

PROSPECT CAPITAL CORP

Form 497

September 03, 2010

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**Filed Pursuant to Rule 497(e)  
Registration No. 333-164270**

**PROSPECTUS SUPPLEMENT  
(To Prospectus dated March 4, 2010)**

**Up to 2,185,472 Shares**

**Common Stock**

Prospect Capital Corporation is a financial services company that lends to and invests in middle market, privately-held companies. We are organized as an externally-managed, non-diversified closed-end management investment company that has elected to be treated as a business development company under the Investment Company Act of 1940. Prospect Capital Management LLC manages our investments and Prospect Administration LLC provides the administrative services necessary for us to operate.

On July 19, 2010, we entered into separate equity distribution agreements with each of RBC Capital Markets Corporation, or RBC, BB&T Capital Markets, a division of Scott & Stringfellow, LLC, or BB&T, and Knight Capital Markets LLC, or Knight, relating to shares of common stock offered by this prospectus supplement and the accompanying prospectus. We sometimes refer to RBC, BB&T and Knight individually as a Sales Manager and together as the Sales Managers. The equity distribution agreements provide that we may offer and sell up to 6,000,000 shares of our common stock from time to time through the Sales Managers, as our agents for the offer and sale of such common stock. During the period from July 19, 2010 (the date of the equity distribution agreements) through August 19, 2010, we sold 3,814,528 shares of our common stock through the Sales Managers pursuant to the equity distribution agreements. No sales of common stock were made pursuant to the equity distribution agreements during the period from August 20, 2010 through the date of this prospectus supplement. As such, there are 2,185,472 shares of common stock remaining that we may offer and sell through the Sales Managers pursuant to the equity distribution agreements and this prospectus supplement and the accompanying prospectus. See Prospectus Summary Recent Developments on page S-1 of this prospectus supplement.

Sales of our common stock, if any, under this prospectus supplement and the accompanying prospectus may be made in negotiated transactions or transactions that are deemed to be at the market as defined in Rule 415 under the Securities Act of 1933, as amended, or the 1933 Act, including sales made directly on the NASDAQ Global Select Market or sales made to or through a market maker other than on an exchange.

Each Sales Manager will receive from us a commission equal to 2% of the gross sales price of all shares of common stock sold through it as Sales Manager under the applicable equity distribution agreement. No Sales Manager is required to sell any specific number or dollar amount of common stock, but each will use its commercially reasonable efforts to sell the common stock offered by this prospectus supplement and the accompanying prospectus. See Plan of Distribution on page S-57 of this prospectus supplement.

These shares of common stock may be offered at a discount from our most recently determined net asset value per share pursuant to authority granted by our stockholders at the annual meeting of stockholders held on December 11,

2009. Sales of common stock at prices below net asset value per share dilute the interests of existing stockholders, have the effect of reducing our net asset value per share and may reduce our market price per share. See **Risk Factors** beginning on page S-7 and **Sales of Common Stock Below Net Asset Value** beginning on page S-52 of this prospectus supplement and on page 80 of the accompanying prospectus.

Our common stock is traded on the NASDAQ Global Select Market under the symbol **PSEC**. The last reported closing sales price for our common stock on September 2, 2010 was \$9.43 per share and our most recently determined net asset value per share was \$10.29 as of June 30, 2010 (\$10.02 on an as adjusted basis solely to give effect to our distributions with record dates of July 30, 2010 and August 31, 2010, our issuance of common stock on July 30, 2010 and August 31, 2010 in connection with our dividend reinvestment plan, our sale of 2,748,600 shares of common stock during the period from June 28, 2010 through July 16, 2010 (with settlement dates of July 1, 2010 through July 21, 2010) and our sale of 3,814,528 shares of common stock during the period from July 19, 2010 through August 19, 2010 (with settlement dates of July 22, 2010 through August 24, 2010).

This prospectus supplement and the accompanying prospectus contain important information you should know before investing in our securities. Please read it before you invest and keep it for future reference. We file annual, quarterly and current reports, proxy statements and other information about us with the Securities and Exchange Commission, or the **SEC**. This information is available free of charge by contacting us at 10 East 40th Street, 44th Floor, New York, NY 10016 or by telephone at (212) 448-0702. The SEC maintains a website at [www.sec.gov](http://www.sec.gov) where such information is available without charge upon written or oral request. Our internet website address is [www.prospectstreet.com](http://www.prospectstreet.com). Information contained on our website is not incorporated by reference into this prospectus supplement or the accompanying prospectus and you should not consider information contained on our website to be part of this prospectus supplement or the accompanying prospectus.

**Investing in our common stock involves risks. See **Risk Factors** beginning on page S-7 of this prospectus supplement and on page 9 of the accompanying prospectus.**

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

**RBC Capital Markets**

**Knight**

**BB&T Capital Markets  
A division of Scott & Stringfellow, LLC**

Prospectus Supplement dated September 3, 2010

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**FORWARD-LOOKING STATEMENTS**

Our annual report on Form 10-K for the year ended June 30, 2010, any of our quarterly reports on Form 10-Q or current reports on Form 8-K, or any other oral or written statements made in press releases or otherwise by or on behalf of Prospect Capital Corporation including this prospectus supplement and the accompanying prospectus may contain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, or the 1934 Act, which involve substantial risks and uncertainties. Forward-looking statements predict or describe our future operations, business plans, business and investment strategies and portfolio management and the performance of our investments and our investment management business. These forward-looking statements are not historical facts, but rather are based on current expectations, estimates and projections about our industry, our beliefs, and our assumptions. Words such as intends, intend, intended, goal, estimate, estimates, expects, expect, project, projected, projections, plans, seeks, anticipates, anticipated, should, could, may, will, future, believe, believes and scheduled and variations of these words and similar expressions are intended to identify forward-looking statements. Our actual results or outcomes may differ materially from those anticipated. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date the statement was made. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. These statements are not guarantees of future performance and are subject to risks, uncertainties, and other factors, some of which are beyond our control and difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements, including without limitation:

our future operating results,

our business prospects and the prospects of our portfolio companies,

the impact of investments that we expect to make,

our contractual arrangements and relationships with third parties,

the dependence of our future success on the general economy and its impact on the industries in which we invest,

the ability of our portfolio companies to achieve their objectives,

difficulty in obtaining financing or raising capital, especially in the current credit and equity environment,

the level and volatility of prevailing interest rates and credit spreads, magnified by the current turmoil in the credit markets,

adverse developments in the availability of desirable loan and investment opportunities whether they are due to competition, regulation or otherwise,

a compression of the yield on our investments and the cost of our liabilities, as well as the level of leverage available to us,

our regulatory structure and tax treatment, including our ability to operate as a business development company and a regulated investment company,

the adequacy of our cash resources and working capital,

the timing of cash flows, if any, from the operations of our portfolio companies,

the ability of our investment adviser to locate suitable investments for us and to monitor and administer our investments,

authoritative generally accepted accounting principles or policy changes from such standard-setting bodies as the Financial Accounting Standards Board, the Securities and Exchange Commission, Internal Revenue Service, the NASDAQ Global Select Market, and other authorities that we are subject to, as well as their counterparts in any foreign jurisdictions where we might do business, and

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

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Although we believe that the assumptions on which these forward-looking statements are based are reasonable, any of those assumptions could prove to be inaccurate, and as a result, the forward-looking statements based on those assumptions also could be inaccurate. Important assumptions include our ability to originate new loans and investments, certain margins and levels of profitability and the availability of additional capital. In light of these and other uncertainties, the inclusion of a projection or forward-looking statement in this prospectus supplement and the accompanying prospectus, respectively, should not be regarded as a representation by us that our plans and objectives will be achieved. These risks and uncertainties include those described or identified in Risk Factors and elsewhere in this prospectus supplement and the accompanying prospectus, respectively. You should not place undue reliance on these forward-looking statements, which apply only as of the date of this prospectus supplement or the accompanying prospectus, as applicable. These forward-looking statements do not meet the safe harbor for forward-looking statements pursuant to Section 27A of the 1933 Act.

You should rely only on the information contained in this prospectus supplement and the accompanying prospectus. We have not, and the Sales Managers have not, authorized any other person to provide you with information that is different from that contained in this prospectus supplement or the accompanying prospectus. If anyone provides you with different or inconsistent information, you should not rely on it. We are not, and the Sales Managers are not, making an offer of these securities in any jurisdiction where the offer is not permitted. You should assume that the information appearing in this prospectus supplement and the accompanying prospectus is accurate only as of their respective dates. Our business, financial condition and results of operations may have changed since those dates. This prospectus supplement supersedes the accompanying prospectus to the extent it contains information that is different from or in addition to the information in that prospectus.

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**PROSPECTUS SUMMARY**

*This summary highlights some information from this prospectus supplement and the accompanying prospectus, and it may not contain all of the information that is important to you. To understand the terms of the common stock offered hereby, you should read this prospectus supplement and the accompanying prospectus carefully. Together, these documents describe the specific terms of the shares of common stock we are offering. You should carefully read the sections titled *Risk Factors* in this prospectus supplement and in the accompanying prospectus and the documents identified in the section *Available Information*.*

*The terms *we*, *us*, *our* and *Company*, refer to Prospect Capital Corporation; *Prospect Capital Management*, *Investment Advisor* and *PCM* refer to Prospect Capital Management LLC; and *Prospect Administration* and the *Administrator* refer to Prospect Administration LLC.*

**The Company**

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

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

We seek to maximize total returns to our investors, including both current yield and equity upside, by applying rigorous credit analysis and asset-based and cash-flow based lending techniques to make and monitor our investments. Many of our investments to date have been in energy-related industries. We have made no investments to date in the real estate or mortgage industries, and we do not intend currently to focus on such investments.

We are currently pursuing multiple investment opportunities, including purchases of portfolios from private and public companies, as well as originations and secondary purchases of particular securities. There can be no assurance that we will successfully consummate any investment opportunity we are currently pursuing. Motivated sellers, including commercial finance companies, hedge funds, other business development companies, total return swap counterparties, banks, collateralized loan obligation funds, and other entities, are suffering from excess leverage, and we believe we are well positioned to capitalize as potential buyers of such assets at attractive prices. If any of these opportunities are consummated, there can be no assurance that investors will share our view of valuation or that any assets acquired will not be subject to future write downs, each of which could have an adverse effect on our stock price.

As of June 30, 2010, we held investments in 58 portfolio companies. The aggregate fair value as of June 30, 2010 of investments in these portfolio companies held on that date is approximately \$748 million. Our portfolio across all our long-term debt and certain equity investments had an annualized current yield of 14.2% as of June 30, 2010. The yield

includes interest as well as dividends.

### **Recent Developments**

#### **Sales Pursuant to the Equity Distribution Agreements**

During the period from July 19, 2010 (the date of the equity distribution agreements) through August 19, 2010, we sold 3,814,528 shares of our common stock through the Sales Managers pursuant to the equity distribution agreements. No sales of common stock were made pursuant to the equity distribution agreements during the period

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from August 20, 2010 through the date of this prospectus supplement. The sales resulted in gross proceeds to the Company of \$37.0 million. The aggregate gross sales commission to RBC, the sole Sales Manager utilized through August 19, 2010, has been \$0.7 million. The aggregate net proceeds from such sales are approximately \$36.3 million after deducting related expenses, including commissions to the Sales Managers.

**Stock Issuance in Connection with Dividend Reinvestment Plan**

On July 30, 2010, we issued 83,875 shares of our common stock in connection with our dividend reinvestment plan.

On August 31, 2010, we issued 89,620 shares of our common stock in connection with our dividend reinvestment plan.

**Dividends**

On August 26, 2010, we declared monthly dividends in the following amounts and with the following record and payment dates:

\$0.100625 per share for September 2010 to holders of record on September 30, 2010 with a payment date of October 29, 2010; and

\$0.100750 per share for October 2010 to holders of record on October 29, 2010 with a payment date of November 30, 2010.

**Recent Investment Activity**

On July 14, 2010, we closed a \$37.4 million first lien senior secured credit facility to support the acquisition by H.I.G. Capital of a leading consumer credit enhancement services company.

On July 23, 2010, we made a secured debt investment of \$21 million in SonicWALL, Inc., a global leader in network security and data protection for small, mid-sized, and large enterprise organizations.

On July 30, 2010, we invested \$52.4 million of combined debt and equity in AIRMALL USA Inc., a leading developer and manager of airport retail operations.

On July 30, 2010, we recapitalized our debt investment in Northwestern Management Services, LLC, a leading dental practice management company in the Southeast Florida market, providing \$10.8 million of additional funding to fund the acquisition of six dental practices.

**Amendment to Charter**

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

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**The Offering**

Common stock offered by us	Up to 2,185,472 shares.
Common stock outstanding as of the date of this prospectus supplement	75,823,485 shares.
Use of proceeds	We expect to use the net proceeds from this offering initially to maintain balance sheet liquidity, involving repayment of debt under our credit facility, investments in high quality short-term debt instruments or a combination thereof, and thereafter to make long-term investments in accordance with our investment objective. See Use of Proceeds in this prospectus supplement.
The NASDAQ Global Select Market symbol	PSEC
Risk factors	See Risk Factors in this prospectus supplement and the accompanying prospectus and other information in this prospectus supplement and the accompanying prospectus for a discussion of factors you should carefully consider before you decide whether to make an investment in shares of our common stock.
Current distribution rate	<p>On June 18, 2010 and August 26, 2010, we announced that our Board of Directors declared monthly distributions in the following amounts and with the following record and payment dates:</p> <p>\$0.10 per share for June 2010 to holders of record on June 30, 2010 with a payment date of July 30, 2010;</p> <p>\$0.10025 per share for July 2010 to holders of record on July 30, 2010 with a payment date of August 31, 2010;</p> <p>\$0.10050 per share for August 2010 to holders of record on August 31, 2010 with a payment date of September 30, 2010;</p> <p>\$0.100625 per share for September 2010 to holders of record on September 30, 2010 with a payment date of October 29, 2010; and</p> <p>\$0.100750 per share for October 2010 to holders of record on October 29, 2010 with a payment date of November 30, 2010,</p> <p>representing an annualized distribution yield (based on the August 2010 distribution) of approximately 12.8% based on our September 2, 2010 closing stock price of \$9.43 per share. Such distributions are expected to be payable out of earnings. Our distribution levels are subject to change or discontinuance at any time in the discretion of our Board of Directors. Our future earnings and operating cash flow may not be sufficient to support a dividend.</p>



**Table of Contents*****Fees and Expenses***

The following tables are intended to assist you in understanding the costs and expenses that an investor in this offering will bear directly or indirectly. In these tables, we assume that we have borrowed \$210 million under our credit facility, which is the maximum amount currently available under the credit facility. As of September 2, 2010, we had \$78.7 million outstanding under our credit facility and, based on the assets currently pledged as collateral on the facility, an additional approximately \$126.2 million was available to us for borrowing under our credit facility. Except where the context suggests otherwise, whenever this prospectus supplement and the accompanying prospectus contains a reference to fees or expenses paid by you, us or Prospect Capital, or that we will pay fees or expenses, the Company will pay such fees and expenses out of our net assets and, consequently, you will indirectly bear such fees or expenses as an investor in the Company. However, you will not be required to deliver any money or otherwise bear personal liability or responsibility for such fees or expenses.

**Stockholder transaction expenses:**

Sales load (as a percentage of offering price)(1)	2.00%
Offering expenses borne by us (as a percentage of offering price)(2)	0.36%
Dividend reinvestment plan expenses(3)	None
Total stockholder transaction expenses (as a percentage of offering price)	2.36%
<b>Annual expenses (as a percentage of net assets attributable to common stock)(4):</b>	
Management Fees(5)	2.65%
Incentive fees payable under Investment Advisory Agreement (20% of realized capital gains and 20% of pre-incentive fee net investment income)(6)	2.34%
Interest payments on borrowed funds	1.26%(7)
Acquired Fund Fees and Expenses	0.01%(8)
Other expenses	1.91%
Total annual expenses	8.17%(6)

***Example***

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

	<b>1 Year</b>	<b>3 Years</b>	<b>5 Years</b>	<b>10 Years</b>
You would pay the following expenses on a \$1,000 investment, assuming a 5% annual return	\$ 80.56	\$ 192.99	\$ 303.56	\$ 572.05

While the example assumes, as required by the SEC, a 5% annual return, our performance will vary and may result in a return greater or less than 5%. The income incentive fee under our Investment Advisory Agreement with Prospect Capital Management would be zero at the 5% annual return assumption required by the SEC for this table, since no incentive fee is paid until the annual return exceeds 7%. This illustration assumes that we will not realize any capital gains computed net of all realized capital losses and unrealized capital depreciation in any of the indicated time periods. If we achieve sufficient returns on our investments, including through the realization of capital gains, to trigger an incentive fee of a material amount, our expenses, and returns to our investors after such expenses, would be

higher. In addition, while the example assumes reinvestment of all dividends and distributions at NAV per share, participants in our dividend reinvestment plan will receive a number of shares of our common stock determined by dividing the total dollar amount of the dividend payable to a participant by the market price per share of our common stock at the close of trading on the valuation date for the dividend. See [Dividend Reinvestment Plan](#) in the accompanying prospectus for additional information regarding our dividend reinvestment plan.

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

- (1) Represents the commission with respect to our shares of common stock being sold in this offering, which we will pay to the Sales Managers in connection with sales of common stock effected by the Sales Managers in this offering. This is the only sales load to be paid in connection with this offering. There is no guaranty that there will be any sales of our common stock pursuant to this prospectus supplement and the accompanying prospectus.
- (2) The offering expenses of this offering are estimated to be approximately \$75,000.
- (3) The expenses of the dividend reinvestment plan are included in other expenses.
- (4) Net assets attributable to our common stock equal net assets (i.e., total assets less liabilities other than liabilities for money borrowed for investment purposes) at June 30, 2010. See Capitalization in this prospectus supplement.
- (5) Our base management fee is 2% of our gross assets (which include any amount borrowed, i.e., total assets without deduction for any liabilities). Assuming that we have borrowed \$210 million (the size of our credit facility), the 2% management fee of gross assets equals 2.65% of net assets. See Management Management Services Investment Advisory Agreement in the accompanying prospectus and footnote 6 below.
- (6) Based on an annualized level of incentive fee paid during our year ended June 30, 2010, all of which consisted of an income incentive fee. For a more detailed discussion of the calculation of the two-part incentive fee, see Management Management Services Investment Advisory Agreement in the accompanying prospectus.
- (7) We may borrow additional money before and after the proceeds of this offering are substantially invested. After this offering, we will have an increased amount available for us under our credit facility and we will continue to seek additional commitments to upsize the facility to up to \$300 million. For more information, see Risk Factors Risks Relating To Our Business Changes in interest rates may affect our cost of capital and net investment income and Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Operating Expenses Financial Condition, Liquidity and Capital Resources in the accompanying prospectus. The table above assumes that we have borrowed \$210 million under our credit facility, which is the maximum amount available under the credit facility. If we do not borrow amounts following this offering, our base management fee, as a percentage of net assets attributable to common stock, will decrease from the percentage shown in the table above, as borrowings will not represent a portion of our overall assets.
- (8) The Company s stockholders indirectly bear the expenses of underlying investment companies in which the Company invests. This amount includes the fees and expenses of investment companies in which the Company is invested in as of June 30, 2010. When applicable, fees and expenses are based on historic fees and expenses for the investment companies and for those investment companies with little or no operating history, fees and expenses are based on expected fees and expenses stated in the investment companies prospectus or other similar communication without giving effect to any performance. Future fees and expenses for certain investment companies may be substantially higher or lower because certain fees and expenses are based on the performance of the investment companies, which may fluctuate over time. The amount of the Company s average net assets used in calculating this percentage was based on net assets of approximately \$711 million as of June 30, 2010.



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You should read the condensed financial information below with the Financial Statements and Notes thereto included in this prospectus supplement and the accompanying prospectus. Financial information below for the twelve months ended June 30, 2010, 2009, 2008, 2007 and 2006 has been derived from the financial statements that were audited by our independent registered public accounting firm. Certain reclassifications have been made to the prior period financial information to conform to the current period presentation. See Management's Discussion and Analysis of Financial Condition and Results of Operations starting on page S-9 for more information.

	<b>For the Year/Period Ended June 30,</b>				
	<b>2010</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>
	<b>(In thousands except data relating to shares, per share and number of portfolio companies)</b>				
<b>Performance Data:</b>					
Interest income	\$ 86,518	\$ 62,926	\$ 59,033	\$ 30,084	\$ 13,268
Dividend income	15,366	22,793	12,033	6,153	3,601
Other income	11,751	14,762	8,336	4,444	
 Total investment income	 113,635	 100,481	 79,402	 40,681	 16,869
Interest and credit facility expenses	(8,382)	(6,161)	(6,318)	(1,903)	(642)
Investment advisory expense	(30,542)	(26,705)	(20,199)	(11,226)	(3,868)
Other expenses	(8,260)	(8,452)	(7,772)	(4,421)	(3,801)
 Total expenses	 (47,184)	 (41,318)	 (34,289)	 (17,550)	 (8,311)
 Net investment income	 66,451	 59,163	 45,113	 23,131	 8,558
Realized and unrealized gains (losses)	(47,565)	(24,059)	(17,522)	(6,403)	4,338
 Net increase in net assets from operations	 \$ 18,886	 \$ 35,104	 \$ 27,591	 \$ 16,728	 \$ 12,896
<b>Per Share Data:</b>					
Net increase in net assets from operations(1)	\$ 0.32	\$ 1.11	\$ 1.17	\$ 1.06	\$ 1.83
Distributions declared per share	\$ (1.33)	\$ (1.62)	\$ (1.59)	\$ (1.54)	\$ (1.12)
Average weighted shares outstanding for the period	59,429,222	31,559,905	23,626,642	15,724,095	7,056,846

**Assets and Liabilities****Data:**

Investments	\$ 748,483	\$ 547,168	\$ 497,530	\$ 328,222	\$ 133,969
Other assets	84,212	119,857	44,248	48,280	4,511
Total assets	832,695	667,025	541,778	376,502	138,480
Amount drawn on credit facility	100,300	124,800	91,167		28,500
Amount owed to related parties	9,115	6,713	6,641	4,838	745
Other liabilities	12,595	2,916	14,347	71,616	965
Total liabilities	122,010	134,429	112,155	76,454	30,210
Net assets	\$ 710,685	\$ 532,596	\$ 429,623	\$ 300,048	\$ 108,270

**Investment Activity****Data:**

No. of portfolio companies at period end	58	30	29(2)	24(2)	15
Acquisitions	\$ 157,662	\$ 98,305	\$ 311,947	\$ 167,255	\$ 83,625
Sales, repayments, and other disposals	\$ 136,221	\$ 27,007	\$ 127,212	\$ 38,407	\$ 9,954
Weighted-Average Yield at end of period(3)	14.2%	13.7%	15.5%	17.1%	17.0%

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

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

(3) Includes dividends from certain equity investments.

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**RISK FACTORS**

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

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

The U.S. financial markets have been experiencing a high level of volatility, disruption and distress, which was exacerbated by the failure of several major financial institutions in the last few months of 2008. Despite actions of the United States federal government, 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. Similar conditions have occurred in the financial markets and economies of numerous other countries. While these conditions appear to be improving, they could continue for a prolonged period of time or worsen in the future both in the U.S. and globally. These conditions have raised the level of many of the risks described in the accompanying prospectus and could have an adverse effect on our portfolio companies as well as on our business, financial condition, results of operations, dividend payments, credit facility, access to capital, valuation of our assets, including our NAV, and our stock price.

***Our most recent NAV was calculated on June 30, 2010 and our NAV when calculated effective September 30, 2010 may be higher or lower.***

Our most recently estimated NAV per share is \$10.02 on an as adjusted basis solely to give effect to our distributions with record dates of July 30, 2010 and August 31, 2010, our issuance of common stock on July 30, 2010 and August 31, 2010 in connection with our dividend reinvestment plan, our sale of 2,748,600 shares of common stock during the period from June 28, 2010 through July 16, 2010 (with settlement dates of July 1, 2010 through July 21, 2010) and our sale of 3,814,528 shares of common stock during the period from July 19, 2010 through August 19, 2010 (with settlement dates of July 22, 2010 through August 24, 2010) versus \$10.29 determined by us as of June 30, 2010. NAV per share as of September 30, 2010, may be higher or lower than \$10.02 based on potential changes in valuations and earnings for the quarter then ended. Our Board of Directors has not yet determined the fair value of portfolio investments at any date subsequent to June 30, 2010. Our Board of Directors determines the fair value of our portfolio investments on a quarterly basis in connection with the preparation of quarterly financial statements and based on input from an independent valuation firm, our Investment Advisor and the audit committee of our Board of Directors.

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

We have obtained approval from our stockholders for us to be able to sell an unlimited number of shares of our common stock at any level of discount from NAV per share in certain circumstances during the one-year period ending on December 11, 2010 as described in the accompanying prospectus. The issuance or sale by us of shares of our common stock at a discount to net asset value poses a risk of dilution to our stockholders. In particular, stockholders who do not purchase additional shares of common stock at or below the discounted price in proportion to

their current ownership will experience an immediate decrease in NAV per share (as well as in the aggregate NAV of their shares of common stock if they do not participate at all). These stockholders will also experience a disproportionately greater decrease in their participation in our earnings and assets and their voting power than the increase we experience in our assets, potential earning power and voting interests from such issuance or sale. In addition, such sales may adversely affect the price at which our common stock trades. For additional information about recent sales below NAV per share, see [Recent Sales of Common Stock Below Net Asset Value](#) in this

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prospectus supplement and for additional information and hypothetical examples of these risks, see Sales of Common Stock Below Net Asset Value in this prospectus supplement and in the accompanying prospectus.

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

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

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

A likelihood of greater volatility in the net asset value and market price of our common stock;

Diminished operating flexibility as a result of asset coverage or investment portfolio composition requirements required by lenders or investors that are more stringent than those imposed by the 1940 Act;

The possibility that investments will have to be liquidated at less than full value or at inopportune times to comply with debt covenants or to pay interest or dividends on the leverage;

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

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

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

For example, the amount we may borrow under our revolving credit facility is determined, in part, by the fair value of our investments. If the fair value of our investments declines, we may be forced to sell investments at a loss to maintain compliance with our borrowing limits. Other debt facilities we may enter into in the future may contain similar provisions. Any such forced sales would reduce our net asset value and also make it difficult for the net asset value to recover. Our Investment Adviser and our Board of Directors in their best judgment nevertheless may determine to use leverage if they expect that the benefits to our stockholders of maintaining the leveraged position will outweigh the risks.

*Illustration.* The following table illustrates the effect of leverage on returns from an investment in our common stock assuming various annual returns, net of interest expense. The calculations in the table below are hypothetical and actual returns may be higher or lower than those appearing below. The calculation assumes (i) \$800 million in total assets, (ii) an average cost of funds of 5.25%, (iii) \$100 million in debt outstanding and (iv) \$675 million of shareholders' equity.

<b>Assumed Return on Our Portfolio (net of expenses)</b>	<b>(10)%</b>	<b>(5)%</b>	<b>0%</b>	<b>5%</b>	<b>10%</b>
Corresponding Return to Stockholder	(12.63)%	(6.70)%	(0.78)%	5.15%	11.07%

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

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

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

The following discussion should be read in conjunction with the consolidated financial statements and notes thereto appearing elsewhere in this prospectus supplement and the accompanying prospectus. Historical results set forth are not necessarily indicative of our future financial position and results of operations.

**Overview**

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

We seek to be a long-term investor with our portfolio companies. From our July 27, 2004 inception to the fiscal year ended June 30, 2007, we invested primarily in industries related to the industrial/energy economy. Since then, we have widened our strategy to focus in other sectors of the economy and continue to diversify our portfolio holdings.

The aggregate value of our portfolio investments was \$748,483 and \$547,168 as of June 30, 2010 and June 30, 2009, respectively. During the fiscal year ended June 30, 2010, our net cost of investments increased by \$197,335, or 37.1%, primarily as a result of the acquisition of Patriot Capital Funding, Inc. ( Patriot ) and our investment in three new and several follow-on investments while we sold one investment and we received repayment on eight other investments.

Compared to the end of last fiscal year (ended June 30, 2009), net assets increased by \$178,089 or 33.4% during the year ended June 30, 2010, from \$532,596 to \$710,685. This increase resulted from the issuance of new shares of our common stock (less offering costs) in the amount of \$156,221, equity issued in conjunction with the Patriot acquisition of \$92,800, dividend reinvestments of \$11,216, and another \$18,886 from operations. These increases, in turn, were offset by \$101,034 in dividend distributions to our stockholders. The \$18,886 increase in net assets resulting from operations is net of the following: net investment income of \$66,451, realized loss on investments of \$51,545, and a net increase in net assets due to changes in net unrealized appreciation of investments of \$3,980.

**Patriot Acquisition**

On December 2, 2009, we acquired the outstanding shares of Patriot Capital Funding, Inc. ( Patriot ) common stock for \$201,083. Under the terms of the merger agreement, Patriot common shareholders received 0.363992 shares of our common stock for each share of Patriot common stock, resulting in 8,444,068 shares of common stock being issued by us. In connection with the transaction, we repaid all the outstanding borrowings of Patriot, in compliance with the merger agreement.

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

The merger has been accounted for as an acquisition of Patriot by Prospect in accordance with the acquisition method of accounting as detailed in ASC 805, *Business Combinations* ( ASC 805 ). The fair value of the consideration paid was allocated to the assets acquired and liabilities assumed based on their fair values as of the date of acquisition. As described in more detail in ASC 805, goodwill, if any, would have been recognized as of the acquisition date, if the consideration transferred exceeded the fair value of identifiable net assets acquired. As of the acquisition date, the fair value of the identifiable net assets acquired exceeded the fair value of the consideration



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transferred, and we recognized the excess as a gain. A preliminary gain of \$5,714 was recorded by Prospect in the quarter ended December 31, 2009 related to the acquisition of Patriot, which was revised in the fourth quarter of the fiscal year ended June 30, 2010, to \$7,708, when we settled severance accruals related to certain members of Patriot's top management. Under ASC 805, the adjustment to our preliminary estimates is reflected in the three and six months ended December 31, 2009 (See Note 13 to our consolidated financial statements.). The acquisition of Patriot was negotiated in July 2009 with the purchase agreement being signed on August 3, 2009. Between July 2009 and December 2, 2009, our valuation of certain of the investments acquired from Patriot increased due to market improvement, which resulted in the recognition of the gain at closing.

The purchase price has been allocated to the assets acquired and the liabilities assumed based on their estimated fair values as summarized in the following table:

Cash (to repay Patriot debt)	\$ 107,313
Cash (to fund purchase of restricted stock from former Patriot employees)	970
Common stock issued(1)	92,800
 Total purchase price	 201,083
 Assets acquired:	
Investments(2)	207,126
Cash and cash equivalents	1,697
Other assets	3,859
 Assets acquired	 212,682
Other liabilities assumed	(3,891)
 Net assets acquired	 208,791
 Preliminary gain on Patriot acquisition(3)	 \$ 7,708

- (1) The value of the shares of common stock exchanged with the Patriot common shareholders was based upon the closing price of our common stock on December 2, 2009, the price immediately prior to the closing of the transaction.
- (2) The fair value of Patriot's investments were determined by the Board of Directors in conjunction with an independent valuation agent. This valuation resulted in a purchase price which was \$98,150 below the amortized cost of such investments. For those assets which are performing, Prospect will record the accretion to par value in interest income over the remaining term of the investment.
- (3) The preliminary gain has been determined based upon the estimated value of certain liabilities which are not yet settled. Any changes to such accruals will be recorded in future periods as an adjustment to such gain. We do not believe such adjustments will be material.

During the period from the acquisition of Patriot on December 2, 2009 to June 30, 2010, we recognized \$18,795 of interest income due to purchase discount accretion from the assets acquired from Patriot. Included in this amount is \$14,216 resulting from the acceleration of purchase discounts from the early repayments of four loans, two revolving

lines of credit, sale of one investment position and restructuring of five loans.

**Market Conditions**

While the economy continues to show signs of recovery from the deteriorating credit markets of 2008 and 2009, there is still a level of uncertainty and volatility in the capital markets. The growth and improvement in the capital markets that began during the second half of 2009 carried over into the first quarter of 2010. While encouraged by the signs of improvement, we operate in a challenging environment that is still recovering from a recession and financial services industry negatively affected by the deterioration of credit quality in subprime residential mortgages that spread rapidly to other credit markets. Market liquidity and credit quality conditions continue to remain weaker today than three years ago.

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We believe that Prospect is well positioned to navigate through these adverse market conditions. As a business development company, we are limited to a maximum 1 to 1 debt to equity ratio, and as of June 30, 2010, we had \$180,678 available under our credit facility, of which \$100,300 was outstanding. Further, as we make additional investments that are eligible to be pledged under the credit facility, we will generate additional credit facility availability. The revolving period for our credit facility continues until June 13, 2012, with an amortization running to June 13, 2013, with interest distributions to us allowed.

We also continue to generate liquidity through public and private stock offerings. On July 7, 2009, we completed a public stock offering for 5,175,000 shares of our common stock at \$9.00 per share, raising \$46,575 of gross proceeds. On August 20, 2009 and September 24, 2009, we issued 3,449,686 shares and 2,807,111 shares, respectively, of our common stock at \$8.50 and \$9.00 per share, respectively, in private stock offerings, raising \$29,322, and \$25,264 of gross proceeds, respectively. Concurrent with the sale of these shares, we entered into a registration rights agreement in which we granted the purchasers certain registration rights with respect to the shares. Under the terms and conditions of the registration rights agreement, we filed with the SEC a post-effective amendment to the registration statement on Form N-2 on November 6, 2009. Such amendment was declared effective by the SEC on November 9, 2009.

On March 4, 2010, our Registration Statement on Form N-2 was declared effective by the SEC. Under this Shelf Registration Statement, we can issue up to \$439,622 of additional equity securities as of June 30, 2010.

On March 17, 2010, we established an at-the-market program through which we sold shares of our common stock. An at-the-market offering is a registered offering by a publicly traded issuer of its listed equity securities selling shares directly into the market at market prices. Through this program we engaged two broker-dealers to act as agents and sell up to 8,000,000 shares of our common stock directly into the market over a period of time. Through this program we issued all 8,000,000 shares at an average price of \$10.90 per share, raising \$87,177 of gross proceeds, from March 23, 2010 through July 16, 2010 and paid a 2% commission to the broker-dealers on shares sold.

On July 19, 2010, we established a new at-the-market program, as we had sold all the shares authorized in the original at-the-market program, through which we may sell, from time to time and at our discretion, 6,000,000 shares of our common stock. We engaged three broker-dealers to act as potential agents and sell our common stock directly into the market over a period of time. We currently pay a 2% commission to the broker-dealers on shares sold. Through this program we have issued 3,814,528 shares of our common stock at an average price of \$9.71 per share, raising \$37,052 of gross proceeds, on sales from July 19, 2010 through August 19, 2010.

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

## **Fourth Quarter Highlights**

### *Investment Transactions*

On April 7, 2010, we purchased \$12,296 of second lien notes in Seaton Corporation, a human resources services company. The second lien notes bear interest in cash at the greater of 12.5% or Libor plus 9.0% and have a final maturity on March 14, 2011.

On May 26, 2010, we purchased \$15,000 in senior notes issued by an affiliate of SkillSoft PLC, a leading Software as a Service provider of on-demand, e-learning, and performance support solutions. The senior notes bear interest in cash

at 11.125% and has a final maturity on June 1, 2018.

On June 2, 2010, we made a secured second lien debt investment of \$20,000 in Hoffmaster, Inc., which primarily serves the foodservice and consumer market segments. The secured second lien debt bears interest in cash at 13.50% and has a final maturity on June 2, 2017.

On June 24, 2010, we closed a \$25,500 senior secured credit facility for EXL Acquisition Corp., a leading manufacturer and marketer of consumable lab testing equipment and supplies. The senior secured credit facility is composed of a Term A Loan and a Term B Loan. The Term A Loan bears interest in cash at the greater of Libor plus

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5.5% or, the greater of the (i) Prime Rate, (ii) the Federal Funds Rate plus 0.5% or (iii) 4.25% plus 4.5% and has a final maturity on June 24, 2015. The Term B Loan bears interest in cash at 12.0% and interest in kind at 2.0% and has a final maturity on December 24, 2015.

### *Equity Issuance*

From April 1, 2010 to July 16, 2010, we completed the sale of the remaining 7,188,500 shares of our common stock pursuant to the March 17, 2010 equity distribution agreements, resulting in net proceeds of approximately \$75,231 after deducting related expenses including commissions.

On April 23, 2010, we issued 248,731 shares of our common stock in connection with the dividend reinvestment plan.

### *Dividend*

On June 18, 2010, we announced a change in dividend policy from quarterly to monthly dividends and declared monthly dividends in the following amounts and with the following dates:

\$0.10 per share for June 2010 to holders of record on June 30, 2010 with a payment date of July 30, 2010;

\$0.10025 per share for July 2010 to holders of record on July 30, 2010 with a payment date of August 31, 2010; and

\$0.10050 per share for August 2010 to holders of record on August 31, 2010 with a payment date of September 30, 2010.

### *Credit Facility*

On June 11, 2010, we closed an extension and expansion of our revolving credit facility with a syndicate of lenders. The lenders have commitments of \$210,000 under the new credit facility as of June 11, 2010. The new credit facility includes an accordion feature which allows the facility to be increased to up to \$300,000 of commitments in the aggregate to the extent additional or existing lenders commit to increase the commitments. We will seek to add additional lenders in order to reach the maximum size; although no assurance can be given we will be able to do so. As we make additional investments which are eligible to be pledged under the credit facility, we will generate additional availability to the extent such investments are eligible to be placed into the borrowing base. The revolving period of the credit facility extends through June 2012, with an additional one year amortization period (with distributions allowed) after the completion of the revolving period. During such one year amortization period, all principal payments on the pledged assets will be applied to reduce the balance. At the end of the one year amortization period, the remaining balance will become due if required by the lenders. Interest on borrowings under the credit facility is one-month Libor plus 325 basis points, subject to a minimum Libor floor of 100 basis points. Additionally, the lenders charge a fee on the unused portion of the credit facility equal to either 75 basis points if at least half of the credit facility is used or 100 basis points otherwise. The credit facility will be used, together with our equity capital, to make additional long-term investments.

The new credit facility contains restrictions pertaining to the geographic and industry concentrations of funded loans, maximum size of funded loans, interest rate payment frequency of funded loans, maturity dates of funded loans and minimum equity requirements. The new credit facility also contains certain requirements relating to portfolio performance, including required minimum portfolio yield and limitations on delinquencies and charge-offs, violation of which could result in the early termination of the new credit facility. The new credit facility also requires the maintenance of a minimum liquidity requirement.

**Recent Developments**

On July 14, 2010, we closed a \$37,400 first lien senior secured credit facility to support the acquisition by H.I.G. Capital of a leading consumer credit enhancement services company.

On July 23, 2010, we made a secured debt investment of \$21,000 in SonicWALL, Inc., a global leader in network security and data protection for small, mid-sized, and large enterprise organizations.

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On July 30, 2010, we issued 83,875 shares of our common stock in connection with the dividend reinvestment plan.

On July 30, 2010, we invested \$52,420 of combined debt and equity in AIRMALL USA Inc., a leading developer and manager of airport retail operations.

On July 30, 2010, we recapitalized our debt investment in Northwestern Management Services, LLC, a leading dental practice management company in the Southeast Florida market, providing \$10,774 of additional funding to fund the acquisition of six dental practices.

During the period June 28, 2010 through July 16, 2010 (with settlement dates of July 1, 2010 through July 21, 2010), we sold 2,748,600 shares of our common stock at an average price of \$9.75 per share, and raised \$26,799 of gross proceeds, under our at-the-market program. Net proceeds were \$26,262 after 2% commission to the broker-dealers on shares sold.

During the period July 19, 2010 through August 19, 2010 (with settlement dates of July 22, 2010 through August 24, 2010), we sold 3,814,528 shares of our common stock at an average price of \$9.71 per share, and raised \$37,052 of gross proceeds, under our at-the-market program. Net proceeds were \$36,335 after 2% commission to the broker-dealer on shares sold.

On August 26, 2010, we declared monthly dividends in the following amounts and with the following dates:

\$0.100625 per share for September 2010 to holders of record on September 30, 2010 with a payment date of October 29, 2010; and

\$0.100750 per share for October 2010 to holders of record on October 29, 2010 with a payment date of November 30, 2010.

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

*Critical Accounting Policies and Estimates*

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

*Basis of Consolidation*

Under the 1940 Act rules, the regulations pursuant to Article 6 of Regulation S-X, and the American Institute of Certified Public Accountants Audit and Accounting Guide for Investment Companies, we are precluded from consolidating any entity other than another investment company or an operating company which provides substantially all of its services and benefits to us. June 30, 2010 and June 30, 2009 financial statements include our accounts and the accounts of Prospect Capital Funding, LLC, our only wholly-owned, closely-managed subsidiary that is also an investment company. All intercompany balances and transactions have been eliminated in consolidation.

*Investment Classification*

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

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

### *Investment Valuation*

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

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

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

- 1) Each portfolio company or investment is reviewed by our investment professionals with the independent valuation firm engaged by our Board of Directors;
- 2) the independent valuation firm conducts independent appraisals and makes their own independent assessment;
- 3) the audit committee of our Board of Directors reviews and discusses the preliminary valuation of our Investment Adviser and that of the independent valuation firm; and
- 4) the Board of Directors discusses the valuations and determines the fair value of each investment in our portfolio in good faith based on the input of our Investment Adviser, the independent valuation firm and the audit committee.

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

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

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

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

**Level 3:** Unobservable inputs for the asset or liability.

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

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

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

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In April 2009, the FASB issued ASC 820-10-65, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* ( ASC 820-10-65 ). This update provides further clarification for ASC 820 in markets that are not active and provides additional guidance for determining when the volume of trading level of activity for an asset or liability has significantly decreased and for identifying circumstances that indicate a transaction is not orderly. ASC 820-10-65 is effective for interim and annual reporting periods ending after June 15, 2009. The adoption of ASC 820-10-65 for year ended June 30, 2010, did not have any effect on our net asset value, financial position or results of operations as there was no change to the fair value measurement principles set forth in ASC 820.

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

*Federal and State Income Taxes*

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

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

We adopted FASB ASC 740, *Income Taxes* ( ASC 740 ). ASC 740 provides guidance for how uncertain tax positions should be recognized, measured, presented, and disclosed in the financial statements. ASC 740 requires the evaluation of tax positions taken or expected to be taken in the course of preparing our tax returns to determine whether the tax positions are more-likely-than-not of being sustained by the applicable tax authority. Tax positions not deemed to meet the more-likely-than-not threshold are recorded as a tax benefit or expense in the current year. Adoption of ASC 740 was applied to all open tax years as of July 1, 2007. The adoption of ASC 740 did not have an effect on our net asset value, financial condition or results of operations as there was no liability for unrecognized tax benefits and no change to our beginning net asset value. As of June 30, 2010 and for the year then ended, we did not have a liability for any unrecognized tax benefits. Management's determinations regarding ASC 740 may be subject to review and adjustment at a later date based upon factors including, but not limited to, an on-going analysis of tax laws, regulations and interpretations thereof.

*Revenue Recognition*

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

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

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security, any prepayment penalties and unamortized loan origination, closing and commitment fees are recorded as interest income.

Loans are placed on non-accrual status when principal or interest payments are past due 90 days or more or when there is reasonable doubt that principal or interest will be collected. Unpaid accrued interest is generally reversed when a loan is placed on non-accrual status. Interest payments received on non-accrual loans may be recognized as income or applied to principal depending upon management's judgment. Non-accrual loans are restored to accrual status when past due principal and interest is paid and in management's judgment, are likely to remain current. As of June 30, 2010, approximately 5.6% of our net assets are in non-accrual status.

Dividend income is recorded on the ex-dividend date.

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

### *Dividends and Distributions*

Dividends and distributions to common stockholders are recorded on the ex-dividend date. The amount, if any, to be paid as a dividend or distribution is approved by our Board of Directors each quarter and is generally based upon our management's estimate of our earnings for the quarter. Net realized capital gains, if any, are distributed at least annually.

### *Financing Costs*

We record origination expenses related to our credit facility as deferred financing costs. These expenses are deferred and amortized as part of interest expense using the effective interest method over the stated life of the facility.

We record registration expenses related to shelf filings as prepaid assets. These expenses consist principally of SEC registration fees, legal fees and accounting fees incurred. These prepaid assets will be charged to capital upon the receipt of an equity offering proceeds or charged to expense if no offering is completed.

### *Guarantees and Indemnification Agreements*

We follow FASB ASC 460, *Guarantees* (ASC 460). ASC 460 elaborates on the disclosure requirements of a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also requires a guarantor to recognize, at the inception of a guarantee, for those guarantees that are covered by ASC 460, the fair value of the obligation undertaken in issuing certain guarantees. ASC 460 did not have a material effect on the financial statements. Refer to Note 3 and Note 11 to our consolidated financial statements for further discussion of guarantees and indemnification agreements.

### *Per Share Information*

Net increase or decrease in net assets resulting from operations per common share are calculated using the weighted average number of common shares outstanding for the period presented. Diluted net increase or decrease in net assets resulting from operations per share are not presented as there are no potentially dilutive securities outstanding.

### *Reclassifications*

Certain reclassifications have been made in the presentation of prior consolidated financial statements to conform to the presentation as of and for the twelve months ended June 30, 2010.

*Recent Accounting Pronouncements*

In May 2009, the FASB issued ASC 855, *Subsequent Events* ( ASC 855 ). ASC 855 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The standard, which includes a new required disclosure of the

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date through which an entity has evaluated subsequent events, is effective for interim or annual periods ending after June 15, 2009. We evaluated all events or transactions that occurred after June 30, 2010 up through the date we issued the accompanying financial statements. During this period, we did not have any material recognizable subsequent events other than those disclosed in our financial statements.

In June 2009, the FASB issued ASC 105, *Generally Accepted Accounting Principles* ( ASC 105 ), which establishes the FASB Codification which supersedes all existing accounting standard documents and will become the single source of authoritative non-governmental GAAP. All other accounting literature not included in the Codification will be considered non-authoritative. The Codification did not change GAAP but reorganizes the literature. ASC 105 is effective for interim and annual periods ending after September 15, 2009. We have conformed our financial statements and related Notes to the new Codification.

In June 2009, the FASB issued ASC 860, *Accounting for Transfers of Financial Assets – an amendment to FAS 140* ( ASC 860 ). ASC 860 improves the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets. ASC 860 is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Our management does not believe that the adoption of the amended guidance in ASC 860 will have a significant effect on our financial statements.

In June 2009, the FASB issued ASC 810, *Consolidation* ( ASC 810 ). ASC 810 is intended to (1) address the effects on certain provisions of FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities, as a result of the elimination of the qualifying special-purpose entity concept in ASC 860, and (2) constituent concerns about the application of certain key provisions of Interpretation 46(R), including those in which the accounting and disclosures under the Interpretation do not always provided timely and useful information about an enterprise's involvement in a variable interest entity. ASC 810 is effective as of the beginning of our first annual reporting period that begins after November 15, 2009. Our management does not believe that the adoption of the amended guidance in ASC 860 will have a significant effect on our financial statements.

In August 2009, the FASB issued Accounting Standards Update ( ASU ) 2009-05, *Measuring Liabilities at Fair Value*, to amend FASB Accounting Standards Codification ASC 820, *Fair Value Measurements and Disclosures* ( ASC 820 ), to clarify how entities should estimate the fair value of liabilities. ASC 820, as amended, includes clarifying guidance for circumstances in which a quoted price in an active market is not available, the effect of the existence of liability transfer restrictions, and the effect of quoted prices for the identical liability, including when the identical liability is traded as an asset. We adopted ASU 2009-05 effective October 1, 2009. The amended guidance in ASC 820 does not have a significant effect on our financial statements for the year ended June 30, 2010.

In September 2009, the FASB issued ASU 2009-12, *Measuring Fair Value of Certain Investments* ( ASU 2009-12 ). This update provides further amendments to ASC 820 to offer investors a practical expedient for measuring the fair value of investments in certain entities that calculate net asset value per share. Specifically, measurement using net asset value per share is reasonable for investments within the scope of ASU 2009-12. We adopted ASU 2009-12 effective October 1, 2009. The amended guidance in ASC 820 does not have a significant effect on our financial statements for the year ended June 30, 2010.

In January 2010, the FASB issued Accounting Standards Update 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements* ( ASC 2010-06 ). ASU 2010-06 amends ASC 820-10 and clarifies and provides additional disclosure requirements related to recurring and non-recurring fair value measurements and employers' disclosures about postretirement benefit plan assets. ASU 2010-06 is effective

December 15, 2009, except for the disclosure about purchase, sales, issuances and settlements in the roll forward of activity in level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. Our management does not believe that the adoption of the amended guidance in ASC 820-10 will have a significant effect on our financial statements.

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In February 2010, the FASB issued Accounting Standards Update 2010-09, *Subsequent Events (Topic 855) Amendments to Certain Recognition and Disclosure Requirements* ( ASU 2010-09 ), which amends ASC Subtopic 855-10. ASU 2010-09 requires an entity that is an SEC filer to evaluate subsequent events through the date that the financial statements are issued and removes the requirement that an SEC filer disclose the date through which subsequent events have been evaluated. ASC 2010-09 was effective upon issuance. The adoption of this standard had no effect on our results of operation or our financial position.

In February 2010, the FASB issued Accounting Standards Update 2010-10, *Consolidation (Topic 810) Amendments for Certain Investments Funds* ( ASU 2010-10 ), which defers the application of the consolidation guidance in ASC 810 for certain investments funds. The disclosure requirements continue to apply to all entities. ASU 2010-10 is effective as of the beginning of the first annual period that begins after November 15, 2009 and for interim periods within that first annual period. Our management does not believe that the adoption of the amended guidance in ASU 2010-10 will have a significant effect on our financial statements.

In August 2010, the FASB issued Accounting Standards Update 2010-21, *Accounting for Technical Amendments to Various SEC Rules and Schedules* ( ASU 2010-21 ). This Accounting Standards Update amends various SEC paragraphs pursuant to the issuance of Release No. 33-9026: *Technical Amendments to Rules, Forms, Schedules and Codification of Financial Reporting Policies*. We are assessing the potential effect this guidance will have on our consolidated financial statements.

In August 2010, the FASB issued Accounting Standards Update 2010-22, *Accounting for Various Topics Technical Corrections to SEC Paragraphs* ( ASU 2010-22 ). ASU 2010-22 amends various SEC paragraphs based on external comments received and the issuance of Staff Accounting Bulletin ( SAB ) 112, which amends or rescinds portions of certain SAB topics. We are assessing the potential effect this guidance will have on our consolidated financial statements.

## **Investment Holdings**

As of June 30, 2010, we continue to pursue our investment strategy. Despite our name change to Prospect Capital Corporation and the termination of our policy to invest at least 80% of our net assets in energy companies in May 2007, we currently have a concentration of investments in companies in the energy and energy related industries. This concentration continues to decrease as we make investments outside of the energy and energy related industries. Some of the companies in which we invest have relatively short or no operating histories. These companies are and will be subject to all of the business risk and uncertainties associated with any new business enterprise, including the risk that these companies may not reach their investment objective or the value of our investment in them may decline substantially or fall to zero.

Our portfolio had an annualized current yield of 14.2% and 13.7% across all our long-term debt and certain equity investments as of June 30, 2010 and June 30, 2009, respectively. This yield includes interest from all of our long-term investments as well as dividends from GSHI for the year ended June 30, 2010 and GSHI and NRG for the year ended June 30, 2009. The 0.5% increase is primarily due to accretion of purchase discounts on the loans acquired from Patriot. This increase is partially offset by an increase in non-accrual loans. Monetization of other equity positions that we hold is not included in this yield calculation. In each of our portfolio companies, we hold equity positions, ranging from minority interests to majority stakes, which we expect over time to contribute to our investment returns. Some of these equity positions include features such as contractual minimum internal rates of returns, preferred distributions, flip structures and other features expected to generate additional investment returns, as well as contractual protections and preferences over junior equity, in addition to the yield and security offered by our cash flow and collateral debt protections.

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

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As of June 30, 2010, we own controlling interests in Ajax Rolled Ring & Machine ( Ajax ), AWCNC, LLC, Borga, Inc., C&J Cladding, LLC, Change Clean Energy Holdings, Inc. ( CCEHI ), Fischbein, LLC ( Fischbein ), Freedom Marine Services LLC ( Freedom Marine ), Gas Solutions Holdings, Inc. ( GSHI ), Integrated Contract Services, Inc. ( ICS ), Iron Horse Coiled Tubing, Inc. ( Iron Horse ), Manx Energy, Inc. ( Manx ), NRG Manufacturing, Inc. ( NRG ), Nupla Corporation, R-V Industries, Inc. ( R-V ), Sidump r Trailer Company, Inc. and Yatesville Coal Holdings, Inc. ( Yatesville ). We also own an affiliated interest in Biotronic NeuroNetwork ( Biotronic ), Boxercraft Incorporated ( Boxercraft ), KTPS Holdings, LLC ( KTPS ), Smart, LLC and Sport Helmets Holdings, LLC ( Sport Helmets ).

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

Level of Control	Cost	June 30, 2010		Percent of Portfolio	Cost	June 30, 2009		Percent of Portfolio
		Percent of Portfolio	Fair Value			Percent of Portfolio	Fair Value	
Control	\$ 185,720	23.3%	\$ 195,958	24.0%	\$ 187,105	29.7%	\$ 206,332	31.9%
Affiliate	65,082	8.2%	73,740	9.0%	33,544	5.3%	32,254	5.0%
Non-control/Non-affiliate	477,957	59.9%	478,785	58.6%	310,775	49.3%	308,582	47.8%
Money Market Funds	68,871	8.6%	68,871	8.4%	98,735	15.7%	98,735	15.3%
<b>Total Portfolio</b>	<b>\$ 797,630</b>	<b>100.0%</b>	<b>\$ 817,354</b>	<b>100.0%</b>	<b>\$ 630,159</b>	<b>100.0%</b>	<b>\$ 645,903</b>	<b>100.0%</b>

The following is our investment portfolio presented by type of investment at June 30, 2010 and June 30, 2009, respectively:

Type of Investment	Cost	June 30, 2010		Percent of Portfolio	Cost	June 30, 2009		Percent of Portfolio
		Percent of Portfolio	Fair Value			Percent of Portfolio	Fair Value	
Money Market Funds	\$ 68,871	8.6%	\$ 68,871	8.4%	\$ 98,735	15.7%	\$ 98,735	15.3%
Revolving Line of Credit	4,754	0.6%	5,017	0.6%		%		%
Senior Secured Debt	313,755	39.4%	287,470	35.2%	232,534	36.9%	220,993	34.2%
Subordinated Secured Debt	333,453	41.8%	313,511	38.4%	251,292	39.9%	194,547	30.1%
Subordinated Unsecured Debt	30,209	3.8%	30,895	3.8%	15,065	2.4%	16,331	2.5%
Preferred Stock	16,969	2.1%	5,872	0.7%	10,432	1.6%	4,139	0.7%
Common Stock	20,243	2.5%	77,131	9.4%	16,310	2.6%	89,278	13.8%
Membership Interests	6,964	0.9%	17,730	2.2%	3,031	0.5%	7,270	1.1%
Overriding Royalty Interests		%	2,768	0.3%		%	3,483	0.5%
Net Profit Interests		%	1,020	0.1%		%	2,561	0.4%
Warrants	2,412	0.3%	7,069	0.9%	2,760	0.4%	8,566	1.4%

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Total Portfolio      \$ 797,630      100.0%    \$ 817,354      100.0%    \$ 630,159      100.0%    \$ 645,903      100.0%

The following is our investment portfolio presented by geographic location of the investment at June 30, 2010 and June 30, 2009, respectively:

Geographic Location	Cost	June 30, 2010		Percent of Portfolio	Cost	June 30, 2009		Percent of Portfolio
		Percent of Portfolio	Fair Value			Percent of Portfolio	Fair Value	
Canada	\$ 21,002	2.6%	\$ 12,054	1.5%	\$ 19,344	3.1%	\$ 12,606	2.0%
Ireland	14,903	1.9%	15,000	1.8%		%		%
Netherlands	1,397	0.2%	1,233	0.2%		%		%
Midwest US	170,869	21.5%	167,571	20.5%	77,681	12.3%	84,097	13.0%
Northeast US	61,813	7.7%	62,727	7.7%	44,875	7.1%	47,049	7.3%
Southeast US	193,420	24.2%	171,144	20.9%	164,652	26.1%	101,710	15.7%
Southwest US	179,641	22.6%	235,945	28.9%	178,993	28.4%	253,615	39.3%
Western US	85,714	10.7%	82,809	10.1%	45,879	7.3%	48,091	7.4%
Money Market Funds	68,871	8.6%	68,871	8.4%	98,735	15.7%	98,735	15.3%
Total Portfolio	\$ 797,630	100.0%	\$ 817,354	100.0%	\$ 630,159	100.0%	\$ 645,903	100.0%

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The following is our investment portfolio presented by industry sector of the investment at June 30, 2010 and June 30, 2009, respectively:

Industry	June 30, 2010			June 30, 2009			Fair Value	Percent of Portfolio
	Cost	Percent of Portfolio	Fair Value	Cost	Percent of Portfolio	Fair Value		
Aerospace and Defense	\$ 56	%	\$ 38	%	\$	%		%
Automobile	19,017	2.4%	18,615	2.3%		%		%
Biomass Power	2,383	0.3%		%	2,530	0.4%	2,530	0.4%
Business Services	12,060	1.5%	12,132	1.5%		%		%
Chemical	1,397	0.2%	1,233	0.2%		%		%
Construction Services		%		%	5,017	0.8%	2,408	0.4%
Contracting	16,652	2.1%	4,542	0.6%	16,652	2.6%	5,000	0.8%
Durable Consumer Products	20,000	2.5%	20,000	2.4%		%		%
Ecological	141	%	340	%		%		%
Electronics	25,777	3.2%	25,629	3.1%		%		%
Financial Services	25,814	3.2%	25,592	3.1%	25,424	4.0%	23,073	3.6%
Food Products	53,681	6.7%	60,882	7.4%	27,413	4.4%	29,416	4.6%
Gas Gathering and Processing	37,503	4.7%	93,096	11.4%	35,003	5.6%	85,187	13.2%
Healthcare	89,026	11.2%	93,593	11.5%	57,535	9.1%	60,293	9.3%
Home and Office Furnishings, Housewares and Durable	14,112	1.8%	17,232	2.1%		%		%
Insurance	5,811	0.7%	5,952	0.7%		%		%
Machinery	15,625	2.0%	17,776	2.2%		%		%
Manufacturing	74,961	9.4%	64,784	7.9%	90,978	14.4%	110,929	17.2%
Metal Services and Minerals	19,252	2.4%	33,620	4.1%	3,302	0.5%	7,133	1.1%
Mining, Steel, Iron and Non-Precious Metals and Coal Production	1,130	0.1%	808	0.1%	48,890	7.8%	13,097	2.0%
Oil and Gas Production	122,034	15.3%	96,988	11.9%	104,183	16.5%	104,806	16.2%
Oilfield Fabrication	30,429	3.8%	30,429	3.7%	34,247	5.4%	34,931	5.4%
Personal and Nondurable Consumer Products	14,387	1.8%	20,049	2.5%		%		%
Pharmaceuticals	11,955	1.5%	12,000	1.5%	11,949	2.0%	11,452	1.8%
Prepackaged Software	14,903	1.9%	15,000	1.8%		%		%
Printing and Publishing	5,222	0.7%	5,284	0.6%		%		%
Production Services	21,002	2.6%	12,054	1.5%	19,344	3.1%	12,606	1.9%

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Retail	14,669	1.8%	2,148	0.3%	14,623	2.3%	6,272	1.0%
Shipping Vessels	10,040	1.3%	3,583	0.4%	7,160	1.1%	7,381	1.1%
Specialty Minerals	15,814	2.1%	18,463	2.3%	15,814	2.5%	18,924	2.9%
Technical Services	11,387	1.4%	11,615	1.4%	11,360	1.8%	11,730	1.8%
Textiles and Leather	22,519	2.8%	25,006	3.1%		%		%
Money Market Funds	68,871	8.6%	68,871	8.4%	98,735	15.7%	98,735	15.3%
Total Portfolio	\$ 797,630	100.0%	\$ 817,354	100.0%	\$ 630,159	100.0%	\$ 645,903	100.0%

**Investment Activity**

At June 30, 2010, approximately 105.3% of our net assets or about \$748,483 was invested in 58 long-term portfolio investments and 9.7% of our net assets invested in money market funds. Liabilities in excess of other assets offset the excess of these amounts over 100%.

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**Long-Term Portfolio Investment Activity**

During the year ended June 30, 2010, we acquired \$207,126 of investments from Patriot, completed follow-on investments in existing portfolio companies totaling approximately \$150,111, and recorded PIK interest of \$7,551, resulting in gross investment originations with a cost basis of \$364,788. The more significant of these investments are described briefly in the following:

During the year ended June 30, 2010, we made follow-on secured debt investments of \$1,708 in Iron Horse in support of the build out of additional equipment and to fund working capital requirements. Effective January 1, 2010, we restructured our senior secured and bridge loans to Iron Horse. Our loans were replaced with three new tranches of senior secured debt.

During the year ended June 30, 2010, we provided additional fundings of \$3,376 to Yatesville to fund ongoing operations.

During the year ended June 30, 2010, we made follow-on secured subordinated debt investments of \$3,530 in Ajax.

On October 5, 2009 we purchased an additional secured debt investment of \$1,675 in Resco Products, Inc. ( Resco ) at a discount of \$670, increasing our cost basis by \$1,005 in this investment.

On December 2, 2009, we acquired portfolio investments with a face amount of \$289,030 for \$207,126 from Patriot.

On March 31, 2010, we made a follow-on secured debt investment of \$9,000 in H&M Oil & Gas ( H&M ) to fund ongoing operations including completion of several previously drilled oil wells.

On March 31, 2010, we made a \$36,322 investment in Shearer s Foods, Inc. ( Shearer s ) for which we received \$35,000 of junior secured debt and \$1,322 of membership interests.

On January 19, 2010, we restructured our debt investment in Appalachian Energy Holdings LLC ( AEH ) and Coalbed, LLC ( Coalbed ) under Manx, a newly formed entity. We funded \$2,800 at closing to Manx to provide working capital.

On April 7, 2010, we purchased \$12,296 of second lien notes in Seaton Corporation, a human resources services company. The second lien notes bear interest in cash at the greater of 12.5% or Libor plus 9.0% and have a final maturity on March 14, 2011.

On May 26, 2010, we purchased \$15,000 in senior notes issued by an affiliate of SkillsSoft PLC, a leading Software as a Service provider of on-demand, e-learning, and performance support solutions. The senior notes bear interest in cash at 11.125% and has a final maturity on June 1, 2018.

On June 2, 2010, we made a secured second lien debt investment of \$20,000 in Hoffmaster, Inc. ( Hoffmaster ), which primarily serves the foodservice and consumer market segments. The secured second lien debt bears interest in cash at 13.50% and has a final maturity on June 2, 2017.

On June 24, 2010, we closed a \$25,500 senior secured credit facility for EXL Acquisition Corp. ( EXL ), a leading manufacturer and marketer of consumable lab testing equipment and supplies. The senior secured credit facility is composed of a Term A Loan and a Term B Loan. The Term A Loan bears interest in cash at the greater of Libor plus 5.5% or, the greater of the (i) Prime Rate, (ii) the Federal Funds Rate plus 0.5% or (iii) 4.25% plus 4.5% and has a final maturity on June 24, 2015. The Term B Loan bears interest in cash at 12.0% and interest in kind at 2.0% and has a final maturity on December 24, 2015.

During the year ended June 30, 2010, we closed-out ten positions which are briefly described below.

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

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

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On December 4, 2009, CS Operating, LLC repaid the \$4,460 loan receivable to us.

On December 10, 2009, Resco repaid the \$11,425 loan receivable to us.

On December 17, 2009, ADAPCO, Inc. repaid the \$7,466 loan receivable to us. We continue to hold warrants for common stock in this investment.

On December 18, 2009, Quartermaster, Inc. repaid the \$11,274 loan receivable to us.

On December 31, 2009, we sold our investment in Aylward Enterprises, LLC for net amount of \$4,775.

On March 31, 2010, Shearer s repaid the \$18,000 loan receivable to us.

On April 9, 2010, Custom Direct repaid the \$3,603 loan receivable to us.

On May 11, 2010, Caleel and Hayden, LLC, repaid the \$12,659 loan receivable to us.

During the year ended June 30, 2010, we also received principal amortization payments of \$23,285 on several loans.

During the year ended June 30, 2010, we restructured our loans to Aircraft Fasteners International, LLC ( AFI ), EXL, LHC Holdings Corp. ( LHC ), Prince Mineral Company, Inc. ( Prince ) and R-O-M Corporation ( ROM ). The revised terms were more favorable than the original terms and increased the present value of the future cash flows. In accordance with ASC 320-20-35 the cost basis of the new loans were recorded at par value, which included \$8,099 of accelerated original purchase discount recognized as interest income.

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

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

<b>Quarter-End</b>	<b>Acquisitions(1)</b>	<b>Dispositions(2)</b>
June 30, 2010	\$ 88,973	\$ 39,883
March 31, 2010	59,311	26,603
December 31, 2009(3)	210,438	45,494
September 30, 2009	6,066	24,241
June 30, 2009	7,929	3,148
March 31, 2009	6,356	10,782
December 31, 2008	13,564	2,128
September 30, 2008	70,456	10,949
June 30, 2008	118,913	61,148
March 31, 2008	31,794	28,891
December 31, 2007	120,846	19,223
September 30, 2007	40,394	17,949
June 30, 2007	130,345	9,857

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March 31, 2007	19,701	7,731
December 31, 2006	62,679	17,796
September 30, 2006	24,677	2,781
June 30, 2006	42,783	5,752
March 31, 2006	15,732	901
December 31, 2005		3,523
September 30, 2005	25,342	
June 30, 2005	17,544	
March 31, 2005	7,332	
December 31, 2004	23,771	32,083
September 30, 2004	30,371	
Since inception	\$ 1,175,317	\$ 370,863

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- (1) Includes new deals, additional fundings, refinancings and PIK interest.
- (2) Includes scheduled principal payments, prepayments and repayments.
- (3) The \$210,438 of acquisitions for the quarter ended December 31, 2009 includes \$207,126 of portfolio investments acquired from Patriot.

## **Investment Valuation**

In determining the fair value of our portfolio investments at June 30, 2010 the Audit Committee considered valuations from the independent valuation firm and from management having an aggregate range of \$726,588 to \$798,597, excluding money market investments.

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

The Board of Directors looked at several factors in determining where within the range to value the asset including: recent operating and financial trends for the asset, independent ratings obtained from third parties and comparable multiples for recent sales of companies within the industry. The composite of all these analyses, applied to each investment, was a total valuation of \$748,483, excluding money market investments.

Our portfolio companies are generally lower middle market companies, outside of the financial sector, with less than \$50,000 of annual EBITDA. We believe our market has experienced less volatility than others because we believe there are more buy and hold investors who own these less liquid investments.

During the year ended June 30, 2010, there has been a general improvement in the markets in which we operate, and market rates of interest negotiated for middle market loans have decreased.

Control investments often offer increased risk and reward over straight debt investments. Operating results and changes in market multiples can result in significant changes in values from quarter to quarter. Significant downturns in operations can further result in our looking to recoveries on sales of assets rather than the enterprise value of the investment. A few of the control investments in our portfolio are discussed below.

### *Ajax Rolled Ring & Machine, Inc.*

We acquired a controlling equity interest in Ajax in a recapitalization of the company that was closed on April 4, 2008. We funded \$22,000 of senior secured term debt, \$11,500 of subordinated term debt and \$6,300 of equity as of that closing. During the fiscal year ended June 30, 2010, we funded an additional \$3,530 of secured subordinated debt to refinance a third-party revolver provider and provide working capital. As of June 30, 2010, we control 78.1% of the fully-diluted common and preferred equity.

Ajax forges seamless steel rings sold to various customers. The rings are used in a range of industrial applications, including in construction equipment and wind power turbines. Ajax's business is cyclical, and the business experienced a significant decline in the first half of 2009 in light of the global macroeconomic crisis. The second half of 2009 and to-date 2010 show steady improvement versus the first half of 2009. At June 30, 2010, Ajax had a backlog of new

business that would indicate continued improvement for 2010.

The Board of Directors decreased the fair value of our investment in Ajax to \$30,904 as of June 30, 2010, a reduction of \$13,006 from its amortized cost, compared to the \$7,581 unrealized depreciation recorded at June 30, 2009.

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

Change Clean Energy, Inc. ( CCEI ) is an investment, that we originated in September 2005, which owns and operated a biomass energy plant. In March 2009, CCEI ceased operations, as the business became uneconomic

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based on the cost of materials and the price being received for the electricity generated. During that quarter, we instituted foreclosure proceedings against the co-borrowers of our debt. In anticipation of such proceedings, CCEHI was established. On March 11, 2009, the foreclosure was completed and the assets were assigned to a wholly owned subsidiary of CCEHI. During the year ended June 30, 2010, we provided additional funding of \$296 to CCEHI to fund ongoing operations. CCEI currently has no material operations. At June 30, 2009, we determined that the impairment at both CCEI and CCEHI was other than temporary and recognized a realized loss of \$41,134, which was the amount by which the amortized cost exceeded the fair value. At June 30, 2010, our Board of Directors, under recommendation from senior management, has set the value of the CCEHI investment with no value, a reduction of \$2,383 from its amortized cost after the recognized depreciation.

*Gas Solutions Holdings, Inc.*

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

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

In February 2010, we hired Robert Bourne as President and CEO of Gas Solutions. Mr. Bourne has over 30 years of experience in the midstream sector, including gathering and processing, gas purchasing, storing and trading; producer services; and business development mergers and acquisitions. He served most recently at Energy Transfer, where he managed Houston Pipeline, among other activities. Mr. Bourne is focusing on our upside plant projects and seeking new opportunities to help Gas Solutions grow beyond its existing footprint.

In April 2010, Gas Solutions purchased a series of propane puts with strike prices of \$1.00 per gallon and \$0.95 per gallon covering the periods May 1, 2010, through April 30, 2011, and May 1, 2011, through April 30, 2012, respectively. Gas Solutions hedged approximately 85% of its current exposure to natural gas liquids based on current plant volumes. These hedges will reduce the volatility on earnings associated with lower prices of natural gas liquids without limiting the upside from higher prices, helping GSHI to continue to generate sufficient cash flow to make interest and dividend payments.

In determining the value of GSHI, we have utilized two valuation techniques to determine the value of the investment. Our Board of Directors has determined the value to be \$93,096 for our debt and equity positions at June 30, 2010 based upon a combination of a discounted cash flow analysis and a public comparables analysis. At June 30, 2010 and June 30, 2009, GSHI was valued \$55,593 and \$50,184 above its amortized cost, respectively.

*Integrated Contract Services, Inc.*

ICS is an investment that we completed in April 2007. Prior to January 2009, ICS owned the assets of ESA Environmental Specialists, Inc. ( ESA ) and 100% of the stock of The Healing Staff ( THS ). ESA originally defaulted under our contract governing our investment in ESA, prompting us to commence foreclosure actions with respect to certain ESA assets in respect of which we have a priority lien. In response to our actions, ESA filed voluntarily for reorganization under the bankruptcy code on August 1, 2007. On September 20, 2007, the U.S. Bankruptcy Court

approved a Section 363 Asset Sale from ESA to us. To complete this transaction, we contributed our ESA debt to a newly-formed entity, ICS, and provided funds for working capital on October 9, 2007. In return for the ESA debt, we received senior secured debt in ICS of equal amount to our ESA debt, preferred stock of ICS, and 49% of the ICS common stock. ICS subsequently ceased operations and assigned the collateral back to us. ICS is in default of both payment and financial covenants. During September and October 2007, we provided \$1,170 to THS for working capital.

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In January 2009, we foreclosed on the real and personal property of ICS. Through this foreclosure process, we gained 100% ownership of THS and certain ESA assets. Based upon an analysis of the liquidation value of the ESA assets and the enterprise value of THS, our Board of Directors determined the fair value of our investment in ICS to be \$4,542 at June 30, 2010, a reduction of \$12,110 from its amortized cost, compared to the \$11,652 unrealized loss recorded at June 30, 2009.

*Iron Horse Coiled Tubing, Inc.*

Iron Horse is an investment that we completed in April 2006. Iron Horse had been a provider of coiled tubing subcontractor services prior to making a strategic decision in late 2007 to directly service natural gas and oil producers in the Western Canadian Sedimentary Basin ( WCSB ) as a fracturing services provider. As a result of the business transition, the Company s 2008 financial performance declined significantly from 2007 levels. Iron Horse completed its transition from a subcontractor to a direct service provider in 2009, but natural gas prices declined to trough levels due to the recession and heightened natural gas inventory levels. Since November 2009, Iron Horse has experienced increased activity in the WCSB and is now completing wells for several large producers in the WCSB.

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

Effective January 1, 2010, we restructured our senior secured and bridge loans to Iron Horse and we reorganized Iron Horse s management structure. Our loans were replaced with three new tranches of senior secured debt and our total ownership of Iron Horse decreased to 70.4%. Our equity ownership will incrementally decrease as debt tranches are repaid upon maturity. There was no change to fair value at the time of restructuring, and we continue to fully reserve any income accrued for Iron Horse.

The Board of Directors wrote-down the fair value of our investment in Iron Horse to \$12,054 as of June 30, 2010, a reduction of \$8,948 from its amortized cost, compared to the \$6,738 unrealized depreciation recorded at June 30, 2009.

*Manx Energy, Inc.*

On January 19, 2010, we modified the terms of our senior secured debt in AEH and Coalbed in conjunction with the formation of Manx Energy, a new entity consisting of the assets of AEH, Coalbed and Kinley Exploration. The assets of the three companies were combined under new common management. We funded \$2,800 at closing to Manx to provide for working capital. A portion of our loans to AEH and Coalbed was exchanged for Manx preferred equity, while our AEH equity interest was converted into Manx common stock. There was no change to fair value at the time of restructuring, and we continue to fully reserve any income accrued for Manx.

The Board of Directors wrote-down the fair value of our investment in Manx to \$4,686 as of June 30, 2010, a reduction of \$13,584 from its amortized cost, compared to the \$5,380 unrealized depreciation, for AEH and Coalbed combined, recorded at June 30, 2009.

*Yatesville Coal Holdings, Inc.*

All of our coal holdings have been consolidated under the Yatesville entity. Yatesville delivered improved operating results after the consolidation of the coal holdings, but the company mined its permitted reserves in December 2008

and has not produced meaningful revenues since then. We continue to evaluate strategies for Yatesville, such as soliciting indications of interest regarding a transaction involving part or all of recoverable reserves. During the year ended June 30, 2010, we provided additional funding of \$3,376 to Yatesville to fund ongoing operations, including new permitting. During the quarter ended December 31, 2009, we discontinued operations at Yatesville. At December 31, 2009, our Board of Directors determined that, consistent with the decision to discontinue operations, the impairment of Yatesville was other than temporary, and we recorded a

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realized loss of \$51,228, which was the amount that the amortized cost exceeded the fair value at December 31, 2009. As of June 30, 2010, our Board of Directors set the value of the remaining Yatesville investment at \$809, which represents the residual value of recoverable reserves, a reduction of \$12,288 from its value as of June 30, 2009.

Equity positions in the portfolio are susceptible to potentially significant changes in value, both increases as well as decreases, due to changes in operating results. Four control investments have experienced such volatility – Fischbein and GSHI with improved operating results and NRG and R-V with declining operating results. Nine of the remaining controlled investments have experienced operating challenges and have been valued at significant discounts to the original investment.

The affiliate investments continue to report strong operating results, with valuations increasing significantly for two investments subsequent to the acquisition of Patriot – Boxercraft and Sport Helmets.

With the non-control/non-affiliate investments, generally, there is less volatility related to our total investments because our equity positions tend to be smaller than with our control/affiliate investments, and debt investments are generally not as susceptible to large swings in value as equity investments. For debt investments, the fair value is limited on the high side to each loan's par value, plus any prepayment premia that could be imposed. Many of the debt investments in this category have not experienced a significant change in value, as they were previously valued at or near par value. The exception to this categorization relates to investments which were acquired in the Patriot acquisition, many of which were acquired at significant discounts to par value, and any changes in operating results or interest rates can have a significant effect on the value of such investments. AFI, Copernicus Group, Impact Products, LLC, Mac & Massey Holdings, LLC and Prince experienced meaningful increases in valuations. AFI, Deb Shops, Inc. ( Deb Shops ), H&M and Wind River Resources Corp. and Wind River II Corp. ( Wind River ) experienced decreases in valuations due to declines in their operating results. Shearer's completed a significant acquisition, which is driving the operating results and the increase in the value of the investment. For one investment, Miller Petroleum, Inc., we have held warrants in the company, and there has been a significant increase in the price per share of the company's stock, driving the increase in the value of our investment. The remaining investments did not experience significant changes in operations or valuation.

During the year ended June 30, 2010, we restructured our loans to AFI, EXL, LHC, Prince and ROM. The revised terms were more favorable than the original terms and increased the present value of the future cash flows. The cost bases of the new loans were recorded at par value, which included \$8,099 of accelerated original purchase discount recognized as interest income.

## **Capitalization**

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

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

On June 11, 2010, we closed an extension and expansion of our revolving credit facility with a syndicate of lenders. The lenders have commitments of \$210 million under the new credit facility as of June 11, 2010. The new credit

facility includes an accordion feature which allows the facility to be increased to up to \$300 million of commitments in the aggregate to the extent additional or existing lenders commit to increase the commitments. We will seek to add additional lenders in order to reach the maximum size; although no assurance can be given we will be able to do so. As we make additional investments which are eligible to be pledged under the credit facility, we will generate additional availability to the extent such investments are eligible to be placed into the borrowing base. The revolving period of the credit facility extends through June 2012, with an additional one year amortization

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

As of June 30, 2010 and 2009, we had \$180,678 and \$125,746 available to us for borrowing under our credit facility, of which \$100,300 and \$124,800 was outstanding, respectively. Interest on borrowings under the credit facility was one-month Libor plus 250 basis points prior to June 25, 2009, increasing to one-month Libor plus 400 basis points, subject to a minimum Libor floor of 200 basis points for the period from June 26, 2009 to June 10, 2010 and thereafter. The maintenance of this facility requires us to pay a fee for the amount not drawn upon. Prior to June 25, 2009, this fee was assessed at the rate of 37.5 basis points per annum of the amount of that unused portion. For the period from June 26, 2010 to June 10, 2010, this rate increased to 100 basis points per annum. After June 11, 2010, the lenders charge a fee on the unused portion of the credit facility equal to either 75 basis points if at least half of the credit facility is used or 100 basis points otherwise. The following table shows the facility amounts and outstanding borrowings at June 30, 2010 and June 30, 2009:

	<b>June 30, 2010</b>		<b>June 30, 2009</b>	
	<b>Facility Amount</b>	<b>Amount Outstanding</b>	<b>Facility Amount</b>	<b>Amount Outstanding</b>
Revolving Credit Facility	\$ 210,000	\$ 100,300	\$ 175,000	\$ 124,800

	<b>Payments Due By Period</b>		
	<b>Less Than 1 Year</b>	<b>1-3 Years</b>	<b>More Than 3 Years</b>
Revolving Credit Facility	\$	\$ 100,300	\$

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

During the year ended June 30, 2009, we completed three stock offerings and raised \$100,304 of additional equity by issuing 12,942,500 shares of our common stock below net asset value diluting shareholder value by \$2.06 per share. The following table shows the calculation of net asset value per share as of June 30, 2010 and June 30, 2009:

	<b>As of June 30, 2010</b>	<b>As of June 30, 2009</b>
Net Assets	\$ 710,685	\$ 532,596
Shares of common stock outstanding	69,086,862	42,943,084
Net asset value per share	\$ 10.29(1)	\$ 12.40

(1) Our most recently estimated NAV per share is \$10.02 on an as adjusted basis solely to give effect to our distributions with record dates of July 30, 2010 and August 31, 2010, our issuance of common shares on July 30,

2010 in connection with our dividend reinvestment plan, and sales during the period June 28, 2010 through August 19, 2010 (which settled during the period from July 1, 2010 to August 24, 2010) under the ATM Program, versus \$10.29 determined by us as of June 30, 2010. NAV as of September 30, 2010 may be higher or lower than \$10.02 based on potential changes in valuations. Our Board of Directors has not yet determined the fair value of portfolio investments subsequent to June 30, 2010. Our Board of Directors determines the fair value of our portfolio investments on a quarterly basis in connection with the preparation of quarterly financial statements and based on input from an independent valuation firm, our Investment Advisor and the audit committee of our Board of Directors.

At June 30, 2010, we had 69,086,862 shares of our common stock outstanding.

### **Results of Operations**

Net increase in net assets resulting from operations for the years ended June 30, 2010, 2009 and 2008 was \$18,886, \$35,104 and \$27,591, respectively, representing \$0.32, \$1.11 and \$1.17 per weighted average share, respectively. During the year ended June 30, 2010, we experienced net unrealized and realized losses of \$47,565 or approximately \$0.80 per weighted average share primarily from the write-downs of our investments in Freedom

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Marine, H&M, Iron Horse, NRG, R-V and Yatesville. During the year ended June 30, 2009, we experienced net unrealized and realized losses of \$24,059 or approximately \$0.76 per weighted average share primarily from the write-downs of our investments in CCEI and Yatesville. During the year ended June 30, 2008, we experienced net unrealized and realized losses of \$17,522 or approximately \$0.74 per weighted average share primarily from the sales of our investments in Advantage Oilfield Group and Central Illinois Energy at a loss.

During the last quarter of the fiscal year ended June 30, 2009 and the fiscal year ended June 30, 2010, we have raised a significant amount of equity capital, which was used in part to fund the Patriot acquisition, but has not yet been fully invested. As a result, our use of the credit facility has been less during the fiscal year ended June 30, 2010 and the excess cash on hand tends to depress our earnings per share. We continue to deploy our debt and equity raised into new investments.

To further illustrate the effects, for the fiscal year ended June 30, 2010 compared to the fiscal year ended June 30, 2009, weighted average shares outstanding have increased from 31,559,905 to 59,429,222, or 88.31%, while the average debt principal of investments increased from \$525,144 to \$633,275, or 20.1%. Partially offsetting this effect on EPS is the increase in the weighted interest rate earning on debt investments from 12.0% for the fiscal year ended June 30, 2009 to 13.7% for the fiscal year ended June 30, 2010.

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

**Investment Income**

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

Investment income, which consists of interest income, including accretion of loan origination fees and prepayment penalty fees, dividend income and other income, including settlement of net profits interests, overriding royalty interests and structuring fees, was \$113,635, \$100,481, and \$79,402 for the years ended June 30, 2010, June 30, 2009 and June 30, 2008, respectively. The primary driver of the increase from the year ended June 30, 2009 to the year ended June 30, 2010 is the acquisition of additional assets from Patriot and other new investments which increased interest income for the second half of the year. This increase is partially offset by a decline in dividend income from GSHI. Drivers of the increase from the year ended June 30, 2008 to the year ended June 30, 2009 include increased assets generating increased interest and dividend income along with increased income from royalty and settlement of net profits interests. The following table describes the various components of investment income and the related levels of debt investments:

Year Ended	Year Ended	Year Ended
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	<b>June 30, 2010</b>	<b>June 30, 2009</b>	<b>June 30, 2008</b>
Interest income	\$ 86,518	\$ 62,926	\$ 59,033
Dividend income	15,366	22,793	12,033
Other income	11,751	14,762	8,336
Total investment income	\$ 113,635	\$ 100,481	\$ 79,402
Average debt principal of investments	\$ 633,275	\$ 525,144	\$ 397,913
Weighted-average interest rate earned	13.7%	12.0%	14.8%

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Total investment income has increased from \$79,402 for the year ended June 30, 2008 to \$100,481 for the year ended June 30, 2009 to \$113,635 for the year ended June 30, 2010. Investment income has been increasing as we continue to deploy the additional capital, raised in both debt and equity offerings, in revenue-producing assets.

Average interest income producing assets have increased from \$397,913 for the year ended June 30, 2008 to \$525,144 for the year ended June 30, 2009 to \$633,275 for the year ended June 30, 2010. The average yield on interest bearing assets increased from 12.0% for the year ended June 30, 2009 to 13.7% for the year ended June 30, 2010. This increase is primarily the result of higher interest rates earned on the assets acquired in the Patriot acquisition (including discount accretion). Average yields on interest bearing assets decreased from 14.8% for the year ended June 30, 2008 to 12.0% for the year ended June 30, 2009. This decrease was the result of our increasing our asset mix in financings with private equity sponsors. We believe that such financings offer less risk, and consequently lower yields, due, in part, to lesser risk to our capital resulting from larger equity at risk underneath our capital. Holding these types of investments has allowed us to more effectively utilize our credit facility to finance such assets at an average rate of 5.8%, 3.8 and 5.7% for the years ended June 30, 2010, June 30, 2009 and June 30, 2008, respectively. Additionally, during the years ended June 30, 2010 and June 30, 2009, interest of \$19,764 and \$18,746, respectively, was foregone on non-accrual debt investments compared to \$3,449 of foregone interest for the year ended June 30, 2008. Without these adjustments, the weighted average interest rates earned on debt investments would have been 17.3%, 15.6% and 15.7% for the years ended June 30, 2010, 2009 and 2008, respectively.

Investment income is also generated from dividends and other income. Dividend income grew significantly from \$12,033 for the year ended June 30, 2008 to \$22,793 for the year ended June 30, 2009 and declined to \$15,366 for the year ended June 30, 2010. Dividend income is mostly attributable to dividends received from our investment in GSHI, which were \$20,500 and \$14,500 during the years ended June 30, 2009 and June 30, 2010, respectively.

Other income has come primarily from structuring fees, overriding royalty interests, and settlement of net profits interests. Income from other sources grew from \$8,336 for the year ended June 30, 2008 to \$14,762 for the year ended June 30, 2009 and decreased to \$11,751 for the year ended June 30, 2010. During the year ended June 30, 2008 we received royalty income and settlement of net profits interest of \$2,984 in the aggregate related to Ken-Tex Energy Corp, and \$4,751 of structuring fees related to Ajax, H&M and various other portfolio investments. During the year ended June 30, 2009, structuring fees of \$1,274 were received primarily related to Biotronic and GSHI, a decrease of \$3,477 from the year ended June 30, 2008. The increase in other income for the year ended June 30, 2009 is largely due to the settlement of our net profit interests in IEC/ARS for \$12,576. During the year ended June 30, 2010, we recognized a \$7,708 gain on the Patriot acquisition and received \$2,388 of structuring and amendment fees primarily related to EXL, H&M, Hoffmaster and Shearer's, an overall decrease of \$3,011 in other income from the year ended June 30, 2009.

**Operating Expenses**

Our primary operating expenses consist of investment advisory fees (base and incentive fees), credit facility costs, legal and professional fees and other operating and overhead-related expenses. These expenses include our allocable portion of overhead under the Administration Agreement with Prospect Administration under which Prospect Administration provides administrative services and facilities for us. Our investment advisory fees compensate our Investment Adviser for its work in identifying, evaluating, negotiating, closing and monitoring our investments. We bear all other costs and expenses of our operations and transactions in accordance with our Administration Agreement with Prospect Administration. Operating expenses were \$47,184, \$41,318 and \$34,289 for the years ended June 30, 2010, June 30, 2009 and June 30, 2008, respectively.

The base investment advisory expenses were \$13,929, \$11,915 and \$8,921 for the years ended June 30, 2010, June 30, 2009 and June 30, 2008, respectively. These increases are directly related to our growth in total assets. \$16,613,

\$14,790 and \$11,278 in income incentive fees were incurred for the years ended June 30, 2010, June 30, 2009 and June 30, 2008, respectively. The increases have occurred as net interest income has increased due primarily to an increase in the asset base. No capital gains incentive fee has yet been incurred pursuant to the Investment Advisory Agreement.

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During the years ended June 30, 2010, June 30, 2009 and June 30, 2008, we incurred \$8,392, \$6,161 and \$6,318, respectively, of expenses related to our credit facilities. These expenses are related directly to the leveraging capacity put into place for each of those years and the levels of indebtedness actually undertaken in those years. The table below describes the various credit facility expenses and the related indicators of leveraging capacity and indebtedness.

	<b>Year Ended June 30, 2010</b>	<b>Year Ended June 30, 2009</b>	<b>Year Ended June 30, 2008</b>
Interest expense	\$ 1,338	\$ 5,075	\$ 5,104
Amortization of deferred financing costs	5,297	759	726
Commitment and other fees	1,747	327	488
<b>Total</b>	<b>\$ 8,382</b>	<b>\$ 6,161</b>	<b>\$ 6,318</b>
Weighted average debt outstanding	\$ 23,147	\$ 132,013	\$ 90,032
Weighted average interest rate	5.78%	3.84%	5.67%
Facility amount at beginning of year	\$ 175,000	\$ 200,000	\$ 200,000

The increase in our interest rate incurred for the year ended June 30, 2010 is primarily due to an increase of 150 basis points in our borrowing rate effective June 25, 2009 and the concurrent introduction of a Libor floor at 200 basis points. This increase was partially amended on June 11, 2010 with the closing of our current facility. The borrowing rate and Libor floor decreased by 75 basis points and 100 basis points, respectively. The decrease in our interest rate incurred for the year ended June 30, 2009 is primarily due to a decrease in average LIBOR of approximately 1.44% in comparison to 4.08% for the year ended June 30, 2008. This decrease was partially offset by an increase of 125 basis points in the then effective borrowing rate at November 14, 2008.

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

Total operating expenses, net of management fees and interest costs ( Other Operating Expenses ), were \$8,280, \$8,452 and \$7,772 for the years ended June 30, 2010, 2009 and 2008, respectively. The decrease in Other Operating Expenses during the year ended June 30, 2010 when compared to the year ended June 30, 2009 is primarily the result operating efficiencies realized upon the termination of the sub-administration agreement and no excise taxes being paid in 2010 offset by the costs incurred in connection with merger discussions with Allied Capital Corporation expensed in the 2010 period. At December 31, 2008, we elected to retain a portion of our annual taxable income and accrued \$533 for the excise tax that was paid with the filing of the return. Legal costs continue to decrease significantly from \$2,503 for the year ended June 30, 2008 to \$947 for the year ended June 30, 2009 to \$702 for the year ended June 30, 2010 as there were reduced costs for litigation.

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

Our net investment income was \$66,451, \$59,163 and \$45,113 for the years ended June 30, 2010, June 30, 2009 and June 30, 2008, respectively. Net investment income represents the difference between investment income and operating expenses and is directly impacted by the items described above.

Net realized (losses) gains were (\$51,545), (\$39,078) and (\$16,222) for the years ended June 30, 2010, June 30, 2009 and June 30, 2008, respectively. The net realized loss during the year ended June 30, 2010 was due primarily to the determination that Yatesville was other than temporarily impaired and recognized a realized loss for the amount

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by which the amortized cost exceeded the current fair value. On June 30, 2009, we determined that the impairment of the CCEHI investment was other than temporarily impaired and recognized a realized loss for the amount by which the amortized cost exceeded the current fair value. This loss was partially offset by realized gains from sales of the Arctic warrants and Deep Down common stock. The net realized loss of \$16,222 sustained in the year ended June 30, 2008 was due mainly to the sale of Charlevoix and Advantage Oilfield Group Ltd. ( AOG ).

Increase (decrease) in net assets from changes in unrealized appreciation/depreciation was \$3,980, \$15,019 and (\$1,300) for the years ended June 30, 2010, June 30, 2009 and June 30, 2008, respectively. For the year ended June 30, 2010, the net unrealized appreciation was driven by \$25,184 of write-ups in our investments in Fischbein, GSHI, Prince, Shearer s, and Regional Management Corporation, and by the disposition of previously written-down investment in Yatesville mentioned above with an unrealized net appreciation of \$35,471, which, in turn, were offset by \$56,954 of write-downs in our investments in Deb Shops, Freedom Marine, H&M, Manx, NRG, R-V and Wind River. For the year ended June 30, 2009, the net unrealized appreciation was driven by significant write-ups of our investments in AGC, GSHI, NRG, R-V, Shearer s and Stryker, and by the disposition of previously written-down investment in CCEI mentioned above, which, in turn, were offset by significant write-downs in our investments in Ajax, AEH, Conquest Cherokee, LLC, Deb Shops, Iron Horse and Yatesville as well as the elimination of the unrealized appreciation resulting from the sale of Deep Down mentioned above. For the year ended June 30, 2008, \$1,300 of the decrease in net assets from the net change in unrealized appreciation/depreciation was driven by significant write-downs in our investments in ICS, Worcester Energy Partners, Inc., and Yatesville partially offset by the write-up in our investment in GSHI and by the disposition of previously written-down investments in AOG and ESA.

**Financial Condition, Liquidity and Capital Resources**

Our cash flows provided by (used in) operating activities totaled \$54,838, (\$74,000) and (\$204,025) for the years ended June 30, 2010, June 30, 2009 and June 30, 2008, respectively. Investing activities used \$106,586 for the acquisition of Patriot for the year ended June 30, 2010. There were no investing activities for the years ended June 30, 2009 and June 30, 2008. Financing activities provided cash flows of \$42,887, \$83,387 and \$204,580 for the years ended June 30, 2010, June 30, 2009 and June 30, 2008, respectively. Dividends paid were \$82,908, \$43,257 and \$24,915 for the years ended June 30, 2010, June 30, 2009 and June 30, 2008, respectively.

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

We have and may continue to fund a portion of our cash needs through borrowings from banks, issuances of senior securities or secondary offerings. We may also securitize a portion of our investments in mezzanine or senior secured loans or other assets. Our objective is to put in place such borrowings in order to enable us to expand our portfolio. At June 30, 2010, we had \$100,300 outstanding borrowings on our \$210,000 revolving credit facility.

On March 4, 2010, our Registration Statement on Form N-2 was declared effective by the SEC. Under this Shelf Registration Statement, we can issue up to \$439,622 of additional equity securities as of June 30, 2010.

We also continue to generate liquidity through public and private stock offerings. On July 7, 2009 we completed a public stock offering for 5,175,000 shares of our common stock at \$9.00 per share, raising \$46,575 of gross proceeds. On August 20, 2009 and September 24, 2009, we issued 3,449,686 shares and 2,807,111 shares, respectively, of our common stock at \$8.50 and \$9.00 per share, respectively, in private stock offerings, raising \$29,322, and \$25,264 of gross proceeds, respectively. Concurrent with the sale of these shares, we entered into a registration rights agreement in which we granted the purchasers certain registration rights with respect to the shares. Under the terms and

conditions of the registration rights agreement, we filed with the SEC a post-effective amendment to the registration statement on Form N-2 on November 6, 2009. Such amendment was declared effective by the SEC on November 9, 2009.

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

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by us. In connection with the transaction, we repaid all the outstanding borrowings of Patriot, in compliance with the merger agreement.

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

**Off-Balance Sheet Arrangements**

At June 30, 2010, we did not have any off-balance sheet liabilities or other contractual obligations that are reasonably likely to have a current or future material effect on our financial condition, other than those which originate from 1) the investment advisory and management agreement and the administration agreement and 2) the portfolio companies.

**QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are subject to financial market risks, including changes in interest rates and equity price risk. At June 30, 2010, most of the loans in our portfolio bore interest at fixed interest rates. Several of our floating rate loans have floors which have effectively converted the loans to fixed rate loans in the current interest rate environment. At June 30, 2010, the principal value of loans totaling approximately \$35.24 million bear interest at floating rates.

If we continue to invest in fixed rate loans, we may hedge against interest rate fluctuations by using standard hedging instruments such as futures, options and forward contracts subject to the requirements of the 1940 Act. While hedging activities may insulate us against adverse changes in interest rates, they may also limit our ability to participate in the benefits of lower interest rates with respect to our portfolio of investments. During the year ended June 30, 2010, we did not engage in interest rate hedging activities.

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**SUPPLEMENT TO MATERIAL U.S. FEDERAL INCOME TAXATION CONSIDERATIONS**

The following summary of certain U.S. Federal income tax considerations supplements the discussion set forth under the heading "Material U.S. Federal Income Tax Considerations" in the accompanying prospectus and is subject to the qualifications and assumptions set forth therein.

The Hiring Incentives to Restore Employment Act of 2010 will require, after December 31, 2012, withholding at a rate of 30% on dividends in respect of, and gross proceeds from the sale or other disposition of, shares of our common stock held by foreign financial institutions (including foreign investment funds), unless such institution enters into an agreement with the Secretary of the Treasury to report, on an annual basis, information about equity and debt interests in, and accounts maintained by, the institution to the extent such interests or accounts are held by certain U.S. persons or by certain non-U.S. entities that are wholly or partially owned by U.S. persons. Similarly, after December 31, 2012, dividends in respect of, and gross proceeds from the sale or other disposition of, shares of our common stock held by an investor that is a non-financial foreign entity will be subject to withholding at a rate of 30%, unless such entity either (i) certifies to us that such entity does not have any substantial United States owners or (ii) provides certain information regarding the entity's substantial United States owners, which we will in turn provide to the Secretary of the Treasury. Non-U.S. shareholders are encouraged to consult with their tax advisers regarding the possible implications of this new legislation on their investment in shares of our common stock.

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**USE OF PROCEEDS**

Sales of our common stock, if any, under this prospectus supplement and the accompanying prospectus may be made in negotiated transactions or transactions that are deemed to be "at the market" as defined in Rule 415 under the 1933 Act, including sales made directly on the NASDAQ Global Select Market or sales made to or through a market maker other than on an exchange. There is no guaranty that there will be any sales of our common stock pursuant to this prospectus supplement and the accompanying prospectus. Actual sales, if any, of our common stock under this prospectus supplement and the accompanying prospectus may be less than as set forth in this paragraph depending on, among other things, the market price of our common stock at the time of any such sale, and may be for prices below our most recently determined net asset value per share. As a result, the actual net proceeds we receive may be more or less than the amount of net proceeds estimated in this prospectus supplement. Assuming the sale of all 2,185,472 shares of common stock offered under this prospectus supplement and the accompanying prospectus, at the last reported sale price of \$9.43 per share for our common stock on the NASDAQ Global Select Market as of September 2, 2010, we estimate that the net proceeds of this offering will be approximately \$20.1 million after deducting the estimated Sales Manager commissions and our estimated offering expenses.

We expect to use the net proceeds from this offering initially to maintain balance sheet liquidity, involving repayment of debt under our credit facility, investments in high quality short-term debt instruments or a combination thereof, and thereafter to make long-term investments in accordance with our investment objective.

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**CAPITALIZATION**

The equity distribution agreements provide that we may offer and sell up to 6,000,000 shares of our common stock from time to time through the Sales Managers, as our agents for the offer and sale of such common stock. During the period from July 19, 2010 (the date of the equity distribution agreements) through August 19, 2010, we sold 3,814,528 shares of our common stock through the Sales Managers pursuant to the equity distribution agreements. No sales of common stock were made pursuant to the equity distribution agreements during the period from August 20, 2010 through the date of this prospectus supplement. As such, there are 2,185,472 shares of common stock remaining that we may offer and sell through the Sales Managers pursuant to the equity distribution agreements. The table below assumes that we will sell all of the 2,185,472 shares remaining at a price of \$9.43 per share (the last reported sale price per share of our common stock on the NASDAQ Global Select Market on September 2, 2010) but there is no guarantee that there will be any sales of our common stock pursuant to this prospectus supplement and the accompanying prospectus. Actual sales, if any, of our common stock under this prospectus supplement and the accompanying prospectus may be less than as set forth in the table below. In addition, the price per share of any such sale may be greater or less than \$9.43, depending on the market price of our common stock at the time of any such sale and whether such sale is made at a discount to our most recently determined net asset value per share.

The following table sets forth our capitalization as of June 30, 2010:

on an actual basis;

on an as adjusted basis giving effect to our distributions with record dates of July 30, 2010 and August 31, 2010, our issuance of 83,875 and 89,620 shares in connection with our dividend reinvestment plan on July 30, 2010 and August 31, 2010, respectively, the sale of 2,748,600 shares of common stock during the period June 28, 2010 through July 16, 2010 (with settlement dates of July 1, 2010 through July 21, 2010), the sale of 3,814,528 shares of our common stock during the period July 19, 2010 through August 19, 2010 (with settlement dates of July 22, 2010 through August 24, 2010) and repayments on our credit facility; and

on an as further adjusted basis giving effect to the transactions noted above and the assumed sale of 2,185,472 shares of our common stock at a price of \$9.43 per share (the last reported sale price per share of our common stock on the NASDAQ Global Select Market on September 2, 2010) less commissions and expenses.

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This table should be read in conjunction with Use of Proceeds and our Management's Discussion and Analysis of Financial Condition and Results of Operations and our financial statements and notes thereto included in this prospectus supplement and the accompanying prospectus.

	<b>As of June 30, 2010</b>		
	<b>As Adjusted for</b>		
	<b>Stock Issuances</b>		
	<b>and</b>		
	<b>Additional</b>		
	<b>Actual</b>	<b>Borrowings After</b>	<b>As further</b>
		<b>June 30, 2010</b>	<b>Adjusted</b>
	<b>(In thousands, except shares and per share data)</b>		
	<b>(Unaudited)</b>		
Long-term debt, including current maturities:			
Borrowings under senior credit facility(1)	\$ 100,300	\$ 78,700	\$ 78,700
Amount owed to affiliates	9,115	9,115	9,115
<b>Total long-term debt</b>	<b>109,415</b>	<b>87,815</b>	<b>87,815</b>
Stockholders' equity:			
Common stock, par value \$0.001 per share (100,000,000(2) common shares authorized; 69,086,862 shares outstanding actual, 75,823,485 shares outstanding as adjusted for stock issuances in connection with our dividend reinvestment plan and pursuant to the March 17, 2010 equity distribution agreements completed after March 31, 2010 and 78,008,957 shares outstanding as further adjusted for this offering)	69	76	78
Paid-in capital in excess of par value	805,918	855,200	875,320
Distributions in excess of net investment income	(10,431)	(10,431)	(10,431)
Accumulated realized losses on investments	(104,595)	(104,595)	(104,595)
Net unrealized appreciation on investments	19,724	19,724	19,724
<b>Total stockholders' equity</b>	<b>710,685</b>	<b>759,974</b>	<b>780,096</b>
<b>Total capitalization</b>	<b>\$ 820,100</b>	<b>\$ 847,789</b>	<b>\$ 867,911</b>

(1) As of June 30, 2010, we had \$100.3 million of borrowings outstanding under our recently completed extended credit facility. As of September 2, 2010, we had \$78.7 million of borrowings under our credit facility, representing a \$21.6 million decrease in borrowing subsequent to June 30, 2010.

(2)

As of August 31, 2010, the number of shares of common stock authorized for issuance by the Company increased from 100,000,000 to 200,000,000.

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At our 2008 annual meeting of stockholders held on February 12, 2009 and our 2009 annual meeting of stockholders held on December 11, 2009, our stockholders approved our ability to sell an unlimited number of shares of our common stock at any level of discount to NAV per share during the twelve-month period following such approval. Accordingly, we may make additional offerings of our common stock without any limitation on the total amount of dilution to stockholders. See *Sales of Common Stock Below Net Asset Value* in this prospectus supplement and in the accompanying prospectus. Pursuant to this authority and the approval of our Board of Directors, we have made the following offerings:

<b>Date of Offering</b>	<b>Price Per Share to Investors</b>	<b>Shares Issued</b>	<b>Estimated Net Asset Value per Share</b>	<b>Percentage Dilution</b>
March 18, 2009	\$8.20	1,500,000	\$14.43	2.20%
April 22, 2009	\$7.75	3,680,000	\$14.15	5.05%
May 19, 2009	\$8.25	7,762,500	\$13.44	7.59%
July 7, 2009	\$9.00	5,175,000	\$12.40	3.37%
August 20, 2009	\$8.50	3,449,686	\$11.57	1.78%
September 24, 2009	\$9.00	2,807,111	\$11.36	1.20%
June 21, 2010 to June 25, 2010(2)	\$10.01-\$10.67	1,072,500	\$10.18	0.03%
June 28, 2010 to July 16, 2010(3)	\$9.47-\$10.04	2,748,600	\$10.26-\$10.29	0.27%
July 19, 2010 to August 19, 2010(4)	\$9.28-\$10.04	3,814,528	\$10.12-\$10.26	0.31%

- (1) The data for sales of shares below NAV pursuant to our at-the-market program are an estimate based on the last reported NAV adjusted for capital events occurring during the period since the last calculated NAV. All amounts presented are approximations based on the best available data at the time of issuance. Overall, the dilution from the issuance of shares below NAV in connection with the at-the-market program is estimated to be less than 1%.
- (2) Dates of offering represent the sales dates of the stock. The settlement dates are three business days later or June 24, 2010 to June 30, 2010.
- (3) Dates of offering represent the sales dates of the stock. The settlement dates are three business days later or July 1, 2010 to July 21, 2010.
- (4) Dates of offering represent the sales dates of the stock. The settlement dates are three business days later or July 22, 2010 to August 24, 2010.

Table of Contents**BOARD OF DIRECTORS****Directors and Executive Officers**

Our directors and executive officers and their positions are set forth below. The address for each director and executive officer is c/o Prospect Capital Corporation, 10 East 40th Street, 44th Floor, New York, NY 10016. On March 23, 2010, our Board of Directors unanimously approved William J. Grempe as a member of the Board of Directors, effective April 1, 2010. Mr. Grempe replaced Mr. Graham D.S. Anderson as an independent director of the Company. Mr. Anderson resigned from the Board of Directors, effective April 1, 2010.

**Independent Directors**

Name and Age	Position(s) Held with the Company	Term of Office(1) and Length of Time Served	Principal Occupation(s) During Past 5 Years	Number of Portfolios in Fund Complex Overseen	
				by Director	Other Directorships Held by Director(2)
William J. Grempe, 67	Director	Class II Director from 2006 to 2009; Class I Director since April 2010; Term expires 2010	Mr. Grempe was responsible for traditional banking services, credit and lending, private equity and corporate cash management with Merrill Lynch & Co. from 1999 to 2009.	One	None
Eugene S. Stark, 52	Director	Class III Director since September 2008; Term expires 2010	Principal Financial Officer, Chief Compliance Officer and Vice President Administration of General American Investors Company, Inc. from May 2005 to present.	One	None
Andrew C. Cooper, 48	Director	Class II Director since February 2009; Term expires 2012	Mr. Cooper is an entrepreneur, who over the last 11 years has founded, built, run and sold three companies. He is Co-Chief Executive Officer of Unison Site Management, Inc., a specialty finance company focusing on cell site easements, and Executive Director of Brand Asset Digital, a digital media marketing and distribution company.	One	Unison Site Management, LLC, Brand Asset Digital, LLC and Aquatic Energy, LLC

- (1) Our Board of Directors is divided into three classes of directors serving staggered three-year terms. Mr. Grep is a Class I director with a term that will expire in December 2010, Mr. Eliasek and Mr. Cooper are Class II directors with terms that will expire in 2012 and Mr. Barry and Mr. Stark are Class III directors with terms that will expire in December 2010.
- (2) No director otherwise serves as a director of an investment company subject to the 1940 Act.

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**Table of Contents****Interested Directors**

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

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

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

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

For the fiscal year ended June 30, 2010, our Board of Directors held eighteen Board meetings, ten Audit Committee meetings, and two Nominating and Corporate Governance Committee meetings. The Audit Committee and Nominating and Corporate Governance Committee are composed of Messrs. Cooper, Grempp and Stark.

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

<b>Name and Age</b>	<b>Position(s) Held with the Company</b>	<b>Term of Office and Length of Time Served</b>	<b>Principal Occupation(s) During Past Five Years</b>
Brian H. Oswald, 49			

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

The following table sets forth information regarding the compensation received by the directors and executive officers from the Company for the fiscal year ended June 30, 2010. No compensation is paid to the interested directors by the Company. The independent directors who serve on both committees of the Board receive an annual fee of \$85,000 per director plus reimbursement of any reasonable out-of-pocket expenses incurred, the independent directors who serve on one committee of the Board receive an annual fee of \$60,000 per director plus reimbursement of any reasonable out-of-pocket expenses incurred and the independent directors who do not serve on any

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committees of the board receive an annual fee of \$11,250 per director plus reimbursement of any out-of-pocket expenses incurred. All independent directors currently serve on both committees.

<b>Name and Position</b>	<b>Aggregate Compensation from the Company</b>	<b>Pension or Retirement Benefits Accrued as Part of the Company's Expenses(1)</b>	<b>Total Compensation Paid to Director/ Officer</b>
<b><i>Interested Directors</i></b>			
John F. Barry(2)	None	None	None
M. Grier Eliasek(2)	None	None	None
<b><i>Independent Directors</i></b>			
Graham D.S. Anderson(3)	\$ 63,750	None	\$ 63,750
Andrew C. Cooper(4)	\$ 85,000	None	\$ 85,000
William J. Grempe(5)	\$ 21,250	None	\$ 21,250
Eugene S. Stark(6)	\$ 85,000	None	\$ 85,000
<b><i>Executive Officers</i></b>			
Brian H. Oswald(2)	None	None	None

- (1) We do not have a bonus, profit sharing or retirement plan, and directors do not receive any pension or retirement benefits.
- (2) We have not paid, and we do not intend to pay, any annual cash compensation to our executive officers for their services as executive officers. Messrs. Barry and Eliasek are compensated by PCM from the income PCM receives under the management agreement between PCM and us. Mr. Oswald is compensated from the income Prospect Administration receives under the administration agreement.
- (3) Mr. Anderson resigned as a Director of the Company effective April 1, 2010.
- (4) Mr. Cooper joined our Board of Directors on February 12, 2009.
- (5) Mr. Grempe joined our Board of Directors on April 1, 2010.
- (6) Mr. Stark joined our Board of Directors on September 4, 2008.

***Board Leadership Structure***

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



identified a lead independent director of the Board of Directors of the Company in as much as the Board consists of only five individuals.

*Director Independence*

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

*Role of the Chairman and Chief Executive Officer*

As Chairman of the Board of Directors and Chief Executive Officer, Mr. Barry assumes a leading role in mid- and long-term strategic planning and supports major transaction initiatives of the Company. Mr. Barry also manages the day-to-day operations of the Company, with the support of the other executive officers. As Chief Executive

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Officer, Mr. Barry has general responsibility for the implementation of the policies of the Company, as determined by the Board of Directors, and for the management of the business and affairs of the Company. The Board of Directors has determined that its leadership structure, in which the majority of the directors are not affiliated with the Company, PCM or Prospect Administration, is appropriate in light of the services that PCM and Prospect Administration and their affiliates provide to the Company and for the potential conflicts of interest that could arise from these relationships.

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

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

*John Francis Barry III*

The Board benefits from Mr. Barry's years of experience in the investment banking and the financial advisory industries, as well as his service on multiple boards for various companies. In addition to overseeing the Company, Mr. Barry has served on the boards of directors of private and public companies, including financial services, financial technology and energy. Mr. Barry also managed an investment bank, focusing on private equity and debt financing for energy and other companies, and was the founding member of the project finance group at Merrill Lynch & Co. The Board also benefits from Mr. Barry's past experience as a corporate securities lawyer at a premiere United States law firm, advising energy companies and their commercial and investment bankers. Mr. Barry is also chairman of the board of directors of the Mathematics Foundation of America, a non-profit foundation which enhances opportunities in mathematics education for students from diverse backgrounds. Mr. Barry's longstanding service as chairman and chief executive officer of the Company and as a Managing Director of PCM and Prospect Administration provide him with a specific understanding of the Company, its operation, and the business and regulatory issues facing the Company.

*M. Grier Eliasek*

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

*Andrew C. Cooper*

Mr. Cooper's 25 years of experience in venture capital management, venture capital investing and investment banking provides the Board with a wealth of leadership, business investing and financial experience. Mr. Cooper's experience as the co-founder, director and former co-CEO of Unison Site Management, LLC, a leading cellular site owner with 2,000 plus cell sites which generate more than \$40 million in annual cash flow, and as co-founder, CFO and VP of business development for Avesta Technologies, an enterprise, information and technology management software company bought by Visual Networks in 2000, Mr. Cooper provides the Board with the benefit of

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leadership and experience in finance and management. Mr. Cooper also serves on the board of Brand Asset Digital, Aquatic Energy and the Madison Square Boys and Girls Club of New York. Further, Mr. Cooper's time as a director of CSG Systems, Protection One Alarm, LionBridge Technologies and Weblink Wireless, provides the Board with a wealth of experience and an in-depth understanding of management practices. Mr. Cooper's knowledge of financial and accounting matters qualifies him to serve on the Company's Audit Committee and his independence from the Company, PCM and Prospect Administration enhances his service as a member of the Nominating and Corporate Governance Committee.

*William J. Grempp*

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

*Eugene S. Stark*

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

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

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

At each regular meeting of the Board of Directors, the executive officers report to the Board of Directors on developments and important issues. Each of the executive officers, as applicable, also provide regular updates to the

members of the Board of Directors regarding the Company's business between the dates of regular meetings of the Board of Directors.

Executive officers and other members of PCM, at the invitation of the Board of Directors, regularly attend portions of meetings of the Board of Directors and its committees to report on the financial results of the Company,

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its operations, performance and outlook, and on areas of the business within their responsibility, including risk management and management information systems, as well as other business matters.

*The Board's Role in Risk Oversight*

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

The Audit Committee and the Nominating and Governance Committee assist the Board of Directors in fulfilling its risk oversight responsibilities. The Audit Committee's risk oversight responsibilities include reviewing and discussing with management and the independent accountants the annual audited financial statements of the Company, including disclosures made in management's discussion and analysis; reviewing and discussing with management and the independent accountants the Company's quarterly financial statements prior to the filings of its quarterly reports on Form 10-Q; pre-approving the independent accountants' engagement to render audit and/or permissible non-audit services; and evaluating the qualifications, performance and independence of the independent accountants. The Nominating and Governance Committee's risk oversight responsibilities include selecting qualified nominees to be elected to the Board of Directors by stockholders; selecting qualified nominees to fill any vacancies on the Board of Directors or a committee thereof; developing and recommending to the Board of Directors a set of corporate governance principles applicable to the Company; and overseeing the evaluation of the Board of Directors and management. Both the Audit Committee and the Nominating and Governance Committee consist solely of independent directors.

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

The Company believes that its Board of Directors' role in risk oversight is effective and appropriate given the extensive regulation to which it is already subject as a business development company, or BDC, under the 1940 Act. Specifically, as a BDC the Company must comply with certain regulatory requirements that control certain types of risk in its business and operations. For example, the Company's ability to incur indebtedness is limited such that its asset coverage must equal at least 200% immediately after each time it incurs indebtedness, the Company generally has to invest at least 70% of its total assets in qualifying assets. In addition, the Company elected to be treated as a regulated investment company, or RIC, under Subchapter M of the Internal Revenue Code of 1986, as amended. As a RIC the Company must, among other things, meet certain income source and asset diversification requirements.

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

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

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**MANAGEMENT SERVICES**

**Investment Advisory Agreement**

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

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

The total base management fees earned by and paid to Prospect Capital Management during the twelve months ended June 30, 2010, June 30, 2009 and June 30, 2008, were \$13.9 million, \$11.9 million and \$8.9 million, respectively.

The income incentive fees were \$16.6 million, \$14.8 million and \$11.3 million for the twelve months ended June 30, 2010, June 30, 2009 and June 30, 2008, respectively. No capital gains incentive fees were earned for the twelve months ended June 30, 2010, June 30, 2009 and June 30, 2008.

The total investment advisory fees were \$30.5 million, \$26.7 million and \$20.2 million for the twelve months ended June 30, 2010, June 30, 2009 and June 30, 2008, respectively.

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

**Duration and Termination**

The Investment Advisory Agreement was originally approved by our Board of Directors on June 23, 2004 and was recently re-approved by the Board of Directors on June 15, 2010 for an additional one-year term expiring June 24, 2011. Unless terminated earlier as described below, it will remain in effect from year to year thereafter if approved annually by our Board of Directors or by the affirmative vote of the holders of a majority of our outstanding voting securities, including, in either case, approval by a majority of our directors who are not interested persons. The Investment Advisory Agreement will automatically terminate in the event of its assignment. The Investment Advisory Agreement may be terminated by either party without penalty upon not more than 60 days' written notice to the other. See Risk Factors Risks Relating to Our Business We are dependent upon Prospect Capital Management's key



management personnel for our future success in the accompanying prospectus.

**Administration Agreement**

We have also entered into an Administration Agreement with Prospect Administration under which Prospect Administration, among other things, provides (or arranges for the provision of) administrative services and facilities for us. For providing these services, we reimburse Prospect Administration for our allocable portion of overhead incurred by Prospect Administration in performing its obligations under the Administration Agreement, including rent and our allocable portion of the costs of our chief compliance officer and chief financial officer and his staff,

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including the internal legal staff. Under this agreement, Prospect Administration furnishes us with office facilities, equipment and clerical, bookkeeping and record keeping services at such facilities. Prospect Administration also performs, or oversees the performance of, our required administrative services, which include, among other things, being responsible for the financial records that we are required to maintain and preparing reports to our stockholders and reports filed with the SEC. In addition, Prospect Administration assists us in determining and publishing our net asset value, overseeing the preparation and filing of our tax returns and the printing and dissemination of reports to our stockholders, and generally oversees the payment of our expenses and the performance of administrative and professional services rendered to us by others. Under the Administration Agreement, Prospect Administration also provides, on our behalf, managerial assistance to those portfolio companies to which we are required to provide such assistance. The Administration Agreement may be terminated by either party without penalty upon 60 days written notice to the other party. Prospect Administration is a wholly owned subsidiary of our Investment Adviser.

We reimbursed Prospect Administration \$3.4 million, \$2.9 million and \$2.1 million for the twelve months ended June 30, 2010, June 30, 2009 and June 30, 2008, respectively, for services it provided to the Company at cost.

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

On June 15, 2010, our Board of Directors voted unanimously to renew the Investment Advisory Agreement for the 12-month period ending June 24, 2011. In its consideration of the Investment Advisory Agreement, the Board of Directors focused on information it had received relating to, among other things: (a) the nature, quality and extent of the advisory and other services to be provided to us by Prospect Capital Management; (b) comparative data with respect to advisory fees or expense ratios paid by other business development companies with similar investment objectives; (c) our projected operating expenses; (d) the projected profitability of Prospect Capital Management and any existing and potential sources of indirect income to Prospect Capital Management or Prospect Administration from their relationships with us and the profitability of those relationships; (e) information about the services to be performed and the personnel performing such services under the Investment Advisory Agreement; (f) the organizational capability and financial condition of Prospect Capital Management and its affiliates; and (g) the possibility of obtaining similar services from other third party service providers or through an internally managed structure. In approving the renewal of the Investment Advisory Agreement, the Board of Directors, including all of the directors who are not interested persons, considered the following:

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

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

*The reasonableness of the fees paid to Prospect Capital Management.* The Board of Directors considered comparative data based on publicly available information on other business development companies with respect to services rendered and the advisory fees (including the management fees and incentive fees) of other business development companies as well as our projected operating expenses and expense ratio compared to other business development companies. The Board of Directors, on behalf of the Company, also considered the

profitability of Prospect Capital Management. Based upon its review, the Board of Directors concluded that the fees to be paid under the Investment Advisory Agreement are reasonable compared to other business development companies.

*Economies of Scale.* The Board of Directors considered information about the potential of Prospect Capital Management to realize economies of scale in managing our assets, and determined that at this time there were no economies of scale to be realized by Prospect Capital Management.

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

**Portfolio Managers**

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

<b>Name</b>	<b>Position</b>	<b>Length of Service with Company (Years)</b>
John F. Barry	Chairman and Chief Executive Officer	6
M. Grier Eliasek	President and Chief Operating Officer	6

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

The following table sets forth the dollar range of our common stock beneficially owned by each of the portfolio managers described above as of June 30, 2010.

<b>Name</b>	<b>Aggregate Dollar Range of Common Stock Beneficially Owned</b>
John F. Barry	Over \$ 100,000
M. Grier Eliasek	Over \$ 100,000

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**BROKERAGE ALLOCATION AND OTHER PRACTICES**

Since we generally acquire and dispose of our investments in privately negotiated transactions, we infrequently use brokers in the normal course of our business. The aggregate amount of brokerage commissions paid by us during the three most recent fiscal years is \$78,544. Subject to policies established by our Board of Directors, Prospect Capital Management is primarily responsible for the execution of the publicly-traded securities portion of our portfolio transactions and the allocation of brokerage commissions.

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

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Information about our senior securities is shown in the following table as of each fiscal year ended June 30, since the Company commenced operations. The report of our independent registered public accounting firm on the senior securities table as of June 30, 2010, is attached as an exhibit to the registration statement.

<b>Class and Year</b>	<b>Total Amount Outstanding(1)</b>	<b>Asset Coverage per Unit(2)</b>	<b>Involuntary Liquidating Preference Per Unit(3)</b>	<b>Average Market Value Per Unit(4)</b>
<b>Credit Facility</b>				
Fiscal 2010 (as of June 30, 2010)	\$ 100,300	\$ 8,086		
Fiscal 2009 (as of June 30, 2009)	124,800	5,268		
Fiscal 2008 (as of June 30, 2008)	91,167	5,712		
Fiscal 2007 (as of June 30, 2007)		N/A		
Fiscal 2006 (as of June 30, 2006)	28,500	4,799		
Fiscal 2005 (as of June 30, 2005)		N/A		
Fiscal 2004 (as of June 30, 2004)		N/A		

- (1) Total amount of each class of senior securities outstanding at the end of the period presented (in 000 s).
- (2) The asset coverage ratio for a class of senior securities representing indebtedness is calculated as our consolidated total assets, less all liabilities and indebtedness not represented by senior securities, divided by senior securities representing indebtedness. This asset coverage ratio is multiplied by \$1,000 to determine the Asset Coverage Per Unit.
- (3) This column is inapplicable because we have had only bank debt outstanding during the time periods.
- (4) This column is inapplicable because we have not had any preferred stock outstanding during any of the time periods.

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**DISTRIBUTIONS AND PRICE RANGE OF COMMON STOCK**

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

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

98% of our ordinary income for the calendar year,

98% of our capital gains in excess of capital losses for the one-year period ending on October 31 of the calendar year, and

any ordinary income and net capital gains for preceding years that were not distributed during such years.

In December 2008, our Board of Directors elected to retain excess profits generated in the quarter ended September 30, 2008 and pay a 4% excise tax on such retained earnings. We paid \$533,000 for the excise tax with the filing of our tax return in March 2009. No such election was made in December 2009.

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

We maintain an **opt out** dividend reinvestment plan for our common stockholders. As a result, if we declare a dividend, then stockholders' cash dividends will be automatically reinvested in additional shares of our common stock, unless they specifically **opt out** of the dividend reinvestment plan so as to receive cash dividends. Stockholders who receive distributions in the form of stock are subject to the same U.S. Federal, state and local tax consequences as are stockholders who elect to receive their distributions in cash. See **Dividend Reinvestment Plan** in the accompanying prospectus. The tax consequences of distributions to stockholders are described in the accompanying prospectus under the label **Material U.S. Federal Income Tax Considerations**. To the extent prudent and practicable, we intend to declare and pay dividends on a monthly basis.

With respect to the distributions paid to stockholders, income from origination, structuring, closing, commitment and other upfront fees associated with investments in portfolio companies were treated as taxable income and accordingly, distributed to stockholders. During the fiscal year ended June 30, 2009, we recorded total dividends of approximately \$56.1 million. For the fiscal year ending June 30, 2010, we recorded total distributions of approximately \$81.5 million. On June 18, 2010, we announced a change in dividend policy from quarterly to monthly dividends and declared a dividend of \$0.10 per share for June 2010 to holders of record on June 30, 2010 with a payment date of

July 30, 2010. On August 26, 2010, we announced the declaration of monthly distributions in the following amounts and with the following dates:

\$0.100625 per share for September 2010 to holders of record on September 30, 2010 with a payment date of October 29, 2010; and

\$0.100750 per share for October 2010 to holders of record on October 29, 2010 with a payment date of November 30, 2010.

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

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Our common stock is quoted on the NASDAQ Global Select Market under the symbol PSEC. The following table sets forth, for the periods indicated, our NAV per share of common stock and the high and low closing prices per share of our common stock as reported on the NASDAQ Global Select Market. Our common stock historically trades at prices both above and below its NAV per share. There can be no assurance, however, that such premium or discount, as applicable, to NAV per share will be maintained. Common stock of business development companies, like that of closed-end investment companies, frequently trades at a discount to current NAV per share. In the past, our common stock has traded at a discount to our NAV per share. The risk that our common stock may continue to trade at a discount to our NAV per share is separate and distinct from the risk that our NAV per share may decline.

	NAV(1)	Stock Price High(2)	Low(2)	Premium (Discount) of High to NAV	Premium (Discount) of Low to NAV	Dividend Declared
<b>Twelve Months Ending June 30, 2005</b>						
First quarter	\$ 13.67	\$ 15.45	\$ 14.42	13.0%	5.5%	
Second quarter	13.74	15.15	11.63	10.3%	(15.4)%	\$ 0.100
Third quarter	13.74	13.72	10.61	(0.1)%	(22.8)%	0.125
Fourth quarter	14.59	13.47	12.27	(7.7)%	(15.9)%	0.150
<b>Twelve Months Ending June 30, 2006</b>						
First quarter	\$ 14.60	\$ 13.60	\$ 11.06	(6.8)%	(24.2)%	\$ 0.200
Second quarter	14.69	15.46	12.84	5.2%	(12.6)%	0.280
Third quarter	14.81	16.64	15.00	12.4%	1.3%	0.300
Fourth quarter	15.31	17.07	15.83	11.5%	3.4%	0.340
<b>Twelve Months Ending June 30, 2007</b>						
First quarter	\$ 14.86	\$ 16.77	\$ 15.30	12.9%	3.0%	\$ 0.380
Second quarter	15.24	18.79	15.60	23.3%	2.4%	0.385
Third quarter	15.18	17.68	16.40	16.5%	8.0%	0.3875
Fourth quarter	15.04	18.68	16.91	24.2%	12.4%	0.390
<b>Twelve Months Ending June 30, 2008</b>						
First quarter	\$ 15.08	\$ 18.68	\$ 14.16	23.9%	(6.1)%	\$ 0.3925
Second quarter	14.58	17.17	11.22	17.8%	(23.0)%	0.395
Third quarter	14.15	16.00	13.55	13.1%	(4.2)%	0.400
Fourth quarter	14.55	16.12	13.18	10.8%	(9.4)%	0.40125
<b>Twelve Months Ending June 30, 2009</b>						
First quarter	\$ 14.63	\$ 14.24	\$ 11.12	(2.7)%	(24.0)%	\$ 0.4025
Second quarter	14.43	13.08	6.29	(9.4)%	(56.4)%	0.40375
Third quarter	14.19	12.89	6.38	(9.2)%	(55.0)%	0.405
Fourth quarter	12.40	10.48	7.95	(15.5)%	(35.9)%	0.40625
<b>Twelve Months Ending June 30, 2010</b>						
First quarter	\$ 11.11	\$ 10.99	\$ 8.82	(1.1)%	(20.6)%	\$ 0.4075
Second quarter	10.09	12.31	9.93	22.0%	(1.6)%	0.40875

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Third quarter	10.11	13.20	10.45	30.6%	3.4%	0.410
Fourth quarter	10.29	12.20	9.65	18.6%	(6.2)%	0.10
<b>Twelve Months Ending</b>						
<b>June 30, 2011</b>						
First quarter (to September 2, 2010)	(3)(4)	\$ 10.00	\$ 9.18	(4)	(4)	\$ 0.31375(5)

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

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- (2) The High/Low Stock Price is calculated as of the closing price on a given day in the applicable quarter.
- (3) Our most recently determined NAV per share was \$10.29 as of June 30, 2010 (\$10.02 on an as adjusted basis solely to give effect to our distributions with record dates of July 30, 2010 and August 31, 2010, our issuance of common stock on July 30, 2010 and August 31, 2010 in connection with our dividend reinvestment plan, our sale of 2,748,600 shares of common stock during the period June 28, 2010 through July 16, 2010 (with settlement dates of July 1, 2010 through July 21, 2010) and our sale of 3,814,528 shares of common stock during the period July 19, 2010 through August 19, 2010 (with settlement dates of July 22, 2010 through August 24, 2010). NAV per share as of September 30, 2010 may be higher or lower than \$10.02 based on potential changes in valuations as of September 30, 2010.
- (4) NAV has not yet been finally determined for any day after June 30, 2010.
- (5) In June 2010, we changed our distribution policy from a quarterly payment to a monthly payment and declared the first three monthly distributions as follows:

\$0.10 per share for June 2010 to holders of record on June 30, 2010 with a payment date of July 30, 2010;

\$0.10025 per share for July 2010 to holders of record on July 30, 2010 with a payment date of August 31, 2010;  
and

\$0.10050 per share for August 2010 to holders of record on August 31, 2010 with a payment date of September 30, 2010.

In August 2010, we declared two additional monthly distributions as follows:

\$0.100625 per share for September 2010 to holders of record on September 30, 2010 with a payment date of October 29, 2010; and

\$0.100750 per share for October 2010 to holders of record on October 24, 2010 with a payment date of November 30, 2010.

On September 2, 2010, the last reported sales price of our common stock was \$9.43 per share.

As of September 2, 2010, we had approximately 52 stockholders of record.

The below table sets forth each class of our outstanding securities as of September 2, 2010.

<b>Title of Class</b>	<b>Amount Authorized</b>	<b>Amount Held by Registrant or for its Account</b>	<b>Amount Outstanding</b>
Common Stock	200,000,000	0	75,823,485



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

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

**We may make sales of our common stock at prices below our most recently determined NAV per share. Pursuant to the approval of our Board of Directors, we have made such sales in the past, including under the equity distribution agreements, and we may continue to do so under this prospectus supplement.**

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

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

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

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

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

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

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

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

The leverage available to us.

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

We will not sell shares of common stock under a prospectus supplement to the registration statement (the current registration statement) if the cumulative dilution to our NAV per share from offerings under the current registration

statement exceeds 15%. This limit would be measured separately for each offering pursuant to the current registration statement by calculating the percentage dilution or accretion to aggregate NAV from that offering and then summing the percentage from each offering. For example, if our most recently determined NAV at the time of the first offering is \$10.02 and we have 76.0 million shares of common stock outstanding, sale of 16 million shares of common stock at net proceeds to us of \$5.01 per share (an approximately 50% discount) would produce dilution of 8.70%. If we subsequently determined that our NAV per share increased to \$10.20 on the then 92.0 million shares of common stock outstanding and then made an additional offering, we could, for example, sell approximately an additional 13.3 million shares of common stock at net proceeds to us of \$5.10 per share, which would produce dilution of 6.30%, before we would reach the aggregate 15% limit. If we file a new post-effective amendment, the threshold would reset.

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

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

existing shareholders who do not purchase any shares of common stock in the offering;

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

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

**NAV per share used in the tables below is based on our most recently determined NAV per share as of June 30, 2010, as adjusted to give effect to distributions with record dates of July 30, 2010 and August 31, 2010, our issuances of our common stock in connection with our dividend re-investment plan, our sale of 2,748,600 shares of common stock during the period June 28, 2010 through July 16, 2010 (with settlement dates of July 1, 2010 through July 21, 2010), and our sale of 3,814,528 shares of common stock during the period July 19, 2010 through August 19, 2010 (with settlement dates of July 22, 2010 through August 24, 2010). The NAV per share used for purposes of providing information in the table below is thus an estimate and does not necessarily reflect actual NAV per share at the time sales are made. Actual NAV per share may be higher or lower based on potential changes in valuations of our portfolio securities, accruals of income, expenses and distributions declared and thus may be higher or lower at the assumed sales prices than shown below.**

**Impact On Existing Stockholders Who Do Not Participate in the Offering**

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

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

The examples assume that the issuer has 76,000,000 common shares outstanding, \$881,520,000 in total assets and \$120,000,000 in total liabilities. The current NAV and NAV per share are thus \$761,520,000 and \$10.02. The chart illustrates the dilutive effect on Stockholder A of (1) an offering of 3,800,000 shares of common stock (5% of the outstanding shares of common stock) at \$9.52 per share after offering expenses and commission (a 5% discount from NAV), (2) an offering of 7,600,000 shares of common stock (10% of the outstanding shares of common stock) at \$9.02 per share after offering expenses and commissions (a 10% discount from NAV) and (3) an offering of

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15,200,000 shares of common stock (20% of the outstanding shares of common stock) at \$8.02 per share after offering expenses and commissions (a 20% discount from NAV).

	<b>Prior to Sale Below NAV</b>	<b>Example 1 5% Offering at 5% Discount Following Sale</b>	<b>% Change</b>	<b>Example 2 10% Offering at 10% Discount Following Sale</b>	<b>% Change</b>	<b>Example 3 20% Offering at 20% Discount Following Sale</b>	<b>% Change</b>
<b>Offering Price</b>							
Price per Share to Public		\$ 9.79		\$ 9.24		\$ 8.20	
Net Proceeds per Share to Offeror		\$ 9.52		\$ 9.02		\$ 8.02	
<b>Increase to NAV</b>							
Total Shares Outstanding	76,000,000	79,800,000	5.00%	83,600,000	10.00%	91,200,000	20.00%
NAV per Share	\$ 10.02	\$ 10.00	(0.24)%	\$ 9.93	(0.91)%	\$ 9.69	(3.33)%
<b>Dilution to Nonparticipating Stockholder</b>							
Shares Held by Stockholder A	76,000	76,000	0.00%	76,000	0.00%	76,000	0.00%
Percentage Held by Stockholder A	0.10%	0.10%	(4.76)%	0.09%	(9.09)%	0.08%	(16.67)%
Total NAV Held by Stockholder A	\$ 761,520	\$ 759,707	(0.24)%	\$ 754,597	(0.91)%	\$ 736,136	(3.33)%
Total Investment by Stockholder A (Assumed to be \$10.02 per Share)	\$ 761,520	\$ 761,520		\$ 761,520		\$ 761,520	
Total Dilution to Stockholder A (Total NAV Less Total Investment)		\$ (1,813)		\$ (6,923)		\$ (25,384)	
NAV per Share Held by Stockholder A		\$ 10.00		\$ 9.93		\$ 9.69	
Investment per Share Held by Stockholder A (Assumed to be \$10.02 per Share on Shares Held Prior to Sale)	\$ 10.02	\$ 10.02		\$ 10.02		\$ 10.02	
Dilution per Share Held by Stockholder A (NAV per Share Less Investment per Share)		\$ (0.02)		\$ (0.09)		\$ (0.33)	
Percentage Dilution to Stockholder A (Dilution per Share Divided by Investment per Share)			(0.24)%		(0.91)%		(3.33)%





**Table of Contents****Impact On Existing Stockholders Who Do Participate in the Offering**

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

The following chart illustrates the level of dilution and accretion in the hypothetical 20% discount offering from the prior chart (Example 3) for a stockholder that acquires shares of common stock equal to (1) 50% of its proportionate share of the offering (i.e., 7,600 shares of common stock, which is 0.05% of an offering of 15,200,000 shares of common stock) rather than its 0.10% proportionate share and (2) 150% of such percentage (i.e. 22,800 shares of common stock, which is 0.15% of an offering of 15,200,000 shares of common stock rather than its 0.10% proportionate share). It is not possible to predict the level of market price decline that may occur.

	<b>Prior to Sale Below NAV</b>	<b>50% Participation Following Sale</b>	<b>% Change</b>	<b>150% Participation Following Sale</b>	<b>% Change</b>
<b>Offering Price</b>					
Price per Share to Public		\$ 8.20		\$ 8.20	
Net Proceeds per Share to Issuer		\$ 8.02		\$ 8.02	
<b>Decrease/Increase to NAV</b>					
Total Shares Outstanding	76,000,000	91,200,000	20.00%	91,200,000	20.00%
NAV per Share	\$ 10.02	\$ 9.69	(3.33)%	\$ 9.69	(3.33)%
<b>Dilution/Accretion to Participating Stockholder</b>					
Shares Held by Stockholder A	76,000	83,600	10.00%	98,800	30.00%
Percentage Held by Stockholder A	0.10%	0.09%	(8.33)%	0.11%	8.33%
Total NAV Held by Stockholder A	\$ 761,520	\$ 809,750	6.33%	\$ 956,977	25.67%
Total Investment by Stockholder A (Assumed to be \$10.02 per Share on Shares held Prior to		\$ 823,838		\$ 948,474	

Sale)								
Total Dilution/Accretion to Stockholder A (Total NAV Less Total Investment)		\$	(14,088)		\$	8,503		
NAV per Share Held by Stockholder A		\$	9.69		\$	9.69		
Investment per Share Held by Stockholder A (Assumed to Be \$10.02 on Shares Held Prior to Sale)	\$	10.02	\$	9.86	(1.65)%	\$	9.60	(4.19)%
Dilution/Accretion per Share Held by Stockholder A (NAV per Share Less Investment per Share)		\$	(0.17)		\$	0.09		
Percentage Dilution/Accretion to Stockholder A (Dilution/Accretion per Share Divided by Investment per Share)					(1.71)%		0.89%	

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**Table of Contents****Impact On New Investors**

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

The following chart illustrates the level of dilution or accretion for new investors that would be experienced by a new investor in the same hypothetical 5%, 10% and 20% discounted offerings as described in the first chart above. The illustration is for a new investor who purchases the same percentage (0.10%) of the shares of common stock in the offering as Stockholder A in the prior examples held immediately prior to the offering. It is not possible to predict the level of market price decline that may occur.

	<b>Prior to Sale Below NAV</b>	<b>Example 1 5% Offering at 5% Discount</b>		<b>Example 2 10% Offering at 10% Discount</b>		<b>Example 3 20% Offering at 20% Discount</b>	
		<b>Following Sale</b>	<b>% Change</b>	<b>Following Sale</b>	<b>% Change</b>	<b>Following Sale</b>	<b>% Change</b>
<b>Offering Price</b>							
Price per Share to Public		\$ 9.79		\$ 9.24		\$ 8.20	
Net Proceeds per Share to Issuer		\$ 9.52		\$ 9.02		\$ 8.02	
<b>Decrease/Increase to NAV</b>							
Total Shares Outstanding	76,000,000	79,800,000	5.00%	83,600,000	10.00%	91,200,000	20.00%
NAV per Share	\$ 10.02	\$ 10.00	(0.24)%	\$ 9.93	(0.91)%	\$ 9.69	(3.33)%
<b>Dilution/Accretion to New Investor A</b>							
Shares Held by Investor	0	3,800		7,600		15,200	
Percentage Held by Investor A	0.00%	0.00%		0.01%		0.02%	
Total NAV Held by Investor A	\$ 0	\$ 37,985		\$ 75,460		\$ 147,227	
Total Investment by Investor A (At Price to		\$ 37,216		\$ 70,242		\$ 124,636	

blic)					
Total Dilution/Accretion					
Investor A (Total NAV					
Less Total Investment)					
	\$	769	\$	5,218	\$ 22,591
NAV per Share Held by					
Investor A					
	\$	10.00	\$	9.93	\$ 9.69
Investment per Share					
Held by Investor A					
\$	0	\$	9.79	\$	9.24
Dilution/Accretion per					
Share Held by Investor A					
NAV per Share Less					
Investment per Share)					
	\$	0.21	\$	0.69	\$ 1.49
Percentage					
Dilution/Accretion to					
Investor A					
Dilution/Accretion per					
Share Divided by					
Investment per Share)					
		(2.07)%		7.43%	18.13%

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**PLAN OF DISTRIBUTION**

Upon written instructions from the Company, RBC, BB&T, and Knight, as applicable, will each use its commercially reasonable efforts consistent with its sales and trading practices to sell, as our sales agent, the common stock under the terms and subject to the conditions set forth in each Sales Manager's equity distribution agreement. We will instruct each Sales Manager as to the amount of common stock to be sold by such Sales Manager; provided, however, that, subject to the terms of the equity distribution agreements, any sales of common stock pursuant to the equity distribution agreements will only be effected by or through only one of RBC, BB&T, and Knight on any single given day, but in no event by more than one Sales Manager. We may instruct the Sales Managers not to sell common stock if the sales cannot be effected at or above the price designated by the Company in any instruction. We or the Sales Managers may suspend the offering of shares of common stock upon proper notice and subject to other conditions.

Each Sales Manager will provide written confirmation of a sale to us no later than the opening of the trading day on the NASDAQ Global Select Market following each trading day in which shares of our common stock are sold under the applicable equity distribution agreement. Each confirmation will include the number of shares of common stock sold on the preceding day, the net proceeds to us and the compensation payable by us to the applicable Sales Manager in connection with the sales.

Each Sales Manager will receive from us a commission equal to 2.0% of the gross sales price of all shares of common stock sold through it as Sales Manager under the applicable equity distribution agreement. We estimate that the total expenses for the offering, excluding compensation payable to the Sales Managers under the terms of the equity distribution agreements, will be approximately \$75,000.

Settlement for sales of shares of common stock will occur on the third trading day following the date on which such sales are made, or on some other date that is agreed upon by the Company and the respective Sales Manager in connection with a particular transaction, in return for payment of the net proceeds to the Company. There is no arrangement for funds to be received in an escrow, trust or similar arrangement.

In connection with the sale of the common stock on our behalf, each Sales Manager may be deemed to be an underwriter within the meaning of the 1933 Act, and the compensation of such Sales Manager may be deemed to be underwriting commissions or discounts. We have agreed to provide indemnification and contribution to each Sales Manager against certain civil liabilities, including liabilities under the 1933 Act.

The offering of our shares of common stock pursuant to the equity distribution agreements will terminate upon the earlier of (i) the sale of all common stock subject to the equity distribution agreements or (ii) the termination of each equity distribution agreement. Each equity distribution agreement may be terminated by the Company in our sole discretion under the circumstances specified in such equity distribution agreement by giving notice to the respective Sales Manager. In addition, each Sales Manager may terminate such equity distribution agreement to which it is a party under the circumstances specified in the equity distribution agreement by giving notice to the Company.

The Sales Managers may perform investment banking and advisory services for us from time to time for which they have received customary fees and expenses. The Sales Managers and their respective affiliates may, from time to time, engage in transactions with and perform services for us in the ordinary course of business.

The principal business address of RBC Capital Markets Corporation is Three World Financial Center, 200 Vesey Street, 8th Floor, New York, NY 10281, the principal business address of BB&T Capital Markets, a division of Scott & Stringfellow, LLC, is 901 East Byrd Street, Suite 410, Richmond, VA 23219 and the principal business

address of Knight Capital Markets LLC is 405 Lexington Avenue, New York, NY 10174.

### **LEGAL MATTERS**

Certain legal matters regarding the common stock offered hereby have been passed upon for the Company by Skadden, Arps, Slate, Meagher & Flom LLP, New York, New York, and Venable LLP as special Maryland counsel. Certain legal matters will be passed upon for the Sales Managers by Troutman Sanders LLP. Troutman Sanders LLP will rely as to certain matters of Maryland law upon Venable LLP.

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**INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

BDO USA, LLP (formerly BDO Seidman, LLP) is the independent registered public accounting firm for the Company.

**AVAILABLE INFORMATION**

We have filed with the SEC a registration statement on Form N-2, together with all amendments and related exhibits, under the 1933 Act, with respect to our common stock offered by this prospectus supplement. The registration statement contains additional information about us and the common stock being registered by this prospectus supplement. We file with or submit to the SEC annual, quarterly and current periodic reports, proxy statements and other information meeting the informational requirements of the 1934 Act. This information and the information specifically regarding how we voted proxies relating to portfolio securities for the period ended June 30, 2010, are available free of charge by contacting us at 10 East 40th Street, 44th floor, New York, NY 10016 or by telephone at toll-free (888) 748-0702. You may inspect and copy these reports, proxy statements and other information, as well as the registration statement and related exhibits and schedules, at the Public Reference Room of the SEC at 100 F Street NE, Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at (202) 551-8090. The SEC maintains an Internet site that contains reports, proxy and information statements and other information filed electronically by us with the SEC which are available on the SEC's Internet site at <http://www.sec.gov>. Copies of these reports, proxy and information statements and other information may be obtained, after paying a duplicating fee, by electronic request at the following E-mail address: [publicinfo@sec.gov](mailto:publicinfo@sec.gov), or by writing the SEC's Public Reference Section, Washington, D.C. 20549-0102.

No dealer, salesperson or other individual has been authorized to give any information or to make any representation other than those contained in this prospectus supplement and, if given or made, such information or representations must not be relied upon as having been authorized by us or the Sales Managers. This prospectus supplement does not constitute an offer to sell or a solicitation of an offer to buy any securities in any jurisdiction in which such an offer or solicitation is not authorized or in which the person making such offer or solicitation is not qualified to do so, or to any person to whom it is unlawful to make such offer or solicitation. Neither the delivery of this prospectus supplement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in our affairs or that information contained herein is correct as of any time subsequent to the date hereof.



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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Stockholders  
Prospect Capital Corporation  
New York, New York

We have audited the accompanying consolidated statements of assets and liabilities of Prospect Capital Corporation, including the schedule of investments, as of June 30, 2010 and 2009, and the related consolidated statements of operations, changes in net assets, and cash flows for each of the three years in the period ended June 30, 2010, and the financial highlights for each of the periods presented. These financial statements and financial highlights are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial highlights based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and financial highlights are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of Prospect Capital Corporation at June 30, 2010 and 2009, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 2010, and the financial highlights for each of the periods presented in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Prospect Capital Corporation's internal control over financial reporting as of June 30, 2010, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated August 30, 2010 expressed an unqualified opinion thereon.

/s/ BDO USA, LLP  
BDO USA, LLP

New York, New York  
August 30, 2010

**Table of Contents****PROSPECT CAPITAL CORPORATION AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES****(In thousands, except share and per share data)**

	<b>June 30, 2010</b>	<b>June 30, 2009</b>
<b>Assets (Note 11)</b>		
Investments at fair value (net cost of \$728,759 and \$531,424, respectively, Note 4)		
Control investments (net cost of \$185,720 and \$187,105, respectively)	\$ 195,958	\$ 206,332
Affiliate investments (net cost of \$65,082 and \$33,544, respectively)	73,740	32,254
Non-control/Non-affiliate investments (net cost of \$477,957 and \$310,775, respectively)	478,785	308,582
Total investments at fair value	748,483	547,168
Investments in money market funds	68,871	98,735
Cash	1,081	9,942
Receivables for:		
Interest, net	5,356	3,562
Dividends	1	28
Other	419	571
Prepaid expenses	371	68
Deferred financing costs	7,579	6,951
Other assets	534	
<b>Total Assets</b>	<b>832,695</b>	<b>667,025</b>
<b>Liabilities</b>		
Credit facility payable (Note 11)	100,300	124,800
Dividends payable	6,909	
Due to Prospect Administration (Note 8)	294	842
Due to Prospect Capital Management (Note 8)	8,821	5,871
Accrued expenses	4,981	2,381
Other liabilities	705	535
<b>Total Liabilities</b>	<b>122,010</b>	<b>134,429</b>
<b>Net Assets</b>	<b>\$ 710,685</b>	<b>\$ 532,596</b>
<b>Components of Net Assets</b>		
Common stock, par value \$0.001 per share (100,000,000 and 100,000,000 common shares authorized, respectively; 69,086,862 and 42,943,084 issued and outstanding, respectively) (Note 6)	\$ 69	\$ 43
Paid-in capital in excess of par (Note 6)	805,918	545,707
(Over) undistributed net investment income	(10,431)	24,152
Accumulated realized losses on investments	(104,595)	(53,050)

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Unrealized appreciation on investments	19,724	15,744
<b>Net Assets</b>	<b>\$ 710,685</b>	<b>\$ 532,596</b>
<b>Net Asset Value Per Share</b>	<b>\$ 10.29</b>	<b>\$ 12.40</b>

See notes to consolidated financial statements.

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**Table of Contents****PROSPECT CAPITAL CORPORATION AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands, except share and per share data)**

	<b>June 30, 2010</b>	<b>Year Ended June 30, 2009</b>	<b>June 30, 2008</b>
<b>Investment Income</b>			
Interest income: (Note 4)			
Control investments (Net of foreign withholding tax of \$19, \$166, and \$230, respectively)	\$ 17,218	\$ 19,281	\$ 21,709
Affiliate investments (Net of foreign withholding tax of \$-, \$-, and \$70, respectively)	7,957	3,039	1,858
Non-control/Non-affiliate investments	61,343	40,606	35,466
Total interest income	86,518	62,926	59,033
Dividend income			
Control investments	14,860	22,468	11,327
Non-control/Non-affiliate investments	474		
Money market funds	32	325	706
Total dividend income	15,366	22,793	12,033
Other income: (Note 5)			
Control investments	261	1,249	1,123
Affiliate investments	169		
Non-control/Non-affiliate investments	3,613	13,513	7,213
Gain on Patriot acquisition (Note 2)	7,708		
Total other income	11,751	14,762	8,336
<b>Total Investment Income</b>	<b>113,635</b>	<b>100,481</b>	<b>79,402</b>
<b>Operating Expenses</b>			
Investment advisory fees:			
Base management fee (Note 8)	13,929	11,915	8,921
Income incentive fee (Note 8)	16,613	14,790	11,278
Total investment advisory fees	30,542	26,705	20,199
Interest and credit facility expenses	8,382	6,161	6,318
Sub-administration fees		846	859
Legal fees	702	947	2,503
Valuation services	734	705	577
Audit, compliance and tax related fees	981	1,015	470

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Allocation of overhead from Prospect Administration (Note 8)	3,361	2,856	2,139
Insurance expense	254	246	256
Directors' fees	255	269	253
Potential merger expenses (Note 12)	852		
Other general and administrative expenses	1,121	1,035	715
Excise taxes		533	
<b>Total Operating Expenses</b>	<b>47,184</b>	<b>41,318</b>	<b>34,289</b>
<b>Net Investment Income</b>	<b>66,451</b>	<b>59,163</b>	<b>45,113</b>
Net realized loss on investments (Note 4)	(51,545)	(39,078)	(16,222)
Net change in unrealized appreciation (depreciation) on investments (Note 4)	3,980	15,019	(1,300)
<b>Net Increase in Net Assets Resulting from Operations</b>	<b>\$ 18,886</b>	<b>\$ 35,104</b>	<b>\$ 27,591</b>
Net increase in net assets resulting from operations per share: (Note 7 and Note 9)	\$ 0.32	\$ 1.11	\$ 1.17
Weighted average shares of common stock outstanding:	59,429,222	31,559,905	23,626,642

See notes to consolidated financial statements.

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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS**  
(In thousands, except share data)

	June 30, 2010	Year Ended June 30, 2009	June 30, 2008
<b>Increase in Net Assets from Operations:</b>			
Net investment income	\$ 66,451	\$ 59,163	\$ 45,113
Net loss on investments	(51,545)	(39,078)	(16,222)
Net change in unrealized appreciation (depreciation) on investments	3,980	15,019	(1,300)
<b>Net Increase in Net Assets Resulting from Operations</b>	<b>18,886</b>	<b>35,104</b>	<b>27,591</b>
<b>Dividends to Shareholders</b>	<b>(101,034)</b>	<b>(36,519)</b>	<b>(39,513)</b>
<b>Capital Share Transactions:</b>			
Net proceeds from capital shares sold	158,002	100,304	140,249
Less: Offering costs of public share offerings	(1,781)	(1,023)	(1,505)
Fair value of equity issued in conjunction with Patriot acquisition	92,800		
Reinvestment of dividends	11,216	5,107	2,753
<b>Net Increase in Net Assets Resulting from Capital Share Transactions</b>	<b>260,237</b>	<b>104,388</b>	<b>141,497</b>
<b>Total Increase in Net Assets:</b>	<b>178,089</b>	<b>102,973</b>	<b>129,575</b>
Net assets at beginning of year	532,596	429,623	300,048
<b>Net Assets at End of Year</b>	<b>\$ 710,685</b>	<b>\$ 532,596</b>	<b>\$ 429,623</b>
<b>Capital Share Activity:</b>			
Shares sold	16,683,197	12,942,500	9,400,000
Shares issued for Patriot acquisition	8,444,068		
Shares issued through reinvestment of dividends	1,016,513	480,205	171,314
Net increase in capital share activity	26,143,778	13,422,705	9,571,314
Shares outstanding at beginning of year	42,943,084	29,520,379	19,949,065
<b>Shares Outstanding at End of Year</b>	<b>69,086,862</b>	<b>42,943,084</b>	<b>29,520,379</b>

See notes to consolidated financial statements.





Table of Contents**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands, except share data)

	<b>June 30, 2010</b>	<b>Year Ended June 30, 2009</b>	<b>June 30, 2008</b>
<b>Cash Flows from Operating Activities:</b>			
Net increase in net assets resulting from operations	\$ 18,886	\$ 35,104	\$ 27,591
Net realized loss on investments	51,545	39,078	16,239
Net change in unrealized (appreciation) depreciation on investments	(3,980)	(15,019)	1,300
Accretion of original issue discount on investments	(20,313)	(2,399)	(2,095)
Amortization of deferred financing costs	5,297	759	727
Gain on Patriot acquisition (Note 2)	(7,708)		
<b>Change in operating assets and liabilities:</b>			
Payments for purchases of investments and payment-in-kind interest	(157,662)	(98,305)	(311,947)
Proceeds from sale of investments and collection of investment principal	136,221	27,007	127,212
Purchases of cash equivalents	(199,997)	(39,999)	(274,949)
Sales of cash equivalents	199,997	39,999	274,932
Net decrease (increase) of investments in money market funds	29,864	(65,735)	8,760
Decrease (increase) in interest receivable, net	530	532	(1,955)
Decrease (increase) in dividends receivable	27	4,220	(3,985)
Decrease (increase) in loan principal receivable		71	(71)
Decrease in receivable for structuring fees			1,625
Decrease (increase) in other receivables	152	(4)	(296)
(Increase) decrease in prepaid expenses	(268)	205	198
Decrease in due from Prospect Administration	1,500		
Increase in other assets	(534)		
Decrease in payables for securities purchased			(70,000)
(Decrease) increase in due to Prospect Administration	(548)	147	365
Increase (decrease) in due to Prospect Capital Management	2,950	(75)	1,438
(Decrease) increase in accrued expenses	(1,291)	1,277	(208)
Increase (decrease) in other liabilities	170	(863)	1,094
<b>Net Cash Provided By Operating Activities:</b>	<b>54,838</b>	<b>(74,000)</b>	<b>(204,025)</b>
<b>Cash Flows from Investing Activities:</b>			
Acquisition of Patriot, net of cash acquired (Note 2)	(106,586)		
<b>Net Cash Used In Investing Activities:</b>	<b>(106,586)</b>		
<b>Cash Flows from Financing Activities:</b>			
Borrowings under credit facility	244,100	100,157	238,492
Payments under credit facility	(268,600)	(66,524)	(147,325)
Financing costs paid and deferred	(5,925)	(6,270)	(416)

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Net proceeds from issuance of common stock	158,001	100,304	140,249
Offering costs from issuance of common stock	(1,781)	(1,023)	(1,505)
Dividends paid	(82,908)	(43,257)	(24,915)
<b>Net Cash Provided By Financing Activities:</b>	42,887	83,387	204,580
<b>Total (Decrease) Increase in Cash</b>	(8,861)	9,387	555
Cash balance at beginning of year	9,942	555	
<b>Cash Balance at End of Year</b>	\$ 1,081	\$ 9,942	\$ 555
<b>Cash Paid For Interest</b>	\$ 1,444	\$ 5,014	\$ 4,942
<b>Non-Cash Financing Activity:</b>			
Amount of shares issued in connection with dividend reinvestment plan	\$ 11,216	\$ 5,107	\$ 2,753
Fair value of shares issued in conjunction with the Patriot Acquisition	\$ 92,800	\$	\$

See notes to consolidated financial statements.

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Table of Contents**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY****CONSOLIDATED SCHEDULE OF INVESTMENTS****June 30, 2010 and June 30, 2009****(In thousands, except share data)**

Portfolio Company	Locale / Industry	Investments(1)	Principal Value	June 30, 2010		% of Net Assets
				Cost	Fair Value(2)	
<b>LEVEL 3 PORTFOLIO INVESTMENTS:</b>						
<b>Control Investments (25.00% or greater of voting control)</b>						
Ajax Rolled Ring & Machine, Inc.	South Carolina/Manufacturing	Senior Secured Note Tranche A (10.50%, due 4/01/2013)(3),(4)	\$ 21,047	\$ 21,047	\$ 21,047	3.0%
		Subordinated Secured Note Tranche B (11.50% plus 6.00% PIK, due 4/01/2013)(3),(4)	16,306	16,306	9,857	1.3%
		Subordinated Secured Note Tranche B (15.00%, due 10/30/2010)	500	500		0.0%
		Convertible Preferred Stock Series A (6,142.6 shares)		6,057		0.0%
		Unrestricted Common Stock (6 shares)				0.0%
				43,910	30,904	4.3%
AWCNC, LLC(20)	North Carolina/Machinery	Members Units Class A (1,800,000 units)				0.0%
		Members Units Class B-1 (1 unit)				0.0%
		Members Units Class B-2 (7,999,999 units)				0.0%
						0.0%
Borga, Inc.	California/Manufacturing	Revolving Line of Credit \$1,000 Commitment (4.75% plus 3.25% default interest, in non-accrual status effective 03/02/2010,	1,000	945	850	0.1%

		past due)(4),(26) Senior Secured Term Loan B (8.25% plus 3.25% default interest, in non-accrual status effective 03/02/2010, past due)(4)	1,612	1,500	1,282	0.2%
		Senior Secured Term Loan C (12.00% plus 4.00% PIK plus 3.00% default interest, in non-accrual status effective 03/02/2010, past due)	8,624	707		0.0%
		Common Stock (100 shares)(22)				0.0%
		Warrants (33,750 warrants)(22)				0.0%
				3,152	2,132	0.3%
C&J Cladding LLC	Texas/Metal Services and Minerals	Membership Interest (400 units)(23)		580	4,128	0.6%
				580	4,128	0.6%
Change Clean Energy Holdings, Inc. ( CCEHI )(5)	Maine/Biomass Power	Common Stock (1,000 shares)		2,383		0.0%
				2,383		0.0%
Fischbein, LLC	North Carolina/Machinery	Senior Subordinated Debt (13.00% plus 5.50% PIK, due 5/01/2013)	3,811	3,631	3,811	0.5%
		Membership Interest(25)		1,899	4,812	0.7%
				5,530	8,623	1.2%
Freedom Marine Services LLC	Louisiana/Shipping Vessels	Subordinated Secured Note (16.00% PIK, due 12/31/2011)(3)	10,088	10,040	3,583	0.5%
		Net Profits Interest (22.50% payable on equity distributions)(3),(7)				0.0%
				10,040	3,583	0.5%
Gas Solutions Holdings, Inc.(8),(3)	Texas/Gas Gathering and Processing	Senior Secured Note (18.00%, due	25,000	25,000	25,000	3.5%

12/11/2016) Junior Secured Note (18.00%, due 12/12/2016)	7,500	7,500	7,500	1.1%
Common Stock (100 shares)		5,003	60,596	8.5%
		37,503	93,096	13.1%

**LEVEL 3 PORTFOLIO INVESTMENTS:****Control Investments (25.00% or greater of voting control)**

Integrated Contract Services, Inc.(9)	North Carolina/Contracting	Senior Demand Note (15.00%, past due)(10)	\$ 1,170	\$ 1,170	\$ 1,170	0.2%
		Senior Secured Note (7.00% plus 7.00% PIK plus 6.00% default interest, in non-accrual status effective 10/09/2007, past due)	1,100	800	1,100	0.2%
		Junior Secured Note (7.00% plus 7.00% PIK plus 6.00% default interest, in non-accrual status effective 10/09/2007, past due)	14,003	14,003	2,272	0.2%
		Preferred Stock Series A (10 shares)				0.0%
		Common Stock (49 shares)		679		0.0%

See notes to consolidated financial statements.

Table of Contents**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY****CONSOLIDATED SCHEDULE OF INVESTMENTS****June 30, 2010 and June 30, 2009****(In thousands, except share data) (Continued)**

Portfolio Company	Locale / Industry	Investments(1)	Principal Value	June 30, 2010		% of Net Assets
				Cost	Fair Value(2)	
				\$ 16,652	\$ 4,542	0.6%
Iron Horse Coiled Tubing, Inc.(24)	Alberta, Canada/Production Services	Senior Secured Tranche 1 (Zero Coupon, in non-accrual status effective 1/01/2010, due 12/31/2016)	\$ 615	396	615	0.1%
		Senior Secured Tranche 2 (Zero Coupon, in non-accrual status effective 1/01/2010, due 12/31/2016)	2,337	2,338	2,338	0.3%
		Senior Secured Tranche 3 (1.00%, in non-accrual status effective 1/01/2010, due 12/31/2016)	18,000	18,000	9,101	1.3%
		Common Stock (3,821 shares)		268		0.0%
				21,002	12,054	1.7%
Manx Energy, Inc. ( Manx )(12)	Kansas/Oil & Gas Production	Appalachian Energy Holdings, LLC ( AEH ) Senior Secured Note (8.00%, in non-accrual status effective 1/19/2010, due 1/19/2013)	2,073	2,000	472	0.1%

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		Coalbed, LLC Senior Secured Note (8.00%, in non-accrual status effective 1/19/2010, due 1/19/2013)(6)	6,219	5,991	1,414	0.2%
		Manx Senior Secured Note (13.00%, in non-accrual status effective 1/19/2010, due 1/19/2013)	2,800	2,800	2,800	0.4%
		Manx Preferred Stock (6,635 shares)		6,308		0.0%
		Manx Common Stock (3,416,335 shares)		1,171		0.0%
				18,270	4,686	0.7%
NRG Manufacturing, Inc.	Texas/Manufacturing	Senior Secured Note (16.50%, due 8/31/2011)(3),(4)	13,080	13,080	13,080	1.8%
		Common Stock (800 shares)		2,317	7,031	1.0%
				15,397	20,111	2.8%
Nupla Corporation	California/Home & Office Furnishings, Housewares & Durable	Revolving Line of Credit \$2,000 Commitment (7.25% plus 2.00% default interest, due 9/04/2012)(4),(26)	1,093	958	1,093	0.2%
		Senior Secured Term Loan A (8.00% plus 2.00% default interest, due 9/04/2012)(4)	5,139	1,503	3,301	0.5%
		Senior Subordinated Debt (10.00% plus 5.00% PIK, in non-accrual status effective 4/01/2009, due 3/04/2013)	3,368			0.0%

		Preferred Stock Class A (2,850 shares)				0.0%
		Preferred Stock Class B (1,330 shares)				0.0%
		Common Stock (2,360,743 shares)				0.0%
			2,461	4,394		0.7%
R-V Industries, Inc.	Pennsylvania/Manufacturing	Warrants (200,000 warrants, expiring 6/30/2017)	1,682	1,697		0.2%
		Common Stock (545,107 shares)	5,086	4,626		0.7%
			6,768	6,323		0.9%

**LEVEL 3 PORTFOLIO INVESTMENTS:  
Control Investments (25.00% or greater of  
voting control)**

Sidump r Trailer Company, Inc.	Nebraska/Automobile	Revolving Line of Credit \$2,000 Commitment (7.25%, in non-accrual status effective 11/01/2008, due 1/10/2011)(4),(26)	\$ 1,025	\$ 479	\$ 574	0.1%
		Senior Secured Term Loan A (7.25%, in non-accrual status effective 11/01/2008, due 1/10/2011)(4)	2,048	463		0.0%
		Senior Secured Term Loan B (8.75%, in-non-accrual status effective 11/01/2008, due 1/10/2011)(4)	2,321			0.0%
		Senior Secured Term Loan C (16.50% PIK, in non-accrual status effective 9/27/2008, due 7/10/2011)	3,085			0.0%



Senior Secured Term Loan D (7.25%, in non-accrual status effective 11/01/2008, due 7/10/2011)(4)	1,700	0.0%
Preferred Stock (49,843 shares)		0.0%
Common Stock (64,050 shares)		0.0%

See notes to consolidated financial statements.

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Table of Contents**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY****CONSOLIDATED SCHEDULE OF INVESTMENTS****June 30, 2010 and June 30, 2009****(In thousands, except share data) (Continued)**

Portfolio Company	Locale / Industry	Investments(1)	Principal Value	June 30, 2010		% of Net Assets
				Cost	Fair Value(2)	
				\$ 942	\$ 574	0.1
resville Coal Holdings, (11)	Kentucky/Mining, Steel, Iron and Non-Precious Metals and Coal Production	Senior Secured Note (Non-accrual status effective 1/01/2009, due 12/31/2010)(4)	\$ 10,000	1,035	808	0.1
		Junior Secured Note (Non-accrual status effective 1/01/2009, due 12/31/2010)(4)	41,931	95		0.0
		Common Stock (1,000 shares)				0.0
				1,130	808	0.1
		<b>Total Control Investments</b>		<b>185,720</b>	<b>195,958</b>	<b>27.6</b>
<b>iliate Investments (5.00% to 24.99% voting control)</b>						
tronic NeuroNetwork(17)	Michigan/Healthcare	Senior Secured Note (11.50% plus 1.00% PIK, due 2/21/2013)(3),(4)	26,227	26,227	26,744	3.8
		Preferred Stock (9,925.455 shares)(13)		2,300	2,759	0.4
				28,527	29,503	4.2
kercraft Incorporated	Georgia/Textiles & Leather	Revolving Line of Credit \$1,000 Commitment (9.00%, due 9/16/2013)(26),(27)	1,000	1,000	1,000	0.1
		Senior Secured Term Loan A (9.50%, due 9/16/2013)(3),(4)	3,843	3,330	3,577	0.5

		Senior Secured Term Loan B (10.00%, due 9/16/2013)(3),(4)	4,822	3,845	4,386	0.6
		Subordinated Secured Term Loan (12.00% plus 6.50% PIK, due 3/16/2014)(3)	7,235	5,775	6,717	0.9
		Preferred Stock (1,000,000 shares)			205	0.0
		Common Stock (10,000 shares)				0.0
				13,950	15,885	2.2
PS Holdings, LLC	Colorado/Textiles & Leather	Revolving Line of Credit \$1,500 Commitment (10.50%, due 1/31/2012)(26),(27)	1,000	1,000	1,000	0.1
		Senior Secured Term Loan A (10.50%, due 1/31/2012)(3),(4)	3,130	2,847	2,916	0.4
		Senior Secured Term Loan B (12.00%, due 1/31/2012)(3)	435	377	409	0.1
		Senior Secured Term Loan C (12.00% plus 6.00% PIK, due 3/31/2012)(3)	4,932	4,345	4,796	0.7
		Membership Interest Class A (730 units)				0.0
		Membership Interest Common (199,795 units)				0.0
				8,569	9,121	1.3
<b>LEVEL 3 PORTFOLIO INVESTMENTS:</b>						
<b>Affiliate Investments (5.00% to 24.99% voting control)</b>						
Part, LLC(15)	New York/Diversified/Conglomerate Service	Membership Interest Class B (1,218 units)		\$	\$	0.0
		Membership Interest Class D (1 unit)				0.0
						0.0
ort Helmets Holdings, C(15)	New York/Personal & Nondurable Consumer Products	Revolving Line of Credit \$3,000 Commitment (4.54%, due				0.0

	12/14/2013)(26),(27)				
	Senior Secured Term				
	Loan A (4.54%, due				
	12/14/2013)(3),(4)	\$ 3,025	1,658	2,993	0.4
	Senior Secured Term				
	Loan B (5.04%, due				
	12/14/2013)(3),(4)	7,388	5,161	6,432	0.9
	Senior Subordinated				
	Debt Series A				
	(12.00% plus 3.00%				
	PIK, due 6/14/2014)(3)	7,325	5,857	6,734	0.9
	Senior Subordinated				
	Debt Series B				
	(10.00% plus 5.00%				
	PIK, due 6/14/2014)(3)	1,357	952	1,160	0.2
	Common Stock				
	(20,554 shares)		408	1,912	0.3
			14,036	19,231	2.7
	<b>Total Affiliate</b>				
	<b>Investments</b>		<b>65,082</b>	<b>73,740</b>	<b>10.4</b>
<b>Non-control/Non- affiliate Investments (less than 5.00% of voting control)</b>					
APCO, Inc.	Florida/Ecological	Common Stock			
		(5,000 shares)	141	340	0.0

See notes to consolidated financial statements.

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Table of Contents**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY****CONSOLIDATED SCHEDULE OF INVESTMENTS****June 30, 2010 and June 30, 2009****(In thousands, except share data) (Continued)**

Portfolio Company	Locale / Industry	Investments(1)	Principal Value	June 30, 2010		% of Net Assets
				Cost	Fair Value(2)	
				\$ 141	\$ 340	0.0%
Aircraft Fasteners International, LLC	California/Machinery	Revolving Line of Credit \$500 Commitment (9.50%, due 11/01/2012)(26),(27)				0.0%
		Senior Secured Term Loan (9.50%, due 11/01/2012)(3),(4)	\$ 4,565	4,565	4,248	0.6%
		Junior Secured Term Loan (12.00% plus 6.00% PIK, due 5/01/2013)(3)	5,134	5,134	4,807	0.7%
		Convertible Preferred Stock (32,500 units)		396	98	0.0%
				10,095	9,153	1.3%
American Gilsonite Company	Utah/Specialty Minerals	Senior Subordinated Note (12.00% plus 3.00% PIK, due 3/14/2013)(3)	14,783	14,783	14,931	2.1%
		Membership Interest in AGC/PEP, LLC (99.9999%)(16)		1,031	3,532	0.5%
				15,814	18,463	2.6%
Arrowhead General Insurance Agency, Inc.(17)	California/Insurance	Senior Secured Term Loan (8.50%, due 8/08/2012)	850	809	830	0.1%
		Junior Secured Term Loan (10.25% plus 2.50% PIK, due 2/08/2013)	6,179	5,002	5,122	0.7%

				5,811	5,952	0.8%
Caleel + Hayden, LLC(15)	Colorado/Personal & Nondurable Consumer Products	Membership Units (7,500 shares)		351	818	0.1%
		Options in Mineral Fusion Natural Brands, LLC (11,662 options)				0.0%
				351	818	0.1%
<b>LEVEL 3 PORTFOLIO INVESTMENTS:</b>						
<b>Non-control/Non- affiliate Investments (less than 5.00% of voting control)</b>						
Castro Cheese Company, Inc.	Texas/Food Products	Subordinated Secured Note (11.00% plus 2.00% PIK, due 2/28/2013)(3)	\$ 7,692	\$ 7,597	\$ 7,769	1.1%
				7,597	7,769	1.1%
Copernicus Group	North Carolina/Healthcare	Revolving Line of Credit \$500 Commitment (10.00%, due 10/08/2013)(4),(26)	150	22	150	0.0%
		Senior Secured Term Loan A (10.00%, due 10/08/2013)(3),(4)	5,850	5,058	5,416	0.8%
		Senior Subordinated Debt (10.00% plus 10.00% PIK, due 4/08/2014)	13,390	11,421	12,677	1.8%
		Preferred Stock Series A (1,000,000 shares)		67	104	0.0%
		Preferred Stock Series C (212,121 shares)		212	246	0.0%
				16,780	18,593	2.6%
Deb Shops, Inc.(17)	Pennsylvania/Retail	Second Lien Debt (14.00% PIK, in non-accrual status effective 2/24/2009, due 10/23/2014)	17,562	14,606	2,051	0.3%
				14,606	2,051	0.3%

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Diamondback Operating, LP	Oklahoma/Oil & Gas Production	Net Profits Interest (15.00% payable on Equity distributions)(7)		193	0.0%	
				193	0.0%	
EXL Acquisition Corporation	South Carolina/Electronics	Revolving Line of Credit \$1,000 Commitment (7.75%, due 06/24/2015)(26),(27)			0.0%	
		Senior Secured Term Loan A (7.75%, due 6/24/2015)(3),(4)	12,250	12,250	12,250	1.7%
		Senior Secured Term Loan B (12.00% plus 2.00% PIK, due 12/24/2015)(3)	12,250	12,250	12,250	1.7%
		Common Stock Class A (2,475 shares)		437	363	0.1%
		Common Stock Class B (25 shares)		252	103	0.0%
		25,189	24,966	3.5%		
Fairchild Industrial Products, Co.(2)	North Carolina/Electronics	Preferred Stock Class A (285.1 shares)		377	435	0.1%
		Common Stock Class B (28 shares)		211	228	0.0%

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Table of Contents**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY****CONSOLIDATED SCHEDULE OF INVESTMENTS****June 30, 2010 and June 30, 2009****(In thousands, except share data) (Continued)**

Portfolio Company	Locale / Industry	Investments(1)	Principal Value	June 30, 2010		% of Net Assets
				Cost	Fair Value(2)	
				\$ 588	\$ 663	0.1%
H&M Oil & Gas, LLC	Texas/Oil & Gas Production	Senior Secured Note (13.00% plus 3.00% PIK, due 9/30/2010)	\$ 59,107	59,107	48,867	6.9%
		Net Profits Interest (8.00% payable on Equity distributions)(7)			827	0.1%
				59,107	49,694	7.0%
Hoffmaster Group, Inc.	Wisconsin/Durable Consumer Products	Second Lien Term Loan (13.50%, due 6/2/2017)(3)	20,000	20,000	20,000	2.8%
				20,000	20,000	2.8%
Hudson Products Holdings, Inc.(17)	Texas/Manufacturing	Senior Secured Term Loan (8.00%, due 8/24/2015)(3),(4)	6,365	5,734	5,314	0.7%
				5,734	5,314	0.7%
IEC Systems LP ( IEC )/Advanced Rig Services LLC ( ARS )	Texas/Oilfield Fabrication	IEC Senior Secured Note (12.00% plus 3.00% PIK, due 11/20/2012)(3),(4)	19,008	19,008	19,008	2.7%
		ARS Senior Secured Note (12.00% plus 3.00% PIK, due 11/20/2012)(3),(4)	11,421	11,421	11,421	1.6%
				30,429	30,429	4.3%

**LEVEL 3 PORTFOLIO INVESTMENTS:**



**Non-control/Non- affiliate Investments (less than 5.00% of voting control)**

Impact Products, LLC	Ohio/Home & Office Furnishings, Housewares & Durable	Junior Secured Term Loan (6.38%, due 9/09/2012)(4)	\$ 7,300	\$ 6,351	\$ 7,290	1.0%
		Senior Subordinated Debt (10.00% plus 5.00% PIK, due 9/09/2012)	5,548	5,300	5,548	0.8%
				11,651	12,838	1.8%
Label Corp Holdings, Inc.	Nebraska/Printing & Publishing	Senior Secured Term Loan (8.50%, due 8/08/2014)(3),(4)	5,794	5,222	5,284	0.7%
				5,222	5,284	0.7%
LHC Holdings Corp.(17)	Florida/Healthcare	Revolving Line of Credit \$1,000 Commitment (9.00%, due 11/30/2012)(26),(27)				0.0%
		Senior Secured Term Loan A (9.00%, due 11/30/2012)(3),(4)	2,015	2,015	1,839	0.3%
		Senior Subordinated Debt (12.00% plus 2.50% PIK, due 5/31/2013)(3)	4,565	4,199	4,220	0.6%
		Membership Interest (125 units)		216	217	0.0%
				6,430	6,276	0.9%
Mac & Massey Holdings, LLC	Georgia/Food Products	Senior Subordinated Debt (10.00% plus 5.75% PIK, due 2/10/2013)	8,671	7,351	8,643	1.2%
		Membership Interest (250 units)		145	390	0.1%
				7,496	9,033	1.3%
Maverick Healthcare, LLC	Arizona/Healthcare	Second Lien Debt (12.50% plus 3.50% PIK, due 4/30/2014)(3)	13,122	13,122	13,247	1.9%
		Preferred Units (1,250,000 units)		1,252	2,025	0.2%
					0.0%	

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		Common Units (1,250,000 units)				
			14,374	15,272	2.1%	
Miller Petroleum, Inc.	Tennessee/Oil & Gas Production	Warrants, Common Stock (2,208,772 warrants, expiring 5/04/2010 to 3/31/2015)(14)	150	1,244	0.2%	
			150	1,244	0.2%	
Northwestern Management Services, LLC	Florida/Healthcare	Revolving Line of Credit \$1,000 Commitment (4.36%, due 12/13/2012)(26),(27)	350	350	350	0.0%
		Senior Secured Term Loan A (4.36%, due 12/13/2012)(3),(4)	4,309	3,516	3,578	0.5%
		Senior Secured Term Loan B (4.86%, due 12/13/2012)(3),(4)	1,219	904	956	0.1%
		Subordinated Secured Term Loan (12.00% plus 3.00%, due 6/13/2013)(3)	2,971	2,468	2,606	0.4%

See notes to consolidated financial statements.

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Table of Contents**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY****CONSOLIDATED SCHEDULE OF INVESTMENTS****June 30, 2010 and June 30, 2009****(In thousands, except share data) (Continued)**

Portfolio Company	Locale / Industry	Investments(1)	Principal Value	June 30, 2010		% of Net Assets
				Cost	Fair Value(2)	
		Common Stock (50 shares)		\$ 371	\$ 564	0.1%
				7,609	8,054	1.1%
Prince Mineral Company, Inc.	New York/Metal Services and Minerals	Junior Secured Term Loan (9.00%, due 12/21/2012)(4)	\$ 11,150	11,150	11,150	1.6%
		Senior Subordinated Debt (13.00% plus 2.00%, due 7/21/2013)	12,260	1,420	12,260	1.7%
				12,570	23,410	3.3%
Qualitest Pharmaceuticals, Inc.(17)	Alabama/Pharmaceuticals	Second Lien Debt (7.79%, due 4/30/2015)(3),(4)	12,000	11,955	12,000	1.7%
				11,955	12,000	1.7%
<b>LEVEL 3 PORTFOLIO INVESTMENTS:</b>						
<b>Non-control/Non- affiliate Investments (less than 5.00% of voting control)</b>						
Regional Management Corporation	South Carolina/Financial Services	Second Lien Debt (12.00% plus 2.00% PIK, due 6/29/2012)(3)	25,814	25,814	25,592	3.6%
				25,814	25,592	3.6%
Roll Coater Acquisition Corp.	Indiana/Metal Services and Minerals	Subordinated Secured Debt (10.25%, due 9/30/2010)	6,268	6,102	6,082	0.9%
				6,102	6,082	0.9%

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R-O-M Corporation	Missouri/Automobile	Revolving Line of Credit \$1,750 Commitment (4.50%, due 2/08/2013)(26),(27)					0.0%
		Senior Secured Term Loan A (4.50%, due 2/08/2013)(3),(4)	4,640	4,025	4,571		0.6%
		Senior Secured Term Loan B (8.00%, due 5/08/2013)(3),(4)	7,251	7,251	7,078		1.0%
		Senior Subordinated Debt (12.00% plus 3.00% PIK due 8/08/2013)(3)	7,118	6,799	6,392		0.9%
				18,075	18,041		2.5%
Seaton Corp.	Illinois/Business Services	Subordinated Secured (12.50% plus 2.00% PIK, due 3/14/2011)	12,296	12,060	12,132		1.7%
				12,060	12,132		1.7%
Shearer s Foods, Inc.	Ohio/Food Products	Junior Secured Debt (12.00% plus 3.00% PIK, due 3/31/2016)(3)	35,266	35,266	36,119		5.1%
		Membership Interest in Mistral Chip Holdings, LLC (2,000 units)(18)		2,560	6,136		0.9%
		Membership Interest in Mistral Chip Holdings, LLC 2 (595 units)(18)		762	1,825		0.3%
				38,588	44,080		6.2%
Skillsoft Public Limited Company	Ireland/Prepackaged Software	Subordinated Unsecured (11.125%, due 06/01/2018)	15,000	14,903	15,000		2.2%
				14,903	15,000		2.2%
Stryker Energy, LLC	Ohio/Oil & Gas Production		29,724	29,507	29,624		4.2%

		Subordinated Secured Revolving Credit Facility (12.00%, due 12/01/2012)(3),(4) Overriding Royalty Interests(19)			2,768	0.4%
			29,507	32,392	4.6%	
TriZetto Group(17)	California/Healthcare	Subordinated Unsecured Note (12.00% plus 1.50% PIK, due 10/01/2016)(3)	15,434	15,306	15,895	2.2%
				15,306	15,895	2.2%
Unitek(17)	Pennsylvania/Technical Services	Second Lien Debt (13.08%, due 12/31/2013)(3),(4)	11,500	11,387	11,615	1.7%
				11,387	11,615	1.7%
Wind River Resources Corp. and Wind River II Corp.	Utah/Oil & Gas Production	Senior Secured Note (13.00% plus 3.00% default interest, in non-accrual status effective 12/01/2008, due 7/31/2010)(4) Net Profits Interest (5.00% payable on Equity distributions)(7)	15,000	15,000	8,779	1.2%
						0.0%
				15,000	8,779	1.2%

See notes to consolidated financial statements.

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Table of Contents**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY****CONSOLIDATED SCHEDULE OF INVESTMENTS****June 30, 2010 and June 30, 2009****(In thousands, except share data) (Continued)**

Portfolio Company	Locale / Industry	Investments(1)	June 30, 2010		% of Net Assets	
			Principal Value	Cost		Fair Value(2)
		<b>Total Non-Control/Non-Affiliate Investments (Level 3 Investments)</b>		<b>\$ 476,441</b>	<b>\$ 477,417</b>	<b>67.1%</b>
		<b>Total Level 3 Portfolio Investments</b>		<b>727,243</b>	<b>747,115</b>	<b>105.1%</b>
<b>LEVEL 1 PORTFOLIO INVESTMENTS:</b>						
<b>Non-control/Non-affiliate Investments (less than 5.00% of voting control)</b>						
Allied Defense Group, Inc.	Virginia/Aerospace & Defense	Common Stock (10,000 shares)		\$ 56	\$ 38	0.0%
				56	38	0.0%
Dover Saddlery, Inc.	Massachusetts/Retail	Common Stock (30,974 shares)		63	97	0.0%
				63	97	0.0%
LyondellBasell Industries N.V.(22)	Netherlands/Chemical Company	Class A Common Stock (26,961 shares)		874	435	0.2%
		Class B Common Stock (49,421 shares)		523	798	0.0%
				1,397	1,233	0.2%
		<b>Total Non-Control/Non-Affiliate Investments (Level 1 Investments)</b>		<b>1,516</b>	<b>1,368</b>	<b>0.2%</b>

	<b>Total Portfolio Investments</b>	<b>728,759</b>	<b>748,483</b>	<b>105.3%</b>
<b>SHORT TERM INVESTMENTS: Money Market Funds (Level 2 Investments)</b>				
Fidelity Institutional Money Market Funds	Government Portfolio (Class I)	62,183	62,183	8.8%
Fidelity Institutional Money Market Funds	Government Portfolio (Class I)(3)	6,687	6,687	0.9%
Victory Government Money Market Funds		1	1	0.0%
	<b>Total Money Market Funds</b>	<b>68,871</b>	<b>68,871</b>	<b>9.7%</b>
	<b>Total Investments</b>	<b>797,630</b>	<b>817,354</b>	<b>115.0%</b>

See notes to consolidated financial statements.

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Portfolio Company	Locale / Industry	Investments(1)	Principal Value	June 30, 2009		% of Net Assets
				Cost	Fair Value(2)	
<b>LEVEL 3 INVESTMENTS:</b>						
<b>Control Investments (25.00% or greater of voting control)</b>						
Ajax Rolled Ring & Machine, Inc.	South Carolina/Manufacturing	Senior Secured Note Tranche A (10.50%, due 4/01/2013)(3),(4)	\$ 21,487	\$ 21,487	\$ 21,487	4.0%
		Subordinated Secured Note Tranche B (11.50% plus 6.00% PIK, due 4/01/2013)(3),(4)	11,675	11,675	10,151	1.9%
		Convertible Preferred Stock Series A (6,143 shares)		6,057		0.0%
		Unrestricted Common Stock (6 shares)				0.0%
				39,219	31,638	5.9%
C&J Cladding LLC	Texas/Metal Services and Minerals	Senior Secured Note (14.00%, due 3/30/2012)(3),(4)	3,150	2,722	3,308	0.6%
		Warrants (400 warrants, expiring 3/30/2014)		580	3,825	0.7%
				3,302	7,133	1.3%
Change Clean Energy Holdings, Inc. ( CCEHI )(5)	Maine/Biomass Power	Common Stock (1,000 shares)		2,530	2,530	0.5%



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			2,530	2,530	0.5%
Gas Solutions Holdings, Inc.(8)	Texas/Gas Gathering and Processing	Senior Secured Note (18.00%, due 12/22/2018)(3)	25,000	25,000	4.7%
		Junior Secured Note (18.00%, due 12/23/2018)(3)	5,000	5,000	0.9%
		Common Stock (100 shares)(3)		5,003	10.4%
			35,003	85,187	16.0%
Integrated Contract Services, Inc.(9)	North Carolina/Contracting	Senior Demand Note (15.00%, due 6/30/2009)(10)	1,170	1,170	0.2%
		Senior Secured Note (7.00% plus 7.00% PIK plus 6.00% default interest, in non-accrual status effective 10/09/2007, past due)	800	800	0.1%
		Junior Secured Note (7.00% plus 7.00% PIK plus 6.00% default interest, in non-accrual status effective 10/09/2007, past due)	14,003	14,003	0.6%
		Preferred Stock Series A (10 shares)			0.0%
		Common Stock (49 shares)		679	0.0%
			16,652	5,000	0.9%
Iron Horse Coiled Tubing, Inc.	Alberta, Canada/Production Services	Bridge Loan (15.00% plus 3.00% PIK, due 12/31/2009)	9,826	9,826	1.8%
		Senior Secured Note (15.00%,	9,250	9,250	0.6%

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		due 12/31/2009) Common Stock (1,781 shares)		268		0.0%
				19,344	12,606	2.4%
NRG Manufacturing, Inc.	Texas/Manufacturing	Senior Secured Note (16.50%, due 8/31/2011)(3),(4)	13,080	13,080	13,080	2.5%
		Common Stock (800 shares)		2,317	19,294	3.6%
				15,397	32,374	6.1%
R-V Industries, Inc.	Pennsylvania/Manufacturing	Warrants (200,000 warrants, expiring 6/30/2017)		1,682	4,500	0.8%
		Common Stock (545,107 shares)		5,086	12,267	2.3%
				6,768	16,767	3.1%
Yatesville Coal Holdings, Inc.(11)	Kentucky/Mining, Steel, Iron and Non-Precious Metals and Coal Production	Senior Secured Note (15.72%, in non-accrual status effective 1/01/2009, due 12/31/2010)(4)	10,000	10,000	10,000	1.9%
		Junior Secured Note (15.72%, in non-accrual status effective 1/01/2009, due 12/31/2010)(4)	38,463	38,463	3,097	0.6%
		Common Stock (1,000 shares)		427		0.0%
				48,890	13,097	2.5%
		<b>Total Control Investments</b>		<b>187,105</b>	<b>206,332</b>	<b>38.7%</b>

**LEVEL 3 INVESTMENTS:**

**Affiliate Investments (5.00% to 24.99% voting control)**

See notes to consolidated financial statements.

Table of Contents**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY****CONSOLIDATED SCHEDULE OF INVESTMENTS****June 30, 2010 and June 30, 2009****(In thousands, except share data) (Continued)**

Portfolio Company	Locale / Industry	Investments(1)	Principal Value	June 30, 2009		% of Net Assets	
				Cost	Fair Value(2)		
Appalachian Energy Holdings LLC(21)	West Virginia/Construction Services	Senior Secured Debt Tranche A (14.00% plus 3.00% PIK plus 3.00% default interest, in non-accrual status effective 11/01/2008, due 1/31/2011)	\$ 1,997	\$ 1,891	\$ 2,052	0.4%	
		Senior Secured Debt Tranche B (14.00% plus 3.00% PIK plus 3.00% default interest, in non-accrual status effective 11/01/2008, past due)	2,050	1,955	356	0.1%	
		Preferred Stock Series A (200 units)		82		0.0%	
		Preferred Stock Series B (241 units)		241		0.0%	
		Preferred Stock Series C (500 units)		500		0.0%	
		Warrants (6,065 warrants, expiring 2/13/2016)		176		0.0%	
		Warrants (6,025 warrants, expiring 6/17/2018)		172		0.0%	
		Warrants (25,000 warrants, expiring 11/30/2018)				0.0%	
					5,017	2,408	0.5%
		Biotronic NeuroNetwork(17)	Michigan/Healthcare		26,227	26,227	27,007

		Senior Secured Note (11.50% plus 1.00% PIK, due 2/21/2013)(3),(4)					
		Preferred Stock (9,925 shares)(13)		2,300	2,839	0.5%	
				28,527	29,846	5.6%	
		<b>Total Affiliate Investments</b>		<b>33,544</b>	<b>32,254</b>	<b>6.1%</b>	
<b>Non-control/Non-affiliate Investments (less than 5.00% of voting control)</b>							
American Gilsonite Company	Utah/Specialty Minerals	Senior Subordinated Note (12.00% plus 3.00% PIK, due 3/14/2013)(3)	14,783	14,783	15,073	2.8%	
		Membership Interest Units in AGC/PEP, LLC (99.9999%)(16)		1,031	3,851	0.7%	
				15,814	18,924	3.5%	
Castro Cheese Company, Inc.	Texas/Food Products	Junior Secured Note (11.00% plus 2.00% PIK, due 2/28/2013)(3)	7,538	7,413	7,637	1.4%	
				7,413	7,637	1.4%	
Conquest Cherokee, LLC(6)	Tennessee/Oil & Gas Production	Senior Secured Note (13.00% plus 4.00% default interest, in non-accrual status effective 4/01/2009, past due)(4)	10,200	10,191	6,855	1.3%	
		Overriding Royalty Interests(19)			565	0.1%	
				10,191	7,420	1.4%	
Deb Shops, Inc.(17)	Pennsylvania/Retail	Second Lien Debt (8.67%, due 10/23/2014)	15,000	14,623	6,272	1.2%	
				14,623	6,272	1.2%	
Diamondback Operating, LP	Oklahoma/Oil & Gas Production	Net Profits Interest (15.00% payable on			458	0.1%	

Equity  
distributions)(7)

458 0.1%

Freedom Marine Services LLC	Louisiana/Shipping Vessels	Subordinated Secured Note (12.00% plus 4.00% PIK, due 12/31/2011)(3)	7,234	7,160	7,152	1.4%
		Net Profits Interest (22.50% payable on Equity distributions)(3),(7)			229	0.0%
				7,160	7,381	1.4%

**LEVEL 3 INVESTMENTS:****Non-control/Non-affiliate Investments (less than 5.00% of voting control)**

H&M Oil & Gas, LLC	Texas/Oil & Gas Production	Senior Secured Note (13.00%, due 6/30/2010)(3)	\$ 49,688	\$ 49,688	\$ 49,697	9.3%
		Net Profits Interest (8.00% payable on Equity distributions)(3),(7)			1,682	0.3%
				49,688	51,379	9.6%
IEC Systems LP ( IEC )/Advanced Rig Services LLC ( ARS )	Texas/Oilfield Fabrication	IEC Senior Secured Note (12.00% plus 3.00% PIK, due 11/20/2012)(3),(4)	21,411	21,411	21,839	4.1%
		ARS Senior Secured Note (12.00% plus 3.00% PIK, due 11/20/2012)(3),(4)	12,836	12,836	13,092	2.5%
				34,247	34,931	6.6%

See notes to consolidated financial statements.

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Table of Contents**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY****CONSOLIDATED SCHEDULE OF INVESTMENTS****June 30, 2010 and June 30, 2009****(In thousands, except share data) (Continued)**

Portfolio Company	Locale / Industry	Investments(1)	Principal Value	June 30, 2009		% of Net Assets
				Cost	Fair Value(2)	
Merck Healthcare,	Arizona/Healthcare	Second Lien Debt (12.00% plus 1.50% PIK, due 4/30/2014)(3)	\$ 12,691	\$ 12,691	\$ 12,816	2.0
		Preferred Units (1,250,000 units)		1,252	1,300	0.0
		Common Units (1,250,000 units)				0.0
				13,943	14,116	2.0
Mer Petroleum, Inc.	Tennessee/Oil & Gas Production	Warrants, Common Stock (1,935,523 warrants, expiring 5/04/2010 to 6/30/2014)(14)				
				150	241	0.0
				150	241	0.0
Less Manufacturing	Texas/Manufacturing	Subordinated Secured Note (11.50% plus 3.50% PIK, due 4/29/2013)(3)	20,000	20,000	20,400	3.0
				20,000	20,400	3.0
Citest Pharmaceuticals, (17)	Alabama/Pharmaceuticals	Second Lien Debt (8.10%, due 4/30/2015)(3),(4)	12,000	11,949	11,452	2.0
				11,949	11,452	2.0
Global Management Corporation.	South Carolina/Financial Services	Second Lien Debt (12.00% plus 2.00% PIK, due 6/29/2012)(3)	25,424	25,424	23,073	4.0
				25,424	23,073	4.0
Pro Products, Inc.	Pennsylvania/Manufacturing	Second Lien Debt (8.67%, due 6/22/2014)(3),(4)	9,750	9,594	9,750	1.0

				9,594	9,750	1.
er s Foods, Inc.	Ohio/Food Products	Second Lien Debt (14.00%, due 10/31/2013)(3)	18,000	18,000	18,360	3.
		Membership Interest Units in Mistral Chip Holdings, LLC (2,000 units)(18)		2,000	3,419	0.
				20,000	21,779	4.
ker Energy, LLC	Ohio/Oil & Gas Production	Subordinated Secured Revolving Credit Facility (12.00%, due 12/01/2011)(3),(4)	29,500	29,154	29,554	5.
		Overriding Royalty Interests(19)			2,918	0.
				29,154	32,472	6.
etto Group(17)	California/Healthcare	Subordinated Unsecured Note (12.00% plus 1.50% PIK, due 10/01/2016)(3)	15,205	15,065	16,331	3.
				15,065	16,331	3.
ek(17)	Pennsylvania/Technical Services	Second Lien Debt (13.08%, due 12/31/2013)(3),(4)	11,500	11,360	11,730	2.
				11,360	11,730	2.
<b>LEVEL 3 INVESTMENTS:</b>						
<b>Non-control/Non-affiliate Investments (less than 5.00% of voting control)</b>						
d River Resources o. and Wind River II o.	Utah/Oil & Gas Production	Senior Secured Note (13.00% plus 3.00% default interest, in non-accrual status effective 12/01/2008, due 7/31/2010)(4)	\$ 15,000	\$ 15,000	\$ 12,644	2.
		Net Profits Interest (5.00% payable on Equity distributions)(7)			192	0.
				15,000	12,836	2.
		<b>Total Non-Control/Non-Affiliate Investments</b>		<b>310,775</b>	<b>308,582</b>	<b>57.</b>
		<b>Total Level 3 Portfolio Investments</b>		<b>531,424</b>	<b>547,168</b>	<b>102.</b>

**LEVEL 2 INVESTMENTS:**

**Money Market Funds**

Quality Institutional Money Market Funds	Government Portfolio (Class I)	94,753	94,753	17.
Quality Institutional Money Market Funds	Government Portfolio (Class I)(3)	3,982	3,982	0.
	<b>Total Money Market Funds (Level 2 Investments)</b>	<b>98,735</b>	<b>98,735</b>	<b>18.</b>
	<b>Total Investments</b>	<b>630,159</b>	<b>645,903</b>	<b>121.</b>

See notes to consolidated financial statements.

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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY**

**CONSOLIDATED SCHEDULE OF INVESTMENTS**

**June 30, 2010 and June 30, 2009**

**(In thousands, except share data) (Continued)**

**Endnote Explanations for the Consolidated Schedule of Investments as of June 30, 2010 and June 30, 2009**

- (1) The securities in which Prospect Capital Corporation ( we , us or our ) has invested were acquired in transactions that were exempt from registration under the Securities Act of 1933, as amended, or the Securities Act. These securities may be resold only in transactions that are exempt from registration under the Securities Act.
- (2) Fair value is determined by or under the direction of our Board of Directors. As of June 30, 2010, three of our portfolio investments, Allied Defense Group, Inc., Dover Saddlery, Inc. and Lyondell, were publically traded and classified as Level 1 within the valuation hierarchy established by Accounting Standards Codification 820, *Fair Value Measurements and Disclosures* ( ASC 820 ). As of June 30, 2010 and June 30, 2009, the fair value of our remaining portfolio investments was determined using significant unobservable inputs. ASC 820 classifies such inputs used to measure fair value as Level 3 within the valuation hierarchy. Our investments in money market funds are classified as Level 2. See Note 3 and Note 4 within the accompanying consolidated financial statements for further discussion.
- (3) Security, or portion thereof, is held as collateral for the revolving credit facility (see Note 11). The market values of these investments at June 30, 2010 and June 30, 2009 were \$512,244 and \$434,069, respectively; they represent 62.7% and 67.2% of total investments at fair value, respectively.
- (4) Security, or portion thereof, has a floating interest rate. Stated interest rate was in effect at June 30, 2010 and June 30, 2009.
- (5) There are several entities involved in the Biomass investment. We own 100 shares of common stock in Worcester Energy Holdings, Inc. ( WEHI ), representing 100% of the issued and outstanding common stock. WEHI, in turn, owns 51 membership certificates in Biochips LLC ( Biochips ), which represents a 51% ownership stake.

We own 282 shares of common stock in Worcester Energy Co., Inc. ( WECO ), which represents 51% of the issued and outstanding common stock. We own directly 1,665 shares of common stock in Change Clean Energy Inc. ( CCEI ), f/k/a Worcester Energy Partners, Inc., which represents 51% of the issued and outstanding common stock and the remaining 49% is owned by WECO. CCEI owns 100 shares of common stock in Precision Logging and Landclearing, Inc. ( Precision ), which represents 100% of the issued and outstanding common stock.

During the quarter ended March 31, 2009, we created two new entities in anticipation of the foreclosure proceedings against the co-borrowers (WECO, CCEI and Biochips) Change Clean Energy Holdings, Inc. ( CCEHI ) and DownEast Power Company, LLC ( DEPC ). We own 1,000 shares of CCEHI, representing 100% of the issued and outstanding stock, which in turn, owns a 100% of the membership interests in DEPC.

On March 11, 2009, we foreclosed on the assets formerly held by CCEI and Biochips with a successful credit bid of \$6,000 to acquire the assets. The assets were subsequently assigned to DEPC. WECO, CCEI and Biochips are joint borrowers on the term note issued to Prospect Capital. Effective July 1, 2008, this loan was placed on non-accrual status.

Biochips, WECO, CCEI, Precision and WEHI currently have no material operations and no significant assets. As of June 30, 2009, our Board of Directors assessed a fair value of \$0 for all of these equity positions and the loan position. We determined that the impairment of both CCEI and CCEHI as of June 30, 2009 was other than temporary and recorded a realized loss for the amount that the amortized cost exceeds the fair value at June 30, 2009. Our Board of Directors set no value for the CCEHI investment as of June 30, 2010, a decrease of \$2,530 from the fair value as of June 30, 2009.

- (6) During the quarter ended December 31, 2009, we created two new entities, Coalbed Inc. and Coalbed LLC, to foreclose on the outstanding senior secured loan and assigned rights and interests of Conquest Cherokee, LLC

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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY**

**CONSOLIDATED SCHEDULE OF INVESTMENTS**

**June 30, 2010 and June 30, 2009**

**(In thousands, except share data) (Continued)**

( Conquest ), as a result of the deterioration of Conquest's financial performance and inability to service debt payments. We own 1,000 shares of common stock in Coalbed Inc., representing 100% of the issued and outstanding common stock. Coalbed Inc., in turn owns 100% of the membership interest in Coalbed LLC.

On October 21, 2009, Coalbed LLC foreclosed on the loan formerly made to Conquest. On January 19, 2010, as part of the Manx rollup, the Coalbed LLC assets and loan was assigned to Manx, the holding company. As of June 30, 2010, our Board of Directors assessed a fair value of \$1,414 for the loan position in Coalbed LLC.

- (7) In addition to the stated returns, the net profits interest held will be realized upon sale of the borrower or a sale of the interests.
- (8) Gas Solutions Holdings, Inc. is a wholly-owned investment of us.
- (9) Entity was formed as a result of the debt restructuring of ESA Environmental Specialist, Inc. In early 2009, we foreclosed on the two loans on non-accrual status and purchased the underlying personal and real property. We own 1,000 shares of common stock in The Healing Staff ( THS ), f/k/a Lisamarie Fallon, Inc. representing 100% ownership. We own 1,500 shares of Vets Securing America, Inc. ( VSA ), representing 100% ownership. VSA is a holding company for the real property of Integrated Contract Services, Inc. ( ICS ) purchased during the foreclosure process.
- (10) Loan is with THS an affiliate of ICS.
- (11) On June 30, 2008, we consolidated our holdings in four coal companies into Yatesville Coal Holdings, Inc. ( Yatesville ), and consolidated the operations under one management team. As part of the transaction, the debt that we held of C&A Construction, Inc. ( C&A ), Genesis Coal Corp. ( Genesis ), North Fork Collieries LLC ( North Fork ) and Unity Virginia Holdings LLC ( Unity ) were exchanged for newly issued debt from Yatesville, and our ownership interests in C&A, E&L Construction, Inc. ( E&L ), Whymore Coal Company Inc. ( Whymore ) and North Fork were exchanged for 100% of the equity of Yatesville. This reorganization allows for a better utilization of the assets in the consolidated group.

At June 30, 2010 and at June 30, 2009, Yatesville owned 100% of the membership interest of North Fork. In addition, Yatesville held a \$9,325 and \$8,062, respectively, note receivable from North Fork as of those two respective dates.

At June 30, 2010 and at June 30, 2009, we owned 96% and 87%, respectively, of the common stock of Genesis and held a note receivable of \$20,897 and \$20,802, respectively, as of those two respective dates.

Yatesville held a note receivable of \$4,261 from Unity at June 30, 2010 and at June 30, 2009.

There are several entities involved in Yatesville's investment in Whymore at June 30, 2009. As of June 30, 2009, Yatesville owned 10,000 shares of common stock or 100% of the equity and held a \$14,973 senior secured debt receivable from C&A, which owns the equipment.

Yatesville owned 10,000 shares of common stock or 100% of the equity of E&L, which leases the equipment from C&A, employs the workers, is listed as the operator with the Commonwealth of Kentucky, mines the coal, receives revenues and pays all operating expenses. Yatesville owned 4,900 shares of common stock or 49% of the equity of Whymore, which applies for and holds permits on behalf of E&L. Yatesville also owned 4,285 Series A convertible preferred shares in each of C&A, E&L and Whymore. Whymore and E&L are guarantors under the C&A credit agreement with Yatesville.

In August 2009, Yatesville sold its 49% ownership interest in the common shares of Whymore to the 51% holder of the Whymore common shares ( Whymore Purchaser ). All reclamation liability was transferred to the Whymore Purchaser. In September 2009, Yatesville completed an auction for all of its equipment.

Yatesville currently has no material operations. During the quarter ended December 31, 2009, our Board of Directors determined that the impairment of Yatesville was other than temporary and we recorded a realized

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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY**

**CONSOLIDATED SCHEDULE OF INVESTMENTS**

**June 30, 2010 and June 30, 2009**

**(In thousands, except share data) (Continued)**

loss for the amount that the amortized cost exceeds the fair value. Our Board of Directors set the value of the remaining Yatesville investment at \$808 as of June 30, 2010.

- (12) On January 19, 2010, we modified the terms of our senior secured debt in AEH and Coalbed in conjunction with the formation of Manx Energy, a new entity consisting in the assets of AEH, Coalbed and Kinley Exploration. The assets of the three companies were brought under new common management. We funded \$2,800 at closing to Manx to provide for working capital. A portion of our loans to AEH and Coalbed was exchanged for Manx preferred equity, while our AEH equity interest was converted into Manx common stock. There was no change to fair value at the time of restructuring, and we continue to fully reserve any income accrued for Manx.
- (13) On a fully diluted basis represents, 11.677% of voting common shares.
- (14) Total common shares outstanding of 33,389,383 as of July 22, 2010 from Miller Petroleum, Inc. s ( Miller ) Annual Report on Form 10-K filed on July 28, 2010 as applicable to our June 30, 2010 reporting date. Total common shares outstanding of 15,811,856 as of March 11, 2009 from Miller s Quarterly Report on Form 10-Q filed on March 16, 2009.
- (15) A portion of the positions listed were issued by an affiliate of the portfolio company.
- (16) We own 99.9999% of AGC/PEP, LLC. AGC/PEP, LLC owns 2,037.65 out of a total of 83,818.69 shares (including 4,932 vested an unvested management options) of American Gilsonite Holding Company which owns 100% of American Gilsonite Company.
- (17) Syndicated investment which had been originated by another financial institution and broadly distributed.
- (18) At June 30, 2010, Mistral Chip Holdings, LLC owns 44,800 shares of Chip Holdings, Inc. and Mistral Chip Holdings 2, LLC owns 11,975 shares in Chip Holdings, Inc. Chip Holdings, Inc. is the parent company of Shearer s Foods, Inc. and has 67,936 shares outstanding before adjusting for management options.
- At June 30, 2009, Mistral Chip Holdings, LLC owns 44,800 shares out of 50,650 total shares outstanding of Chip Holdings, Inc., before adjusting for management options.
- (19) The overriding royalty interests held receive payments at the stated rates based upon operations of the borrower.
- (20) On December 31, 2009, we sold our investment in Aylward Enterprises, LLC. AWCNC, LLC is the remaining holding company with zero assets and our remaining outstanding debt has no value of June 30, 2010.
- (21) There are several entities involved in the Appalachian Energy Holdings LLC ( AEH ) investment. We own warrants, the exercise of which will permit us to purchase 37,090 Class A common units of AEH at a nominal cost and in near-immediate fashion. We own 200 units of Series A preferred equity, 241 units of Series B preferred equity, and 500 units of Series C preferred equity of AEH. The senior secured notes are with C&S Operating LLC and East Cumberland L.L.C., both operating companies owned by AEH.

- (22) We own warrants to purchase 33,750 shares of common stock in Metal Buildings Holding Corporation ( Metal Buildings ), the former holding company of Borga, Inc. Metal Buildings Holding Corporation owned 100% of Borga, Inc.

On March 8, 2010, we foreclosed on the stock in Borga, Inc. that was held by Metal Buildings, obtaining 100% ownership of Borga, Inc.

- (23) We own 100% of C&J Cladding Holding Company, Inc., which owns 40% of the membership interests in C&J Cladding, LLC.

- (24) On January 1, 2010, we restructured our senior secured and bridge loans investment in Iron Horse Coiled Tubing, Inc. ( Iron Horse ) and we reorganized Iron Horse s management structure. The senior secured loan and bridge loan were replaced with three new tranches of senior secured debt. From June 30, 2009 to June 30, 2010, our total ownership of Iron Horse decreased from 80.0% to 70.4%, respectively.

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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY**

**CONSOLIDATED SCHEDULE OF INVESTMENTS**

**June 30, 2010 and June 30, 2009**

**(In thousands, except share data) (Continued)**

As of June 30, 2010 and June 30, 2009, our Board of Directors assessed a fair value in Iron Horse of \$12,054 and \$12,606, respectively.

- (25) We own 2,800,000 units in Class A Membership Interests and 372,094 units in Class A-1 Membership Interests.
- (26) Undrawn committed revolvers incur a 0.50% commitment fee. As of June 30, 2010, we have \$10,632 of undrawn revolver commitments to our portfolio companies.
- (27) Stated interest rates are based on June 30, 2010 one month LIBOR rates plus applicable spreads based on the respective credit agreements. Interest rates are subject to change based on actual elections by the borrower for a LIBOR rate contract or Base Rate contract when drawing on the revolver.

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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(In thousands, except share and per share data)**

**Note 1. Organization**

References herein to we, us or our refer to Prospect Capital Corporation ( Prospect ) and its subsidiary unless the context specifically requires otherwise.

We were formerly known as Prospect Energy Corporation, a Maryland corporation. We were organized on April 13, 2004 and were funded in an initial public offering ( IPO ), completed on July 27, 2004. We are a closed-end investment company that has filed an election to be treated as a Business Development Company ( BDC ), under the Investment Company Act of 1940 (the 1940 Act ). As a BDC, we have qualified and have elected to be treated as a regulated investment company ( RIC ), under Subchapter M of the Internal Revenue Code. We invest primarily in senior and subordinated debt and equity of companies in need of capital for acquisitions, divestitures, growth, development, project financings, recapitalizations, and other purposes.

On May 15, 2007, we formed a wholly-owned subsidiary, Prospect Capital Funding, LLC, a Delaware limited liability company, for the purpose of holding certain of our loan investments in the portfolio which are used as collateral for our credit facility.

**Note 2. Patriot Acquisition**

On December 2, 2009, we acquired the outstanding shares of Patriot Capital Funding, Inc. ( Patriot ) common stock for \$201,083. Under the terms of the merger agreement, Patriot common shareholders received 0.363992 shares of our common stock for each share of Patriot common stock, resulting in 8,444,068 shares of common stock being issued by us. In connection with the transaction, we repaid all the outstanding borrowings of Patriot, in compliance with the merger agreement.

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

The merger has been accounted for as an acquisition of Patriot by Prospect Capital Corporation ( Prospect ) in accordance with acquisition method of accounting as detailed in ASC 805, *Business Combinations* ( ASC 805 ). The fair value of the consideration paid was allocated to the assets acquired and liabilities assumed based on their fair values as the date of acquisition. As described in more detail in ASC 805, goodwill, if any, would have been recognized as of the acquisition date, if the consideration transferred exceeded the fair value of identifiable net assets acquired. As of the acquisition date, the fair value of the identifiable net assets acquired exceeded the fair value of the consideration transferred, and we recognized the excess as a gain. A preliminary gain of \$5,714 was recorded by Prospect in the quarter ended December 31, 2009 related to the acquisition of Patriot, which was revised in the fourth quarter of Fiscal 2010, to \$7,708, when we settled severance accruals related to certain members of Patriot's top management. Under ASC 805, the adjustment to our preliminary estimates is reflected in the three and six months ended December 31, 2009 (See Note 13). The acquisition of Patriot was negotiated in July 2009 with the purchase agreement being signed on August 3, 2009. Between July 2009 and December 2, 2009, our valuation of certain of the investments acquired from Patriot increased due to market improvement, which resulted in the recognition of the gain at closing.





**Table of Contents****PROSPECT CAPITAL CORPORATION AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(In thousands, except share and per share data) (Continued)*****Preliminary Purchase Price Allocation***

The purchase price has been allocated to the assets acquired and the liabilities assumed based on their estimated fair values as summarized in the following table:

Cash (to repay Patriot debt)	\$ 107,313
Cash (to fund purchase of restricted stock from former Patriot employees)	970
Common stock issued(1)	92,800
 Total purchase price	 201,083
 Assets acquired:	
Investments(2)	207,126
Cash and cash equivalents	1,697
Other assets	3,859
 Assets acquired	 212,682
Other liabilities assumed	(3,891)
 Net assets acquired	 208,791
 Preliminary gain on Patriot acquisition(3)	 \$ 7,708

- (1) The value of the shares of common stock exchanged with the Patriot common shareholders was based upon the closing price of our common stock on December 2, 2009, the price immediately prior to the closing of the transaction.
- (2) The fair value of Patriot's investments were determined by the Board of Directors in conjunction with an independent valuation agent. This valuation resulted in a purchase price which was \$98,150 below the amortized cost of such investments. For those assets which are performing, Prospect will record the accretion to par value in interest income over the remaining term of the investment.
- (3) The preliminary gain has been determined based upon the estimated value of certain liabilities which are not yet settled. Any changes to such accruals will be recorded in future periods as an adjustment to such gain. We do not believe such adjustments will be material.

***Preliminary Condensed Statement of Net Assets Acquired***

The following condensed statement of net assets acquired reflects the preliminary values assigned to Patriot's net assets as of the acquisition date, December 2, 2009.

Investment securities	\$ 207,126
Cash and cash equivalents	1,697
Other assets	3,859
Total assets	212,682
Other liabilities	(3,891)
Preliminary fair value of net assets acquired	\$ 208,791

The following unaudited pro forma condensed combined financial information does not purport to be indicative of actual financial position or results of our operations had the Patriot acquisition actually been consummated at the beginning of each period presented. Certain one-time charges have been eliminated. The pro forma adjustments reflecting the allocation of the purchase price of Patriot and the gain of \$7,708 recognized on

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the Patriot Acquisition have been eliminated from all periods presented. Management expects to realize net operating synergies from this transaction. The pro forma condensed combined financial information does not reflect the potential impact of these synergies and does not reflect any impact of additional accretion which would have been recognized on the transaction, except for that which was recorded after the transaction was consummated on December 2, 2009.

	<b>Year Ended June 30,</b>	
	<b>2010</b>	<b>2009</b>
Total Investment Income	\$ 119,258	\$ 137,473
Net Investment Income	65,538	74,553
Net Increase (Decrease) in Net Assets Resulting from Operations	12,117	(7,302)
Net Increase (Decrease) in Net Assets Resulting from Operations per share	0.19	(0.14)

**Note 3. Significant Accounting Policies**

The following are significant accounting policies consistently applied by us:

***Basis of Presentation***

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ) and pursuant to the requirements for reporting on Form 10-K and Regulation S-X. The financial results of our portfolio investments are not consolidated in the financial statements.

***Use of Estimates***

The preparation of GAAP financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reported period. Changes in the economic environment, financial markets, creditworthiness of our portfolio companies and any other parameters used in determining these estimates could cause actual results to differ, and these differences could be material.

***Basis of Consolidation***

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

***Investment Classification***

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

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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(In thousands, except share and per share data) (Continued)**

a lesser degree of influence and are deemed to exist through the possession outright or via the right to acquire within 60 days or less, beneficial ownership of 5% or more of the outstanding voting securities of another person.

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

***Investment Risks***

The Company's investments are subject to a variety of risks. Those risks include the following:

***Market Risk***

Market risk represents the potential loss that can be caused by a change in the fair value of the financial instrument.

***Credit Risk***

Credit risk represents the risk that the Company would incur if the counterparties failed to perform pursuant to the terms of their agreements with the Company.

***Liquidity Risk***

Liquidity risk represents the possibility that the Company may not be able to rapidly adjust the size of its positions in times of high volatility and financial stress at a reasonable price.

***Interest Rate Risk***

Interest rate risk represents a change in interest rates, which could result in an adverse change in the fair value of an interest-bearing financial instrument.

***Prepayment Risk***

Most of the Company's debt investments allow for prepayment of principal without penalty. Downward changes in interest rates may cause prepayments to occur at a faster than expected rate, thereby effectively shortening the maturity of the security and making the security less likely to be an income producing instrument.

***Investment Valuation***

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

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

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

(1) Each portfolio company or investment is reviewed by our investment professionals with the independent valuation firm;

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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(In thousands, except share and per share data) (Continued)**

(2) the independent valuation firm engaged by our Board of Directors conducts independent appraisals and makes their own independent assessment;

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

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

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

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

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

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

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

*Level 3:* Unobservable inputs for the asset or liability.

In all cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to each investment. The changes to GAAP from the application of ASC 820 relate to the definition of fair value, framework for measuring fair value, and the expanded disclosures about fair value measurements. ASC 820 applies to fair value measurements already required or permitted by other standards. In accordance with ASC 820, the fair value of our investments is defined as the price that we would receive upon selling an investment in an orderly



transaction to an independent buyer in the principal or most advantageous market in which that investment is transacted.

In April 2009, the FASB issued ASC Subtopic 820-10-65, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* ( ASC 820-10-65 ). This update provides further clarification for ASC 820 in markets that are not active and provides additional guidance for determining when the volume of trading level of activity for an asset or liability has significantly decreased and for identifying circumstances that indicate a transaction is not orderly.

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**(In thousands, except share and per share data) (Continued)**

ASC 820-10-65 is effective for interim and annual reporting periods ending after June 15, 2009. The adoption of ASC 820-10-65 for the year ended June 30, 2010, did not have any effect on our net asset value, financial position or results of operations as there was no change to the fair value measurement principles set forth in ASC 820.

***Valuation of Other Financial Assets and Financial Liabilities***

In February 2007, FASB issued ASC Subtopic 820-10-05-1, *The Fair Value Option for Financial Assets and Financial Liabilities* ( ASC 820-10-05-1 ). ASC 820-10-05-1 permits an entity to elect fair value as the initial and subsequent measurement attribute for many of assets and liabilities for which the fair value option has been elected and similar assets and liabilities measured using another measurement attribute. We adopted this statement on July 1, 2008 and have elected not to value other assets and liabilities at fair value as would be permitted by ASC 820-10-05-1.

***Revenue Recognition***

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

Interest income, adjusted for amortization of premium and accretion of discount, is recorded on an accrual basis. Origination, closing and/or commitment fees associated with investments in portfolio companies are accreted into interest income over the respective terms of the applicable loans. Accretion of such purchase discounts or premiums is calculated by the effective interest method as of the purchase date and adjusted only for material amendments or prepayments. Upon the prepayment of a loan or debt security, any prepayment penalties and unamortized loan origination, closing and commitment fees are recorded as interest income. The purchase discount for portfolio investments acquired from Patriot was determined based on the difference between par value and fair market value as of December 2, 2009, and will continue to accrete until maturity or repayment of the respective loans.

Dividend income is recorded on the ex-dividend date.

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

Loans are placed on non-accrual status when principal or interest payments are past due 90 days or more or when there is reasonable doubt that principal or interest will be collected. Accrued interest is generally reversed when a loan is placed on non-accrual status. Interest payments received on non-accrual loans may be recognized as income or applied to principal depending upon management's judgment. Non-accrual loans are restored to accrual status when past due principal and interest is paid and in management's judgment, are likely to remain current.

***Federal and State Income Taxes***

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

relating to stockholder dividends and distributions and other permanent book and tax differences are reclassified to paid-in capital.

If we do not distribute (or are not deemed to have distributed) at least 98% of our annual taxable income in the calendar year it is earned, we will generally be required to pay an excise tax equal to 4% of the amount by which 98% of our annual taxable income exceeds the distributions from such taxable income for the year. To the extent that

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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(In thousands, except share and per share data) (Continued)**

we determine that our estimated current year annual taxable income will be in excess of estimated current year dividend distributions from such taxable income, we accrue excise taxes, if any, on estimated excess taxable income as taxable income is earned using an annual effective excise tax rate. The annual effective excise tax rate is determined by dividing the estimated annual excise tax by the estimated annual taxable income.

We adopted FASB ASC 740, *Income Taxes* ( ASC 740 ). ASC 740 provides guidance for how uncertain tax positions should be recognized, measured, presented, and disclosed in the financial statements. ASC 740 requires the evaluation of tax positions taken or expected to be taken in the course of preparing our tax returns to determine whether the tax positions are more-likely-than-not of being sustained by the applicable tax authority. Tax positions not deemed to meet the more-likely-than-not threshold are recorded as a tax benefit or expense in the current year. Adoption of ASC 740 was applied to all open tax years as of July 1, 2007. The adoption of ASC 740 did not have an effect on our net asset value, financial condition or results of operations as there was no liability for unrecognized tax benefits and no change to our beginning net asset value. As of June 30, 2010 and for the year then ended, we did not have a liability for any unrecognized tax benefits. Management's determinations regarding ASC 740 may be subject to review and adjustment at a later date based upon factors including, but not limited to, an on-going analysis of tax laws, regulations and interpretations thereof.

***Dividends and Distributions***

Dividends and distributions to common stockholders are recorded on the ex-dividend date. The amount, if any, to be paid as a dividend or distribution is approved by our Board of Directors each quarter and is generally based upon our management's estimate of our earnings for the quarter. Net realized capital gains, if any, are distributed at least annually.

***Financing Costs***

We record origination expenses related to our credit facility as deferred financing costs. These expenses are deferred and amortized as part of interest expense using the effective interest method over the stated life of the facility.

We record registration expenses related to shelf filings as prepaid assets. These expenses consist principally of Securities and Exchange Commission ( SEC ) registration fees, legal fees and accounting fees incurred. These prepaid assets will be charged to capital upon the receipt of an equity offering proceeds or charged to expense if no offering completed.

***Guarantees and Indemnification Agreements***

We follow FASB ASC 460, *Guarantees* ( ASC 460 ). ASC 460 elaborates on the disclosure requirements of a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also requires a guarantor to recognize, at the inception of a guarantee, for those guarantees that are covered by ASC 460, the fair value of the obligation undertaken in issuing certain guarantees. ASC 460 did not have a material effect on the financial statements. Refer to Note 11 for further discussion of guarantees and indemnification agreements.

***Per Share Information***

Net increase or decrease in net assets resulting from operations per common share are calculated using the weighted average number of common shares outstanding for the period presented. Diluted net increase or decrease in net assets resulting from operations per share are not presented as there are no potentially dilutive securities outstanding.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(In thousands, except share and per share data) (Continued)**

***Reclassifications***

Certain reclassifications have been made in the presentation of prior consolidated financial statements to conform to the presentation as of and for the twelve months ended June 30, 2010.

***Recent Accounting Pronouncements***

In May 2009, the FASB issued ASC 855, *Subsequent Events* ( ASC 855 ). ASC 855 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The standard, which includes a new required disclosure of the date through which an entity has evaluated subsequent events, is effective for interim or annual periods ending after June 15, 2009. We evaluated all events or transactions that occurred after June 30, 2010 up through the date we issued the accompanying financial statements. During this period, we did not have any material recognizable subsequent events other than those disclosed in our financial statements.

In June 2009, the FASB issued ASC 105, *Generally Accepted Accounting Principles* ( ASC 105 ), which establishes the FASB Codification which supersedes all existing accounting standard documents and will become the single source of authoritative non-governmental U.S. GAAP. All other accounting literature not included in the Codification will be considered non-authoritative. The Codification did not change GAAP but reorganizes the literature. ASC 105 is effective for interim and annual periods ending after September 15, 2009. We have conformed our financial statements and related Notes to the new Codification.

In June 2009, the FASB issued ASC 860, *Accounting for Transfers of Financial Assets – an amendment to FAS 140* ( ASC 860 ). ASC 860 improves the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets: the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets. ASC 860 is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Our management does not believe that the adoption of the amended guidance in ASC 860 will have a significant effect on our financial statements.

In June 2009, the FASB issued ASC 810, *Consolidation* ( ASC 810 ). ASC 810 is intended to (1) address the effects on certain provisions of FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities, as a result of the elimination of the qualifying special-purpose entity concept in ASC 860, and (2) constituent concerns about the application of certain key provisions of Interpretation 46(R), including those in which the accounting and disclosures under the Interpretation do not always provided timely and useful information about an enterprise's involvement in a variable interest entity. ASC 810 is effective as of the beginning of our first annual reporting period that begins after November 15, 2009. Our management does not believe that the adoption of the amended guidance in ASC 860 will have a significant effect on our financial statements.

In August 2009, the FASB issued Accounting Standards Update ( ASU ) 2009-05, *Measuring Liabilities at Fair Value, to amend FASB Accounting Standards Codification ASC 820, Fair Value Measurements and Disclosures* ( ASC 820 ), to clarify how entities should estimate the fair value of liabilities. ASC 820, as amended, includes clarifying guidance for circumstances in which a quoted price in an active market is not available, the effect of the existence of liability

transfer restrictions, and the effect of quoted prices for the identical liability, including when the identical liability is traded as an asset. We adopted ASU 2009-05 effective October 1, 2009. The amended guidance in ASC 820 does not have a significant effect on our financial statements for the year ended June 30, 2010.

In September 2009, the FASB issued ASU 2009-12, *Measuring Fair Value of Certain Investments* ( ASU 2009-12 ). This update provides further amendments to ASC 820 to offer investors a practical expedient for measuring the fair value of investments in certain entities that calculate net asset value per share. Specifically, measurement using net asset value per share is reasonable for investments within the scope of ASU 2009-12. We

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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY**

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**(In thousands, except share and per share data) (Continued)**

adopted ASU 2009-12 effective October 1, 2009. The amended guidance in ASC 820 does not have a significant effect on our financial statements for the year ended June 30, 2010.

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

In February 2010, the FASB issued Accounting Standards Update 2010-09, *Subsequent Events (Topic 855) Amendments to Certain Recognition and Disclosure Requirements* ( ASU 2010-09 ), which amends ASC Subtopic 855-10. ASU 2010-09 requires an entity that is an SEC filer to evaluate subsequent events through the date that the financial statements are issued and removes the requirement that an SEC filer disclose the date through which subsequent events have been evaluated. ASC 2010-09 was effective upon issuance. The adoption of this standard had no effect on our results of operation or our financial position.

In February 2010, the FASB issued Accounting Standards Update 2010-10, *Consolidation (Topic 810) Amendments for Certain Investments Funds* ( ASU 2010-10 ), which defers the application of the consolidation guidance in ASC 810 for certain investments funds. The disclosure requirements continue to apply to all entities. ASU 2010-10 is effective as of the beginning of the first annual period that begins after November 15, 2009 and for interim periods within that first annual period. Our management does not believe that the adoption of the amended guidance in ASU 2010-10 will have a significant effect on our financial statements.

In August 2010, the FASB issued Accounting Standards Update 2010-21, *Accounting for Technical Amendments to Various SEC Rules and Schedules* ( ASU 2010-21 ). This Accounting Standards Update various SEC paragraphs pursuant to the issuance of Release No. 33-9026: Technical Amendments to Rules, Forms, Schedules and Codification of Financial Reporting Policies. We are assessing the potential effect this guidance will have on our consolidated financial statements.

In August 2010, the FASB issued Accounting Standards Update 2010-22, *Accounting for Various Topics - Technical Corrections to SEC Paragraphs* ( ASU 2010-22 ). ASU 2010-22 amends various SEC paragraphs based on external comments received and the issuance of Staff Accounting Bulletin ( SAB ) 112, which amends or rescinds portions of certain SAB topics. We are assessing the potential effect this guidance will have on our consolidated financial statements.

**Note 4. Portfolio Investments**

At June 30, 2010, we had invested in 58 long-term portfolio investments, which had an amortized cost of \$728,759 and a fair value of \$748,483 and at June 30, 2009, we had invested in 30 long-term portfolio investments, which had an amortized cost of \$531,424 and a fair value of \$547,168.



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As of June 30, 2010, we own controlling interests in Ajax Rolled Ring & Machine ( Ajax ), AWCNC, LLC, Borga, Inc. ( Borga ), C&J Cladding, LLC, Change Clean Energy Holdings, Inc. ( CCEHI ), Fischbein, LLC, Freedom Marine Services LLC, Gas Solutions Holdings, Inc. ( GSHI ), Integrated

Contract Services, Inc. ( ICS ), Iron Horse Coiled Tubing, Inc. ( Iron Horse ), Manx Energy, Inc. ( Manx ), NRG Manufacturing, Inc., Nupla Corporation ( Nupla ), R-V Industries, Inc., Sidump r Trailer Company, Inc.

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( Sidump r ) and Yatesville Coal Holdings, Inc. ( Yatesville ). We also own an affiliated interest in Biotronic NeuroNetwork, Boxercraft Incorporated, KTPS Holdings, LLC, Smart, LLC, and Sport Helmets Holdings, LLC.

The fair values of our portfolio investments as of June 30, 2010 disaggregated into the three levels of the ASC 820 valuation hierarchy are as follows:

	<b>Fair Value Hierarchy</b>			<b>Total</b>
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	
<b>Investments at fair value</b>				
Control investments	\$	\$	\$ 195,958	\$ 195,958
Affiliate investments			73,740	73,740
Non-control/non-affiliate investments	1,368		477,417	478,785
	1,368		747,115	748,483
Investments in money market funds		68,871		68,871
Total assets reported at fair value	\$ 1,368	\$ 68,871	\$ 747,115	\$ 817,354

The fair values of our portfolio investments as of June 30, 2009 disaggregated into the three levels of the ASC 820 valuation hierarchy are as follows:

	<b>Fair Value Hierarchy</b>			<b>Total</b>
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	
<b>Investments at fair value</b>				
Control investments	\$	\$	\$ 206,332	\$ 206,332
Affiliate investments			32,254	32,254
Non-control/non-affiliate investments			308,582	308,582
			547,168	547,168
Investments in money market funds		98,735		98,735
Total assets reported at fair value	\$	\$ 98,735	\$ 547,168	\$ 645,903

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The aggregate values of Level 3 portfolio investments changed during the twelve months ended June 30, 2010 as follows:

	Fair Value Measurements Using Unobservable Inputs (Level 3)			Total
	Control Investments	Affiliate Investments	Non-Control/ Non-Affiliate Investments	
Fair value as of June 30, 2009	\$ 206,332	\$ 32,254	\$ 308,582	\$ 547,168
Total realized losses	(51,228)			(51,228)
Change in unrealized (depreciation) appreciation	(8,403)	9,948	4,085	5,630(1)
Net realized and unrealized (loss) gain	(59,631)	9,948	4,085	(45,598)
Assets acquired in the Patriot acquisition	10,534	36,400	160,073	207,007
Purchases of portfolio investments	16,240	2,800	126,788	145,828
Payment-in-kind interest	2,871	775	3,905	7,551
Accretion of original issue discount	3,535	1,475	15,303	20,313
Dispositions of portfolio investments	(9,396)	(4,884)	(120,874)	(135,154)
Transfers within Level 3	25,473	(5,028)	(20,445)	
Transfers in (out) of Level 3				
Fair value as of June 30, 2010	\$ 195,958	\$ 73,740	\$ 477,417	\$ 747,115

(1) Relates to assets held at June 30, 2010

During the year ended June 30, 2010, the valuation methodology for Ajax changed from a discounted cash flow analysis to an enterprise and equity valuation. The independent valuation agent proposed this adjustment due to our controlling equity interest in Ajax. As a result, and combined with declining financial results, the fair market value of Ajax decreased from \$31,638 to \$30,904 as of June 30, 2009 and June 30, 2010, respectively. There were no other material changes to our valuation methodology.

At June 30, 2010, nine loan investments were on non-accrual status: Borga, Deb Shops, Inc., ICS, Iron Horse, Nupla, Manx, Sidump r, Wind River Resources Corp. and Wind River II Corp. ( Wind River ), and Yatesville. At June 30, 2009, five loan investments were on non-accrual status: Appalachian Energy Holdings, LLC ( AEH ), Coalbed LLC./Coalbed Inc. ( Coalbed ), ICS, Wind River and Yatesville. The loan principal of these loans amounted to \$163,653 and \$92,513 as of June 30, 2010 and June 30, 2009, respectively. The fair values of these investments represent approximately 5.6% and 7.3% of our net assets as of June 30, 2010 and June 30, 2009, respectively. For the years ended June 30, 2010, June 30, 2009 and June 30, 2008, the income foregone as a result of not accruing interest on non-accrual debt investments amounted to \$19,764, \$18,746 and \$3,449, respectively.

During the quarter ended December 31, 2009, we discontinued operations at Yatesville. At December 31, 2009, consistent with the decision to discontinue operations, we determined that the impairment of Yatesville was other-than-temporary and recorded a realized loss of \$51,228 for the amount that the amortized cost exceeded the fair market value. As of June 30, 2010 and June 30, 2009, Yatesville is valued at \$808 and \$13,097, respectively. At June 30, 2009, we determined that one of our investments, CCEHI was other than temporarily impaired and recorded a realized loss representing the amount by which the amortized cost exceeded the fair value.

GSHI has indemnified us against any legal action arising from its investment in Gas Solutions, LP. We have incurred approximately \$2,093 from the inception of the investment in GSHI through June 30, 2010 for fees associated with a legal action, and GSHI has reimbursed us for the entire amount. Of the \$2,093 reimbursement, \$179 and \$118 was reflected as dividend income: control investments in the Consolidated Statements of Operations

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for the years ended June 30, 2009 and June 30, 2008, respectively. There were no such legal fees incurred or reimbursed for the year ended June 30, 2010. Additionally, certain other expenses incurred by us which are attributable to GSHI have been reimbursed by GSHI and are reflected as dividend income: control investments in the Consolidated Statements of Operations. For the years ended June 30, 2010, June 30, 2009 and June 30, 2008, such reimbursements totaled as \$3,103, \$4,422 and \$4,589, respectively.

The original cost basis of debt placements and equity securities acquired, including follow-on investments for existing portfolio companies, totaled \$157,662, \$98,305 and \$311,947 during the year ended June 30, 2010, June 30, 2009 and June 30, 2008, respectively. Debt repayments and sales of equity securities with a cost basis of approximately \$136,221, \$66,084 and \$143,434 were received during the year ended June 30, 2010, June 30, 2009 and June 30, 2008, respectively.

During the year ended June 30, 2010, we restructured our loans to Aircraft Fasteners International, LLC, EXL Acquisition Corporation, LHC Holdings Corp., Prince Mineral Company, Inc. and R-O-M Corporation. The revised terms were more favorable than the original terms and increased the present value of the future cash flows. In accordance with ASC 320-20-35 the cost basis of the new loans were recorded at par value, which included \$8,099 of accelerated original purchase discount recognized as interest income.

**Note 5. Other Investment Income**

Other investment income consists of structuring fees, overriding royalty interests, prepayment penalty on net profits interests, settlement of net profits interests, deal deposits, administrative agent fee, and other miscellaneous and sundry cash receipts. Income from such sources was \$11,751, \$14,762 and \$8,336 for the years ended June 30, 2010, June 30, 2009 and June 30, 2008, respectively.

<b>Income Source</b>	<b>For the Year Ended</b>		
	<b>June 30, 2010</b>	<b>June 30, 2009</b>	<b>June 30, 2008</b>
Gain on Patriot acquisition (Note 2)	\$ 7,708	\$	\$
Structuring and amendment fees	3,338	1,274	4,751
Overriding royalty interests	194	550	1,819
Prepayment penalty on net profits interests			1,659
Settlement of net profits interests		12,651	
Deal deposit		62	49
Administrative agent fee	100	55	48
Miscellaneous	411	170	10
Other Investment Income	\$ 11,751	\$ 14,762	\$ 8,336

**Note 6. Equity Offerings, Offering Expenses, and Distributions**

During the year ended June 30, 2010, we issued 16,683,197 shares of our common stock through public offerings, a registered direct offering, and through the exercise of over-allotment options on the part of the underwriters. Offering expenses were charged against paid-in capital in excess of par. All underwriting fees and

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offering expenses were borne by us. The proceeds raised, the related underwriting fees, the offering expenses, and the prices at which common stocks were issued since inception are detailed in the following table:

<b>Issuances of Common Stock</b>	<b>Number of Shares Issued</b>	<b>Gross Proceeds Raised</b>	<b>Underwriting Fees</b>	<b>Offering Expenses</b>	<b>Offering Price</b>
March 23, 2010 June 30, 2010(1)	5,251,400	\$ 60,378	\$ 1,210	\$ 624	\$ 11.50
September 24, 2009(2)	2,807,111	\$ 25,264	\$	\$ 840	\$ 9.000
August 20, 2009(2)	3,449,686	\$ 29,322	\$	\$ 117	\$ 8.500
July 7, 2009	5,175,000	\$ 46,575	\$ 2,329	\$ 200	\$ 9.000
May 26, 2009 over-allotment	1,012,500	\$ 8,353	\$ 418	\$	\$ 8.250
May 26, 2009	6,750,000	55,687	2,784	300	8.250
April 27, 2009 over-allotment	480,000	\$ 3,720	\$ 177	\$	\$ 7.750
April 27, 2009	3,200,000	24,800	1,177	210	7.750
March 19, 2009	1,500,000	\$ 12,300	\$	\$ 513	\$ 8.200
June 2, 2008	3,250,000	\$ 48,425	\$ 2,406	\$ 254	\$ 14.900
March 31, 2008	1,150,000	\$ 17,768	\$ 759	\$ 350	\$ 15.450
March 28, 2008	1,300,000	19,786		350	15.220
November 13, 2007 over-allotment	200,000	\$ 3,268	\$ 163	\$	\$ 16.340
October 17, 2007	3,500,000	57,190	2,860	551	16.340
January 11, 2007 over-allotment	810,000	\$ 14,026	\$ 688	\$	\$ 17.315(3)
December 13, 2006	6,000,000	106,200	5,100	279	17.700
August 28, 2006 over-allotment	745,650	\$ 11,408	\$ 566	\$	\$ 15.300
August 10, 2006	4,971,000	76,056	3,778	595	15.300
August 27, 2004 over-allotment	55,000	\$ 825	\$ 58	\$ 2	\$ 15.000
July 27, 2004	7,000,000	105,000	7,350	1,385	15.000

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

(2) Concurrent with the sale of these shares, we entered into a registration rights agreement in which we granted the purchasers certain registration rights with respect to the shares. We have filed with the SEC a post-effective amendment to the registration statement on Form N-2 which has been declared effective by the SEC.

(3) We declared a dividend of \$0.385 per share between offering and over allotment dates.

Our shareholders' equity accounts at June 30, 2010 and June 30, 2009 reflect cumulative shares issued as of those respective dates. Our common stock has been issued through public offerings, a registered direct offering, the exercise of over-allotment options on the part of the underwriters and our dividend reinvestment plan. When our common

stock is issued, the related offering expenses have been charged against paid-in capital in excess of par. All underwriting fees and offering expenses were borne by us.

On October 9, 2008, our Board of Directors approved a share repurchase plan under which we may repurchase up to \$20,000 of our common stock at prices below our net asset value as reported in our financial statements published for the year ended June 30, 2008. We have not made any purchases of our common stock during the period from October 9, 2008 to June 30, 2010 pursuant to this plan.

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On June 18, 2010, we announced a change in dividend policy from quarterly to monthly dividends and declared monthly dividends in the following amounts and with the following dates:

\$0.10 per share for June 2010 to holders of record on June 30, 2010 with a payment date of July 30, 2010;

\$0.10025 per share for July 2010 to holders of record on July 30, 2010 with a payment date of August 31, 2010; and

\$0.10050 per share for August 2010 to holders of record on August 31, 2010 with a payment date of September 30, 2010.

**Note 7. Net Increase in Net Assets per Common Share**

The following information sets forth the computation of net increase in net assets resulting from operations per common share for the years ended June 30, 2010, 2009 and 2008, respectively.

	<b>For the Year Ended</b>		
	<b>June 30, 2010</b>	<b>June 30, 2009</b>	<b>June 30, 2008</b>
Net increase in net assets resulting from operations	\$ 18,886	\$ 35,104	\$ 27,591
Weighted average common shares outstanding	59,429,222	31,559,905	23,626,642
Net increase in net assets resulting from operations per common share	\$ 0.32	\$ 1.11	\$ 1.17

**Note 8. Related Party Agreements and Transactions*****Investment Advisory Agreement***

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

Prospect Capital Management's services under the Investment Advisory Agreement are not exclusive, and it is free to furnish similar services to other entities so long as its services to us are not impaired. For providing these services the Investment Adviser receives a fee from us, consisting of two components: a base management fee and an incentive fee. The base management fee is calculated at an annual rate of 2.00% on our gross assets (including amounts

borrowed). For services currently rendered under the Investment Advisory Agreement, the base management fee is payable quarterly in arrears. The base management fee is calculated based on the average value of our gross assets at the end of the two most recently completed calendar quarters and appropriately adjusted for any share issuances or repurchases during the current calendar quarter.

The total base management fees earned by and paid to Prospect Capital Management for the years ended June 30, 2010, June 30, 2009 and June 30, 2008 were \$13,929, \$11,915 and \$8,921, respectively.

The incentive fee has two parts. The first part, the income incentive fee, is calculated and payable quarterly in arrears based on our pre-incentive fee net investment income for the immediately preceding calendar quarter. For this purpose, pre-incentive fee net investment income means interest income, dividend income and any other income (including any other fees (other than fees for providing managerial assistance), such as commitment, origination, structuring, diligence and consulting fees and other fees that we receive from portfolio companies)

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accrued during the calendar quarter, minus our operating expenses for the quarter (including the base management fee, expenses payable under the Administration Agreement described below, and any interest expense and dividends paid on any issued and outstanding preferred stock, but excluding the incentive fee). Pre-incentive fee net investment income includes, in the case of investments with a deferred interest feature (such as original issue discount, debt instruments with payment in kind interest and zero coupon securities), accrued income that we have not yet received in cash. Pre-incentive fee net investment income does not include any realized capital gains, realized capital losses or unrealized capital appreciation or depreciation. Pre-incentive fee net investment income, expressed as a rate of return on the value of our net assets at the end of the immediately preceding calendar quarter, is compared to a hurdle rate of 1.75% per quarter (7.00% annualized).

The net investment income used to calculate this part of the incentive fee is also included in the amount of the gross assets used to calculate the 2.00% base management fee. We pay the Investment Adviser an income incentive fee with respect to our pre-incentive fee net investment income in each calendar quarter as follows:

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

100.00% of our pre-incentive fee net investment income with respect to that portion of such pre-incentive fee net investment income, if any, that exceeds the hurdle rate but is less than 125.00% of the quarterly hurdle rate in any calendar quarter (8.75% annualized assuming a 7.00% annualized hurdle rate); and

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

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

The second part of the incentive fee, the capital gains incentive fee, is determined and payable in arrears as of the end of each calendar year (or upon termination of the Investment Advisory Agreement, as of the termination date), and equals 20.00% of our realized capital gains for the calendar year, if any, computed net of all realized capital losses and unrealized capital depreciation at the end of such year. In determining the capital gains incentive fee payable to the Investment Adviser, we calculate the aggregate realized capital gains, aggregate realized capital losses and aggregate unrealized capital depreciation, as applicable, with respect to each investment that has been in its portfolio. For the purpose of this calculation, an investment is defined as the total of all rights and claims which may be asserted against a portfolio company arising from our participation in the debt, equity, and other financial instruments issued by that company. Aggregate realized capital gains, if any, equal the sum of the differences between the aggregate net sales price of each investment and the aggregate cost basis of such investment when sold or otherwise disposed. Aggregate realized capital losses equal the sum of the amounts by which the aggregate net sales price of each investment is less than the aggregate cost basis of such investment when sold or otherwise disposed. Aggregate unrealized capital depreciation equals the sum of the differences, if negative, between the aggregate valuation of each investment and the aggregate cost basis of such investment as of the applicable calendar year-end. At the end of the applicable calendar year, the amount of capital gains that serves as the basis for our calculation of the capital gains incentive fee involves netting aggregate realized capital gains against aggregate realized capital losses on a since-inception basis and then reducing this amount by the aggregate unrealized capital depreciation. If this number is positive, then the capital gains

incentive fee payable is equal to 20.00% of such amount, less the aggregate amount of any capital gains incentive fees paid since inception.

Income incentive fees totaling \$16,613, \$14,790 and \$11,278 were earned for the years ended June 30, 2010, June 30, 2009 and June 30, 2008, respectively. No capital gains incentive fees were earned for years ended June 30, 2010, June 30, 2009 and June 30, 2008.

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***Administration Agreement***

We have also entered into an Administration Agreement with Prospect Administration, LLC ( Prospect Administration ) under which Prospect Administration, among other things, provides (or arranges for the provision of) administrative services and facilities for us. For providing these services, we reimburse Prospect Administration for our allocable portion of overhead incurred by Prospect Administration in performing its obligations under the Administration Agreement, including rent and our allocable portion of the costs of our chief compliance officer and chief financial officer and their respective staffs. For the years ended June 30, 2010, 2009 and 2008, the reimbursement was approximately \$3,361, \$2,856 and \$2.139, respectively. Under this agreement, Prospect Administration furnishes us with office facilities, equipment and clerical, bookkeeping and record keeping services at such facilities. Prospect Administration also performs, or oversees the performance of, our required administrative services, which include, among other things, being responsible for the financial records that we are required to maintain and preparing reports to our stockholders and reports filed with the SEC. In addition, Prospect Administration assists us in determining and publishing our net asset value, overseeing the preparation and filing of our tax returns and the printing and dissemination of reports to our stockholders, and generally oversees the payment of our expenses and the performance of administrative and professional services rendered to us by others. Under the Administration Agreement, Prospect Administration also provides on our behalf managerial assistance to those portfolio companies to which we are required to provide such assistance. The Administration Agreement may be terminated by either party without penalty upon 60 days written notice to the other party. Prospect Administration is a wholly owned subsidiary of our Investment Adviser.

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

Prior to July 1, 2009, Prospect Administration, pursuant to the approval of our Board of Directors, engaged Vastardis Fund Services LLC ( Vastardis ) to serve as our sub-administrator to perform certain services required of Prospect Administration. Under the sub-administration agreement, Vastardis provided us with office facilities, equipment, clerical, bookkeeping and record keeping services at such facilities. Vastardis also conducted relations with custodians, depositories, transfer agents, dividend disbursing agents, other stockholder servicing agents, accountants, attorneys, underwriters, brokers and dealers, corporate fiduciaries, insurers, banks and such other persons in any such other capacity deemed to be necessary or desirable. Vastardis provided reports to the Administrator and the Directors of its performance of obligations and furnished advice and recommendations with respect to such other aspects of our business and affairs as it shall determine to be desirable. Under the sub-administration agreement, Vastardis also provided the service of William E. Vastardis as our Chief Financial Officer ( CFO ). We compensated Vastardis for providing us these services by the payment of an asset-based fee with a \$400 annual minimum, payable monthly. Our service agreement was amended on September 28, 2008 so that Mr. Vastardis no longer served as our CFO effective as of November 11, 2008. At that time, Brian H. Oswald, a managing director at Prospect Administration, assumed the role of CFO.

We terminated our agreement with Vastardis to provide sub-administration services effective June 30, 2009. We entered into a new consulting services agreement for the period from July 1, 2009 until the filing of our Form 10-K for the year ended June 30, 2009. We paid Vastardis a total of \$30 for services rendered in conjunction with preparation of Form 10-K under the new agreement. This amount was accrued during the quarter ended June 30, 2009. All services previously provided by Vastardis were assumed by Prospect Administration beginning on July 1, 2009 for the fiscal year ending June 30, 2010 and thereafter.

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**Table of Contents****PROSPECT CAPITAL CORPORATION AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(In thousands, except share and per share data) (Continued)****Managerial Assistance**

As a business development company, we offer, and must provide upon request, managerial assistance to certain of our portfolio companies. This assistance could involve, among other things, monitoring the operations of our portfolio companies, participating in board and management meetings, consulting with and advising officers of portfolio companies and providing other organizational and financial guidance. We billed \$892, \$846, and \$1,027 of managerial assistance fees for the years ended June 30, 2010, June 30, 2009, and June 30, 2008, respectively, of which \$247 and \$60 remains on the consolidated statement of assets and liabilities as of June 30, 2010, and June 30, 2009, respectively. These fees are paid to the Administrator so we simultaneously accrue a payable to the Administrator for the same amounts, which remain on the consolidated statements of assets and liabilities.

**Note 9. Financial Highlights**

	<b>Year Ended June 30, 2010</b>	<b>Year Ended June 30, 2009</b>	<b>Year Ended June 30, 2008</b>	<b>Year Ended June 30, 2007</b>	<b>Year Ended June 30, 2006</b>
<b>Per Share Data(1):</b>					
Net asset value at beginning of period	\$ 12.40	\$ 14.55	\$ 15.04	\$ 15.31	\$ 14.59
Costs related to the initial public offering					0.01
Costs related to the secondary public offering			(0.07)	(0.06)	
Net investment income	1.12	1.87	1.91	1.47	1.21
Realized (loss) gain	(0.87)	(1.24)	(0.69)	0.12	0.04
Net unrealized appreciation (depreciation)	0.07	0.48	(0.05)	(0.52)	0.58
Net (decrease) increase in net assets as a result of public offering	(0.85)	(2.11)		0.26	
Net increase in net assets as a result of shares issued for Patriot acquisition	0.12				
Dividends declared and paid	(1.70)	(1.15)	(1.59)	(1.54)	(1.12)

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Net asset value at end of period	\$	10.29	\$	12.40	\$	14.55	\$	15.04	\$	15.31
Per share market value at end of period	\$	9.65	\$	9.20	\$	13.18	\$	17.47	\$	16.99
Total return based on market value(2)		21.96%		(22.04)%		(15.90)%		12.65%		44.90%
Total return based on net asset value(2)		(3.51)%		(4.81)%		7.84%		7.62%		12.76%
Shares outstanding at end of period		69,086,862		42,943,084		29,520,379		19,949,065		7,069,873
Average weighted shares outstanding for period		59,429,222		31,559,905		23,626,642		15,724,095		7,056,846
<b>Ratio / Supplemental Data:</b>										
Net assets at end of period (in thousands)	\$	710,685	\$	532,596	\$	429,623	\$	300,048	\$	108,270
Annualized ratio of operating expenses to average net assets		7.51%		9.03%		9.62%		7.36%		8.19%
Annualized ratio of net investment income to average net assets		10.58%		13.14%		12.66%		9.71%		7.90%

(1) Financial highlights are based on weighted average shares.

(2) 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 our



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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(In thousands, except share and per share data) (Continued)**

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 our dividend reinvestment plan.

**Note 10. Litigation**

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

On December 6, 2004, Dallas Gas Partners, L.P. ( DGP ) served us with a complaint filed November 30, 2004 in the U.S. District for the Southern District of Texas, Galveston Division. DGP alleges that DGP was defrauded and that we breached our fiduciary duty to DGP and tortiously interfered with DGP s contract to purchase Gas Solutions, Ltd. (a subsidiary of our portfolio company, GSHI) in connection with our alleged agreement in September 2004 to loan DGP funds with which DGP intended to buy Gas Solutions, Ltd. for approximately \$26,000. The complaint sought relief not limited to \$100,000. On November 30, 2005, U.S. Magistrate Judge John R. Froeschner of the U.S. District Court for the Southern District of Texas, Galveston Division, issued a recommendation that the court grant our Motion for Summary Judgment dismissing all claims by DGP. On February 21, 2006, U.S. District Judge Samuel Kent of the U.S. District Court for the Southern District of Texas, Galveston Division issued an order granting our Motion for Summary Judgment dismissing all claims by DGP, against us. On May 16, 2007, the Court also granted us summary judgment on DGP s liability to us on our counterclaim for DGP s breach of a release and covenant not to sue. On January 4, 2008, the Court, Judge Melinda Harmon presiding, granted our motion to dismiss all DGP s claims asserted against certain of our officers and affiliates. On August 20, 2008, Judge Harmon entered a Final Judgment dismissing all of DGP s claims. DGP appealed to the U.S. Court of Appeals for the Fifth Circuit, which affirmed the Final Judgment on June 24, 2009. DGP then moved for rehearing on July 8, 2009, which the Fifth Circuit denied on August 6, 2009. Our damage claims against DGP remain pending.

In May 2006, based in part on unfavorable due diligence and the absence of investment committee approval, we declined to extend a loan for \$10,000 to a potential borrower ( plaintiff ). Plaintiff was subsequently sued by its own attorney in a local Texas court for plaintiff s failure to pay fees owed to its attorney. In December 2006, plaintiff filed a cross-action against us and certain affiliates (the defendants ) in the same local Texas court, alleging, among other things, tortious interference with contract and fraud. We petitioned the United States District Court for the Southern District of New York (the District Court ) to compel arbitration and to enjoin the Texas action. In February 2007, our motions were granted. Plaintiff appealed that decision. On July 24, 2008, the Second Circuit Court of Appeals affirmed the judgment of the District Court. The arbitration commenced in July 2007 and concluded in late November 2007. Post-hearing briefings were completed in February 2008. On April 14, 2008, the arbitrator rendered an award in our favor, rejecting all of plaintiff s claims. On April 18, 2008, we filed a petition before the District Court to confirm the award. On October 8, 2008, the District Court granted the Company s petition to confirm the award, confirmed the awards and subsequently entered judgment thereon in favor of the Company in the amount of \$2,288. After filing a defective notice of appeal to the United States Court of Appeals for the Second Circuit on November 5, 2008, plaintiff s counsel resubmitted a new notice of appeal on January 9, 2009. The plaintiff subsequently requested that the Company agree to stipulate to the withdrawal of plaintiff s appeal to the Second Circuit. Such a stipulation was filed with the Second Circuit on or about April 14, 2009. Based on this stipulation, the Second Circuit issued a mandate

terminating the appeal, which was transmitted to the District Court on April 23, 2009. Post-judgment discovery against plaintiff is continuing and we have filed a motion for sanctions against plaintiff's counsel. Argument for the motion for sanctions was held on November 19, 2009 and a decision from the court is pending. On March 9, 2010, Judge Leonard Sands granted our motion for sanctions against

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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(In thousands, except share and per share data) (Continued)**

plaintiff's counsel. On July 14, 2010, Arnold & Itkin filed a notice of appeal appealing the judgment and the Court's March 9, 2010 Memorandum and Order.

**Note 11. Revolving Credit Agreements**

On June 6, 2007, we closed on a \$200,000 three-year revolving credit facility (as amended on December 31, 2007) with Rabobank Nederland (Rabobank) as administrative agent and sole lead arranger (the Rabobank Facility). Until November 14, 2008, interest on the Rabobank Facility was charged at LIBOR plus 175 basis points; thereafter, under the terms of a commitment letter with Rabobank to arrange and structure a new rated credit facility, we agreed to an immediate increase in the current borrowing rate on the Rabobank Facility to LIBOR plus 250 basis points. Additionally, Rabobank charged a fee on the unused portion of the facility. This fee is assessed at the rate of 37.5 basis points per annum of the amount of that unused portion.

On June 25, 2009, we completed a first closing on an expanded \$250,000 revolving credit facility (the Syndicated Facility). The new Syndicated Facility, which had \$175,000 total commitments as of June 30, 2009, includes an accordion feature which allows the Syndicated Facility to accept up to an aggregate total of \$250,000 of commitments for which we continue to solicit additional commitments from other lenders for the additional \$75,000. The revolving period extends through June 24, 2010, with an additional one year amortization period thereafter whereby all principal, interest and fee payments received in conjunction with collateral pledged to the Syndicated Facility, less a monthly servicing fee payable to us, are required to be used to repay outstanding borrowings under the Syndicated Facility. Any remaining outstanding borrowings would be due and payable on the commitment termination date, which is currently June 24, 2011.

On June 11, 2010, we closed an extension and expansion of our revolving credit facility with a syndicate of lenders. The lenders have commitments of \$210 million under the new credit facility as of June 11, 2010. The new credit facility includes an accordion feature which allows the facility to be increased to up to \$300 million of commitments in the aggregate to the extent additional or existing lenders commit to increase the commitments. We will seek to add additional lenders in order to reach the maximum size; although no assurance can be given we will be able to do so. As we make additional investments which are eligible to be pledged under the credit facility, we will generate additional availability to the extent such investments are eligible to be placed into the borrowing base. The revolving period of the credit facility extends through June 2012, with an additional one year amortization period (with distributions allowed) after the completion of the revolving period. During such one year amortization period, all principal payments on the pledged assets will be applied to reduce the balance. At the end of the one year amortization period, the remaining balance will become due if required by the lenders.

The Syndicated Facility contains restrictions pertaining to the geographic and industry concentrations of funded loans, maximum size of funded loans, interest rate payment frequency of funded loans, maturity dates of funded loans and minimum equity requirements. The Syndicated Facility also contains certain requirements relating to portfolio performance, including required minimum portfolio yield and limitations on delinquencies and charge-offs, violation of which could result in the early termination of the Syndicated Facility. The Syndicated Facility also requires the maintenance of a minimum liquidity requirement. At June 30, 2010, we were in compliance with the applicable covenants.

Interest on borrowings under the credit facility is one-month LIBOR plus 325 basis points, subject to a minimum Libor floor of 100 basis points. Additionally, the lenders charge a fee on the unused portion of the credit facility equal to either 75 basis points if at least half of the credit facility is used or 100 basis points otherwise. As of June 30, 2010 and 2009, we had \$180,678 and \$125,746 available to us for borrowing under our credit facility, of which \$100,300 and \$124,800 was outstanding, respectively. As we make additional investments which are eligible to be pledged under the credit facility, we will generate additional availability to the extent such investments are eligible to be placed into the borrowing base. At June 30, 2010, the investments used as collateral for the Syndicated Facility had an aggregate market value of \$512,244, which represents 72.1% of net assets.

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In connection with the origination and amendment of the Syndicated Facility, we incurred approximately \$7,580 of fees, including \$3,224 of fees carried over from the previous facility, which are being amortized over the term of the facility, and wrote off \$759 of the unamortized debt issue costs associated with the original credit facility, in accordance with ASC 470-50, *Debt Modifications and Extinguishments*.

**Note 12. Merger Proposal to Allied Capital Corporation**

In January 2010, we delivered a proposal letter to Allied Capital Corporation (Allied) noting our opposition to Allied's proposed merger with Ares Capital Corporation (Ares) and containing an offer to acquire each outstanding Allied share in exchange for 0.385 of a share of our common stock. Allied expressed that our offer did not constitute a

Superior Proposal as defined in their Merger Agreement with Ares and declined our January 2010 offer. In February 2010, we increased our offer to 0.4416 of a share of our common stock. This final offer was also declined by Allied. On March 5, 2010, following Allied's announcement of a special dividend to shareholders, we terminated our solicitation in opposition of the proposed merger with Ares. We incurred \$852 of administrative and legal expense for advice relating to this potential acquisition for the year ended June 30, 2010.

**Note 13. Selected Quarterly Financial Data (Unaudited)**

Quarter Ended	Investment Income		Net Investment Income		Net Realized and Unrealized Gains (Losses)		Net Increase (Decrease) in Net Assets from Operations	
	Total	Per Share(1)	Total	Per Share(1)	Total	Per Share(1)	Total	Per Share(1)
September 30, 2007	15,391	0.77	7,865	0.39	685	0.04	8,550	0.43
December 31, 2007	18,563	0.80	10,660	0.46	(14,346)	(0.62)	(3,686)	(0.16)
March 31, 2008	22,000	0.92	12,919	0.54	(14,178)	(0.59)	(1,259)	(0.05)
June 30, 2008	23,448	0.85	13,669	0.50	10,317	0.38	23,986	0.88
September 30, 2008(2)	35,799	1.21	23,502	0.80	(9,504)	(0.33)	13,998	0.47
December 31, 2008	22,213	0.75	11,960	0.40	(5,436)	(0.18)	6,524	0.22
March 31, 2009	20,669	0.69	11,720	0.39	3,611	0.12	15,331	0.51
June 30, 2009	21,800	0.59	11,981	0.32	(12,730)	(0.34)	(749)	(0.02)
September 30, 2009	21,517	0.43	12,318	0.25	(18,696)	(0.38)	(6,378)	(0.13)
December 31, 2009(3)	30,877	0.54	18,519	0.32	(33,778)	(0.59)	(15,259)	(0.26)
March 31, 2010	32,005	0.50	18,974	0.30	6,966	0.11	25,940	0.41
June 30, 2010	29,236	0.44	16,640	0.25	(2,057)	(0.03)	14,583	0.22

(1) Per share amounts are calculated using weighted average shares during period.

(2) Additional income for this quarter was driven by other investment income from the settlement of net profits interests on IEC Systems LP and Advanced Rig Services LLC for \$12,576. See Note 5.

(3) As adjusted for increase in earnings from Patriot. See Note 2.

**Note 14. Subsequent Events**

On July 14, 2010, we closed a \$37,400 first lien senior secured credit facility to support the acquisition by H.I.G. Capital of a leading consumer credit enhancement services company.

On July 23, 2010, we made a secured debt investment of \$21,000 in SonicWALL, Inc., a global leader in network security and data protection for small, mid-sized, and large enterprise organizations.

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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(In thousands, except share and per share data) (Continued)**

On July 30, 2010, we issued 83,875 shares of our common stock in connection with the dividend reinvestment plan.

On July 30, 2010, we invested \$52,420 of combined debt and equity in AIRMALL USA Inc., a leading developer and manager of airport retail operations.

On July 30, 2010, we recapitalized our debt investment in Northwestern Management Services, LLC, a leading dental practice management company in the Southeast Florida market, providing \$10,774 of additional funding to fund the acquisition of six dental practices.

During the period from July 1, 2010 to July 21, 2010, we issued 2,748,600 shares of our common stock at an average price of \$9.75 per share, and raised \$26,799 of gross proceeds, under our at-the-market program. Net proceeds were \$26,262 after 2% commission to the broker-dealer on shares sold.

During the period from July 22, 2010 to August 24, 2010, we issued 3,814,528 shares of our common stock at an average price of \$9.71 per share, and raised \$37,052 of gross proceeds, under our at-the-market program. Net proceeds were \$36,335 after 2% commission to the broker-dealer on shares sold.

On August 26, 2010, we declared monthly dividends in the following amounts and with the following dates:

\$0.100625 per share for September 2010 to holders of record on September 30, 2010 with a payment date of October 29, 2010;

\$0.100750 per share for October 2010 to holders of record on October 29, 2010 with a payment date of November 30, 2010.

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

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**\$500,000,000**

**PROSPECT CAPITAL CORPORATION**

**Common Stock  
Preferred Stock  
Debt Securities  
Warrants**

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

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

Our Securities may be offered directly to one or more purchasers, or through agents designated from time to time by us, or to or through underwriters or dealers. The prospectus supplement relating to the offering will identify any agents or underwriters involved in the sale of our Securities, and will disclose any applicable purchase price, fee, commission or discount arrangement between us and our agents or underwriters or among our underwriters or the basis upon which such amount may be calculated. See Plan of Distribution. We may not sell any of our Securities through agents, underwriters or dealers without delivery of the prospectus and a prospectus supplement describing the method and terms of the offering of such Securities. Our common stock is traded on The NASDAQ Global Select Market under the symbol PSEC. As of February 25 2010, the last reported sales price for our common stock was \$11.66.

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

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

**Investing in our Securities involves a heightened risk of total loss of investment and is subject to risks. Before buying any Securities, you should read the discussion of the material risks of investing in our Securities in Risk Factors beginning on page 9 of this prospectus.**

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



(<http://www.sec.gov>).

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

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

The date of this Prospectus is March 4, 2010

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**ABOUT THIS PROSPECTUS**

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

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**PROSPECTUS SUMMARY**

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

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

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

**The Company**

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

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

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

**The Investment Adviser**

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

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**The Offering**

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

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

We may sell our common stock, or warrants, options or rights to acquire our common stock, at a price below the current net asset value of our common stock upon approval of our directors, including a majority of our independent directors, in certain circumstances. See Sales of Common Stock Below Net Asset Value in this prospectus and in the prospectus supplement, if applicable. Sales of common stock at prices below net asset value per share dilute the interests of existing stockholders, have the effect of reducing our net asset value per share and may reduce our market price per share.

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

**Use of proceeds**

Unless otherwise specified in a prospectus supplement, we intend to use the net proceeds from selling Securities pursuant to this prospectus initially to maintain balance sheet liquidity, involving repayment of debt under our credit facility, investments in high quality short-term debt instruments or a combination thereof, and thereafter to make long-term investments in accordance with our investment objective. See Use of Proceeds.

**Distributions**

We have paid quarterly distributions to the holders of our common stock and generally intend to continue to do so. The amount of the quarterly distributions is determined by our Board of Directors and is based on our estimate of our investment company taxable income and net short-term capital gains. Certain amounts of the quarterly distributions may from time to time be paid out of our capital rather than from earnings for the quarter as a result of our deliberate planning or accounting reclassifications. Distributions in excess of our current or accumulated earnings or profits constitute a return of capital and will reduce the stockholder's adjusted tax basis in such stockholder's common stock. After the adjusted basis is reduced to zero, these distributions will constitute capital gains to such stockholders. Certain additional amounts may be deemed as distributed to stockholders for income tax purposes. Other types of Securities will likely pay distributions in accordance with their terms. See Price Range of Common Stock, Distributions and Material U.S. Federal Income Tax Considerations.

**Taxation**

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

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as a RIC and obtain RIC tax treatment, we must maintain specified source-of-income and asset diversification requirements and distribute annually at least 90% of our ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any. See Distributions and Material U.S. Federal Income Tax Considerations.

**Dividend reinvestment plan**

We have a dividend reinvestment plan for our stockholders. This is an opt out dividend reinvestment plan. As a result, when we declare a dividend, the dividends are automatically reinvested in additional shares of our common stock, unless a stockholder specifically opts out of the dividend reinvestment plan so as to receive cash dividends. Stockholders who receive distributions in the form of stock are subject to the same U.S. Federal, state and local tax consequences as stockholders who elect to receive their distributions in cash. See Dividend Reinvestment Plan.

**The NASDAQ Global Select Market Symbol**

PSEC

**Anti-takeover provisions**

Our charter and bylaws, as well as certain statutory and regulatory requirements, contain provisions that may have the effect of discouraging a third party from making an acquisition proposal for us. These anti-takeover provisions may inhibit a change in control in circumstances that could give the holders of our common stock the opportunity to realize a premium over the market price of our common stock. See Description Of Our Capital Stock.

**Management arrangements**

Prospect Capital Management serves as our investment adviser. Prospect Administration serves as our administrator. For a description of Prospect Capital Management, Prospect Administration and our contractual arrangements with these companies, see Management Management Services Investment Advisory Agreement, and Management Management Services Administration Agreement.

**Risk factors**

Investment in our Securities involves certain risks relating to our structure and investment objective that should be considered by prospective purchasers of our Securities. In addition, investment in our Securities involves certain risks relating to investing in the energy sector, including but not limited to risks associated with commodity pricing, regulation, production, demand, depletion and expiration, weather, and valuation. We have a limited operating history upon which you can evaluate our business. In addition, as a business development company, our portfolio primarily includes securities issued by privately-held companies. These investments generally involve a high degree of business and financial risk, and are less liquid than public securities. We are required to mark the carrying value of our investments to fair value on a quarterly basis, and economic events, market conditions and events affecting individual portfolio companies can result in quarter-to-quarter mark-downs and mark-ups of the value of individual investments that collectively can materially affect our net asset value, or NAV. Also, our determinations of



fair value of privately-held securities may differ materially from the values that would exist if there was a ready market for these investments. A large number of entities compete for the same kind of

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

**Plan of distribution**

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

**Fees and Expenses**

The following tables are intended to assist you in understanding the costs and expenses that an investor in this offering will bear directly or indirectly. We caution you that some of the percentages indicated in the table below are estimates and may vary. In these tables, we assume that we have borrowed \$195 million under our credit facility, which is the maximum amount available under the credit facility. Except where the context suggests otherwise, whenever this prospectus contains a reference to fees or expenses paid by you or us or that we will pay fees or expenses, the Company will pay such fees and expenses out of our net assets and, consequently, you will indirectly bear such fees or expenses as an investor in the Company. However, you will not be required to deliver any money or otherwise bear personal liability or responsibility for such fees or expenses.

**Stockholder transaction expenses:**

Sales load (as a percentage of offering price)(1)	5.00%
Offering expenses borne by us (as a percentage of offering price)(2)	0.50%
Dividend reinvestment plan expenses(3)	None
Total stockholder transaction expenses (as a percentage of offering price)(4)	5.50%
<b>Annual expenses (as a percentage of net assets attributable to common stock)(4):</b>	
Management Fees(5)	2.74%
Incentive fees payable under Investment Advisory Agreement (20% of realized capital gains and 20% of pre-incentive fee net investment income)(6)	2.29%
Interest payments on borrowed funds	1.84%
Acquired Fund Fees and Expenses	0.02%(7)
Other expenses	1.99%(8)

Total annual expenses

8.89%(6)(8)

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The following table demonstrates the projected dollar amount of cumulative expenses we would pay out of net assets and that you would indirectly bear over various periods with respect to a hypothetical investment in our common stock. In calculating the following expense amounts, we have assumed we would have borrowed all \$195 million available under our line of credit, that our annual operating expenses would remain at the levels set forth in the table above and that we would pay the costs shown in the table above.

	<b>1 Year</b>	<b>3 Years</b>	<b>5 Years</b>	<b>10 Years</b>
You would pay the following expenses on a \$1,000 investment, assuming a 5% annual return	\$ 117.33	\$ 239.02	\$ 356.86	\$ 635.38

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

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

- (1) In the event that the Securities to which this prospectus relates are sold to or through underwriters, a corresponding prospectus supplement will disclose the estimated applicable sales load.
- (2) The related prospectus supplement will disclose the estimated amount of offering expenses, the offering price and the estimated offering expenses borne by us as a percentage of the offering price.
- (3) The expenses of the dividend reinvestment plan are included in other expenses.
- (4) The related prospectus supplement will disclose the offering price and the total stockholder transaction expenses as a percentage of the offering price.
- (5) Our base management fee is 2% of our gross assets (which include any amount borrowed, i.e., total assets without deduction for any liabilities). Although no plans are in place to borrow the full amount under our line of credit, assuming that we borrowed \$195 million, the 2% management fee of gross assets equals approximately 2.74% of net assets. See [Management Services](#) [Investment Advisory Agreement](#) and footnote 6 below.

- (6) The incentive fee payable to our Investment Adviser under the Investment Advisory Agreement is based on our performance and will not be paid unless we achieve certain goals. Under the assumption of a 5% return required in the example, no incentive fee would be payable. For a more detailed discussion of the calculation of the two-part incentive fee, see Management Services Investment Advisory Agreement.
- (7) The Company's stockholders indirectly bear the expenses of underlying investment companies in which the Company invests. This amount includes the fees and expenses of investment companies in which the Company is invested in as of December 31, 2009. When applicable, fees and expenses are based on historic fees and expenses for the investment companies and for those investment companies with little or no operating history, fees and expenses are based on expected fees and expenses stated in the investment companies' prospectus or other similar communication without giving effect to any performance. Future fees and expenses for certain investment companies may be substantially higher or lower because certain fees and expenses are based on the performance of the investment companies, which may fluctuate over time. The amount of the Company's

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average net assets used in calculating this percentage was based on average monthly net assets of approximately \$637 million for the six months ended December 31, 2009.

- (8) Other expenses are based on estimated amounts for the current fiscal year. The amount shown above represents annualized expenses during our six months ended December 31, 2009 representing all of our estimated recurring operating expenses (except fees and expenses reported in other items of this table) that are deducted from our operating income and reflected as expenses in our Statement of Operations. The estimate of our overhead expenses, including payments under an administration agreement with Prospect Administration, or the Administration Agreement, based on our projected allocable portion of overhead and other expenses incurred by Prospect Administration in performing its obligations under the Administration Agreement. Other expenses does not include non-recurring expenses. See Management Management Services Administration Agreement.

**Table of Contents****SELECTED CONDENSED FINANCIAL DATA**

You should read the condensed financial information below with the Financial Statements and Notes thereto included in this prospectus. Financial information below for the twelve months ended June 30, 2009, 2008, 2007, 2006 and 2005 has been derived from the financial statements that were audited by our independent registered public accounting firm. The selected consolidated financial data at and for the six months ended December 31, 2009 and 2008 have been derived from unaudited financial data, but in the opinion of our management, reflects all adjustments (consisting only of normal recurring adjustments) that are necessary to present fairly the results for such interim periods. Interim results at and for the six months ended December 31, 2009 are not necessarily indicative of the results that may be expected for the year ending June 30, 2010. Certain reclassifications have been made to the prior period financial information to conform to the current period presentation. See Management's Discussion and Analysis of Financial Condition and Results of Operations starting on page 27 for more information.

	For the Six Months Ended			For the Year/Period Ended June 30,			2005
	2009	2008	2009	2008	2007	2006	
	(In thousands except data relating to shares, per share and number of portfolio companies)						
<b>Income Data:</b>							
Income	\$ 33,374	\$ 34,797	\$ 62,926	\$ 59,033	\$ 30,084	\$ 13,268	\$ 4,388
Net income	10,388	9,388	22,793	12,033	6,153	3,601	3,601
Operating income	6,638	13,827	14,762	8,336	4,444		
Investment	50,400	58,012	100,481	79,402	40,681	16,869	8,387
Interest and credit							
expenses	(3,369)	(3,483)	(6,161)	(6,318)	(1,903)	(642)	
Investment advisory	(13,696)	(14,628)	(26,705)	(20,199)	(11,226)	(3,868)	(1,387)
expenses	(4,092)	(4,439)	(8,452)	(7,772)	(4,421)	(3,801)	(3,801)
expenses	(21,157)	(22,550)	(41,318)	(34,289)	(17,550)	(8,311)	(5,588)
Investment	29,243	35,462	59,163	45,113	23,131	8,558	2,387
Realized and							
unrealized gains	(52,474)	(14,940)	(24,059)	(17,522)	(6,403)	4,338	6,387
Increase in net							
assets from							
operations	\$ (23,231)	\$ 20,522	\$ 35,104	\$ 27,591	\$ 16,728	\$ 12,896	\$ 8,387

**Share Data:**

Increase in net								
from								
operations(1)	\$ (0.43)	\$ 0.69	\$ 1.11	\$ 1.17	\$ 1.06	\$ 1.83	\$	
operations								
per share	\$ (0.82)	\$ (0.80)	\$ (1.62)	\$ (1.59)	\$ (1.54)	\$ (1.12)	\$	
average weighted								
shares outstanding								
at period	53,709,197	29,569,571	31,559,905	23,626,642	15,724,095	7,056,846	7,055	
and								
<b>Key Data:</b>								
Assets	\$ 648,135	\$ 555,661	\$ 547,168	\$ 497,530	\$ 328,222	\$ 133,969	\$	55
Liabilities	40,945	32,316	119,857	44,248	48,280	4,511		48
Equity	689,080	587,977	667,025	541,778	376,502	138,480		103
Amount drawn on								
facility	10,000	138,667	124,800	91,167		28,500		
owed to								
parties	7,412	6,312	6,713	6,641	4,838	745		
Liabilities	34,191	15,195	2,916	14,347	71,616	965		
Liabilities								
Liabilities	51,603	160,174	134,429	112,155	76,454	30,210		
Assets	\$ 637,477	\$ 427,803	\$ 532,596	\$ 429,623	\$ 300,048	\$ 108,270	\$	102
<b>Investment Activity</b>								
Portfolio								
companies at period								
End of period	55	30	30	29(2)	24(2)	15		
Operations	\$ 216,504	\$ 84,020	\$ 98,305	\$ 311,947	\$ 167,255	\$ 83,625	\$	79
Repayments,								
and disposals	\$ 69,735	\$ 13,077	\$ 27,007	\$ 127,212	\$ 38,407	\$ 9,954	\$	32
Weighted-Average								
Cost of Equity								
at end of								
period	15.6%	16.0%	13.7%	15.5%	17.1%	17.0%		

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

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

(3) Includes dividends from certain equity investments.



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**RISK FACTORS**

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

**Risks Relating To Our Business**

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

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

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

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

*We operate in a highly competitive market for investment opportunities.*

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

Many of our existing and potential competitors are substantially larger and have considerably greater financial, technical and marketing resources than we do. For example, some competitors may have a lower cost of funds and access to funding sources that are not available to us. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more or fuller relationships with borrowers and sponsors than us. Furthermore, many of our competitors are not subject to the regulatory restrictions that the 1940 Act imposes on us as a business development company. We cannot assure you that the competitive pressures we face will not have a materially adverse effect on our

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business, financial condition and results of operations. Also, as a result of existing and increasing competition and our competitors ability to provide a total package solution, we may not be able to take advantage of attractive investment opportunities from time to time, and we can offer no assurance that we will be able to identify and make investments that are consistent with our investment objective.

We do not seek to compete primarily based on the interest rates that we offer, and we believe that some of our competitors make loans with interest rates that are comparable to or lower than the rates we offer. We may lose investment opportunities if we do not match our competitors pricing, terms and structure. If we match our competitors pricing, terms and structure, we may experience decreased net interest income and increased risk of credit loss.

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

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

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

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

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

A likelihood of greater volatility in the net asset value and market price of our common stock;

Diminished operating flexibility as a result of asset coverage or investment portfolio composition requirements required by lenders or investors that are more stringent than those imposed by the 1940 Act;

The possibility that investments will have to be liquidated at less than full value or at inopportune times to comply with debt covenants or to pay interest or dividends on the leverage;

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

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

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

For example, the amount we may borrow under our revolving credit facility is determined, in part, by the fair value of our investments. If the fair value of our investments declines, we may be forced to sell investments at a loss to maintain compliance with our borrowing limits. Other debt facilities we may enter into in the future may contain similar provisions. Any such forced sales would reduce our net asset value and also make it difficult for the net asset value to recover. Our Investment Adviser and our Board of Directors in their best judgment nevertheless may determine to use leverage if they expect that the benefits to our stockholders of maintaining the leveraged position will outweigh the risks.

*Illustration.* The following table illustrates the effect of leverage on returns from an investment in our common stock assuming various annual returns, net of expenses. The calculations in the table below are hypothetical and actual returns may be higher or lower than those appearing below. The calculation assumes (i) \$667 million in total assets, (ii) an average cost of funds of 7.0%, (iii) \$124.8 million in debt outstanding and (iv) \$532.6 million of shareholders equity.

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

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

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

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

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

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

We generally make investments in private companies. Substantially all of these securities are subject to legal and other restrictions on resale or are otherwise less liquid than publicly traded securities. The illiquidity of our investments may make it difficult for us to sell such investments if the need arises. In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the value at which we have

previously recorded our investments. In addition, we may face other restrictions on our ability to liquidate an investment in a portfolio company to the extent that we or our Investment Adviser has material non-public information regarding such portfolio company.

*We may experience fluctuations in our quarterly results.*

We could experience fluctuations in our quarterly operating results due to a number of factors, including the interest or dividend rates payable on the debt or equity securities we hold, the default rate on debt securities, the level of our expenses, variations in and the timing of the recognition of realized and unrealized gains or losses, the

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

***Our most recent net asset value was calculated on December 31, 2009 and our NAV when calculated effective March 31, 2010 may be higher or lower.***

Our most recently estimated NAV per share is \$10.07 on an as adjusted basis solely to give effect to our issuance of common shares on January 25, 2010 in connection with our dividend reinvestment plan, versus \$10.06 determined by us as of December 31, 2009. NAV as of March 31, 2010 may be higher or lower than \$10.07 based on potential changes in valuations and earnings for the quarter then ended. Our Board of Directors has not yet determined the fair value of portfolio investments subsequent to December 31, 2009. Our Board of Directors determines the fair value of our portfolio investments on a quarterly basis in connection with the preparation of quarterly financial statements and based on input from an independent valuation firm, our Investment Advisor and the audit committee of our Board of Directors.

***Potential conflicts of interest could impact our investment returns.***

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

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

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

The income incentive fee payable by us is computed and paid on income that may include interest that has been accrued but not yet received in cash. If a portfolio company defaults on a loan that has a deferred interest feature, it is possible that interest accrued under such loan that has previously been included in the calculation of the income

incentive fee will become uncollectible. If this happens, our Investment Adviser is not required to reimburse us for any such income incentive fee payments. If we do not have sufficient liquid assets to pay this incentive fee or distributions to stockholders on such accrued income, we may be required to liquidate assets in order to do so. This fee structure could give rise to a conflict of interest for our Investment Adviser to the extent that it may encourage



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the Investment Adviser to favor debt financings that provide for deferred interest, rather than current cash payments of interest.

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

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

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

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

***Changes in laws or regulations governing our operations may adversely affect our business.***

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

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

The U.S. financial markets have been experiencing a high level of volatility, disruption and distress, which was exacerbated by the failure of several major financial institutions in the last few months of 2008. In addition, the U.S. economy has been in a recession, the aftermath of which may be severe and prolonged. Similar conditions have occurred in the financial markets and economies of numerous other countries and could worsen, both in the U.S. and

globally. These conditions have raised the level of many of the risks described in this document and could have an adverse effect on our portfolio companies as well as on our business, financial condition, results of operations, dividend payments, credit facility, access to capital, valuation of our assets, NAV and our stock price.

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

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

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

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

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

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

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

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

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

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

If we fail to qualify as a RIC for any reason or become subject to corporate income tax, the resulting corporate taxes could substantially reduce our net assets, the amount of income available for distribution, and the actual amount of our distributions. Such a failure would have a materially adverse effect on us and our stockholders. For additional

information regarding asset coverage ratio and RIC requirements, see Regulation Senior Securities and Material U.S. Federal Income Tax Considerations .

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

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

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

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

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

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

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

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

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

At our 2009 annual meeting of stockholders held on December 11, 2009, our stockholders approved our ability to sell an unlimited number of shares of our common stock at any level of discount from net asset value per share during the 12 month period following the December 11, 2009 approval in accordance with the exception described above in

Regulations governing our operation as a business development company affect our ability to raise, and the way in which we raise, additional capital. The issuance or sale by us of shares of our common stock at a discount to net asset value poses a risk of dilution to our stockholders. In particular, stockholders who do not purchase additional shares at or below the discounted price in proportion to their current ownership will experience an immediate decrease in net asset value per share (as well as in the aggregate net asset value of their shares if they do not participate at all). These stockholders will also experience a disproportionately greater decrease in their participation in our earnings and assets and their voting power than the increase we experience in our assets, potential earning power and voting interests from such issuance or sale. They may also experience a reduction in the market price of our common stock. For additional information and hypothetical examples of these risks, see [Sales of Common Stock Below Net Asset Value](#) and the prospectus supplement pursuant to which such sale is made.

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

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

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

Since in some cases we may recognize taxable income before or without receiving cash representing such income, we may have difficulty meeting the tax requirement to distribute at least 90% of our ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, to maintain RIC tax treatment. Accordingly, we may have to sell some of our investments at times we would not consider advantageous, raise

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



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

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

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

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

**Risks Relating To Our Investments**

We may not realize gains or income from our investments.

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

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

As of February 25, 2010, we had invested in a number of companies in the energy and energy related industries. A consequence of this lack of diversification is that the aggregate returns we realize may be significantly and adversely affected if a small number of such investments perform poorly or if we need to write down the value of any one investment. Beyond our income tax diversification requirements, we do not have fixed guidelines for diversification, and our investments are concentrated in relatively few portfolio companies. In addition, to date we have concentrated on making investments in the energy industry. While we expect to be less focused on the energy and energy related industries in the future, we anticipate that we will continue to have significant holdings in the energy and energy related industries. As a result, a downturn in the energy industry could materially and adversely affect us.

***The energy industry is subject to many risks.***

We have a significant concentration in the energy industry. Our definition of energy, as used in the context of the energy industry, is broad, and different sectors in the energy industry may be subject to variable risks and economic pressures. As a result, it is difficult to anticipate the impact of changing economic and political conditions

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on our portfolio companies and, as a result, our financial results. The revenues, income (or losses) and valuations of energy companies can fluctuate suddenly and dramatically due to any one or more of the following factors:

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

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

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

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

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

of capital.

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

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

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

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

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

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

*Climate Change.* There is evidence of global climate change. Climate change creates physical and financial risk and some of our portfolio companies may be adversely affected by climate change. For example, customers of energy companies needs vary with weather conditions, primarily temperature and humidity. To the extent weather conditions are affected by climate change, energy use could increase or decrease depending on the duration and magnitude of any changes. Increased energy use due to weather changes may require additional investments by our portfolio companies in more pipelines and other infrastructure to serve increased demand. A decrease in energy use due to weather changes may affect our portfolio companies financial condition, through decreased revenues. Extreme weather conditions in general require more system backup, adding to costs, and can contribute to increased system stresses, including service interruptions. Energy companies could also be affected by the potential for lawsuits against or taxes or other regulatory costs imposed on greenhouse gas emitters, based on links drawn between greenhouse gas emissions and climate change.

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

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

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

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

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

because many of these companies are privately held companies, public information is generally not available about these companies. As a result, we will depend on the ability of our Investment Adviser to obtain adequate information to evaluate these companies in making investment decisions. If our Investment Adviser is unable to uncover all material information about these companies, it may not make a fully informed investment decision, and we may lose money on our investments;

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

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

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

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

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

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

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

As a result, many of our portfolio companies may be susceptible to economic slowdowns or recessions and may be unable to repay our loans or meet other obligations during these periods. Therefore, our non-performing assets are

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

A portfolio company's failure to satisfy financial or operating covenants imposed by us or other lenders could lead to defaults and, potentially, termination of its loans and foreclosure on its secured assets, which could trigger



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cross-defaults under other agreements and jeopardize a portfolio company's ability to meet its obligations under the debt or equity securities that we hold. We may incur expenses to the extent necessary to seek recovery upon default or to negotiate new terms, which may include the waiver of certain financial covenants, with a defaulting portfolio company. In addition, if one of our portfolio companies were to go bankrupt, even though we may have structured our interest as senior debt or preferred equity, depending on the facts and circumstances, including the extent to which we actually provided managerial assistance to that portfolio company, a bankruptcy court might re-characterize our debt or equity holding and subordinate all or a portion of our claim to those of other creditors.

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

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

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

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

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

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

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

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



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

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

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

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

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

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

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

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

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

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

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

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

We may employ hedging techniques to minimize certain investment risks, such as fluctuations in interest and currency exchange rates, but we can offer no assurance that such strategies will be effective. If we engage in hedging transactions, we may expose ourselves to risks associated with such transactions. We may utilize instruments such as forward contracts, currency options and interest rate swaps, caps, collars and floors to seek to hedge against fluctuations in the relative values of our portfolio positions from changes in currency exchange rates and market

interest rates. Hedging against a decline in the values of our portfolio positions does not eliminate the possibility of fluctuations in the values of such positions or prevent losses if the values of such positions decline. However, such hedging can establish other positions designed to gain from those same developments, thereby offsetting the decline in the value of such portfolio positions. Such hedging transactions may also limit the opportunity for gain if the values of the portfolio positions should increase. Moreover, it may not be possible to hedge against an exchange rate or interest rate fluctuation that is so generally anticipated that we are not able to enter into a hedging transaction at an acceptable price.

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

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

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

## **Risks Relating To Our Securities**

***Investing in our securities may involve a high degree of risk.***

The investments we make in accordance with our investment objective may result in a higher amount of risk than alternative investment options and volatility or loss of principal. Our investments in portfolio companies may be speculative and aggressive, and therefore, an investment in our shares may not be suitable for someone with low risk tolerance.

***The market price of our securities may fluctuate significantly.***

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

- significant volatility in the market price and trading volume of securities of business development companies or other companies in the energy industry, which are not necessarily related to the operating performance of these companies;

- changes in regulatory policies or tax guidelines, particularly with respect to RICs or business development companies;

- loss of RIC qualification;

- changes in earnings or variations in operating results;

- changes in the value of our portfolio of investments;

- any shortfall in revenue or net income or any increase in losses from levels expected by investors or securities analysts;

departure of one or more of Prospect Capital Management's key personnel;

operating performance of companies comparable to us;

changes in prevailing interest rates;

litigation matters;

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general economic trends and other external factors; and

loss of a major funding source.

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

As of February 25, 2010, we have 63,586,731 shares of common stock outstanding. Sales of substantial amounts of our securities or the availability of such securities for sale could adversely affect the prevailing market price for our securities. If this occurs and continues it could impair our ability to raise additional capital through the sale of securities should we desire to do so.

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

We have made and intend to continue to make distributions on a quarterly basis to our stockholders out of assets legally available for distribution. We cannot assure you that we will achieve investment results or maintain a tax status that will allow or require any specified level of cash distributions or year-to-year increases in cash distributions. In addition, due to the asset coverage test applicable to us as a business development company, we may be limited in our ability to make distributions.

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

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

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

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

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

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

The Maryland Control Share Acquisition Act, which provides that control shares of a Maryland corporation (defined as shares of common stock which, when aggregated with other shares of common stock controlled by the stockholder, entitles the stockholder to exercise one of three increasing ranges of



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voting power in electing directors, as described more fully below) acquired in a control share acquisition (defined as the direct or indirect acquisition of ownership or control of control shares ) have no voting rights except to the extent approved by stockholders by the affirmative vote of at least two-thirds of all the votes entitled to be cast on the matter, excluding all interested shares of common stock.

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

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

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

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

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

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

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

**Note on Forward Looking Statements**

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

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

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

We have based the forward-looking statements included in herein on information available to us on the date of this document, and we assume no obligation to update any such forward-looking statements. Although we undertake no obligation to revise or update any forward-looking statements, whether as a result of new information, future events or otherwise, you are advised to consult any additional disclosures that we may make directly to you or through reports

that we in the future may file with the Securities and Exchange Commission ( SEC ), including any annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K.

**General**

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

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

**Patriot Acquisition**

On December 2, 2009, we acquired the outstanding shares of Patriot Capital Funding, Inc. ( Patriot ) common stock for \$201,083. Under the terms of the merger agreement, Patriot common shareholders received 0.363992 shares of our common stock for each share of Patriot common stock, resulting in 8,444,068 shares of common stock being issued by us. In connection with the transaction, we repaid all the outstanding borrowings of Patriot, in compliance with the merger agreement.

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

The merger has been accounted for as an acquisition of Patriot by Prospect Capital Corporation ( Prospect ) in accordance with acquisition method of accounting as detailed in ASC 805, *Business Combinations* ( ASC 805 ). The fair value of the consideration paid was allocated to the assets acquired and liabilities assumed based on their fair values as the date of acquisition. As described in more detail in ASC 805, goodwill, if any, would have been recognized as of the acquisition date, if the consideration transferred exceeded the fair value of identifiable net assets acquired. As of the acquisition date, the fair value of the identifiable net assets acquired exceeded the fair value of the consideration transferred, and we recognized the excess as a gain. A gain of \$5,714 was recorded by Prospect in the quarter ended December 31, 2009 related to the acquisition of Patriot. The acquisition of Patriot was negotiated in July 2009 with the purchase agreement being signed on August 3, 2009. Between July 2009 and December 2, 2009, our valuation of certain of the investments acquired from Patriot increased due to market improvement, which resulted in the recognition of the gain at closing.

The purchase price has been allocated to the assets acquired and the liabilities assumed based on their estimated fair values as summarized in the following table:

Cash (to repay Patriot debt)	\$ 107,313
Cash (to fund purchase of restricted stock from former Patriot employees)	970
Common stock issued(1)	92,800
 Total purchase price	 201,083
 Assets acquired:	
Investments(2)	207,126
Cash and cash equivalents	1,697
Other assets	3,859
 Assets acquired	 212,682
Other liabilities assumed	(5,885)
 Net assets acquired	 206,797
 Preliminary gain on Patriot acquisition(3)	 \$ 5,714

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

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- (3) The preliminary gain has been determined based upon the estimated value of certain liabilities which are not yet settled. Any changes to such accruals will be recoded in future periods as an adjustment to such gain. We do not believe such adjustments will be material.

During the period from the acquisition of Patriot on December 2, 2009 to December 31, 2009, we recognized \$7,495 of interest income from the assets acquired from Patriot. Included in this amount is \$4,560 resulting from the acceleration of purchase discounts from the early repayments of three loans, three revolving lines of credit and the sale of one investment position.

## **Market Conditions**

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

We believe that Prospect Capital is well positioned to navigate through these adverse market conditions. As a business development company, we are limited to a maximum 1 to 1 debt to equity ratio, and as of December 31, 2009, we had \$62,914 available under our credit facility, of which \$10,000 was outstanding. In addition, we had \$105,050 of eligible assets from the Patriot acquisition in the process of being pledged to the facility which will generate an additional \$67,086 of availability. Further, as we make additional investments that are eligible to be pledged under the credit facility, we will generate additional availability. The revolving period for the extended credit facility continues until June 25, 2010, with an amortization running to June 25, 2011.

We also continue to generate liquidity through public and private stock offerings. On July 7, 2009 we completed a public stock offering for 5,175,000 shares of our common stock at \$9.00 per share, raising \$46,575 of gross proceeds. On August 20, 2009 and September 24, 2009, we issued 3,449,686 shares and 2,807,111 shares, respectively, of our common stock at \$8.50 and \$9.00 per share, respectively, in private stock offerings, raising \$29,322, and \$25,264 of gross proceeds, respectively. Concurrent with the sale of these shares, we entered into a registration rights agreement in which we granted the purchasers certain registration rights with respect to the shares. Under the terms and conditions of the registration rights agreement, we filed with the SEC a post-effective amendment to the registration statement on Form N-2 on November 6, 2009. Such amendment was declared effective by the SEC on November 9, 2009.

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

## **Critical Accounting Policies and Estimates**

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

***Basis of Consolidation***

Under the 1940 Act rules, the regulations pursuant to Article 6 of Regulation S-X, and the American Institute of Certified Public Accountants Audit and Accounting Guide for Investment Companies, we are precluded from consolidating any entity other than another investment company or an operating company which provides substantially all of its services and benefits to us. Our December 31, 2009 and June 30, 2009 financial statements include our accounts and the accounts of Prospect Capital Funding, LLC, our only wholly-owned, closely-managed

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subsidiary that is also an investment company. All intercompany balances and transactions have been eliminated in consolidation.

### ***Investment Classification***

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

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

### ***Investment Valuation***

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

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

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

- 1) Each portfolio company or investment is reviewed by our investment professionals with the independent valuation firm engaged by our Board of Directors;
- 2) the independent valuation firm conducts independent appraisals and makes their own independent assessment;
- 3) the audit committee of our Board of Directors reviews and discusses the preliminary valuation of our Investment Adviser and that of the independent valuation firm; and
- 4) the Board of Directors discusses the valuations and determines the fair value of each investment in our portfolio in good faith based on the input of our Investment Adviser, the independent valuation firm and the audit committee.

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

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



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

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

*Level 3:* Unobservable inputs for the asset or liability.

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

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

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

In April 2009, the FASB issued ASC 820-10-65, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* ( ASC 820-10-65 ). This update provides further clarification for ASC 820 in markets that are not active and provides additional guidance for determining when the volume of trading level of activity for an asset or liability has significantly decreased and for identifying circumstances that indicate a transaction is not orderly. ASC 820-10-65 is effective for interim and annual reporting periods ending after June 15, 2009. The adoption of ASC 820-10-65 for the three and six months ended December 31, 2009, did not have any effect on our net asset value, financial position or results of operations as there was no change to the fair value measurement principles set forth in ASC 820.

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

## ***Federal and State Income Taxes***

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

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

We adopted FASB ASC 740, *Income Taxes* ( ASC 740 ). ASC 740 provides guidance for how uncertain tax positions should be recognized, measured, presented, and disclosed in the financial statements. ASC 740 requires the evaluation of tax positions taken or expected to be taken in the course of preparing our tax returns to determine whether the tax positions are more-likely-than-not of being sustained by the applicable tax authority. Tax positions not deemed to meet the more-likely-than-not threshold are recorded as a tax benefit or expense in the current year. Adoption of ASC 740 was applied to all open tax years as of July 1, 2007. The adoption of ASC 740 did not have an effect on our net asset value, financial condition or results of operations as there was no liability for

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unrecognized tax benefits and no change to our beginning net asset value. As of December 31, 2009 and for the three and six months then ended, we did not have a liability for any unrecognized tax benefits. Management's determinations regarding ASC 740 may be subject to review and adjustment at a later date based upon factors including, but not limited to, an on-going analysis of tax laws, regulations and interpretations thereof.

### ***Revenue Recognition***

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

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

Loans are placed on non-accrual status when principal or interest payments are past due 90 days or more or when there is reasonable doubt that principal or interest will be collected. Unpaid accrued interest is generally reversed when a loan is placed on non-accrual status. Interest payments received on non-accrual loans may be recognized as income or applied to principal depending upon management's judgment. Non-accrual loans are restored to accrual status when past due principal and interest is paid and in management's judgment, are likely to remain current. As of December 31, 2009, approximately 5.7% of our net assets are in non-accrual status.

Dividend income is recorded on the ex-dividend date.

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

### **Statement of Assets and Liabilities Overview**

During the six months ended December 31, 2009, net assets have increased by \$104,881 from \$532,596 as of June 30, 2009 to \$637,477 as of December 31, 2009. This net increase in assets primarily resulted from \$195,833 of capital share transactions including 8,444,068 of shares issued in conjunction with the Patriot Acquisition, offset by \$67,721 in dividends declared to our stockholders. During this six month period we recognized net investment income of \$29,243, a decrease in net assets due to realized losses of \$51,229 and a decrease in net assets due to changes in unrealized depreciation of investments of \$1,245.

The aggregate fair value of our portfolio investments was \$648,135 and \$547,168 as of December 31, 2009 and June 30, 2009, respectively. During the six months ended December 31, 2009, our net cost of investments increased by \$102,212, or 19.2%, primarily from the acquisition of Patriot. At December 31, 2009, we were invested in 55 long-term portfolio investments.

### **Investment Activity**

During the six months ended December 31, 2009, we acquired \$207,126 of investments from Patriot, completed follow-on investments in existing portfolio companies totaling approximately \$7,321, and recorded PIK interest of \$2,059, resulting in gross investment originations with a cost basis of \$216,506. The more significant of these investments are described briefly in the following:

During the six months ended December 31, 2009, we made follow-on secured debt investments of \$1,423 in Iron Horse Coiled Tubing, Inc. ( Iron Horse ) in support of the build out of additional equipment and to fund working capital

requirements.

During the six months ended December 31, 2009, we provided additional fundings of \$3,376 to Yatesville Coal Holdings, Inc. ( Yatesville ) to fund ongoing operations.

On October 5, 2009 we purchased an additional secured debt investment of \$1,675 in Resco Products, Inc. ( Resco ) at a discount of \$670, increasing our cost basis by \$1,005 in this investment.

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On October 30, 2009, we made a follow-on secured subordinated debt investment of \$500 in Ajax Rolled Ring & Machine ( Ajax ).

On December 2, 2009, we acquired portfolio investments with a face amount of \$289,030 for \$207,126 from Patriot.

During the six months ended December 31, 2009, we closed-out six positions which are briefly described below.

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

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

On December 4, 2009, CS Operating, LLC repaid the \$4,460 loan receivable to us.

On December 10, 2009, Resco repaid the \$11,425 loan receivable to us.

On December 17, 2009, ADAPCO, Inc. ( ADAPCO ) repaid the \$7,466 loan receivable to us. We continue to hold warrants for common stock in this investment.

On December 18, 2009, Quartermaster, Inc. ( Quartermaster ) repaid the \$11,274 loan receivable to us.

On December 31, 2009, we sold our investment in Aylward Enterprises, LLC ( Aylward ) for net amount of \$4,775.

During the six months ended December 31, 2009, we also received principal amortization payments of \$7,184 on several loans.

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

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

<b>Quarter-End</b>	<b>Acquisitions(1)</b>	<b>Dispositions(2)</b>
December 31, 2009	\$ 210,438	\$ 45,494
September 30, 2009	6,066	24,241
June 30, 2009	7,929	3,148
March 31, 2009	6,356	10,782
December 31, 2008	13,564	2,128
September 30, 2008	70,456	10,949
June 30, 2008	118,913	61,148
March 31, 2008	31,794	28,891
December 31, 2007	120,846	19,223
September 30, 2007	40,394	17,949
June 30, 2007	130,345	9,857
March 31, 2007	19,701	7,731

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December 31, 2006	62,679	17,796
September 30, 2006	24,677	2,781
June 30, 2006	42,783	5,752
March 31, 2006	15,732	901
December 31, 2005		3,523
September 30, 2005	25,342	
June 30, 2005	17,544	
March 31, 2005	7,332	
December 31, 2004	23,771	32,083
September 30, 2004	30,371	
Since inception	\$ 1,027,033	\$ 304,377

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

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

**Table of Contents****Investment Holdings**

As of December 31, 2009, we continue to pursue our investment strategy. Despite our name change to Prospect Capital Corporation and the termination of our policy to invest at least 80% of our net assets in energy companies in May 2007, we currently have a concentration of investments in companies in the energy and energy related industries. This concentration continues to decrease as we make investments outside of the energy and energy related industries. Some of the companies in which we invest have relatively short or no operating histories. These companies are and will be subject to all of the business risk and uncertainties associated with any new business enterprise, including the risk that these companies may not reach their investment objective or the value of our investment in them may decline substantially or fall to zero.

Our portfolio had an annualized current yield of 15.6% and 16.0% across all our long-term debt and certain equity investments as of December 31, 2009 and December 31, 2008, respectively. At December 31, 2009, this yield includes interest from all of our long-term investments as well as dividends from Gas Solutions Holdings, Inc. ( GSHI ) and NRG Manufacturing, Inc. ( NRG ). We expect the current yield to decline over time as add to the portfolio. Monetization of other equity positions that we hold is not included in this yield calculation. In each of our portfolio companies, we hold equity positions, ranging from minority interests to majority stakes, which we expect over time to contribute to our investment returns. Some of these equity positions include features such as contractual minimum internal rates of returns, preferred distributions, flip structures and other features expected to generate additional investment returns, as well as contractual protections and preferences over junior equity, in addition to the yield and security offered by our cash flow and collateral debt protections.

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

As of December 31, 2009, we own controlling interests in Ajax, AWCNC, LLC, C&J, Change Clean Energy Holdings, Inc. ( CCEHI ), Coalbed, Inc./Coalbed, LLC (formerly Conquest Cherokee, LLC) ( Coalbed ), Fischbein, LLC ( Fischbein ), Freedom Marine Services LLC ( Freedom Marine ), GSHI, Integrated Contract Services, Inc. ( ICS ), Iron Horse, NRG, Nupla Corporation ( Nupla ), R-V Industries, Inc. ( R-V ), Sidump r Trailer Company, Inc. ( Sidump r ) and Yatesville. We also own an affiliated interest in Appalachian Energy Holdings, LLC ( AEH ), Biotronic NeuroNetwork ( Biotronic ), Boxercraft Incorporated ( Boxercraft ), KTPS Holdings, LLC ( KTPS ), Miller Petroleum, Inc. ( Miller ), Smart, LLC ( Smart ) and Sport Helmets Holdings, LLC ( Sport Helmets ).

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

Level of Control	Cost	December 31, 2009		Percent of Portfolio	Cost	June 30, 2009		Percent of Portfolio
		Percent of Portfolio	Fair Value			Percent of Portfolio	Fair Value	
Control	\$ 165,867	25.2%	\$ 191,898	28.6%	\$ 187,105	29.7%	\$ 206,332	31.9%
Affiliate	68,052	10.4%	66,479	9.9%	33,544	5.3%	32,254	5.0%



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Non-control/Non-affiliate	399,717	60.8%	389,758	58.0%	310,775	49.3%	308,582	47.8%
Money Market Funds	23,418	3.6%	23,418	3.5%	98,735	15.7%	98,735	15.3%
Total Portfolio	\$ 657,054	100.0%	\$ 671,553	100.0%	\$ 630,159	100.0%	\$ 645,903	100.0%

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The following is our investment portfolio presented by type of investment at December 31, 2009 and June 30, 2009, respectively:

Level of Control	Cost	December 31, 2009		June 30, 2009		Cost	Fair Value	Percent of Portfolio
		Percent of Portfolio	Fair Value	Percent of Portfolio	Fair Value			
Money Market Funds	\$ 23,418	3.6%	23,418	3.5%	\$ 98,735	15.7%	\$ 98,735	15.3%
Revolving Line of Credit	2,041	0.3%	2,013	0.3%		%		%
Senior Secured Debt	306,009	46.6%	281,321	41.9%	232,534	36.9%	220,993	34.2%
Subordinated Secured Debt	272,320	41.4%	239,968	35.7%	251,292	39.9%	194,547	30.1%
Subordinated Unsecured Debt	15,185	2.3%	15,771	2.4%	15,065	2.4%	16,331	2.5%
Preferred Stock	11,484	1.7%	6,106	0.9%	10,432	1.6%	4,139	0.7%
Common Stock	18,713	2.9%	82,213	12.2%	16,310	2.6%	89,278	13.8%
Membership Interests	5,124	0.8%	9,287	1.4%	3,031	0.5%	7,270	1.1%
Overriding Royalty Interests		%	2,762	0.4%		%	3,483	0.5%
Net Profit Interests		%	1,451	0.2%		%	2,561	0.4%
Warrants	2,760	0.4%	7,243	1.1%	2,760	0.4%	8,566	1.4%
<b>Total Portfolio</b>	<b>\$ 657,054</b>	<b>100.0%</b>	<b>\$ 671,553</b>	<b>100.0%</b>	<b>\$ 630,159</b>	<b>100.0%</b>	<b>\$ 645,903</b>	<b>100.0%</b>

The following is our investment portfolio presented by geographic location of the investment at December 31, 2009 and June 30, 2009, respectively:

Level of Control	Cost	December 31, 2009		June 30, 2009		Cost	Fair Value	Percent of Portfolio
		Percent of Portfolio	Fair Value	Percent of Portfolio	Fair Value			
Canada	\$ 20,717	3.1%	\$ 12,318	1.8%	\$ 19,344	3.1%	\$ 12,606	2.0%
Midwest US	115,332	17.6%	122,125	18.2%	77,681	12.3%	84,097	13.0%
Northeast US	61,171	9.3%	53,823	8.0%	44,875	7.1%	47,049	7.3%
Southeast US	189,313	28.8%	152,209	22.7%	164,652	26.1%	101,710	15.7%
Southwest US	183,428	27.9%	245,792	36.6%	178,993	28.4%	253,615	39.3%
Western US	63,675	9.7%	61,868	9.2%	45,879	7.3%	48,091	7.4%
Money Market Funds	23,418	3.6%	23,418	3.5%	98,735	15.7%	98,735	15.3%
<b>Total Portfolio</b>	<b>\$ 657,054</b>	<b>100.0%</b>	<b>\$ 671,553</b>	<b>100.0%</b>	<b>\$ 630,159</b>	<b>100.0%</b>	<b>\$ 645,903</b>	<b>100.0%</b>

The following is our investment portfolio presented by industry sector of the investment at December 31, 2009 and June 30, 2009, respectively:

Level of Control	December 31, 2009				June 30, 2009			
	Cost	Percent of Portfolio	Fair Value	Percent of Portfolio	Cost	Percent of Portfolio	Fair Value	Percent of Portfolio
Aerospace and Defense	\$ 56	%	\$ 48	%	\$	%	\$	%
Automobile	868	0.1%	868	0.1%		%		%
Biomass Power	2,825	0.4%	1,976	0.3%	2,530	0.4%	2,530	0.4%
Construction Services	5,028	0.8%	1,165	0.2%	5,017	0.8%	2,408	0.4%
Contracting	16,652	2.5%	5,275	0.8%	16,652	2.6%	5,000	0.8%
Ecological	141	%	295	%		%		%
Electronics	14,910	2.3%	14,994	2.2%		%		%
Financial Services	25,685	3.9%	24,511	3.6%	25,424	4.0%	23,073	3.6%
Food Products	34,634	5.3%	37,412	5.6%	27,413	4.4%	29,416	4.6%
Gas Gathering and Processing	35,003	5.3%	85,187	12.7%	35,003	5.6%	85,187	13.2%
Healthcare	88,217	13.4%	92,253	13.7%	57,535	9.1%	60,293	9.3%

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Level of Control	December 31, 2009				June 30, 2009			
	Cost	Percent of Portfolio	Fair Value	Percent of Portfolio	Cost	Percent of Portfolio	Fair Value	Percent of Portfolio
Home and Office Furnishings,								
Housewares and Durable	2,436	0.4%	2,432	0.4%		%		%
Insurance	3,873	0.6%	3,871	0.6%		%		%
Machinery	26,952	4.1%	27,088	4.0%		%		%
Manufacturing	80,590	12.3%	83,112	12.4%	90,978	14.4%	110,929	17.2%
Metal Services and Minerals	9,492	1.4%	12,180	1.8%	3,302	0.5%	7,133	1.1%
Mining, Steel, Iron and Non-Precious Metals and Coal								
Production	10,527	1.6%	10,705	1.6%	48,890	7.8%	13,097	2.0%
Oil and Gas								
Production	104,469	15.9%	93,904	14.0%	104,183	16.5%	104,806	16.2%
Oilfield Fabrication	32,337	4.9%	32,337	4.8%	34,247	5.4%	34,931	5.4%
Personal and Nondurable								
Consumer Products	28,705	4.4%	28,845	4.3%		%		%
Pharmaceuticals	11,952	1.8%	12,000	1.8%	11,949	2.0%	11,452	1.8%
Printing and Publishing	7,640	1.2%	7,803	1.2%		%		%
Production Services	20,717	3.2%	12,318	1.8%	19,344	3.1%	12,606	1.9%
Retail	14,670	2.2%	2,388	0.4%	14,623	2.3%	6,272	1.0%
Shipping Vessels	7,899	1.2%	6,181	0.9%	7,160	1.1%	7,381	1.1%
Specialty Minerals	15,814	2.4%	17,806	2.7%	15,814	2.5%	18,924	2.9%
Technical Services	11,373	1.7%	11,615	1.7%	11,360	1.8%	11,730	1.8%
Textiles and Leather	20,171	3.1%	19,566	2.9%		%		%
Money Market Funds	23,418	3.6%	23,418	3.5%	98,735	15.7%	98,735	15.3%
Total Portfolio	\$ 657,054	100.0%	\$ 671,553	100.0%	\$ 630,159	100.0%	\$ 645,903	100.0%

**Investment Valuation**

In determining the fair value of our portfolio investments at December 31, 2009, the Audit Committee considered valuations from the independent valuation firm and from management having an aggregate range of \$604,614 to \$680,622, excluding money market investments.

In determining the range of value for debt instruments, management and the independent valuation firm generally shadow rated the investment and then based upon the range of ratings, determined appropriate yields to maturity for a loan rated as such. A discounted cash flow analysis was then prepared using the appropriate yield to maturity as the

discount rate, yielding the ranges. For equity investments, the enterprise value was determined by applying EBITDA multiples for similar recent investment sales. For stressed equity investments, a liquidation analysis was prepared.

The Board of Directors looked at several factors in determining where within the range to value the asset including: recent operating and financial trends for the asset, independent ratings obtained from third parties and comparable multiples for recent sales of companies within the industry. The composite of all these analysis, applied to each investment, was a total valuation of \$648,135, excluding money market investments.

Our investments are generally lower middle market companies, outside of the financial sector, with less than \$30,000 of annual EBITDA. We believe our market has experienced less volatility than others because we believe there are more buy and hold investors who own these less liquid investments.

During the six months ended December 31, 2009, there has been a general improvement in the markets in which we operate and market rates of interest demanded for middle market loans have decreased. The fair value is limited on the high side to the loans par value, plus any prepayment penalties that would be imposed. Many of the debt investments in this category have not seen a significant change in value as they were previously valued at or near par value. In comparison to assets held as of June 30, 2009, these assets include: American Gilsonite Company,

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Biotronic, Castro Cheese Company, Inc., IEC/ARS, Maverick Healthcare, LLC, Qualitest Pharmaceuticals, Inc., Regional Management Corp., Shearer's Foods, Inc., Stryker Energy, LLC, TriZetto Group and Unitek. Such assets acquired from Patriot include: Aircraft Fasteners International, LLC, Boxercraft, Copernicus Group, EXL Acquisition Corp., Fairchild Industrial Products Co., Hudson Products Holdings, Inc., KTPS, Label Corp Holdings, Inc., LHC Holdings Corp., Northwestern Management Services LLC, R-O-M Corporation and Sport Helmets.

Nine debt investments were made to companies that are not performing in line with budget expectations as of December 31, 2009 and have seen a diminution of value since June 30, 2009 (Ajax, Coalbed, Deb Shops, Inc., H&M Oil & Gas, LLC, Iron Horse, NRG, R-V, Wind River Resources Corp. and Wind River II Corp. and Yatesville). The valuation of these assets is further stressed by declining market demand within their respective industries, primarily retail, industrial and energy-related. For these assets, we have increased the market interest rates to take into account the increased credit risk, illiquidity and general changes in current interest rates for similar assets to determine their fair value.

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

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

***Ajax Rolled Ring & Machine, Inc.***

We acquired a controlling equity interest in Ajax in a recapitalization of the company that was closed on April 4, 2008. We funded \$22,000 of senior secured term debt, \$11,500 of subordinated term debt and \$6,300 of equity as of that closing. As of December 31, 2009, we control 78.1% of the fully-diluted common and preferred equity.

Ajax forges seamless steel rings sold to various customers. The rings are used in a range of industrial applications, including in construction equipment and wind power turbines. Ajax's business is cyclical, and the business suffered in light of the global macroeconomic crisis of the past several quarters. 2008 was relatively strong for Ajax, but in the first half of 2009, Ajax experienced massive cuts in ordering of steel rings by its key customers. The second half of 2009 showed steady improvement versus very weak performance in the first half of the year and despite improvement in the second half of the year, Ajax's overall performance in 2009 was well below that of 2008. At December 31, 2009, Ajax had a backlog of new business that would indicate continued improvement through 2010.

The Board of Directors wrote-down the fair value of our investment in Ajax to \$25,802 as of December 31, 2009, a reduction of \$14,059 from its amortized cost, compared to the \$7,581 unrealized loss recorded at June 30, 2009.

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

Change Clean Energy, Inc. ( CCEI ) is an investment that we originated in September 2005 which owns and operated a bio-mass energy plant. In March 2009 CCEI ceased operations temporarily as it was not economically feasible to make a profit based on the cost of materials and the price being paid for electricity. During that quarter, we determined that it was appropriate to institute foreclosure proceedings against the co-borrowers of our debt to take full control of the assets. In anticipation of such proceedings CCEHI was established and on March 11, 2009, the foreclosure was completed and the assets were assigned to a wholly owned subsidiary of CCEHI. During the six months ended December 31, 2009, we provided additional funding of \$296 to CCEHI to fund ongoing operations. CCEI currently

has no material operations. At June 30, 2009 we determined that the impairment at both CCEI and CCEHI was other than temporary and recognized a realized loss of \$41,134, which was the amount by which the amortized cost exceeded the fair value. At December 31, 2009, our Board of Directors, under recommendation from senior management, has set the value of the CCEHI investment at \$1,976, a reduction of \$849 from its amortized cost.

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***Gas Solutions Holdings, Inc.***

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

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

In early May 2008, Gas Solutions II Ltd purchased a series of propane puts at \$0.10 out of the money and at prices of \$1.53 per gallon and \$1.394 per gallon covering the periods May 1, 2008, through April 30, 2009, and May 1, 2009, through April 30, 2010, respectively. These hedges were executed at close to the highest market propane prices ever achieved on an historical basis; such hedges preserve the upside of Gas Solutions II Ltd to benefit from potential future increases in commodity prices. GSHI generated approximately \$26,172 of EBITDA for the fiscal year ending December 31, 2008, an increase of 67% from 2007 results. Despite the volatility in commodity prices over the last year, GSHI generated approximately \$25,816 of EBITDA for the fiscal year ending December 31, 2009.

In determining the value of GSHI, we have utilized several valuation techniques to determine the value of the investment. These techniques offer a wide range of values. Our Board of Directors has determined the value to be \$85,187 for our debt and equity positions at December 31, 2009 based upon a combination of a discounted cash flow analysis and a public comparables analysis. At December 31, 2009 and June 30, 2009, GSHI was valued \$50,184 above its amortized cost.

***Integrated Contract Services, Inc.***

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

In January 2009, we foreclosed on the real and personal property of ICS. Through this foreclosure process, we gained 100% ownership of THS and certain ESA assets. Based upon an analysis of the liquidation value of the ESA assets and the enterprise value of THS, our Board of Directors affirmed the fair value of our investment in ICS at \$5,275 at December 31, 2009, a reduction of \$11,377 from its amortized cost, compared to the \$11,652 unrealized loss recorded at June 30, 2009.

***Iron Horse Coiled Tubing, Inc.***



Iron Horse is an investment that we made in April 2006. Iron Horse had been a provider of coiled tubing subcontractor services prior to making a strategic decision in late 2007 to directly service natural gas and oil producers in the Western Canadian Sedimentary Basin ( WCSB ) as a fracturing services provider. As a result of the business transition, the Company s 2008 financial performance declined significantly from 2007 levels. Iron

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Horse completed its transition from a subcontractor to a direct service provider in 2009, but natural gas prices fell to trough levels due to the recession and heightened natural gas inventory levels. Since November 2009, Iron Horse has seen increased activity in the WCSB and is now completing wells for several large producers in the WCSB.

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

The Board of Directors wrote-down the fair value of our investment in Iron Horse to \$12,318 as of December 31, 2009, a reduction of \$8,399 from its amortized cost, compared to the \$6,738 unrealized loss recorded at June 30, 2009.

***Yatesville Coal Holdings, Inc.***

All of our coal holdings have been consolidated under common management in Yatesville. Yatesville began to show improvement after the consolidation of the coal holdings, but the company exhausted its permitted reserves in December 2008 and has not had any meaningful revenue stream since. We continue to evaluate strategies for Yatesville such as soliciting indications of interest regarding a transaction involving part or all of recoverable reserves. During the six months ended December 31, 2009, we provided additional funding of \$3,376 to Yatesville to fund ongoing operations including new permitting. During the quarter, we discontinued operations at Yatesville. As of December 31, 2009, our Board of Directors determined that consistent with the decision to discontinue operations, the impairment of Yatesville was other than temporary and we recorded a realized loss of \$51,228 which was the amount that the amortized cost exceeded the fair value at December 31, 2009. Our Board of Directors set the value of the remaining Yatesville investment at \$1,035, which represents the residual value of recoverable reserves, as of December 31, 2009, a reduction of \$12,062 from its value as of June 30, 2009.

**Capitalization**

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

On June 25, 2009, we completed a first closing on an expanded \$250,000 syndicated revolving credit facility (the Facility ). The new Facility, for which six lenders have closed on \$210,000 to date, includes an accordion feature which allows the Facility to accept up to an aggregate total of \$250,000 of commitments for which we continue to solicit additional commitments from other lenders for the additional \$40,000. The revolving period of the Facility extends through June 2010, with an additional one year amortization period after the completion of the revolving period. As of December 31, 2009 and June 30, 2009, we had \$10,000 and \$124,800 of borrowings outstanding under our credit facility, respectively.

Interest on borrowings under the credit facility is one-month Libor plus 400 basis points, subject to a minimum Libor floor of 200 basis points after that date. The maintenance of this facility requires us to pay a fee for the amount not drawn upon. This fee assessed at the rate of 100 basis points per annum. The following table shows the facility amounts and outstanding borrowings at December 31, 2009 and June 30, 2009:

**As of**

**As of**

	<b>December 31, 2009</b>		<b>June 30, 2009</b>	
	<b>Facility Amount</b>	<b>Amount Outstanding</b>	<b>Facility Amount</b>	<b>Amount Outstanding</b>
Revolving Credit Facility	\$ 195,000	\$ 10,000	\$ 175,000	\$ 124,800

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The following table shows the contractual maturity of our revolving credit facility at December 31, 2009:

	<b>Payments Due By Period</b>		
	<b>Less Than 1 Year</b>	<b>1-3 Years</b>	<b>More Than 3 Years</b>
Credit Facility Payable	\$ 10,000	\$	\$

During the six months ended December 31, 2009, we completed public and private offerings and raised \$97,675 of additional equity by issuing 11,431,797 shares of our common stock below net asset value diluting shareholder value by \$0.75 per share. We also issued 8,444,068 shares to acquire Patriot increasing net asset value to shareholders by \$0.03 per share. The following table shows the calculation of net asset value per share as of December 31, 2009 and June 30, 2009:

	<b>As of December 31, 2009</b>	<b>As of June 30, 2009</b>
Net Assets	\$ 637,477	\$ 532,596
Shares of common stock outstanding	63,349,746	42,943,084
Net asset value per share	\$ 10.06	\$ 12.40

At December 31, 2009, we had 63,349,746 of our common stock issued and outstanding.

**Results of Operations**

For the three months ended December 31, 2009 and December 31, 2008, the net (decrease) increase in net assets resulting from operations was (\$16,853) and \$6,524, respectively, representing (\$0.29) and \$0.22 per share, respectively. We experienced a net realized and unrealized loss of \$33,778 or approximately \$0.59 per share in the three months ended December 31, 2009. This compares with the net realized and unrealized loss of \$5,436 during the three months ended December 31, 2008 or approximately \$0.18 per share.

For the six months ended December 31, 2009 and December 31, 2008, the net (decrease) increase in net assets resulting from operations was (\$23,231) and \$20,522, respectively, representing (\$0.43) and \$0.69 per share, respectively. We experienced a net realized and unrealized loss of \$52,474 or approximately \$0.98 per share in the six months ended December 31, 2009. This compares with the net realized and unrealized loss of \$14,940 during the six months ended December 31, 2008 or approximately \$0.51 per share.

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

## **Investment Income**

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

Investment income consists of interest income, including accretion of loan origination fees and prepayment penalty fees, dividend income and other income, including net profits interest, overriding royalties interest and

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structuring fees. The following table details the various components of investment income and the related levels of debt investments for the three months ended December 31, 2009 and December 31, 2008:

	For the Three Months Ended December 31,		For the Six Months Ended December 31,	
	2009	2008	2009	2008
Interest income	\$ 18,539	\$ 17,241	\$ 33,374	\$ 34,797
Dividend income	4,170	4,665	10,388	9,388
Other income	6,174	307	6,638	13,827
Total investment income	\$ 28,883	\$ 22,213	\$ 50,400	\$ 58,012
Average debt principal of investments	\$ 571,809	\$ 537,101	\$ 535,069	\$ 517,421
Weighted-average interest rate earned	12.86%	12.74%	12.37%	13.34%

Total investment income increased significantly from \$22,213 for the three months ended December 31, 2008 to \$28,883 for the six months ended December 31, 2009. This \$6,670 increase is primarily due to the Patriot acquisition, for which we recognized a gain from the acquisition of \$5,714 and purchase discount accretion of \$5,320 during the three months ended December 31, 2009. The discount accretion includes \$4,560 of accelerated accretion from early repayments of ADAPCO, Quartermaster and Aylward. Total investment income has decreased for the six months ended December 31, 2009 from the amount reported for the six months ended December 31, 2008 primarily due to a decrease in other income. This \$7,189 decrease in other income is primarily due to the settlement of our net profit interests in IEC/ARS for \$12,576 during the six months ended December 31, 2008, partially offset but gain from the acquisition of Patriot.

Average principal balances of debt investments have increased from \$537,101 for the three months ended December 31, 2008 to \$571,809 for the three months ended December 31, 2009. For the six months ended December 31, 2008 and 2009, average principal balances of debt investments increased from \$517,421 to \$535,069, respectively. These increases are primarily due to the Patriot acquisition which resulted in an additional \$289,030 of debt principal to our portfolio.

The weighted-average interest rate earned increased from 12.74% for the three months ended December 31, 2008 to 12.86% for the three months ended December 31, 2009. This increase is primarily the result of purchase discount accretion of \$5,320 from the Patriot acquisition. For the six months ended December 31, 2008 and 2009, weighted-average interest rate earned decreased from 13.34% to 12.37%, respectively. This decrease is primarily the result of Patriot acquisition purchase discount accretion, offset by foregone interest on non-accrual loans. During the six month period ended December 31, 2009, interest of \$12,510 was foregone on non-accrual debt investments compared to \$4,983 of forgone interest for the three months ended December 31, 2008. Without adjustments for foregone interest and purchase discount accretion from the Patriot acquisition, the weighted average interest rates earned on debt investments would have been 15.0% and 15.3% for the three months ended December 31, 2009 and 2008, respectively.

**Operating Expenses**

Our primary operating expenses consist of investment advisory fees (base management and income incentive fees), credit facility costs, legal and professional fees and other operating and overhead-related expenses. These expenses include our allocable portion of overhead under the Administration Agreement with Prospect Administration under which Prospect Administration provides administrative services and facilities for us. Our investment advisory fees compensate our Investment Adviser for its work in identifying, evaluating, negotiating, closing and monitoring our investments. We bear all other costs and expenses of our operations and transactions in accordance with our Administration Agreement with Prospect Administration. Operating expenses were \$11,958 and \$10,253 for the three months ended December 31, 2009 and December 31, 2008, respectively. Operating expenses were \$21,157 and \$22,550 for the six months ended December 31, 2009 and December 31, 2008, respectively.

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The base management fee was \$3,176 and \$2,940 for the three months ended December 31, 2009 and December 31, 2008, respectively. The base management fee was \$6,385 and \$5,763 for the six months ended December 31, 2009 and December 31, 2008, respectively. The increase in this expense for the three and six months ended December 31, 2009 is directly related to our growth in total assets.

For the three months ended December 31, 2009 and December 31, 2008, we incurred \$4,231 and \$2,990, respectively, of income incentive fees. The \$1,241 increase in the income incentive fee for the respective three-month period is driven by an increase in pre-incentive fee net investment income from \$14,950 for the three months ended December 31, 2008 to \$21,156 for the three months ended December 31, 2009, primarily the result of additional investment income from the Patriot acquisition. For the six months ended December 31, 2009 and December 31, 2008, we incurred \$7,311 and \$8,865, respectively, of income incentive fees. The \$1,554 decrease in the income incentive fee for the respective six-month period is driven by a decrease in pre-incentive fee net investment income from \$44,327 for the six months ended December 31, 2008 to \$36,554 for the six months ended December 31, 2009, primarily the result of the settlement of net profits interest in IEC/ARS in the 2008 period offset by the income from the Patriot acquisition. No capital gains incentive fee has yet been incurred pursuant to the Investment Advisory Agreement.

During the three and six months ended December 31, 2009, we incurred \$1,995 and \$3,369 of expenses related to our credit facility. This compares with expenses of \$1,965 and \$3,483 incurred during the three and six months ended December 31, 2008. These expenses are related directly to the leveraging capacity put into place for each of those periods and the levels of indebtedness actually undertaken during those quarters. The table below describes the various credit facility expenses and the related indicators of leveraging capacity and indebtedness during these periods.

	<b>For the Three Months Ended December 31,</b>		<b>For the Six Months Ended December 31,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Interest on borrowings	\$ 266	\$ 1,712	\$ 393	\$ 2,942
Amortization of deferred financing costs	1,282	180	2,106	360
Commitment and other fees	447	73	870	181
<b>Total</b>	<b>\$ 1,995</b>	<b>\$ 1,965</b>	<b>\$ 3,369</b>	<b>\$ 3,483</b>
Weighted-average debt outstanding	\$ 17,609	\$ 137,525	\$ 13,003	\$ 125,845
Weighted-average interest rate on borrowings	6.00%	4.94%	6.00%	4.64%
Facility amount at beginning of period	\$ 195,000	\$ 200,000	\$ 195,000	\$ 200,000

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

As our asset base has grown and we have added complexity to our capital raising activities, due, in part, to our assumption of the sub-administration role from Vastardis, we have commensurately increased the size of our administrative and financial staff, accounting for a significant increase in the overhead allocation from Prospect



Administration. Over the last year, Prospect Administration has added several additional staff members, including a senior finance professional, a controller, two corporate counsels and other finance professionals. As our portfolio continues to grow, we expect to continue to increase the size of our administrative and financial staff on a basis that provides increasing returns to scale. However, initial investments in administrative and financial staff may not provide returns to scale immediately, perhaps not until the portfolio increases to a greater size. Other allocated expenses from Prospect Administration have, as expected, increased alongside with the increase in staffing and asset base.

Legal costs increased from \$184 for the three months ended December 31, 2008 to \$390 for the three months ended December 31, 2009 primarily due to the increased size of our portfolio. Legal costs decreased from \$483 for the six months ended December 31, 2008 to \$390 for the six months ended December 31, 2009 as there were legal matters in the prior year that are no longer active.

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

Net investment income was \$16,925 and \$11,960 for the three months ended December 31, 2009 and December 31, 2008, respectively. This \$4,965 increase was due primarily to the Patriot acquisition, for we recognized a gain from the acquisition and purchase discount accretion, partially offset by increased advisory fees and forgone interest related to Iron Horse. Net investment income was \$29,243 and \$35,462 for the six months ended December 31, 2009 and December 31, 2008, respectively. This \$6,219 decrease is due primarily to the settlement of our net profit interests in IEC/ARS during the six months ended December 31, 2008, offset by the Patriot acquisition, increased advisory fees and forgone interest related to Iron Horse for the six months ended December 31, 2009.

Net realized (loss) gains were (\$51,229) and \$16 for the three months ended December 31, 2009 and December 31, 2008, respectively. Net realized (loss) gains were (\$51,229) and \$1,661 for the six months ended December 31, 2009 and December 31, 2008, respectively. The net realized loss of \$51,229 for the three and six months ended December 31, 2009 was due primarily to the impairment of Yatesville. See *Investment Valuations* for further discussion.

Net increase (decrease) in net assets from changes in unrealized appreciation/depreciation was \$17,451 and (\$5,452) for the three months ended December 31, 2009 and December 31, 2008, respectively. For the three months ended December 31, 2009, the \$17,451 increase in net assets from the net change in unrealized appreciation/depreciation was driven primarily by our impairment of Yatesville which resulted in \$40,856 being reversed out of unrealized, partially offset by write-downs of our investments in Ajax, H&M, NRG and R-V. For the three months ended December 31, 2008, the \$5,452 decrease in net assets from the net change in unrealized appreciation/depreciation was driven primarily by write-downs to our investments in Deb Shops, Iron Horse, Qualitest, RMC, Resco, WEPI, and Yatesville which were partially offset by unrealized appreciation of our investment in GSHI.

Net decrease in net assets from changes in unrealized appreciation/depreciation was \$1,245 and \$16,601 for the six months ended December 31, 2009 and December 31, 2008, respectively. The \$1,245 decrease occurring during the six months ended December 31, 2009 was primarily attributable to unrealized depreciation recognized for our investments in Ajax, Coalbed, Deb Shops, H&M, NRG, and R-V partially offset by the impairment of our investment in Yatesville of \$51,228. The \$16,601 decrease occurring during the six months ended December 31, 2008 was attributable to unrealized depreciation recognized for our investments in Deb Shops, Iron Horse, Qualitest, RMC, Resco, WEPI, and Yatesville partially offset by a write-up of our investment in GSHI.

**Financial Condition, Liquidity and Capital Resources**

For the six months ended December 31, 2009 and December 31, 2008, our operating activities provided (used) \$155,128 and (\$23,126) of cash, respectively. Investing activities for the Patriot acquisition used \$106,586 and zero for the six months ended December 31, 2009 and December 31, 2008, respectively. Financing activities provided \$54,640 and \$25,009 of cash during the six months ended December 31, 2009 and December 31, 2008, respectively, which included the payments of dividends of \$36,469 and \$22,221, during the six months ended December 31, 2009 and December 31, 2008, respectively.

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

We have and may continue to fund a portion of our cash needs through borrowings from banks, issuances of senior securities or secondary offerings. We may also securitize a portion of our investments in mezzanine or senior secured loans or other assets. Our objective is to put in place such borrowings in order to enable us to expand our portfolio. At December 31, 2009, we had \$10,000 outstanding borrowings on our \$195,000 revolving credit facility. Subsequent to December 31, 2009, we completed a closing for an additional \$15,000 commitment to the revolving credit facility, increasing total commitments to \$210,000.

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On September 6, 2007, our Registration Statement on Form N-2 was declared effective by the SEC. At December 31, 2009, under the Registration Statement, we had remaining availability to issue up to approximately \$147,500 of our equity securities over the next eight months.

We also continue to generate liquidity through public and private stock offerings. On July 7, 2009 we completed a public stock offering for 5,175,000 shares of our common stock at \$9.00 per share, raising \$46,575 of gross proceeds. On August 20, 2009 and September 24, 2009, we issued 3,449,686 shares and 2,807,111 shares, respectively, of our common stock at \$8.50 and \$9.00 per share, respectively, in private stock offerings, raising \$29,322, and \$25,264 of gross proceeds, respectively. Concurrent with the sale of these shares, we entered into a registration rights agreement in which we granted the purchasers certain registration rights with respect to the shares. Under the terms and conditions of the registration rights agreement, we filed with the SEC a post-effective amendment to the registration statement on Form N-2 on November 6, 2009. Such amendment was declared effective by the SEC on November 9, 2009.

On December 2, 2009 we acquired the outstanding shares of Patriot common stock for approximately \$201,083. Under the terms of the merger agreement, Patriot common shareholders received 0.363992 shares of our common stock for each share of Patriot common stock, resulting in 8,444,068 shares of common stock being issued by us. In connection with the transaction, we repaid all the outstanding borrowings of Patriot, in compliance with the merger agreement.

## **Off-Balance Sheet Arrangements**

At December 31, 2009, we did not have any off-balance sheet liabilities or other contractual obligations that are reasonably likely to have a current or future material effect on our financial condition, other than those which originate from 1) the investment advisory and management agreement and the administration agreement and 2) the portfolio companies.

## **Developments Since the End of the Fiscal Quarter**

On January 25, 2010, we issued 236,985 shares of our common stock in connection with the dividend reinvestment plan.

On January 4, 2010, we completed a closing for an additional \$15,000 commitment to the Facility, increasing total commitments to \$210,000.

## ***Merger Discussions with Allied Capital Corporation***

On January 14, 2010, Prospect Capital delivered a proposal letter to the Allied Capital Board (the First Prospect Capital Merger Offer Letter ) containing an offer to acquire each outstanding Allied Capital Corporation ( Allied Capital ) Share in exchange for 0.385 of a share of Prospect Capital Common Stock (the First Prospect Capital Merger Offer ).

On January 19, 2010, Allied Capital filed a Form 8-K stating that the Allied Capital Board determined that the First Prospect Capital Merger Offer did not constitute a Superior Proposal as such term is defined in the Ares Capital Merger Agreement.

On January 20, 2010, Prospect Capital issued a press release containing a copy of a letter it subsequently sent to the Allied Capital Board in connection with the First Prospect Capital Merger Offer.

On January 26, 2010, Prospect Capital announced that it delivered another letter to the Allied Capital Board, raising its offer to acquire Allied Capital (the Second Prospect Capital Merger Offer Letter ).

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On February 3, 2010, Allied Capital informed us and filed a Form 8-K stating that the Allied Capital Board determined that the Second Prospect Capital Merger Offer did not constitute a Superior Proposal as such term is defined in the Ares Capital Merger Agreement.

On February 9, 2010, Prospect Capital announced that it delivered another letter to the Allied Capital Board, raising its offer to acquire Allied Capital (the Third Prospect Capital Merger Offer Letter ).

On February 11, 2010, Allied Capital informed us and filed a Form 8-K stating that the Allied Capital Board determined that the Third Prospect Capital Merger Offer did not constitute a Superior Proposal as such term is defined in the Ares Capital Merger Agreement. Prospect Capital has filed proxy materials to solicit Allied Shareholders to vote against Allied s proposed merger with Ares Capital Corporation. A merger with Allied would be material to Prospect Capital and its shareholders. If Prospect Capital were to negotiate a merger agreement with Allied, Prospect Capital would provide extensive disclosure to its shareholders regarding the terms and conditions of and risks regarding such transaction.

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**REPORT OF MANAGEMENT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

Management is responsible for establishing and maintaining adequate internal control over financial reporting, and for performing an assessment of the effectiveness of internal control over financial reporting as of June 30, 2009. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company's internal control over financial reporting includes those policies and procedures that (i) pertain to assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

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

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

**USE OF PROCEEDS**

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

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

**FORWARD-LOOKING STATEMENTS**

Our annual report on Form 10-K for the year ended June 30, 2009, any of our quarterly reports on Form 10-Q or current reports on Form 8-K, or any other oral or written statements made in press releases or otherwise by or on behalf of Prospect Capital Corporation including this prospectus may contain forward looking statements within the meaning of the Section 21E of the Securities Exchange Act of 1934, as amended, which involve substantial risks and uncertainties. Forward looking statements predict or describe our future operations, business plans, business and investment strategies and portfolio management and the performance of our investments and our investment



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

our future operating results,

our business prospects and the prospects of our portfolio companies,

the impact of investments that we expect to make,

the dependence of our future success on the general economy and its impact on the industries in which we invest,

the ability of our portfolio companies to achieve their objectives,

difficulty in obtaining financing or raising capital, especially in the current credit and equity environment,

the level and volatility of prevailing interest rates and credit spreads, magnified by the current turmoil in the credit markets,

adverse developments in the availability of desirable loan and investment opportunities whether they are due to competition, regulation or otherwise,

a compression of the yield on our investments and the cost of our liabilities, as well as the level of leverage available to us,

our regulatory structure and tax treatment, including our ability to operate as a business development company and a regulated investment company;

the adequacy of our cash resources and working capital;

the timing of cash flows, if any, from the operations of our portfolio companies;

the ability of our investment adviser to locate suitable investments for us and to monitor and administer our investments,

authoritative generally accepted accounting principles or policy changes from such standard-setting bodies as the Financial Accounting Standards Board, the Securities and Exchange Commission, Internal Revenue Service, the New York Stock Exchange, and other authorities that we are subject to, as well as their

counterparts in any foreign jurisdictions where we might do business; and

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

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

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**DISTRIBUTIONS**

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

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

98% of our ordinary income for the calendar year,

98% of our capital gains in excess of capital losses for the one-year period ending on October 31 of the calendar year, and

any ordinary income and net capital gains for preceding years that were not distributed during such years.

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

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

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

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

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



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

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

**Table of Contents****SENIOR SECURITIES**

Information about our senior securities is shown in the following table as of each fiscal year ended June 30 since the Company commenced operations and as of December 31, 2009, unless otherwise noted. The report of our independent registered public accounting firm on the senior securities table as of June 30, 2009 is attached as an exhibit to the registration statement of which this prospectus is a part.

<b>Class and Year</b>	<b>Total Amount Outstanding(1)</b>	<b>Asset Coverage per Unit(2)</b>	<b>Involuntary Liquidating Preference Per Unit(3)</b>	<b>Average Market Value Per Unit(4)</b>
<b>Credit Facility</b>				
Fiscal 2010 (as of December 31, 2009, unaudited)	\$ 10,000	\$ 64,748		
Fiscal 2009 (as of June 30, 2009)	124,800	5,268		
Fiscal 2008 (as of June 30, 2008)	91,167	5,712		
Fiscal 2007 (as of June 30, 2007)		N/A		
Fiscal 2006 (as of June 30, 2006)	28,500	4,799		
Fiscal 2005 (as of June 30, 2005)		N/A		
Fiscal 2004 (as of June 30, 2004)		N/A		

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

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

(3) This column is inapplicable because we have had only bank debt outstanding during the time periods.

(4) This column is inapplicable because we have not had any preferred stock outstanding during any of the time periods.

**Table of Contents****PRICE RANGE OF COMMON STOCK**

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

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

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First quarter	\$ 11.11	\$ 10.99	\$ 8.82	(1.1)%	(20.6)%	\$ 0.4075
Second quarter	10.06	12.31	9.93	22.4%	(1.3)%	0.40875
Third quarter (to 2/25/10)	(3)(4)	13.20	10.45	(4)	(4)	(5)

- (1) Net asset value per share is determined as of the last day in the relevant quarter and therefore may not reflect the net asset value per share on the date of the high or low sales price. The NAVs shown are based on outstanding shares at the end of each period.
- (2) The High/Low Stock Price is calculated as of the closing price on a given day in the applicable quarter.
- (3) Our most recently determined NAV per share was \$10.06 as of December 31, 2009 (\$10.07 on an as adjusted basis solely to give effect to our issuance of common stock on January 25, 2010 in connection with our dividend reinvestment plan). NAV as of March 31, 2010 may be higher or lower than \$10.07 based on potential changes in valuations as of March 31, 2010.
- (4) NAV has not yet been finally determined for any day after December 31, 2009.
- (5) The dividend for the third quarter of 2010 will be declared in March 2010.

On February 25, 2010, the last reported sales price of our common stock was \$11.66 per share. As of February 25, 2010, we had approximately 69 stockholders of record.



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**BUSINESS**

**General**

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

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

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

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

**Our Investment Objective and Policies**

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

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

We seek to maximize returns and protect risk for our investors by applying rigorous analysis to make and monitor our investments. While the structure of our investments varies, we can invest in senior secured debt, senior unsecured debt, subordinated secured debt, subordinated unsecured debt, mezzanine debt, convertible debt, convertible preferred equity, preferred equity, common equity, warrants and other instruments, many of which generate current yield. Our

investments primarily range between approximately \$5 million and \$50 million each, although this investment size may vary as the size of our capital base changes.

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

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

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

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

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

## **Industry Sectors**

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

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

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

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

## **Ongoing Relationships with Portfolio Companies**

### ***Monitoring***

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

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

Assessment of success in adhering to the portfolio company's business plan and compliance with covenants;

Regular contact with portfolio company management and, if appropriate, the financial or strategic sponsor, to discuss financial position, requirements and accomplishments;

Attendance at and participation in board meetings of the portfolio company; and

Review of monthly and quarterly financial statements and financial projections for the portfolio company.

***Investment Valuation***

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

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

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

- 1) each portfolio company or investment is reviewed by our investment professionals with the independent valuation firm engaged by our Board of Directors;
- 2) the independent valuation firm conducts independent appraisals and makes their own independent assessment;
- 3) the audit committee of our Board of Directors reviews and discusses the preliminary valuation of our Investment Adviser and that of the independent valuation firm; and
- 4) the Board of Directors discusses the valuations and determines the fair value of each investment in our portfolio in good faith based on the input of our Investment Adviser, the independent valuation firm and the audit committee.

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

In September 2006, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Codification ( ASC or Codification ) 820, *Fair Value Measurements and Disclosures* ( ASC 820 ). ASC 820 defines fair value,

establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. We adopted ASC 820 on a prospective basis beginning in the quarter ended September 30, 2008.

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

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

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

*Level 3:* Unobservable inputs for the asset or liability.

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

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

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

In April 2009, the FASB issued ASC 820-10-65, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* ( ASC 820-10-65 ). This update provides further clarification for ASC 820 in markets that are not active and provides additional guidance for determining when the volume of trading level of activity for an asset or liability has significantly decreased and for identifying circumstances that indicate a transaction is not orderly. ASC 820-10-65 is effective for interim and annual reporting periods ending after June 15, 2009. The adoption of ASC 820-10-65 for the three and six months ended December 31, 2009, did not have any effect on our net asset value, financial position or results of operations as there was no change to the fair value measurement principles set forth in ASC 820.

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

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

### ***Valuation of Other Financial Assets and Financial Liabilities***

In February 2007, FASB issued ASC Subtopic 820-10-05-1, *The Fair Value Option for Financial Assets and Financial Liabilities* ( ASC 820-10-05-1 ). ASC 820-10-05-1 permits an entity to elect fair value as the initial and subsequent measurement attribute for many of assets and liabilities for which the fair value option has been elected and similar assets and liabilities measured using another measurement attribute. We have adopted this statement on July 1, 2008 and have elected not to value some assets and liabilities at fair value as would be permitted by ASC 820-10-05-1.

## **The Investment Adviser**

Prospect Capital Management manages our investments as our investment adviser. Prospect Capital Management is a Delaware limited liability corporation that has been registered as an investment adviser under the Advisers Act since March 31, 2004. Prospect Capital Management is led by John F. Barry III and M. Grier Eliasek, two senior executives with significant investment advisory and business experience. Both Messrs. Barry and Eliasek spend a significant amount of their time in their roles at Prospect Capital Management working on the Company's behalf. The principal executive offices of Prospect Capital Management are 10 East 40th Street,



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44th Floor, New York, NY 10016. We depend on the diligence, skill and network of business contacts of the senior management of our Investment Adviser. We also depend, to a significant extent, on our Investment Adviser's investment professionals and the information and deal flow generated by those investment professionals in the course of their investment and portfolio management activities. The Investment Adviser's senior management team evaluates, negotiates, structures, closes, monitors and services our investments. Our future success depends to a significant extent on the continued service of the senior management team, particularly John F. Barry III and M. Grier Eliasek. The departure of any of the senior managers of our Investment Adviser could have a materially adverse effect on our ability to achieve our investment objective. In addition, we can offer no assurance that Prospect Capital Management will remain our Investment Adviser or that we will continue to have access to its investment professionals or its information and deal flow. Under our Investment Advisory Agreement, we pay Prospect Capital Management investment advisory fees, which consist of an annual base management fee based on our gross assets as well as a two-part incentive fee based on our performance. Mr. Barry currently controls Prospect Capital Management. See Management Management Services Board of Directors approval of the Investment Advisory Agreement.

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

## **Staffing**

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

## **Properties**

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

## **Legal Proceedings**

On December 6, 2004, Dallas Gas Partners, L.P. ("DGP") served us with a complaint filed November 30, 2004 in the U.S. District for the Southern District of Texas, Galveston Division. DGP alleges that DGP was defrauded and that we breached our fiduciary duty to DGP and tortiously interfered with DGP's contract to purchase Gas Solutions, Ltd. (a subsidiary of our portfolio company, GSHI) in connection with our alleged agreement in September 2004 to loan DGP funds with which DGP intended to buy Gas Solutions, Ltd. for approximately \$26 million. The complaint sought relief not limited to \$100 million. On November 30, 2005, U.S. Magistrate Judge John R. Froeschner of the

U.S. District Court for the Southern District of Texas, Galveston Division, issued a recommendation that the court grant our Motion for Summary Judgment dismissing all claims by DGP. On February 21, 2006, U.S. District Judge Samuel Kent of the U.S. District Court for the Southern District of Texas, Galveston Division issued an order granting our Motion for Summary Judgment dismissing all claims by DGP, against us. On May 16, 2007, the Court also granted us summary judgment on DGP's liability to us on our

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counterclaim for DGP's breach of a release and covenant not to sue. On January 4, 2008, the Court, Judge Melinda Harmon presiding, granted our motion to dismiss all DGP's claims asserted against certain of our officers and affiliates. On August 20, 2008, Judge Harmon entered a Final Judgment dismissing all of DGP's claims. DGP appealed to the U.S. Court of Appeals for the Fifth Circuit, which affirmed the Final Judgment on June 24, 2009. DGP has moved for rehearing. Our damage claims against DGP remain pending.

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

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

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

## **Management**

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

## **Board Of Directors And Executive Officers**

Under our charter, our directors are divided into three classes. Directors are elected for a staggered term of three years each, with a term of office of one of the three classes of directors expiring each year. At each annual meeting of our stockholders, the successors to the class of directors whose terms expire at such meeting are elected to hold office for

a term expiring at the annual meeting of stockholders held in the third year following the year of their election. Each director holds office for the term to which he or she is elected and until his or her successor is duly elected and qualifies.

**Table of Contents****Directors and Executive Officers**

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

**Independent Directors**

<b>Name and Age</b>	<b>Position(s) Held with the Company</b>	<b>Term of Office(1) and Length of Time Served</b>	<b>Principal Occupation(s) During Past 5 Years</b>	<b>Number of Portfolios in Fund Complex Overseen by Director</b>	<b>Other Directorships Held by Director(2)</b>
Graham D.S. Anderson, 45	Director	Class I Director since September 2008; Term expires 2011	General Partner of Euclid SR Partners from 2000 to present. From 1996 to 2000, Mr. Anderson was a General Partner of Euclid Partners, the predecessor to Euclid SR Partners.	One	None
Eugene S. Stark, 52	Director	Class III Director since September 2008; Term expires 2010	Principal Financial Officer, Chief Compliance Officer and Vice President Administration of General American Investors Company, Inc. from May 2005 to present. Prior to his role with General American Investors Company, Inc., Mr. Stark served as the Chief Financial Officer of Prospect Capital Corporation from January 2005 to April 2005. From May 1987 to December 2004 Mr. Stark served as Senior Vice President and Vice President with Prudential Financial, Inc.	One	None
Andrew C. Cooper, 48	Director	Class II Director since February 2009; Term expires 2012	Mr. Cooper is an entrepreneur, who over the last 11 years has founded, built, run and sold three companies. He is Co-Chief Executive Officer of Unison Site Management, Inc., a specialty finance company focusing on cell site easements, and Executive Director of Brand Asset Digital, a digital media marketing and distribution company. Prior to that, Mr. Cooper focused on venture capital and investment banking for Morgan Stanley for 14 years.	One	Unison Site Management, LLC, Brand Asset Digital, LLC and Aquatic Energy, LLC

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

terms that will expire in 2012 and Mr. Barry and Mr. Stark are Class III directors with terms that will expire in 2010.

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

**Table of Contents****Interested Directors**

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

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

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

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

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

<b>Name and Age</b>	<b>Position(s) Held with the Company</b>	<b>Term of Office and Length of Time Served</b>	<b>Principal Occupation(s) During Past Five Years</b>
Brian H. Oswald, 49			

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

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

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



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

***Interested Directors***

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

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

***Executive Officer***

*Brian H. Oswald.* Mr. Oswald is chief financial officer, chief compliance officer, secretary and treasurer of the Company. He began his career at KPMG Peat Marwick, where he held various positions over his ten-year tenure, finishing as a Senior Manager in the financial institutions group. During his time at KPMG, he served as the reviewing senior manager for several initial public offerings of financial institutions. After KPMG, Mr. Oswald served as the Executive Vice President and President of Gloversville Federal Savings and Loan Association, served as the Director of Financial Reporting and Subsidiary Accounting for River Bank America and served as the Corporate Controller for Magic Solutions, Inc. In each of these positions, Mr. Oswald instituted significant operational changes and was

instrumental in raising additional equity for River Bank America. From 2003 to 2005, Mr. Oswald led Capital Trust, Inc., a self-managed finance and investment management REIT which specializes in credit-sensitive structured financial products, as Chief Financial Officer. From 1997 to 2003, he served as Chief Accounting Officer for Capital Trust. Prior to joining the Company, Mr. Oswald spent two years with the Structured

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

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

## **Committees of the Board of Directors**

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

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

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

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

As such, it is not the duty or the responsibility of the Audit Committee or its members to conduct field work or other types of auditing or accounting reviews or procedures, to determine that the financial statements are complete and accurate and are in accordance with generally accepted accounting principles, or to set auditor independence standards. Each member of the Audit Committee is entitled to rely on (a) the integrity of those persons within and outside us and management from which it receives information; (b) the accuracy of the financial and other information provided to the Audit Committee absent actual knowledge to the contrary (which is required to be

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promptly reported to the Board of Directors); and (c) statements made by our officers and employees, our Investment Adviser or other third parties as to any information technology, internal audit and other non-audit services provided by the independent accountants to us.

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

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

**Corporate Governance**

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

*Code of Conduct.* We have adopted a code of conduct which applies to, among others, our senior officers, including our Chief Executive Officer and Chief Financial Officer, as well as all of our employees. Our code of conduct is an

exhibit to our Annual Report on Form 10-K filed with the SEC, and can be accessed via the Internet site of the SEC at <http://www.sec.gov>. We intend to disclose amendments to or waivers from a required provision of the code of conduct on Form 8-K.

*Code of Ethics.* We, Prospect Capital Management and Prospect Administration have each adopted a code of ethics pursuant to Rule 17j-1 under the 1940 Act that establishes procedures for personal investments and restricts

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certain personal securities transactions. Personnel subject to each code may invest in securities for their personal investment accounts, including securities that may be purchased or held by us, so long as such investments are made in accordance with the code s requirements.

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

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

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

***Independent Directors***

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

**Proxy Voting Policies And Procedures**

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

**Compensation of Directors and Officers**

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

<b>Name and Position</b>	<b>Aggregate Compensation from the Company</b>	<b>Pension or Retirement Benefits Accrued as Part of the Company s Expenses(1)</b>	<b>Total Compensation Paid to Director/ Officer</b>
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**Interested Directors**

John F. Barry(2)	None	None	None
M. Grier Eliasek(2)	None	None	None

**Independent Directors**

Graham D.S. Anderson(3)	\$ 67,750	None	\$ 67,750
Andrew C. Cooper(4)	\$ 32,381	None	\$ 32,381
Eugene S. Stark(5)	\$ 70,500	None	\$ 70,500

**Executive Officers**

William E. Vastardis(6,7)		None	
Brian H. Oswald(2)	None	None	None

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



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- (2) We have not paid, and we do not intend to pay, any annual cash compensation to our executive officers for their services as executive officers. Messrs. Barry and Eliasek are compensated by Prospect Capital Management from the income Prospect Capital Management receives under the management agreement between Prospect Capital Management and us. Mr. Oswald is compensated by Prospect Administration from the income Prospect Administration receives under the Administration Agreement.
- (3) Mr. Anderson joined our Board of Directors on September 15, 2008.
- (4) Mr. Cooper joined our Board of Directors on February 12, 2009.
- (5) Mr. Stark joined our Board of Directors on September 4, 2008.
- (6) Mr. Vastardis is no longer employed by the Company, but served as Chief Compliance Officer from January 4, 2005 through September 30, 2008, and served as Chief Financial Officer and Treasurer from April 30, 2005 through November 11, 2008. Mr. Vastardis served as Secretary from April 30, 2005 through June 6, 2008.
- (7) The compensation of William E. Vastardis for his service as Chief Financial Officer and Treasurer of the Company was paid by Vastardis Fund Services LLC, formerly our sub-administrator. Vastardis Fund Services was in turn paid by the Company at a monthly minimum rate of \$33,333.33 or annual fees on gross assets of 0.20% on the first \$250 million, 0.15% on the next \$250 million, 0.10% on the next \$250 million, 0.075% on the next \$250 million and 0.05% over one billion. The compensation of William E. Vastardis for his service as Chief Compliance Officer of the Company was paid by Vastardis Compliance Services LLC. Vastardis Compliance Services LLC was in turn paid by the Company at a monthly rate of \$6,250. In addition, the Company paid Vastardis Compliance Services LLC for certain other services at the rate of \$270 per hour. Both Vastardis Fund Services LLC and Vastardis Compliance Services LLC determined the compensation to be paid to Mr. Vastardis with respect to the Company based on a case-by-case evaluation of the time and resources that is required to fulfill his duties to the Company. For the fiscal year ending June 30, 2009, the Company paid Vastardis Compliance Services LLC \$25,000 for services rendered by Mr. Vastardis as Chief Compliance Officer. For the fiscal year ending June 30, 2009, the Company paid Vastardis Fund Services LLC approximately \$827,083 for services required to be provided by Prospect Administration, including, but not limited to, (a) clerical, bookkeeping and record keeping services, (b) conducting relations with custodians, depositories, transfer agents and other third-party service providers and (c) furnishing reports to Prospect Administration and the Board of Directors of the Company of its performance of obligations. In addition, the fees paid to Vastardis Fund Service LLC cover the services rendered by Mr. Vastardis as our Chief Financial Officer and Treasurer.

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

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

Effective January 12, 2009, the independent directors who serve on both committees of the Board receive an annual fee of \$85,000 plus reimbursement of any reasonable out-of-pocket expenses incurred, the independent directors who serve on one committee of the Board receive an annual fee of \$60,000 plus reimbursement of any reasonable

out-of-pocket expenses incurred and the independent directors who do not serve on any committees of the board receive an annual fee of \$11,250. No compensation was paid to directors who are interested persons of the Company as defined in 1940 Act. In addition, the Company purchases directors and officers liability insurance on behalf of the directors and officers. Through December 31, 2009, each of the three independent directors has been paid \$42,500 for the fiscal year ending June 30, 2010.

**Table of Contents****Management Services*****Investment Advisory Agreement***

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

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

The incentive fee has two parts. The first part, the income incentive fee, which is payable quarterly in arrears, will equal 20% of the excess, if any, of our pre-incentive fee net investment income that exceeds a 1.75% quarterly (7% annualized) hurdle rate, subject to a catch up provision measured as of the end of each calendar quarter. In the three months ended December 31, 2009, we paid an incentive fee of \$4.23 million (see calculation below). For this purpose, pre-incentive fee net investment income means interest income, dividend income and any other income (including any other fees (other than fees for providing managerial assistance), such as commitment, origination, structuring, diligence and consulting fees and other fees that we receive from portfolio companies) accrued during the calendar quarter, minus our operating expenses for the quarter (including the base management fee, expenses payable under the Administration Agreement described below, and any interest expense and dividends paid on any issued and outstanding preferred stock, but excluding the incentive fee). Pre-incentive fee net investment income includes, in the case of investments with a deferred interest feature (such as original issue discount, debt instruments with payment in kind interest and zero coupon securities), accrued income that we have not yet received in cash. Pre-incentive fee net investment income does not include any realized capital gains, realized capital losses or unrealized capital appreciation or depreciation. Pre-incentive fee net investment income, expressed as a rate of return on the value of our net assets at the end of the immediately preceding calendar quarter, is compared to a hurdle rate of 1.75% per quarter (7% annualized).

We expect the incentive fees we pay to increase to the extent we earn greater interest and dividend income through our investments in portfolio companies and, to a lesser extent, realize capital gains upon the sale of warrants or other equity investments in our portfolio companies and to decrease if our interest and dividend income and capital gains decrease. The catch-up provision requires us to pay 100% of our pre-incentive fee net investment income with respect to that portion of such income, if any, that exceeds the hurdle rate but is less than 125% of the quarterly hurdle rate in any calendar quarter (8.75% annualized assuming an annualized hurdle rate of 7%). The catch-up provision is meant to provide Prospect Capital Management with 20% of our pre-incentive fee net investment income as if a hurdle rate did not apply when our pre-incentive fee net investment income exceeds 125% of the quarterly hurdle rate in any calendar quarter (8.75% annualized assuming an annualized hurdle rate of 7%). The income incentive fee will be computed and paid on income that may include interest that is accrued but not yet received in cash. If interest income is accrued but never paid, the Board of Directors would decide to write off the accrual in the quarter when the accrual

is determined to be uncollectible. The write off would cause a decrease in interest income for the quarter equal to the amount of the prior accrual. The Investment Adviser is not under any obligation to reimburse us for any part of the incentive fee it received that was based on accrued income that we never receive as a result of a default by an entity on the obligation that resulted in the accrual of such income.

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

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

100.00% of our pre-incentive fee net investment income with respect to that portion of such pre-incentive fee net investment income, if any, that exceeds the hurdle rate but is less than 125.00% of the quarterly hurdle rate in any calendar quarter (8.75% annualized assuming a 7.00% annualized hurdle rate); and

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

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

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

The following is a calculation of the most recently paid incentive fee paid in January 2010 (for the quarter ended December 31, 2009) (in thousands):

Prior Quarter Net Asset Value (adjusted for stock offerings during the quarter)	\$ 637,507
Quarterly Hurdle Rate	1.75%
Current Quarter Hurdle	\$ 11,156
125% of the Quarterly Hurdle Rate	2.1875%
125% of the Current Quarter Hurdle	\$ 13,945

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Current Quarter Pre Incentive Fee Net Investment Income	\$ 21,156
Incentive Fee Catch-Up	\$ 2,789
Incentive Fee 20% in excess of 125% of the Current Quarter Hurdle	\$ 1,442
Total Current Quarter Incentive Fee	\$ 4,231

The total base management fees earned by and paid to Prospect Capital Management during the twelve months ended June 30, 2009, June 30, 2008 and June 30, 2007 were \$11.9 million, \$8.9 million and \$5.4 million,

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respectively. The total base management fees earned by and paid to Prospect Capital Management for the six months ended December 31, 2009 and December 31, 2008 were \$6.4 million and \$5.7 million, respectively.

The income incentive fees were \$14.8 million, \$11.3 million and \$5.8 million for the twelve months ended June 30, 2009, June 30, 2008 and June 30, 2007, respectively. No capital gains incentive fees were earned for the twelve months ended June 30, 2009, June 30, 2008 and June 30, 2007. The total income incentive fees for the six months ended December 31, 2009 and December 31, 2008 were \$7.3 million and \$8.9 million, respectively.

The total investment advisory fees were \$26.7 million, \$20.2 million and \$11.2 million for the twelve months ended June 30, 2009, June 30, 2008 and June 30, 2007, respectively. The total investment advisory fees for the six months ended December 31, 2009 and December 31, 2008 were \$13.7 million and \$14.6 million, respectively.

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

***Examples of Quarterly Incentive Fee Calculation***

Example 1: Income Incentive Fee(\*):

**Alternative 1**

Assumptions

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

Hurdle rate(1) = 1.75%

Base management fee(2) = 0.50%

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

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

(1) Represents 7% annualized hurdle rate

(2) Represents 2% annualized base management fee.

(3) Excludes organizational and offering expenses.

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

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

**Alternative 2**

Assumptions

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