

PROSPECT CAPITAL CORP
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Registration No. 333-143819

Prospectus dated March 18, 2009

\$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 March 17, 2009, the last reported sales price for our common stock was \$7.61.

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.

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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. This information will be available free of charge by writing to Prospect Capital Corporation at 10 East 40th Street, 44th Floor, New York, NY 10016, or by calling collect at 212-448-0702. Our Internet address is <http://www.prospectstreet.com>. You may also obtain information about us from the SEC's website (<http://www.sec.gov>).

Neither the SEC nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

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

The date of this Prospectus is March 18, 2009

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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.

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. 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.

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 to, which we expect to use initially to maintain balance sheet liquidity and thereafter to make long-term investments in accordance with our investment objectives.

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

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

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

Use of proceeds

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

Distributions

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

Stock," "Distributions" and "Material U.S. Federal Income Tax Considerations."

Taxation

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

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

Dividend reinvestment plan

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

The NASDAQ Global Select Market Symbol

PSEC

Anti-takeover provisions

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

Management arrangements

Prospect Capital Management serves as our investment adviser. Prospect Administration serves as our administrator and has engaged Vastardis Fund Services, LLC, or Vastardis (formerly, EOS Fund Services LLC), as sub-administrator. For a description of Prospect Capital Management, Prospect Administration, Vastardis 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 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 \$200 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)	4.50%
Offering expenses borne by us (as a percentage of offering price)(2)	0.20%
Dividend reinvestment plan expenses(3)	None
Total stockholder transaction expenses (as a percentage of offering price)(4)	4.70%
Annual expenses (as a percentage of net assets attributable to common stock)*:	
Combined base management fee (3.04%)(5) and incentive fees payable under Investment Advisory Agreement (20% of realized capital gains and 20% of pre-incentive fee net investment income) (2.8%)(6)	5.84%
Interest payments on borrowed funds	1.37%(7)
Other expenses	2.39%(8)
Total annual expenses	9.59%(6)(8)

Example

The following table demonstrates the projected dollar amount of cumulative expenses we would pay out of net assets and that you would indirectly bear over various periods with respect to a hypothetical investment in our common stock. In calculating the following expense amounts, we have assumed we would have borrowed all \$200 million available under our line of credit, that our annual operating expenses would remain at the levels set forth in the table above and that we would pay the stockholder costs shown in the table above.

	1 Year	3 Years	5 Years	10 Years
You would pay the following expenses on a \$1,000 investment, assuming a 5% annual return	\$ 111.80	\$ 237.93	\$ 359.56	\$ 644.99

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.

*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 December 31, 2008.

- (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 \$200 million, the 2% management fee of gross assets equals approximately 3.04% of net assets. See "Management Management Services Investment Advisory Agreement" and footnote 6 below.
- (6) The incentive fee payable to our Investment Adviser under the Investment Advisory Agreement is based on our performance and will not be paid unless we achieve certain goals. Under the assumption of a 5% return required in the example, no incentive fee would be payable. The incentive fee consists of two parts. The first part, the income incentive fee, which is payable quarterly in arrears, will equal 20% of the excess, if any, of our pre-incentive fee net investment income that exceeds a 1.75% quarterly (7% annualized) hurdle rate, subject to a "catch up" provision measured as of the end of each calendar quarter. In the three months ended December 31, 2008, we paid an incentive fee of \$2.99 million (see calculation below). We expect the incentive fees we pay to increase to the extent we earn greater interest and dividend income through our investments in portfolio companies and, to a lesser extent, realize capital gains upon the sale of warrants or other equity investments in our portfolio companies and to decrease if our interest and dividend income and capital gains decrease. The "catch-up" provision requires us to pay 100% of our pre-incentive fee net investment income with respect to that portion of such income, if any, that exceeds the hurdle rate but is less than 125% of the quarterly hurdle rate in any calendar quarter (8.75% annualized assuming an annualized hurdle rate of 7%). The catch-up provision is meant to provide Prospect Capital Management with 20% of our pre-incentive fee net investment income as if a hurdle rate did not apply when our pre-incentive fee net investment income exceeds 125% of the quarterly hurdle rate in any calendar quarter (8.75% annualized assuming an annualized hurdle rate of 7%). The income incentive fee will be computed and paid on

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

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

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

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

$$= 100\% \times (2\% - 1.75\%)$$

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= 0.25%

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

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

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

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

= 20% × (6%-1%)

= 20% × 5% = 1%

The following is a calculation of the most recently paid incentive fee paid in September 2008 (for the quarter ended December 31, 2008) (in thousands):

Prior Quarter Net Asset Value	\$ 431,739
Quarterly Hurdle Rate	1.75%
Current Quarter Hurdle	\$ 7,555
125% of the Quarterly Hurdle Rate	2.1875%
125% of the Current Quarter Hurdle	\$ 9,444
Current Quarter Pre Incentive Fee Net Investment Income	\$ 14,950
Incentive Fee "Catch-Up"	\$ 1,889
Incentive Fee 20% in excess of 125% of the Current Quarter Hurdle	\$ 1,101
Total Current Quarter Incentive Fee	\$ 2,990

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

(7) The table above assumes that we have borrowed all \$200 million available under our line of credit, although no plans are in place to borrow the full amount under our line of credit. The table below shows our estimated annual expenses as a percentage of net assets attributable to common stock, assuming that we did not incur any indebtedness.

Base management fee	2.10%
Incentive fees payable under Investment Advisory Agreement (20% of realized capital gains and 20% of pre-incentive fee net investment income)	2.80%
Interest payments on borrowed funds	None
Other expenses	3.32%
Total annual expenses (estimated)	8.22%

(8) "Other expenses" is based on our annualized expenses during our quarter ended December 31, 2008 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 Administration Agreement." Management Services

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 for the twelve months ended June 30, 2008, 2007, 2006 and 2005 and for the period from April 13, 2004 (inception) through June 30, 2004 has been derived from the audited financial statements for that period. Quarterly financial information is derived from unaudited financial data, but in the opinion of management, reflects all adjustments (consisting only of normal recurring adjustments) that are necessary to present fairly the results of such interim periods. Interim results for the three and six months ended December 31, 2008 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2009. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" starting on page 26 for more information.

	For the Year/Period Ended June 30,				
	2008	2007	2006	2005	2004 (1)
	(in thousands except data relating to shares, per share and number of portfolio companies)				
Performance Data:					
Interest income	\$ 59,033	\$ 30,084	\$ 13,268	\$ 4,586	\$ —
Dividend income	12,033	6,153	3,601	3,435	—
Other income	8,336	4,444	—	72	—
Total investment income	79,402	40,681	16,869	8,093	—
Interest and credit facility expenses	(6,318)	(1,903)	(642)	—	—
Investment advisory expense	(20,199)	(11,226)	(3,868)	(1,808)	—
Other expenses	(7,772)	(4,421)	(3,801)	(3,874)	(100)
Total expenses	(34,289)	(17,550)	(8,311)	(5,682)	(100)
Net investment income	45,113	23,131	8,558	2,411	(100)
Realized and unrealized gains (losses)	(17,522)	(6,403)	4,338	6,340	—
Net increase in net assets from operations	\$ 27,591	\$ 16,728	\$ 12,896	\$ 8,751	\$ (100)
Per Share Data (2):					
Net increase in net assets from operations	\$ 1.17	\$ 1.06	\$ 1.83	\$ 1.24	na
Distributions declared per share	\$ (1.59)	\$ (1.54)	\$ (1.12)	\$ (0.38)	na
Average weighted shares outstanding for the period	23,626,642	15,724,095	7,056,846	7,055,100	100
Assets and Liabilities Data:					
Investments	\$ 497,530	\$ 328,222	\$ 133,969	\$ 55,030	\$ —
Other assets	44,248	48,280	4,511	48,879	1
Total assets	541,778	376,502	138,480	103,909	1
Amount drawn on credit facility	91,167	—	28,500	—	—
	6,641	4,838	745	77	100

Amount owed to related parties					
Other liabilities	14,347	71,616	965	865	—
Total liabilities	112,155	76,454	30,210	942	100
Net assets	\$ 429,623	\$ 300,048	\$ 108,270	102,967	\$ 99
Investment Activity Data:					
No. of portfolio companies at period end	29 (3)	24 (3)	15	6	—
Acquisitions	\$ 311,947	\$ 167,255	\$ 83,625	\$ 79,018	\$ —
Sales, repayments, and other disposals	\$ 127,212	\$ 38,407	\$ 9,954	\$ 32,083	\$ —
Weighted-Average Yield (4)	15.5%	17.1%	17.0%	21.3%	na

(1) For the period April 13, 2004 (inception) through June 30, 2004

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

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

(4) Includes dividends from certain equity investments

	For the Three Months ended December 31,		For the Six Months ended December 31,	
	2008 (unaudited)	2007 (unaudited)	2008 (unaudited)	2007 (unaudited)
Performance Data:				
Interest income	\$ 17,241	\$ 14,816	\$ 34,707	\$ 27,648
Dividend income	4,665	2,466	9,388	4,084
Other income	307	1,281	13,827	2,222
Total investment income	22,213	18,563	58,012	33,954
Interest and credit facility expenses	(1,965)	(1,618)	(3,483)	(2,856)
Investment advisory expense	(5,930)	(4,777)	(14,628)	(8,609)
Other expenses	(2,358)	(1,508)	(4,439)	(3,964)
Total expenses	(10,253)	(7,903)	(22,550)	(15,429)
Net investment income	11,960	10,660	35,462	18,525
Realized and unrealized gains (losses)	(5,436)	(14,346)	(14,940)	(13,661)
Net increase in net assets from operations	\$ 6,524	\$ (3,686)	\$ 20,522	\$ 4,864
Per Share Data (1):				
Net increase in net assets from operations	\$ 0.22	\$ (0.16)	\$ 0.69	\$ 0.23
Distributions declared per share	\$ (0.40)	\$ (0.39)	\$ (0.80)	\$ (0.78)
Average weighted shares outstanding for the period	29,618,762	23,249,399	29,569,571	21,603,932
Assets and Liabilities Data:				
Investments	\$ 555,661	\$ 440,085	\$ 555,661	\$ 440,085
Other assets	32,316	35,144	32,316	35,144
Total assets	587,977	475,229	587,977	475,229
Amount drawn on credit facility	138,667	107,042	138,667	107,042
Amount owed to related parties	6,312	4,842	6,312	4,842
Other liabilities	15,195	17,521	15,195	17,521
Total liabilities	160,174	129,405	160,174	129,405
Net assets	\$ 427,803	\$ 345,824	\$ 427,803	\$ 345,824
Investment Activity Data:				
No. of portfolio companies at period end	31 (2)	32 (2)	31 (2)	32 (2)
Acquisitions	\$ 13,564	\$ 120,846	\$ 84,020	\$ 161,240
Sales, repayments, and other disposals	\$ 2,128	\$ 19,223	\$ 13,077	\$ 37,172
Weighted-Average Yield (3)	12.7%	14.9%	13.3%	15.0%

(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

RISK FACTORS

Investing in our Securities involves a high degree of risk. You should carefully consider the risks described below, together with all of the other information included in this prospectus, before you decide whether to make an investment in our Securities. The risks set forth below are not the only risks we face. If any of the adverse events or conditions described below occur, our business, financial condition and results of operations could be materially adversely affected. In such case, our NAV, and the trading price of our common stock could decline, or the value of our preferred stock, debt securities, warrants 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. As such, each entity is subject to the business risks and uncertainties associated with any young business enterprise, including the limited experience in managing or operating a business development company under the 1940 Act. 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 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 are a relatively new company with limited operating history.

We were incorporated in April 2004 and have conducted investment operations since July 2004. We are subject to all of the business risks and uncertainties associated with any new business enterprise, including the risk that we may not fully achieve our investment objective or be able to obtain sufficient debt financing for our portfolio and that the value of your investment in us could decline substantially or fall to zero. Dividends that we pay prior to being fully invested may be substantially lower than the dividends that we expect to pay when our portfolio is fully invested and levered. If we do not realize yields in excess of our expenses, we may incur operating losses and the market price of our shares may decline.

We operate in a highly competitive market for investment opportunities.

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

Many of our existing and potential competitors are substantially larger and have considerably greater financial, technical and marketing resources than we do. For example, some competitors may have a lower cost of funds and access to funding sources that are not available to us. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more or fuller relationships with borrowers and sponsors than us. Furthermore, many of our competitors are not subject to the regulatory restrictions that the 1940 Act imposes on us as a business development company. We cannot assure you that the competitive pressures we face will not have a materially adverse effect on our business, financial condition and results of operations. Also, as a result of existing and increasing competition and our competitors ability to provide a total package solution, we may not be able to take advantage of attractive investment opportunities from time to time, and we can offer no assurance that we will be able to identify and make investments that are consistent with our investment objective.

We do not seek to compete primarily based on the interest rates that we offer, and we believe that some of our competitors make loans with interest rates that are comparable to or lower than the rates we offer. We may lose investment opportunities if we do not match our competitors' pricing, terms and structure. If we match our competitors' pricing, terms and structure, we may experience decreased net interest income and increased risk of credit loss.

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

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

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

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

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

- A likelihood of greater volatility in the net asset value and market price of our common stock;
- Diminished operating flexibility as a result of asset coverage or investment portfolio composition requirements that are more stringent than those imposed by the 1940 Act;
- The possibility that investments will have to be liquidated at less than full value or at inopportune times to comply with debt covenants or to pay interest or dividends on the leverage;
 - Increased operating expenses due to the cost of leverage, including issuance and servicing costs;
- Convertible or exchangeable securities issued in the future may have rights, preferences and privileges more favorable than those of our common stock; and
- Subordination to lenders' superior claims on our assets as a result of which lenders will be able to receive proceeds available in the case of our liquidation before any proceeds are distributed to our stockholders.

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

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

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

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

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

We need additional capital to fund growth in our investments. A reduction in the availability of new capital could limit our ability to grow. We must distribute at least 90% of our ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, to our stockholders 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 at least 200% of total assets to total borrowings, 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 acquire, the default rate on debt securities, the level of our expenses, variations in and the timing of the recognition of realized and unrealized gains or losses, the degree to which we encounter competition in our markets, the seasonality of the energy industry, weather patterns, changes in energy prices and general economic conditions. As a result of these factors, results for any period should not be relied upon as being indicative of performance in future periods.

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 readjust the hurdle rate by amending the Investment Advisory Agreement.

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

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

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

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

The incentive fee payable by us to Prospect Capital Management could create an incentive for our Investment Adviser to invest on our behalf in instruments, such as zero coupon bonds, that have a deferred interest feature. Under these investments, we would accrue interest income over the life of the investment but would not receive payments in cash on the investment until the end of the term. Our net investment income used to calculate the income incentive fee, however, includes accrued interest. For example, accrued interest, if any, on our investments in zero coupon bonds will be included in the calculation of our incentive fee, even though we will not receive any cash interest payments in respect of payment on the bond until its maturity date. Thus, a portion of this incentive fee would be based on income that we may not have yet received in cash and 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."

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 the 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 U.S. 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 stock, securities or options thereon or foreign currencies, or other income derived with respect to our business of investing in such stock, 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".

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 could 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 (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.

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.

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. Recently, our common stock has traded at a discount to our net asset value, adversely affecting our ability to raise capital. 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 annual meeting of stockholders held on February 12, 2009, our stockholders approved our ability to sell an unlimited number of shares of our common stock at any level of discount from net asset value per share during the 12 month period following such approval in accordance with the exception described above in " – Regulations governing our operation as a business development company affect our ability to raise, and the way in which we raise, additional capital." The issuance or sale by us of shares of our common stock at a discount to net asset value poses a risk of dilution to our stockholders. In particular, stockholders who do not purchase additional shares at or below the discounted price in proportion to their current ownership will experience an immediate decrease in net asset value per share (as well as in the aggregate net asset value of their shares if they do not participate at all). These stockholders will also experience a disproportionately greater decrease in their participation in our earnings and assets and their voting power than the increase we experience in our assets, potential earning power and voting interests from such issuance or sale. They also may 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".

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

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

Risks Relating To Our Investments

We may not realize gains or income from our investments.

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

Our portfolio is concentrated in a limited number of portfolio companies 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 December 31, 2008, we had invested in a number of companies in the energy and energy related industries. A consequence of this lack of diversification is that the aggregate returns we realize may be significantly and adversely affected if a small number of such investments perform poorly or if we need to write down the value of any one investment. Beyond our income tax diversification requirements, we do not have fixed guidelines for diversification, and our investments are concentrated in relatively few portfolio companies. In addition, to date we have concentrated on making investments in the energy industry. While we expect to be less focused on the energy and energy related industries in the future, we anticipate that we will continue to have significant holdings in the energy and energy related industries. As a result, a downturn in the energy industry could materially and adversely affect us.

The energy industry is subject to many risks.

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

- Commodity Pricing Risk. Energy companies in general are directly affected by energy commodity prices, such as the market prices of crude oil, natural gas and wholesale electricity, especially for those that own the underlying energy commodity. In addition, the volatility of commodity prices can affect other energy companies due to the impact of prices on the volume of commodities transported, processed, stored or distributed and on the cost of fuel for power generation companies. The volatility of commodity prices can also affect energy companies' ability to access the capital markets in light of market perception that their performance may be directly tied to commodity prices. Historically, energy commodity prices have been cyclical and exhibited significant volatility. Although we

generally prefer risk controls, including

appropriate commodity and other hedges, by certain of our portfolio companies, if available, some of our portfolio companies may not engage in hedging transactions to minimize their exposure to commodity price risk. For those companies that engage in such hedging transactions, they remain subject to market risks, including market liquidity and counterparty creditworthiness. In addition, such companies may also still have exposure to market prices if such companies do not produce volumes or other contractual obligations in accordance with such hedging contracts.

- **Regulatory Risk.** The profitability of energy companies could be adversely affected by changes in the regulatory environment. The businesses of energy companies are heavily regulated by U.S. 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 U.S. 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, Organization of Petroleum Exporting Countries 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.
- **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.

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- 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 U.S. government has issued public warnings indicating that energy assets, specifically those related to pipeline infrastructure, production facilities and transmission and distribution facilities, might be specific targets of terrorist activity. The continued threat of terrorism and related military activity will likely increase volatility for prices of natural gas and oil and could affect the market for products and services of energy companies. In addition, any future terrorist attack or armed conflict in the United States or elsewhere may undermine economic conditions in the United States in general.
- Financing Risk. Some of our portfolio companies rely on the capital markets to raise money to pay their existing obligations. Their ability to access the capital markets on attractive terms or at all may be affected by any of the risks associated with energy companies described above, by general economic and market conditions or by other factors. This may in turn affect their ability to satisfy their obligations with us.

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

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

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

- these companies may have limited financial resources and may be unable to meet their obligations under their securities that we hold, which may be accompanied by a deterioration in the value of their securities or of any collateral with respect to any securities and a reduction in the likelihood of our realizing on any guarantees we may have obtained in connection with our investment;
- they may have shorter operating histories, narrower product lines and smaller market shares than larger businesses, which tend to render them more vulnerable to competitors' actions and market conditions, as well as general economic downturns;
- because many of these companies are privately held companies, public information is generally not available about these companies. As a result, we will depend on the ability of our Investment Adviser to obtain adequate information to evaluate these companies in making investment decisions. If our Investment Adviser is unable to uncover all material information about these companies, it may not make a fully informed investment decision, and we may lose money on our investments;
- they are more likely to depend on the management talents and efforts of a small group of persons; therefore, the death, disability, resignation or termination of one or more of these persons could have a materially adverse impact

on our portfolio company and, in turn, on us;

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

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

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

The U.S. and most other economies have entered a recessionary period, which may be prolonged and severe. Our portfolio companies will generally be affected by the conditions and overall strength of the national, regional and local economies, including interest rate fluctuations, changes in the capital markets and changes in the prices of their primary commodities and products. These factors also impact the amount of residential, industrial and commercial growth in the energy industry. Additionally, these factors could adversely impact the customer base and customer collections of our portfolio companies.

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

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

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

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

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

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adequate information to evaluate the potential returns from investing in these companies. These companies and their financial information are not subject to the Sarbanes-Oxley Act and other rules that govern public companies. If we are unable to uncover all material information about these companies, we may not make a fully informed investment decision, and we may lose money on our investment.

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

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

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

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

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

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

- our debt investments are primarily made in the form of mezzanine loans, therefore our liens on the collateral, if any, are subordinated to those of the senior secured debt of the portfolio companies, if any. As a result, we may not be able to control remedies with respect to the collateral;
- the collateral may not be valuable enough to satisfy all of the obligations under our secured loan, particularly after giving effect to the repayment of secured debt of the portfolio company that ranks senior to our loan;
- bankruptcy laws may limit our ability to realize value from the collateral and may delay the realization process;
- our rights in the collateral may be adversely affected by the failure to perfect security interests in the collateral;
- the need to obtain regulatory and contractual consents could impair or impede how effectively the collateral would be liquidated and could affect the value received; and

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

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

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

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

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

Our Board of Directors has the authority to modify or waive our current operating policies and our strategies without prior notice and without stockholder approval. We cannot predict the effect any changes to our

current operating policies and strategies would have on our business, financial condition, and value of our common stock. However, the effects might be adverse, which could negatively impact our ability to pay dividends and cause stockholders to lose all or part of their investment.

Risks Relating To Our Securities

Investing in our securities may involve a high degree of risk.

The investments we make in accordance with our investment objective may result in a higher amount of risk than alternative investment options and volatility or loss of principal. Our investments in portfolio companies may be speculative and aggressive, and therefore, an investment in our shares may not be suitable for someone with low risk tolerance.

The market price of our securities may fluctuate significantly.

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

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

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

As of March 17, 2009, we have 29,786,128 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 dividends or that our dividends 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 you from being able to sell shares of our common stock at a premium over the current of prevailing market prices.

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

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

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

- The Maryland Business Combination Act, which, subject to certain limitations, prohibits certain business combinations between us and an "interested stockholder" (defined generally as any person who beneficially owns 10% or more of the voting power of the common stock or an affiliate thereof) for five years after the most recent date on which the stockholder becomes an interested stockholder and, thereafter, imposes special minimum price provisions and special stockholder voting requirements on these combinations; and
- The Maryland Control Share Acquisition Act, which provides that "control shares" of a Maryland corporation (defined as shares of common stock which, when aggregated with other shares of common stock controlled by the stockholder, entitles the stockholder to exercise one of three increasing ranges of voting power in electing directors) 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.

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

(All figures in this item are in thousands except 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.

Overview

Introduction

We are a financial services company that primarily lends 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. To date we have invested primarily in industries related to the industrial/energy economy. However, we continue to widen our strategy focus in other sectors of the economy to diversify our portfolio holdings.

Market Conditions

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

We believe that Prospect Capital is well positioned to navigate through these adverse market conditions. As a BDC, we are limited to a maximum 1 to 1 debt to equity ratio, and as of December 31, 2008, our debt to equity ratio was 0.32 to 1. As of December 31, 2008, we have borrowed \$138,667 against our credit facility with Rabobank Nederland. The revolving period for this facility continues until June 6, 2009, with a term out maturity on June 6, 2010, and we expect to enter into a new extended facility prior to this date. While we are optimistic, we cannot guarantee the completion of such extension.

We also continue to generate liquidity through the realization of portfolio investments, including the loan to Diamondback Operating L.P., such loan which was repaid in January 2009. As is typical for our portfolio, we currently have investments in various stages in the exit process that continue to draw interest from prospective buyers.

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, or 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 registered investment company or an operating company which provides substantially all of its services and benefits to us. Our December 31, 2008, June 30, 2008, December 31, 2007 and June 30, 2007 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 presumed to exist when a company or individual possesses 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 possession 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.

Short-term investments that mature in 60 days or less and are viewed as creditworthy, such as U.S. Treasury Bills, are valued at amortized cost, which approximates fair value. The amortized cost method involves recording a security at its cost (i.e., principal amount plus any premium and less any discount) on the date of purchase and thereafter amortizing/ accreting that difference between the principal amount due at maturity and cost assuming a constant yield to maturity as determined at the time of purchase. Short-term securities that mature in more than 60 days are valued at current market quotations by an independent pricing service or at the mean between

the bid and ask prices obtained from at least two brokers or dealers (if available, or otherwise by a principal market maker or a primary market dealer). Investments in money market mutual funds are valued at their net asset value as of the close of business on the day of valuation.

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

- 1) Each portfolio company or investment is reviewed by our investment professionals with the independent valuation firm;
- 2) the independent valuation firm engaged by our Board of Directors conducts independent appraisals and makes their own independent assessment;
- 3) the audit committee of our Board of Directors reviews and discusses the preliminary valuation of our Investment Adviser and that of the independent valuation firm; and
- 4) the Board of Directors discusses 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 discounts 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, or FASB, issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements", or FAS 157. FAS 157 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those years. We have adopted this statement on a prospective basis beginning in the quarter ended September 30, 2008. Adoption of this statement did not have a material effect on our financial statements for that quarter or for the current quarter ended December 31, 2008.

FAS 157 classifies the inputs used to measure these fair values into the following hierarchy:

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

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

Level 3: Unobservable inputs for the asset or liability.

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

The changes to generally accepted accounting principles from the application of FAS 157 relate to the definition of fair value, framework for measuring fair value, and the expanded disclosures about fair value measurements. FAS 157 applies to fair value measurements already required or permitted by other standards. In accordance with FAS 157, 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.

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.

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 interest 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. At December 31, 2008 two loans extended to Integrated Contract Services, Inc., or Integrated, and one loan extended to Worcester Energy Partners, Inc., or WEPI, were on non-accrual status. The loan principal of these loans amounted to \$55,747 at December 31, 2008.

Statement of Assets and Liabilities Overview

During the six months ended December 31, 2008, net assets have decreased by \$1,820 from \$429,623 as of June 30, 2008 to \$427,803 as of December 31, 2008. This net decrease in assets resulted from a \$20,522 increase from operations, offset by \$23,848 in dividends declared to our stockholders. During this six-month period we recognized net investment income of \$35,462, net realized gains on investments of \$1,661 and a decrease in net

assets due to changes in unrealized appreciation/ depreciation of investments of \$16,601. The result was the \$20,522 increase in net assets resulting from operations.

The aggregate value of our portfolio investments was \$555,661 and \$497,530 as of December 31, 2008 and June 30, 2008, respectively. During the six months ended December 31, 2008, our net cost of investments increased by \$74,732, or 15.0%, as we invested in three new investments and follow-on investments while we sold one investment, received repayment on another investment, and settled the net profit interests on a third investment. This increased level of investment was financed by increased borrowings on our credit facility. At December 31, 2008, we were invested in 31 long-term portfolio investments (including a net profits interest remaining in Charlevoix).

During the fiscal year ended June 30, 2008, net assets increased by \$129,575, from \$300,048 to \$429,623. This increase resulted from the issuance of new shares of our common stock (less offering costs) in the amount of \$138,744, dividend reinvestments of \$2,753, and another \$27,591 from operations. These increases, in turn, were offset by \$39,513 in dividend distributions to our stockholders. The \$27,591 increase in net assets resulting from operations is net of the following: Net investment income of \$45,113, realized loss on investments of \$16,222, and a net decrease in net assets due to changes in unrealized appreciation/depreciation of investments of \$1,300. The realized losses were mainly due to the sale of Central Illinois Energy, LLC, or CIE, and Advantage Oilfield Group Ltd., or AOG. The net unrealized depreciation was driven by significant write-downs in our investments in, Integrated, WEPI, and our coal holdings (Whymore, Genesis, North Fork Collieries LLC, or North Fork, and Unity Virginia Holdings LLC, or Unity – now consolidated into Yatesville), which, in turn, were almost offset by write-ups for our investments in GSHI, and by the disposition of previously written-down investments in AOG and in ESA.

The aggregate value of our portfolio investments was \$497,530 and \$328,222 as of June 30, 2008 and June 30, 2007, respectively. During the fiscal year ended June 30, 2008, our net cost of investments increased by \$170,608, or 51.6%, as we invested in 15 new and follow-on investments while we sold three investments and we received repayment on five other investments.

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.

Investment Activity

During the six months ended December 31, 2008, we completed three new investments and several follow-on investments in existing portfolio companies, totaling approximately \$83,089. The more significant of these investments are described briefly in the following:

On August 1, 2008, we provided \$7,400 in debt financing to Castro Cheese Company, Inc., or Castro, based in Houston, Texas. Castro is a leading manufacturer, marketer, and distributor of Hispanic cheeses and creams.

On August 4, 2008, we provided \$15,000 in debt financing to support the take-private acquisition of the TriZetto Group, or TriZetto. TriZetto is a leading healthcare information technology company.

On August 21, 2008, we provided a \$26,000 senior secured debt financing and co-invested \$2,300 in equity alongside Great Point Partners, LLC, or Great Point, in its growth recapitalization of BNN Holdings Corp. d/b/a

Biotronic NeuroNetwork, or Biotronic, based in Ann Arbor, Michigan. Biotronic is the largest independent national provider of intra-operative neurophysiological monitoring services.

On July 23, 2008, September 8, 2008, and November 7, 2008 we made follow-on secured debt investments of \$400, \$2,700, and \$2,900 respectively in Iron Horse Coiled Tubing, Inc., or Iron Horse, in support of the build out of additional equipment.

On December 10, 2008 we made a follow-on investment of \$5,000 in Gas Solutions Holdings, Inc., or GSHI or Gas Solutions for the repayment of third-party bank senior credit facility.

During the year ended June 30, 2008, we completed 15 new investments and several follow-on investments in existing portfolio companies, totaling approximately \$311,947. The more significant of these investments are described briefly in the following:

On July 31, 2007, we provided \$15,000 growth financing to Wind River, a privately-held oil and gas production business based in Salt Lake City, Utah. The investment was in the form of senior secured notes with a net profits interest.

On August 8, 2007, we provided \$6,000 growth and recapitalization financing to Deep Down, a deepwater drilling services and manufacturing provider based in Houston, Texas. The investment was in the form of senior secured notes and warrants.

On August 28, 2007, we provided \$9,200 growth and recapitalization financing to Diamondback, an oil and gas production company based in Tulsa, Oklahoma. The investment was in the form of senior secured notes with a net profits interest.

On October 9, 2007, we made a second lien debt investment of \$9,750 in Resco Products, Inc., a leading designer and manufacturer of refractory materials based in Pittsburgh, Pennsylvania.

On October 17, 2007, we made a \$3,000 follow-on secured debt investment in NRG, in support of NRG's acquisition of Dynafab Corporation, or Dynafab. Dynafab is a manufacturer of a range of metal structures and vessels for use in the oil and gas and transportation industries, including fuel tanks for on-road and off-road vehicles as well as various drilling rig components.

On October 19, 2007, we made a second lien debt investment of approximately \$5,000 in a leading provider of outsourced technical services based in Pennsylvania. The Company's investment is supporting the acquisition of this service provider by HM Capital Partners, L.P., or HM, a \$1.6 billion private equity fund based in Dallas, Texas. HM's investment professionals previously were principals with Hicks, Muse, Tate & Furst, Inc.

On November 1, 2007, we made a second lien secured debt investment, as well as a small equity co-investment, aggregating approximately \$13,750 in Maverick Healthcare Group, L.L.C. (d/b/a Preferred Homecare) a leading comprehensive home healthcare services provider based in Mesa, Arizona.

On November 5, 2007, we invested approximately \$18,000 in second lien secured financing in Shearer's, a snack food manufacturer based in Brewster, Ohio, with Winston Partners as the private equity financial sponsor.

On November 9, 2007, we made a second lien debt investment of \$12,000 in Qualitest, and its affiliates, a leading manufacturer and distributor of generic pharmaceuticals based in Huntsville, Alabama.

On November 14, 2007, we entered into an agreement to invest in a second lien secured debt from Deb Shops of \$15,000. This transaction was consummated on December 10, 2007. Deb Shops is a leading specialty apparel retailer based in Philadelphia, Pennsylvania.

On November 21, 2007, we provided combined debt financing of \$25,386 to IEC and ARS, two related oilfield service companies based in Houston, Texas. This investment took the form of two separate senior secured instruments with cross-collateralized guarantees and a NPI in each company.

On February 11, 2008, we made a \$5,121 senior secured loan to North Fork, a Kentucky-based mining and coal production company. We also have a controlling equity interest in North Fork.

On March 5, 2008, we made an additional secured Term C debt investment of approximately \$6,500 in Unitek Acquisition, Inc., or Unitek, a leading provider of outsourced technical services based in Blue Bell, Pennsylvania. We have now extended in the aggregate \$11,500 of debt capital to Unitek.

On March 14, 2008, we provided debt financing of \$14,500 to support the acquisition of American Gilsonite Company, or AGC by a private equity firm based in New York. AGC is a specialty mineral company with operations based in Bonanza, Utah. Furthermore, we made an additional \$1,000 investment in the equity of AGC.

On April 3, 2008, we provided \$39,800 of first and second lien debt and equity for the recapitalization of Ajax, a custom forger of seamless rolled steel rings located in York, South Carolina. Our debt is secured by a first lien on inventory, machinery, and certain other assets of Ajax. The equity interest purchased in Ajax is controlling in nature and was made alongside equity co-investments by Ajax's senior managers.

On April 30, 2008, we provided debt financing of \$20,000 to support the acquisition by Peerless, headquartered in Dallas, Texas, of Nitram. Peerless is a leading designer, manufacturer, and marketer of industrial environmental separation and filtration systems while Nitram focuses on separation, heat transfer, pulsation dampening, and industrial silencing products. Peerless and Nitram serve a diversified, global list of customers in industries such as oil and gas production, gas pipelines, chemical and petrochemical processing, and power generation.

During the six months ended December 31, 2008, we closed-out 2 positions which are briefly described below.

On July 3, 2008, we exercised our warrant for 4,960,585 shares of common stock in Deep Down, Inc., or Deep Down. As permitted by the terms of the warrant, we elected to make this exercise on a cashless basis entitling us to 2,618,129 common shares. On August 1, 2008, we sold all the shares acquired receiving \$1,649 of net proceeds.

On August 27, 2008, R-V Industries, Inc., or R-V repaid the \$7,526 debt outstanding to us.

On September 30, 2008, we settled our net profits interests, or NPIs, in IEC Systems LP, or IEC and Advanced Rig Services LLC, or 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 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.

For the year ended June 30, 2008, we closed-out seven positions which are briefly described below.

On August 16, 2007, Arctic completely paid its loan with an additional prepayment penalty of \$461 for the loan. Including the prepayment premium, we realized a 20% cash internal rate of return on this investment, representing 1.25 times cash on cash (not including the equity investments that the Company continues to hold). On April 30, 2008, we fully exited out of our investment in Arctic through the sale of our equity interest in Arctic for approximately \$3,400.

On December 5, 2007, we received \$5,099 from the sale of our debt investment in CIE, an ethanol project.

On December 28, 2007 and December 31, 2007, we entered into two agreements which monetized our investment in AOG. These transactions generated aggregate proceeds of \$3,939 for us.

On February 20, 2008, Ken-Tex Energy Corp., or Ken-Tex, repaid the \$10,800 debt that it owed us. As part of the transaction, we also sold back our NPI and overriding royalty interest, ORRI, in Ken-Tex. In addition to the debt repayment, this transaction generated \$3,300 in the form of a prepayment penalty and the sale of the NPI and ORRI.

On March 5, 2008, we closed out our position of common shares of Evolution Petroleum Corp. , or Evolution, at a gain of \$486.

On March 31, 2008, TLOGH, L.P. repaid the \$15,500 debt that it owed to us.

On June 6, 2008, Deep Down repaid the \$12,000 debt that it owed us. We realized an approximately 29% cash-on-cash internal rate of return, or IRR on the Deep Down investment, representing a 1.2 times cash-on-cash multiple, from a prepayment premium of approximately \$450, upfront fees, and interest. At June 30, 2008, we own a warrant to purchase approximately 5.0 million shares of Deep Down common stock at an exercise price of \$0.507 per share. On July 3, 2008, we exercised our warrant on a cashless basis entitling us to 2,618,129 common shares. On August 1, 2008, we sold all the shares acquired receiving \$1,649 of net proceeds.

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

Quarter-End	Acquisitions(1)	Dispositions(2)
December 31, 2008	\$ 13,564	\$ 2,128
September 30, 2008	70,456	10,949
June 30, 2008	118,913	61,148
March 31, 2008	31,794	28,891
December 31, 2007	120,846	19,223
September 30, 2007	40,394	17,949
June 30, 2007	130,345	9,857
March 31, 2007	19,701	7,731
December 31, 2006	62,679	17,796
September 30, 2006	24,677	2,781
June 30, 2006	42,783	5,752
March 31, 2006	15,732	901
December 31, 2005	—	3,523
September 30, 2005	25,342	—

June 30, 2005	17,544	—
March 31, 2005	7,332	—
December 31, 2004	23,771	32,083
September 30, 2004	30,371	—
Since inception	\$ 796,244	\$ 220,712

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

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

Investment Holdings

As of December 31, 2008, we continued 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, we currently have a concentration of investments in companies in the energy and energy related industries. Some of the companies in which we invest have relatively short or no operating histories. These companies are and will be subject to all of the business risk and uncertainties associated with any new business enterprise, including the risk that these companies may not reach their investment objective or the value of our investment in them may decline substantially or fall to zero.

Our portfolio had an annualized current yield of 16.0% and 15.6% across all our long-term debt and certain equity investments as of December 31, 2008 and December 31, 2007, respectively. This yield includes interest from all of our long-term investments as well as dividends from Gas Solutions Holdings, Inc., or GSHI, NRG Manufacturing, Inc., or NRG and Ajax Rolled Ring & Machine, or Ajax. We expect the current yield to decline over time as we increase the size of the portfolio. Monetization of other equity positions that we hold is not included in this yield calculation. In each of our portfolio companies, we hold equity positions, ranging from minority interests to majority stakes, which we expect over time to contribute to our investment returns. Some of these equity positions include features such as contractual minimum internal rates of returns, preferred distributions, flip structures and other features expected to generate additional investment returns, as well as contractual protections and preferences over junior equity, in addition to the yield and security offered by our cash flow and collateral debt protections.

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

As of December 31, 2008, we own controlling interests in Ajax Rolled Ring & Machine, or Ajax, C&J Cladding, LLC, or C&J, GSHI, Integrated, Iron Horse, NRG, R-V, WEPI and Yatesville Coal Holdings, Inc., or Yatesville. We also own affiliated interests in Appalachian Energy Holdings, LLC, or AEH, and Biotronic.

The following is a summary of our investment portfolio by level of control at December 31, 2008 and 2007:

Level of Control	December 31, 2008		December 31, 2007	
	Fair Value	Percent of Portfolio	Fair Value	Percent of Portfolio
Control	\$ 216,448	37.4%	\$ 150,156	32.3%

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Affiliate	31,721	5.5%	5,288	1.2%
Non-Control/Non-Affiliate	307,492	53.2%	284,641	61.2%
Money Market Funds	22,606	3.9%	24,734	5.3%
Total Portfolio	\$ 578,267	100.0%	\$ 464,819	100.0%

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The following is a summary of our investment portfolio by level of control at June 30, 2008 and 2007:

Level of Control	June 30, 2008		June 30, 2007	
	Fair Value	Percent of Portfolio	Fair Value	Percent of Portfolio
Control	\$ 205,827	38.8%	\$ 145,121	39.5%
Affiliate	6,043	1.2%	14,625	4.0%
Non-Control/Non-Affiliate	285,660	53.8%	168,476	45.2%
Money Market Funds	33,000	6.2%	41,760	11.3%
Total Portfolio	\$ 530,530	100.0%	\$ 369,982	100.0%

The following is our investment portfolio presented by type of investment at December 31, 2008 and December 31, 2007, respectively:

Type of Investment	December 31, 2008		December 31, 2007	
	Fair Value	Percent of Portfolio	Fair Value	Percent of Portfolio
Money Market Funds	\$ 22,606	3.9%	\$ 24,734	5.3%
Senior Secured Debt	247,009	42.7%	251,258	54.1%
Subordinated Secured Debt	198,736	34.4%	28,157	27.6%
Subordinated Unsecured Debt	13,930	2.4%	—	0.0%
Preferred Stock	8,804	1.5%	1,388	0.3%
Common Stock	72,892	12.6%	53,939	11.6%
Membership Interests	5,780	1.0%	—	0.0%
Warrants	8,510	1.5%	5,343	1.1%
Total Portfolio	\$ 578,267	100.0%	\$ 464,819	100.0%

The following is our investment portfolio presented by type of investment at June 30, 2008 and June 30, 2007, respectively:

Type of Investment	June 30, 2008		June 30, 2007	
	Fair Value	Percent of Portfolio	Fair Value	Percent of Portfolio
Money Market Funds	\$ 33,000	6.2%	\$ 41,760	11.3%
Senior Secured Debt	203,985	38.5%	202,243	54.7%
Subordinated Secured Debt	215,585	40.6%	78,905	21.3%
Preferred Stock	6,455	1.2%	106	0.0%
Common Stock	59,563	11.2%	43,517	11.8%
Membership Interests	3,000	0.6%	—	0.0%
Warrants	8,942	1.7%	3,451	0.9%
Total Portfolio	\$ 530,530	100.0%	\$ 369,982	100.0%

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The following is our investment portfolio presented by geographic location of the investment at December 31, 2008 and December 31, 2007, respectively:

Geographic Exposure	December 31, 2008		December 31, 2007	
	Fair Value	Percent of Portfolio	Fair Value	Percent of Portfolio
Canada	\$ 13,347	2.3%	\$ 9,053	2.0%
Midwest US	77,239	13.4%	46,990	10.1%
Northeast US	52,582	9.1%	67,997	14.6%
Southeast US	122,121	21.1%	79,810	17.2%
Southwest US	245,607	42.5%	221,235	47.6%
Western US	44,765	7.7%	15,000	3.2%
Money Market Funds	22,606	3.9%	24,734	5.3%
Total Portfolio	\$ 578,267	100.0%	\$ 464,819	100.0%

The following is our investment portfolio presented by geographic location of the investment at June 30, 2008 and June 30, 2007, respectively:

Geographic Exposure	June 30, 2008		June 30, 2007	
	Fair Value	Percent of Portfolio	Fair Value	Percent of Portfolio
Western US	\$ 30,322	5.7%	\$ —	0.0%
Southeast US	128,512	24.2%	70,545	19.1%
Southwest US	211,177	39.9%	157,097	42.5%
Midwest US	47,869	9.0%	36,942	10.0%
Northeast US	68,468	12.9%	44,558	12.0%
Canada	11,182	2.1%	19,080	5.1%
Money Market Funds	33,000	6.2%	41,760	11.3%
Total Portfolio	\$ 530,530	100.0%	\$ 369,982	100.0%

The following is our investment portfolio presented by industry sector of the investment at December 31, 2008 and December 31, 2007, respectively:

Industry Sector	December 31, 2008		December 31, 2007	
	Fair Value	Percent of Portfolio	Fair Value	Percent of Portfolio
Biomass Power	\$ 10,900	1.9%	\$ 24,413	5.3%
Construction Services	4,265	0.7%	5,288	1.1%
Contracting	5,000	0.9%	5,000	1.1%
Financial Services	21,507	3.7%	25,000	5.4%
Food Products	28,274	4.9%	18,000	3.9%
Gas Gathering and Processing	77,158	13.3%	47,500	10.2%
Healthcare	54,839	9.5%	13,750	3.0%
Manufacturing	103,203	17.7%	57,964	12.4%
Metal Services	9,195	1.6%	6,076	1.3%
Mining and Coal Production	25,848	4.5%	15,795	3.4%
Oilfield Fabrication	36,155	6.3%	25,387	5.5%
Oil and Gas Production	110,549	19.1%	134,796	29.0%

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Pharmaceuticals	9,692	1.7%	11,941	2.6%
Production Services	13,347	2.3%	22,993	4.9%
Retail	10,139	1.8%	14,555	3.1%
Shipping Vessels	6,993	1.2%	6,700	1.4%
Specialty Minerals	17,248	3.0%	—	0.0%
Technical Services	11,349	2.0%	4,927	1.1%
Money Market Funds	22,606	3.9%	24,734	5.3%
Total Portfolio	\$ 578,267	100.0%	\$ 464,819	100.0%

The following is our investment portfolio presented by industry sector of the investment at June 30, 2008 and June 30, 2007, respectively:

Industry Sector	June 30, 2008		June 30, 2007	
	Fair Value	Percent of Portfolio	Fair Value	Percent of Portfolio
Biofuels/Ethanol	\$ —	0.0%	\$ 8,000	2.1%
Biomass Power	15,580	2.9%	25,047	6.8%
Construction Services	6,043	1.1%	15,305	4.1%
Contracting	5,000	0.9%	5,000	1.3%
Financial Services	23,699	4.5%	25,000	6.8%
Food Products	19,351	3.7%	—	0.0%
Gas Gathering and Processing	61,542	11.6%	44,500	12.0%
Healthcare	13,752	2.6%	—	0.0%
Manufacturing	109,542	20.7%	41,376	11.2%
Metal Services	6,829	1.3%	5,829	1.6%
Mining and Coal Production	25,726	4.9%	18,499	5.0%
Oilfield Fabrication	24,854	4.7%	—	0.0%
Oil and Gas Production	112,850	21.3%	110,243	29.8%
Pharmaceuticals	11,523	2.2%	—	0.0%
Production Services	14,038	2.6%	22,870	6.2%
Retail	13,428	2.5%	—	0.0%
Shipping Vessels	6,804	1.3%	6,553	1.8%
Specialty Minerals	15,632	2.9%	—	0.0%
Technical Services	11,337	2.1%	—	0.0%
Money Market Funds	33,000	6.2%	41,760	11.3%
Total Portfolio	\$ 530,530	100.0%	\$ 369,982	100.0%

Investment Valuation

In determining the fair value of our portfolio investments at December 31, 2008, the Audit Committee considered valuations from the independent valuation firm and from management having an aggregate range of \$511,622 to \$593,857, 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 \$555,661, excluding money market investments.

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

During the fiscal year ended June 30, 2008 and continuing through December 31, 2008, several general economic factors have occurred which have affected the valuation of our investment portfolio.

Generally, interest rates offered on loans similar to those that we have originated have changed since our investments were consummated. While we do not believe that there has been any diminution of credit quality, general changes in current interest rates would affect the price for which we could sell these assets and we have adjusted our fair value of these assets to reflect such changes. We have adjusted the value of fourteen debt investments based upon such general changes in market interest rates including: AEH, Biotronic, C&J, Deb Shops,

Inc. (“Deb Shops”), Castro, H&M Oil & Gas, LLC, Freedom Marine Services LLC, Maverick Healthcare LLC, Qualitest Pharmaceuticals, Inc. (“Qualitest”), Regional Management Corp. (“RMC”), Resco Products, Inc. (“Resco”), Shearer’s Foods, Inc., Stryker Energy, LLC, and TriZetto.

Three debt investments were made to companies that are not performing in line with budget expectations. These investments (Conquest Cherokee, LLC, Iron Horse, and Wind River Resources Corp. and Wind River II Corp.) are adequately collateralized and we expect full recovery. For these assets, we used higher market interest rates to take into account the increased credit risk and general changes in current interest rates for similar assets to determine their fair value.

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 assets in our portfolio are under enhanced scrutiny by our senior management and our Board of Directors and are discussed below.

Gas Solutions Holdings, Inc.

GSHI is an investment that we made in September 2004 and 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 latter two metrics on both an absolute and a percentage of revenues basis) over the past four years.

During the past year, 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 late March 2008, Royal Bank of Canada provided a \$38,000 term loan to Gas Solutions II Ltd, a wholly owned subsidiary of GSHI, the proceeds of which were used to refinance all of Citibank’s approximately \$8,000 of outstanding senior secured debt as well as to make a \$30,000 cash distribution to GSHI. We had non-recourse access to this cash at GSHI. In December 2008, we lent an additional \$5,000 to GSHI which enabled the company to repay the loan to the Royal Bank of Canada. Upon repayment, we now hold a first lien position in GSHI, improving our leverage position with our lender.

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 have been 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 has generated approximately \$21,200 of EBITDA for the first ten months ending October 31, 2008. Annualizing the current year results, this is an increase of 73.7% from the 2007 results.

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 \$77,158 for our debt and equity positions at December 31, 2008 based upon a combination of a discounted cash flow analysis, a public comparables analysis and review of recent indications of interest. GSHI is valued \$47,126 above its amortized cost, compared to the \$36,321 unrealized gain recorded at June 30, 2008.

Integrated Contract Services, Inc.

Our investment in ICS is under enhanced review by our senior management team due to existing or potential payment and/or covenant defaults under the contracts governing these investments. ICS owns 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.

We have a senior-secured, first-lien debt position with collateral in the form of receivables, real estate, other assets, guaranties, and the stock of THS. Based upon an analysis of the liquidation value of the ESA assets and the enterprise value of THS, our Board of Directors reaffirmed the fair value of our investment in ICS at \$5,000, a reduction of \$11,675 from its amortized cost, compared to the \$11,464 unrealized loss recorded at June 30, 2008.

R-V Industries, Inc.

R-V demonstrated strong performance in operations throughout 2008 with trailing twelve-month EBITDA increasing by over 50% since our closing in May 2007. R-V continues to pay down debt, repaying \$7,000 of our debt during the fiscal year ended June 30, 2008. Our Board of Directors, upon recommendation from senior management, has set the value of the R-V investment at \$18,549 at June 30, 2008, \$5,924 above its amortized cost, compared to valuing the R-V investment at par at June 30, 2007. During the quarter ended September 30, 2008, R-V repaid the remainder of its senior secured debt owed to us. Our Board of Directors, upon recommendation from senior management, has set the value of the R-V equity investment at \$11,991 at September 30, 2008, \$5,241 above its amortized cost.

Worcester Energy Partners, Inc.

WEPI is under enhanced review by our senior management team due to poor operating results since investment. We have installed a new manager at WEPI who continues to institute new controls to reduce costs and improve efficiency. WEPI has negotiated an interim agreement with the buyer of its energy production and is now earning revenues sufficient to cover its debt service requirements. Our Board of Directors, upon recommendation from senior management, has set the value of the WEPI investment based upon an enterprise valuation at \$10,900 at December 31, 2008, a reduction of \$31,307 from its amortized cost, compared to the \$22,141 unrealized loss recorded at June 30, 2008.

Yatesville Coal Holdings, Inc.

As we previously discussed, all of our coal holdings are now held in one consolidated entity, Yatesville. The consolidated group has seen an improvement in operating results primarily from increased prices in coal, improved production, reductions in operating expenses from the consolidation of the management and operations and the allocation of assets to their most efficient use. Until a longer track record is established or a viable sales process is in place, we will continue to value Yatesville on an asset basis. Our Board of Directors, upon recommendation from senior management, has set the value of the Yatesville investment at \$25,848 at December 31, 2008, a reduction of \$18,253 from its amortized cost, compared to the \$14,694 unrealized loss recorded at June 30, 2008.

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 up to \$200,000 of debt and our equity capital is currently comprised entirely of common equity.

We had \$138,667 and \$91,167 of borrowings at December 31, 2008 and June 30, 2008, respectively. These borrowings were made against a credit facility in place at Rabobank Nederland. The maintenance of this facility requires us to pay a fee for the amount not drawn upon. Through November 30, 2007, this fee is assessed at the rate of 37.5 basis points per annum of the amount of that unused portion; after that date, this rate increased to 50.0 basis points per annum if that unused portion was greater than 50% of the total amount of the facility. The following table shows the facility amounts and outstanding borrowings at September 30, 2008, June 30, 2008 and June 30, 2007:

	December 31, 2008		June 30, 2008		June 30, 2007	
	Facility Amount	Amount Outstanding	Facility Amount	Amount Outstanding	Facility Amount	Amount Outstanding
Revolving Credit Facility	\$ 200,000	\$ 138,667	\$ 200,000	\$ 91,167	\$ 200,000	\$ —

The following table shows the contractual maturity of our revolving credit facility at December 31, 2008:

	Payments Due By Period			
	Less Than 1 year	1-3 Years	3-5 Years	More Than 5 Years
Credit Facility Payable	\$ 138,667	\$ —	\$ —	\$ —

During the quarter ended December 31, 2008, we did not raise any additional equity as the market was not conducive to a public offering. The following table shows the calculation of net asset value per share as of December 31, 2008 June 30, 2008 and June 30, 2007:

	December 31, 2008	June 30, 2008	June 30, 2007
Net Assets	\$ 427,803	\$ 429,623	\$ 300,048
Shares of common stock outstanding	29,637,928	29,520,379	19,949,065
Net asset value per share	\$ 14.43	\$ 14.55	\$ 15.04

At December 31, 2008, we had 29,637,928 of our common stock issued and outstanding.

Results of Operations

For the three months ended December 31, 2008 and December 31, 2007, the net increase (decrease) in net assets resulting from operations was \$6,524 and (\$3,686), respectively, representing \$0.22 and (\$0.16) per share, respectively. We experienced a net realized and unrealized loss of \$5,436 or approximately \$0.18 per share in the three months ended December 31, 2008. This compares with the net realized and unrealized loss of \$14,346 during the three months ended December 31, 2007 or approximately (\$0.62) per share.

For the six months ended December 31, 2008 and December 31, 2007, the net increase in net assets resulting from operations was \$20,522 and \$4,864, respectively, representing \$0.69 and \$0.23 per share, respectively. We

experienced a net realized and unrealized loss of \$14,940 or approximately \$0.50 per share in the six months ended December 31, 2008. This compares with the net realized and unrealized loss of \$13,661 during the six months ended December 31, 2007 or approximately \$0.63 per share.

Net increase in net assets resulting from operations for the years ended June 30, 2008, 2007 and 2006 was \$27,591, \$16,728 and \$12,896, respectively, representing \$1.17, \$1.06 and \$1.83 per share, respectively. We experienced realized and unrealized gains of \$4,338 or approximately \$0.61 per share in the year ended June 30, 2006, primarily from the unrealized gain recognized on our investment in GSHI. During the year ended June 30, 2007, we experienced unrealized and realized losses of \$6,403 or approximately \$0.41 per share primarily from the write-downs of our investments in AOG. During the year ended June 30, 2008, we experienced unrealized and realized losses of \$17,522 or approximately \$0.74 per share primarily from the sales of our investments in AOG and CIE at a loss.

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, which consists of interest income, including accretion of loan origination fees and prepayment penalty fees, dividend income and other income, including net profits interest, overriding royalties interest and structuring fees, was \$35,799 and \$15,391 for the three months ended September 30, 2008 and September 30, 2007, respectively. The following table details the various components of investment income and the related levels of debt investment for the three and six months ended December 31, 2008 and December 31, 2007:

	For The Three Months Ended December 31,		For The Six Months Ended December 31,	
	2008	2007	2008	2007
Interest income	\$ 17,241	\$ 14,816	\$ 34,797	\$ 27,648
Dividend income	4,665	2,466	9,388	4,084
Other income	307	1,281	13,827	2,222
Total investment income	\$ 22,213	\$ 18,563	\$ 58,012	\$ 33,954
Average debt principal of investments	\$ 537,101	\$ 396,741	\$ 517,421	\$ 360,824
Weighted-average interest rate earned	12.74%	14.86%	13.34%	14.99%

Investment income has been increasing as a larger investment portfolio has been generating greater income from both interest and dividends. Average interest income producing assets have increased from \$396,741 for the three months ended December 31, 2007 to \$537,101 for the three months ended December 31, 2008. Average interest income producing assets have increased from \$360,824 for the six months ended December 31, 2007 to \$517,421 for the six months ended December 31, 2008. While we have been able to increase the gross amount of interest income, average yields on interest bearing assets have decreased from 15.0% for the six months ended December 31, 2007 to 13.3%

for six months ended December 31, 2008. The decrease in yield is 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 4.7% for the six months ended December 31, 2008.

The increase in investment income is also driven by increases in income from dividends. Dividend income has grown significantly from \$2,466 to \$4,665 for the three months ended December 31, 2007 and December 31, 2008, respectively, and from \$4,084 to \$9,388 for the six months ended December 31, 2007 and December 31, 2008, respectively. Much of the increases in dividend income is attributable to dividends received as a result of our investment in GSHI which paid \$4,000 and \$1,600 for the three months ended December 31, 2008 and December 31, 2007, respectively, and \$8,000 and \$2,450 for the six months ended December 31, 2008 and December 31, 2007, respectively. Dividends were also received from our investments in Ajax and NRG.

The increase in investment income is also the result of increases in income from other sources. The significant increase in other income reflects our settlement of our net profit interests in IEC/ ARS for \$12,576. In addition to settlement of net profit interests, sources of other income include, but are not limited to, income from structuring fees and overriding royalty interests.

Investment income was \$79,402, \$40,681, and \$16,869 for the years ended June 30, 2008, June 30, 2007 and June 30, 2006, respectively. Drivers of these increases include increased assets generating increased interest income along with increased income from royalty, net profits, and restructuring fees. The following table describes the various components of investment income and the related levels of debt investments:

	Year Ended June 30, 2008	Year Ended June 30, 2007	Year Ended June 30, 2006
Interest income	\$ 59,033	\$ 30,084	\$ 13,268
Dividend income	12,033	6,153	3,601
Other income	8,336	4,444	—
Total investment income	\$ 79,402	\$ 40,681	\$ 16,869
Average debt principal of investments	\$ 397,913	\$ 172,605	\$ 70,727
Other income – Restructuring fee income	\$ 4,751	\$ 2,574	\$ —

Total investment income has increased from \$16,869 for the year ended June 30, 2006 to \$40,681 for the year ended June 30, 2007 to \$79,402 for the year ended June 30, 2008. 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 \$70,727 for the year ended June 30, 2006 to \$172,605 for the year ended June 30, 2007 to \$397,913 for the year ended June 30, 2008. While we have been able to increase the gross amount of interest income, average yields on interest bearing assets have decreased from 18.8% for the year ended June 30, 2006 to 17.4% for the year ended June 30, 2007 to 14.8% for the year ended June 30, 2008. These decreases are 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 5.67% for the year ended June 30, 2008.

Investment income is also generated from dividends and other income. Dividend income has grown significantly from \$3,601 for the year ended June 30, 2006 to \$6,153 for the year ended June 30, 2007 to \$12,033 for the year ended June 30, 2008. We have received dividends from our investments in GSHI, R-V, Ajax, C&J and NRG. Other income has come primarily from structuring fees, overriding royalty interests, and prepayment penalties on net profits interests.

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 \$10,253 and \$7,903 for the three months ended December 31, 2008 and December 31, 2007, respectively. For the six months ended December 31, 2008 and December 31, 2007, they were \$22,550 and \$15,429, respectively. Operating expenses were \$34,289, \$17,550, and \$8,311 for the years ended June 30, 2008, June 30, 2007 and June 30, 2006, respectively.

The base management fee was \$2,940 and \$2,112 for the three months ended December 31, 2008 and December 31, 2007, respectively. It was \$5,763 and \$3,978 for the six months ended December 31, 2008 and December 31, 2007, respectively. The increases in this expense are directly related to our growth in total assets. For the three months ended December 31, 2008 and December 31, 2007, we incurred \$2,990 and \$2,665, respectively, of income incentive fees. For the six months ended December 31, 2008 and December 31, 2007, we incurred \$8,865 and \$4,631, respectively, of income incentive fees. The increases in the income incentive fees are driven by increases in pre-base management fee net investment income of \$14,900 and \$12,772 for the three months ended December 31, 2008 and December 31, 2007, respectively. Pre-base management fee net investment income was \$41,225 and \$22,503 for the six months ended December 31, 2008 and December 31, 2007, respectively. No capital gains incentive fee has yet been incurred pursuant to the Investment Advisory Agreement.

The base investment advisory expenses were \$8,921, \$5,445, and \$2,082 for the years ended June 30, 2008, June 30, 2007 and June 30, 2006, respectively. These increases are directly related to our growth in total assets. \$11,278, \$5,781, and \$1,786 income incentive fees were earned for the years ended June 30, 2008, June 30, 2007 and June 30, 2006, respectively. The increases in the income incentive fees are driven by our stronger performance with respect to net investment income as evidenced by net operating income ratios of 12.66%, 9.71% and 7.90% for the years ended June 30, 2008, June 30, 2007 and June 30, 2006, respectively. No capital gains incentive fee has yet been incurred pursuant to the Investment Advisory Agreement.

During the three and six months ended December 31, 2008, we incurred \$1,965 and \$3,483, respectively of expenses related to our credit facility. This compares with expenses of \$1,618 and \$2,856 incurred during the three and six months ended December 31, 2007. These expenses are related directly to the leveraging capacity put into place for each of those periods and the levels of indebtedness actually undertaken during those quarters.

The table below describes the various credit facility expenses and the related indicators of leveraging capacity and indebtedness during these periods.

	For The Three Months Ended December 31,		For The Six Months Ended December 31,	
	2008	2007	2008	2007
Interest expense	\$ 1,712	\$ 1,307	\$ 2,942	\$ 2,197
Amortization of deferred financing costs	180	180	360	367
Commitment and other fees	73	131	181	292
Total	\$ 1,965	\$ 1,618	\$ 3,483	\$ 2,856
Weighted-average debt outstanding	\$ 137,525	\$ 80,348	\$ 125,845	\$ 64,785

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Weighted-average interest rate incurred	4.95%	6.45%	4.65%	6.73%
Facility amount at beginning of period	\$ 200,000	\$ 200,000	\$ 200,000	\$ 200,000

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During the years ended June 30, 2008, June 30, 2007 and June 30, 2006, we incurred \$6,318, \$1,903, and \$642, respectively of expenses related to our credit facilities. The table below describes the various credit facility expenses and the related indicators of leveraging capacity and indebtedness.

	Year Ended June 30, 2008	Year Ended June 30, 2007	Year Ended June 30, 2006
Interest expense	\$ 5,104	\$ 357	\$ 422
Amortization of deferred financing costs	726	1,264	220
Commitment and other fees	488	282	—
Total	\$ 6,318	\$ 1,903	\$ 642
Weighted-average debt outstanding	\$ 90,032	\$ 4,282	\$ 4,696
Weighted-average interest rate	5.67%	8.37%	9.01%
Facility amount at beginning of year	\$ 200,000	\$ 30,000	\$ —

As our asset base has grown and we have added complexity to our capital raising activities, due, in part, to our securitization credit facility initiated in June 2007, 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 treasurer, a corporate counsel 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.

Asset-based fees from Vastardis Capital, the sub-administrator to Prospect Administration, have also grown as assets have grown. Legal costs decreased significantly from \$1,775 for the six months ended December 31, 2007 to \$483 for the six months ended December 31, 2008 as there were reduced costs for litigation during the 2008 period. Legal costs for the year ended June 30, 2008 increased significantly from the year ended June 30, 2007 as we continue to vigorously defend certain legal actions against us during this period.

Net Realized Gains (Loss)

Net realized gains (losses) were \$16 and \$(18,610) for the three months ended December 31, 2008 and December 31, 2007, respectively. For the six months ended December 31, 2008 and December 31, 2007, net realized gains (losses) were \$1,661 and \$(18,621), respectively. The net realized gain of \$1,661 for the six months ended December 31, 2008 was due primarily to the sale of the warrant related to Deep Down, Inc. The net realized loss of \$18,610 for the six months ended December 31, 2007 was attributable primarily to our disposition of our investments in Central Illinois Energy, LLC and Advantage Oilfield Group, Ltd. ("AOG") during the three months then ended.

Net realized gains (losses) were (\$16,222), \$1,949, and \$303 for the years ended June 30, 2008, June 30, 2007 and June 30, 2006, respectively. The net realized loss of (\$16,222) sustained in FY2008 was due mainly to the sale of CIE and AOG while the \$1,949 realized gain registered for FY2007 is attributable to the sale of Evolution.

Increase (Decrease) in Net Assets from Net Changes in Unrealized Appreciation/Depreciation

Increase (decrease) in net assets from changes in unrealized appreciation/depreciation was (\$5,452) and \$4,264 for the three months ended December 31, 2008 and December 31, 2007, respectively. 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. For the three months ended December 31, 2007, the \$4,264 increase in net assets from such

changes is attributable to write-ups of our investments in ESA Environmental Specialists, Inc., Arctic Acquisition Corp. and C&J offset by write-downs for our investments in Integrated, WECO, and Genesis Coal Corp.

For the six months ended December 31, 2008 and December 31, 2007, net assets (decreased) increased by (\$16,601) and \$4,960, respectively from changes in unrealized appreciation/depreciation. 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. The \$4,960 increase from changes in unrealized appreciation/depreciation for the six months ended December 31, 2007 was the net result of write-ups of our investments in ESA Environmental Specialists, Inc. and NRG by the disposition of AOG (which had been previously valued below cost) offset by a write-down for our investment in Integrated.

Increase (decrease) in net assets from changes in unrealized appreciation/depreciation was (\$1,300), (\$8,352), and \$4,035 for the years ended June 30, 2008, June 30, 2007 and June 30, 2006, respectively. For FY2008, the (\$1,300) decrease in net assets from the net change in unrealized appreciation/depreciation was driven by significant write-downs in our investments in Integrated, Worcester Energy Co., Inc., or WECO, and Yatesville partially offset by the write-up for our investment in GSHI and by the disposition of previously written-down investments in AOG and ESA. FY2007's (\$8,352) decrease in net assets from such changes is attributable to significant write-downs of our investments in AOG, ESA, Unity and Whymore which, in turn, were slightly offset by a significant write-up in the value for GSHI. For FY2006, the \$4,035 increase in net assets due to changes in unrealized appreciation/depreciation was mainly attributable to a write-up of the investment in GSHI.

Financial Condition, Liquidity and Capital Resources

For the three months ended December 31, 2008 and December 31, 2007, our operating activities provided (used) \$4,659 and (\$102,990) of cash, respectively. Financing activities (used) provided (\$3,490) and \$104,326 of cash during the three months ended December 31, 2008 and December 31, 2007, respectively which included the payments of dividends of \$10,376 and \$0, during the three months ended December 31, 2008 and December 31, 2007, respectively.

For the six months ended December 31, 2008 and December 31, 2007, our operating activities used \$23,126 and \$155,568 of cash, respectively. Financing activities provided \$25,009 and \$156,904 of cash during the six months ended December 31, 2008 and December 31, 2007, respectively which included the payments of dividends of \$22,221 and \$6,587, during the six months ended December 31, 2008 and December 31, 2007, respectively. Our cash flows provided by (used in) operating activities totaled (\$204,025), (\$143,890), (\$29,919), for the years ended June 30, 2008, June 30, 2007 and June 30, 2006, respectively. Financing activities provided (used) cash flows of \$204,580, \$143,890, and \$20,332, for the years ended June 30, 2008, June 30, 2007 and June 30, 2006, respectively. Dividends paid and declared were \$24,915, \$21,634, and \$7,663, for the years ended June 30, 2008, June 30, 2007 and June 30, 2006, respectively.

Our primary uses of funds have been to add to our investments in our portfolio companies, to add new companies to our investment portfolio, and to make cash distributions to holders of our common stock. In the future, we may also use some of our funds to buy back our common stock on the open market.

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, 2008, we had a \$200,000 revolving credit facility on which \$138,667 was outstanding. At June 30, 2008, we had a \$200,000 revolving credit facility on which \$91,167 was outstanding. This facility matures on June 6, 2009, and we are currently negotiating for an extension and expansion of the facility.

On September 6, 2007, our Registration Statement on Form N-2 was declared effective by the SEC. At December 31, 2008, under the Registration Statement, we had remaining availability to issue up to approximately \$354,000 of our equity securities over the next three years.

Off-Balance Sheet Arrangements

At December 31, 2008, 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 20, 2009, we issued 148,200 shares of our common stock in connection with the Dividend Reinvestment Plan.

On January 21, 2009, Diamondback repaid the \$9,200 debt outstanding to us. We continue to hold net profit interests on this investment.

On February 12, 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.

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, 2008. 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, 2008 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, 2008 based on the criteria on Internal Control — Integrated Framework issued by COSO.

Our management's assessment of the effectiveness of our internal control over financial reporting as of June 30, 2008 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 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, 2008, any of our quarterly reports on Form 10-Q or current reports on Form 8-K, or any other oral or written statements made in press releases or otherwise by or on behalf of Prospect Capital Corporation including this prospectus may contain forward looking statements within the meaning of the Section 21E of the Securities Exchange Act of 1934, as amended, which involve substantial risks and uncertainties. Forward looking statements predict or describe our future operations, business plans, business and investment strategies and portfolio management and the performance of our investments and our investment management business. These forward-looking statements are not historical facts, but rather are based on current expectations, estimates and projections about our industry, our beliefs, and our assumptions. Words such as "intends," "intend," "intended," "goal," "estimate," "estimates," "expects," "expect," "expected," "project," "projected," "projections," "plans," "seeks," "anticipates," "anticipated," "should," "could," "may," "will," "designed to," "foreseeable future," "believe," "believes" and "scheduled" and variations of these words and similar expressions are intended to identify forward-looking statements. Our actual results or outcomes may differ materially from those anticipated. Readers are cautioned not to place undue reliance on these forward looking statements, which speak only as of the date the statement was made. We undertake no obligation to publicly update or revise any forward looking statements, whether as a result of new information, future events or otherwise. These forward-looking statements do not meet the safe harbor for forward-looking statements pursuant to Section 27A of the Securities Act. These statements are not guarantees of future performance and are subject to risks, uncertainties, and other factors, some of which are beyond our control and difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements, including without limitation:

- our future operating results,
- our business prospects and the prospects of our portfolio companies,
- the impact of investments that we expect to make,
- the dependence of our future success on the general economy and its impact on the industries in which we invest,
- the ability of our portfolio companies to achieve their objectives,
- difficulty in obtaining financing or raising capital, especially in the current credit and equity environment,
- the level and volatility of prevailing interest rates and credit spreads, magnified by the current turmoil in the credit markets,
- adverse developments in the availability of desirable loan and investment opportunities whether they are due to competition, regulation or otherwise,
- a compression of the yield on our investments and the cost of our liabilities, as well as the level of leverage available to us,
- our regulatory structure and tax treatment, including our ability to operate as a business development company and a regulated investment company;
- the adequacy of our cash resources and working capital;
- the timing of cash flows, if any, from the operations of our portfolio companies;

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

- authoritative generally accepted accounting principles or policy changes from such standard-setting bodies as the Financial Accounting Standards Board, the 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.

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. We anticipate that the tax to be paid in the quarter ending March 31, 2009 will be approximately \$532,000.

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, 2008, we declared total dividends of approximately \$39.5 million.

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

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

Date Declared	Record Date	Payment Date	Per Share	Amount
11/11/2004	12/10/2004	12/30/2004	\$ 0.100	\$ 705,510
2/9/2005	3/11/2005	3/30/2005	\$ 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	3/23/2006	3/30/2006	\$ 0.300	\$ 2,116,530
6/14/2006	6/23/2006	6/30/2006	\$ 0.340	\$ 2,401,060
7/31/2006	9/22/2006	9/29/2006	\$ 0.380	\$ 4,858,879
12/15/2006	12/29/2006	1/5/2007	\$ 0.385	\$ 7,263,926
3/14/2007	3/23/2007	3/30/2007	\$ 0.3875	\$ 7,666,837
6/14/2007	6/22/2007	6/29/2007	\$ 0.390	\$ 7,752,900
9/6/2007	9/19/2007	9/28/2007	\$ 0.3925	\$ 7,830,008
12/18/2007	12/28/2007	1/7/2008	\$ 0.395	\$ 9,369,850
3/6/2008	3/31/2008	4/16/2008	\$ 0.400	\$ 10,468,455
6/19/2008	6/30/2008	7/16/2008	\$ 0.40125	\$ 11,845,052
9/16/2008	9/30/2008	10/16/2008	\$ 0.4025	\$ 11,881,953
12/19/2008	12/31/2008	1/20/2009	\$ 0.40375	\$ 11,958,904
Total Declared				\$ 101,446,465

PRICE RANGE OF COMMON STOCK

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

	NAV(1)	Stock Price High(2)	Low(2)	Premium (Discount) of High to NAV	Premium (Discount) of Low to NAV	Dividend Declared
Twelve Months Ending June 30, 2005						
First quarter	\$ 13.67	\$ 15.45	\$ 14.42	13.0%	5.5%	—
Second quarter	13.74	15.15	11.63	10.3%	(15.4)%	\$ 0.100
Third quarter	13.74	13.72	10.61	(0.1)%	(22.8)%	0.125
Fourth quarter	14.59	13.47	12.27	(7.7)%	(15.9)%	0.150
Twelve Months Ending June 30, 2006						
First quarter	\$ 14.60	\$ 13.60	\$ 11.06	(6.8)%	(24.2)%	\$ 0.200
Second quarter	14.69	15.46	13.02	5.2%	(12.6)%	0.280
Third quarter	14.81	16.64	15.00	12.4%	1.3%	0.300
Fourth quarter	15.31	17.05	15.83	11.5%	3.4%	0.340
Twelve Months Ending June 30, 2007						
First quarter	\$ 14.86	\$ 16.77	\$ 15.30	12.9%	2.3%	\$ 0.380
Second quarter	15.24	18.79	15.60	24.5%	(0.9)%	0.385
Third quarter	15.18	17.68	16.40	16.5%	8.0%	0.3875
Fourth quarter	15.04	18.68	16.91	24.2%	12.4%	0.390
Twelve Months Ending June 30, 2008						
First quarter	\$ 15.08	\$ 18.68	\$ 14.15	24.7%	(16.1)%	\$ 0.3925
Second quarter	14.58	17.17	11.22	18.3%	(23.3)%	0.395
	14.15	16.00	13.55	13.1%	(4.2)%	0.400

Third quarter									
Fourth quarter	\$	14.55	\$	16.12	\$	13.18	10.8%	(9.4)%	0.40125
Twelve Months Ending June 30, 2009									
First quarter	\$	14.63	\$	14.24	\$	11.12	(0.3)%	(24.0)%	\$ 0.4025
Second quarter		14.43	\$	13.08	\$	6.29	(9.4)%	(56.4)	0.40375
Third quarter (to 3/17/09)		—(3)	\$	12.89	\$	6.38	—(3)	—(3)	—

(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 net asset values 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) NAV has not yet been finally determined for any day after December 31, 2008.

On March 17, 2009, the last reported sales price of our common stock was \$7.61 per share. As of December 31, 2008, we had approximately 47 stockholders of record.

BUSINESS

General

We are a financial services company that primarily lends 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 as amended, or the 1940 Act. We are a Maryland corporation that was organized on April 13, 2004 under the name "Prospect Street Energy Corporation". We changed our name to "Prospect Energy Corporation" on June 23, 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.

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.

We concentrate on making investments in companies having annual revenues of less than \$500 million and in transaction sizes of less than \$250 million, which we refer to as "target" or "middle market" companies. In most cases, these middle market companies are privately-held companies at the time we invest in them.

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 on seeking 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.

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 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 Related to our Investments."

Industry Sectors

We have invested significantly in industrial and energy related companies. However, we continue to widen our strategy 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 byproducts in a form that is usable by wholesale power generation, utility, petrochemical, industrial and gasoline customers.
- Downstream businesses include the power and electricity segment as well as businesses that process, refine, market or distribute hydrocarbons or other energy resources, such as customer-ready natural gas, propane and gasoline, to end-user customers.

Ongoing Relationships with Portfolio Companies

Monitoring

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

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

- Assessment of success in adhering to the portfolio company's business plan and compliance with covenants;
- Regular contact with portfolio company management and, if appropriate, another 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 portfolio companies.

Valuation Process

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.

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

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

- 1) Each portfolio company or investment is reviewed by our investment professionals with the independent valuation firm;
- 2) the independent valuation firm engaged by our Board of Directors conducts independent appraisals and makes their own independent assessment;
- 3) the audit committee of our Board of Directors reviews and discusses the preliminary valuation of our Investment Adviser and that of the independent valuation firms; 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 discounts 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, or FASB, issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements", or FAS 157. FAS 157 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those years. We have adopted this statement on a prospective basis beginning in the quarter ended September 30, 2008. Adoption of this statement did not have a material effect on our financial statements for that quarter or for the current quarter ended December 31, 2008.

FAS 157 classifies the inputs used to measure these fair values into the following hierarchy:

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

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

Level 3: Unobservable inputs for the asset or liability.

In all cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to each investment. The changes to generally accepted accounting principles from the application of FAS 157 relate to the definition of fair value, framework for measuring fair value, and the expanded disclosures about fair value measurements. FAS 157 applies to fair value measurements already required or permitted by other standards. In accordance with FAS 157, 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.

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

Valuation of Other Financial Assets and Financial Liabilities

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

The Investment Adviser

Prospect Capital Management manages our investments as our investment adviser. Prospect Capital Management is a Delaware limited liability corporation that has been registered as an investment adviser under the Advisers Act since March 31, 2004. Prospect Capital Management is led by John F. Barry III and M. Grier Eliasek, two senior executives with significant investment advisory and business experience. Both Messrs. Barry and Eliasek spend a significant amount of their time in their roles at Prospect Capital Management working on the Company's behalf. The principal executive offices of Prospect Capital Management are 10 East 40th Street, 44th Floor, New York, NY 10016. We depend on the diligence, skill and network of business contacts of the senior management of our Investment Adviser. We also depend, to a significant extent, on our Investment Adviser's investment professionals and the information and deal flow generated by those investment professionals in the course of their investment and portfolio management activities. The Investment Adviser's senior management team evaluates, negotiates, structures, closes, monitors and services our investments. Our future success depends to a significant extent on the continued service of the senior management team, particularly John F. Barry III and M. Grier Eliasek. The departure of any of the senior managers of our Investment Adviser could have a materially 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., or DGP, served the Company 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 the Company breached its 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 the Company's alleged agreement in September 2004 to loan DGP funds with which DGP intended to buy Gas Solutions, Ltd. for approximately \$26 million. The complaint seeks relief not limited to \$100 million. The Company believes that the DGP complaint is frivolous and without merit, and intend to defend the matter vigorously. 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 the Company's 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 the Company's Motion for Summary Judgment dismissing all claims by DGP, against the Company. On May 16, 2007, the Court also granted us summary judgment on DGP's liability to the Company 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 the Company's motion to dismiss all DGP's claims asserted against certain officers and affiliates of the Company. The Company's damage claims against DGP remain pending.

In May 2006, based in part on unfavorable due diligence and the absence of investment committee approval, the Company declined to extend a loan for \$10 million to a potential borrower, or 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 the Company and certain affiliates, or collectively the defendants, in the same local Texas court, alleging, among other things, tortious interference with contract and fraud. The Company petitioned the U.S. District Court for the Southern District of New York, or the District Court to compel arbitration and to enjoin the Texas action. In February 2007, the Company's motions were granted. Plaintiff appealed that decision. 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 favor of the Company, rejecting all of plaintiff's claims. On April 18, 2008, the Company filed a petition before the District Court to confirm the award, which is now pending.

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

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

MANAGEMENT

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

Board Of Directors And Executive Officers

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

Directors and Executive Officers

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

Independent Directors

Name and Age	Position(s) Held with the Company	Term of Office(1) and Length of Time Served	Principal Occupation(s) During Past 5 Years	Number of Portfolios in Fund Complex Overseen by Director	Other Directorships Held by Director(2)
Graham D.S. Anderson, 43	Director	Class I Director since September 2008; Term expires 2011	General Partner of Euclid SR Partners from 2000 to present. From 1996 to 2000, Mr. Anderson was a General Partner of Euclid Partners, the predecessor to Euclid SR Partners.	One	None
Eugene S. Stark, 51	Director	Class III Director since September 2008; Term expires 2010	Principal Financial Officer, Chief Compliance Officer and Vice President – Administration of General American Investors Company, Inc. from May 2005 to present. Prior to his role with General American Investors Company, Inc., Mr. Stark served as the Chief Financial Officer of Prospect Capital Corporation from	One	None

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.

Andrew C. Cooper, 47	Director	Class II Director since February 2009; Term expires 2009	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
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(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 is a Class II director with a term that will expire in 2009 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.

Interested Directors

Name and Age	Position(s) Held with the Company	Term of Office(1) and Length of Time Served	Principal Occupation(s) During Past 5 Years	Number of Portfolios in Fund Complex Overseen by Director	Other Directorships Held by Director(2)
John F. Barry III,(3) 57	Director, Chairman of the Board of Directors, and Chief Executive Officer	Class III Director since June 2004; Term expires 2010	Chairman and Chief Executive Officer of the Company; Managing Director and Chairman of the Investment Committee of Prospect Capital Management and Prospect Administration since June 2004; Managing Director of Prospect Capital Management.	One	None
M. Grier Eliasek,(3) 35	Director, President and Chief Operating	Class II Director since June 2004; Term expires	President and Chief Operating Officer of the Company, Managing Director of Prospect Capital	One	None

Officer	2009	Management and Prospect Administration
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- (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 is a Class II director with a term that will expire in 2009 and Mr. Barry and Mr. Stark are Class III directors with terms that will expire in 2010.
- (2) No director otherwise serves as a director of an investment company subject to the 1940 Act.
- (3) Messrs. Barry and Eliasek are each considered an "interested person" under the 1940 Act by virtue of serving as one of our officers and having a relationship with Prospect Capital Management.

Information about Executive Officers who are not Directors

Name and Age	Position(s) Held with the Company	Term of Office and Length of Time Served	Principal Occupation(s) During Past Five Years
Brian H. Oswald, 48	Chief Financial Officer, Chief Compliance Officer, Treasurer and Secretary(1)	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)

- (1) Mr. William E. Vastardis was the Chief Compliance Officer until September 30, 2008. On October 1, 2008, Brian H. Oswald assumed this role and effective November 11, 2008, Mr. Oswald also assumed the roles of Chief Financial Officer and Treasurer, replacing Mr. Vastardis.

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.

Eugene S. Stark. Mr. Stark has served as Principal Financial Officer, Chief Compliance Officer and Vice President - Administration of General American Investors Company, Inc. from May 2005 to present. Prior to his role with

General American Investors Company, Inc., Mr. Stark served as the Chief Financial Officer of Prospect Capital Corporation from January 2005 to April 2005. From May 1987 to December 2004 Mr. Stark served as

Senior Vice President (division level) and Vice President (corporate level) with Prudential Financial, Inc. in various financial management positions. Mr. Stark serves as a member of the Board of Directors of Prospect Capital Funding LLC, a wholly-owned subsidiary of the Company, and sits on the Board of Trustees and is a Member of the Finance Committee of Mount Saint Mary Academy.

Interested Directors

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

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

Executive Officer

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

Trust. Prior to joining the Company, Mr. Oswald spent two years with the Structured Finance Division of GSC Group, serving as Managing Director of Finance for this asset management company. At GSC, Mr. Oswald managed the finances for a REIT, two hedge funds and thirteen CDOs. Mr. Oswald joined the Administrator on June 16, 2008. Mr. Oswald holds a B.A. degree in Accounting from Moravian College. He is a

licensed Certified Public Accountant in the States of New York and Pennsylvania, and is a Certified Management Accountant. Mr. Oswald also serves as a board member of RMJ Laboratories, Inc.

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

Committees of the Board of Directors

Our Board of Directors has established an Audit Committee and a Nominating and Corporate Governance Committee. For the fiscal year ended June 30, 2008, our Board of Directors held twenty-three Board of Director meetings, sixteen Audit Committee meetings, and one Nominating and Corporate Governance Committee meeting. All directors attended at least 75% of the aggregate number of meetings of the Board of Directors and of the respective committees on which they served. We require each director to make a diligent effort to attend all board and committee meetings, as well as each annual meeting of stockholders.

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

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

In fulfilling their responsibilities, it is recognized that members of the Audit Committee are not our full-time employees or management and are not, and do not represent themselves to be, accountants or auditors by profession. As such, it is not the duty or the responsibility of the Audit Committee or its members to conduct "field work" or other types of auditing or accounting reviews or procedures, to determine that the financial statements are complete and accurate and are in accordance with generally accepted accounting principles, or to set auditor independence standards. Each member of the Audit Committee is entitled to rely on (a) the integrity of those persons within and

outside us and management from which it receives information; (b) the accuracy of the financial and

other information provided to the Audit Committee absent actual knowledge to the contrary (which is required to be promptly reported to the Board of Directors); and (c) statements made by our officers and employees, our Investment Adviser or other third parties as to any information technology, internal audit and other non-audit services provided by the independent accountants to us.

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

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

Corporate Governance

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

Code of Conduct. We have adopted a code of conduct which applies to, among others, our senior officers, including our Chief Executive Officer and Chief Financial Officer, as well as all of our employees. Our code of

conduct is an exhibit to our Annual Report on Form 10-K filed with the SEC, and can be accessed via the Internet site of the SEC at <http://www.sec.gov>. We intend to disclose amendments to or waivers from a required provision of the code of conduct on Form 8-K.

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

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

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

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

Independent Directors

The Board of Directors, in connection with the 1940 Act and Marketplace Rules 4200(a)(15) and 4350(c) 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, Liebolt 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, Liebolt 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, 2008. No compensation is paid to the interested directors by the Company.

Name and Position	Aggregate Compensation from the Company	Pension or Retirement Benefits Accrued as Part of the Company's Expenses(1)	Total Compensation Paid to Director/Officer
Interested Directors			
John F. Barry(2)	None	None	None
M. Grier Eliasek(2)	None	None	None
Independent Directors			
Graham D.S. Anderson(3)	None	None	None
Andrew C. Cooper(4)	None	None	None
William J. Grempp(5)	\$86,250	None	\$86,250
F. Lee Liebolt, Jr.(6)	\$80,000	None	\$80,000
Walter V.E. Parker(7)	\$86,250	None	\$86,250
Eugene S. Stark(8)	None	None	None
Executive Officers			
William E. Vastardis(9,10)	—	None	—
Brian H. Oswald(2)	None	None	None

- (1) We do not have a bonus, profit sharing or retirement plan, and directors do not receive any pension or retirement benefits.
- (2) We have not paid, and we do not intend to pay, any annual cash compensation to our executive officers for their services as executive officers. Messrs. Barry and Eliasek are compensated by Prospect Capital Management from the income Prospect Capital Management receives under the management agreement between Prospect Capital Management and us. Mr. Oswald is compensated by Prospect Administration from the income Prospect Administration receives under the Administration Agreement.
- (3) Mr. Anderson joined our Board of Directors on September 15, 2008.
- (4) Mr. Cooper joined our Board of Directors on February 12, 2009.
- (5) Mr. Grempp ceased being a member of the Board of Directors concurrent with his resignation on December 10, 2008.
- (6) Mr. Liebolt ceased being a member of the Board of Directors concurrent with the election of directors at the Company's most recent annual meeting held on February 12, 2009.
- (7) Mr. Parker ceased being a member of the Board of Directors concurrent with his resignation on December 12, 2008.
- (8) Mr. Stark joined our Board of Directors on September 4, 2008.
- (9) Mr. Vastardis 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.
- (10) 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, 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 is in turn paid by the Company at a monthly rate of \$6,250. In addition, the Company pays 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 determine 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, 2008, the Company paid Vastardis Compliance Services LLC \$75,000 for services rendered by Mr. Vastardis as Chief Compliance Officer. For the fiscal year ending June 30, 2008, the Company paid Vastardis Fund Services LLC approximately \$783,520 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.

For the first nine months of the fiscal year ended June 30, 2008, the independent directors received an annual fee of \$70,000, paid monthly in advance, plus reimbursement of any reasonable out-of-pocket expenses incurred. The chairman of each committee also received an additional annual fee of \$5,000. For the last three months of the fiscal year ended June 30, 2008, the independent directors received an annual fee of \$75,000, paid monthly in advance, plus \$1,250 in connection with each board or committee meeting attended, and the chairman of each committee also received an additional annual fee of \$5,000. The independent directors were also reimbursed for any reasonable out-of-pocket expenses incurred. 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.

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.

Management Services

Investment Advisory Agreement

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

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

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

quarter (7% annualized).

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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 total base management fees earned by and paid to Prospect Capital Management during the three months ended September 30, 2008 and September 30, 2007 were \$2.8 million and \$1.9 million respectively, and \$8.9 million, \$5.4 million and \$2.1 million for the twelve months ended June 30, 2008, June 30, 2007 and June 30, 2006, respectively.

The income incentive fees were \$5.9 million and \$1.9 million, for the three months ended September 30, 2008 and September 30, 2007 respectively, and \$11.3 million, \$5.8 million and \$1.8 million for the twelve months ended June 30, 2008, June 30, 2007 and June 30, 2006, respectively. No capital gains incentive fees were earned for the three months ended September 30, 2008 and September 30, 2007.

The total investment advisory fees were \$8.7 million, and \$3.8 million for the three months ended September 30, 2008 and September 30, 2007 respectively, and \$20.2 million, \$11.2 million and \$3.9 million for the twelve months ended June 30, 2008, June 30, 2007 and June 30, 2006, 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%

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

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

Alternative 2

Assumptions

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

Hurdle rate(1) = 1.75%

Base management fee(2) = 0.50%

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

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

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

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

Alternative 3

Assumptions

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

Hurdle rate(1) = 1.75%

Base management fee(2) = 0.50%

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

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

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

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

(*) 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.

Example 2: Capital Gains Incentive Fee:

Alternative 1

Assumptions

- Year 1: \$20 million investment made
- Year 2: Fair market value, or FMV of investment determined to be \$22 million
- Year 3: FMV of investment determined to be \$17 million
- Year 4: Investment sold for \$21 million

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

- Year 1: No impact
- Year 2: No impact

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

Alternative 2

Assumptions

- Year 1: \$20 million investment made
- Year 2: FMV of investment determined to be \$17 million
- Year 3: FMV of investment determined to be \$17 million
- Year 4: FMV of investment determined to be \$21 million
- Year 5: FMV of investment determined to be \$18 million
- Year 6: Investment sold for \$15 million

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

- Year 1: No impact

- Year 2: Decrease base amount on which the second part of the incentive fee is calculated by \$3 million (unrealized capital depreciation)
- Year 3: No impact

- Year 4: Increase base amount on which the second part of the incentive fee is calculated by \$3 million (reversal in unrealized capital depreciation)
- Year 5: Decrease base amount on which the second part of the incentive fee is calculated by \$2 million (unrealized capital depreciation)

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

Alternative 3

Assumptions

- Year 1: \$20 million investment made in company A, or Investment A, and \$20 million investment made in company B, or Investment B
- Year 2: FMV of Investment A is determined to be \$21 million, and Investment B is sold for \$18 million
- Year 3: Investment A is sold for \$23 million

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

- Year 1: No impact
- Year 2: Decrease base amount on which the second part of the incentive fee is calculated by \$2 million (realized capital loss on Investment B)
- Year 3: Increase base amount on which the second part of the incentive fee is calculated by \$3 million (realized capital gain on Investment A)

Alternative 4

Assumptions

- Year 1: \$20 million investment made in company A, or Investment A, and \$20 million investment made in company B, or Investment B
- Year 2: FMV of Investment A is determined to be \$21 million, and FMV of Investment B is determined to be \$17 million
- Year 3: FMV of Investment A is determined to be \$18 million, and FMV of Investment B is determined to be \$18 million
- Year 4: FMV of Investment A is determined to be \$19 million, and FMV of Investment B is determined to be \$21 million
- Year 5: Investment A is sold for \$17 million, and Investment B is sold for \$23 million

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

- Year 1: No impact
- Year 2: Decrease base amount on which the second part of the incentive fee is calculated by \$3 million (unrealized capital depreciation on Investment B)

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

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

Payment of our expenses

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

Duration and termination

The Investment Advisory Agreement was originally approved by our Board of Directors on June 23, 2004 and was re-approved by the Board of Directors on June 6, 2008 for an additional one-year term expiring June 22, 2009. Unless terminated earlier as described below, it will remain in effect from year to year thereafter if approved annually by our Board of Directors or by the affirmative vote of the holders of a majority of our outstanding voting securities, including, in either case, approval by a majority of our directors who are not interested persons. The Investment Advisory Agreement will automatically terminate in the event of its assignment. The Investment Advisory Agreement may be terminated by either party without penalty upon not more than 60 days' written notice to the other. See "Risk factors—Risks Relating to Our Business—We are dependent upon Prospect Capital Management's key management personnel for our future success."

Administration Agreement

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

Prospect Administration, pursuant to the approval of our Board of Directors, has engaged Vastardis to serve as our sub-administrator to perform certain services required of Prospect Administration. Under the sub-administration agreement, Vastardis provides us with office facilities, equipment, clerical, bookkeeping and record keeping services at such facilities. Vastardis also conducts relations with custodians, depositories, transfer agents, dividend disbursing agents, other stockholder servicing agents, accountants, corporate fiduciaries, and such other persons in any such other capacity deemed to be necessary or desirable. Vastardis provides reports to the Administrator and the Board of Directors of its performance of obligations and furnishes advice and recommendations with respect to such other aspects of our business and affairs as it shall determine to be desirable. In May 2006, the engagement was revised and renewed as an asset-based fee on a sliding scale starting at 0.20% on the first \$250 million in gross assets and ending at 0.05% on gross assets over \$1 billion with a \$400,000 annual minimum, payable monthly. Vastardis does not provide any advice or recommendation relating to the securities and other assets that we should purchase, retain or sell or any other investment advisory services to us. Vastardis is responsible for the financial and other records that either we (or the Administrator on our behalf) are required to maintain and prepares reports to stockholders, and reports and other materials filed with the SEC. In addition, Vastardis 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 overseeing the payment of our expenses and the performance of administrative and professional services rendered to us by others.

We reimbursed Prospect Administration \$0.589 million and \$0.259 million, for the three months ended September 30, 2008 and September 30, 2007 respectively, and \$2.139 million, \$0.785 million and \$0.310 million for the twelve months ended June 30, 2008, June 30, 2007 and June 30, 2006, respectively, for services it provided to the Company at cost.

Indemnification

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

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

Under the sub-administration agreement, Vastardis and its officers, partners, agents, employees, controlling persons, members, and any other person or entity affiliated with Vastardis, are not liable to the Administrator or to us for any action taken or omitted to be taken by Vastardis in connection with the performance of any of its duties or obligations or otherwise as sub-administrator for the Administrator on our behalf. The agreement also provides that, absent willful misfeasance, bad faith or negligence in the performance of Vastardis' duties or by reason of the reckless disregard of Vastardis' duties and obligations, Vastardis and its officers, partners, agents, employees, controlling persons, members, and any other person or entity affiliated with Vastardis are entitled to indemnification from the

Administrator and us. All damages, liabilities, costs and expenses (including reasonable attorneys' fees and amounts reasonably paid in settlement) incurred in or by reason of any pending, threatened or completed action, suit,

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investigation or other proceeding (including an action or suit by or in the right of the Administrator or us or our security holders) arising out of or otherwise based upon the performance of any of Vastardis' duties or obligations under the agreement or otherwise as sub-administrator for the Administrator on our behalf.

Board of Directors approval of the Investment Advisory Agreement

On June 6, 2008, our Board of Directors voted unanimously to renew the Investment Advisory Agreement for the 12-month period ending June 22, 2009. 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 not economies of scale to be realized by Prospect Capital Management.

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

Portfolio Managers

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

Name	Position	Length of Service with Company(Years)
John F. Barry	Chairman and Chief Executive Officer	4
M. Grier Eliasek	President and Chief Operating Officer	4

Mr. Eliasek receive 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 January 29, 2009.

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

Managerial Assistance

As a business development company, we offer, and must provide upon request, managerial assistance to certain of our portfolio companies. This assistance could involve, among other things, monitoring the operations of our portfolio companies, participating in board and management meetings, consulting with and advising officers of portfolio companies and providing other organizational and financial guidance. We may receive fees for these services. Such fees, if received by us, and not other entities, may not always 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 and is compensated therefore when we are required to provide this assistance. We received \$0.2 million and \$0.2 million in managerial assistance for the three months ended September 30, 2008 and September 30, 2007 respectively, and \$0.7 million, \$0.5 million and \$0.2 million in managerial assistance for the twelve months ended June 30, 2008, June 30, 2007 and June 30, 2006, respectively. These fees are paid to the Administrator.

License Agreement

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

CERTAIN RELATIONSHIPS AND TRANSACTIONS

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

In addition, pursuant to the terms of the Administration Agreement, Prospect Administration provides, or arranges to provide, the Company with the office facilities and administrative services necessary to conduct our day-to-day operations. Prospect Capital Management is the sole member of and controls Prospect Administration. Prospect Administration, pursuant to the approval of our Board of Directors, has engaged Vastardis to serve as the sub-administrator of the Company.

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

CONTROL PERSONS AND PRINCIPAL STOCKHOLDERS

As of March 17, 2009, there were no persons that owned 25% or more of our outstanding voting securities, and we believe no person should be deemed to control us, as such term is defined in the 1940 Act.

The following table sets forth, as of March 17, 2009, certain ownership information with respect to our common stock for those persons who directly or indirectly own, control or hold with the power to vote, 5% or more of our outstanding common stock and all officers and directors, as a group. Unless otherwise indicated, we believe that the beneficial owners set forth in the tables below have sole voting and investment power.

Name and Address	Type of Ownership	Shares Owned	Percentage of Common Stock Outstanding(1)
Prospect Capital Management LLC(2)	Record and beneficial	826,635	2.56%
All officers and directors as a group (7 persons)(3)	Record and beneficial	1,416,284	4.21%

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

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

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

The following table sets forth the dollar range of our equity securities beneficially owned by each of our directors and officers as of January 16, 2009. We are not part of a "family of investment companies" as that term is defined in the 1940 Act.

Name of Director or Officer	Dollar Range of Equity Securities in the Company(1)
Independent Directors	
Graham D.S. Anderson	\$10,001-\$50,000
Andrew C. Cooper	none
Eugene S. Stark	\$10,001-\$50,000
Interested Directors	
John F. Barry III(2)	Over \$100,000
M. Grier Eliasek	Over \$100,000
Officer	
Brian H. Oswald(3)	\$50,001-\$100,000

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

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

(3) Mr. William E. Vastardis was also the Chief Compliance Officer until September 30, 2008. On October 1, 2008, Brian H. Oswald assumed this role and effective November 11, 2008, Mr. Oswald also assumed the roles of Chief Financial Officer and Treasurer, replacing Mr. Vastardis. Mr. Oswald is also the Secretary of the Company.

PORTFOLIO COMPANIES

The following is a listing of our portfolio companies at September 30, 2008. Values are as of September 30, 2008.

The portfolio companies are presented in three categories: “companies more than 25% owned” are portfolio companies in which we directly or indirectly own more than 25% of the outstanding voting securities of such portfolio company and, therefore, are presumed to be controlled by us under the 1940 Act; “companies owned 5% to 25%” are portfolio companies where we directly or indirectly own 5% to 25% of the outstanding voting securities of such portfolio company and/or hold one or more seats on the portfolio company’s Board of Directors and, therefore, are deemed to be an affiliated person under the 1940 Act; “companies less than 5% owned” are portfolio companies where we directly or indirectly own less than 5% of the outstanding voting securities of such portfolio company and where we have no other affiliations with such portfolio company. As of September 30, 2008, we owned 100% of the fully diluted common equity of GSHI, 51% of the common equity of WEPI, 49% of the fully diluted common equity of Integrated, 79.83% of the fully diluted common equity of Iron Horse, 80% of the fully diluted common equity of NRG, 74.51% of the fully diluted equity of R-V, 76.55% of the fully diluted common equity of Ajax and 100% of the fully diluted common equity of Yatesville. We make available significant managerial assistance to our portfolio companies. We generally request and may receive rights to observe the meetings of our portfolio companies’ Boards of Directors.

Name of Portfolio Company	Nature of its Principal Business (Location)	Title and Class of Securities Held	Collateral Held	Investment Structure	Equity Securities Held, at Fair Value (In millions)	Loans, at Fair Value (In millions)
Companies more than 25% owned						
Ajax Rolled Ring and Machine	Manufacturing (South Carolina)	Senior secured debt, subordinated secured debt, preferred stock and common equity	First priority lien on substantially all assets	Common shares; Preferred shares; Senior secured note Tranche A, 10.50% due 4/01/2013; Subordinated secured note Tranche B, 11.50% plus 6.00% PIK due 4/01/2013	6.1	33.2
C&J Cladding LLC	Metal services (Texas)	Senior secured debt and warrants	First priority lien on substantially all assets	Warrants, common shares, expiring 3/30/2014; Senior secured note, 14.00% due 3/30/2012	5.2	4.0
					52.2	25.0

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Gas Solutions Holdings, Inc.	Gas gathering and processing (Texas)	Senior secured debt and common equity	First priority lien on substantially all assets	Common shares; Senior secured note, 18.00% due 12/22/2018		
Integrated Contract Services, Inc.	Contracting (North Carolina)	Senior and junior secured debt, preferred stock and common equity	First priority lien on substantially all assets	Common shares; Preferred shares; Senior and junior secured notes, 7.00% plus 7.00% PIK due 9/30/2010; Senior demand note, 15.00% due 6/30/2009	0.0	5.0
Iron Horse Coiled Tubing, Inc.	Production services (Alberta, Canada)	Senior secured debt, bridge loan and common equity	First priority lien on substantially all assets	Common shares; Senior secured note, 15.00% due 4/19/2009; Bridge loan, 15.00% plus 3.00% PIK due 4/30/2009	0.0	13.3
NRG Manufacturing, Inc.	Manufacturing (Texas)	Senior secured debt and common equity	First priority lien on substantially all assets	Common shares; Senior secured note, 16.50% due 8/31/2011	10.6	13.1
R-V Industries, Inc.	Manufacturing (Pennsylvania)	Warrants and common equity	N/A – loan repaid	Common shares; Warrants, common shares, expiring 6/30/2017	12.0	0.0
Worcester Energy Partners, Inc.	Biomass power (Maine)	Senior secured debt, convertible preferred stock and common equity	First priority lien on substantially all assets	Common shares; Convertible Preferred shares; Senior secured note, 12.50% due 12/31/2012	0.0	10.9

Name of Portfolio Company	Nature of its Principal Business (Location)	Title and Class of Securities Held	Collateral Held	Investment Structure	Equity Securities Held, at Fair Value (In millions)	Loans, at Fair Value (In millions)
Yatesville Coal Holdings, Inc.	Mining and coal production (Kentucky)	Senior and junior secured debt and common equity	First priority lien on substantially all assets	Common shares; Senior secured note, 15.66% due 12/31/2010; Junior secured note, 15.66% due 12/31/2010	0.0	25.8
Companies 5% to 25% owned Appalachian Energy Holdings LLC	Construction services (West Virginia)	Senior secured debt, warrants and preferred units	First priority lien on substantially all assets	Preferred units; Warrants, common shares, expiring 2/13/2016, 6/17/2018, 11/30/2018; Senior secured note Tranche A, 14.00% plus 3.00% PIK plus 3.00% default interest due 1/31/2011; Senior secured note Tranche B, 14.00% plus 3.00% PIK due 5/01/2009	0.1	4.1
Biotronic NeuroNetwork	Healthcare (Michigan)	Senior secured debt and preferred stock	First priority lien on substantially	Preferred shares; Senior secured note,	2.6	24.9

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			all assets	11.50%, 1.00% PIK due 2/21/2013		
Companies less than 5% owned						
American Gilsonite Company	Specialty minerals (Utah)	Subordinated secured debt and membership interests	Second priority lien on substantially all assets	Membership interests; Subordinated secured note, 12.00% plus 3.00% PIK due 3/14/2013	2.3	14.9
Castro Cheese Company, Inc.	Food products (Texas)	Junior secured debt	Second priority lien on substantially all assets	Junior secured note, 11.00% plus 2.00% PIK due 2/28/2013	0.0	7.1
Conquest Cherokee LLC	Oil and gas production (Tennessee)	Senior secured debt, net profits interest and overriding royalty interest	First priority lien on substantially all assets	Overriding royalty interest, 5.00%; net profits interest, 10.00% Senior secured note, 13.00% due 5/05/2009	0.0	9.4
Deb Shops, Inc.	Retail (Pennsylvania)	Second lien debt	Second priority lien on substantially all assets	Second lien note, 10.16% due 10/23/2014	0.0	10.1
Diamondback Operating LP	Oil and gas production (Oklahoma)	Senior secured debt and net profit interest	First priority lien on substantially all assets	Net profit interest, 15.00%; Senior secured note, 12.00% plus 2.00% PIK due 8/27/2011	0.0	8.9
Freedom Marine Services LLC	Shipping vessels (Louisiana)	Subordinated secured debt and net profit interest	Second priority lien on substantially all assets	Net profit interest, 22.50%; Subordinated secured note, 12.00% plus 4.00% PIK due	0.0	7.0

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12/31/2011

H&M Oil & Gas LLC	Oil and gas production (Texas)	Senior secured debt and net profit interest	First priority lien on substantially all assets	Net profit interest, 8.00%; Senior secured note, 13.00% due 6/30/2010	0.0	48.8
IEC Systems LP/ Advanced Rig Services LLC ("ARS")	Oilfield fabrication (Texas)	Senior secured debt	First priority lien on substantially all assets	Senior secured notes 12.00% plus 3.00% PIK due 11/20/2012	0.0	36.2
Maverick Healthcare LLC	Healthcare (Arizona)	Second lien debt, preferred units and common units	Second priority lien on substantially all assets	Common units; Preferred units; Second lien debt, 12.00% plus 1.50% PIK due 4/30/2014	1.4	12.1

Name of Portfolio Company	Nature of its Principal Business (Location)	Title and Class of Securities Held	Collateral Held	Investment Structure	Equity Securities Held, at Fair Value (In millions)	Loans, at Fair Value (In millions)
Miller Petroleum, Inc.	Oil and gas production (Tennessee)	Warrants	N/A — loan repaid	Warrants, expiring 5/04/2010 through 12/31/2013	0.1	0.0
Peerless Manufacturing Co.	Manufacturing (Texas)	Subordinated secured debt	Second priority lien on substantially all assets	Subordinated secured debt, 11.50% plus 3.50% PIK due 4/29/2013	0.0	20.0
Qualitest Pharmaceuticals, Inc.	Pharmaceuticals (Alabama)	Second lien debt	Second priority lien on substantially all assets	Second lien debt, 8.96% due 4/30/2015	0.0	9.7
Regional Management Corp.	Financial services (South Carolina)	Subordinated secured debt	Second priority lien on substantially all assets	Subordinated secured note, 12.00% plus 2.00% PIK due 6/29/2012	0.0	21.5
Resco Products, Inc.	Manufacturing (Pennsylvania)	Second lien debt	Second priority lien on substantially all assets	Second lien debt, 10.20% due 6/22/2014	0.0	8.2
Shearer's Foods, Inc.	Food products (Ohio)	Second lien debt and membership interests	Common equity; Second priority lien on substantially all assets	Membership interests; Second lien debt, 14.00% due 10/31/2013	3.5	17.7
Stryker Energy LLC	Oil and gas production (Ohio)	Subordinated secured revolving credit facility and overriding	Second priority lien on substantially all assets	Overriding royalty interest, 3.50%; Subordinated secured	0.0	28.6

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		royalty interest		revolving credit facility, 12.00% due 12/01/2011		
TriZetto Group	Healthcare (California)	Subordinated unsecured debt	Unsecured	Subordinated unsecured note, 12.00% plus 1.50% PIK due 10/01/2016	0.0	13.9
Unitek	Technical services (Pennsylvania)	Second lien debt	Second priority lien on substantially all assets	Second lien debt, 14.50% due 12/31/2013	0.0	11.3
Wind River Resources Corp. and Wind River II Corp.	Oil and gas production (Utah)	Senior secured debt and net profit interest	First priority lien on substantially all assets	Senior secured note, 13.00% due 7/31/2010; net profit interest, 5.00%	0.0	14.3

DETERMINATION OF NET ASSET VALUE

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

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

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

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

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

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

SALES OF COMMON STOCK BELOW NET ASSET VALUE

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

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

- The effect that an offering below NAV per share would have on our stockholders, including the potential dilution they would experience as a result of the offering;
- The amount per share by which the offering price per share and the net proceeds per share are less than the most recently determined NAV per share;
- The relationship of recent market prices of par common stock to NAV per share and the potential impact of the offering on the market price per share of our common stock;
 - Whether the estimated offering price would closely approximate the market value of our shares;
 - The potential market impact of being able to raise capital during the current financial market difficulties;
 - the nature of any new investors anticipated to acquire shares in the offering;
 - The anticipated rate of return on and quality, type and availability of investments; and
 - The leverage available to us.

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

We will not sell shares under a prospectus supplement to the post-effective amendment to the registration statement of which this prospectus forms a part (the "current amendment") if the cumulative dilution to the Company's NAV per share from offerings under the current amendment exceeds 15%. This would be measured separately for each offering pursuant to the current amendment by calculating the percentage dilution or accretion to aggregate NAV from that offering and then summing the percentage from each offering. For example, if our most recently determined NAV at the time of the first offering is \$15.00 and we have 30 million shares outstanding, sale of 6 million shares at net

proceeds to us of \$7.50 per share (a 50% discount) would produce dilution of 8.33%. If we subsequently determined that our NAV per share increased to \$15.75 on the then 36 million shares outstanding and then made an additional offering, we could, for example, sell approximately an additional 7.2 million shares at net proceeds to us of \$9.45 per share, which would produce dilution of 6.67%, before we would reach the aggregate 15% limit. If we file a new post-effective amendment, the threshold would reset.

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

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

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

Impact On Existing Stockholders Who Do Not Participate in the Offering

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

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

The examples assume that the issuer has 30,000,000 common shares outstanding, \$600,000,000 in total assets and \$150,000,000 in total liabilities. The current NAV and NAV per share are thus \$450,000,000 and \$15.00. The chart illustrates the dilutive effect on Stockholder A of (1) an offering of 1,500,000 shares (5% of the outstanding shares) at \$14.25 per share after offering expenses and commission (a 5% discount from NAV), (2) an offering of 3,000,000 shares (10% of the outstanding shares) at \$13.50 per share after offering expenses and commissions (a 10% discount from NAV) and (3) an offering of 6,000,000 shares (20% of the outstanding shares) at \$12.00 per share after offering expenses and commissions (a 20% discount from NAV). The prospectus supplement pursuant to which any discounted offering is made will include a chart based on the actual number of shares in such offering and the actual discount to the most recently determined NAV.

	Prior to Sale Below NAV	Example 1 5% Offering at 5% Discount		Example 2 10% Offering at 10% Discount		Example 3 20% Offering at 20% Discount	
		Following Sale	% Change	Following Sale	% Change	Following Sale	% Change
Offering Price							
Price per Share to Public		\$ 15.00	-	\$ 14.21	-	\$ 12.63	-
Net Proceeds per Share to Issuer		\$ 14.25	-	\$ 13.50	-	\$ 12.00	-
Decrease to NAV							
Total Shares Outstanding	30,000,000	31,500,000	5.00%	33,000,000	10.00%	36,000,000	20.00%
NAV per Share	\$ 15.00	\$ 14.96	(0.24)%	\$ 14.86	(0.91)%	\$ 14.50	(3.33)%
Dilution to Nonparticipating Stockholder							
Shares Held by Stockholder A	30,000	30,000	0.00%	30,000	0.00%	30,000	0.00%
	0.10%	0.10%	(4.76)%	0.09%	(9.09)%	0.08%	(16.67)%

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Percentage Held by Stockholder A								
Total NAV Held by Stockholder A	\$ 450,000	\$ 448,929	(0.24)%	\$ 445,909	(0.91)%	\$ 435,000	(3.33)%	
Total Investment by Stockholder A								
(Assumed to Be \$15.00 per Share)	\$ 450,000	\$ 450,000		\$ 450,000		\$ 450,000		
Total Dilution to Stockholder A								
(Total NAV Less Total Investment)		\$ (1,071)		\$ (4,091)		\$ (15,000)		
Investment per Share Held by Stockholder A								
(Assumed to be \$15.00 per Share on Shares Held Prior to Sale)	\$ 15.00	\$ 15.00	0.00%	\$ 15.00	0.00%	\$ 15.00	0.00%	
NAV per Share Held by Stockholder A		\$ 14.96		\$ 14.86		\$ 14.50		
Dilution per Share Held by Stockholder A								
(NAV per Share Less Investment per Share)		\$ (0.04)		\$ (0.14)		\$ (0.50)		
Percentage Dilution to Stockholder A								
(NAV per Share Divided by Investment per Share)			(0.24)%		(0.91)%		(3.33)%	

Impact On Existing Stockholders Who Do Participate in the Offering

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

The following chart illustrates the level of dilution and accretion in the hypothetical 20% discount offering from the prior chart (Example 3) for a stockholder that acquires shares equal to (1) 50% of its proportionate share of the offering (i.e., 3,000 shares, which is 0.05% of an offering of 6,000,000 shares) rather than its 0.10% proportionate share and (2) 150% of such percentage (i.e. 9,000 shares, which is 0.15% of an offering of 6,000,000 shares rather than its 0.10% proportionate share). The prospectus supplement pursuant to which any discounted offering is made will include a chart for these examples based on the actual number of shares in such offering and the actual discount from the most recently determined NAV per share. It is not possible to predict the level of market price decline that may occur.

	Prior to Sale Below NAV	50% Participation Following Sale	% Change	150% Participation Following Sale	% Change
Offering Price					
Price per Share to Public		\$ 12.63		\$ 12.63	
Net Proceeds per Share to Issuer		\$ 12.00		\$ 12.00	
Decrease/Increase to NAV					
Total Shares Outstanding	30,000,000	36,000,000	20%	36,000,000	20%
NAV per Share	\$ 15.00	\$ 14.50	(3.33)%	\$ 14.50	(3.33)%
Dilution/Accretion to Participating Stockholder					
Shares Held by Stockholder A	30,000	33,000	10%	39,000	30%
Percentage Held by Stockholder A	0.10%	0.09%	(8.33)%	0.11%	8.33%
Total NAV Held by Stockholder A					
	\$ 450,000	\$ 478,500	6.33%	\$ 565,500	25.67%

Total Investment by Stockholder A (Assumed to be \$15.00 per Share on Shares Held Prior to Sale)		\$	487,895		\$	563,684		
Total Dilution/Accretion to Stockholder A (Total NAV Less Total Investment)		\$	(9,395)		\$	1,816		
Investment per Share Held by Stockholder A (Assumed to Be \$15.00 on Shares Held Prior to Sale)	\$	15.00	\$	14.78	(1.44)%	\$	14.45	(3.64)%
NAV per Share Held by Stockholder A	\$		\$	14.50		\$	14.50	
Dilution/Accretion per Share Held by Stockholder A (NAV per Share Less Investment per Share)	\$		\$	(0.28)		\$	0.05	
Percentage Dilution/Accretion to Stockholder A (NAV per Share Divided by Investment per Share)					(1.96)%			0.32%

Impact On New Investors

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

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

	Prior to Sale Below NAV	Example 1 5% Offering at 5% Discount		Example 2 10% Offering at 10% Discount		Example 3 20% Offering at 20% Discount	
		Following Sale	% Change	Following Sale	% Change	Following Sale	% Change
Offering Price							
Price per Share to Public		\$ 15.00		\$ 14.21		\$ 12.63	
Net Proceeds per Share to Issuer		\$ 14.25		\$ 13.50		\$ 12.00	
Decrease/Increase to NAV							
Total Shares Outstanding	30,000,000	31,500,000	5%	33,000,000	10%	36,000,000	20%
NAV per Share	\$ 15.00	\$ 14.96	(0.24)%	\$ 14.86	(0.91)%	\$ 14.50	(3.33)%
Dilution/Accretion to New Investor A							
Shares Held by Investor A	0	1,500		3,000		6,000	
Percentage Held by Investor A	0.00%	0.00%		0.01%		0.02%	

Total NAV Held by Investor A	\$	0	\$	22,446	\$	44,591	\$	87,000
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