PROSPECT CAPITAL CORP
Form N-14 8C/A
February 28, 2014

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As filed with the Securities and Exchange Commission on February 28, 2014

Registration No. 333-193344

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form N-14

REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933
Pre-Effective Amendment No. 1 ý
Post-Effective Amendment No. o
(Check appropriate box or boxes)

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)

Telephone Number: (212) 448-0702
(Area Code and Telephone Number)

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 to:

Richard T. Prins, Esq.
Skadden, Arps, Slate, Meagher & Flom LLP
Four Times Square
New York, New York 10036
Telephone: (212) 735-5000
Facsimile: (212) 777-2790

Todd B. Pfister
Foley & Lardner LLP
321 North Clark Street, Suite 2800
Chicago, Illinois 60654
Telephone: (312) 832-4579
Facsimile: (312) 832-4700

Approximate Date of Proposed Public Offering:
As soon as practicable after this registration statement becomes effective and upon completion of the arrangement described in the enclosed documents.

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount to be Registered(1)	Proposed Maximum Offering Price per Unit	Proposed Maximum Aggregate Offering Price(2)	Amount of Registration Fee
Common Stock, $0.001 par value per share	21,703,607 shares	N/A	$195,332,464.00	$25,158.82(3)

(1) The number of shares to be registered represents an estimate of the maximum number of shares of the registrant's common stock issuable in connection with the arrangement agreement described in the enclosed documents. The estimate was calculated assuming $9.00 is the volume-weighted average price ("VWAP") of the registrant's common stock for the 20 trading days prior to and ending on the trading day immediately preceding the effective time of the arrangement described in the enclosed documents. The actual VWAP used may be higher and therefore the actual number of shares issued pursuant to the arrangement may be less than the number of shares being registered.

(2) Estimated solely for the purpose of calculating the registration fee and calculated pursuant to Rules 457(c) and 457(f)(1) under the Securities Act of 1933, the proposed maximum aggregate offering price is equal to $195,332,464.00, which is $16.00 multiplied by 12,208,279, the maximum expected number of shares outstanding for Nicholas Financial, Inc. as of the effective time as defined in the arrangement agreement.

(3) Previously paid in connection with the initial filing of this registration statement on January 13, 2014.

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 this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until the Registration Statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

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SUBJECT TO COMPLETION DATED FEBRUARY 28, 2014

Information contained herein is subject to completion or amendment. A registration statement relating to these securities has been filed with the United States Securities and Exchange Commission. These securities may not be sold nor may offers to buy be accepted prior to the time the registration statement becomes effective. This document shall not constitute an offer to sell or the solicitation of any offer to buy nor shall there be any sale of these securities in any jurisdiction in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of any such jurisdiction.

ARRANGEMENT PROPOSED YOUR VOTE IS VERY IMPORTANT

Dear Nicholas Financial, Inc. shareholders and optionholders:

On behalf of the board of directors of Nicholas Financial, Inc. (the "Company" or "Nicholas Financial-Canada"), we are pleased to enclose this proxy circular/prospectus relating to the arrangement pursuant to which Prospect Capital Corporation ("Prospect") will acquire the Company.

In connection with the transaction, shareholders and optionholders of the Company are cordially invited to attend a special meeting of the shareholders and optionholders of the Company to be held on [ ] [ ], 2014 at [ ] a.m., local time, at the Company's corporate headquarters, located at 2454 McMullen Booth Road, Building C, Clearwater, Florida (the "special meeting").

At the special meeting, holders of Nicholas Financial-Canada Common Shares and options will be asked to adopt a special resolution approving the arrangement and the arrangement agreement (including the plan of arrangement attached thereto) with Prospect (the "Arrangement Resolution").

The Company's board of directors, including its independent directors, has reviewed and considered the terms of the arrangement and the arrangement agreement and has unanimously determined that the arrangement agreement and the transactions contemplated by the arrangement agreement, including the arrangement, are fair to shareholders and optionholders of Nicholas Financial-Canada and in the best interests of Nicholas Financial-Canada and unanimously recommends that Nicholas Financial-Canada's shareholders and optionholders vote *FOR* the Arrangement Resolution and thereby approve the arrangement.

The Arrangement Resolution must be approved by at least three-quarters (75%) of the votes cast by Nicholas Financial-Canada shareholders, as well as at least three-quarters (75%) of the votes cast by Nicholas Financial-Canada shareholders and optionholders (voting together as a group). Holders may vote either in person or by proxy at the special meeting and will be entitled to one vote for each share held and one vote for each share the holder has an option to acquire.

If the arrangement is completed, each outstanding Common Share of Nicholas Financial-Canada will be converted into the right to receive the number of shares of common stock of Prospect determined by dividing $16.00 by the volume-weighted average price ("VWAP") of Prospect common stock for the 20 trading days prior to and ending on the trading day immediately preceding the effective time of the arrangement. Each option to acquire shares of Nicholas Financial-Canada common stock outstanding immediately prior to the effective time of the arrangement will be cancelled or transferred by the holder thereof in exchange for a cash amount equal to the amount by which (i) the product obtained by multiplying (x) the number of Common Shares of Nicholas Financial-Canada underlying such option by (y) $16.00 exceeds (ii) the aggregate exercise price payable under such option. As of February 25, 2014, the last reported sales price for Prospect common stock was $11.03.

Upon completion of the transaction, assuming the VWAP of Prospect's common stock for the 20 trading days prior to and ending on the record date, which was $[ ], is the same as the VWAP used to determine the conversion rate, Prospect's stockholders immediately prior to the closing of the arrangement will own approximately [ ]% of Prospect's outstanding stock and former Nicholas Financial-Canada shareholders will own approximately [ ]% of Prospect's outstanding stock. Prospect common stock is traded on The NASDAQ Global Select Market under the symbol "PSEC."

Prospect is a financial services company that primarily lends to and invests in middle market privately-held companies. Prospect, a Maryland corporation, has been 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 (the "1940 Act"), and is a non-diversified investment company within the meaning of the 1940 Act.

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Common Shares of Nicholas Financial-Canada are traded on The NASDAQ Global Select Market under the symbol "NICK." As of February 25, 2014, the last reported sales price for the Nicholas Financial-Canada's Common Shares was $15.69.

Because of variable elements that will not be known until immediately prior to the consummation of the arrangement, at the time they vote on the Arrangement Resolution, holders of Nicholas Financial-Canada Common Shares will not know the exact number of shares of Prospect common stock that they will receive in the arrangement. Based on the formula that will be used to determine that number, the value of such Prospect common stock is expected to be equal to $16.00 per Common Share of Nicholas Financial-Canada; however, the actual value of shares of Prospect common stock received may be greater than or less than $16.00 on the day of the effective time of the arrangement.

We urge you to read the accompanying proxy circular/prospectus, which includes important information about the arrangement and the special meeting of the Company's shareholders and optionholders. In particular, see "Risks Related to the Arrangement" beginning on page 25 of the accompanying proxy circular/prospectus which contains a description of the risks that you should consider in evaluating the transaction.

Your vote is very important. Whether or not you expect to attend the special meeting of the Company, the details of which are described in the accompanying proxy circular/prospectus, please vote immediately. If you are a shareholder, you may vote by submitting your proxy by telephone or the Internet or by completing, signing, dating and returning your signed proxy card(s) in the enclosed prepaid return envelope. If you are an optionholder, you may vote by completing, signing, dating and returning your signed proxy card(s) in the enclosed prepaid return envelope.

If shareholders or optionholders of the Company have any questions or require assistance in voting their securities, they should call [ ] at 1-[ ]-[ ]-[ ].

Sincerely,

Peter L. Vosotas
Chairman of the Board, Chief Executive Officer and President

The accompanying proxy circular/prospectus contains important information about Prospect that you should know before voting to approve the Arrangement Resolution. Please read it before voting and keep it for future reference. Prospect files annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission. You may obtain such information free of charge by writing to Prospect at its principal executive offices, located at 10 East 40th Street, 44th Floor, New York, NY 10016, or by calling 212-448-0702.

Neither the United States Securities and Exchange Commission nor any state securities commission has approved or disapproved of the transaction described in the proxy circular/prospectus or the securities to be issued pursuant to the transaction described in the proxy circular/prospectus or determined if the proxy circular/prospectus is accurate or adequate. Any representation to the contrary is a criminal offense.

The accompanying proxy circular/prospectus is dated , 2014 and is first being mailed to the Company's shareholders and optionholders on or about , 2014.

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NICHOLAS FINANCIAL, INC.

Building C
2454 McMullen Booth Road
Clearwater, FL 33759-1343
(727) 726-0763

NOTICE OF SPECIAL MEETING OF SECURITYHOLDERS
TO BE HELD ON [ ] [ ], 2014

To the shareholders and optionholders of Nicholas Financial, Inc. (the "Company" or "Nicholas Financial-Canada"):

A special meeting of the holders of Nicholas Financial-Canada Common Shares and options will be held at Nicholas Financial-Canada's corporate headquarters, located at 2454 McMullen Booth Road, Building C, Clearwater, Florida, on [ ], [ ], 2014, at [ ] a.m., local time, for the following purposes:

1. To consider, pursuant to an interim order of the British Columbia Supreme Court, dated [ ] [ ], 2014, as the same may be amended (sometimes referred to as the "Interim Order"), and, if deemed advisable, to pass, with or without variation, a special resolution, the full text of which is attached to the accompanying proxy circular/prospectus as Annex A (sometimes referred to as the "Arrangement Resolution"), to approve an arrangement under the provisions of Division 5 of Part 9 of the *Business Corporations Act* (British Columbia) involving, among other things, the acquisition by a portfolio company of Prospect Capital Corporation ("Prospect") of all of the issued and outstanding Common Shares of Nicholas Financial-Canada; and

2. To transact such other business as may properly come before the special meeting or any postponement(s) or adjournment(s) of the special meeting.

The full text of the Arrangement Resolution is set out in Annex A to the accompanying proxy circular/prospectus. The Arrangement Resolution must be approved by at least three-quarters (75%) of the votes cast by shareholders, as well as at least three-quarters (75%) of the votes cast by shareholders and optionholders of the Company voting together as a group (collectively, the "Securityholders"). Holders may vote in person or by proxy at the special meeting and will be entitled to one vote for each share held and one vote for each share the holder has an option to acquire. The arrangement is described in the accompanying proxy circular/prospectus, which serves as (i) Nicholas Financial-Canada's management proxy circular in connection with management's solicitation of proxies, and (ii) a prospectus of Prospect relating to its issuance of common stock in connection with the arrangement.

The Company's board of directors unanimously recommends that you vote FOR the Arrangement Resolution. Securityholders of record as of [ ], 2014, the record date for the special meeting, will be entitled to vote at the meeting and at any postponement or adjournment thereof.

All registered Securityholders, whether or not they expect to be present at the meeting, are requested to sign, date, and mail the accompanying proxy in the envelope provided for this purpose or, if they are a shareholder, by following the procedures for either telephone or Internet voting provided in the accompanying proxy circular/prospectus. **Proxies must be received by the Company's transfer agent, Computershare Investor Services Inc. (Attention: Proxy Department, [ ], or by fax to Nicholas Financial, Inc., c/o Computershare Investor Services Inc. at ([ ]) [ ]-[ ] or 1-[ ]-[ ]-[ ] or by Internet at www.[ ].com), before 5:00 p.m. (Eastern Time), on [ ][ ], 2014 (or the date that is two days, excluding Saturdays, Sundays and holidays, prior to the date set for any postponement or adjournment of the original meeting)**.

If you are a non-registered, beneficial shareholder, you must follow the instructions provided by your broker, investment dealer, bank, trust company or other intermediary to ensure that your vote is counted at the special meeting.

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TAKE NOTICE that in accordance with the Interim Order, registered holders of Nicholas Financial-Canada Common Shares and options have a right to dissent from the arrangement and to be paid an amount equal to the fair value of their shares or options, as applicable. This right is described in the accompanying proxy circular/prospectus. **Failure to comply strictly with the dissent procedures may result in the loss or unavailability of the right to dissent**. See "The Special Meeting Dissent Rights" in the accompanying proxy circular/prospectus.

If you have any questions or require more information regarding the procedures for voting or completing your proxy or transmittal documentation, please contact [ ]at 1-[ ]-[ ]- [ ].

By Order of the Board of Directors

Ralph T. Finkenbrink
Secretary

In the accompanying proxy circular/prospectus, references to "$" refer to United States dollars, unless otherwise noted.

REFERENCES TO ADDITIONAL INFORMATION

Prospect has filed a registration statement on Form N-14 to register with the United States Securities and Exchange Commission (the "SEC") the Prospect common stock, par value $0.001 per share ("Prospect common stock"), to be issued to the Company's shareholders upon consummation of the arrangement. The accompanying proxy circular/prospectus is a part of that registration statement and constitutes a prospectus of Prospect in addition to being a proxy circular of the Company for its special meeting. As allowed by SEC rules, this proxy circular/prospectus does not contain all the information you can find in the registration statement or the exhibits to the registration statement.

The accompanying proxy circular/prospectus incorporates important business and financial information about Prospect and the Company from other documents that are not included in or delivered with this proxy circular/prospectus. This information is available to you without charge upon your written or oral request. You can obtain copies of the accompanying proxy circular/prospectus, as well as the documents incorporated by reference into the accompanying proxy circular/prospectus through the SEC website at www.sec.gov, or by requesting them in writing or by telephone from the appropriate company at the following addresses and telephone numbers:

Prospect Capital Corporation	**Nicholas Financial, Inc.**
Attention: Brian H. Oswald	Attention: Ralph T. Finkenbrink
10 East 40th Street, 44th Floor	2454 McMullen Booth Road, Building C
New York, New York 10016	Clearwater, Florida 33759
(212) 448-0702	(727) 726-0763

If you would like to request documents, please do so by [ ] [ ], 2014, in order to receive them before the Company's special meeting.

See "Where You Can Find More Information" beginning on page 324 of the accompanying proxy circular/prospectus.

SUBMITTING PROXIES BY MAIL, TELEPHONE OR INTERNET

Nicholas Financial-Canada shareholders of record may submit their proxies:

- by telephone, by calling the toll-free number 1-[ ]-[ ]-[ ] on a touch-tone phone and following the recorded instructions;

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by accessing the Internet website at www.[ ].com and following the instructions on the website; or

by mail, by indicating their voting preference on the proposals on each proxy card received, signing and dating each proxy card and returning each proxy card in the prepaid envelope that accompanied that proxy card.

Nicholas Financial-Canada optionholders may submit their proxies by mail, by indicating their voting preference on the proposals on each proxy card received, signing and dating each proxy card and returning each proxy card in the prepaid envelope that accompanied that proxy card.

Shareholders of the Company whose Common Shares are held in "street name" must provide their brokers with instructions on how to vote their shares; otherwise, their brokers will not vote their shares on any resolution before the special meeting. Shareholders should check the voting form provided by their brokers for instructions on how to vote their shares.

The accompanying proxy circular/prospectus does not constitute an offer to sell, or a solicitation of an offer to purchase, any securities, or the solicitation of a proxy, by any person in any jurisdiction in which such an offer or solicitation is not authorized or in which the person making the offer or solicitation is not qualified to do so or to any person to whom it is unlawful to make such an offer or solicitation.

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QUESTIONS AND ANSWERS ABOUT THE PROPOSED ARRANGEMENT

Q:

When and where is the special meeting of shareholders and optionholders?

A:

The special meeting of shareholders and optionholders will take place at Nicholas Financial, Inc.'s (the "Company" or "Nicholas Financial-Canada") corporate headquarters, located at 2454 McMullen Booth Road, Building C, Clearwater, Florida, on [ ], [ ], 2014, at [ ] a.m., local time.

Q:

What is happening at the special meeting?

A:

Nicholas Financial-Canada's shareholders and optionholders are being asked to consider and vote on the following item at the special meeting:

A proposal to adopt a special resolution, the full text of which is attached hereto as Annex A (the "Arrangement Resolution"), to approve the arrangement and the arrangement agreement, dated as of December 17, 2013, by and among Prospect Capital Corporation ("Prospect"), Watershed Acquisition LP ("USCo"), 0988007 B.C. Unlimited Liability Company (the "Purchaser"), Nicholas Financial LLC (formerly known as Watershed Operating LLC) ("US New Opco," and together with Prospect, USCo and the Purchaser, the "Prospect Parties") and Nicholas Financial-Canada (collectively, the "Parties" and each a "Party"), as such agreement may be amended from time to time. The full text of the arrangement agreement is attached hereto as Annex B.

Q:

What is an arrangement?

A:

An arrangement is a securityholder and court-approved procedure under British Columbia corporate law pursuant to which two or more corporations can effect a business combination or corporate restructuring.

Q:

What will happen in the proposed arrangement?

A:

If the Arrangement Resolution is approved, Nicholas Financial-Canada and the Purchaser will amalgamate and form an entity ("Amalco"), which will be an unlimited liability company under the *Business Corporations Act* (British Columbia) (the "BCBCA"). Amalco will be the surviving entity and will succeed to and assume all of the rights and obligations of the Purchaser and Nicholas Financial-Canada. Amalco will be an indirect wholly-owned portfolio company of Prospect. As a result of the proposed arrangement, all Nicholas Financial-Canada's assets and liabilities immediately before the amalgamation will become assets and liabilities of Amalco immediately after the amalgamation, and Nicholas Financial-Canada's wholly-owned subsidiaries, Nicholas Financial, Inc., a Florida corporation, and Nicholas Data Services, Inc., a Florida corporation, will become direct subsidiaries of Amalco.

Q:

What will shareholders of Nicholas Financial-Canada receive in the arrangement?

A:

Each Nicholas Financial-Canada shareholder will receive for each Common Share of Nicholas Financial-Canada owned as of the time of consummation of the arrangement (the "effective time"), that number of shares of common stock, par value $0.001 per share, of Prospect ("Prospect common stock") determined by dividing $16.00 by the volume-weighted average price of Prospect common stock on the NASDAQ Global Select Market ("NASDAQ"), as displayed under the heading "Bloomberg VWAP" on Bloomberg Financial L.P. ("VWAP") for the 20 trading days prior to and ending on the trading day immediately preceding the effective time of the arrangement. Holders of Nicholas Financial-Canada Common Shares will not receive any fractional

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shares of Prospect common stock in the arrangement. Instead, each Nicholas Financial-Canada shareholder otherwise entitled to a fractional share interest in Prospect will be paid an amount in cash determined by multiplying such fraction by the amount equal to the VWAP as calculated above. ***Pursuant to the arrangement agreement, Nicholas Financial-Canada has agreed, prior to completion or termination of the transaction, not to declare, set aside, pay or make any dividend or other distribution (whether in cash, stock or other property) with respect to any of its Common Shares.***

Prospect is a financial services company that primarily lends to and invests in middle market privately-held companies. Prospect, a Maryland corporation, has been 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 (the "1940 Act"), and is a non-diversified investment company within the meaning of the 1940 Act. Please see "Business of Prospect" for more information regarding Prospect and please see "Regulation of Prospect" and Annex C: Summary of Certain Provisions of the 1940 Act Applicable to Business Development Companies for more information regarding business development companies and the 1940 Act.

Q:

What will optionholders of Nicholas Financial-Canada receive in the arrangement?

Prospect will cash out holders of options to purchase Company Common Shares ("options") outstanding pursuant to the Nicholas Financial-Canada stock option plans. Such holders of options will receive a cash amount equal to the amount, if any, by which (i) the product obtained by multiplying (x) the number of Nicholas Financial-Canada Common Shares underlying such option by (y) $16.00, exceeds (ii) the aggregate exercise price payable under such option by the optionholder to acquire the Nicholas Financial-Canada Common Shares underlying such option.

Q:

What is a business development company ("BDC")?

A:

A BDC is a specialized type of closed-end investment company regulated under certain provisions of the 1940 Act. The 1940 Act and the Investment Advisers Act of 1940 regulate BDCs through various restrictions on capitalization, types of investments, investment adviser compensation, director independence, transactions with affiliates and governance matters. As a BDC, Prospect is generally required to invest at least 70% of its assets in private or small domestic companies engaged primarily in non-financial businesses as well as in cash items, United States Government securities and high-quality short-term debt securities (and is required to offer managerial assistance to such companies). In addition, as a BDC, Prospect can have, and does have, multiple classes of debt outstanding and can incur a greater amount of leverage in the form of debt (as opposed to preferred stock) than a registered closed-end fund, which can only have one class of debt outstanding. See "Regulation of Prospect," "Business of Prospect" and Annex C: Summary of Certain Provisions of the 1940 Act Applicable to Business Development Companies.

Q:

Is the consideration subject to any adjustment for shareholders?

A:

No. However, the number of shares of Prospect common stock that a Nicholas Financial-Canada shareholder will receive will depend on the VWAP for the 20 trading days prior to and ending on the trading day immediately preceding the effective time of the arrangement and consequently the value of the shares of Prospect common stock received may be greater than or less than $16.00 on the day of the effective time.

Q:

Is Prospect required to make any other payments to any of the parties in connection with the arrangement?

A:

No. However, if Nicholas Financial-Canada terminates the arrangement agreement due to a breach by Prospect, Prospect could be obligated to pay a $6,000,000 termination fee to Nicholas Financial-Canada. Please see "Description of the Arrangement Agreement Termination of the Arrangement Agreement."

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Q: **Who will pay the expenses relating to the preparation of this document and the solicitation of proxies?**

A: Whether or not the arrangement is consummated, each of Prospect and Nicholas Financial-Canada is responsible for its own fees and expenses relating to the arrangement, including the preparation of this document and the solicitation of the proxies. Upon consummation of the arrangement, all of the fees and expenses will be borne by USCo. However, in the event the arrangement is not consummated, under certain conditions, a termination fee of $6,000,000 will be paid by Nicholas Financial-Canada or Prospect, as applicable, to the other party in accordance with the arrangement agreement. Please see "Description of the Arrangement Agreement Termination of the Arrangement Agreement."

Q: **Are shareholders and optionholders able to exercise dissent rights?**

A: Yes. As further discussed below under "The Special Meeting Dissent Rights," shareholders and optionholders are able to exercise dissent rights. A written objection to the Arrangement Resolution must be received by Nicholas Financial-Canada not later than 5:00 pm (Vancouver time) on the last business day preceding the date of the special meeting. Shareholders and optionholders that are ultimately determined to be entitled to dissent rights and that have validly exercised their dissent rights will be paid in cash the fair value by the Purchaser for their shares or options, as applicable. See also Annex D and Annex E to this proxy circular/prospectus.

Q: **When do you expect to complete the proposed arrangement?**

A: We are working to complete the proposed arrangement early in the second quarter of 2014, assuming all regulatory approvals and other required matters are completed at such time.

Q: **What are the United States federal income tax consequences of the proposed arrangement?**

A: See "Certain United States Federal Income Tax Considerations" for important information regarding the United States federal income tax consequences relating to the proposed arrangement.

Q: **What shareholder and optionholder vote is required to approve the Arrangement Resolution?**

A: The Arrangement Resolution must be approved by at least three-quarters (75%) of the votes cast by Nicholas Financial-Canada shareholders, as well as at least three-quarters (75%) of the votes cast by Nicholas Financial-Canada shareholders and optionholders (voting together as a group). Holders may vote either in person or by proxy at the special meeting and will be entitled to one vote for each share held and one vote for each share the holder has an option to acquire. Nicholas Financial-Canada shareholders and optionholders who abstain, fail to return their proxies or do not otherwise vote will not have an effect on the vote. A quorum for the special meeting is at least two shareholders or proxyholders representing two shareholders, or one shareholder and a proxyholder representing another shareholder, holding at least $33^1/_3$% of the total issued and outstanding shares of Nicholas Financial-Canada on the record date for the meeting.

Q: **Does Nicholas Financial-Canada's board of directors recommend approval of the Arrangement Resolution?**

A: Yes. Nicholas Financial-Canada's board of directors, including its independent directors, who constitute a majority of its board of directors, unanimously approved and adopted the Arrangement Resolution and unanimously recommends that Nicholas Financial-Canada's shareholders vote "FOR" approval of the Arrangement Resolution. In connection with Nicholas Financial-Canada's board of directors' consideration of this matter, it received an opinion from

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Janney Montgomery Scott LLC ("Janney") addressing the fairness, from a financial point of view, of the consideration to be received by Nicholas Financial-Canada shareholders.

Q:

What do I need to do now?

A:

We urge you to read carefully this document, including its annexes. You also may want to review the documents referenced under "Where You Can Find More Information" and consult with your accounting, legal and tax advisors.

Q:

How do I vote my shares or options?

A:

You may indicate how you want to vote on your proxy card and then sign and mail your proxy card in the enclosed return envelope as soon as possible so that your shares or options, as applicable, may be represented at the special meeting. If you are a shareholder, you may also vote (1) by telephone, by calling toll free 1-[ ]-[ ]-[ ] on a touch-tone phone and following the recorded instructions or (2) by accessing the Internet website at www.[ ].com and following the instructions on the website. If you are a record shareholder, you may also attend the special meeting in person and vote at the meeting instead of submitting a proxy. If your shares are held in a brokerage account or in "street name" and you wish to vote your shares in person at the special meeting, please see the answer to the next question.

Unless your shares are held in a brokerage account or in "street name", if you sign, date and send your proxy and do not indicate how you want to vote, your proxy will be voted "FOR" the approval of the arrangement agreement and the arrangement. If your shares are held in a brokerage account or in "street name", please see the answer to the next question.

If you fail either to return your proxy card and, if you are a shareholder, to vote via the telephone or the Internet, or if you "abstain" with respect to the Arrangement Resolution, you will not affect the outcome of the vote.

Q:

If my shares are held in a brokerage account, or in "street name," will my broker vote my shares for me?

A:

No. If you do not provide your broker with instructions on how to vote your street name shares, your broker will not be permitted to vote them.

You should, therefore, provide your broker with instructions on how to vote your shares or arrange to attend the special meeting and vote your shares in person. If your shares are held in a brokerage account or in "street name," you may vote your shares in person at the special meeting ONLY if you bring your proxy to the special meeting. The proxy would be provided by your broker, fiduciary, custodian or other nominee. You must request this proxy from your nominee, as they will not automatically send you one.

If you do not provide your broker with instructions and do not attend the special meeting, your failure will not have an effect on the outcome of the vote. Shares held in a brokerage account or in "street name" for which written authority to vote has not been obtained will be treated as not present and not entitled to vote with respect to the Arrangement Resolution and will, therefore, reduce the absolute number (but not the percentage) of the affirmative votes required for approval of the Arrangement Resolution. Shareholders are urged to utilize telephonic or Internet voting if their broker has provided them with the opportunity to do so. See your voting instruction form for instructions.

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Q: **What do I do if I want to change my vote?**

A: You may change your vote at any time before the vote takes place at the special meeting. To do so, you may either complete and submit a new proxy card or send a written notice stating that you would like to revoke your proxy. If you are a shareholder, you may also change your vote if you voted and revote (1) by telephone, by calling the toll-free number 1-[ ]-[ ]-[ ] on a touch-tone phone and following the recorded instructions or (2) by accessing the Internet website at www.[ ].com and following the instructions on the website. The last recorded vote will be what is counted at the special meeting. In addition, you may elect to attend the special meeting and vote in person, as described above.

Q: **If my shares are represented by stock certificates, should I send in my stock certificates now?**

A: No. If the arrangement is completed and your Common Shares are represented by stock certificates, we will send you written instructions for exchanging your stock certificates for the appropriate number of shares of Prospect common stock.

Q: **Will a proxy solicitor be used?**

A: No. Nicholas Financial-Canada has not engaged a proxy solicitor to assist in the solicitation of proxies for the special meeting. Nicholas Financial-Canada's officers and employees may request the return of proxies by telephone or in person, but no additional compensation will be paid to them for doing so.

Q: **Who can I contact with any additional questions?**

A: You may call Nicholas Financial-Canada's Corporate Secretary, Ralph T. Finkenbrink, with respect to any additional questions at: 1-727-726-0763.

Q: **Where can I find more information about the companies?**

A: You can find more information about Nicholas Financial-Canada and Prospect in the documents described under "Where You Can Find More Information."

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SUMMARY

This summary highlights material information in this proxy circular/prospectus. It may not contain all of the information that is important to you. We urge you to carefully read the entire document and the other documents to which we refer in order to fully understand the proposed arrangement. See "Where You Can Find More Information." Unless otherwise noted, the terms "Nicholas Financial-Canada" or the "Company" refers to Nicholas Financial, Inc., a company existing under the laws of British Columbia; "Nicholas Financial" refers to Nicholas Financial, Inc., a Florida corporation; "NDS" refers to Nicholas Data Services, Inc., a Florida corporation; the "Company" also refers to Nicholas Financial-Canada, Nicholas Financial and NDS collectively, as appropriate in the context; "Prospect" refers to Prospect Capital Corporation, a Maryland corporation; "USCo" refers to Watershed Acquisition LP, a Delaware limited partnership that is wholly owned by Prospect; the "Purchaser" refers to 0988007 B.C. Unlimited Liability Company, an unlimited liability company existing under the laws of British Columbia that is wholly owned by USCo; "US New Opco" refers to Nicholas Financial LLC (formerly known as Watershed Operating LLC), a Delaware limited liability company that is wholly owned by USCo; "Prospect Capital Management," "Investment Adviser" and "PCM" refer to Prospect Capital Management LLC; and "Prospect Administration" and the "Administrator" refer to Prospect Administration LLC. When discussing the arrangement agreement, the terms: "Prospect Parties" refers to Prospect, USCo, Purchaser and US New Opco; and "Parties" refers to Nicholas Financial-Canada and the Prospect Parties.

Information about the Companies

Nicholas Financial, Inc.
2454 McMullen Booth Road
Building C
Clearwater, FL 33759

Nicholas Financial-Canada is a Canadian holding company incorporated under the laws of British Columbia in 1986. Its business activities are conducted through two wholly-owned subsidiaries formed pursuant to the laws of the State of Florida, Nicholas Financial and NDS. Nicholas Financial is a specialized consumer finance company engaged primarily in acquiring and servicing retail installment sales contracts ("Contracts") for purchases of new and used cars and light trucks. To a lesser extent, Nicholas Financial also makes direct loans and sells consumer-finance related products. NDS is engaged in supporting and updating industry specific computer application software for small businesses located primarily in the Southeastern United States. For the fiscal years ended March 31, 2013 and 2012 and the nine-month periods ended December 31, 2013 and 2012, the Company had consolidated revenues of $82.1 million, $80.5 million, $62.2 million, and $61.7 million, respectively. Nicholas Financial accounted for approximately 99% of the Company's consolidated revenues for each of such periods, and NDS sales accounted for less than 1% of consolidated revenues during each of the same periods.

The Company's principal business is providing financing programs primarily to purchasers of new and used cars and light trucks who meet the Company's credit standards, but who do not meet the credit standards of traditional lenders, such as banks and credit unions. Unlike these traditional lenders, which make lending decisions primarily based on the credit history of the borrower and typically finance new automobiles, the Company purchases Contracts of borrowers who may not have a good credit history or Contracts for older model and high mileage automobiles. This is typically referred to as the non-prime automobile finance market.

The non-prime automobile finance market is highly fragmented and historically has been serviced by a variety of financial entities, including captive finance subsidiaries of major automobile manufactures, banks, independent finance companies, and small loan companies. Many of these financial entities do not consistently provide financing to this market. Although prime borrowers represent a large segment of the automobile financing market, there are many potential purchasers of automobiles who do not qualify as prime borrowers. Purchasers the Company considers to be non-prime borrowers are generally unable to obtain credit from traditional sources of automobile financing. The Company believes that, because these potential purchasers represent a substantial market, there is a demand by automobile dealers with respect to financing for non-prime borrowers that has not been effectively served by traditional automobile financing sources.

The Company purchases Contracts from automobile dealers at a negotiated price that is less than the original principal amount being financed by the purchaser of the automobile. The Contracts are predominately for used vehicles. As of December 31, 2013, the average model year of vehicles collateralizing the portfolio was 2006. The average loan to value ratio, which expresses the amount of the Contract as a percentage of the value of the automobile, is approximately 94%. The initial terms of the Contracts range from 12 to 72 months. In addition, taxes, title fees and, if applicable, premiums for extended service contracts, accident and health insurance and credit life insurance can also be included in the amount financed.

The Company's automobile finance programs are currently conducted in 15 states through a total of 65 branches, including 20 in Florida, eight in Ohio, six in North Carolina, six in Georgia, three in Kentucky, three in Indiana, three in Missouri, three in Michigan, three in Alabama, two in Virginia, two in Tennessee, two in Illinois, two in South Carolina, one in Maryland and one in Kansas. Each office is budgeted (size of branch, number of employees and location) to handle up to 1,000 accounts and up to $7.5 million in gross finance receivables. To date, 14 of the Company's branches meet that capacity. The Company continues to evaluate additional markets for future branch locations, and subject to market conditions, would expect to open additional branch locations during fiscal 2014. The Company remains open to acquisitions should an opportunity present itself.

In addition to the automobile finance program, the Company also provides direct loans. Direct loans are loans originated directly between the Company and the consumer. These loans are typically for amounts ranging from $1,000 to $8,000 and are generally secured by a lien on an automobile, water craft or other permissible tangible personal property. The average loan made to date by the Company had an initial principal balance of approximately $3,000. The Company does not expect the average loan size to increase significantly within the foreseeable future. The majority of direct loans are originated with current or former customers under the Company's automobile financing program. The typical direct loan represents a significantly better credit risk than the Company's typical Contract due to the customer's historical payment history with the Company.

The Company is currently licensed to provide direct consumer loans in Florida and North Carolina. In addition, the Company continues to analyze the direct loan market in Ohio for possible future expansion into such market. The Company does not expect to pursue a direct loan license in any other state during the fiscal year ending March 31, 2014. The Company does not have any current plans to expand its strategy of soliciting current customers and expects total direct loans to remain approximately 3% of its total portfolio.

In connection with its direct loan program, the Company also makes available credit disability and credit life insurance coverage to customers through an unaffiliated third-party insurance carrier. Customers in approximately 77% of the 3,079 direct loan transactions outstanding as of December 31, 2013 had elected to purchase third-party insurance coverage made available by the Company. The cost of this insurance is included in the amount financed by the customer.

The Company's executive offices are located at 2454 McMullen Booth Road, Building C, Suite 501, Clearwater, Florida 33759, and the Company's telephone number is (727) 726-0763.

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Prospect Capital Corporation
10 East 40th Street, 44th Floor
New York, NY 10016
(212) 448-0702

Prospect is a financial services company that primarily lends to and invests in middle market privately held companies. In this proxy circular/prospectus, the term "middle market" refers to companies with annual revenues of less than $750 million and enterprise values of less than $1 billion. Prospect is a closed-end investment company that has filed an election to be treated as a business development company under the 1940 Act. Prospect invests primarily in senior and subordinated debt and equity of companies in need of capital for acquisitions, divestitures, growth, development and recapitalization. Prospect works with management teams or financial sponsors to seek investments with historical cash flows, asset collateral or contracted pro forma cash flows.

Prospect currently has seven origination strategies in which it makes investments: (1) lending in private equity sponsored transactions, (2) lending directly to companies not owned by private equity firms, (3) control investments in corporate operating companies, (4) control investments in financial companies, (5) investments in structured credit, (6) real estate investments, and (7) investments in syndicated debt. Prospect continues to evaluate other origination strategies in the ordinary course of business with no specific tops down allocation to any single origination strategy.

Lending in Private Equity Sponsored Transactions Prospect makes loans to companies which are controlled by leading private equity firms. This debt can take the form of first lien, second lien, unitranche or mezzanine loans. In making these investments, Prospect looks for a diversified customer base, recurring demand for the product or service, barriers to entry, strong historical cash flow and experienced management teams. These loans typically have significant equity subordinate to Prospect's loan position. Historically, this strategy has comprised approximately 50%-60% of its business, but more recently it is less than 50% of its business.

Lending Directly to Companies Prospect provides debt financing to companies owned by non private equity firms, the company founder, a management team or a family. Here, in addition to the strengths Prospect looks for in a sponsored transaction, Prospect also looks for the alignment with the management team with significant invested capital. This strategy often has less competition than the private equity sponsor strategy because such company financing needs are not easily addressed by banks and often require more diligence preparation. Direct lending can result in higher returns and lower leverage than sponsor transactions and may include warrants or equity to Prospect. This strategy has comprised approximately 5%-15% of its business.

Control Investments in Corporate Operating Companies This strategy involves acquiring controlling stakes in non financial operating companies. Prospect investments in these companies are generally structured as a combination of yield producing debt and equity. Prospect provides certainty of closure to Prospect's counterparties, gives the seller personal liquidity and generally looks for management to continue on in their current roles. This strategy has comprised approximately 10%-15% of its business.

Control Investments in Financial Companies This strategy involves acquiring controlling stakes in financial companies, including consumer direct lending, subprime auto lending and other strategies. Prospect's investments in these companies are generally structured as a combination of yield producing debt and equity. These investments are often structured in a tax efficient partnership formed consistent with Prospect's regulated investment company tax structure, thereby enhancing returns. This strategy has comprised approximately 10%-15% of its business.

Investments in Structured Credit Prospect makes investments in collateralized loan obligations ("CLOs"), generally taking a significant position in the subordinated interests (equity) of the CLOs.

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The CLOs include a diversified portfolio of broadly syndicated loans and do not have direct exposure to real estate, mortgages, sub prime debt, or consumer based debt. The CLOs in which Prospect invests are managed by top tier collateral managers that have been thoroughly diligenced prior to investment. This strategy has comprised approximately 10%-20% of its business.

Real Estate Investments Prospect makes investments in real estate through its three wholly-owned tax-efficient real estate investment trusts ("REITs"), American Property Holdings Corp., National Property Holdings Corp., and United Property Holdings Corp. Prospect's real estate investments are in various classes of fully developed and occupied real estate properties that generate current yields. Prospect seeks to identify properties that have historically high occupancy and steady cash flow generation. Prospect partners with established property managers with experience in managing the property type to manage such properties after acquisition. This is a more recent investment strategy that has comprised approximately 5%-10% of its business.

Investments in Syndicated Debt On an opportunistic basis, Prospect makes investments in loans and high yield bonds that have been sold to a syndicate of buyers. Here Prospect looks for investments with attractive risk adjusted returns after it has completed a fundamental credit analysis. These investments are purchased with a long term, buy and hold outlook and Prospect looks to provide significant structuring input by providing anchoring orders. This strategy has comprised approximately 5%-10% of its business.

Prospect invests 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 in the assets of the portfolio company, which may rank ahead of or be junior to other security interests. Mezzanine debt and Prospect's investments in CLOs are subordinated to senior loans and are generally unsecured. Prospect invests in debt and equity positions of CLOs which are a form of securitization in which the cash flows of a portfolio of loans are pooled and passed on to different classes of owners in various tranches. Prospect's CLO investments are derived from portfolios of corporate debt securities which are generally risk rated from BB to B.

Prospect also acquires controlling interests in companies in conjunction with making secured debt investments in such companies. These may be in several industries, including industrial, service, real estate and financial businesses. In most cases, companies in which it invests are privately held at the time it invests in them.

Prospect Capital Management LLC serves as Prospect's investment adviser and manages its investments, and Prospect Administration LLC serves as Prospect's administrator and provides the administrative services necessary for it to operate. Prospect has also elected to be treated for federal income tax purposes as a regulated investment company ("RIC") under Subchapter M of the Internal Revenue Code of 1986, or the "Code."

Purpose of the Special Meeting

Shareholders and optionholders are being asked to consider and to approve the Arrangement Resolution, which includes approval of the following matters:

- To approve and adopt the proposed arrangement and to authorize the board of directors of Nicholas Financial-Canada to amend or revise the proposed arrangement in its discretion to the extent permitted by the arrangement agreement without further approval of the shareholders and optionholders;

- To ratify, confirm and approve the arrangement agreement, and to authorize the board of directors to amend or revise the arrangement agreement in its discretion to the extent permitted therein without further approval of the shareholders and optionholders;

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To authorize the board of directors of Nicholas Financial-Canada to amend or decide not to proceed with the proposed arrangement, without further notice to or approval of the shareholders and optionholders; and

To authorize any one director or officer of Nicholas Financial-Canada to do all such acts necessary or desirable to carry out these resolutions.

Terms of the Arrangement Agreement

Pursuant to the terms of the proposed arrangement, Nicholas Financial-Canada and the Purchaser will amalgamate and form an entity ("Amalco"), which will be an unlimited liability company under the *Business Corporations Act* (British Columbia). Amalco will be the surviving entity and will succeed to and assume all of the rights and obligations of the Purchaser and Nicholas Financial-Canada. Amalco will be an indirect wholly-owned portfolio company of Prospect. As a result of the proposed arrangement, all Nicholas Financial-Canada's assets and liabilities immediately before the amalgamation will become assets and liabilities of Amalco immediately after the amalgamation and Nicholas Financial-Canada's wholly-owned subsidiaries, Nicholas Financial and NDS, will become direct subsidiaries of Amalco.

Based on the number of shares of Prospect common stock issued and outstanding on the record date and the VWAP of Prospect's common stock over the 20 trading days prior to the record date, Nicholas Financial-Canada's shareholders will own approximately [ ]% of Prospect's common stock outstanding immediately after the consummation of the arrangement.

The arrangement agreement is attached as Annex B to this proxy circular/prospectus (the "arrangement agreement") and is part of this document. Nicholas Financial-Canada encourages its shareholders to read the arrangement agreement (including the plan of arrangement attached as Schedule B thereto) carefully and in its entirety, as it is the principal legal document governing the proposed arrangement. Please see "Description of the Arrangement Agreement."

Nicholas Financial-Canada's Shareholders Will Receive Shares of Prospect's Common Stock in the Proposed Arrangement

If the proposed arrangement is consummated, each Nicholas Financial-Canada shareholder will receive for each Common Share of Nicholas Financial-Canada owned as of the effective time, that number of shares of Prospect common stock determined by dividing $16.00 by the VWAP of Prospect common stock on NASDAQ for the 20 trading days prior to and ending on the trading day immediately preceding the effective time. Holders of Common Shares of Nicholas Financial-Canada will not receive any fractional shares of Prospect common stock in the arrangement. Instead, each Nicholas Financial-Canada shareholder otherwise entitled to a fractional share interest in Prospect will be paid an amount in cash, based on a formula set forth in the arrangement agreement and rounded to the nearest cent. **Pursuant to the arrangement agreement, Nicholas Financial-Canada has agreed, prior to completion or termination of the transaction, not to declare, set aside, pay or make any dividend or other distribution (whether in cash, stock or other property) with respect to any of its Common Shares.**

Reasons for the Proposed Arrangement

In evaluating the arrangement proposal from Prospect, Nicholas Financial-Canada's board of directors considered numerous factors, including, among others, the ones described below, and, as a result, determined that the proposed arrangement was in the Company's best interests and the best interests of the Company's shareholders and optionholders. Ultimately, the Company's board of directors believed that the potential advantages of the proposed arrangement outweigh the negative factors, whether considered individually or collectively. For a more detailed discussion of the factors

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identified below, and for additional factors considered by the board, see "The Arrangement Resolution Proposal Reasons for the Arrangement."

The Company's board of directors did not attempt to quantify or otherwise assign relative weights to the specific factors it considered nor did it determine that any factor was of particular importance. A determination of various weightings would, in the view of the Company's board of directors, be impractical. In addition, individual members of the Company's board of directors may have given different weight to different factors. Rather, the Company's board of directors viewed its position and recommendations as being based on the totality of the information presented to, and considered by, the Company's board of directors.

The Company's board of directors considered the following factors in its deliberations concerning the arrangement:

- The Company engaged in a thorough review of the potential strategic alternatives to a Prospect proposal, including, among other things, the possible sale of the Company or certain of its assets, potential acquisition and expansion opportunities and/or a possible debt or equity financing. Based on the company's lengthy and thorough review process, the Company's board of directors believes it has explored all possible strategic alternatives reasonably available to it.

- In evaluating the consideration payable to the Company's shareholders and optionholders pursuant to the arrangement, the Company's board of directors noted that $16.00 represents a premium of approximately 21% to the average closing market price of the Company's Common Shares for the twenty trading days immediately prior to the March 20, 2013 announcement by the Company that its board of directors had retained Janney as its independent financial advisor to assist the Company in evaluating possible strategic alternatives.

- The Company's recent financial performance, including recent trends in delinquencies, losses and gross margins, and their impact on the Company's operating results. The Company's board of directors also considered the fact that, as a result of the arrangement, existing shareholders would be unable to benefit directly from any future growth of the Company.

- Because the Company's shareholders will be shareholders in Prospect following the arrangement, the Company's shareholders stand to participate in the future growth and prospects of Prospect and its portfolio companies, including the Company.

- The oral opinion from Janney (which was subsequently confirmed by delivery of Janney's written opinion dated December 17, 2013) with respect to the fairness, from a financial point of view, of the transaction consideration to be received by the Company's shareholders pursuant to the arrangement.

- The costs of remaining an independent public company, including the costs of compliance related to disclosure and corporate governance rules of the SEC and Nasdaq, auditing fees and directors' and officers' insurance.

- The current lack of liquidity for the Company's shareholders, given the low trading volume of the Company's Common Shares, as compared to the significant trading market for Prospect common stock.

- The terms of the arrangement agreement, including the representations, warranties and covenants of the parties, as well as the conditions to their respective obligations under the arrangement agreement, the likelihood of the consummation of the arrangement, the termination provisions of the arrangement agreement and the Company's board of directors' evaluation of the likely time period necessary to effect the arrangement.

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- The fact that dissent rights will be available to the Company's shareholders and optionholders in connection with the arrangement.

The Company's board of directors also considered the risks related to the proposed arrangement (see "Risks Related to the Arrangement"), and the following potentially material negative factors in its deliberations concerning the arrangement:

- The limited ability of the Company under the arrangement agreement to provide information to, or enter into discussions with, other potential business combination parties who might make an unsolicited proposal to acquire the Company.

- Prospect's obligation to complete the arrangement is subject to certain conditions, and it has the right to terminate the arrangement agreement in specified circumstances.

- The substantial transaction costs to be incurred by the Company even if the arrangement is not consummated.

- The announcement and pendency of the transaction could have an adverse effect on the Company's business, financial condition, results of operations or business prospects and on its stock price.

- The substantial management time and effort required to effectuate the arrangement and the related disruption to the Company's operations, including the disruption which would result if the arrangement were not consummated after the arrangement agreement had been entered into.

- The fact that, as a result of the arrangement, existing Company shareholders and optionholders would be unable to benefit directly from any future growth or improved operating performance of the Company.

- The restrictions on the conduct of the Company's business prior to the completion of the arrangement, requiring the Company to conduct its business only in the ordinary course, subject to specific limitations, which may delay or prevent the Company from undertaking business opportunities that may arise pending completion of the arrangement.

- The fact that certain persons, including directors and officers of the Company, have interests in the arrangement that are different from, or in addition to, those of Company shareholders generally.

- Because the Company currently does not anticipate asking Janney to update its opinion, the opinion will not address the fairness, from a financial point of view, of the consideration to be received by the Company's shareholders at the time the arrangement is completed.

- Prospect is a business development company and is subject to substantially different risks than the Company.

Risks Related to the Proposed Arrangement

Below are certain of the material risks related to the proposed arrangement considered by Nicholas Financial-Canada's board of directors:

- ***Consideration:*** Because the number of shares of Prospect common stock into which Nicholas Financial-Canada's Common Shares are exchangeable will be determined only at the effective time, Nicholas Financial-Canada shareholders cannot be sure of the precise value of the transaction consideration they will receive.

Share Dilution: Nicholas Financial-Canada shareholders will experience a reduction in percentage ownership and voting power with respect to their shares as a result of the arrangement.

Restriction on Ability to Solicit Alternative Offers: The arrangement agreement limits Nicholas Financial-Canada's ability to pursue alternatives to the transaction.

Adverse Effect on Business: The announcement and pendency of the transaction could have an adverse effect on the Company's businesses, financial conditions, results of operations or business prospects and on its stock price. In addition, the arrangement agreement does not permit Nicholas Financial-Canada to make any distributions to its shareholders without the written consent of Prospect.

Opinion of Financial Advisor: Certain financial projections considered by Nicholas Financial-Canada, Janney and Prospect may not be realized, which may adversely affect the market price of Prospect common stock following the consummation of the arrangement.

Business Development Company: Prospect is a business development company regulated under the 1940 Act and is subject to substantially different risks than the Company.

Completion of the Proposed Arrangement

It is expected that the proposed arrangement will be completed shortly after Nicholas Financial-Canada's shareholders approve the Arrangement Resolution at the special meeting, assuming all regulatory approvals and other required matters are completed at such time. If approved by Nicholas Financial-Canada's shareholders, Prospect and Nicholas Financial-Canada will work to complete the proposed arrangement early in the second quarter of 2014. The arrangement agreement currently permits either party to terminate the arrangement agreement if the arrangement is not completed on or before June 12, 2014.

Recommendation of the Board of Directors of Nicholas Financial-Canada

Nicholas Financial-Canada's board of directors, including its independent directors, who constitute a majority of the board of directors, believes that the proposed arrangement is advisable and in the best interest of Nicholas Financial-Canada's shareholders and unanimously recommends that shareholders vote "FOR" approval of the Arrangement Resolution.

Opinion of Nicholas Financial-Canada's Financial Advisor

Nicholas Financial-Canada's financial advisor, Janney, rendered its oral opinion, subsequently confirmed in writing, that as of December 17, 2013, and based upon and subject to the procedures followed, assumptions made, qualifications and limitations on the review undertaken, and other matters considered by Janney in preparing its opinion, the consideration to be received by the holders of Nicholas Financial-Canada's common stock, as set forth in the arrangement agreement was fair, from a financial point of view, to such holders.

The full text of the written opinion of Janney, dated as of December 17, 2013, is attached to this proxy circular/prospectus as Annex H. The opinion sets forth the procedures followed, assumptions made, qualifications and limitations on the review undertaken, and other matters considered by Janney in preparing its opinion. However, neither Janney's written opinion nor the summary of its opinion and the related analyses set forth in this proxy circular/prospectus are intended to be, and they do not constitute, a recommendation as to or otherwise address how any holder of Nicholas Financial-Canada's Common Shares should vote or act in respect of the Arrangement Resolution or any related matter. Nicholas Financial-Canada encourages you to read carefully the entire opinion.

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The opinion does not in any manner address the price at which Prospect common stock will trade at any time following consummation of the arrangement. Janney provided its opinion for the information and assistance of the Nicholas Financial-Canada's board of directors in connection with the directors' consideration of the arrangement and addresses only the fairness, from a financial point of view, of the transaction consideration pursuant to the arrangement agreement for holders of Nicholas Financial-Canada's Common Shares as of the date of the opinion. It does not address any other aspect of the arrangement. The summary of Janney's opinion set forth in this proxy circular/prospectus is qualified in its entirety by reference to the full text of its opinion.

Janney's opinion was necessarily based on financial, economic, market and other conditions as in effect on, and the information made available to it as of, December 17, 2013. Events occurring after December 17, 2013 may affect the opinion and the assumptions used in preparing it, and Janney did not assume any obligation to update, revise or reaffirm the opinion.

Nicholas Financial-Canada agreed to pay Janney a fee based upon the closing of an arrangement or sale. The engagement agreement provided that, if Nicholas Financial-Canada requested and Janney agreed, that Janney would provide a fairness opinion in regard to the transaction that would be credited against any fees due under the engagement agreement. Nicholas Financial-Canada has also agreed to reimburse Janney for reasonable out-of-pocket expenses and disbursements incurred in connection with its retention and to indemnify Janney for certain liabilities arising out of its engagement.

Interests of Nicholas Financial-Canada's Management in the Proposed Arrangement

In considering the recommendation of Nicholas Financial-Canada's board of directors to approve the Arrangement Resolution, you should be aware that certain of Nicholas Financial-Canada's directors and executive officers have interests in the transaction that are different from, or are in addition to, the interests of Nicholas Financial-Canada's shareholders and optionholders generally. Nicholas Financial-Canada's board of directors was aware of these interests and considered them along with other matters when they determined to recommend the arrangement.

The Company's two executive officers, Messrs. Vosotas and Finkenbrink, have entered into agreements with the Prospect Parties that will supersede their prior employment agreements upon consummation of the arrangement and which, among other things, will cause Mr. Vosotas and Mr. Finkenbrink not to receive any "change of control" payments upon the consummation of the arrangement. Mr. Vosotas entered into a consulting agreement pursuant to which he has agreed to make himself reasonably available for up to twenty hours per month to consult with Nicholas Financial and US New Opco regarding matters relating to the Company's business. During the term of the consulting agreement, Mr. Vosotas will be paid twelve monthly installments of $10,000. Mr. Finkenbrink has entered into an employment agreement pursuant to which he will serve as the Chief Executive Officer of Amalco and US New Opco. The employment agreement has a five-year term commencing upon the effective time of the arrangement, and provides for a base salary of $325,000 per annum. For more information regarding these arrangement, please see "Description of The Arrangement Interests of Nicholas Financial-Canada's Directors and Executive Officers in the Arrangement."

At Prospect's request, Mr. Vosotas has agreed to loan $1,000,000 to Nicholas Financial and US New Opco at the effective time of the arrangement, as evidenced by a subordinated unsecured promissory note. Interest on the principal amount will accrue quarterly at a rate per annum equal to the sum of (i) the LIBOR Rate (as defined below) and (ii) a spread of 6.00%. The principal amount of the note, together with accrued and unpaid interest on such amount, will be due and payable on the third anniversary of the effective time of the arrangement. For more information regarding these arrangements, please see "Description of The Arrangement Interests of Nicholas Financial-Canada's Directors and Executive Officers in the Arrangement."

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Optionholders will receive cash for their options. The only persons that hold options are Nicholas Financial-Canada's directors and executive officers. For more information regarding this term of the arrangement, please see "Description of The Arrangement Interests of Nicholas Financial-Canada's Directors and Executive Officers in the Arrangement."

United States Federal Income Tax Consequences of the Arrangement

See "Certain United States Federal Income Tax Considerations" for important information regarding the United States federal income tax consequences relating to the arrangement.

Dividends and Other Distributions

Pursuant to the arrangement agreement, Nicholas Financial-Canada has agreed, prior to completion or termination of the transaction, not to declare, set aside, pay or make any dividend or other distribution (whether in cash, stock or other property) with respect to any of its Common Shares.

Dissent Rights

Shareholders and optionholders are able to exercise dissent rights. In order to exercise such rights, a shareholder or optionholder must send a written objection to the Arrangement Resolution to Nicholas Financial-Canada and such written objection must be received by Nicholas Financial-Canada not later than 5:00 pm (Vancouver time) on the last business day preceding the date of the special meeting. Shareholders and optionholders that have validly exercised their dissent rights will be paid in cash the fair value by the Purchaser for their shares or options, as applicable.

Vote Required to Approve the Arrangement Resolution

The Arrangement Resolution must be approved by at least three-quarters (75%) of the votes cast by Nicholas Financial-Canada shareholders, as well as at least three-quarters (75%) of the votes cast by Nicholas Financial-Canada shareholders and optionholders (voting as a group). Holders may vote either in person or by proxy at the special meeting and will be entitled to one vote for each share held and one vote for each share the holder has an option to acquire. Nicholas Financial-Canada shareholders and optionholders who abstain, or who fail to return their proxies and do not otherwise vote will not have an effect on the outcome of the vote. A quorum for the special meeting of the Company is at least two shareholders or proxyholders representing two shareholders, or one shareholder and a proxyholder representing another shareholder, holding at least $33^1/_3$% of the total issued and outstanding shares of the Company on the record date for the special meeting.

Voting Power of Nicholas Financial-Canada's Management

At the close of business on the record date, Nicholas Financial-Canada's executive officers and directors owned and were entitled to vote [ ] Common Shares and [ ] options, representing [ ]% of the aggregate number of outstanding Common Shares and [ ]% of the combined number of Common Shares and options of Nicholas Financial-Canada on that date. None of Nicholas Financial-Canada's executive officers or directors has entered into any voting agreement relating to the proposed arrangement; however, each of Nicholas Financial-Canada executive officers and directors has indicated that he intends to vote his Common Shares and options, if any, in favor of the approval of the Arrangement Resolution.

Conditions to the Arrangement

There are certain obligations of Nicholas Financial-Canada and the Prospect Parties, both collectively and individually, to complete the proposed arrangement, which are subject to the satisfaction or, where permissible, waiver of certain conditions. Certain of these conditions applicable to Nicholas Financial-Canada and the Prospect Parties include:

- the Interim Order having been granted in form and substance satisfactory to Nicholas Financial-Canada and the Prospect Parties;
- approval of the Arrangement Resolution by Nicholas Financial-Canada's shareholders having been obtained in accordance with the provisions of the Interim Order;
- the Final Order having been granted in form and substance reasonably satisfactory to Prospect and Nicholas Financial-Canada; and
- the registration statement of Prospect of which this proxy circular/prospectus forms a part thereof will have become effective under the Securities Act.

Certain of these conditions applicable to Nicholas Financial-Canada include:

- the representations and warranties of the Prospect Parties contained in the arrangement agreement being true and correct in all respects subject to certain qualifications;
- each of the Prospect Parties having performed in all material respects all obligations and complied in all material respects with all covenants required by the arrangement agreement; and
- since the date of the arrangement agreement, except as contemplated by the arrangement agreement, there having not occurred a material adverse change to any of the Prospect Parties.

Certain of these conditions applicable to the Prospect Parties include:

- the representations and warranties of the Nicholas Financial-Canada contained in the arrangement agreement being true and correct in all respects subject to certain qualifications;
- Nicholas Financial-Canada having performed in all material respects all obligations and complied in all material respects with all covenants required by the arrangement agreement;
- since the date of the arrangement agreement, except as contemplated by the arrangement agreement, there has not occurred a material adverse change to Nicholas Financial-Canada; and
- no more than 10% of Nicholas Financial-Canada's common stock outstanding will have validly exercised dissenting rights.

Please see "Description of the Arrangement Agreement Conditions to the Arrangement" for a full description of the conditions to the arrangement.

Termination of the Arrangement Agreement

The arrangement agreement may be terminated at any time before completion of the arrangement, whether before or after approval of the Arrangement Resolution by Nicholas Financial-Canada shareholders, in a number of ways, including, but not limited to:

- by mutual written consent of Nicholas Financial-Canada and the Prospect Parties;

- by either Nicholas Financial-Canada or Prospect if (1) the arrangement is not completed prior to the termination deadline, except (i) the termination deadline will be automatically extended for a period not to exceed 45 days to the extent necessary to satisfy certain conditions and (ii) that the right to terminate will not be available to any Party that has breached in any material respect its obligations under the arrangement agreement or caused the failure of the arrangement to be consummated on or before such termination deadline; or (2) shareholders do not approve the Arrangement Resolution at the special meeting;

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by Nicholas Financial-Canada or Prospect, as the case may be, if (i) the other Party is in material breach or failed to perform in any material respect its representations, warranties, covenants or other agreements contained in the arrangement agreement, (ii) such breach or failure to perform entitles the other Party to not consummate the arrangement, and (iii) such breach or failure to perform is not curable;

by Nicholas Financial-Canada or Prospect, as the case may be, in certain events such as the Nicholas Financial-Canada's board of directors withdrawing or modifying in a manner adverse to the Prospect Parties its recommendation to approve the Arrangement Resolution or entering into a superior proposal.

Please see "Description of the Arrangement Agreement Termination of the Arrangement Agreement" for a full description of the termination provisions, including termination fees in certain situations, under the arrangement agreement.

Comparison of Shareholder Rights

The rights of Nicholas Financial-Canada's shareholders are currently governed by British Columbia law and Nicholas Financial-Canada's Articles. When the proposed arrangement is completed, Nicholas Financial-Canada's shareholders will become stockholders of Prospect, a Maryland corporation, and their rights will be governed by Maryland law and Prospect's charter and bylaws. The rights of Nicholas Financial-Canada's shareholders and the rights of Prospect stockholders differ in many respects. See "Comparison of Shareholder Rights" for a discussion of the material differences between the rights of Nicholas Financial-Canada shareholders and the rights of Prospect stockholders.

Post-Arrangement Recapitalization

Upon consummation of the arrangement, Prospect intends to refinance the Company using proceeds from a newly committed $250 million revolving credit facility from bank lenders and an operating company term loan that Prospect will provide. The aggregate net proceeds from this recapitalization will be used to repay the existing debt of the Company and return a portion of capital issued by Prospect to complete the transaction on the closing date. After receipt of the recapitalization cash distribution, Prospect will have a net investment in the transaction of approximately $136 million. Prospect's post-arrangement recapitalization $136 million investment in the Company is expected to consist of $122 million of operating and holding company term loans and $14 million of a holding company equity investment. The interest payable on the term loans to USCo and Amalco will be payable to Prospect. Such interest payments will constitute investment income and contribute to Prospect's net investment income.

Litigation

Jason Simpson v. Nicholas Financial, Inc., et al., Case No. 13-011726-CI (Circuit Court, Pinellas County, Florida), filed December 24, 2013; *Gabriella Rago v. Nicholas Financial, Inc., et al.*, Case No. 8:13-cv-03261-VMC-TGW (U.S. District Court, Tampa, Florida), filed December 30, 2013; *Matthew John Leonard v. Nicholas Financial, Inc., et al.*, Case No. 13-011811-CI (Circuit Court, Pinellas County, Florida), filed December 31, 2013; *Michelangelo Lombardo v. Nicholas Financial, Inc., et al.*, Case No. 14-000095-CI (Circuit Court, Pinellas County, Florida), filed January 3, 2014; *Edward Opton v. Stephen Bragin, et al.*, Case No. 14-000139-CI (Circuit Court, Pinellas County, Florida), filed January 6, 2014 and *Marvin Biver v. Nicholas Financial, Inc. et al.*, Case No. 8:14-cv-00250-EAK-MAP (U.S. District Court, Tampa, Florida), filed February 3, 2014. The six pending, substantially similar lawsuits were filed in connection with the arrangement contemplated by the arrangement agreement. Each plaintiff purports to represent a class of all Nicholas Financial-Canada shareholders other than the defendants and any person or entity related to or affiliated with any defendant. Five of the lawsuits name as defendants Nicholas Financial-Canada, Nicholas Financial-Canada's directors, Prospect, the Purchaser, USCo and US New Opco. The sixth lawsuit names those same parties as defendants, with the exception of the Purchaser and US New Opco. Each plaintiff alleges that the consideration to be paid for Nicholas Financial-Canada's shares is inadequate and/or that certain terms of the arrangement agreement are contrary to the interests of Nicholas Financial-Canada's public shareholders. The plaintiff in the *Biver* lawsuit makes such allegations only in the context of asserting claims against Nicholas Financial-Canada's directors and the Prospect Parties under Sections 14(a) and/or 20(a) of the Securities Exchange Act of 1934, predicated on alleged misrepresentations or omissions in the Registration Statement filed by Prospect on January 13, 2014. Each plaintiff, except for the plaintiff in the *Biver* lawsuit, asserts a breach of fiduciary duty claim against Nicholas Financial-Canada's directors, and an aiding and abetting claim against Nicholas Financial-Canada and/or certain of the Prospect Parties. The plaintiff in the *Rago* lawsuit also alleges claims against all defendants under Sections 14(a) and/or 20(a) of the Securities Exchange Act of 1934. Each plaintiff seeks declaratory relief, injunctive relief, other equitable relief and/or damages with respect to the proposed transaction. Each plaintiff, except for the plaintiff in the *Biver* lawsuit, also seeks an award of attorneys' fees. The Prospect Parties, Nicholas Financial-Canada and Nicholas Financial-Canada's directors do not believe that there is any merit to any of the pending actions, and they intend to defend vigorously against such actions.

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COMPARATIVE FEES AND EXPENSE RATIOS

The purpose of the tables in this section is to assist you in understanding the various costs and expenses that a stockholder will bear directly or indirectly by investing in Prospect's common stock and Prospect's costs and expenses that are expected to be incurred in the first year following the arrangement.

Prospect's Expenses

The table below illustrates the change in operating expenses expected as a result of the arrangement. The table sets forth (i) the annualized fees, expenses, and interest payments on borrowed funds of Prospect for the six months ended December 31, 2013 and (ii) the pro forma annualized fees, expenses and interest payments on borrowed funds of Prospect for the six months ended December 31, 2013 assuming consummation of the arrangement as of July 1, 2013. Upon consummation of the arrangement, the fees and expenses incurred by Prospect and Nicholas Financial-Canada in connection with the arrangement will be borne by USCo, which is a portfolio company of Prospect.

	Actual Prospect	Pro Forma Combined Prospect
Stockholder transaction expenses		
Sales load (as a percentage of offering price)	None(1)	None(1)
Dividend reinvestment plan expenses	None(2)	None(2)

	Actual Prospect	Pro Forma Combined Prospect
Annual expenses (as a percentage of net assets attributable to common stock):		
Management fees(3)	3.73%	3.63%
Incentive fees(4)	2.70%	2.70%
Total advisory fees	6.43%	6.33%
Interest expense(5)	4.04%	3.81%
Acquired Fund Fees and Expenses(6)	0.01%	0.01%
Other expenses(7)	1.31%	1.24%
Total annual expenses(8)	11.79%	11.39%

(1) Purchases of shares of common stock of Prospect on the secondary market are not subject to sales charges but may be subject to brokerage commissions or other charges. The table does not include any sales load (underwriting discount or commission) that stockholders may have paid in connection with their purchase of shares of Prospect's common stock.

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

(3) Prospect's base management fee is 2% of its gross assets (which include any amount borrowed, i.e., total assets without deduction for any liabilities, including any borrowed amounts for non-investment purposes, for which purpose Prospect has not borrowed and has no intention of borrowing). Although Prospect has no intent to borrow the entire amount available under its line of credit, assuming that it borrowed $2.6 billion, the 2% management fee of gross assets equals approximately 3.73% of net assets (actual) and 3.63% of net assets (pro forma). Based on Prospect's borrowings as of February 21, 2014 of $1.9 billion, the 2% management fee of gross assets equals approximately 3.30% of net assets (actual) and 3.22% of net assets (pro forma). See

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"Business of Prospect Management Services Investment Advisory Agreement" and footnote 4 below.

(4)
Based on the incentive fee paid during Prospect's six months ended December 31, 2013, all of which consisted of an income incentive fee. The capital gain incentive fee is paid without regard to pre-incentive fee income. For a more detailed discussion of the calculation of those incentive fees, see "Business of Prospect Management Services Investment Advisory Agreement" in this proxy circular/prospectus.

(5)
As of February 21, 2014, Prospect has $1.9 billion outstanding of its Senior Notes (as defined below) in various maturities, ranging from December 15, 2015 to December 15, 2043, and interest rates, ranging from 4.0% to 7.0%, some of which are convertible into shares of Prospect common stock at various conversion rates. Please see "Business of Prospect General" and "Risks Related to Prospect Risks Relating to Prospect's Business" below for more detail on the Senior Notes.

(6)
Prospect's stockholders indirectly bear the expenses of underlying investment companies in which Prospect invests. This amount includes the fees and expenses of investment companies in which Prospect is invested in as of December 31, 2013. 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 Prospect's average net assets used in calculating this percentage was based on net assets of approximately $3.2 billion as of December 31, 2013.

(7)
"Other expenses" are based on estimated amounts for the current fiscal year. The amount shown above represents annualized expenses during Prospect's six months ended December 31, 2013 representing all of Prospect's estimated recurring operating expenses (except fees and expenses reported in other items of this table) that are deducted from its operating income and reflected as expenses in Prospect's Statement of Operations. The estimate of Prospect's overhead expenses, including payments under an administration agreement with Prospect Administration, or the "Administration Agreement," based on Prospect's 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 of Prospect Management Services Administration Agreement."

(8)
Prospect expects to incur significant transaction costs, which it currently estimates to be approximately $12 million, including the Company's transaction costs up to the consummation of the arrangement, in connection with the arrangement. The substantial majority of these costs will be non-recurring expenses related to the arrangement, including professional fees and other non-recurring expenses, which will be borne by USCo, the portfolio company, and capitalized into Prospect's cost basis for USCo.

Example

The following table demonstrates the projected dollar amount of cumulative expenses Prospect would pay out of net assets and that you would indirectly bear over various periods with respect to a hypothetical investment in Prospect's common stock before and after the consummation of the arrangement. In calculating the following expense amounts, Prospect has assumed it would have borrowed $1.9 billion, that its annual operating expenses would remain at the levels set forth in the

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table above and that Prospect would pay the costs shown in the table above. You would pay the following expenses on a $1,000 investment, assuming a 5% annual return:

	1 Year	3 Years	5 Years	10 Years
Prospect	90.88	261.65	418.74	758.60
Pro Forma Combined Prospect(1)	86.84	251.04	403.36	737.70

(1) The pro forma combined row shown assumes the arrangement is completed.

While the example assumes, as required by the SEC, a 5% annual return, Prospect's performance will vary and may result in a return greater or less than 5%. The income incentive fee under Prospect's Investment Advisory Agreement with Prospect Capital Management assuming a 5% annual return would be zero and is not included in the example. If Prospect achieves sufficient returns on its investments, including through the realization of capital gains, to trigger an incentive fee of a material amount, its distributions to its common stockholders and its expenses would likely be higher. The income incentive fee will be calculated and payable quarterly in arrears based upon Prospect's pre-incentive fee net investment income for the immediately preceding quarter. Prospect's pre-incentive fee net investment income, expressed as a rate of return on the value of Prospect's net assets at the end of the immediately preceding calendar quarter, is compared to a "hurdle rate" of 1.75% per quarter (7.00% annualized). As Prospect cannot predict whether it will meet the necessary performance target, Prospect has assumed that no income incentive fee will be paid for purposes of this chart. Because the example above assumes a 5.0% annual return, as required by the SEC, no subordinated incentive fee would be payable in the following twelve months. In addition, while the example assumes reinvestment of all dividends and other distributions at net asset value, or "NAV," participants in Prospect's dividend reinvestment plan will receive a number of shares of its common stock determined by dividing the total dollar amount of the distribution payable to a participant by the market price per share of its common stock at the close of trading on the valuation date for the distribution. See "Prospect's Dividend Reinvestment Plan" for additional information regarding its dividend reinvestment plan.

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

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SELECTED FINANCIAL DATA OF PROSPECT

You should read the condensed consolidated financial information of Prospect below with the consolidated financial statements and notes thereto included in this proxy circular/prospectus. Financial information below for the years ended June 30, 2013, 2012, 2011, 2010 and 2009 has been derived from the financial statements that were audited by Prospect's independent registered public accounting firm. The selected consolidated financial data at and for the three and six months ended December 31, 2013 and 2012 has been derived from unaudited financial data. Interim results for the three and six months ended December 31, 2013 are not necessarily indicative of the results that may be expected for the year ending June 30, 2014. 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 of Prospect" for more information.

	For the Three Months Ended December 31,		For the Six Months Ended December 31,		For the Year Ended June 30,				
	2013	2012	2013	2012	2013	2012	2011	2010	2009
	(in thousands except data relating to shares, per share and number of portfolio companies)								
Performance Data:									
Interest income	$ 147,103	$ 116,866	$ 285,524	$ 195,176	$ 435,455	$ 219,536	$ 134,454	$ 86,518	$ 62,926
Dividend income	8,892	31,955	15,981	68,163	82,705	64,881	15,092	15,366	22,793
Other income	22,095	17,214	37,619	26,332	58,176	36,493	19,930	12,675	14,762
Total investment income	178,090	166,035	339,124	289,671	576,336	320,910	169,476	114,559	100,481
Interest and credit facility expenses	(29,256)	(16,414)	(56,663)	(29,925)	(76,341)	(38,534)	(17,598)	(8,382)	(6,161)
Investment advisory expense	(48,129)	(41,110)	(91,758)	(72,845)	(151,031)	(82,507)	(46,051)	(30,727)	(26,705)
Other expenses	(8,490)	(9,295)	(16,151)	(13,658)	(24,040)	(13,185)	(11,606)	(8,260)	(8,452)
Total expenses	(85,875)	(66,819)	(164,572)	(116,428)	(251,412)	(134,226)	(75,255)	(47,369)	(41,318)
Net investment income	92,215	99,216	174,552	173,243	324,924	186,684	94,221	67,190	59,163
Realized and unrealized (losses) gains	(6,853)	(52,727)	(9,290)	(79,505)	(104,068)	4,220	24,017	(47,565)	(24,059)
Net increase in net assets from operations	$ 85,362	$ 46,489	$ 165,262	$ 93,738	$ 220,856	$ 190,904	$ 118,238	$ 19,625	$ 35,104
Per Share Data:									
Net increase in net assets from operations(1)	$ 0.30	$ 0.24	$ 0.61	$ 0.52	$ 1.07	$ 1.67	$ 1.38	$ 0.33	$ 1.11
Distributions declared per	$ (0.33)	$ (0.31)	$ (0.66)	$ (0.62)	$ (1.28)	$ (1.22)	$ (1.21)	$ (1.33)	$ (1.62)

share									
Average weighted shares outstanding for the period	287,016,433	195,585,502	272,550,293	179,039,198	207,069,971	114,394,554	85,978,757	59,429,222	31,559,905
Assets and Liabilities Data:									
Investments	$ 4,886,020	$ 3,038,808	$ 4,886,020	$ 3,038,808	$ 4,172,852	$ 2,094,221	$ 1,463,010	$ 748,483	$ 547,168
Other assets	308,002	490,913	308,002	490,913	275,365	161,033	86,307	84,212	119,857
Total assets	5,194,022	3,529,721	5,194,022	3,529,721	4,448,217	2,255,254	1,549,317	832,695	667,025
Amount drawn on credit facility					124,000	96,000	84,200	100,300	124,800
Senior convertible notes	847,500	847,500	847,500	847,500	847,500	447,500	322,500		
Senior unsecured notes	347,814	100,000	347,814	100,000	347,725	100,000			
InterNotes®	600,907	164,993	600,907	164,993	363,777	20,638			
Amount owed to related parties	49,849	2,392	49,849	2,392	6,690	8,571	7,918	9,300	6,713
Other liabilities	116,853	88,201	116,853	88,201	102,031	70,571	20,342	11,671	2,916
Total liabilities	1,962,923	1,203,086	1,962,923	1,203,086	1,791,723	743,280	434,960	121,271	134,429
Net assets	$ 3,231,099	$ 2,326,635	$ 3,231,099	$ 2,326,635	$ 2,656,494	$ 1,511,974	$ 1,114,357	$ 711,424	$ 532,596
Investment Activity Data:									
No. of portfolio companies at period end	130	106	130	106	124	85	72	58	30
Acquisitions	$ 607,657	$ 772,125	$ 1,164,500	$ 1,520,062	$ 3,103,217	$ 1,120,659	$ 953,337	$ 364,788(2)	$ 98,305
Sales, repayments, and other disposals	$ 255,238	$ 349,269	$ 419,405	$ 507,392	$ 931,534	$ 500,952	$ 285,562	$ 136,221	$ 27,007
Total return based on market value(3)	3.41%	(2.99)%	10.12%	0.71%	6.2%	27.2%	17.2%	17.7%	(18.6)%
Total return based on net asset value(3)	3.04%	2.14%	6.09%	5.33%	10.9%	18.0%	12.5%	(6.8)%	(0.6)%
Weighted average yield at end of period(4)	12.9%	14.7%	12.9%	14.7%	13.6%	13.9%	12.8%	16.2%	14.6%

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

(2) Includes $207,126 of acquired portfolio investments from Patriot Capital Funding, Inc.

(3)

Total return based on market value is based on the change in market price per share between the opening and ending market prices per share in each period and assumes that dividends are reinvested in accordance with Prospect's dividend reinvestment plan. Total return based on net asset value is based upon the change in net asset value per share between the opening and ending net asset values per share in each period and assumes that dividends are reinvested in accordance with Prospect's dividend reinvestment plan.

(4) Excludes equity investments and non-performing loans.

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SELECTED FINANCIAL DATA OF THE COMPANY

You should read the condensed consolidated financial information below with the consolidated financial statements and notes thereto included in this proxy circular/prospectus. The following tables present selected consolidated financial data of the Company as of and for the fiscal years ended March 31, 2013, 2012, 2011, 2010 and 2009, and the nine-month periods ended December 31, 2013 and 2012. The selected consolidated financial data have been derived from the Company's consolidated financial statements. All historical share and per share amounts have been restated for all periods presented to reflect a 10% stock dividend paid on December 7, 2009 to shareholders of record as of the close of business on November 20, 2009. See "Management's Discussion and Analysis of Financial Condition and Results of Operation of the Company" for more information.

	Nine months ended December 31,		Fiscal Year ended March 31,				
	2013	**2012**	**2013**	**2012**	**2011**	**2010**	**2009**
Statement of Operations Data							
Interest income on finance receivables*	$ 62,168,567	$ 61,708,812	$ 82,072,643	$ 80,470,980	$ 73,661,457	$ 65,571,587	$ 62,137,387
Sales	17,322	29,196	37,803	44,070	53,622	68,117	69,933
	62,185,889	61,738,008	82,110,446	80,515,050	73,715,079	65,639,704	62,207,320
Interest expense	4,288,979	3,717,386	5,120,827	4,891,854	5,599,951	5,169,736	5,384,532
Provision for credit losses*	10,797,930	9,849,798	13,391,875	12,367,593	15,611,544	20,567,707	25,571,453
Salaries and employee benefits	14,542,906	13,539,636	18,325,945	17,582,967	16,430,763	14,380,695	13,349,523
Change in fair value of interest rate swaps	(681,989)	645,772	504,852		(495,136)	(1,034,869)	1,530,005
Other expenses	10,109,767	9,332,736	12,280,792	9,524,361	9,280,923	8,984,047	8,900,260
	39,057,593	37,085,328	49,624,291	44,366,775	46,428,045	48,067,316	54,735,773
Operating income before income taxes*	23,128,296	24,652,680	32,486,155	36,148,275	27,287,034	17,572,388	7,471,547
Income tax expense*	9,284,483	9,499,030	12,545,209	13,926,516	10,518,740	6,755,850	2,803,627
Net income*	$ 13,843,813	$ 15,153,650	$ 19,940,946	$ 22,221,759	$ 16,768,294	$ 10,816,538	$ 4,667,920
Earnings per share basic:	$ 1.15	$ 1.27	$ 1.66	$ 1.89	$ 1.44	$ 0.94	$ 0.41
Weighted average shares outstanding	12,088,835	11,961,886	11,977,174	11,747,160	11,607,341	11,470,318	11,273,811
Earnings per share diluted:	$ 1.13	$ 1.24	$ 1.63	$ 1.85	$ 1.41	$ 0.93	$ 0.41
Weighted average shares outstanding	12,285,971	12,191,781	12,218,416	12,033,131	11,893,518	11,689,123	11,440,313

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	As of and for the nine months ended December 31,		As of and for the Fiscal Year ended March 31,				
	2013	2012	2013	2012	2011	2010	2009
Balance Sheet Data							
Total assets	$ 276,086,152	$ 262,807,543	$ 263,835,468	$ 256,560,144	$ 242,975,768	$ 213,505,606	$ 197,199,732
Finance receivables, net	261,254,324	245,217,238	249,825,801	241,253,430	229,082,589	201,418,259	185,750,682
Line of credit	127,000,000	130,500,000	125,500,000	112,000,000	118,000,000	107,274,971	102,030,195
Share-holders' equity*	138,814,925	123,282,109	126,965,096	135,263,161	114,546,111	96,984,906	84,435,270
Operating Data							
Return on average assets	6.92%	7.74%	7.66%	8.90%	7.35%	5.27%	2.41%
Return on average equity	14.06%	15.56%	15.21%	17.79%	15.85%	11.92%	5.73%
Gross portfolio yield(1)*	28.67%	29.26%	29.22%	29.48%	29.35%	29.33%	29.96%
Pre-tax yield(1)*	10.42%	12.07%	11.82%	13.31%	10.75%	7.47%	4.46%
Total delinquencies over 30 days	7.15%	6.23%	3.73%	2.99%	2.19%	3.16%	4.20%
Write-off to liquidation(1)	7.24%	6.82%	6.81%	5.66%	6.18%	9.87%	12.39%
Net charge-off percentage(1)	6.20%	5.74%	5.88%	4.59%	4.65%	7.37%	9.93%
Automobile Finance Data & Direct Loan Origination							
Contracts purchased/ direct loans originated	$ 128,060,684	$ 114,531,520	$ 160,077,713	$ 152,315,679	$ 151,874,846	$ 125,315,736	$ 117,653,858
Average dealer discount*	8.47%	8.59%	8.54%	9.23%	9.55%	9.91%	9.84%
Weighted average contractual rate(1)	22.96%	23.37%	23.43%	23.93%	23.66%	23.62%	24.17%
Number of branch locations	65	63	64	60	56	52	48

(1) See the definitions set forth in the notes to the Portfolio Summary table under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operation of the Company Portfolio Summary."

* The amounts for 2009 through 2012 and the amount for the nine months ended December 31, 2012 have been revised as discussed in Note 2 to the Company's consolidated financial statements.

RISKS RELATED TO THE ARRANGEMENT

Because the number of shares of Prospect common stock into which Company Common Shares are exchangeable will be determined only at closing, Company shareholders cannot be sure prior to the effective time of the precise value of the transaction consideration they will receive.

Under the terms of the arrangement agreement, the number of shares of Prospect common stock (or fraction thereof) into which Nicholas Financial-Canada common stock are exchangeable is determined by dividing $16.00 by the VWAP of Prospect common stock for the 20 trading days prior to and ending on the trading day immediately preceding the effective time of the arrangement. In light of this uncertainty, holders of Nicholas Financial-Canada Common Shares will not be able to calculate the precise value of the consideration that they will receive upon completion of the arrangement until the effective time, and developments reducing the price of Prospect common stock could reduce the value of the consideration holders of Nicholas Financial-Canada Common Shares will receive.

Company shareholders will experience a reduction in percentage ownership and voting power with respect to their shares as a result of the arrangement.

Company shareholders will experience a substantial reduction in their respective percentage ownership interests and effective voting power relative to their respective percentage ownership interests in the Company prior to the arrangement. If the arrangement is consummated, based on the VWAP for the 20 days preceding the record date, which was $[ ], and the number of shares of Prospect common stock issued and outstanding as of such date, Company shareholders will own approximately [ ]% of Prospect's outstanding common stock. In addition, both prior to and after completion of the arrangement, Prospect may issue additional shares of common stock in public offerings, mergers and acquisitions or otherwise (including at prices below its then current net asset value), all of which would further reduce the percentage ownership of Prospect held by former Company shareholders. The issuance or sale by Prospect of shares of its common stock at a discount to net asset value also poses a risk of dilution to stockholders. In particular, stockholders who do not purchase additional shares at or below the discounted price in proportion to their then 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 Prospect's earnings and assets and their voting power than the increase Prospect experiences in its assets, potential earning power and voting interests from such issuance or sale. Shareholders may also experience a reduction in the market price of Prospect's common stock.

The arrangement agreement limits the Company's ability to pursue alternatives to the transaction.

The arrangement agreement contains provisions that make it more difficult for the Company to sell its business to a party other than Prospect. These provisions include a general prohibition on the Company taking certain actions that might lead to or otherwise facilitate an acquisition proposal (as defined in "Description of the Arrangement Agreement Covenants of Nicholas Financial-Canada Regarding Non-Solicitation") and the requirement that the Company pay Prospect a termination fee of $6.0 million in connection with the transaction if the arrangement agreement is terminated in specified circumstances. See "Description of the Arrangement Agreement Termination of the Arrangement Agreement."

These provisions may discourage a third party that might have an interest in acquiring all or a significant part of the stock, properties or assets of the Company from considering or proposing that acquisition, even if that party were prepared to pay consideration with a higher per share value than the current proposed transaction consideration. Prior to entering the arrangement agreement, the

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Company hired an investment banking firm, Janney, as its independent financial advisor and conducted a broad solicitation of parties potentially interested in acquiring the Company.

Directors and executive officers of Nicholas Financial-Canada may have potential conflicts of interest in connection with the transaction.

Some of the directors and executive officers of Nicholas Financial-Canada have interests in the arrangement that are different from, or are in addition to, the interests of Nicholas Financial-Canada's shareholders generally. These interests may create potential conflicts of interest. These interests may include positions as officers of Amalco or US New Opco, potential benefits under employment or consulting arrangements that may be available as a result of the arrangement and in conjunction with other events, the cash payment to be made to optionholders, and the right to continued indemnification and insurance coverage by the resulting company for acts or omissions occurring prior to the closing of the arrangement. See "The Arrangement Resolution Proposal Interests of Nicholas Financial-Canada's Directors and Executive Officers in the Arrangement."

The announcement and pendency of the transaction could have an adverse effect on the Company's businesses, financial condition, results of operations or business prospects and on its stock price.

The announcement and pendency of the transaction could disrupt the Company's businesses in the following ways, among others:

- Company employees may experience uncertainty regarding their future roles with the resulting company, which might adversely affect the Company's ability to retain, recruit and motivate key personnel;

- the attention of the Company's management may be directed towards the completion of the transaction and transaction-related considerations and may be diverted from the day-to-day business operations of the Company, and matters related to the transaction may require commitments of time and resources that could otherwise have been devoted to other opportunities that might have been beneficial to the Company; and

- dealers and other third parties who have business relationships with the Company may decide not to renew such relationships or seek to terminate, change and/or renegotiate their relationships with the Company as a result of the transaction, whether pursuant to the terms of their existing agreements with the Company or otherwise.

Any of these matters could adversely affect the businesses, financial condition, results of operations or business prospects of the Company and its stock price.

Prospect and the Company are engaged in significantly different businesses and Prospect's business may not perform as well as the Company would on its own.

The Company is primarly in the business of making auto loans to consumers, whereas Prospect, which is much larger than the Company, is primarily in the business of making investments in companies it does not control. Further, Prospect is subject to a substantially different regulatory framework than is the Company. If Prospect's investments perform poorly, the Company's shareholders could have an interest in a company that is performing more poorly than the Company would have performed and that could decrease the value of the Company's shareholders' investment in Prospect below the value they would have had in the Company had the Company remained independent or completed a transaction with a different company than Prospect.

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Failure to complete the transaction could negatively impact the stock price and the future business and financial results of the Company.

If the arrangement is not completed, the ongoing business of the Company may be adversely affected and, without realizing any of the benefits of having completed the arrangement, the Company will be subject to a number of risks, including the following:

- the Company may be required to pay Prospect a termination fee of $6.0 million if the arrangement is terminated under certain circumstances, as described in the arrangement agreement and summarized in this proxy circular/prospectus;

- the Company will be required to pay its costs relating to the arrangement, even if the arrangement is not completed;

- under the arrangement agreement, the Company is subject to certain restrictions on the conduct of its business prior to completing the arrangement, which may affect its ability to execute certain of its business strategies;

- matters relating to the arrangement may require substantial commitments of time and resources by the Company's management, which could otherwise be devoted to other opportunities that may be beneficial to the Company as an independent entity; and

- since the Company announced on March 20, 2013 that it would retain an investment bank, Janney, as its independent financial advisor to help it consider its strategic alternatives, the Company has announced results from operations for the quarters ending June and September 2013 which were below the results for each respective prior quarter. Consequently, failure to complete the transaction might cause the price of the Company's common stock to decline.

Prospect's stock price will fluctuate after the completion of the arrangement, and as a result, Company shareholders could lose a significant part or all of their investment.

There can be no assurance that the price of Prospect common stock will not fluctuate or decline significantly in the future. The trading volume of Prospect common stock may fluctuate and cause significant price variations to occur. In addition, the stock market in general can experience considerable price and volume fluctuations that may be unrelated to Prospect's financial performance. The factors that could cause fluctuations in the stock price or trading volume of Prospect common stock include:

- general market and economic conditions, including fluctuations in interest rates;

- actual or expected variations in quarterly results of operations;

- differences between actual results of operations and those expected by investors and securities analysts;

- changes in recommendations by securities analysts;

- operations and stock performance of industry participants;

- accounting charges, including charges relating to the impairment of long-lived assets, including goodwill;

- significant acquisitions or strategic alliances by Prospect;

sales of Prospect common stock, including sales by Prospect's directors and officers or significant investors; and

recruitment or departure of key personnel.

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The occurrence of any or all of these factors could cause the price of Prospect common stock to decline, with the result that shareholders of the Company who receive Prospect common stock from the transaction could suffer a decline in the value of their investment, which could be significant.

Prospect will incur significant transaction costs in connection with the arrangement.

Prospect expects to incur significant transaction costs, which it currently estimates to be approximately $12 million, including the Company's transaction costs up to the consummation of the arrangement, in connection with the arrangement. The substantial majority of these costs will be non-recurring expenses related to the arrangement, including professional fees and other non-recurring expenses, which will be borne by USCo, which is a portfolio company of Prospect, and capitalized into Prospect's cost basis for USCo.

The regulatory approvals required for the completion of the arrangement may not be obtained, or may contain materially burdensome conditions that could have an adverse effect on either Prospect or the Company.

Completion of the arrangement is conditional upon the receipt of certain regulatory approvals. Although Prospect and the Company have agreed to use their commercially reasonable efforts to obtain the requisite governmental and court approvals, there can be no assurance that these approvals will be obtained. In addition, the governmental authorities from which these approvals are required may impose conditions on the completion of the arrangement or require changes to the terms of the arrangement. If, although it is not required under the arrangement agreement to do so, Prospect agrees to such conditions in order to obtain any approvals required to complete the arrangement, then the business and results of operations of the combined company may be adversely affected.

Certain financial projections considered by the Company, Janney and Prospect may not be realized, which may adversely affect the market price of Prospect common stock following the consummation of the arrangement.

In arriving at its opinion regarding the fairness from a financial point of view of the transaction consideration to be received by the holders of Nicholas Financial-Canada Common Shares pursuant to the arrangement agreement, Janney relied upon, without independent verification, the accuracy and completeness of the information that was made available to Janney by the Company and Prospect. See "The Arrangement Resolution Proposal Opinion of Nicholas Financial-Canada's Financial Advisor." These financial projections were prepared by, or as directed by, the management of the Company and were also considered by the Company's board of directors and Prospect. None of these financial projections were prepared with a view towards public disclosure or compliance with the published guidelines of the SEC or the American Institute of Certified Public Accountants regarding projections and forecasts. The financial projections are inherently based on various estimates and assumptions that are subject to the judgment of those preparing them and are also subject to significant economic, competitive, industry and other uncertainties and contingencies, all of which are difficult or impossible to predict and many of which are beyond the control of Prospect and the Company. Accordingly, there can be no assurance that Prospect's or the Company's financial condition or results of operations will not be significantly worse than those set forth in such projections. Significantly worse financial results could have a material adverse effect on the market price of Prospect common stock following the consummation of the arrangement.

Prospect is a business development company regulated under the 1940 Act and is subject to substantially different risks than the Company.

An investment in Prospect common stock involves certain risks relating to Prospect's structure and investment objective. Prospect is a business development company regulated under the 1940 Act. As a business development company, Prospect is required to comply with various restrictions on its

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capitalization, types of investments and transactions with affiliates. For example, Prospect is generally required to, among other things, invest at least 70% of its assets in private or small domestic companies engaged primarily in non-financial businesses as well as in cash items, U.S. Government securities and high quality short term debt securities (and is required to offer managerial assistance to such companies). As such, Prospect's 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. Prospect is required to mark the carrying value of its 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 Prospect's net asset value, or NAV. Also, Prospect's 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 Prospect does. Moreover, Prospect's business requires a substantial amount of capital to operate and to grow and Prospect may 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 Prospect common stock. See "Risks Related to Prospect" and the other information included in this proxy circular/prospectus.

On the other hand, the Company is a specialized consumer finance company engaged primarily in acquiring and servicing retail installment sales contracts for purchase of new and used cars and light trucks. To a lesser extent, the Company also makes direct loans and sells consumer finance related products. The industry in which the Company operates is highly competitive. There are numerous financial service companies that provide consumer credit in the markets served by the Company, including banks, credit unions, other consumer finance companies and captive finance companies owned by automobile manufacturers and retailers. Many of these competitors have substantially greater financial resources than the Company. The Company may also experience high delinquency rates in its loan portfolios, which could reduce its profitability. Further, the Company's business is highly dependent upon its relationships with its dealers.

Overall, there are a significant number of differences between the risks related to investing in Prospect and the risks related to investing in the Company. Shareholders of the Company should carefully consider the risks related to investing in Prospect prior to submitting their vote.

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RISKS RELATED TO PROSPECT

Risks Relating to Prospect's Business

Capital markets could experience a period of disruption and instability. Such market conditions have historically and could again have a material and adverse effect on debt and equity capital markets in the United States and abroad, which had, and may in the future have, a negative impact on Prospect's business and operations.

The global capital markets have periodically experienced periods of instability as evidenced by the extended disruptions from 2007 to 2010 in 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 during such period, 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 recent market conditions have improved, there can be no assurance that adverse market conditions will not repeat themselves or worsen in the future. If these adverse and volatile market conditions repeat themselves or worsen in the future, Prospect 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, Prospect is generally not able to issue additional shares of its common stock at a price less than net asset value without first obtaining approval for such issuance from its stockholders and its independent directors. At Prospect's annual meeting of stockholders held on December 6, 2013, 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 Prospect's then outstanding common stock immediately prior to each such offering, Prospect's stockholders approved Prospect's ability to sell or otherwise issue shares of Prospect's 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. It should be noted that, theoretically, Prospect may offer up to 25% of its then outstanding common stock each day. In addition, Prospect's ability to incur indebtedness (including by issuing preferred stock) is limited by applicable regulations such that Prospect's asset coverage, as calculated in accordance with the 1940 Act, must equal at least 200% immediately after each time Prospect incurs indebtedness. The debt capital that will be available to Prospect in the future, if at all, may be at a higher cost and on less favorable terms and conditions than what it currently experiences. Any inability to raise capital could have a negative effect on Prospect's business, financial condition and results of operations.

Moreover, the re-appearance of market conditions similar to those experienced from 2007 through 2009 for any substantial length of time could make it difficult to extend the maturity of or refinance Prospect's existing indebtedness under similar terms and any failure to do so could have a material adverse effect on Prospect's business.

Given the extreme volatility and dislocation that the capital markets have historically experienced, many BDCs have faced, and may in the future face, a challenging environment in which to raise or access capital. In addition, significant changes in the capital markets, including the extreme volatility and disruption over the past several years, has had, and may in the future have, a negative effect on the valuations of Prospect's investments and on the potential for liquidity events involving Prospect's investments. While most of Prospect's investments are not publicly traded, applicable accounting standards require Prospect to assume as part of Prospect's valuation process that its investments are sold in a principal market to market participants (even if Prospect plans on holding an investment through its maturity). As a result, volatility in the capital markets can adversely affect Prospect's investment valuations. Further, the illiquidity of Prospect's investments may make it difficult for it to

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sell such investments to access capital if required. As a result, Prospect could realize significantly less than the value at which it has recorded its investments if it were required to sell them for liquidity purposes. An inability to raise or access capital could have a material adverse impact on Prospect's business, financial condition or results of operations.

The current financial market situation, as well as various social and political tensions in the United States and around the world, particularly in the Middle East, may continue to contribute to increased market volatility, may have long-term effects on the United States and worldwide financial markets, and may cause further economic uncertainties or deterioration in the United States and worldwide. Since 2010, several European Union countries, including Greece, Ireland, Italy, Spain, and Portugal have faced budget issues, some of which may have negative long-term effects for the economies of those countries and other European Union countries. There is continued concern about national- level support for the euro and the accompanying coordination of fiscal and wage policy among European Economic and Monetary Union member countries. Prospect does not know how long the financial markets will continue to be affected by these events and cannot predict the effects of these or similar events in the future on the United States economy and securities markets or on its investments. Prospect monitors developments and seeks to manage its investments in a manner consistent with achieving Prospect's investment objective, but there can be no assurance that it will be successful in doing so; and Prospect may not timely anticipate or manage existing, new or additional risks, contingencies or developments, including regulatory developments in the current or future market environment.

Prospect 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 United States and many other economies have recently been experiencing. See " Risks Relating to Prospect's Investments."

Prospect's financial condition and results of operations will depend on its ability to manage its future growth effectively.

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

Prospect is dependent upon Prospect Capital Management's key management personnel for Prospect's future success.

Prospect depends on the diligence, skill and network of business contacts of the senior management of the Investment Adviser. Prospect also depends, to a significant extent, on the 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 Prospect's investments. Prospect's success depends to a significant extent on the continued service of the Investment Adviser's 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 Prospect's ability to achieve Prospect's investment objective. In addition, Prospect can offer no assurance that Prospect Capital Management will remain the Investment Adviser or that Prospect will continue to have access to its investment professionals or its information and deal flow.

Prospect operates in a highly competitive market for investment opportunities.

A number of entities compete with Prospect to make the types of investments that it makes in middle-market companies. Prospect competes with other BDCs, public and private funds, commercial and investment banks, commercial financing companies, insurance companies, hedge funds, and, to the extent they provide an alternative form of financing, private equity funds. Many of Prospect's competitors are substantially larger and have considerably greater financial, technical and marketing resources than Prospect does. Some competitors may have a lower cost of funds and access to funding sources that are not available to Prospect. In addition, some of Prospect's competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more relationships than Prospect. Furthermore, many of Prospect's competitors are not subject to the regulatory restrictions that the 1940 Act imposes on Prospect as a BDC and that the Code imposes on Prospect as a RIC. Prospect cannot assure you that the competitive pressures it faces will not have a material adverse effect on Prospect's business, financial condition and results of operations. Also, as a result of this competition, Prospect may not be able to pursue attractive investment opportunities from time to time.

Prospect does not seek to compete primarily based on the interest rates it offers and Prospect believes that some of its competitors may make loans with interest rates that are comparable to or lower than the rates it offers. Rather, Prospect competes with its competitors based on its existing investment platform, seasoned investment professionals, experience and focus on middle-market companies, disciplined investment philosophy, extensive industry focus and flexible transaction structuring.

Prospect may lose investment opportunities if it does not match its competitors' pricing, terms and structure. If Prospect matches its competitors' pricing, terms and structure, it may experience decreased net interest income and increased risk of credit loss. As a result of operating in such a competitive environment, Prospect may make investments that are on less favorable terms than what it may have originally anticipated, which may impact Prospect's return on these investments.

Prospect funds a portion of its investments with borrowed money, which magnifies the potential for gain or loss on amounts invested and may increase the risk of investing in Prospect.

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 Prospect's securities. Prospect's lenders have fixed dollar claims on its assets that are superior to the claims of Prospect's common stockholders or any preferred stockholders. If the value of Prospect's assets increases, then leveraging would cause the net asset value to increase more sharply than it would have had it not leveraged. Conversely, if the value of Prospect's assets decreases, leveraging would cause net asset value to decline more sharply than it otherwise would have had it not leveraged. Similarly, any increase in Prospect's income in excess of consolidated interest payable on the borrowed funds would cause its net income to increase more than it would without the leverage, while any decrease in Prospect's income would cause net income to decline more sharply than it would have had it not borrowed. Such a decline could negatively affect Prospect's ability to make common stock dividend payments. Leverage is generally considered a speculative investment technique.

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Changes in interest rates may affect Prospect's cost of capital and net investment income.

A portion of the debt investments Prospect makes bears interest at fixed rates and other debt investments bear interest at variable rates with floors and the value of these investments could be negatively affected by increases in market interest rates. In addition, as the interest rate on Prospect's 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 Prospect's investments. As a result, an increase in market interest rates could both reduce the value of Prospect's portfolio investments and increase Prospect's cost of capital, which could reduce Prospect's net investment income or net increase in net assets resulting from operations.

Prospect needs to raise additional capital to grow because it must distribute most of its income.

Prospect needs additional capital to fund growth in its investments. A reduction in the availability of new capital could limit Prospect's ability to grow. Prospect must distribute at least 90% of its ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, to its stockholders to maintain its status as a RIC for United States federal income tax purposes. As a result, such earnings are not available to fund investment originations. Prospect has sought additional capital by borrowing from financial institutions and may issue debt securities or additional equity securities. If Prospect fails to obtain funds from such sources or from other sources to fund its investments, Prospect could be limited in its ability to grow, which may have an adverse effect on the value of Prospect's common stock. In addition, as a business development company, Prospect generally may not borrow money or issue debt securities or issue preferred stock unless immediately thereafter its ratio of total assets to total borrowings and other senior securities is at least 200%. This may restrict Prospect's ability to obtain additional leverage in certain circumstances.

Prospect may experience fluctuations in its quarterly results.

Prospect could experience fluctuations in its quarterly operating results due to a number of factors, including the interest or dividend rates payable on the debt or equity securities Prospect holds, the default rate on debt securities, the level of Prospect's expenses, variations in and the timing of the recognition of realized and unrealized gains or losses, the degree to which Prospect encounters competition in its markets, 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.

Prospect's most recent NAV was calculated on December 31, 2013 and its NAV when calculated effective March 31, 2014 may be higher or lower.

Prospect's most recently estimated NAV per share is $10.75 on an as adjusted basis solely to give effect to its issuance of common stock since December 31, 2013 in connection with its dividend reinvestment plan and its issuance of 17,766,711 shares of common stock during the period from January 1, 2014 to February 21, 2014 (with settlement through February 26, 2014) under its at-the-market offering program, or the "ATM Program," $0.02 higher than the $10.73 determined by Prospect as of December 31, 2013. NAV per share as of March 31, 2014, may be higher or lower than $10.75 based on potential changes in valuations, issuances of securities, dividends paid and earnings for the quarter then ended. Prospect's board of directors has not yet determined the fair value of portfolio investments at any date subsequent to December 31, 2013. Prospect's board of directors determines the fair value of its portfolio investments on a quarterly basis in connection with the preparation of quarterly financial statements and based on input from independent valuation firms, the Investment Adviser, the Administrator and the Audit Committee of Prospect's board of directors.

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The Investment Adviser's liability is limited under the Investment Advisory Agreement, and Prospect is required to indemnify the Investment Adviser against certain liabilities, which may lead the Investment Adviser to act in a riskier manner on Prospect's behalf than it would when acting for its own account.

The Investment Adviser has not assumed any responsibility to Prospect other than to render the services described in the Investment Advisory Agreement, and it will not be responsible for any action of Prospect's board of directors in declining to follow the Investment Adviser's advice or recommendations. Pursuant to the Investment Advisory Agreement, the Investment Adviser and its members and their respective officers, managers, partners, agents, employees, controlling persons and members and any other person or entity affiliated with it will not be liable to Prospect for their acts under the Investment Advisory Agreement, absent willful misfeasance, bad faith, gross negligence or reckless disregard in the performance of their duties. Prospect has agreed to indemnify, defend and protect the Investment Adviser and its members and their respective officers, managers, partners, agents, employees, controlling persons and members and any other person or entity affiliated with it with respect to all damages, liabilities, costs and expenses resulting from acts of the Investment Adviser not arising out of willful misfeasance, bad faith, gross negligence or reckless disregard in the performance of their duties under the Investment Advisory Agreement. These protections may lead the Investment Adviser to act in a riskier manner when acting on Prospect's behalf than it would when acting for its own account.

Potential conflicts of interest could impact Prospect's investment returns.

Prospect's executive officers and directors, and the executive officers of the Investment Adviser, may serve as officers, directors or principals of entities that operate in the same or related lines of business as Prospect does or of investment funds managed by Prospect's affiliates. Accordingly, they may have obligations to investors in those entities, the fulfillment of which might not be in Prospect's best interests or those of Prospect's stockholders. Nevertheless, it is possible that new investment opportunities that meet Prospect's 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 Prospect. However, as an investment adviser, Prospect Capital Management has a fiduciary obligation to act in the best interests of its clients, including Prospect. 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 Prospect's investing activities, under the Investment Advisory Agreement Prospect pays base management and incentive fees to Prospect Capital Management, and reimburses 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 Prospect's stockholders, giving rise to a conflict.

The Investment Adviser receives a quarterly income incentive fee based, in part, on Prospect's 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 Prospect Capital Management. 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 Prospect investment income to exceed the hurdle rate and, as a result, more likely that Prospect Capital Management will receive an income incentive fee than if interest rates on Prospect's investments remained constant or decreased. Subject to the receipt of any requisite stockholder

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approval under the 1940 Act, Prospect's board of directors may adjust the hurdle rate by amending the Investment Advisory Agreement.

The income incentive fee payable by Prospect 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, Prospect Capital Management is not required to reimburse Prospect for any such income incentive fee payments. If Prospect does not have sufficient liquid assets to pay this incentive fee or distributions to stockholders on such accrued income, Prospect may be required to liquidate assets in order to do so. This fee structure could give rise to a conflict of interest for Prospect Capital Management to the extent that it may encourage Prospect Capital Management to favor debt financings that provide for deferred interest, rather than current cash payments of interest.

Prospect has entered into a royalty-free license agreement with Prospect Capital Management. Under this agreement, Prospect Capital Management agrees to grant Prospect a non-exclusive license to use the name "Prospect Capital." Under the license agreement, Prospect has the right to use the "Prospect Capital" name for so long as Prospect Capital Management or one of its affiliates remains Prospect's investment adviser. In addition, Prospect rents office space from Prospect Administration, an affiliate of Prospect Capital Management, and pays Prospect Administration Prospect's allocable portion of overhead and other expenses incurred by Prospect Administration in performing its obligations as Administrator under the Administration Agreement, including rent and Prospect's allocable portion of the costs of its chief financial officer and chief compliance officer and their respective staffs. This may create conflicts of interest that Prospect's board of directors monitors.

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

The incentive fee payable by Prospect to Prospect Capital Management may create an incentive for the Investment Adviser to make investments on Prospect's 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 Prospect's 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 Prospect's common stock. Similarly, because the Investment Adviser will receive an incentive fee based, in part, upon net capital gains realized on Prospect's 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 Prospect's 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 Prospect to Prospect Capital Management could create an incentive for the Investment Adviser to invest on Prospect's behalf in instruments, such as zero coupon bonds, that have a deferred interest feature. Under these investments, Prospect 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. Prospect's net investment income used to calculate the income incentive fee, however, includes accrued interest. For example, accrued interest, if any, on Prospect's investments in zero coupon bonds will be included in the calculation of its incentive fee, even though Prospect 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 use may not have yet received in cash in the event of default may never receive.

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Prospect may be obligated to pay its Investment Adviser incentive compensation even if Prospect incurs a loss.

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

The Investment Adviser and Administrator have the right to resign on 60 days' notice, and Prospect may not be able to find a suitable replacement within that time, resulting in a disruption in Prospect's operations that could adversely affect Prospect's business, financial condition and results of operations.

The Investment Adviser and Administrator have the right, under the Investment Advisory Agreement and Administration Agreement, respectively, to resign at any time upon not less than 60 days' written notice, whether Prospect has found a replacement or not. If the Investment Adviser or Administrator resigns, Prospect may not be able to find a replacement or hire internal management or administration with similar expertise and ability to provide the same or equivalent services on acceptable terms within 60 days, or at all. If Prospect is unable to do so quickly, Prospect's operations are likely to experience a disruption, Prospect's business, financial condition and results of operations as well as Prospect's ability to pay distributions are likely to be adversely affected and the market price of Prospect's shares may decline. In addition, the coordination of Prospect's internal management and investment activities or Prospect's internal administration activities, as applicable, is likely to suffer if Prospect is unable to identify and reach an agreement with a single institution or group of executives having the expertise possessed by the Investment Adviser and its affiliates or the Administrator and its affiliates. Even if Prospect is able to retain comparable management or administration, whether internal or external, the integration of such management or administration and their lack of familiarity with Prospect's investment objective may result in additional costs and time delays that may adversely affect Prospect's business, financial condition and results of operations.

Changes in the laws or regulations governing Prospect's business or the businesses of Prospect's portfolio companies and any failure by Prospect or Prospect's portfolio companies to comply with these laws or regulations, could negatively affect the profitability of Prospect's operations or of Prospect's portfolio companies.

Prospect is subject to changing rules and regulations of federal and state governments, as well as the stock exchange on which Prospect's common stock is listed. These entities, including the Public Company Accounting Oversight Board, the SEC and NASDAQ, have issued a significant number of new and increasingly complex requirements and regulations over the course of the last several years and continue to develop additional regulations. In particular, changes in the laws or regulations or the interpretations of the laws and regulations that govern BDCs, RICs or non-depository commercial lenders could significantly affect Prospect's operations and Prospect's cost of doing business. Prospect is subject to federal, state and local laws and regulations and are subject to judicial and administrative decisions that affect Prospect's operations, including Prospect's loan originations, maximum interest rates, fees and other charges, disclosures to portfolio companies, the terms of secured transactions, collection and foreclosure procedures and other trade practices. If these laws, regulations or decisions change, or if Prospect expands its business into jurisdictions that have adopted more stringent requirements than those in which Prospect currently conducts business, it may have to incur significant expenses in order to comply, or it might have to restrict its operations. In addition, if Prospect does not comply with applicable laws, regulations and decisions, it may lose licenses needed for the conduct of its business and be subject to civil fines and criminal penalties, any of which could have a material adverse effect upon its business, financial condition and results of operations.

Foreign and domestic political risk may adversely affect Prospect's business.

Prospect is 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 United States 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 Prospect's strategy.

Risks Relating to Prospect's Operation as a Business Development Company

If Prospect does not invest a sufficient portion of its assets in qualifying assets, Prospect could fail to qualify as a BDC or be precluded from investing according to its current business strategy.

As a BDC, Prospect may not acquire any assets other than "qualifying assets" unless, at the time of and after giving effect to such acquisition, at least 70% of Prospect's total assets are qualifying assets. Prospect believe that most of the investments that Prospect may acquire in the future will constitute qualifying assets. However, Prospect may be precluded from investing in what it believes are attractive investments if such investments are not qualifying assets for purposes of the 1940 Act. If Prospect does not invest a sufficient portion of its assets in qualifying assets, Prospect could be found to be in violation of the 1940 Act provisions applicable to BDCs, which would have a material adverse effect on its business, financial condition and results of operations. Similarly, these rules could prevent Prospect from making follow-on investments in existing portfolio companies (which could result in the dilution of its position) or could require Prospect to dispose of investments at inappropriate times in order to come into compliance with the 1940 Act. Because most of Prospect's investments will be in private companies, and therefore will be relatively illiquid, any such dispositions could be made at disadvantageous prices and could result in substantial losses.

If Prospect fails to qualify as a RIC, it will have to pay corporate-level taxes on its income, and Prospect's income available for distribution would be reduced.

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

The source of income requirement is satisfied if Prospect derives at least 90% of its 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 Prospect's 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 Prospect distributes at least 90% of its ordinary income and net short-term capital gains in excess of net long-term capital losses, if any, to Prospect's stockholders on an annual basis. Because Prospect uses debt financing, it is subject to certain asset coverage ratio requirements under the 1940 Act and financial covenants that could, under certain circumstances, restrict it from making distributions necessary to qualify for RIC tax treatment. If Prospect is unable to obtain cash from other sources, it may fail to qualify for RIC tax treatment and, thus, may be subject to corporate-level income tax on all of its taxable income.

To maintain Prospect's qualification as a RIC, it must also meet certain asset diversification requirements at the end of each quarter of its taxable year. Failure to meet these tests may result in

Prospect having to dispose of certain investments quickly in order to prevent the loss of RIC status. Because most of Prospect's investments are in private companies, any such dispositions could be made at disadvantageous prices and may result in substantial losses.

If Prospect fails to qualify as a RIC for any reason or become subject to corporate income tax, the resulting corporate taxes would substantially reduce its net assets, the amount of income available for distribution, and the actual amount of its distributions. Such a failure would have a materially adverse effect on Prospect and its stockholders. For additional information regarding asset coverage ratio and RIC requirements, see "Certain United States Federal Income Tax Considerations" and "Business Regulation as a Business Development Company."

Prospect may have difficulty paying its required distributions if it recognizes income before or without receiving cash representing such income.

For United States federal income tax purposes, Prospect includes in income certain amounts that it has 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 amounts could be significant relative to Prospect's overall investment activities. Prospect also may be required to include in taxable income certain other amounts that it does not receive in cash. While Prospect focuses primarily on investments that will generate a current cash return, its investment portfolio currently includes, and Prospect 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 Prospect 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 Prospect may recognize taxable income before or without receiving cash representing such income, it may have difficulty distributing at least 90% of its 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, Prospect may have to sell some of its investments at times it would not consider advantageous, raise additional debt or equity capital or reduce new investment originations to meet these distribution requirements. If Prospect is not able to obtain cash from other sources, it may fail to qualify for RIC treatment and thus become subject to corporate-level income tax. See "Certain United States Federal Income Tax Considerations" and "Business of Prospect Regulation as a Business Development Company."

Regulations governing Prospect's operation as a business development company affect its ability to raise, and the way in which it raises, additional capital.

Prospect has incurred indebtedness under its revolving credit facility and through the issuance of the Senior Notes and, in the future, may issue preferred stock or debt securities and/or borrow additional money from banks or other financial institutions, which Prospect refers to collectively as "senior securities," up to the maximum amount permitted by the 1940 Act. Under the provisions of the 1940 Act, Prospect is permitted, as a BDC, to incur indebtedness or issue senior securities only in amounts such that its asset coverage, as defined in the 1940 Act, equals at least 200% after each issuance of senior securities. If the value of Prospect's assets declines, it may be unable to satisfy this test, which would prohibit it from paying dividends in cash or other property and could prohibit it from qualifying as a RIC. If Prospect cannot satisfy this test, it may be required to sell a portion of its investments or sell additional shares of common stock at a time when such sales may be disadvantageous in order to repay a portion of its indebtedness or otherwise increase its net assets. In

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addition, issuance of additional common stock could dilute the percentage ownership of Prospect's current stockholders.

As a BDC regulated under provisions of the 1940 Act, Prospect is not generally able to issue and sell its common stock at a price below the current net asset value per share without stockholder approval. If Prospect's common stock trades at a discount to net asset value, this restriction could adversely affect its ability to raise capital. Prospect may, however, sell its common stock, or warrants, options or rights to acquire its common stock, at a price below the current net asset value of its common stock in certain circumstances, including if (i)(1) the holders of a majority of its shares (or, if less, at least 67% of a quorum consisting of a majority of its shares) and a similar majority of the holders of its shares who are not affiliated persons of Prospect approve the sale of its common stock at a price that is less than the current net asset value, and (2) a majority of Prospect's directors who have no financial interest in the transaction and a majority of Prospect's independent directors (a) determine that such sale is in Prospect's and its 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 Prospect or on its 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 Prospect's common stock entitled to vote at its annual meeting, without regard to whether a majority of such shares are voted in favor of the proposal, approve the sale of Prospect's common stock at a price that is less than the current net asset value per share.

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

Alternatively, Prospect may securitize its future loans to generate cash for funding new investments. See "Securitization of Prospect's assets subjects it to various risks."

Securitization of Prospect's assets subjects it to various risks.

Prospect may securitize assets to generate cash for funding new investments. Prospect refers to the term securitize to describe a form of leverage under which a company such as Prospect (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.

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In accordance with the above description, to securitize loans, Prospect may create a wholly owned subsidiary and contribute a pool of its assets to such subsidiary. The SPE may be funded with, among other things, whole loans and such loans may or may not be rated. The SPE would then sell its notes to purchasers who Prospect would expect to be willing to accept a lower interest rate and the absence of any recourse against Prospect to invest in a pool of income producing assets to which none of Prospect's creditors would have access. Prospect would retain all or a portion of the equity in the SPE. An inability to successfully securitize portions of Prospect's portfolio or otherwise leverage Prospect's portfolio through secured and unsecured borrowings could limit its ability to grow its business and fully execute its business strategy, and could decrease its earnings. However, the successful securitization of portions of Prospect's portfolio exposes it to a risk of loss for the equity it retains in the SPE and might expose it to greater risk on Prospect's remaining portfolio because the assets it retains 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 Prospect's business activities and may include limitations that could hinder Prospect's ability to finance additional loans and investments or to make the distributions required to maintain its status as a RIC under Subchapter M of the Code. The 1940 Act may also impose restrictions on the structure of any securitizations.

Interests Prospect holds in the SPE, if any, will be subordinated to the other interests issued by the SPE. As such, Prospect 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, Prospect's 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 SPEs 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 Prospect retains would be reduced. Securitization imposes on Prospect the same risks as borrowing except that Prospect's risk in a securitization is limited to the amount of subordinated interests it retains, whereas in a borrowing or debt issuance by Prospect directly, Prospect would be at risk for the entire amount of the borrowing or debt issuance.

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

Prospect may also engage in transactions utilizing SPEs and securitization techniques where the assets sold or contributed to the SPE remain on Prospect's balance sheet for accounting purposes. If, for example, Prospect sells the assets to the SPE with recourse or provides a guarantee or other credit support to the SPE, its assets will remain on Prospect's balance sheet. Consolidation would also generally result if Prospect, in consultation with the SEC, determines that consolidation would result in a more accurate reflection of Prospect's 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 Prospect's 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 Prospect for purposes of Prospect's limitation on the issuance of senior securities.

The Investment Adviser may have conflicts of interest with respect to potential securitizations in as much as securitizations that are not consolidated may reduce Prospect's assets for purposes of determining its investment advisory fee although in some circumstances the 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.

Prospect's ability to invest in public companies may be limited in certain circumstances.

As a BDC, Prospect 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 its 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.

Risks Relating to Prospect's Investments

Prospect may not realize gains or income from its investments.

Prospect seeks to generate both current income and capital appreciation. However, the securities Prospect invests in may not appreciate and, in fact, may decline in value, and the issuers of debt securities Prospect invests in may default on interest and/or principal payments. Accordingly, Prospect may not be able to realize gains from its investments, and any gains that it does realize may not be sufficient to offset any losses it experiences. See "Business of Prospect Prospect's Investment Objective and Policies."

Most of Prospect's portfolio investments are recorded at fair value as determined in good faith under the direction of its board of directors and, as a result, there is uncertainty as to the value of its portfolio investments.

A large percentage of Prospect's 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 Prospect may incur in any year, is to a degree subjective, and the Investment Adviser has a conflict of interest in making the determination. Prospect values these securities quarterly at fair value as determined in good faith by its board of directors based on input from the Investment Adviser, the Administrator, a third party independent valuation firm and Prospect's Audit Committee. Prospect's 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 Prospect's 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 Prospect's 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. Prospect's net asset value could be adversely affected if the determinations regarding the fair value of its investments were materially higher than the values that Prospect ultimately realizes upon the disposal of such securities.

In addition, decreases in the market values or fair values of Prospect's 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 Prospect's portfolio in the past. The effect of all of these factors on Prospect's portfolio reduced its NAV by increasing net unrealized depreciation in its portfolio. Depending on market conditions, Prospect could incur substantial realized losses and may continue to suffer additional unrealized losses

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in future periods, which could have a material adverse impact on Prospect's business, financial condition and results of operations. Prospect has no policy regarding holding a minimum level of liquid assets. As such, a high percentage of Prospect's portfolio generally is not liquid at any given point in time. See "The lack of liquidity in Prospect's investments may adversely affect its business."

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

As a BDC, Prospect is required to carry its 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 its board of directors. As part of the valuation process, the types of factors that Prospect may take into account in determining the fair value of its 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, Prospect's principal market (as the reporting entity) and enterprise values. Decreases in the market values or fair values of Prospect's investments are recorded as unrealized depreciation. The effect of all of these factors on Prospect's portfolio can reduce Prospect's net asset value by increasing net unrealized depreciation in its portfolio. Depending on market conditions, Prospect could incur substantial realized losses and may suffer additional unrealized losses in future periods, which could have a material adverse impact on its business, financial condition and results of operations.

Prospect's investments in prospective portfolio companies may be risky and it could lose all or part of its investment.

Some of Prospect's 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 Prospect's investment in them may decline substantially or fall to zero.

In addition, investment in the middle market companies that Prospect is 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 Prospect holds, 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 Prospect's realizing on any guarantees it may have obtained in connection with its 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, Prospect will depend on the ability of the Investment Adviser to obtain adequate information to evaluate these companies in making investment decisions. If the Investment Adviser is unable to uncover all material information about these companies, it may not make a fully informed investment decision, and Prospect may lose money on its 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 Prospect's portfolio company and, in turn, on Prospect;

- 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;

- changes in laws and regulations, as well as their interpretations, may adversely affect their business, financial structure or prospects; and

- 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, Prospect's executive officers, directors and the Investment Adviser could, in the ordinary course of business, be named as defendants in litigation arising from proposed investments or from its investments in the portfolio companies.

The lack of liquidity in Prospect's investments may adversely affect its business.

Prospect makes 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 Prospect's investments may make it difficult for it to sell such investments if the need arises. In addition, if Prospect is required to liquidate all or a portion of its portfolio quickly, Prospect may realize significantly less than the value at which it has previously recorded its investments. In addition, Prospect faces other restrictions on its ability to liquidate an investment in a business entity to the extent that it or the Investment Adviser has or could be deemed to have material non-public information regarding such business entity.

Economic recessions or downturns could impair Prospect's portfolio companies and harm its operating results.

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

A portfolio company's failure to satisfy financial or operating covenants imposed by Prospect 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 Prospect holds. Prospect 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 Prospect's portfolio companies were to go bankrupt, even though Prospect may

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have structured Prospect's interest as senior debt or preferred equity, depending on the facts and circumstances, including the extent to which Prospect actually provided managerial assistance to that portfolio company, a bankruptcy court might re-characterize Prospect's debt or equity holding and subordinate all or a portion of Prospect's claim to those of other creditors.

Investments in equity securities, many of which are illiquid with no readily available market, involve a substantial degree of risk.

Prospect may purchase common and other equity securities. Although common stock has historically generated higher average total returns than fixed income securities over the long-term, common stock also has experienced significantly more volatility in those returns and in recent years has significantly underperformed relative to fixed income securities. The equity securities Prospect acquires may fail to appreciate and may decline in value or become worthless and Prospect's ability to recover its investment will depend on its portfolio company's success. Investments in equity securities involve a number of significant risks, including:

- any equity investment Prospect makes in a portfolio company could be subject to further dilution as a result of the issuance of additional equity interests and to serious risks as a junior security that will be subordinate to all indebtedness (including trade creditors) or senior securities in the event that the issuer is unable to meet its obligations or becomes subject to a bankruptcy process;

- to the extent that the portfolio company requires additional capital and is unable to obtain it, Prospect may not recover its investment; and

- in some cases, equity securities in which Prospect invests will not pay current dividends, and Prospect's ability to realize a return on its investment, as well as to recover its investment, will be dependent on the success of the portfolio company. Even if the portfolio company is successful, Prospect's ability to realize the value of its investment may be dependent on the occurrence of a liquidity event, such as a public offering or the sale of the portfolio company. It is likely to take a significant amount of time before a liquidity event occurs or Prospect can otherwise sell its investment. In addition, the equity securities Prospect receives or invests in may be subject to restrictions on resale during periods in which it could be advantageous to sell them.

There are special risks associated with investing in preferred securities, including:

- preferred securities may include provisions that permit the issuer, at its discretion, to defer distributions for a stated period without any adverse consequences to the issuer. If Prospect owns a preferred security that is deferring its distributions, Prospect may be required to report income for tax purposes before Prospect receives such distributions;

- preferred securities are subordinated to debt in terms of priority to income and liquidation payments, and therefore will be subject to greater credit risk than debt;

- preferred securities may be substantially less liquid than many other securities, such as common stock or United States government securities; and

- generally, preferred security holders have no voting rights with respect to the issuing company, subject to limited exceptions.

Additionally, when Prospect invest in first lien senior secured loans (including unitranche loans), second lien senior secured loans or mezzanine debt, Prospect may acquire warrants or other equity securities as well. Prospect's goal is ultimately to dispose of such equity interests and realize gains upon Prospect's disposition of such interests. However, the equity interests Prospect receives may not appreciate in value and, in fact, may decline in value. Accordingly, Prospect may not be able to realize gains from its equity interests and any gains that it does realize on the disposition of any equity interests may not be sufficient to offset any other losses Prospect experiences.

Prospect may invest, to the extent permitted by law, in the equity securities of investment funds that are operating pursuant to certain exceptions to the 1940 Act and in advisers to similar investment funds and, to the extent Prospect so invests, will bear Prospect's ratable share of any such company's expenses, including management and performance fees. Prospect will also remain obligated to pay management and incentive fees to Prospect Capital Management with respect to the assets invested in the securities and instruments of such companies. With respect to each of these investments, each of Prospect's common stockholders will bear his or her share of the management and incentive fee of Prospect Capital Management as well as indirectly bearing the management and performance fees and other expenses of any such investment funds or advisers.

There may be circumstances where Prospect's debt investments could be subordinated to claims of other creditors or Prospect could be subject to lender liability claims.

If one of Prospect's portfolio companies were to go bankrupt, even though Prospect may have structured its interest as senior debt, depending on the facts and circumstances, a bankruptcy court might re-characterize Prospect's debt holding as an equity investment and subordinate all or a portion of Prospect's claim to that of other creditors. In addition, lenders can be subject to lender liability claims for actions taken by them where they become too involved in the borrower's business or exercise control over the borrower. For example, Prospect could become subject to a lender's liability claim, if, among other things, Prospect actually renders significant managerial assistance.

Prospect's portfolio companies may incur debt or issue equity securities that rank equally with, or senior to, its investments in such companies.

Prospect's portfolio companies may have, or may be permitted to incur, other debt, or issue other equity securities, that rank equally with, or senior to, its investments. 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 Prospect is entitled to receive payments in respect of its investments. These debt instruments would usually prohibit the portfolio companies from paying interest on or repaying Prospect's investments in the event and during the continuance of a default under such debt. Also, in the event of insolvency, liquidation, dissolution, reorganization or bankruptcy of a portfolio company, holders of securities ranking senior to Prospect's investment in that portfolio company typically are entitled to receive payment in full before Prospect receives any distribution in respect of its investment. After repaying such holders, the portfolio company may not have any remaining assets to use for repaying its obligation to Prospect. In the case of securities ranking equally with Prospect's investments, Prospect 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.

The rights Prospect may have with respect to the collateral securing any junior priority loans Prospect makes to its portfolio companies may also be limited pursuant to the terms of one or more intercreditor agreements (including agreements governing "first out" and "last out" structures) that Prospect enters into with the holders of senior debt. Under such an intercreditor agreement, at any time that senior obligations are outstanding, Prospect may forfeit certain rights with respect to the collateral to the holders of the senior obligations. These rights may include the right to commence enforcement proceedings against the collateral, the right to control the conduct of such enforcement proceedings, the right to approve amendments to collateral documents, the right to release liens on the collateral and the right to waive past defaults under collateral documents. Prospect may not have the ability to control or direct such actions, even if as a result Prospect's rights as junior lenders are adversely affected.

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When Prospect is a debt or minority equity investor in a portfolio company, Prospect is often not in a position to exert influence on the entity, and other equity holders and management of the company may make decisions that could decrease the value of its portfolio holdings.

When Prospect makes debt or minority equity investments, Prospect is subject to the risk that a portfolio company may make business decisions with which Prospect disagrees and the other equity holders and management of such company may take risks or otherwise act in ways that do not serve Prospect's interests. As a result, a portfolio company may make decisions that could decrease the value of Prospect's investment.

Prospect's portfolio companies may be highly leveraged.

Some of Prospect's portfolio companies may be highly leveraged, which may have adverse consequences to these companies and to Prospect as an investor. These companies may be subject to restrictive financial and operating covenants and the leverage may impair these companies' ability to finance their future operations and capital needs. As a result, these companies' flexibility to respond to changing business and economic conditions and to take advantage of business opportunities may be limited. Further, a leveraged company's income and net assets will tend to increase or decrease at a greater rate than if borrowed money were not used.

Prospect's portfolio contains a limited number of portfolio companies, which subjects Prospect 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 Prospect's portfolio is that the aggregate returns Prospect realizes may be significantly adversely affected if one or more of Prospect's significant portfolio company investments perform poorly or if Prospect needs to write down the value of any one significant investment. Beyond Prospect's income tax diversification requirements, Prospect does not have fixed guidelines for diversification, and Prospect's portfolio could contain relatively few portfolio companies.

Prospect's failure to make follow-on investments in its portfolio companies could impair the value of its portfolio.

Following an initial investment in a portfolio company, Prospect may make additional investments in that portfolio company as "follow-on" investments, in order to: (1) increase or maintain in whole or in part Prospect's 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 Prospect's investment.

Prospect may elect not to make follow-on investments, may be constrained in its ability to employ available funds, or otherwise may lack sufficient funds to make those investments. Prospect has 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 Prospect's initial investment, or may result in a missed opportunity for Prospect to increase its participation in a successful operation. Even if Prospect has sufficient capital to make a desired follow-on investment, it may elect not to make a follow-on investment because it may not want to increase its concentration of risk, because Prospect prefers other opportunities, or because Prospect is inhibited by compliance with BDC requirements or the desire to maintain Prospect's tax status.

Prospect may be unable to invest the net proceeds raised from offerings and repayments from investments on acceptable terms, which would harm its financial condition and operating results.

Until Prospect identifies new investment opportunities, it intends to either invest the net proceeds of future offerings and repayments from investments in interest-bearing deposits or other short-term

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instruments or use the net proceeds from such offerings to reduce then-outstanding obligations under Prospect's credit facility. Prospect cannot assure you that it will be able to find enough appropriate investments that meet its investment criteria or that any investment Prospect completes using the proceeds from an offering will produce a sufficient return.

Prospect may have limited access to information about privately held companies in which it invests.

Prospect invests primarily in privately-held companies. Generally, little public information exists about these companies, and Prospect is required to rely on the ability of the Investment Adviser's investment professionals to obtain adequate information to evaluate the potential returns from investing in these companies. These companies and their financial information are not subject to the Sarbanes-Oxley Act of 2002 and other rules that govern public companies. If Prospect is unable to uncover all material information about these companies, Prospect may not make a fully informed investment decision, and Prospect may lose money on its investment.

Prospect may not be able to fully realize the value of the collateral securing its debt investments.

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

- Prospect's debt investments may be in the form of mezzanine loans, therefore its liens on the collateral, if any, are subordinated to those of the senior secured debt of the portfolio companies, if any. As a result, Prospect 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 Prospect's secured loan, particularly after giving effect to the repayment of secured debt of the portfolio company that ranks senior to Prospect's loan;
- bankruptcy laws may limit Prospect's ability to realize value from the collateral and may delay the realization process;
- Prospect's 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
- 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.

Prospect's investments in foreign securities may involve significant risks in addition to the risks inherent in United States investments.

Prospect's investment strategy contemplates potential investments in securities of foreign companies, including those located in emerging market countries. Investing in foreign companies may expose Prospect to additional risks not typically associated with investing in United States 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.

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Although currently all of Prospect's investments are, and Prospect expects that most of its investments will be, United States 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.

Prospect may expose itself to risks if it engages in hedging transactions.

Prospect may employ hedging techniques to minimize certain investment risks, such as fluctuations in interest and currency exchange rates, but it can offer no assurance that such strategies will be effective. If Prospect engages in hedging transactions, it may expose itself to risks associated with such transactions. Prospect 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 Prospect's portfolio positions from changes in currency exchange rates and market interest rates. Hedging against a decline in the values of Prospect's 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 Prospect is not able to enter into a hedging transaction at an acceptable price. Furthermore, Prospect's ability to engage in hedging transactions may also be adversely affected by recent rules adopted by the United States Commodity Futures Trading Commission.

The success of Prospect's hedging transactions depends on its ability to correctly predict movements, currencies and interest rates. Therefore, while Prospect 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 Prospect 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, Prospect may not seek to establish a perfect correlation between such hedging instruments and the portfolio holdings being hedged. Any such imperfect correlation may prevent Prospect from achieving the intended hedge and expose Prospect 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. Prospect 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.

Prospect's board of directors may change Prospect's operating policies and strategies without prior notice or stockholder approval, the effects of which may be adverse to Prospect and could impair the value of Prospect's stockholders' investment.

Prospect's board of directors has the authority to modify or waive Prospect's current operating policies and Prospect's strategies without prior notice and without stockholder approval. Prospect cannot predict the effect any changes to its current operating policies and strategies would have on Prospect's business, financial condition, and value of its common stock. However, the effects might be adverse, which could negatively impact Prospect's ability to pay dividends and cause stockholders to lose all or part of their investment.

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Prospect's investments in CLOs may be riskier and less transparent to Prospect and its stockholders than direct investments in the underlying companies.

Prospect invests in CLOs. Generally, there may be less information available to Prospect regarding the underlying debt investments held by CLOs than if Prospect had invested directly in the debt of the underlying companies. As a result, Prospect's stockholders will not know the details of the underlying securities of the CLOs in which Prospect will invest. Prospect's CLO investments are subject to the risk of leverage associated with the debt issued by such CLOs and the repayment priority of senior debt holders in such CLOs. Prospect's investments in portfolio companies may be risky, and Prospect could lose all or part of its investment.

CLOs typically will have no significant assets other than their underlying Senior Secured Loans; payments on CLO investments are and will be payable solely from the cashflows from such Senior Secured Loans.

CLOs typically will have no significant assets other than their underlying Senior Secured Loans. Accordingly, payments on CLO investments are and will be payable solely from the cashflows from such Senior Secured Loans, net of all management fees and other expenses. Payments to Prospect as a holder of CLO junior securities are and will be made only after payments due on the senior secured notes, and, where appropriate, the junior secured notes, have been made in full. This means that relatively small numbers of defaults of Senior Secured Loans may adversely impact Prospect's returns.

Prospect's CLO investments are exposed to leveraged credit risk.

Generally, Prospect is in a subordinated position with respect to realized losses on the Senior Secured Loans underlying Prospect's investments in CLOs. The leveraged nature of CLOs, in particular, magnifies the adverse impact of Senior Secured Loan defaults. CLO investments represent a leveraged investment with respect to the underlying Senior Secured Loans. Therefore, changes in the market value of the CLO investments could be greater than the change in the market value of the underlying Senior Secured Loans, which are subject to credit, liquidity and interest rate risk.

There is the potential for interruption and deferral of cashflow from CLO investments.

If certain minimum collateral value ratios and/or interest coverage ratios are not met by a CLO, primarily due to