0.0	25.1

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Caleel & Hayden	Personal & Nondurable Consumer Products (Colorado)	Options and membership units	First priority lien on all assets and stock	Options; membership units	0.7	0.0
Cargo Airport Services USA, LLC	Transportation (New York)	Common equity, revolving line of credit and senior secured debt	First priority lien on substantially all assets	Common shares; revolving line of credit, 11.50% due 3/31/2012; senior secured term loan, 11.50% due 3/31/2016	1.8	58.4
Clearwater Seafoods LP	Food Products (Canada)	Second lien debt	Second lien on substantially all assets	Second lien term loan, 12.00% due 2/4/2016	0.0	45.0

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Name of Portfolio Company	Nature of its Principal Business (Location)	Title and Class of Securities Held	Collateral Held	Investment Structure	Equity Securities Held, at Fair Value (In millions of \$)	Loans, at Fair Value (In millions of \$)
CRT MIDCO, LLC	Media (Wisconsin)	Revolving line of credit and senior secured debt	First priority lien on substantially all assets	Revolving line of credit, 10.5% due 6/30/2012; senior secured term loan, 10.5% due 6/30/2017	0.0	75.0
The Deb Shops, Inc.	Retail (Pennsylvania)	Second lien debt	Second priority lien on substantially all assets	Second lien note, 14% PIK in non accrual status effective 2/24/2009, due 10/23/2014	0.0	0.0
Diamondback Operating LP	Oil and gas production (Oklahoma)	Net profit interest	N/A loan repaid	Net profit interest, 15.00%	0.0	0.0
Dover Saddlery, Inc.	Retail (Massachusetts)	Common equity	N/A	Common shares	0.0	0.0
Empire Today, LLC	Durable Consumer Products (Illinois)	Senior secured debt	First priority lien on substantially all assets	Senior secured note, 11.375% due 2/1/2017	0.0	7.5
Fairchild Industrial Products, Co.	Electronics (North Carolina)	Preferred stock and common equity	N/A	Common shares; Preferred shares	1.4	0.0
Fischbein, LLC	Machinery (North Carolina)	Senior subordinated debt and membership interests	Second priority lien on all assets and stock	Membership interests; Senior subordinated debt, 12.00% plus 2.00% PIK due 10/31/2016	1.0	3.3
H&M Oil & Gas LLC	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% plus 3% PIK past due, in non-accrual status effective 1/1/2011	0.0	38.5
Hoffmaster Group, Inc.	Durable Consumer Products (Wisconsin)	Second lien debt	Second priority lien on substantially all assets	Second lien term loan, 13.50% due 6/2/2017	0.0	20.4
Hudson Products Holdings, Inc.	Manufacturing (Texas)	Senior secured debt	First priority lien on substantially all assets	Senior secured Term Loan, 8.5% due 8/24/2015	0.0	5.6
ICON Health & Fitness, Inc.	Durable Consumer Products (Utah)	Senior secured debt	First priority lien on substantially all assets	Senior secured notes, 11.875%, due 10/15/2016	0.0	45.0
IFC Systems LP/Advanced Rig Services 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	23.1
Jordan Healthcare Holdings, Inc.	Healthcare (Texas)	Senior Subordinated debt	Subordinated lien on substantially all assets	Senior Subordinated debt, 12.00% plus 2.50% PIK, due 6/23/2016	0.0	15.4
LHC Holdings Corp.	Healthcare (Florida)	Revolving line of credit, senior secured debt, senior subordinated debt and membership interests	First priority lien on all assets and stock	Membership interests; Revolving line of credit 8.50% due 6/30/2012; Senior secured Term Loan A, 8.5% due 6/30/2012; Senior subordinated debt, 12.00% plus 2.50% PIK due 5/31/2013	0.2	5.5
Mac & Massey Holdings, LLC	Food Products (Georgia)	Senior subordinated debt	Subordinated lien on substantially	Membership interests;	0.6	9.2

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		and membership interests	all assets	Senior subordinated debt, 10.00% plus 5.75% PIK due 2/10/2013		
Maverick Healthcare LLC	Healthcare (Arizona)	Preferred units and common units	N/A	Common units; Preferred units	1.6	0.0
Medical Security Card Company, LLC	Healthcare (Arizona)	Revolving line of credit and senior secured debt	First priority lien on substantially all assets	Revolving line of credit, 9.50% due 2/1/2016	0.0	20.5
Mood Media Corporation	Media (Canada)	Senior subordinated debt	Subordinated lien on substantially all assets	Senior subordinated term loan, 10.25% due 11/6/2018	0.0	14.9

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Name of Portfolio Company	Nature of its Principal Business (Location)	Title and Class of Securities Held	Collateral Held	Investment Structure	Equity Securities Held, at Fair Value (In millions of \$)	Loans, at Fair Value (In millions of \$)
New Meatco Provisions, LLC.	Food Products (California)	Senior subordinated debt	Subordinated lien on substantially all assets	Senior subordinated term loan, 12.00% plus 4.00% PIK due 4/18/2016	0.0	13.1
Northwestern Management Services, LLC	Healthcare (Florida)	Revolving line of credit, senior debt and common equity	First priority lien on all assets and stock	Common shares; Revolving line of credit, 10.5% due 7/30/15; Senior secured Term Loan A, 10.5% due 7/30/15	0.5	17.4
Out Rage, LLC	Durable Consumer Products (Wisconsin)	Revolving line of credit and senior secured debt	First priority lien on substantially all assets	Revolving line of credit, 11.00% due 3/2/2015; senior secured term loan, 11.00% due 3/2/2015	0.0	12.4
Pinnacle Treatment Centers, Inc	Healthcare (Pennsylvania)	Revolving line of credit and senior secured debt	First priority lien on substantially all assets	Revolving line of credit, 8.00% due 1/10/2016; senior secured term loan, 11.00% due 1/10/2016	0.0	19.0
Potters Holdings II, L.P.	Manufacturing (Pennsylvania)	Senior subordinated debt	Subordinated lien on substantially all assets	Senior subordinated term loan, 10.25% due 11/6/2017	0.0	14.8
Pre-Paid Legal Services, Inc.	Consumer Services (Oklahoma)	Senior subordinated debt	Subordinated lien on substantially all assets	Senior subordinated term loan, 11.00% due 12/31/2016	0.0	5.0
Progressive Logistics Services, LLC	Commercial Services (Georgia)	Senior secured debt	First priority lien on substantially all assets	Senior secured term loan A, 8.50% due 1/6/2016; senior secured term loan B, 14.50% due 1/6/2016	0.0	29.6
Progeion Holdings, Inc.	Consumer Services (Utah)	Senior secured debt	First priority lien on substantially all assets	Senior Secured Term Loan A, 10.75%, due 12/31/2014; Senior Secured Term Loan B, 10.75% due 12/31/2014	0.0	68.3
ROM Acquisition Corporation	Automobile (Missouri)	Revolving line of credit, senior secured debt and senior subordinated debt	First priority lien on all assets and stock	Revolving line of credit, 4.25% due 2/08/2013; Senior Secured Term Loan A, 4.25% due 2/08/2013; Senior Secured Term Loan B, 8% due 5/08/2013; Senior subordinated debt, 12.00% plus 3.00% PIK due 8/08/2013	0.0	17.4
Royal Adhesives & Sealants, LLC	Chemicals (Indiana)	Senior Subordinated debt	Subordinated lien on substantially all assets	Senior Subordinated debt, 12.00% plus 2.00% PIK due 11/29/2016	0.0	25.3
SG Acquisition, Inc	Insurance (Georgia)	Senior secured debt	First priority lien on substantially all assets	Senior secured term loan A, 8.50% due 3/18/2016; senior secured term loan B, 14.50% due 3/18/2016	0.0	60.4
Seaton Corp.	Business Services (Illinois)	Subordinated secured debt	Second priority lien on substantially all	Subordinated secured debt, 12.5% plus 2.00% PIK, due	0.0	6.8

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Shearer's Foods, Inc.	Food products (Ohio)	Junior secured debt and membership interests	assets Second priority lien on substantially all assets	3/14/2014 Membership interests; Junior secured debt, 12% plus 3.75% PIK due 3/31/2016	4.0	36.2
Skillsoft Public Limited Company	Software and computer services (Ireland)	Subordinated unsecured debt	Unsecured	Subordinated unsecured debt, 11.125% due 6/1/2018	0.0	15.0
Snacks Holding Corporation	Food Products (Minnesota)	Senior Subordinated debt, preferred stock and warrants	Unsecured	Warrants, expiring 11/12/2020; preferred shares; Senior Subordinated unsecured debt, 12.00% plus 1.00% PIK, due 11/12/2017	0.5	15.1

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Name of Portfolio Company	Nature of its Principal Business (Location)	Title and Class of Securities Held	Collateral Held	Investment Structure	Equity Securities Held, at Fair Value (In millions of \$)	Loans, at Fair Value (In millions of \$)
SonicWall Inc,	Software and computer services (California)	Subordinated secured debt	Second priority lien on substantially all assets	Subordinated secured debt 12% due 1/23/17	0.0	23.0
Springs Window Fashions, LLC	Durable Consumer Products (Wisconsin)	Second lien debt	Second lien on substantially all assets	Second lien term loan, 11.25% due 11/30/2017	0.0	35.0
ST Products, LLC	Manufacturing (Pennsylvania)	Senior secured debt	First priority lien on substantially all assets	Senior secured term loan, 12.00% due 6/16/2016	0.0	26.5
Stauber Performance Ingredients, Inc.	Food Products (California)	Senior secured debt	First priority lien on substantially all assets	Senior secured term loan, 10.50% due 1/21/2016	0.0	22.7
Stryker Energy LLC	Oil and gas production (Ohio)	Subordinated secured revolving credit facility and overriding royalty interest	Second priority lien on substantially all assets	Overriding royalty interest; Subordinated secured revolving credit facility, 8.5% plus 3.75% PIK due 12/01/2015	2.2	21.7
U.S. HealthWorks Holding Company, Inc.	Healthcare (California)	Second lien debt	Second priority lien on substantially all assets	Second lien term loan, 10.50% due 6/15/2017	0.0	25.0
Targus Group International, Inc.	Durable Consumer Products (California)	First lien debt	First priority lien on substantially all assets	First lien term loan, 11.00% due 5/25/2016	0.0	24.0
VPSI, Inc.	Transportation (Michigan)	Senior secured debt	First priority lien on substantially all assets	First Lien Senior secured note, 12.00% due 12/23/2015	0.0	17.6
Wind River Resources Corp. and Wind River II Corp.	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 on principal, 16% default interest on past due interest, in non-accrual status effective 12/01/2008, past due	0.0	7.2

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**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.



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**SALES OF COMMON STOCK BELOW NET ASSET VALUE**

At our 2010 annual meeting of stockholders held on December 10, 2010, our stockholders approved our ability to sell an unlimited number of shares of our common stock at any level of discount from 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 or sales manager or sales managers 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 of common stock, 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 may make sales of our common stock at prices below our most recently determined NAV per share. Pursuant to the approval of our Board of Directors, we have made such sales in the past and we may continue to do so under this prospectus.**

In making a determination that an offering below NAV per share is in our and our stockholders' best interests, our Board of Directors considers a variety of factors including matters such as:

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 of common stock 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 also considers 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 of common stock under a prospectus supplement to the registration statement (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 registration statement 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 per share at the time of the first offering is \$10.04 and we have 110.0 million shares of common stock outstanding, sale of 10.0 million shares of common stock at net proceeds to us of \$5.02 per share (an approximately 50% discount) would produce dilution of 4.17%. If we subsequently determined that our NAV per share increased back to \$10.00 on the then 120.0 million shares of common stock outstanding and then made an additional offering, we could, for example, sell approximately an additional 33.2 million shares of common stock



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at net proceeds to us of \$5.00 per share, which would produce dilution of 10.83%, 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 per share 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 of common stock in the offering;

existing shareholders who purchase a relatively small amount of shares of common stock in the offering or a relatively large amount of shares of common stock in the offering; and

new investors who become shareholders by purchasing shares of common stock in the offering.

The tables below provide hypothetical examples of the impact that an offering at a price less than NAV per share may have on the NAV per share of shareholders and investors who do and do not participate in such an offering. However, the tables below do not show and are not intended to show any potential changes in market price that may occur from an offering at a price less than NAV per share and it is not possible to predict any potential market price change that may occur from such an offering.

**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 of common stock 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 of common stock 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 stockholders may also experience a decline in the market price of their shares of common stock, 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 110.0 million common shares outstanding, \$1,554,400,000 in total assets and \$450,000,000 in total liabilities. The current NAV and NAV per share are thus \$1,104,400,000 and \$10.04. The chart illustrates the dilutive effect on Stockholder A of (1) an offering of 5,500,000 shares of common stock (5% of the outstanding shares of common stock) at \$9.54 per share after offering expenses and commission (a 5% discount from NAV), (2) an offering of 11,000,000 shares of common stock (10% of the outstanding shares of common stock) at \$9.04 per share after offering expenses and commissions (a 10% discount from NAV) and (3) an offering of 22,000,000

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shares of common stock (20% of the outstanding shares of common stock) at \$8.03 per share after offering expenses and commissions (a 20% discount from NAV).

	Prior to Sale Below NAV	Example 1 5% Offering at 5% Discount	% Change	Example 2 10% Offering at 10% Discount	% Change	Example 3 20% Offering at 20% Discount	% Change
<b>Offering Price</b>							
Price per Share to Public		\$ 10.03		\$ 9.46		\$ 8.39	
Net Proceeds per Share to Issuer		\$ 9.54		\$ 9.04		\$ 8.03	
<b>Decrease to NAV</b>							
Total Shares Outstanding	110,000,000	115,500,000	5.00%	121,000,000	10.00%	132,000,000	20.00%
NAV per Share	\$ 10.04	\$ 10.02	(0.24)%	\$ 9.95	(0.91)%	\$ 9.71	(3.33)%
<b>Dilution to Nonparticipating Stockholder</b>							
Shares Held by Stockholder A	110,000	110,000	0.00%	110,000	0.00%	110,000	0.00%
Percentage Held by Stockholder A	0.10%	0.10%	(4.76)%	0.09%	(9.09)%	0.08%	(16.67)%
Total NAV Held by Stockholder A	\$ 10.04	\$ 1,101,770	(0.24)%	\$ 1,094,360	(0.91)%	\$ 1,067,587	(3.33)%
Total Investment by Stockholder A (Assumed to be \$10.15 per Share)		\$ 1,104,400		\$ 1,104,400		\$ 1,104,400	
Total Dilution to Stockholder A (Total NAV Less Total Investment)		\$ (2,630)		\$ (10,040)		\$ (36,813)	
NAV per Share Held by Stockholder A		\$ 10.02		\$ 9.95		\$ 9.71	
Investment per Share Held by Stockholder A (Assumed to be \$10.15 per Share on Shares Held Prior to Sale)		\$ 10.04		\$ 10.04		\$ 10.04	
Dilution per Share Held by Stockholder A (NAV per Share Less Investment per Share)		\$ (0.02)		\$ (0.09)		\$ (0.33)	
Percentage Dilution to Stockholder A (Dilution per Share Divided by Investment per Share)			(0.24)%		(0.91)%		(3.33)%

**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 of common stock 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 of common stock immediately prior to the offering. The level of NAV dilution will decrease as the number of shares of common stock such stockholders purchase increases. Existing stockholders who buy more than such percentage will experience NAV dilution on their existing shares but will, in contrast to existing stockholders who purchase less than their proportionate share of the offering, experience an increase (often called accretion) in average 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 of common stock such stockholder purchases increases. Even a stockholder who over-participates 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 of common stock, which often reflects to some degree announced or potential 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 of common stock

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equal to (1) 50% of its proportionate share of the offering (i.e., 11,000 shares of common stock, which is 0.05% of an offering of 22,000,000 shares of common stock) rather than its 0.10% proportionate share and (2) 150% of such percentage (i.e. 33,000 shares of common stock, which is 0.15% of an offering of 22,000,000 shares of common stock rather than its 0.10% proportionate share). It is not possible to predict the level of market price decline that may occur.

	Prior to Sale Below NAV	50% Participation Following Sale	% Change	150% Participation Following Sale	% Change
<b>Offering Price</b>					
Price per Share to Public		\$ 8.39		\$ 8.39	
Net Proceeds per Share to Issuer		\$ 8.03		\$ 8.03	
<b>Decrease/Increase to NAV</b>					
Total Shares Outstanding	110,000,000	132,000,000	20.00%	132,000,000	20.00%
NAV per Share	\$ 10.04	\$ 9.71	(3.33)%	\$ 9.71	(3.33)%
<b>Dilution/Accretion to Participating Stockholder</b>					
Shares Held by Stockholder A	110,000	121,000	10.00%	143,000	30.00%
Percentage Held by Stockholder A	0.10%	0.09%	(8.33)%	0.11%	8.33%
Total NAV Held by Stockholder A	\$ 10.04	\$ 1,174,345	6.33%	\$ 1,387,863	25.67%
Total Investment by Stockholder A (Assumed to be \$10.15 per Share on Shares held Prior to Sale)		\$ 1,196,694		\$ 1,381,281	
Total Dilution/Accretion to Stockholder A (Total NAV Less Total Investment)		\$ (22,349)		\$ 6,582	
NAV per Share Held by Stockholder A		\$ 9.71		\$ 9.71	
Investment per Share Held by Stockholder A (Assumed to be \$10.15 on Shares Held Prior to Sale)		\$ 9.89		\$ 9.66	
Dilution/Accretion per Share Held by Stockholder A (NAV per Share Less Investment per Share)		\$ (0.18)		\$ 0.05	
Percentage Dilution/Accretion to Stockholder A (Dilution/Accretion per Share Divided by Investment per Share)			(1.87)%		0.48%
<b>Impact On New Investors</b>					

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 of common stock and their NAV per share compared to the price they pay for their shares of common stock. 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 of common stock and their NAV per share compared to the price they pay for their shares of common stock. 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 of common stock, 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

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percentage (0.10%) of the shares of common stock in the offering as Stockholder A in the prior examples held immediately prior to the offering. It is not possible to predict the level of market price decline that may occur.

	Prior to Sale Below NAV	Example 1 5% Offering at 5% Discount	% Change	Example 2 10% Offering at 10% Discount	% Change	Example 3 20% Offering at 20% Discount	% Change
<b>Offering Price</b>							
Price per Share to Public		\$ 10.03		\$ 9.46		\$ 8.39	
Net Proceeds per Share to Issuer		\$ 9.54		\$ 9.04		\$ 8.03	
<b>Decrease/Increase to NAV</b>							
Total Shares Outstanding	110,000,000	115,500,000	5.00%	121,000,000	10.00%	132,000,000	20.00%
NAV per Share	\$ 10.04	\$ 10.02	(0.24)%	\$ 9.95	(0.91)%	\$ 9.71	(3.33)%
<b>Dilution/Accretion to New Investor A</b>							
Shares Held by Investor A		5,500		11,000		22,000	
Percentage Held by Investor A	0.00%	0.00%		0.01%		0.02%	
Total NAV Held by Investor A	\$	\$ 55,089		\$ 109,436		\$ 213,517	
Total Investment by Investor A (At Price to Public)	\$	\$ 55,166		\$ 104,058		\$ 184,588	
Total Dilution/Accretion to Investor A (Total NAV Less Total Investment)	\$	\$ (77)		\$ 5,378		\$ 28,929	
NAV per Share Held by Investor A	\$	\$ 10.02		\$ 9.95		\$ 9.71	
Investment per Share Held by Investor A	\$	\$ 10.03		\$ 9.46		\$ 8.39	
Dilution/Accretion per Share Held by Investor A (NAV per Share Less Investment per Share)	\$	\$ (0.01)		\$ 0.49		\$ 1.32	
Percentage Dilution/Accretion to Investor A (Dilution/Accretion per Share Divided by Investment per Share)			(0.14)%		5.17%		15.67%

**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.

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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](http://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.

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**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 does not discuss any aspects of U.S. estate or gift tax or foreign, state or local tax. This summary assumes that investors hold our common stock as capital assets (within the meaning of the Code). This discussion is based upon the Code, Treasury regulations, and administrative and judicial interpretations thereof, each as of the date of this prospectus and all of which are subject to differing interpretation or 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. No assurance can be given that the IRS would not assert, or that a court would not sustain, a position contrary to the any of the tax aspects set forth below.

This summary does not discuss the consequences of an investment in shares of our preferred stock, debt securities or warrants representing rights to purchase shares of our common stock, preferred stock or debt securities, or units comprised of any of the foregoing. The tax consequences of such an investment will be discussed in a relevant prospectus supplement.

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 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.



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**Election To Be Taxed As A RIC**

As a business development company, we intend to qualify and continue to elect 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 (the Annual Distribution Requirement).

**Taxation As A RIC**

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) (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."

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 asset diversification tests. If the partnership is a "qualified publicly traded partnership," the net income derived from such partnership will be qualifying income for purposes of the 90% Income Test, and interests in the partnership will be "securities" for purposes of the diversification tests. 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.

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.

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Federal income tax, and could result in a reduced after-tax yield on the portion of our assets held by such corporation.

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 investment company taxable income and net 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 unless we distribute during each calendar year an amount at least equal to the sum of (1) 98% of our ordinary income for the calendar year and (2) 98.2% 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 addition, the minimum amounts that must be distributed in any year to avoid the excise tax will be increased or decreased to reflect any under-distribution or over-distribution, as the case may be, from the previous year.

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. No additional excise taxes have been paid or accrued since that time.

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, 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. As a RIC, 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.

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. 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 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 we be required to make distributions. Distributions would generally be taxable to our individual and other non-corporate taxable stockholders as ordinary dividend income eligible for the reduced maximum rate for taxable years beginning before 2013 (but not for taxable years beginning thereafter, unless the relevant provisions are extended by legislation) to the extent of our current and accumulated earnings and profits, provided certain holding period and other requirements are met. Subject to certain limitations under the Code,

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corporate distributees would be eligible for the dividends-received deduction. To qualify again to be taxed as a RIC in a subsequent year, we would be required to distribute to our stockholders our accumulated earnings and profits attributable to non-RIC years reduced by an interest charge on 50% of such earnings and profits payable by us as an additional tax. In addition, if we failed to qualify as a RIC for a period greater than two taxable years, then, in order to qualify as a RIC in a subsequent year, we would be required to elect to recognize and pay tax on any net built-in gain (the excess of aggregate gain, including items of income, over aggregate loss that would have been realized if we had been liquidated) or, alternatively, be subject to taxation on such built-in gain recognized for a period of ten 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.

We may invest in preferred securities or other securities the U.S. Federal income tax treatment of which may be unclear 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 and accumulated earnings and profits, whether paid in cash or reinvested in additional common stock. Distributions of our net capital gain (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, regardless of the U.S. Stockholder's holding period for 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. Dividends distributed by us generally will not be eligible for the dividends-received deduction or the preferential rate applicable to so-called qualified dividend income.

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, and 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 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 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 its common stock. Since we expect to pay tax on any retained capital gains at our regular

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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 such U.S. Stockholder's liability for U.S. Federal income tax. A U.S. 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 a U.S. Stockholder 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 its investment.

A U.S. Stockholder generally will recognize taxable gain or loss if such U.S. Stockholder sells or otherwise disposes of its shares of our common stock. Any gain or loss arising from such sale or taxable disposition generally will be treated as long-term capital gain or loss if the U.S. Stockholder has held 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 taxable 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 taxable 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. Capital losses are deductible only to the extent of capital gains (subject to an exception for individuals under which a limited amount of capital losses may be offset against ordinary income).

In general, individual U.S. Stockholders currently are subject to a preferential rate 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 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 ordinary income rates. For tax years beginning after December 31, 2012, the U.S. Federal tax rates applicable to ordinary income and capital gain for individuals will increase unless further Congressional action is taken.

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 amount and the U.S. federal tax status of each year's distributions generally will be reported to the IRS. Distributions may also be subject to additional state, local and foreign taxes depending on a U.S. Stockholder's particular situation.

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Payments of dividends, including deemed payments of constructive dividends, or the proceeds of the sale or other taxable disposition of our common stock generally are subject to information reporting unless the U.S. Stockholder is an exempt recipient. Such payments may also be subject to U.S. federal backup withholding at the applicable rate if the recipient of such payment fails to supply a taxpayer identification number and otherwise comply with the rules for establishing an exemption from backup withholding. Backup withholding is not an additional tax, and any amounts withheld under the backup withholding rules generally will be allowed as a refund or credit against the holder's U.S. Federal income tax liability, provided that certain information is provided timely to the IRS.

**Taxation Of Non-U.S. Stockholders**

Whether an investment in our common stock is appropriate for a Non-U.S. Stockholder will depend upon that person's particular circumstances. An investment in our common stock 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 conducted 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 applicable treaty rate) to the extent of our current and accumulated earnings and profits.

For our taxable years beginning before January 1, 2012, properly designated distributions to Non-U.S. Stockholders are generally exempt from U.S. federal withholding tax where they (i) are paid in respect of our "qualified net interest income" (generally, our U.S.-source interest income, other than certain contingent interest and interest from obligations of a corporation or partnership in which we are at least a 10% shareholder, reduced by expenses that are allocable to such income) or (ii) are paid in respect of our "qualified short-term capital gains" (generally, the excess of our net short-term capital gain over our long-term capital loss for such taxable year). Depending on the circumstances, however, we may designate all, some or none of our potentially eligible distributions as such qualified net interest income or as qualified short-term capital gains, and/or treat such distributions, in whole or in part, as ineligible for this exemption from withholding. In order to qualify for this exemption from withholding, a Non-U.S. Stockholder will need to comply with applicable certification requirements relating to its non-U.S. status (including, in general, furnishing an IRS Form W-8BEN or substitute Form). In the case of our shares held through an intermediary, the intermediary may withhold even if we designate the payment as qualified net interest income or qualified short-term capital gain. Non-U.S. Stockholders should contact their intermediaries with respect to the application of these rules to their accounts. There can be no assurance as to what portion of our distributions will qualify for favorable treatment as qualified net interest income or qualified short-term capital gains.

Actual or deemed distributions of our net capital gain to a Non-U.S. Stockholder, and gains recognized 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 conducted 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 U.S. for 183 or more days during the taxable year and meets certain other requirements. A Non-U.S. Stockholder that is so present in the U.S. will be subject to tax as described in the following paragraph.

Distributions of our investment company taxable income and net capital gain (including deemed distributions) to Non-U.S. Stockholders, and gains recognized by Non-U.S. Stockholders upon the sale of our common stock, that are effectively connected with a U.S. trade or business conducted by the Non-U.S. Stockholder will be subject to U.S. Federal income tax at the graduated rates applicable to U.S. citizens, residents and domestic corporations. In addition, if such Non-U.S. Stockholder is a foreign corporation, it may also be subject to a 30% (or lower applicable treaty rate) branch profits tax

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on its effectively connected earnings and profits for the taxable year, subject to adjustments, if its investment in our common stock is effectively connected with its conduct of a U.S. trade or business.

If we distribute our net capital gain 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.

In addition, after December 31, 2013, withholding at a rate of 30% will be required on dividends in respect of, and after December 31, 2014, withholding at a rate of 30% will be required on gross proceeds from the sale of, shares of our stock held by or through certain foreign financial institutions (including investment funds), unless such institution enters into an agreement with the Secretary of the Treasury to report, on an annual basis, information with respect to shares in, and accounts maintained by, the institution to the extent such shares or accounts are held by certain U.S. persons or by certain non-U.S. entities that are wholly or partially owned by U.S. persons. Accordingly, the entity through which our shares are held will affect the determination of whether such withholding is required. Similarly, dividends in respect of, and gross proceeds from the sale of, our shares held by an investor that is a non-financial non-U.S. entity will be subject to withholding at a rate of 30%, unless such entity either (i) certifies to us that such entity does not have any "substantial U.S. owners" or (ii) provides certain information regarding the entity's "substantial U.S. owners," which we will in turn provide to the Secretary of the Treasury. Non-U.S. Stockholders are encouraged to consult with their tax advisers regarding the possible implications of the legislation on their investment in our common stock.

A Non-U.S. Holder generally will be required to comply with certain certification procedures to establish that such holder is not a U.S. person in order to avoid backup withholding with respect to payments of dividends, including deemed payments of constructive dividends, or the proceeds of a disposition of our common stock. In addition, we are required to annually report to the IRS and each Non-U.S. Holder the amount of any dividends or constructive dividends treated as paid to such Non-U.S. Holder, regardless of whether any tax was actually withheld. Copies of the information returns reporting such dividend or constructive dividend payments and the amount withheld may also be made available to the tax authorities in the country in which a Non-U.S. Holder resides under the provisions of an applicable income tax treaty. Backup withholding is not an additional tax, and any amounts withheld under the backup withholding rules generally will be allowed as a refund or credit against a Non-U.S. Holder's U.S. Federal income tax liability, if any, provided that certain required information is provided timely to the IRS.

Non-U.S. persons should consult their tax advisers with respect to the U.S. Federal income tax and withholding tax, and state, local and foreign tax consequences of an investment in our common stock.

**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 advisers concerning the tax considerations relevant to their particular situation.

Table of Contents**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 200,000,000 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. Our Board of Directors will only take such actions in accordance with Section 18 as modified by Section 61 of the 1940 Act. The 1940 Act limits business development companies to only one class or series of common stock and only one class of preferred stock. 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 October 6, 2011:

(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	200,000,000	0	109,417,083

***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.

***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

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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.



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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 the affirmative vote of holders 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

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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 redeem 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 redeem 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

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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 such business combination 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 provides various exemptions from its provisions, including for 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.

***Conflicts 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 2013 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 to hold office for a term expiring at the annual meeting of stockholders held in the third 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. 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.

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***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

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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.

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**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**

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We currently have the Notes outstanding. However, we may issue additional debt securities in one or more series in the future 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. The prospectus supplement may or may not modify the general terms found in this prospectus and will be filed with the SEC. For

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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 description below is a summary with respect to future debt securities we may issue and not a summary of the Notes. Please see "Business General Notes" for a description of the Notes.

As required by federal law for all bonds and notes of companies that are publicly offered, the debt securities are governed by a document called an "indenture." An indenture is a contract between us and American Stock Transfer & Trust Company, LLC, a financial institution acting as trustee on your behalf, and is subject to and governed by the Trust Indenture Act of 1939, as amended. The trustee has two main roles. First, the trustee can enforce your rights against us if we default. There are some limitations on the extent to which the trustee acts on your behalf, described in the second paragraph under "Events of Default Remedies if an Event of Default Occurs." Second, the trustee performs certain administrative duties for us.

Because this section is a summary, it does not describe every aspect of the debt securities and the indenture. We urge you to read the indenture because it, and not this description, defines your rights as a holder of debt securities. For example, in this section, we use capitalized words to signify terms that are specifically defined in the indenture. Some of the definitions are repeated in this prospectus, but for the rest you will need to read the indenture. We have filed the form of the indenture with the SEC. See "Available Information" for information on how to obtain a copy of the indenture.

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;

whether the amount of payments of principal, premium or interest, if any, on a series of debt securities will be determined with reference to an index, formula or other method (which could be based on one or more currencies, commodities, equity indices or other indices) and how these amounts will be determined;

the place or places, if any, other than or in addition to The City of New York, of payment, transfer, conversion and/or exchange of the debt securities;



the denominations in which the offered debt securities will be issued;

the provision for any sinking fund;

any restrictive covenants;

any events of default;

whether the series of debt securities are issuable in certificated form;

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any provisions for defeasance or covenant defeasance;

any special federal income tax implications, including, if applicable, federal income tax considerations relating to original issue discount;

whether and under what circumstances we will pay additional amounts in respect of any tax, assessment or governmental charge and, if so, whether we will have the option to redeem the debt securities rather than pay the additional amounts (and the terms of this option);

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; 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 BDC, 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.

**General**

The indenture provides that any debt securities proposed to be sold under this prospectus and the attached prospectus supplement ("offered debt securities") and any debt securities issuable upon the exercise of warrants or upon conversion or exchange of other offered securities ("underlying debt securities"), may be issued under the indenture in one or more series.

For purposes of this prospectus, any reference to the payment of principal of or premium or interest, if any, on debt securities will include additional amounts if required by the terms of the debt securities.

The indenture limits the amount of debt securities that may be issued thereunder from time to time. Debt securities issued under the indenture, when a single trustee is acting for all debt securities issued under the indenture, are called the "indenture securities." The indenture also provides that there may be more than one trustee thereunder, each with respect to one or more different series of indenture securities. See "Resignation of Trustee" below. At a time when two or more trustees are acting under the indenture, each with respect to only certain series, the term "indenture securities" means the one or more series of debt securities with respect to which each respective trustee is acting. In the event that there is more than one trustee under the indenture, the powers and trust obligations of each trustee described in this prospectus will extend only to the one or more series of indenture securities for which it is trustee. If two or more trustees are acting under the indenture, then the indenture securities for which each trustee is acting would be treated as if issued under separate indentures.

The indenture does not contain any provisions that give you protection in the event we issue a large amount of debt.

We refer you to the prospectus supplement for information with respect to any deletions from, modifications of or additions to the Events of Default or our covenants that are described below, including any addition of a covenant or other provision providing event risk or similar protection.

We have the ability to issue indenture securities with terms different from those of indenture securities previously issued and, without the consent of the holders thereof, to reopen a previous issue



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of a series of indenture securities and issue additional indenture securities of that series unless the reopening was restricted when that series was created.

**Conversion and Exchange**

If any debt securities are convertible into or exchangeable for other securities, the prospectus supplement will explain the terms and conditions of the conversion or exchange, including the conversion price or exchange ratio (or the calculation method), the conversion or exchange period (or how the period will be determined), if conversion or exchange will be mandatory or at the option of the holder or us, provisions for adjusting the conversion price or the exchange ratio and provisions affecting conversion or exchange in the event of the redemption of the underlying debt securities. These terms may also include provisions under which the number or amount of other securities to be received by the holders of the debt securities upon conversion or exchange would be calculated according to the market price of the other securities as of a time stated in the prospectus supplement.

**Issuance of Securities in Registered Form**

We may issue the debt securities in registered form, in which case we may issue them either in book-entry form only or in "certificated" form. Debt securities issued in book-entry form will be represented by global securities. We expect that we will usually issue debt securities in book-entry only form represented by global securities.

We also will have the option of issuing debt securities in non-registered form as bearer securities if we issue the securities outside the United States to non-U.S. persons. In that case, the prospectus supplement will set forth the mechanics for holding the bearer securities, including the procedures for receiving payments, for exchanging the bearer securities, including the procedures for receiving payments, for exchanging the bearer securities for registered securities of the same series, and for receiving notices. The prospectus supplement will also describe the requirements with respect to our maintenance of offices or agencies outside the United States and the applicable U.S. federal tax law requirements.

**Book-Entry Holders**

We will issue registered debt securities in book-entry form only, unless we specify otherwise in the applicable prospectus supplement. This means debt securities will be represented by one or more global securities registered in the name of a depository that will hold them on behalf of financial institutions that participate in the depository's book-entry system. These participating institutions, in turn, hold beneficial interests in the debt securities held by the depository or its nominee. These institutions may hold these interests on behalf of themselves or customers.

Under the indenture, only the person in whose name a debt security is registered is recognized as the holder of that debt security. Consequently, for debt securities issued in book-entry form, we will recognize only the depository as the holder of the debt securities and we will make all payments on the debt securities to the depository. The depository will then pass along the payments it receives to its participants, which in turn will pass the payments along to their customers who are the beneficial owners. The depository and its participants do so under agreements they have made with one another or with their customers; they are not obligated to do so under the terms of the debt securities.

As a result, investors will not own debt securities directly. Instead, they will own beneficial interests in a global security, through a bank, broker or other financial institution that participates in the depository's book-entry system or holds an interest through a participant. As long as the debt securities are represented by one or more global securities, investors will be indirect holders, and not holders, of the debt securities.

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**Street Name Holders**

In the future, we may issue debt securities in certificated form or terminate a global security. In these cases, investors may choose to hold their debt securities in their own names or in "street name." Debt securities held in street name are registered in the name of a bank, broker or other financial institution chosen by the investor, and the investor would hold a beneficial interest in those debt securities through the account he or she maintains at that institution.

For debt securities held in street name, we will recognize only the intermediary banks, brokers and other financial institutions in whose names the debt securities are registered as the holders of those debt securities and we will make all payments on those debt securities to them. These institutions will pass along the payments they receive to their customers who are the beneficial owners, but only because they agree to do so in their customer agreements or because they are legally required to do so. Investors who hold debt securities in street name will be indirect holders, and not holders, of the debt securities.

**Legal Holders**

Our obligations, as well as the obligations of the applicable trustee and those of any third parties employed by us or the applicable trustee, run only to the legal holders of the debt securities. We do not have obligations to investors who hold beneficial interests in global securities, in street name or by any other indirect means. This will be the case whether an investor chooses to be an indirect holder of a debt security or has no choice because we are issuing the debt securities only in book-entry form.

For example, once we make a payment or give a notice to the holder, we have no further responsibility for the payment or notice even if that holder is required, under agreements with depository participants or customers or by law, to pass it along to the indirect holders but does not do so. Similarly, if we want to obtain the approval of the holders for any purpose (for example, to amend an indenture or to relieve us of the consequences of a default or of our obligation to comply with a particular provision of an indenture), we would seek the approval only from the holders, and not the indirect holders, of the debt securities. Whether and how the holders contact the indirect holders is up to the holders.

When we refer to you, we mean those who invest in the debt securities being offered by this prospectus, whether they are the holders or only indirect holders of those debt securities. When we refer to your debt securities, we mean the debt securities in which you hold a direct or indirect interest.

*Special Considerations for Indirect Holders*

If you hold debt securities through a bank, broker or other financial institution, either in book-entry form or in street name, we urge you to check with that institution to find out:

how it handles securities payments and notices,

whether it imposes fees or charges,

how it would handle a request for the holders' consent, if ever required,

whether and how you can instruct it to send you debt securities registered in your own name so you can be a holder, if that is permitted in the future for a particular series of debt securities,

how it would exercise rights under the debt securities if there were a default or other event triggering the need for holders to act to protect their interests, and

if the debt securities are in book-entry form, how the depository's rules and procedures will affect these matters.



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**Global Securities**

As noted above, we usually will issue debt securities as registered securities in book-entry form only. A global security represents one or any other number of individual debt securities. Generally, all debt securities represented by the same global securities will have the same terms.

Each debt security issued in book-entry form will be represented by a global security that we deposit with and register in the name of a financial institution or its nominee that we select. The financial institution that we select for this purpose is called the depository. Unless we specify otherwise in the applicable prospectus supplement, The Depository Trust Company, New York, New York, known as DTC, will be the depository for all debt securities issued in book-entry form.

A global security may not be transferred to or registered in the name of anyone other than the depository or its nominee, unless special termination situations arise. We describe those situations below under "Special Situations when a Global Security Will Be Terminated". As a result of these arrangements, the depository, or its nominee, will be the sole registered owner and holder of all debt securities represented by a global security, and investors will be permitted to own only beneficial interests in a global security. Beneficial interests must be held by means of an account with a broker, bank or other financial institution that in turn has an account with the depository or with another institution that has an account with the depository. Thus, an investor whose security is represented by a global security will not be a holder of the debt security, but only an indirect holder of a beneficial interest in the global security.

*Special Considerations for Global Securities*

As an indirect holder, an investor's rights relating to a global security will be governed by the account rules of the investor's financial institution and of the depository, as well as general laws relating to securities transfers. The depository that holds the global security will be considered the holder of the debt securities represented by the global security.

If debt securities are issued only in the form of a global security, an investor should be aware of the following:

An investor cannot cause the debt securities to be registered in his or her name, and cannot obtain certificates for his or her interest in the debt securities, except in the special situations we describe below.

An investor will be an indirect holder and must look to his or her own bank or broker for payments on the debt securities and protection of his or her legal rights relating to the debt securities, as we describe under "Issuance of Securities in Registered Form" above.

An investor may not be able to sell interests in the debt securities to some insurance companies and other institutions that are required by law to own their securities in non-book-entry form.

An investor may not be able to pledge his or her interest in a global security in circumstances where certificates representing the debt securities must be delivered to the lender or other beneficiary of the pledge in order for the pledge to be effective.

The depository's policies, which may change from time to time, will govern payments, transfers, exchanges and other matters relating to an investor's interest in a global security. We and the trustee have no responsibility for any aspect of the depository's actions or for its records of ownership interests in a global security. We and the trustee also do not supervise the depository in any way.

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If we redeem less than all the debt securities of a particular series being redeemed, DTC's practice is to determine by lot the amount to be redeemed from each of its participants holding that series.

An investor is required to give notice of exercise of any option to elect repayment of its debt securities, through its participant, to the applicable trustee and to deliver the related debt securities by causing its participant to transfer its interest in those debt securities, on DTC's records, to the applicable trustee.

DTC requires that those who purchase and sell interests in a global security deposited in its book-entry system use immediately available funds. Your broker or bank may also require you to use immediately available funds when purchasing or selling interests in a global security.

Financial institutions that participate in the depositary's book-entry system, and through which an investor holds its interest in a global security, may also have their own policies affecting payments, notices and other matters relating to the debt securities. There may be more than one financial intermediary in the chain of ownership for an investor. We do not monitor and are not responsible for the actions of any of those intermediaries.

*Special Situations when a Global Security will be Terminated*

In a few special situations described below, a global security will be terminated and interests in it will be exchanged for certificates in non-book-entry form (certificated securities). After that exchange, the c