

PROSPECT CAPITAL CORP

Form 10-Q

November 09, 2009

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the Quarter Ended September 30, 2009**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**Commission File Number: 814-00659**

**PROSPECT CAPITAL CORPORATION**

**(Exact name of registrant as specified in its charter)**

**Maryland**

**(State or other jurisdiction of incorporation or organization)**

**43-2048643**

**(I.R.S. Employer Identification No.)**

**10 East 40th Street  
44th Floor**

**New York, New York**

**(Address of principal executive offices)**

**10016**

**(Zip Code)**

**(212) 448-0702**

**(Registrant's telephone number, including area code)**

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  Yes  No

The number of shares of the registrant's common stock, \$0.001 par value, outstanding as of November 9, 2009 was 54,905,678.



**PROSPECT CAPITAL CORPORATION**  
**FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2009**  
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CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES**

September 30, 2009 and June 30, 2009

(in thousands, except share and per share data)

|  | September 30,<br>2009<br>(Unaudited) | June 30,<br>2009<br>(Audited) |
|--|--------------------------------------|-------------------------------|
| <b>Assets (Note 9)</b>   |                                      |                               |
| Investments at fair value (cost of \$513,750 and \$531,424, respectively, Note 3)  |                                      |                               |
| Control investments (cost of \$188,886 and \$187,105, respectively)  | \$ 198,043                           | \$ 206,332                    |
| Affiliate investments (cost of \$33,555 and \$33,544, respectively)  | 31,790                               | 32,254                        |
| Non-control/Non-affiliate investments (cost of \$291,309 and \$310,775, respectively)  | 280,965                              | 308,582                       |
| Total investments at fair value  | 510,798                              | 547,168                       |
| Investments in money market funds  | 85,143                               | 98,735                        |
| Cash   | 7,020                                | 9,942                         |
| Receivables for:   |                                      |                               |
| Interest, net  | 4,652                                | 3,562                         |
| Dividends  | 7                                    | 28                            |
| Other  | 314                                  | 571                           |
| Prepaid expenses   | 780                                  | 68                            |
| Deferred financing costs, net  | 6,781                                | 6,951                         |
| <b>Total Assets</b>  | <b>615,495</b>                       | <b>667,025</b>                |
| <b>Liabilities</b>   |                                      |                               |
| Credit facility payable (Note 9)   |                                      | 124,800                       |
| Due to Prospect Administration (Note 7)  | 157                                  | 842                           |
| Due to Prospect Capital Management (Note 7)  | 5,874                                | 5,871                         |
| Accrued expenses   | 1,447                                | 2,381                         |
| Other liabilities  | 771                                  | 535                           |
| <b>Total Liabilities</b>   | <b>8,249</b>                         | <b>134,429</b>                |
| <b>Net Assets</b>  | <b>\$ 607,246</b>                    | <b>\$ 532,596</b>             |
| <b>Components of Net Assets</b>  |                                      |                               |
| Common stock, par value \$0.001 per share (100,000,000 and 100,000,000 common shares authorized, respectively; 54,672,155 and 42,943,084 issued) | \$ 55                                | \$ 43                         |

and outstanding, respectively)

|   |          |          |
|---|----------|----------|
| Paid-in capital in excess of par                      | 646,271  | 545,707  |
| Undistributed net investment income                   | 16,922   | 24,152   |
| Accumulated realized losses on investments            | (53,050) | (53,050) |
| Unrealized (depreciation) appreciation on investments | (2,952)  | 15,744   |

|                   |    |         |    |         |
|-------------------|----|---------|----|---------|
| <b>Net Assets</b> | \$ | 607,246 | \$ | 532,596 |
|-------------------|----|---------|----|---------|

|                                  |    |       |    |       |
|----------------------------------|----|-------|----|-------|
| <b>Net Asset Value Per Share</b> | \$ | 11.11 | \$ | 12.40 |
|----------------------------------|----|-------|----|-------|

See notes to consolidated financial statements.

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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**For The Three Months Ended September 30, 2009 and 2008**  
(in thousands, except share and per share data)  
(Unaudited)

|   | <b>For Three Months Ended</b> |                      |
|---|-------------------------------|----------------------|
|   | <b>September</b>              | <b>September 30,</b> |
|   | <b>30,</b>                    | <b>2008</b>          |
|   | <b>2009</b>                   | <b>2008</b>          |
| <b>Investment Income</b>  |                               |                      |
| Interest income:  |                               |                      |
| Control investments (Net of foreign withholding tax of \$32 and \$47, respectively)             | \$ 4,591                      | \$ 6,722             |
| Affiliate investments   | 849                           | 560                  |
| Non-control/non-affiliate investments   | 9,395                         | 10,274               |
| <b>Total interest income</b>  | <b>14,835</b>                 | <b>17,556</b>        |
| Dividend income:  |                               |                      |
| Control investments   | 6,200                         | 4,584                |
| Money market funds  | 18                            | 139                  |
| <b>Total dividend income</b>  | <b>6,218</b>                  | <b>4,723</b>         |
| Other income: (Note 4)  |                               |                      |
| Control/affiliate investments   |                               | 744                  |
| Non-control/non-affiliate investments   | 464                           | 12,776               |
| <b>Total other income</b>   | <b>464</b>                    | <b>13,520</b>        |
| <b>Total Investment Income</b>  | <b>21,517</b>                 | <b>35,799</b>        |
| <b>Operating Expenses</b>   |                               |                      |
| Investment advisory fees:   |                               |                      |
| Base management fee (Note 7)  | 3,209                         | 2,823                |
| Income incentive fee (Note 7)   | 3,080                         | 5,875                |
| <b>Total investment advisory fees</b>   | <b>6,289</b>                  | <b>8,698</b>         |
| Interest and credit facility expenses   | 1,374                         | 1,518                |
| Sub-administration fees (including former Chief Financial Officer and Chief Compliance Officer) |                               | 250                  |
| Legal fees  |                               | 597                  |
| Valuation services  | 120                           | 160                  |
| Audit, compliance and tax related fees  | 262                           | 177                  |



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|  |                   |                  |
|--|-------------------|------------------|
| Allocation of overhead from Prospect Administration (Note 7)               | 840               | 588              |
| Insurance expense  | 63                | 61               |
| Directors fees   | 64                | 81               |
| Other general and administrative expenses                                  | 187               | 167              |
| <b>Total Operating Expenses</b>  | <b>9,199</b>      | <b>12,297</b>    |
| <b>Net Investment Income</b>   | <b>12,318</b>     | <b>23,502</b>    |
| Net realized gain on investments   |                   | 1,645            |
| Net change in unrealized depreciation on investments                       | (18,696)          | (11,149)         |
| <b>Net (Decrease) Increase in Net Assets Resulting from Operations</b>     | <b>\$ (6,378)</b> | <b>\$ 13,998</b> |
| Net (decrease) increase in net assets resulting from operations per share: | \$ (0.13)         | \$ 0.47          |
| Dividends declared per share:  | \$ 0.41           | \$ 0.40          |

See notes to consolidated financial statements.

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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS**  
**For The Three Months Ended September 30, 2009 and 2008**  
(in thousands, except share data)  
(Unaudited)

|   | <b>For The Three Months Ended</b> |                      |
|---|-----------------------------------|----------------------|
|   | <b>September</b>                  |                      |
|   | <b>30,</b>                        | <b>September 30,</b> |
|   | <b>2009</b>                       | <b>2008</b>          |
| <b>Increase in Net Assets from Operations:</b>                              |                                   |                      |
| Net investment income   | \$ 12,318                         | \$ 23,502            |
| Net realized gain on investments  |                                   | 1,645                |
| Net change in unrealized depreciation on investments                        | (18,696)                          | (11,149)             |
| <b>Net (Decrease) Increase in Net Assets Resulting from Operations</b>      | <b>(6,378)</b>                    | <b>13,998</b>        |
| <b>Dividends to Shareholders:</b>   | <b>(19,548)</b>                   | <b>(11,882)</b>      |
| <b>Capital Share Transactions:</b>  |                                   |                      |
| Net proceeds from capital shares sold                                       | 98,833                            |                      |
| Less: Offering costs of public share offerings                              | (1,158)                           |                      |
| Reinvestment of dividends   | 2,901                             |                      |
| <b>Net Increase in Net Assets Resulting from Capital Share Transactions</b> | <b>100,576</b>                    |                      |
| <b>Total Increase in Net Assets:</b>  | <b>74,650</b>                     | <b>2,116</b>         |
| Net assets at beginning of period   | 532,596                           | 429,623              |
| <b>Net Assets at End of Period</b>  | <b>\$ 607,246</b>                 | <b>\$ 431,739</b>    |
| <b>Capital Share Activity:</b>  |                                   |                      |
| Shares sold   | 11,431,797                        |                      |
| Shares issued through reinvestment of dividends                             | 297,274                           |                      |
| Net increase in capital share activity                                      | 11,729,071                        |                      |
| Shares outstanding at beginning of period                                   | 42,943,084                        | 29,520,379           |
| <b>Shares Outstanding at End of Period</b>                                  | <b>54,672,155</b>                 | <b>29,520,379</b>    |

See notes to consolidated financial statements.



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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For The Three Months Ended September 30, 2009 and 2008**  
(in thousands, except share data)  
(Unaudited)

|  | <b>For The Three Months Ended</b> |                      |
|--|-----------------------------------|----------------------|
|  | <b>September</b>                  | <b>September 30,</b> |
|  | <b>30, 2009</b>                   | <b>2008</b>          |
| <b>Cash Flows from Operating Activities:</b>                             |                                   |                      |
| Net (decrease) increase in net assets resulting from operations          | \$ (6,378)                        | \$ 13,998            |
| Net realized gain on investments   |                                   | (1,645)              |
| Net change in unrealized depreciation on investments                     | 18,696                            | 11,149               |
| Accretion of original issue discount on investments                      | (501)                             | (1,770)              |
| Amortization of deferred financing costs                                 | 823                               | 180                  |
| Gain on settlement of net profits interest                               |                                   | (12,576)             |
| <b>Change in operating assets and liabilities:</b>                       |                                   |                      |
| Payments for purchases of investments                                    | (4,599)                           | (57,460)             |
| Payment-In-Kind interest   | (1,467)                           | (420)                |
| Proceeds from sale of investments and collection of investment principal | 24,241                            | 10,949               |
| Purchases of cash equivalents  | (124,998)                         | (9,999)              |
| Sales of cash equivalents  | 124,998                           | 9,999                |
| Net investments in money market funds                                    | 13,592                            | 4,342                |
| Increase in interest receivable  | (1,090)                           | (1,422)              |
| Decrease in dividends receivable   | 21                                | 4,018                |
| Decrease in loan principal receivable                                    |                                   | 8                    |
| Increase in receivable for managerial assistance                         |                                   | (2)                  |
| Increase in receivable for potential deal expenses                       |                                   | (303)                |
| Decrease (increase) in other receivables                                 | 257                               | (45)                 |
| Increase in prepaid expenses   | (712)                             | (73)                 |
| (Decrease) increase in due to Prospect Administration                    | (685)                             | 343                  |
| Increase in due to Prospect Capital Management                           | 3                                 | 2,685                |
| Decrease in accrued expenses   | (934)                             | (110)                |
| Increase in other liabilities  | 236                               | 369                  |
| <b>Net Cash Provided By (Used In) Operating Activities:</b>              | <b>41,503</b>                     | <b>(27,785)</b>      |
| <b>Cash Flows from Financing Activities:</b>                             |                                   |                      |
| Borrowings under credit facility   |                                   | 47,500               |
| Payments under credit facility   | (124,800)                         | (7,000)              |
| Financing costs paid and deferred  | (653)                             | (156)                |
| Net proceeds from issuance of common stock                               | 98,833                            |                      |
| Offering costs from issuance of common stock                             | (1,158)                           |                      |
| Dividends paid   | (16,647)                          | (11,845)             |
| <b>Net Cash Provided By Financing Activities:</b>                        | <b>(44,425)</b>                   | <b>28,499</b>        |

|   |    |         |    |       |
|---|----|---------|----|-------|
| <b>Total (Decrease) Increase in Cash</b>                              |    | (2,922) |    | 714   |
| Cash balance at beginning of period                                   |    | 9,942   |    | 555   |
| <b>Cash Balance at End of Period</b>                                  | \$ | 7,020   | \$ | 1,269 |
| <b>Cash Paid For Interest</b>   | \$ | 348     | \$ | 1,250 |
| <b>Non-Cash Financing Activity:</b>                                   |    |         |    |       |
| Amount of shares issued in connection with dividend reinvestment plan | \$ | 2,901   | \$ |       |

See notes to consolidated financial statements.

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CONSOLIDATED SCHEDULE OF INVESTMENTS****September 30, 2009 and June 30, 2009****(in thousands, except share data)**

|   | Locale/Industry                          | Par Value /                | September 30, 2009 |                              |                       |
|---|--|----------------------------|--------------------|------------------------------|-----------------------|
|   |  | Shares /<br>Ownership<br>% | Cost               | Fair<br>Value <sup>(2)</sup> | % of<br>Net<br>Assets |
| <b>Portfolio Investments<sup>(1)</sup></b>  |  |                            |                    |                              |                       |
| <b>Control Investments (25.00% or greater of voting control)</b>  |  |                            |                    |                              |                       |
| Ajax Rolled Ring & Machine  | South Carolina/<br>Manufacturing         |                            |                    |                              |                       |
| Unrestricted common shares (7 total unrestricted common shares issued and outstanding and 681.86 restricted common shares issued and outstanding) |  | 6                          | \$                 | \$                           | 0.0%                  |
| Series A convertible preferred shares (7,182.6 total preferred shares issued and outstanding)   |  | 6,142.6                    | 6,057              |                              | 0.0%                  |
| Subordinated secured note Tranche B, 11.50% plus 6.00% PIK, 4/01/2013 (3), (4)  |  | \$ 11,855                  | 11,855             | 8,192                        | 1.3%                  |
| Senior secured note Tranche A, 10.50%, 4/01/2013 (3), (5)   |  | \$ 21,377                  | 21,377             | 21,377                       | 3.5%                  |
| <b>Total</b>  |  |                            | <b>39,289</b>      | <b>29,569</b>                | <b>4.8%</b>           |
| C&J Cladding LLC  | Texas/Metal<br>Services                  |                            |                    |                              |                       |
| Warrant, common units, expiring 3/30/2014 (1,000 total company units outstanding)   |  | 400                        | 580                | 3,067                        | 0.5%                  |
| Change Clean Energy Holdings, Inc. ( CCEHI ) (7)  | Maine/Biomass<br>Power                   |                            |                    |                              |                       |
| CCEHI common shares (1,000 total common shares issued and outstanding)  |  | 1,000                      | 2,826              | 2,530                        | 0.4%                  |
| Gas Solutions Holdings, Inc. (3), (8)   | Texas/Gas<br>Gathering and<br>Processing |                            |                    |                              |                       |
| Common shares (100 total common shares outstanding)   |  | 100                        | 5,003              | 55,187                       | 9.1%                  |
| Junior secured note, 18.00%, 12/23/2018   |  | \$ 5,000                   | 5,000              | 5,000                        | 0.8%                  |
| Senior secured note, 18.00%, 12/22/2018   |  | \$ 25,000                  | 25,000             | 25,000                       | 4.1%                  |

|       |        |        |       |
|-------|--------|--------|-------|
| Total | 35,003 | 85,187 | 14.0% |
|-------|--------|--------|-------|

See notes to consolidated financial statements.

**Table of Contents****PROSPECT CAPITAL CORPORATION AND SUBSIDIARY  
CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)**

September 30, 2009 and June 30, 2009

(in thousands, except share data)

| Portfolio Investments <sup>(1)</sup><br>Control Investments (continued)  | Locale/Industry                        | Par Value                       | September 30, 2009 |                              |                       |
|--|--|---------------------------------|--------------------|------------------------------|-----------------------|
|  |  | /<br>Shares /<br>Ownership<br>% | Cost               | Fair<br>Value <sup>(2)</sup> | % of<br>Net<br>Assets |
| Integrated Contract Services, Inc. (9)<br>Common stock (100 total common<br>shares outstanding)  | North Carolina/Contracting             | 49                              | \$ 679             | \$                           | 0.0%                  |
| Series A preferred shares (10 total<br>Series A preferred shares outstanding)  |  | 10                              |                    |                              | 0.0%                  |
| Junior secured note, stated rate 7.00%<br>plus 7.00% PIK plus 6.00% default<br>interest, in non-accrual status effective<br>10/09/2007, past due |  | \$ 14,003                       | 14,003             | 4,001                        | 0.7%                  |
| Senior secured note, stated rate 7.00%<br>plus 7.00% PIK plus 6.00% default<br>interest, in non-accrual status effective<br>10/09/2007, past due |  | \$ 800                          | 800                | 800                          | 0.1%                  |
| Senior demand note, 15.00%, 12/31/09<br>(10)   |  | \$ 1,170                        | 1,170              | 1,170                        | 0.2%                  |
| Total  |  |                                 | 16,652             | 5,971                        | 1.0%                  |
| Iron Horse Coiled Tubing, Inc.   | Alberta, Canada/Production<br>Services |                                 |                    |                              |                       |
| Common shares (2,231 total class A<br>common shares outstanding)   |  | 1,781                           | 268                |                              | 0.0%                  |
| Senior secured note, 15.00%,<br>12/31/2009   |  | \$ 9,250                        | 9,250              | 2,213                        | 0.4%                  |
| Bridge loan, 15.00% plus 3.00% PIK,<br>12/31/2009  |  | \$ 11,003                       | 11,003             | 10,695                       | 1.8%                  |
| Total  |  |                                 | 20,521             | 12,908                       | 2.2%                  |
| NRG Manufacturing, Inc.  | Texas/ Manufacturing                   |                                 |                    |                              |                       |
| Common shares (1,000 total common<br>shares issued and outstanding)  |  | 800                             | 2,317              | 19,015                       | 3.1%                  |
| Senior secured note, 16.50%, 8/31/2011<br>(3), (11)  |  | \$ 13,080                       | 13,080             | 13,080                       | 2.2%                  |



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|  |                                     |           |         |         |       |
|--|-------------------------------------|-----------|---------|---------|-------|
| Total  |                                     | 15,397    | 32,095  | 5.3%    |       |
| R-V Industries, Inc.   | Pennsylvania/Manufacturing          |           |         |         |       |
| Common shares (1,000,000 total common shares issued and outstanding)                       |                                     | 545,107   | 5,086   | 11,502  | 1.9%  |
| Warrants, common shares, expiring 6/30/2017 (1,000,000 total common shares outstanding)    |                                     | 200,000   | 1,682   | 4,220   | 0.7%  |
| Total  |                                     | 6,768     | 15,722  | 2.6%    |       |
| Yatesville Coal Holdings, Inc. (12)  | Kentucky/Mining and Coal Production |           |         |         |       |
| Common stock (1,000 total common shares outstanding)                                       |                                     | 1,000     | 427     |         | 0.0%  |
| Junior secured note, 15.75%, in non-accrual status effective 1/01/2009, matures 12/31/2010 |                                     | \$ 41,423 | 41,423  | 994     | 0.2%  |
| Senior secured note, 15.75%, in non-accrual status effective 1/01/2009, matures 12/31/2010 |                                     | \$ 10,000 | 10,000  | 10,000  | 1.6%  |
| Total  |                                     |           | 51,850  | 10,994  | 1.8%  |
| <b>Total Control Investments</b>   |                                     |           | 188,886 | 198,043 | 32.6% |

See notes to consolidated financial statements.

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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY  
CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)**

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

**(in thousands, except share data)**

|  | Locale/Industry                           | Par Value /                | September 30, 2009 |                              |                       |
|--|---|----------------------------|--------------------|------------------------------|-----------------------|
|  |   | Shares /<br>Ownership<br>% | Cost               | Fair<br>Value <sup>(2)</sup> | % of<br>Net<br>Assets |
| <b>Portfolio Investments<sup>(1)</sup></b>   |   |                            |                    |                              |                       |
| <b>Affiliate Investments (5.00% to 24.99% of voting control)</b>   |   |                            |                    |                              |                       |
| Appalachian Energy Holdings LLC (13)   | West<br>Virginia/Construction<br>Services |                            |                    |                              |                       |
| Warrants Class A common units, expiring 2/13/2016 (86,843 total fully-diluted class A common units outstanding)                              |   | 6,065                      | \$ 176             | \$                           | 0.0%                  |
| Warrants Class A common units, expiring 6/17/2018 (86,843 total fully-diluted class A common units outstanding)                              |   | 6,025                      | 172                |                              | 0.0%                  |
| Warrants Class A common units, expiring 11/30/2018 (86,843 total fully-diluted class A common units outstanding)                             |   | 25,000                     |                    |                              | 0.0%                  |
| Series A preferred equity (1,075 total series A preferred equity units outstanding)  |   | 200                        | 82                 |                              | 0.0%                  |
| Series B preferred equity (794 total series B preferred equity units outstanding)  |   | 241                        | 241                |                              | 0.0%                  |
| Series C preferred equity (500 total series C preferred equity units outstanding)  |   | 500                        | 500                |                              | 0.0%                  |
| Senior Secured Debt Tranche B, 14.00% plus 3.00% PIK plus 3.00% default interest, non-accrual status effective 11/01/2008, past due          |   | \$ 2,087                   | 1,960              |                              | 0.0%                  |
| Senior Secured Debt Tranche A, 14.00% plus 3.00% PIK plus 3.00% default interest, non-accrual status effective 11/01/2008, matures 1/31/2011 |   | \$ 2,034                   | 1,897              | 1,123                        | 0.2%                  |
| Total  |   |                            | 5,028              | 1,123                        | 0.2%                  |
| Biotronic NeuroNetwork Preferred shares (85,000 total preferred shares outstanding) (14)   | Michigan/ Healthcare                      | 9,925.455                  | 2,300              | 3,653                        | 0.6%                  |
| Senior secured note, 11.50% plus 1.00% PIK, 2/21/2013 (3), (15)  |   | \$ 26,227                  | 26,227             | 27,014                       | 4.4%                  |

|                                    |  |        |        |      |
|------------------------------------|--|--------|--------|------|
| Total                              |  | 28,527 | 30,667 | 5.0% |
| <b>Total Affiliate Investments</b> |  | 33,555 | 31,790 | 5.2% |

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

|   |                            |           |        |        |      |
|---|----------------------------|-----------|--------|--------|------|
| American Gilsonite Company  | Utah/Specialty<br>Minerals |           |        |        |      |
| Membership interest units in AGCVPEP, LLC<br>(16)                 |                            | 99.9999%  | 1,031  | 3,084  | 0.5% |
| Senior subordinated note, 12.00% plus<br>3.00% PIK, 3/14/2013 (3) |                            | \$ 14,783 | 14,783 | 15,078 | 2.5% |
| Total   |                            |           | 15,814 | 18,162 | 3.0% |

See notes to consolidated financial statements.

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CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)**

September 30, 2009 and June 30, 2009

(in thousands, except share data)

| Portfolio Investments <sup>(1)</sup><br>Non-control/Non-affiliate Investments<br>(continued)                            | Locale/Industry                        | Par Value /                | September 30, 2009 |                              |                       |
|---|--|----------------------------|--------------------|------------------------------|-----------------------|
|   |  | Shares /<br>Ownership<br>% | Cost               | Fair<br>Value <sup>(2)</sup> | % of<br>Net<br>Assets |
| Castro Cheese Company, Inc. (3)   | Texas/Food<br>Products                 |                            |                    |                              |                       |
| Junior secured note, 11.00% plus 2.00% PIK,<br>2/28/2013  |  | \$ 7,577                   | \$ 7,459           | \$ 7,608                     | 1.2%                  |
| Conquest Cherokee, LLC (17)   | Tennessee/Oil<br>and Gas<br>Production |                            |                    |                              |                       |
| Overriding Royalty Interests  |  |                            |                    | 362                          | 0.1%                  |
| Net profits interest, 10.00% payable on equity<br>distributions   |  |                            |                    |                              | 0.0%                  |
| Senior secured note, 13.00%, in non-accrual status<br>effective 4/01/2009 plus 4.00% default interest,<br>past due (18) |  | \$ 10,450                  | 10,441             | 4,963                        | 0.8%                  |
| Total   |  |                            | 10,441             | 5,325                        | 0.9%                  |
| Deb Shops, Inc.   | Pennsylvania/<br>Retail                |                            |                    |                              |                       |
| Second lien debt, 1.00% plus 13.00% PIK,<br>10/23/2014  |  | \$ 15,805                  | 15,440             | 4,236                        | 0.7%                  |
| Diamondback Operating, LP   | Oklahoma/Oil<br>and Gas<br>Production  |                            |                    |                              |                       |
| Net profits interest, 15.00% payable on equity<br>distributions (20)  |  |                            |                    | 438                          | 0.1%                  |
| Freedom Marine Services LLC (3), (21)   | Louisiana/<br>Shipping Vessels         |                            |                    |                              |                       |
| Net profits interest, 22.50% payable on equity<br>distributions   |  |                            |                    |                              | 0.0%                  |

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|  |    |        |        |        |      |
|--|----|--------|--------|--------|------|
| Subordinated secured note, 12.00% plus 4.00% PIK, 12/31/2011 (22)    | \$ | 7,309  | 7,241  | 6,469  | 1.1% |
| Total  |    |        | 7,241  | 6,469  | 1.1% |
| H&M Oil & Gas, LLC (21)  |    |        |        |        |      |
|  |    |        |        |        |      |
| Net profits interest, 8.00% payable on equity distributions          |    |        |        | 1,519  | 0.3% |
| Senior secured note, 13.00%, 6/30/2010 (23)                          | \$ | 49,661 | 49,661 | 49,284 | 8.1% |
| Total  |    |        | 49,661 | 50,803 | 8.4% |
| IEC Systems LP ( IEC ) / Advanced Rig Services LLC ( ARS ) (3), (24) |    |        |        |        |      |
|  |    |        |        |        |      |
| IEC senior secured note, 12.00% plus 3.00% PIK, 11/20/2012           | \$ | 20,810 | 20,810 | 21,226 | 3.5% |
| ARS senior secured note, 12.00% plus 3.00% PIK, 11/20/2012           | \$ | 12,482 | 12,482 | 12,731 | 2.1% |
| Total  |    |        | 33,292 | 33,957 | 5.6% |

See notes to consolidated financial statements.

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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY  
CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)**

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

**(in thousands, except share data)**

|  |                                      | <b>Par Value /<br/>Shares /<br/>Ownership<br/>%</b> | <b>September 30, 2009<br/>Fair<br/>Value<sup>(2)</sup></b> | <b>% of<br/>Net<br/>Assets</b> |
|--|--------------------------------------|---|--|--------------------------------|
| <b>Portfolio Investments<sup>(1)</sup><br/>Non-control/Non-affiliate Investments<br/>(continued)</b>           | <b>Locale/Industry</b>               | <b>Cost</b>   | <b>Value<sup>(2)</sup></b>                                 | <b>Assets</b>                  |
| Maverick Healthcare, LLC<br>Common units (79,000,000 total class A<br>common units outstanding)                | Arizona/Healthcare                   | 1,250,000   | \$   | 0.0%                           |
| Preferred units (79,000,000 total<br>preferred units outstanding)  |                                      | 1,250,000   | 1,252  | 1,549                          |
| Second lien debt, 12.50% plus 3.50%<br>PIK, 4/30/2014 (3)  |                                      | \$ 12,779   | 12,779   | 12,904                         |
| <b>Total</b>   |                                      |   | 14,031   | 14,453                         |
| Miller Petroleum, Inc. (25)  | Tennessee/Oil and Gas<br>Production  |   |  |                                |
| Warrants, common shares, expiring<br>5/04/2010 to 9/30/2014 (18,324,356 total<br>common shares outstanding)    |                                      | 2,026,606   | 150  | 312                            |
|  |                                      |   |  | 0.1%                           |
| Qualitest Pharmaceuticals, Inc. (3), (26)  | Alabama/Pharmaceuticals              |   |  |                                |
| Second lien debt, 8.10%, 4/30/2015   |                                      | \$ 12,000   | 11,951   | 11,684                         |
|  |                                      |   |  | 1.9%                           |
| Regional Management Corp. (3)  | South Carolina/Financial<br>Services |   |  |                                |
| Second lien debt, 12.00% plus 2.00%<br>PIK, 6/29/2012  |                                      | \$ 25,554   | 25,554   | 23,365                         |
|  |                                      |   |  | 3.8%                           |
| Resco Products, Inc. (3), (27)   | Pennsylvania/Manufacturing           |   |  |                                |
| Second lien debt, 8.37%, 6/22/2014   |                                      | \$ 9,750  | 9,599  | 9,750                          |
|  |                                      |   |  | 1.6%                           |
| Shearer's Foods, Inc.  | Ohio/Food Products                   |   |  |                                |
| Membership interest units in Mistral Chip<br>Holdings, LLC (45,300 total membership<br>units outstanding) (28) |                                      | 2,000   | 2,000  | 3,762                          |
|  |                                      |   |  | 0.6%                           |

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|  |    |        |        |        |      |
|--|----|--------|--------|--------|------|
| Second lien debt, 14.00%, 10/31/2013 (3)                                     | \$ | 18,000 | 18,000 | 18,360 | 3.0% |
| Total  |    |        | 20,000 | 22,122 | 3.6% |
| Stryker Energy, LLC (29)   |    |        |        |        |      |
|  |    |        |        |        |      |
| Overriding Royalty Interests   |    |        |        | 2,825  | 0.5% |
| Subordinated secured revolving credit facility, 12.00%, 12/01/2011 (3), (30) | \$ | 29,500 | 29,185 | 28,468 | 4.7% |
| Total  |    |        | 29,185 | 31,293 | 5.2% |

See notes to consolidated financial statements.

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CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)**

September 30, 2009 and June 30, 2009

(in thousands, except share data)

| Portfolio Investments <sup>(1)</sup><br>Non-control/Non-affiliate Investments<br>(continued)  | Locale/Industry                    | Par Value /                | September 30, 2009 |                              |                       |
|---|------------------------------------|----------------------------|--------------------|------------------------------|-----------------------|
|   |                                    | Shares /<br>Ownership<br>% | Cost               | Fair<br>Value <sup>(2)</sup> | % of<br>Net<br>Assets |
| TriZetto Group (3)<br>Subordinated unsecured note, 12.00% plus<br>1.50% PIK, 10/01/2016   | California/ Healthcare             | \$ 15,262                  | \$ 15,125          | \$ 16,410                    | 2.7%                  |
| Unitek (3), (31)<br>Second lien debt, 13.08%, 12/31/2013  | Pennsylvania/Technical<br>Services | \$ 11,500                  | 11,366             | 11,730                       | 1.9%                  |
| Wind River Resources Corp. and Wind<br>River II<br>Corp. (21)<br>Net profits interest, 5.00% payable on<br>equity distributions<br>Senior secured note, stated rate 13.00%<br>plus 3.00% default interest, in non-accrual<br>status effective 12/01/2008, matures<br>7/31/2010 (32) | Utah/Oil and Gas<br>Production     | \$ 15,000                  | 15,000             | 12,718                       | 2.1%                  |
| Total   |                                    |                            | 15,000             | 12,848                       | 2.1%                  |
| <b>Total Non-control/Non-affiliate<br/>Investments</b>  |                                    |                            | 291,309            | 280,965                      | 46.3%                 |
| <b>Total Portfolio Investments</b>  |                                    |                            | 513,750            | 510,798                      | 84.1%                 |
| <b>Money Market Funds</b>   |                                    |                            |                    |                              |                       |
| Fidelity Institutional Money Market Funds<br>Government Portfolio (Class I)   |                                    | 61,864,980                 | 61,865             | 61,865                       | 10.2%                 |
|   |                                    | 23,278,164                 | 23,278             | 23,278                       | 3.8%                  |



Fidelity Institutional Money Market Funds  
Government Portfolio  
(Class I) (3)

|                                 |            |            |       |
|---------------------------------|------------|------------|-------|
| <b>Total Money Market Funds</b> | 85,143     | 85,143     | 14.0% |
| <b>Total Investments</b>        | \$ 598,893 | \$ 595,941 | 98.1% |

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CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)**

September 30, 2009 and June 30, 2009

(in thousands, except share data)

| Portfolio Investments <sup>(1)</sup><br>Control Investments (25.00% or greater<br>of voting control)   | Locale/Industry                       | Par Value /                | June 30, 2009 |                              | % of<br>Net<br>Assets |      |
|--|---------------------------------------|----------------------------|---------------|------------------------------|-----------------------|------|
|  |                                       | Shares /<br>Ownership<br>% | Cost          | Fair<br>Value <sup>(2)</sup> |                       |      |
| Ajax Rolled Ring & Machine   | South<br>Carolina/Manufacturing       |                            |               |                              |                       |      |
| Unrestricted common shares (7 total<br>unrestricted common shares issued and<br>outstanding and 681.85 restricted common<br>shares issued and outstanding) |                                       | 6                          | \$            | \$                           | 0.0%                  |      |
| Series A convertible preferred shares<br>(7,192.6 total preferred shares issued and<br>outstanding)  |                                       | 6,142.6                    |               | 6,057                        | 0.0%                  |      |
| Subordinated secured note Tranche B,<br>11.50% plus 6.00% PIK,<br>4/01/2013 (3), (4)   |                                       | \$ 11,675                  | 11,675        | 10,151                       | 1.9%                  |      |
| Senior secured note Tranche A, 10.50%,<br>4/01/2013 (3), (5)   |                                       | \$ 21,487                  | 21,487        | 21,487                       | 4.0%                  |      |
| Total  |                                       |                            | 39,219        | 31,638                       | 5.9%                  |      |
| C&J Cladding LLC   | Texas/Metal Services                  |                            |               |                              |                       |      |
| Warrant, common units, expiring 3/30/2014<br>(1,000 total company units outstanding)   |                                       | 400                        |               | 580                          | 3,825                 | 0.7% |
| Senior secured note, 14.00%, 3/30/2012 (3),<br>(6)   |                                       | \$ 3,150                   | 2,722         | 3,308                        | 0.6%                  |      |
| Total  |                                       |                            | 3,302         | 7,133                        | 1.3%                  |      |
| Change Clean Energy Holdings, Inc.<br>( CCEHI ) (7)  | Maine/Biomass Power                   |                            |               |                              |                       |      |
| CCEHI common shares (1,000 total common<br>shares issued and outstanding)  |                                       | 1,000                      | 2,530         | 2,530                        | 0.5%                  |      |
| Gas Solutions Holdings, Inc. (3), (8)  | Texas/Gas Gathering<br>and Processing |                            |               |                              |                       |      |
|  |                                       | 100                        | 5,003         | 55,187                       | 10.4%                 |      |

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Common shares (100 total common shares  
outstanding)

|   |    |        |        |        |       |
|---|----|--------|--------|--------|-------|
| Junior secured note, 18.00%, 12/23/2018 | \$ | 5,000  | 5,000  | 5,000  | 0.9%  |
| Senior secured note, 18.00%, 12/22/2018 | \$ | 25,000 | 25,000 | 25,000 | 4.7%  |
| Total                                   |    |        | 35,003 | 85,187 | 16.0% |

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CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)**

September 30, 2009 and June 30, 2009

(in thousands, except share data)

| Portfolio Investments <sup>(1)</sup><br>Control Investments (continued)  | Locale/Industry                            | Par Value /                | June 30, 2009 |                              | % of<br>Net<br>Assets |
|--|--|----------------------------|---------------|------------------------------|-----------------------|
|  |  | Shares /<br>Ownership<br>% | Cost          | Fair<br>Value <sup>(2)</sup> |                       |
| Integrated Contract Services, Inc. (9)   | North Carolina/<br>Contracting             |                            |               |                              |                       |
| Common stock (100 total common shares<br>outstanding)  |  | 49                         | \$ 679        | \$                           | 0.0%                  |
| Series A preferred shares (10 total Series A<br>preferred shares outstanding)  |  | 10                         |               |                              | 0.0%                  |
| Junior secured note, stated rate 7.00% plus<br>7.00% PIK plus 6.00% default interest, in<br>non-accrual status effective 10/09/2007, past<br>due |  | \$ 14,003                  | 14,003        | 3,030                        | 0.6%                  |
| Senior secured note, stated rate 7.00% plus<br>7.00% PIK plus 6.00% default interest, in<br>non-accrual status effective 10/09/2007, past<br>due |  | \$ 800                     | 800           | 800                          | 0.1%                  |
| Senior demand note, 15.00%, 6/30/2009 (10)   |  | \$ 1,170                   | 1,170         | 1,170                        | 0.2%                  |
| Total  |  |                            | 16,652        | 5,000                        | 0.9%                  |
| Iron Horse Coiled Tubing, Inc.   | Alberta, Canada/<br>Production<br>Services |                            |               |                              |                       |
| Common shares (2,231 total class A common<br>shares outstanding)   |  | 1,781                      | 268           |                              | 0.0%                  |
| Senior secured note, 15.00%, 12/31/2009  |  | \$ 9,250                   | 9,250         | 3,004                        | 0.6%                  |
| Bridge loan, 15.00% plus 3.00% PIK,<br>12/31/2009  |  | \$ 9,826                   | 9,826         | 9,602                        | 1.8%                  |
| Total  |  |                            | 19,344        | 12,606                       | 2.4%                  |
| NRG Manufacturing, Inc.  | Texas/<br>Manufacturing                    |                            |               |                              |                       |
| Common shares (1,000 total common shares<br>issued and outstanding)  |  | 800                        | 2,317         | 19,294                       | 3.6%                  |
| Senior secured note, 16.50%, 8/31/2011 (3),<br>(11)  |  | \$ 13,080                  | 13,080        | 13,080                       | 2.5%                  |

|  |   |           |         |        |       |
|--|---|-----------|---------|--------|-------|
| Total  |   | 15,397    | 32,374  | 6.1%   |       |
| R-V Industries, Inc.   | Pennsylvania/<br>Manufacturing            |           |         |        |       |
| Common shares (750,000 total common shares issued and outstanding)                         |   | 545,107   | 5,086   | 12,267 | 2.3%  |
| Warrants, common shares, expiring 6/30/2017 (200,000 total common shares outstanding)      |   | 200,000   | 1,682   | 4,500  | 0.8%  |
| Total  |   | 6,768     | 16,767  | 3.1%   |       |
| Yatesville Coal Holdings, Inc. (12)  | Kentucky/Mining<br>and Coal<br>Production |           |         |        |       |
| Common stock (1,000 total common shares outstanding)                                       |   | 1,000     | 427     |        | 0.0%  |
| Junior secured note, 15.72%, in non-accrual status effective 1/01/2009, matures 12/31/2010 |   | \$ 38,463 | 38,463  | 3,097  | 0.6%  |
| Senior secured note, 15.72%, in non-accrual status effective 1/01/2009, matures 12/31/2010 |   | \$ 10,000 | 10,000  | 10,000 | 1.9%  |
| Total  |   | 48,890    | 13,097  |        | 2.5%  |
| <b>Total Control Investments</b>   |   | 187,105   | 206,332 |        | 38.7% |

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

**(in thousands, except share data)**

|  |   | Par Value / |              | June 30, 2009        |               |
|--|---|-------------|--------------|----------------------|---------------|
|  |   | Shares /    |              | Fair                 | % of          |
|  |   | Ownership   |              | Value <sup>(2)</sup> | Net           |
| <b>Portfolio Investments<sup>(1)</sup></b>   | <b>Locale/Industry</b>                    | <b>%</b>    | <b>Cost</b>  |                      | <b>Assets</b> |
| <b>Affiliate Investments (5.00% to 24.99% of voting control)</b>   |   |             |              |                      |               |
| Appalachian Energy Holdings LLC (13)   | West<br>Virginia/Construction<br>Services |             |              |                      |               |
| Warrants Class A common units, expiring 2/13/2016 (86,843 total fully-diluted class A common units outstanding)                              |   | 6,065       | \$ 176       | \$                   | 0.0%          |
| Warrants Class A common units, expiring 6/17/2018 (86,843 total fully-diluted class A common units outstanding)                              |   | 6,025       | 172          |                      | 0.0%          |
| Warrants Class A common units, expiring 11/30/2018 (86,843 total fully-diluted class A common units outstanding)                             |   | 25,000      |              |                      | 0.0%          |
| Series A preferred equity (1,075 total series A preferred equity units outstanding)  |   | 200         | 82           |                      | 0.0%          |
| Series B preferred equity (794 total series B preferred equity units outstanding)  |   | 241         | 241          |                      | 0.0%          |
| Series C preferred equity (500 total series C preferred equity units outstanding)  |   | 500         | 500          |                      | 0.0%          |
| Senior Secured Debt Tranche B, 14.00% plus 3.00% PIK plus 3.00% default interest, non-accrual status effective 11/01/2008, past due          |   | \$ 2,050    | 1,955        | 356                  | 0.1%          |
| Senior Secured Debt Tranche A, 14.00% plus 3.00% PIK plus 3.00% default interest, non-accrual status effective 11/01/2008, matures 1/31/2011 |   | \$ 1,997    | 1,891        | 2,052                | 0.4%          |
| <b>Total</b>   |   |             | <b>5,017</b> | <b>2,408</b>         | <b>0.5%</b>   |
| <br>   |   |             |              |                      |               |
| Biotronic NeuroNetwork Preferred shares (85,000 total preferred shares outstanding) (14)   | Michigan/ Healthcare                      | 9,925.455   | 2,300        | 2,839                | 0.5%          |
| Senior secured note, 11.50% plus 1.00% PIK, 2/21/2013 (3), (15)  |   | \$ 26,227   | 26,227       | 27,007               | 5.1%          |

|                                    |  |        |        |      |
|------------------------------------|--|--------|--------|------|
| Total                              |  | 28,527 | 29,846 | 5.6% |
| <b>Total Affiliate Investments</b> |  | 33,544 | 32,254 | 6.1% |

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

|   |                            |           |        |        |      |
|---|----------------------------|-----------|--------|--------|------|
| American Gilsonite Company  | Utah/Specialty<br>Minerals |           |        |        |      |
| Membership interest units in AGC\PEP, LLC<br>(16)                 |                            | 99.9999%  | 1,031  | 3,851  | 0.7% |
| Senior subordinated note, 12.00% plus<br>3.00% PIK, 3/14/2013 (3) |                            | \$ 14,783 | 14,783 | 15,073 | 2.8% |
| Total   |                            |           | 15,814 | 18,924 | 3.5% |

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CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)**

September 30, 2009 and June 30, 2009

(in thousands, except share data)

| Portfolio Investments <sup>(1)</sup><br>Non-control/Non-affiliate Investments<br>(continued)  | Locale/Industry                        | Par Value /                | June 30, 2009 |                              | % of<br>Net<br>Assets |
|---|--|----------------------------|---------------|------------------------------|-----------------------|
|   |  | Shares /<br>Ownership<br>% | Cost          | Fair<br>Value <sup>(2)</sup> |                       |
| Castro Cheese Company, Inc. (3)   | Texas/Food<br>Products                 |                            |               |                              |                       |
| Junior secured note, 11.00% plus 2.00% PIK,<br>2/28/2013  |  | \$ 7,538                   | \$ 7,413      | \$ 7,637                     | 1.4%                  |
| Conquest Cherokee, LLC (17)   | Tennessee/Oil<br>and Gas<br>Production |                            |               | 565                          | 0.1%                  |
| Overriding Royalty Interests<br>Senior secured note, 13.00%, in non-accrual status<br>effective 4/01/2009 plus 4.00% default interest,<br>past due (18) |  | \$ 10,200                  | 10,191        | 6,855                        | 1.3%                  |
| Total   |  |                            | 10,191        | 7,420                        | 1.4%                  |
| Deb Shops, Inc. (19)  | Pennsylvania/<br>Retail                |                            |               |                              |                       |
| Second lien debt, 8.67%, 10/23/2014   |  | \$ 15,000                  | 14,623        | 6,272                        | 1.2%                  |
| Diamondback Operating, LP   | Oklahoma/Oil<br>and Gas<br>Production  |                            |               |                              |                       |
| Net profits interest, 15.00% payable on equity<br>distributions (20)  |  |                            |               | 458                          | 0.1%                  |
| Freedom Marine Services LLC (3), (21)   | Louisiana/<br>Shipping Vessels         |                            |               |                              |                       |
| Net profits interest, 22.50% payable on equity<br>distributions   |  |                            |               | 229                          | 0.0%                  |
| Subordinated secured note, 12.00% plus 4.00%<br>PIK, 12/31/2011 (22)  |  | \$ 7,234                   | 7,160         | 7,152                        | 1.4%                  |



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|   |    |                                 |        |        |      |
|---|----|---------------------------------|--------|--------|------|
| Total   |    |                                 | 7,160  | 7,381  | 1.4% |
|   |    |                                 |        |        |      |
| H&M Oil & Gas, LLC (3), (21)  |    | Texas/Oil and<br>Gas Production |        |        |      |
| Net profits interest, 8.00% payable on equity<br>distributions          |    |                                 |        | 1,682  | 0.3% |
| Senior secured note, 13.00%, 6/30/2010 (23)                             | \$ | 49,688                          | 49,688 | 49,697 | 9.3% |
| Total   |    |                                 | 49,688 | 51,379 | 9.6% |
|   |    |                                 |        |        |      |
| IEC Systems LP ( IEC ) / Advanced Rig Services<br>LLC ( ARS ) (3), (24) |    | Texas/Oilfield<br>Fabrication   |        |        |      |
| IEC senior secured note, 12.00% plus 3.00% PIK,<br>11/20/2012           | \$ | 21,411                          | 21,411 | 21,839 | 4.1% |
| ARS senior secured note, 12.00% plus 3.00% PIK,<br>11/20/2012           | \$ | 12,836                          | 12,836 | 13,092 | 2.5% |
| Total   |    |                                 | 34,247 | 34,931 | 6.6% |

See notes to consolidated financial statements.

**Table of Contents****PROSPECT CAPITAL CORPORATION AND SUBSIDIARY  
CONSOLIDATED SCHEDULES OF INVESTMENTS (CONTINUED)**

September 30, 2009 and June 30, 2009

(in thousands, except share data)

| Portfolio Investments <sup>(1)</sup><br>Non-control/Non-affiliate Investments<br>(continued)   | Locale/Industry                      | Par Value /                | June 30, 2009 |                              | % of<br>Net<br>Assets |
|--|--------------------------------------|----------------------------|---------------|------------------------------|-----------------------|
|  |                                      | Shares /<br>Ownership<br>% | Cost          | Fair<br>Value <sup>(2)</sup> |                       |
| Maverick Healthcare, LLC<br>Common units (79,000,000 total class A<br>common units outstanding)  | Arizona/Healthcare                   | 1,250,000                  | \$            | \$                           | 0.0%                  |
| Preferred units (79,000,000 total preferred<br>units outstanding)  |                                      | 1,250,000                  | 1,252         | 1,300                        | 0.2%                  |
| Second lien debt, 12.00% plus 1.50% PIK,<br>4/30/2014 (3)  |                                      | \$ 12,691                  | 12,691        | 12,816                       | 2.4%                  |
| Total  |                                      |                            | 13,943        | 14,116                       | 2.6%                  |
| Miller Petroleum, Inc. (25)<br>Warrants, common shares, expiring<br>5/04/2010 to 6/30/2014 (15,811,856 total<br>common shares outstanding) | Tennessee/Oil and Gas<br>Production  | 1,935,523                  | 150           | 241                          | 0.1%                  |
| Peerless Manufacturing Co. (3)<br>Subordinated secured note, 11.50% plus<br>3.50% PIK, 4/29/2013   | Texas/ Manufacturing                 | \$ 20,000                  | 20,000        | 20,400                       | 3.8%                  |
| Qualitest Pharmaceuticals, Inc. (3), (26)<br>Second lien debt, 8.10%, 4/30/2015  | Alabama/Pharmaceuticals              | \$ 12,000                  | 11,949        | 11,452                       | 2.2%                  |
| Regional Management Corp. (3)<br>Second lien debt, 12.00% plus 2.00% PIK,<br>6/29/2012   | South Carolina/Financial<br>Services | \$ 25,424                  | 25,424        | 23,073                       | 4.3%                  |
| Resco Products, Inc. (3), (27)<br>Second lien debt, 8.67%, 6/22/2014   | Pennsylvania/<br>Manufacturing       | \$ 9,750                   | 9,594         | 9,750                        | 1.8%                  |

|  |                             |           |        |        |      |
|--|-----------------------------|-----------|--------|--------|------|
| Shearer s Foods, Inc.  | Ohio/Food Products          |           |        |        |      |
| Membership interest units in Mistral Chip Holdings, LLC (45,300 total membership units outstanding) (28) |                             | 2,000     | 2,000  | 3,419  | 0.6% |
| Second lien debt, 14.00%, 10/31/2013 (3)   |                             | \$ 18,000 | 18,000 | 18,360 | 3.5% |
| Total  |                             |           | 20,000 | 21,779 | 4.1% |
| <br>   |                             |           |        |        |      |
| Stryker Energy, LLC (29)   | Ohio/Oil and Gas Production |           |        |        |      |
| Overriding Royalty Interests   |                             |           |        | 2,918  | 0.6% |
| Subordinated secured revolving credit facility, 12.00%, 12/01/2011 (3), (30)                             |                             | \$ 29,500 | 29,154 | 29,554 | 5.5% |
| Total  |                             |           | 29,154 | 32,472 | 6.1% |

See notes to consolidated financial statements.

**Table of Contents****PROSPECT CAPITAL CORPORATION AND SUBSIDIARY  
CONSOLIDATED SCHEDULES OF INVESTMENTS (CONTINUED)**

September 30, 2009 and June 30, 2009

(in thousands, except share data)

|   |                                    | Par Value / |           | June 30, 2009        |        |
|---|------------------------------------|-------------|-----------|----------------------|--------|
|   |                                    | Shares /    |           | Fair                 | % of   |
|   | Locale/Industry                    | Ownership   | Cost      | Value <sup>(2)</sup> | Net    |
| Portfolio Investments <sup>(1)</sup>  |                                    | %           |           |                      | Assets |
| Non-control/Non-affiliate Investments<br>(continued)  |                                    |             |           |                      |        |
| TriZetto Group (3)<br>Subordinated unsecured note, 12.00%<br>plus 1.50% PIK, 10/01/2016   | California/Healthcare              | \$ 15,205   | \$ 15,065 | \$ 16,331            | 3.1%   |
| Unitek (3), (31)<br>Second lien debt, 13.08%, 12/31/2013  | Pennsylvania/Technical<br>Services | \$ 11,500   | 11,360    | 11,730               | 2.2%   |
| Wind River Resources Corp. and Wind<br>River II<br>Corp. (21)<br>Net profits interest, 5.00% payable on<br>equity distributions<br>Senior secured note, stated rate 13.00%<br>plus 3.00% default interest, in non-accrual<br>status effective 12/01/2008, matures<br>7/31/2010 (32) | Utah/Oil and Gas<br>Production     | \$ 15,000   | 15,000    | 12,644               | 2.4%   |
|   |                                    |             |           | 192                  | 0.0%   |
| Total   |                                    |             | 15,000    | 12,836               | 2.4%   |
| <b>Total Non-control/Non-affiliate<br/>Investments</b>  |                                    |             | 310,775   | 308,582              | 57.9%  |
| <b>Total Portfolio Investments</b>  |                                    |             | 531,424   | 547,168              | 102.7% |
| <b>Money Market Funds</b>   |                                    |             |           |                      |        |
| Fidelity Institutional Money Market<br>Funds Government Portfolio (Class I)   |                                    | 94,752,972  | 94,753    | 94,753               | 17.8%  |
|   |                                    | 3,982,278   | 3,982     | 3,982                | 0.7%   |

Fidelity Institutional Money Market  
Funds Government Portfolio (Class I) (3)

|                                 |            |            |        |
|---------------------------------|------------|------------|--------|
| <b>Total Money Market Funds</b> | 98,735     | 98,735     | 18.5%  |
| <b>Total Investments</b>        | \$ 630,159 | \$ 645,903 | 121.2% |

See notes to consolidated financial statements.

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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY  
CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)**

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

**(in thousands, except share data)**

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

- (1) The securities in which Prospect Capital Corporation ( we , us or our ) has invested were acquired in transactions that were exempt from registration under the Securities Act of 1933, as amended, or the Securities Act. These securities may be resold only in transactions that are exempt from registration under the Securities Act.
- (2) Fair value is determined by or under the direction of our Board of Directors (see Note 2).
- (3) Security, or portion thereof, is held as collateral for the credit facility with Rabobank Nederland (see Note 11). The market values of these investments at September 30, 2009 and June 30, 2009 were \$373,911 and \$434,069, respectively; they represent 62.7% and 67.2% of total investments at fair value, respectively.
- (4) Interest rate is the greater of 11.5% or 3-month LIBOR plus 8.5%; rate reflected is as of the reporting date September 30, 2009 or June 30, 2009, as applicable.
- (5) Interest rate is the greater of 10.5% or 3-month LIBOR plus 7.5%; rate reflected is as of the reporting date September 30, 2009 or June 30, 2009, as applicable.
- (6) Interest rate is the greater of 14.0% or 12-Month LIBOR plus 7.5%; rate reflected is as of June 30, 2009.
- (7) There are several entities involved in the Biomass investment. We own 100 shares of common stock in Worcester Energy Holdings, Inc. ( WEHI ), representing 100% of the issued and outstanding common stock. WEHI, in turn, owns 51 membership certificates in Biochips LLC ( Biochips ), which represents a 51% ownership stake. We own 282 shares of common stock in Worcester Energy Co., Inc. ( WECO ), which represents 51% of the issued and outstanding common stock. We own directly 1,665 shares of common stock in Change Clean Energy Inc. ( CCEI ), f/k/a Worcester Energy Partners, Inc., which represents 51% of the issued and outstanding common stock and the remaining 49% is owned by WECO. CCEI owns 100 shares of common stock in Precision Logging and Landclearing, Inc. ( Precision ), which represents 100% of the issued and outstanding common stock. During the quarter ended March 31, 2009, we created two new entities in anticipation of the foreclosure proceedings against the co-borrowers (WECO, CCEI and Biochips) Change Clean Energy Holdings, Inc. ( CCEHI ) and DownEast Power Company, LLC ( DEPC ). We own 1,000 shares of CCEHI, representing 100% of the issued and outstanding stock, which in turn, owns a 100% of the membership interests in DEPC. On March 11, 2009, we foreclosed on the assets formerly held by CCEI and Biochips with a successful credit bid of \$6,000 to acquire the assets. The assets were subsequently assigned to DEPC. WECO, CCEI and Biochips are joint borrowers on the term note issued to Prospect Capital. Effective July 1, 2008, this loan was placed on non-accrual status. Biochips, WECO, CCEI, Precision and WEHI currently have no material operations and no significant assets. As of June 30, 2009, our Board of Directors assessed a fair value of \$0 for all of these equity positions and the loan position. We determined that the impairment of both CCEI and CCEHI as of June 30, 2009 was other than temporary and recorded a realized loss for the amount that the amortized cost exceeds the fair value at June 30, 2009. Our Board of Directors set the value of the remaining CCEHI investment at \$2,530 as of September 30, 2009 and June 30, 2009.
- (8) Gas Solutions Holdings, Inc. is a wholly-owned investment of us.
- (9) Entity was formed as a result of the debt restructuring of ESA Environmental Specialist, Inc. In early 2009, we foreclosed on the two loans on non-accrual status and purchased the underlying personal and real property. We own 1,000 shares of common stock in The Healing Staff ( THS ), f/k/a Lisamarie Fallon, Inc. representing 100% ownership. We own 1,500 shares of Vets Securing America, Inc. ( VSA ), representing 100% ownership. VSA is a holding company for the real property of Integrated Contract Services, Inc. ( ICS ) purchased during the foreclosure process.

See notes to consolidated financial statements.



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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY  
CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)**

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

**(in thousands, except share data)**

**Endnote Explanations for the Consolidated Schedule of Investments as of September 30, 2009 and June 30, 2009 (continued)**

(10) Loan is with THS an affiliate of ICS.

(11) Interest rate is the greater of 16.5% or 12-Month LIBOR plus 11.0%; rate reflected is as of the reporting date September 30, 2009 or June 30, 2009, as applicable.

(12) On June 30, 2008, we consolidated our holdings in four coal companies into Yatesville Coal Holdings, Inc. ( Yatesville ), and consolidated the operations under one management team. In the transaction, the debt that we held of C&A Construction, Inc. ( C&A ), Genesis Coal Corp. ( Genesis ), North Fork Collieries LLC ( North Fork ) and Unity Virginia Holdings LLC ( Unity ) were exchanged for newly issued debt from Yatesville, and our ownership interests in C&A, E&L Construction, Inc. ( E&L ), Whymore Coal Company Inc. ( Whymore ), Genesis and North Fork were exchanged for 100% of the equity of Yatesville. This reorganization allows for a better utilization of the assets in the consolidated group.

At September 30, 2009 and at June 30, 2009, Yatesville owned 100% of the membership interest of North Fork. In addition, Yatesville held a \$9,272 and \$8,062, respectively, note receivable from North Fork as of those two respective dates.

At September 30, 2009 and at June 30, 2009, Yatesville owned 90% and 87%, respectively, of the common stock of Genesis and held a note receivable of \$20,880 and \$20,802, respectively, as of those two respective dates.

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

There are several entities involved in Yatesville's investment in Whymore at June 30, 2009. As of June 30, 2009, Yatesville owned 10,000 shares of common stock or 100% of the equity and held a \$14,973 senior secured debt receivable from C&A, which owns the equipment. Yatesville owned 10,000 shares of common stock or 100% of the equity of E&L, which leases the equipment from C&A, employs the workers, is listed as the operator with the Commonwealth of Kentucky, mines the coal, receives revenues and pays all operating expenses. Yatesville owned 4,900 shares of common stock or 49% of the equity of Whymore, which applies for and holds permits on behalf of E&L. Yatesville also owned 4,285 Series A convertible preferred shares in each of C&A, E&L and Whymore. Whymore and E&L are guarantors under the C&A credit agreement with Yatesville.

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

(13) There are several entities involved in the Appalachian Energy Holdings LLC ( AEH ) investment. We own warrants, the exercise of which will permit us to purchase 37,090 Class A common units of AEH at a nominal cost and in near-immediate fashion. We own 200 units of Series A preferred equity, 241 units of Series B preferred equity, and 500 units of Series C preferred equity of AEH. The senior secured notes are with C&S Operating LLC and East Cumberland L.L.C., both operating companies owned by AEH.

(14) On a fully diluted basis represents, 11.677% of voting common shares.

(15) Interest rate is the greater of 11.5% or 6-month LIBOR plus 7.0%; rate reflected is as of the reporting date September 30, 2009 or June 30, 2009, as applicable.

(16) We own 99.9999% of AGC/PEP, LLC. AGC/PEP, LLC owns 2,038 out of a total of 83,694 shares (including 4,510 vested and unvested management options) of American Gilsonite Holding Company which owns 100% of American Gilsonite Company.

(17) In addition to the stated returns, we hold overriding royalty interests on which we receive payment based upon operations of the borrower and net profits interest of 10.00% on equity distributions which will be realized upon sale of the borrower or a sale of the interests.

See notes to consolidated financial statements.





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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY  
CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)**

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

**(in thousands, except share data)**

**Endnote Explanations for the Consolidated Schedule of Investments as of September 30, 2009 and June 30, 2009 (continued)**

- (18) Interest rate is the greater of 13.0% or 12-Month LIBOR plus 7.5% not to exceed 14.50%; rate reflected is as of the reporting date September 30, 2009 or June 30, 2009, as applicable.
- (19) Interest rate is 3-Month LIBOR plus 8.0%; rate reflected is as of June 30, 2009.
- (20) In January 2009, our loan was repaid in full and we retained a 15.0% net profits interest payable on equity distributions.
- (21) In addition to the stated returns, we also hold net profits interest which will be realized upon sale of the borrower or a sale of the interests.
- (22) Interest rate is the greater of 12.0% or 3-Month LIBOR plus 6.11%; rate reflected is as of the reporting date September 30, 2009 or June 30, 2009, as applicable.
- (23) Interest rate is the greater of 13.0% or 12-Month LIBOR plus 7.5%; rate reflected is as of the reporting date September 30, 2009 or June 30, 2009, as applicable.
- (24) Interest rate is the greater of 12.0% or 12-month LIBOR plus 6.0%; rate reflected is as of the reporting date - September 30, 2009 or June 30, 2009, as applicable.
- (25) Total common shares outstanding of 18,324,356 as of September 15, 2009 from Miller Petroleum, Inc.'s Quarterly Report on Form 10-Q filed on September 21, 2009 as applicable to our September 30, 2009 reporting date. Total common shares outstanding of 15,811,856 as of March 11, 2009 from Miller's Quarterly Report on Form 10-Q filed on March 16, 2009.
- (26) Interest rate is 3-Month LIBOR plus 7.5%; rate reflected is as of the reporting date June 30, 2009 or June 30, 2008, as applicable.
- (27) Interest rate is 3-Month LIBOR plus 8.0%; rate reflected is as of the reporting date September 30, 2009 or June 30, 2009, as applicable.
- (28) Mistral Chip Holdings, LLC owns 45,300 shares out of 50,500 total shares outstanding of Chip Holdings, Inc., the parent company of Shearer's Foods, Inc., before adjusting for management options.
- (29) In addition to the stated returns, we also hold overriding royalty interests on which we receive payment based upon operations of the borrower.
- (30) Interest rate is the greater of 12.0% or 12-Month LIBOR plus 7.0%; rate reflected is as of the reporting date June 30, 2009 or June 30, 2008, as applicable.
- (31) Interest rate is the greater of 13.08% or 3-Month LIBOR plus 7.25%; rate reflected is as of the reporting date September 30, 2009 or June 30, 2009, as applicable.
- (32) Interest rate is the greater of 13.0% or 12-month LIBOR plus 7.5% not to exceed 14.0%; rate reflected is as of the reporting date September 30, 2009 or June 30, 2009, as applicable.

See notes to consolidated financial statements.

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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2009**

**(Unaudited)**

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

**Note 1. Organization**

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

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

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

**Note 2. Significant Accounting Policies**

The following are significant accounting policies consistently applied by us:

*Basis of Presentation*

The accompanying interim financial statements, which are not audited, have been prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ) for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 6 or 10 of Regulation S-X, as appropriate. The financial results of our portfolio investments are not consolidated in the interim financial statements.

*Use of Estimates*

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

*Basis of Consolidation*

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

*Investment Classification*

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



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

*Investment Valuation*

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

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

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

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

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

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

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

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

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

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



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

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

*Valuation of Other Financial Assets and Financial Liabilities*

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

*Revenue Recognition*

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

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

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

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

*Federal and State Income Taxes*

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

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

distributions from such taxable income, we accrue excise taxes, if any, on estimated excess taxable income as taxable income is earned using an annual effective excise tax rate. The annual effective excise tax rate is determined by dividing the estimated annual excise tax by the estimated annual taxable income.



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

*Dividends and Distributions*

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

*Financing Costs*

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

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

*Guarantees and Indemnification Agreements*

We follow FASB ASC 460, *Guarantees* ( ASC 460 ). ASC 460 elaborates on the disclosure requirements of a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also requires a guarantor to recognize, at the inception of a guarantee, for those guarantees that are covered by ASC 460, the fair value of the obligation undertaken in issuing certain guarantees. ASC 460 did not have a material effect on the financial statements. Refer to Note 3, Note 7 and Note 10 for further discussion of guarantees and indemnification agreements.

*Per Share Information*

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

*Reclassifications*

Certain reclassifications have been made in the presentation of prior consolidated financial statements to conform to the presentation as of and for the three months ended September 30, 2009.

*Recent Accounting Pronouncements*

In March 2008, the FASB issued ASC 815, *Derivatives and Hedging* ( ASC 815 ). ASC 815 is intended to improve financial reporting for derivative instruments by requiring enhanced disclosure that enables investors to understand how and why the entity uses derivatives, how derivatives are accounted for, and how derivatives affect an entity's results of operations, financial position, and cash flows. ASC 815 is effective for interim and annual periods beginning after November 15, 2008. For the three months ended September 30, 2009, our adoption of ASC 815 did not impact results of operations or financial condition.

In May 2009, the FASB issued ASC 855, *Subsequent Events* ( ASC 855 ). ASC 855 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The standard, which includes a new required disclosure of the date through which an entity has evaluated subsequent events, is effective for interim or annual periods ending after June 15, 2009. We evaluated all events or transactions that occurred after September 30, 2009 up through November 9, 2009, the date we issued the accompanying financial statements. During this period, we did not have any material recognizable

subsequent events other than those disclosed in our financial statements.

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In June 2009, the FASB issued ASC 105, *Generally Accepted Accounting Principles* ( ASC 105 ), which establishes the FASB Codification which supersedes all existing accounting standard documents and will become the single source of authoritative non-governmental U.S. GAAP. All other accounting literature not included in the Codification will be considered non-authoritative. The Codification did not change GAAP but reorganizes the literature. ASC 105 is effective for interim and annual periods ending after September 15, 2009. We have conformed our financial statements and related Notes to the new Codification for the quarter ended September 30, 2009.

In August 2009, the FASB issued Accounting Standards Update ASU 2009-05, *Measuring Liabilities at Fair Value, to amend FASB Accounting Standards Codification ASC 820, Fair Value Measurements and Disclosures* ( ASC 820 ), to clarify how entities should estimate the fair value of liabilities. ASC 820, as amended, includes clarifying guidance for circumstances in which a quoted price in an active market is not available, the effect of the existence of liability transfer restrictions, and the effect of quoted prices for the identical liability, including when the identical liability is traded as an asset. The amended guidance in ASC 820 on measuring liabilities at fair value is effective for the first interim or annual reporting period beginning after August 28, 2009, with earlier application permitted. Our management does not believe that the adoption of the amended guidance in ASC 820 will have a significant effect on our financial statements.

**Note 3. Portfolio Investments**

At September 30, 2009, we had invested in 29 long-term portfolio investments, which had an amortized cost of \$513,750 and a fair value of \$510,798 and at June 30, 2009, we had invested in 30 long-term portfolio investments, which had an amortized cost of \$531,424 and a fair value of \$547,168.

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

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

|                                       | Quoted Prices<br>in<br>Active Markets<br>for<br>Identical<br>Securities<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Total      |
|---------------------------------------|--|---|--|------------|
| Investments at fair value             |  |   |  |            |
| Control investments                   | \$   | \$  | \$ 198,043   | \$ 198,043 |
| Affiliate investments                 |  |   | 31,790   | 31,790     |
| Non-control/non-affiliate investments |  |   | 280,965  | 280,965    |
|                                       |  |   | 510,798  | 510,798    |
| Investments in money market funds     |  | 85,143  |  | 85,143     |
| Total assets reported at fair value   | \$   | \$ 85,143   | \$ 510,798   | \$ 595,941 |

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The aggregate values of Level 3 portfolio investments changed during the three months ended September 30, 2009 as follows:

|  | Fair Value Measurements Using Unobservable Inputs (Level 3) |                       |                                       | Total                   |
|--|---|-----------------------|---------------------------------------|-------------------------|
|  | Control Investments   | Affiliate Investments | Non-Control/Non-Affiliate Investments |                         |
| Fair value as of June 30, 2009                   | \$ 206,332  | \$ 32,254             | \$ 308,582                            | \$ 547,168              |
| Total realized losses                            |   |                       |                                       |                         |
| Change in unrealized depreciation                | (9,484)   | (475)                 | (7,751)                               | (17,710) <sup>(1)</sup> |
| Purchases, issuances, settlements and other, net | 1,195   | 11                    | (19,866)                              | (18,660)                |
| Transfers within Level 3                         |   |                       |                                       |                         |
| Transfers in (out) of Level 3                    |   |                       |                                       |                         |
| Fair value as of September 30, 2009              | \$ 198,043  | \$ 31,790             | \$ 280,965                            | \$ 510,798              |

<sup>(1)</sup> Relates to assets held at September 30, 2009

At September 30, 2009 and June 30, 2009, five loan investments were on non-accrual status: AEH, Conquest Cherokee, LLC ( Conquest ), ICS, Wind River Resources Corp. and Wind River II Corp. ( Wind River ), and Yatesville. The loan principal of these loans amounted to \$95,797 and \$92,513 as of September 30, 2009 and June 30, 2009, respectively. The fair values of these investments represent approximately 5.7% and 7.3% of our net assets as of September 30, 2009 and June 30, 2009, respectively. For the three months ended September 30, 2009 and September 30, 2008, the income foregone as a result of not accruing interest on non-accrual debt investments amounted to \$4,448 and \$1,989, respectively. At September 30, 2009, we held one asset on which payment of interest was past-due more than 90 days for which we continue to accrue interest. The principal balance of such loan is \$20,253 and the accrued interest receivable is \$1,237 at September 30, 2009. We expect full repayment of principal and interest on this loan.

GSHI has indemnified us against any legal action arising from its investment in Gas Solutions, LP. We have incurred approximately \$2,093 from the inception of the investment in GSHI through September 30, 2009 for fees associated with a legal action, and GSHI has reimbursed us for the entire amount. Of the \$2,093 reimbursement, \$277 was reflected as dividend income: control investments in the Consolidated Statements of Operations for the three months ended September 30, 2008. There were no such legal fees incurred or reimbursed for the three months ended September 30, 2009. Additionally, certain other expenses incurred by us which are attributable to GSHI have been reimbursed by GSHI and are reflected as dividend income: control investments in the Consolidated Statements of Operations. For the three months ended September 30, 2009 and September 30, 2008, such reimbursements totaled as \$1,231 and \$1,620, respectively.

The original cost basis of debt placements and equity securities acquired totaled to approximately \$6,066 and \$70,456 during the three months ended September 30, 2009 and September 30, 2008, respectively. Debt repayments and sales of equity securities with a cost basis of approximately \$24,241 and \$10,949 were received during the three months ended September 30, 2009 and September 30, 2008, respectively.

**Note 4. Other Investment Income**

Other investment income consists of structuring fees, overriding royalty interests, settlement of net profit interests, deal deposits, administrative agent fee, and other miscellaneous and sundry cash receipts. Income from such sources

for the three months ended September 30, 2009 and September 30, 2008 were as follows:

| <b>Income Source</b>                | <b>For The Three Months Ended</b> |                                     |
|-------------------------------------|-----------------------------------|-------------------------------------|
|                                     | <b>2009</b>                       | <b>September 30,</b><br><b>2008</b> |
| Structuring and amendment fees      | \$ 405                            | \$ 687                              |
| Overriding royalty interests        | 44                                | 158                                 |
| Settlement of net profits interests |                                   | 12,576                              |
| Deal deposit                        |                                   | 82                                  |
| Administrative agent fee            | 15                                | 17                                  |
| Other Investment Income             | \$ 464                            | \$ 13,520                           |

**Table of Contents****Note 5. Equity Offerings and Related Expenses**

We issued 11,431,797 shares of our common stock in public and private offerings during the three months ended September 30, 2009. We did not issue any common stock during the three months ended September 30, 2008. The proceeds raised, the related underwriting fees, the offering expenses and the prices at which these shares were issued are as follows:

| <b>Issuances of Common Stock</b>  | <b>Number of<br/>Shares<br/>Issued</b> | <b>Gross<br/>Proceeds<br/>Raised</b> | <b>Underwriting<br/>Fees</b> | <b>Offering<br/>Expenses</b> | <b>Offering<br/>Price</b> |
|-----------------------------------|--|--------------------------------------|------------------------------|------------------------------|---------------------------|
| July 7, 2009                      | 5,175,000                              | \$ 46,575                            | \$ 2,329                     | \$ 200                       | \$ 9.000                  |
| August 20, 2009 <sup>(1)</sup>    | 3,449,686                              | \$ 29,322                            |                              | \$ 117                       | \$ 8.500                  |
| September 24, 2009 <sup>(1)</sup> | 2,807,111                              | \$ 25,264                            |                              | \$ 840                       | \$ 9.000                  |

<sup>(1)</sup> Concurrent with the sale of these shares, we entered into a registration rights agreement in which we granted the purchasers certain registration rights with respect to the shares. We will use our reasonable best efforts to file with the SEC within sixty (60) days a post-effective amendment to the registration statement on Form N-2 and will also use our reasonable best efforts to cause such post-effective amendment to be declared

effective no  
later than  
December 15,  
2009. Under the  
registration  
rights  
agreement, we  
may be  
obligated to  
make liquidated  
damages  
payments to  
holders upon the  
occurrence of  
certain events.

Our shareholders' equity accounts at September 30, 2009 and June 30, 2009 reflect cumulative shares issued as of those respective dates. Our common stock has been issued through public offerings, a registered direct offering, private offerings, the exercise of over-allotment options on the part of the underwriters and our dividend reinvestment plan. When our common stock is issued, the related offering expenses have been charged against paid-in capital in excess of par. All underwriting fees and offering expenses were borne by us.

On October 9, 2008, our Board of Directors approved a share repurchase plan under which we may repurchase up to \$20,000 of our common stock at prices below our net asset value as reported in our financial statements published for the year ended June 30, 2008. We have not made any purchases of our common stock during the period from October 9, 2008 to September 30, 2009 pursuant to this plan.

**Note 6. Net Decrease (Increase) in Net Assets per Common Share**

The following information sets forth the computation of net (decrease) increase in net assets resulting from operations per common share for the three months ended September 30, 2009 and September 30, 2008, respectively.

|  | <b>For The Three Months Ended</b> |             |
|--|-----------------------------------|-------------|
|  | <b>September 30,</b>              |             |
|  | <b>2009</b>                       | <b>2008</b> |
| Net (decrease) increase in net assets resulting from operations                  | \$ (6,378)                        | \$ 13,998   |
| Weighted average common shares outstanding                                       | 49,804,906                        | 29,520,379  |
| Net (decrease) increase in net assets resulting from operations per common share | \$ (0.13)                         | \$ 0.47     |

**Table of Contents****Note 7. Related Party Agreements and Transactions***Investment Advisory Agreement*

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

Prospect Capital Management's services under the Investment Advisory Agreement are not exclusive, and it is free to furnish similar services to other entities so long as its services to us are not impaired. For providing these services the Investment Adviser receives a fee from us, consisting of two components: a base management fee and an incentive fee. The base management fee is calculated at an annual rate of 2.00% on our gross assets (including amounts borrowed). For services currently rendered under the Investment Advisory Agreement, the base management fee is payable quarterly in arrears. The base management fee is calculated based on the average value of our gross assets at the end of the two most recently completed calendar quarters and appropriately adjusted for any share issuances or repurchases during the current calendar quarter.

The total base management fees incurred to the favor of the Investment Adviser for the three months ended September 30, 2009 and September 30, 2008 were \$3,209, and \$2,823, respectively.

The incentive fee has two parts. The first part, the income incentive fee, is calculated and payable quarterly in arrears based on our pre-incentive fee net investment income for the immediately preceding calendar quarter. For this purpose, pre-incentive fee net investment income means interest income, dividend income and any other income (including any other fees (other than fees for providing managerial assistance), such as commitment, origination, structuring, diligence and consulting fees and other fees that we receive from portfolio companies) accrued during the calendar quarter, minus our operating expenses for the quarter (including the base management fee, expenses payable under the Administration Agreement described below, and any interest expense and dividends paid on any issued and outstanding preferred stock, but excluding the incentive fee). Pre-incentive fee net investment income includes, in the case of investments with a deferred interest feature (such as original issue discount, debt instruments with payment in kind interest and zero coupon securities), accrued income that we have not yet received in cash. Pre-incentive fee net investment income does not include any realized capital gains, realized capital losses or unrealized capital appreciation or depreciation. Pre-incentive fee net investment income, expressed as a rate of return on the value of our net assets at the end of the immediately preceding calendar quarter, is compared to a hurdle rate of 1.75% per quarter (7.00% annualized).

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

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

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

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

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



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The second part of the incentive fee, the capital gains incentive fee, is determined and payable in arrears as of the end of each calendar year (or upon termination of the Investment Advisory Agreement, as of the termination date), and equals 20.00% of our realized capital gains for the calendar year, if any, computed net of all realized capital losses and unrealized capital depreciation at the end of such year. In determining the capital gains incentive fee payable to the Investment Adviser, we calculate the aggregate realized capital gains, aggregate realized capital losses and aggregate unrealized capital depreciation, as applicable, with respect to each investment that has been in its portfolio. For the purpose of this calculation, an investment is defined as the total of all rights and claims which maybe asserted against a portfolio company arising from our participation in the debt, equity, and other financial instruments issued by that company. Aggregate realized capital gains, if any, 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 20.00% of such amount, less the aggregate amount of any capital gains incentive fees paid since inception.

For the three months ended September 30, 2009 and September 30, 2008, \$3,080 and \$5,875, respectively, of income incentive fees were incurred. No capital gains incentive fees were incurred for the three months ended September 30, 2009 and September 30, 2008.

*Administration Agreement*

We have also entered into an Administration Agreement with Prospect Administration, LLC ( Prospect Administration ) under which Prospect Administration, among other things, provides (or arranges for the provision of) administrative services and facilities for us. For providing these services, we reimburse Prospect Administration for our allocable portion of overhead incurred by Prospect Administration in performing its obligations under the Administration Agreement, including rent and our allocable portion of the costs of our chief compliance officer and chief financial officer and their respective staffs. For the three months ended September 30, 2009 and 2008, the reimbursement was approximately \$840 and \$588, respectively. Under this agreement, Prospect Administration furnishes us with office facilities, equipment and clerical, bookkeeping and record keeping services at such facilities. Prospect Administration also performs, or oversees the performance of, our required administrative services, which include, among other things, being responsible for the financial records that we are required to maintain and preparing reports to our stockholders and reports filed with the SEC. In addition, Prospect Administration assists us in determining and publishing our net asset value, overseeing the preparation and filing of our tax returns and the printing and dissemination of reports to our stockholders, and generally oversees the payment of our expenses and the performance of administrative and professional services rendered to us by others. Under the Administration Agreement, Prospect Administration also provides on our behalf managerial assistance to those portfolio companies to which we are required to provide such assistance. The Administration Agreement may be terminated by either party without penalty upon 60 days written notice to the other party. Prospect Administration is a wholly owned subsidiary of our Investment Adviser.

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



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Prospect Administration, pursuant to the approval of our Board of Directors, engaged Vastardis Fund Services LLC ( Vastardis ) to serve as our sub-administrator to perform certain services required of Prospect Administration. Under the sub-administration agreement, Vastardis provided us with office facilities, equipment, clerical, bookkeeping and record keeping services at such facilities. Vastardis also conducted relations with custodians, depositories, transfer agents, dividend disbursing agents, other stockholder servicing agents, accountants, attorneys, underwriters, brokers and dealers, corporate fiduciaries, insurers, banks and such other persons in any such other capacity deemed to be necessary or desirable. Vastardis provided reports to the Administrator and the Directors of its performance of obligations and furnished advice and recommendations with respect to such other aspects of our business and affairs as it shall determine to be desirable. Under the sub-administration agreement, Vastardis also provided the service of William E. Vastardis as our Chief Financial Officer ( CFO ). We compensated Vastardis for providing us these services by the payment of an asset-based fee with a \$400 annual minimum, payable monthly. Our service agreement was amended on September 28, 2008 so that Mr. Vastardis no longer served as our CFO effective as of November 11, 2008. At that time, Brian H. Oswald, a managing director at Prospect Administration, assumed the role of CFO. On April 30, 2009 we gave a 60-day notice to Vastardis of termination of our agreement to provide sub-administration services effective June 30, 2009. We entered into a new consulting services agreement for the period from July 1, 2009 until the filing of our Form 10-K for the year ended June 30, 2009. We paid Vastardis a total of \$30 for services rendered in conjunction with preparation of Form 10-K under the new agreement. All services previously provided by Vastardis were assumed by Prospect Administration beginning on July 1, 2009 for the fiscal year ending June 30, 2010 and thereafter.

*Managerial Assistance*

As a business development company, we offer, and must provide upon request, managerial assistance to certain of our portfolio companies. This assistance could involve, among other things, monitoring the operations of our portfolio companies, participating in board and management meetings, consulting with and advising officers of portfolio companies and providing other organizational and financial guidance. We billed \$200 and \$215 of managerial assistance fees for the three months ended September 30, 2009 and June 30, 2009, respectively, of which \$129 and \$60 remains on the consolidated statement of assets and liabilities as of September 30, 2009, and June 30, 2009, respectively. These fees are paid to the Administrator when received. We simultaneously accrue a payable to the Administrator for the same amounts, which remain on the consolidated statements of assets and liabilities.

**Table of Contents****Note 8. Financial Highlights**

|  | <b>For The Three Months Ended<br/>September 30,</b> |             |
|--|---|-------------|
|  | <b>2009</b>   | <b>2008</b> |
| <b>Per Share Data<sup>(1)</sup>:</b>                           |   |             |
| Net asset value at beginning of period                         | \$ 12.40  | \$ 14.55    |
| Net investment income  | 0.25  | 0.80        |
| Realized gain  |   | 0.05        |
| Net unrealized depreciation                                    | (0.38)  | (0.38)      |
| Net decrease in net assets as a result of public offerings     | (0.77)  |             |
| Dividends declared and paid                                    | (0.39)  | (0.39)      |
| <br>   |   |             |
| Net asset value at end of period                               | \$ 11.11  | \$ 14.63    |
| <br>   |   |             |
| Per share market value at end of period                        | \$ 10.71  | \$ 12.81    |
| Total return based on market value <sup>(2)</sup>              | 20.83%  | 0.25%       |
| Total return based on net asset value <sup>(2)</sup>           | (7.00%)   | 3.71%       |
| Shares outstanding at end of period                            | 54,672,155  | 29,520,379  |
| Average weighted shares outstanding for period                 | 49,804,906  | 29,520,379  |
| <b>Ratio / Supplemental Data:</b>                              |   |             |
| Net assets at end of period                                    | \$ 607,246  | \$ 431,439  |
| Annualized ratio of operating expenses to average net assets   | 7.59%   | 11.38%      |
| Annualized ratio of net operating income to average net assets | 10.02%  | 12.09%      |

**Table of Contents****Note 8. Financial Highlights (continued)**

|  | <b>Year<br/>Ended<br/>June 30,<br/>2009</b> | <b>Year<br/>Ended<br/>June 30,<br/>2008</b> | <b>Year<br/>Ended<br/>June 30,<br/>2007</b> | <b>Year<br/>Ended<br/>June 30,<br/>2006</b> | <b>Year<br/>Ended<br/>June 30,<br/>2005</b> |
|--|---|---|---|---|---|
| <b>Per Share Data<sup>(1)</sup>:</b>                                 |   |   |   |   |   |
| Net asset value at beginning of period                               | \$ 14.55                                    | \$ 15.04                                    | \$ 15.31                                    | \$ 14.59                                    | \$ (0.01)                                   |
| Costs related to the initial public offering                         |   |   |   | 0.01  | (0.21)                                      |
| Costs related to the secondary public offering                       |   | (0.07)                                      | (0.06)                                      |   |   |
| Net investment income  | 1.87  | 1.91  | 1.47  | 1.21  | 0.34  |
| Realized (loss) gain   | (1.24)                                      | (0.69)                                      | 0.12  | 0.04  |   |
| Net unrealized appreciation (depreciation)                           | 0.48  | (0.05)                                      | (0.52)                                      | 0.58  | 0.90  |
| Net (decrease) increase in net assets as a result of public offering | (2.11)                                      |   | 0.26  |   | 13.95                                       |
| Dividends declared and paid  | (1.15)                                      | (1.59)                                      | (1.54)                                      | (1.12)                                      | (0.38)                                      |
| Net asset value at end of period                                     | \$ 12.40                                    | \$ 14.55                                    | \$ 15.04                                    | \$ 15.31                                    | \$ 14.59                                    |
| Per share market value at end of period                              | \$ 9.20                                     | \$ 13.18                                    | \$ 17.47                                    | \$ 16.99                                    | \$ 12.60                                    |
| Total return based on market value <sup>(2)</sup>                    | (22.04%)                                    | (15.90%)                                    | 12.65%                                      | 44.90%                                      | (13.46%)                                    |
| Total return based on net asset value <sup>(2)</sup>                 | (4.81%)                                     | 7.84%                                       | 7.62%                                       | 12.76%                                      | 7.40%                                       |
| Shares outstanding at end of period                                  | 42,943,084                                  | 29,520,379                                  | 19,949,065                                  | 7,069,873                                   | 7,055,100                                   |
| Average weighted shares outstanding for period                       | 31,559,905                                  | 23,626,642                                  | 15,724,095                                  | 7,056,846                                   | 7,055,100                                   |
| <b>Ratio / Supplemental Data:</b>                                    |   |   |   |   |   |
| Net assets at end of period  | \$ 532,596                                  | \$ 429,623                                  | \$ 300,048                                  | \$ 108,270                                  | \$ 102,967                                  |
| Annualized ratio of operating expenses to average net assets         | 9.03%                                       | 9.62%                                       | 7.36%                                       | 8.19%                                       | 5.52%                                       |
| Annualized ratio of net investment income to average net assets      | 13.14%                                      | 12.66%                                      | 9.71%                                       | 7.90%                                       | 8.50%                                       |

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

(2) Total return based on market value is based on the change in market price per share between the opening and ending market

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

**Note 9. Revolving Credit Agreements**

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

On June 25, 2009, we completed a first closing on an expanded \$250,000 revolving credit facility (the Syndicated Facility ). The new Syndicated Facility, which had \$195,000 and \$175,000 total commitments as of September 30, 2009 and June 30, 2009, respectively, includes an accordion feature which allows the Syndicated Facility to accept up to an aggregate total of \$250,000 of commitments for which we continue to solicit additional commitments from other lenders for the additional \$55,000 as of September 30, 2009. The revolving period extends through June 24, 2010. If not renewed or extended by the participant banks, a one year amortization period would commence whereby we may not borrow additional funds. Thereafter for ten years, all principal, interest and fee payments received in conjunction with collateral pledged to the Syndicated Facility, less a monthly servicing fee payable to us, are required to be used to repay outstanding borrowings under the Syndicated Facility. Any remaining outstanding borrowings would be due and payable on the commitment termination date, which is currently June 24, 2011.

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The Syndicated Facility contains restrictions pertaining to the geographic and industry concentrations of funded loans, maximum size of funded loans, interest rate payment frequency of funded loans, maturity dates of funded loans and minimum equity requirements. The Syndicated Facility also contains certain requirements relating to portfolio performance, including required minimum portfolio yield and limitations on delinquencies and charge-offs, violation of which could result in the early termination of the Syndicated Facility. The Syndicated Facility also requires the maintenance of a minimum liquidity requirement. At September 30, 2009 and June 30, 2009, we were in compliance with the applicable covenants.

Interest on borrowings under the credit facility is one-month LIBOR plus 400 basis points, subject to a minimum Libor floor of 200 basis points. Additionally, the banks charge a fee on the unused portion of the credit facility equal to 100 basis points. As of September 30, 2009 and June 30, 2009, we had zero and \$124,800 outstanding under our credit facility, respectively. As of September 30, 2009 and June 30, 2009, \$89,391 and \$946 was available to us for additional borrowing under our credit facility, respectively. As we make additional investments which are eligible to be pledged under the credit facility, we will generate additional availability to the extent such investments are eligible to be placed into the borrowing base. At September 30, 2009 and June 30, 2009, the investments used as collateral for the Syndicated Facility had an aggregate market value of \$373,911 and \$434,069, which represents 61.5% and 81.5% of net assets, respectively.

In connection with the origination and amendment of the Syndicated Facility, we incurred approximately \$6,922 of fees which are being amortized over the term of the facility.

**Note 10. Commitments and Off-Balance Sheet Risks**

From time to time, we provide guarantees for portfolio companies for payments to counterparties, usually as an alternative to investing additional capital. Currently, an agreement for one contingent indemnification is outstanding related to a North Fork Collieries LLC ( North Fork ), a consolidated entity of Yatesville. The contingent indemnification obligation arose from our acquisition of the assets of Traveler Coal, LLC ( Traveler ), through our subsidiary, North Fork. Specifically, as part of that acquisition, we have agreed, subject to the satisfaction of certain conditions, to indemnify the seller of those assets for personal guarantees that seller had extended on behalf of Traveler. As of September 30, 2009, the amount of this contingency is approximately \$1,300.

We also provide indemnifications to Prospect Administration in accordance with our respective agreements with that service provider. These indemnifications are described in further detail in Note 7.

**Note 11. Litigation**

From time to time, we may become involved in various investigations, claims and legal proceedings that arise in the ordinary course of our business. These matters may relate to intellectual property, employment, tax, regulation, contract or other matters. The resolution of these matters as they arise will be subject to various uncertainties and, even if such claims are without merit, could result in the expenditure of significant financial and managerial resources. On December 6, 2004, Dallas Gas Partners, L.P. ( DGP ) served us with a complaint filed November 30, 2004 in the U.S. District for the Southern District of Texas, Galveston Division. DGP alleges that DGP was defrauded and that we breached our fiduciary duty to DGP and tortiously interfered with DGP's contract to purchase Gas Solutions, Ltd. (a subsidiary of our portfolio company, GSHI) in connection with our alleged agreement in September 2004 to loan DGP funds with which DGP intended to buy Gas Solutions, Ltd. for approximately \$26,000. The complaint sought relief not limited to \$100,000. On November 30, 2005, U.S. Magistrate Judge John R. Froeschner of the U.S. District Court for the Southern District of Texas, Galveston Division, issued a recommendation that the court grant our Motion for Summary Judgment dismissing all claims by DGP. On February 21, 2006, U.S. District Judge Samuel Kent of the U.S. District Court for the Southern District of Texas, Galveston Division issued an order granting our Motion for Summary Judgment dismissing all claims by DGP, against us. On May 16, 2007, the Court also granted us summary judgment on DGP's liability to us on our counterclaim for DGP's breach of a release and covenant not to sue. On January 4, 2008, the Court, Judge Melinda Harmon presiding, granted our motion to dismiss all DGP's claims asserted against certain of our officers and affiliates. On August 20, 2008, Judge Harmon entered a Final Judgment dismissing all of DGP's claims. DGP appealed to the U.S. Court of Appeals for the Fifth Circuit, which affirmed the Final Judgment on June 24, 2009. DGP then moved for rehearing on July 8, 2009, which the Fifth Circuit denied on August 6, 2009. Our damage claims against DGP remain pending.





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In May 2006, based in part on unfavorable due diligence and the absence of investment committee approval, we declined to extend a loan for \$10,000 to a potential borrower ( plaintiff ). Plaintiff was subsequently sued by its own attorney in a local Texas court for plaintiff's failure to pay fees owed to its attorney. In December 2006, plaintiff filed a cross-action against us and certain affiliates (the defendants ) in the same local Texas court, alleging, among other things, tortious interference with contract and fraud. We petitioned the United States District Court for the Southern District of New York (the District Court ) to compel arbitration and to enjoin the Texas action. In February 2007, our motions were granted. Plaintiff appealed that decision. On July 24, 2008, the Second Circuit Court of Appeals affirmed the judgment of the District Court. The arbitration commenced in July 2007 and concluded in late November 2007. Post-hearing briefings were completed in February 2008. On April 14, 2008, the arbitrator rendered an award in our favor, rejecting all of plaintiff's claims. On April 18, 2008, we filed a petition before the District Court to confirm the award. On October 8, 2008, the District Court granted the Company's petition to confirm the award, confirmed the awards and subsequently entered judgment thereon in favor of the Company in the amount of \$2,288. After filing a defective notice of appeal to the United States Court of Appeals for the Second Circuit on November 5, 2008, plaintiff's counsel resubmitted a new notice of appeal on January 9, 2009. The plaintiff subsequently requested that the Company agree to stipulate to the withdrawal of plaintiff's appeal to the Second Circuit. Such a stipulation was filed with the Second Circuit on or about April 14, 2009. Based on this stipulation, the Second Circuit issued a mandate terminating the appeal, which was transmitted to the District Court on April 23, 2009. Post-judgment discovery against plaintiff is continuing and we have filed a motion for sanctions against plaintiff's counsel which will be scheduled for argument in November 2009.

**Note 12. Proposed Merger**

On August 3, 2009, we announced that we had entered into a definitive agreement to acquire Patriot Capital Funding, Inc. (NASDAQ: PCAP) ( Patriot ) for approximately \$197,000 comprised of our common stock and cash to repay all Patriot debt, anticipated to be \$110,500 when the acquisition closes. Our common shares will be exchanged at a ratio of approximately 0.3992 for each Patriot share, or 8,616,467 shares of our common stock for 21,584,251 Patriot shares, with such exchange ratio decreased for any tax distributions Patriot may declare before closing. In return, we will acquire assets with an amortized cost of approximately \$311,000 for approximately \$197,000, based on an estimate of our common stock price of \$10 per share and the anticipated debt outstanding at the closing, the value of either may change prior to the closing. We, in conjunction with an independent valuation agent, have determined that the fair value of the assets is approximate to the anticipated purchase price and do not anticipate recording any material gain on the consummation of the transaction.

Patriot has reduced its debt balance to \$112,706 at September 30, 2009.

On November 3, 2009, Patriot announced that it would be making a final dividend equal to its undistributed net ordinary income and capital gains. Patriot has estimated that this final dividend will be \$0.38 per share and the actual amount of the final dividend may be more or less than the estimated amount and will be determined immediately prior to the date on which the final dividend is paid to Patriot shareholders. In accordance with a recent IRS revenue procedure, the dividend will be payable up to 10% in cash and at least 90% in newly issued shares of Patriot's common stock. If \$0.038 of the dividend is distributed as cash, the total number of shares to be issued by us will be reduced to 8,534,111 shares.

**Table of Contents****Note 13. Selected Quarterly Financial Data (Unaudited)**

| Quarter Ended                     | Investment Income |                          | Net Investment Income |                          | Net Realized and Unrealized Gains (Losses) |                          | Net Increase (Decrease) in Net Assets from Operations |                          |
|-----------------------------------|-------------------|--------------------------|-----------------------|--------------------------|--|--------------------------|---|--------------------------|
|                                   | Total             | Per Share <sup>(1)</sup> | Total                 | Per Share <sup>(1)</sup> | Total                                      | Per Share <sup>(1)</sup> | Total   | Per Share <sup>(1)</sup> |
| September 30, 2006                | \$ 6,432          | \$ 0.65                  | \$ 3,274              | \$ 0.33                  | \$ 690                                     | \$ 0.07                  | \$ 3,964  | \$ 0.40                  |
| December 31, 2006                 | 8,171             | 0.60                     | 4,493                 | 0.33                     | (1,553)                                    | (0.11)                   | 2,940   | 0.22                     |
| March 31, 2007                    | 12,069            | 0.61                     | 7,015                 | 0.36                     | (2,039)                                    | (0.10)                   | 4,976   | 0.26                     |
| June 30, 2007                     | 14,009            | 0.70                     | 8,349                 | 0.42                     | (3,501)                                    | (0.18)                   | 4,848   | 0.24                     |
| September 30, 2007                | 15,391            | 0.77                     | 7,865                 | 0.39                     | 685  | 0.04                     | 8,550   | 0.43                     |
| December 31, 2007                 | 18,563            | 0.80                     | 10,660                | 0.46                     | (14,346)                                   | (0.62)                   | (3,686)   | (0.16)                   |
| March 31, 2008                    | 22,000            | 0.92                     | 12,919                | 0.54                     | (14,178)                                   | (0.59)                   | (1,259)   | (0.05)                   |
| June 30, 2008                     | 23,448            | 0.85                     | 13,669                | 0.50                     | 10,317                                     | 0.38                     | 23,986  | 0.88                     |
| September 30, 2008 <sup>(2)</sup> | 35,799            | 1.21                     | 23,502                | 0.80                     | (9,504)                                    | (0.33)                   | 13,998  | 0.47                     |
| December 31, 2008                 | 22,213            | 0.75                     | 11,960                | 0.40                     | (5,436)                                    | (0.18)                   | 6,524   | 0.22                     |
| March 31, 2009                    | 20,669            | 0.69                     | 11,720                | 0.39                     | 3,611                                      | 0.12                     | 15,331  | 0.51                     |
| June 30, 2009                     | 21,800            | 0.59                     | 11,981                | 0.32                     | (12,730)                                   | (0.34)                   | (749)   | (0.02)                   |
| September 30, 2009                | 21,517            | 0.43                     | 12,318                | 0.25                     | (18,696)                                   | (0.38)                   | (6,378)   | (0.13)                   |

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

(2) Additional income for this quarter was driven by other investment income from the settlement of net profits interests

on IEC Systems  
LP and  
Advanced Rig  
Services LLC.  
See Note 4.

**Note 14. Subsequent Events**

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

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

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

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

The following discussion should be read in conjunction with the consolidated financial statements and notes thereto appearing elsewhere in this quarterly report on Form 10-Q. Historical results set forth are not necessarily indicative of our future financial position and results of operations.

**Note on Forward Looking Statements**

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

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

We generally use words such as anticipates, believes, expects, intends and similar expressions to identify forward-looking statements. Our actual results could differ materially from those projected in the forward-looking statements for any reason, including the factors set forth in Risk Factors and elsewhere in this report.

We have based the forward-looking statements included in this report on information available to us on the date of this report, and we assume no obligation to update any such forward-looking statements. Although we undertake no obligation to revise or update any forward-looking statements, whether as a result of new information, future events or otherwise, you are advised to consult any additional disclosures that we may make directly to you or through reports that we in the future may file with the Securities and Exchange Commission (SEC), including any annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K.

**General**

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

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

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### **Pending Acquisition**

On August 3, 2009, we announced that we had entered into a definitive agreement to acquire Patriot Capital Funding, Inc. (NASDAQ: PCAP) ( Patriot ) for approximately \$197,000 comprised of our common stock and cash to repay all Patriot debt, anticipated to be \$110,500 when the acquisition closes. Our common shares will be exchanged at a ratio of approximately 0.3992 for each Patriot share, or 8,616,467 shares of our common stock for 21,584,251 Patriot shares, with such exchange ratio decreased for any tax distributions Patriot may declare before closing. In return, we will acquire assets with an amortized cost of approximately \$311,000 for approximately \$197,000, based on an estimate of our common stock price of \$10 per share and the anticipated debt outstanding at the closing, the value of either may change prior to the closing. We, in conjunction with an independent valuation agent, have determined that the fair value of the assets is approximate to the anticipated purchase price and do not anticipate recording any material gain on the consummation of the transaction.

Patriot has reduced its debt balance to \$112,706 at September 30, 2009.

On November 3, 2009, Patriot announced that it would be making a final dividend equal to its undistributed net ordinary income and capital gains. Patriot has estimated that this final dividend will be \$0.38 per share and the actual amount of the final dividend may be more or less than the estimated amount and will be determined immediately prior to the date on which the final dividend is paid to Patriot shareholders. In accordance with a recent IRS revenue procedure, the dividend will be payable up to 10% in cash and at least 90% in newly issued shares of Patriot's common stock. If \$0.038 of the dividend is distributed as cash, the total number of shares to be issued by us will be reduced to 8,534,111 shares.

### **Market Conditions**

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

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

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

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

### **Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with GAAP. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Changes in the economic environment, financial markets and any other parameters used in

determining such estimates could cause actual results to differ materially. In addition to the discussion below, our critical accounting policies are further described in the notes to the financial statements.

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*Basis of Consolidation*

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

*Investment Classification*

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

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

*Investment Valuation*

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

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

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

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

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

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

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

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

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

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

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

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

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

### *Federal and State Income Taxes*

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

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

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



review and adjustment at a later date based upon factors including, but not limited to, an on-going analysis of tax laws, regulations and interpretations thereof.

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*Revenue Recognition*

Realized gains or losses on the sale of investments are calculated using the specific identification method. Interest income, adjusted for amortization of premium and accretion of discount, is recorded on an accrual basis. Origination, closing and/or commitment fees associated with investments in portfolio companies are accreted into interest income over the respective terms of the applicable loans. Upon the prepayment of a loan or debt security, any prepayment penalties and unamortized loan origination, closing and commitment fees are recorded as interest income. Loans are placed on non-accrual status when principal or interest payments are past due 90 days or more or when there is reasonable doubt that principal or interest will be collected. Unpaid accrued interest is generally reversed when a loan is placed on non-accrual status. Interest payments received on non-accrual loans may be recognized as income or applied to principal depending upon management's judgment. Non-accrual loans are restored to accrual status when past due principal and interest is paid and in management's judgment, are likely to remain current. As of September 30, 2009, approximately 5.7% of our net assets are in non-accrual status.

Dividend income is recorded on the ex-dividend date.

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

**Statement of Assets and Liabilities Overview**

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

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

**Investment Activity**

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

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

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

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

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

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

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

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

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

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

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

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

**Investment Holdings**

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

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

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

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

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

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

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

| Level of Control             | Cost      | September 30, 2009   |            |                      | Cost      | June 30, 2009        |            |                      |
|------------------------------|-----------|----------------------|------------|----------------------|-----------|----------------------|------------|----------------------|
|                              |           | Percent of Portfolio | Fair Value | Percent of Portfolio |           | Percent of Portfolio | Fair Value | Percent of Portfolio |
| Money Market Funds           | \$ 85,143 | 14.2%                | \$ 85,143  | 14.3%                | \$ 98,735 | 15.7%                | \$ 98,735  | 15.3%                |
| Senior Secured Debt          | 230,158   | 38.4%                | 213,394    | 35.8%                | 232,534   | 36.9%                | 220,993    | 34.2%                |
| Subordinated Secured Debt    | 235,638   | 39.4%                | 167,839    | 28.2%                | 251,292   | 39.9%                | 194,547    | 30.1%                |
| Subordinated Unsecured Debt  | 15,125    | 2.5%                 | 16,410     | 2.8%                 | 15,065    | 2.4%                 | 16,331     | 2.5%                 |
| Preferred Stock              | 10,432    | 1.7%                 | 5,202      | 0.9%                 | 10,432    | 1.6%                 | 4,139      | 0.7%                 |
| Common Stock                 | 16,606    | 2.8%                 | 88,234     | 14.8%                | 16,310    | 2.6%                 | 89,278     | 13.8%                |
| Membership Interests         | 3,031     | 0.5%                 | 6,846      | 1.1%                 | 3,031     | 0.5%                 | 7,270      | 1.1%                 |
| Overriding Royalty Interests |           | 0.0%                 | 3,187      | 0.5%                 |           | 0.0%                 | 3,483      | 0.5%                 |
| Net Profit Interests         |           | 0.0%                 | 2,087      | 0.3%                 |           | 0.0%                 | 2,561      | 0.4%                 |
| Warrants                     | 2,760     | 0.5%                 | 7,599      | 1.3%                 | 2,760     | 0.4%                 | 8,566      | 1.4%                 |

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|                 |            |        |            |        |            |        |            |        |
|-----------------|------------|--------|------------|--------|------------|--------|------------|--------|
| Total Portfolio | \$ 598,893 | 100.0% | \$ 595,941 | 100.0% | \$ 630,159 | 100.0% | \$ 645,903 | 100.0% |
|-----------------|------------|--------|------------|--------|------------|--------|------------|--------|

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

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

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

| Level of Control             | Cost     | September 30, 2009   |            |                      | Cost     | June 30, 2009        |            |                      |
|------------------------------|----------|----------------------|------------|----------------------|----------|----------------------|------------|----------------------|
|                              |          | Percent of Portfolio | Fair Value | Percent of Portfolio |          | Percent of Portfolio | Fair Value | Percent of Portfolio |
| Biomass Power                | \$ 2,826 | 0.5%                 | \$ 2,530   | 0.4%                 | \$ 2,530 | 0.4%                 | \$ 2,530   | 0.4%                 |
| Construction                 |          |                      |            |                      |          |                      |            |                      |
| Services                     | 5,028    | 0.8%                 | 1,123      | 0.2%                 | 5,017    | 0.8%                 | 2,408      | 0.4%                 |
| Contracting                  | 16,652   | 2.8%                 | 5,971      | 1.0%                 | 16,652   | 2.6%                 | 5,000      | 0.8%                 |
| Financial Services           | 25,554   | 4.3%                 | 23,365     | 3.9%                 | 25,424   | 4.0%                 | 23,073     | 3.6%                 |
| Food Products                | 27,459   | 4.6%                 | 29,730     | 5.0%                 | 27,413   | 4.4%                 | 29,416     | 4.6%                 |
| Gas Gathering and Processing | 35,003   | 5.8%                 | 85,187     | 14.3%                | 35,003   | 5.6%                 | 85,187     | 13.2%                |
| Healthcare                   | 57,683   | 9.6%                 | 61,530     | 10.3%                | 57,535   | 9.1%                 | 60,293     | 9.3%                 |
| Manufacturing                | 71,053   | 11.9%                | 87,136     | 14.6%                | 90,978   | 14.4%                | 110,929    | 17.2%                |
| Metal Services               | 580      | 0.1%                 | 3,067      | 0.5%                 | 3,302    | 0.5%                 | 7,133      | 1.1%                 |
| Mining and Coal Production   | 51,850   | 8.7%                 | 10,994     | 1.8%                 | 48,890   | 7.8%                 | 13,097     | 2.0%                 |
| Oil and Gas Production       | 104,437  | 17.4%                | 101,019    | 17.0%                | 104,183  | 16.5%                | 104,806    | 16.2%                |
| Oilfield Fabrication         | 33,292   | 5.6%                 | 33,957     | 5.7%                 | 34,247   | 5.4%                 | 34,931     | 5.4%                 |
| Pharmaceuticals              | 11,951   | 2.0%                 | 11,684     | 2.0%                 | 11,949   | 2.0%                 | 11,452     | 1.8%                 |
| Production                   |          |                      |            |                      |          |                      |            |                      |
| Services                     | 20,521   | 3.4%                 | 12,908     | 2.2%                 | 19,344   | 3.1%                 | 12,606     | 1.9%                 |
| Retail                       | 15,440   | 2.6%                 | 4,236      | 0.7%                 | 14,623   | 2.3%                 | 6,272      | 1.0%                 |
| Shipping Vessels             | 7,241    | 1.2%                 | 6,469      | 1.1%                 | 7,160    | 1.1%                 | 7,381      | 1.1%                 |
| Specialty Minerals           | 15,814   | 2.6%                 | 18,162     | 3.0%                 | 15,814   | 2.5%                 | 18,924     | 2.9%                 |
| Technical Services           | 11,366   | 1.9%                 | 11,730     | 2.0%                 | 11,360   | 1.8%                 | 11,730     | 1.8%                 |

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|                    |            |        |            |        |            |        |            |        |
|--------------------|------------|--------|------------|--------|------------|--------|------------|--------|
| Money Market Funds | 85,143     | 14.2%  | 85,143     | 14.3%  | 98,735     | 15.7%  | 98,735     | 15.3%  |
| Total Portfolio    | \$ 598,893 | 100.0% | \$ 595,941 | 100.0% | \$ 630,159 | 100.0% | \$ 645,903 | 100.0% |



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### **Investment Valuation**

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

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

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

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

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

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

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

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

#### *Gas Solutions Holdings, Inc.*

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

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



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

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

*Integrated Contract Services, Inc.*

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

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

*Yatesville Coal Holdings, Inc.*

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

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

Change Clean Energy, Inc. ( CCEI ) is an investment that we originated in September 2005 which owns and operated a bio-mass energy plant. In March 2009 CCEI ceased operations temporarily as it was not economically feasible to make a profit based on the cost of materials and the price being paid for electricity. During that quarter, we determined that it was appropriate to institute foreclosure proceedings against the co-borrowers of our debt to take full control of the assets. In anticipation of such proceedings CCEHI was established and on March 11, 2009, the foreclosure was completed and the assets were assigned to a wholly owned subsidiary of CCEHI. During the three months ended September 30, 2009, we provided additional funding of \$296 to CCEHI to fund ongoing operations. CCEI currently

has no material operations. At June 30, 2009 we determined that the impairment at both CCEI and CCEHI was other than temporary and recognized a realized loss of \$41,134, which was the amount by which the amortized cost exceeded the fair value. At September 30, 2009, our Board of Directors, under recommendation from senior management, has reaffirmed the value of the CCEHI investment at \$2,530, a reduction of \$296 from its amortized cost.

**Table of Contents****Capitalization**

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

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

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

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

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

|                         | Payments Due By Period |             |                   |
|-------------------------|------------------------|-------------|-------------------|
|                         | Less Than 1 Year       | 1 - 3 Years | More Than 3 Years |
| Credit Facility Payable | \$                     | \$          | \$                |

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

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

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

**Results of Operations**

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

While we seek to maximize gains and minimize losses, our investments in portfolio companies can expose our capital to risks greater than those we may anticipate as these companies are typically not issuing securities rated investment

grade, have limited resources, have limited operating history, are generally private companies with limited operating information available and are likely to depend on a small core of management talents. Changes in any of these factors can have a significant impact on the value of the portfolio company.

**Table of Contents****Investment Income**

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

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

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

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

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

While average principal balances of debt investments have increased from \$493,487 for the three months ended September 30, 2008 to \$497,161 for the three months ended September 30, 2009, the weighted-average interest rate earned decreased from 14.11% to 11.84%. During the three month period ended September 30, 2009, interest of \$4,448 was foregone on non-accrual debt investments compared to \$1,989 of forgone interest for the three months ended September 30, 2008. Without these adjustments, the weighted average interest rates earned on debt investments would have been 15.39% and 15.71% for the three months ended September 30, 2009 and 2008, respectively.

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

**Operating Expenses**

Our primary operating expenses consist of investment advisory fees (base management and income incentive fees), credit facility costs, legal and professional fees and other operating and overhead-related expenses. These expenses include our allocable portion of overhead under the Administration Agreement with Prospect Administration under which Prospect Administration provides administrative services and facilities for us. Our investment advisory fees

compensate our Investment Adviser for its work in identifying, evaluating, negotiating, closing and monitoring our investments. We bear all other costs and expenses of our operations and transactions in accordance with our Administration Agreement with Prospect Administration. Operating expenses were \$9,199 and \$12,297 for the three months ended September 30, 2009 and September 30, 2008, respectively.



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

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

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

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

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

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

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

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



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

**Financial Condition, Liquidity and Capital Resources**

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

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

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

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

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

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

**Off-Balance Sheet Arrangements**

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

**Developments Since the End of the Fiscal Quarter**

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



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**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

We are subject to financial market risks, including changes in interest rates and equity price risk. At September 30, 2009, most of the loans in our portfolio bore interest at fixed interest rates. Several of our floating rate loans have floors which have effectively converted the loans to fixed rate loans in the current interest rate environment. At September 30, 2009, the principal value of loans totaling \$21,750 bear interest at floating rates.

If we continue to invest in fixed rate loans, we may hedge against interest rate fluctuations by using standard hedging instruments such as futures, options and forward contracts subject to the requirements of the 1940 Act. While hedging activities may insulate us against adverse changes in interest rates, they may also limit our ability to participate in the benefits of lower interest rates with respect to our portfolio of investments. During the three months ended September 30, 2009, we did not engage in interest rate hedging activities.

**Item 4. Controls and Procedures**

As of the end of the period covered by this quarterly report on Form 10-Q, the Company's Chief Executive Officer and Chief Financial Officer conducted an evaluation of the Company's disclosure controls and procedures (as defined in Rules 13a-15 and 15d-15 of the Securities Exchange Act of 1934). Based upon this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective to allow timely decisions regarding required disclosure of any material information relating to the Company that is required to be disclosed by the Company in the reports it files or submits under the Securities Exchange Act of 1934.

There have been no changes in the Company's internal controls over financial reporting that occurred during the quarter ended September 30, 2009 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Table of Contents****PART II: OTHER INFORMATION****Item 1. Legal Proceedings**

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

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

In May 2006, based in part on unfavorable due diligence and the absence of investment committee approval, we declined to extend a loan for \$10,000 to a potential borrower ( plaintiff ). Plaintiff was subsequently sued by its own attorney in a local Texas court for plaintiff s failure to pay fees owed to its attorney. In December 2006, plaintiff filed a cross-action against us and certain affiliates (the defendants ) in the same local Texas court, alleging, among other things, tortious interference with contract and fraud. We petitioned the United States District Court for the Southern District of New York (the District Court ) to compel arbitration and to enjoin the Texas action. In February 2007, our motions were granted. Plaintiff appealed that decision. On July 24, 2008, the Second Circuit Court of Appeals affirmed the judgment of the District Court. The arbitration commenced in July 2007 and concluded in late November 2007. Post-hearing briefings were completed in February 2008. On April 14, 2008, the arbitrator rendered an award in our favor, rejecting all of plaintiff s claims. On April 18, 2008, we filed a petition before the District Court to confirm the award. On October 8, 2008, the District Court granted the Company s petition to confirm the award, confirmed the awards and subsequently entered judgment thereon in favor of the Company in the amount of \$2,288. After filing a defective notice of appeal to the United States Court of Appeals for the Second Circuit on November 5, 2008, plaintiff s counsel resubmitted a new notice of appeal on January 9, 2009. The plaintiff subsequently requested that the Company agree to stipulate to the withdrawal of plaintiff s appeal to the Second Circuit. Such a stipulation was filed with the Second Circuit on or about April 14, 2009. Based on this stipulation, the Second Circuit issued a mandate terminating the appeal, which was transmitted to the District Court on April 23, 2009. Post-judgment discovery against plaintiff is continuing and we have filed a motion for sanctions against plaintiff s counsel which will be scheduled for argument in November 2009.

**Item 1A. Risk Factors**

There have been no material changes to our risk factors as previously disclosed in our most recent 10-K filing.

**Table of Contents****Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following table reflects the history of shares issued under the dividend reinvestment plan:

| <b>Record Date/Issuance Date</b>        | <b>Shares Issued</b> | <b>Aggregate Offering Price<br/>(in 000s)</b> | <b>% of Dividend</b> |
|---|----------------------|---|----------------------|
| March 23, 2006 / March 30, 2006         | 6,841                | \$ 111  | 5.2%                 |
| June 23, 2006 / June 30, 2006           | 7,932                | 130   | 5.4%                 |
| September 22, 2006 / September 29, 2006 | 80,818               | 1,273   | 26.2%                |
| December 29, 2006 / January 5, 2007     | 108,047              | 1,850   | 25.5%                |
| March 23, 2007 / March 30, 2007         | 93,843               | 1,595   | 20.8%                |
| June 22, 2007 / June 29, 2007           | 69,834               | 1,190   | 15.3%                |
| September 19, 2007 / September 28, 2007 | 72,073               | 1,243   | 15.9%                |
| March 31, 2008 / April 16, 2008         | 99,241               | 1,510   | 14.4%                |
| September 30, 2008 / October 16, 2008   | 117,549              | 1,506   | 12.7%                |
| December 31, 2008 / January 20, 2009    | 148,200              | 1,774   | 14.8%                |
| March 31, 2009 / April 20, 2009         | 214,456              | 1,827   | 14.4%                |
| July 8, 2009 / July 20, 2009            | 297,274              | 2,901   | 14.8%                |

The following table reflects recent sales of unregistered common stock:

| <b>Issuances of Common Stock</b> | <b>Number of Shares Issued</b> | <b>Gross Proceeds Raised</b> | <b>Underwriting Fees</b> | <b>Offering Expenses</b> | <b>Offering Price</b> |
|----------------------------------|--------------------------------|------------------------------|--------------------------|--------------------------|-----------------------|
| August 20, 2009                  | 3,449,686                      | \$ 29,322                    |                          | \$ 117                   | \$ 8.500              |
| September 24, 2009               | 2,807,111                      | \$ 25,264                    |                          | \$ 840                   | \$ 9.000              |

(1) Concurrent with the sale of these shares, we entered into a registration rights agreement in which we granted the purchasers certain registration rights with respect to the shares. We filed with the SEC a post-effective amendment to the registration statement on

Form N-2 on October 9, 2009, and will also use our reasonable best efforts to cause such post-effective amendment to be declared effective by the SEC no later than December 15, 2009. Under the registration rights agreement, we may be obligated to make liquidated damages payments to holders upon the occurrence of certain events.

- (2) We claimed exemption to registration under Rule 506 of Regulation D of the Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder (the Securities Act ).
- (3) Shares were purchased by qualified institutional buyers and institutional accredited investors as defined in Rule 144A



under the  
Securities Act.

**Item 3. Defaults upon Senior Securities**

Not applicable.

**Item 4. Submission of Matters to a Vote of Security Holders**

No matters were submitted to a vote of security holders during the first quarter of the fiscal year ended June 30, 2010.

**Item 5. Other Information**

None.

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**Item 6. Exhibits**

The following exhibits are filed as part of this report or hereby incorporated by reference to exhibits previously filed with the SEC (according to the number assigned to them in Item 601 of Regulation S-K):

- 2.1 Agreement and Plan of Merger by and between Patriot Capital Funding, Inc. and Prospect Capital Corporation, dated as of August 3, 2009 (12).
- 3.1 Articles of Amendment and Restatement (1).
- 3.2 Amended and Restated Bylaws (9).
- 4.1 Form of Share Certificate (1).
- 10.1 Investment Advisory Agreement between Registrant and Prospect Capital Management LLC (1).
- 10.2 Custodian Agreement (2).
- 10.3 Administration Agreement between Registrant and Prospect Administration LLC (1).
- 10.4 Transfer Agency and Service Agreement (2).
- 10.5 Dividend Reinvestment Plan (1).
- 10.6 License Agreement between Registrant and Prospect Capital Management LLC (1).
- 10.7 Loan and Servicing Agreement dated June 6, 2007 among Prospect Capital Funding LLC, Prospect Capital Corporation, the lenders from time to time party thereto and Coöperative Centrale Raisseisen-Boerenleenbank B.A., Rabobank Nederland, New York Branch (6).
- 10.8 First Amendment to Loan and Servicing Agreement dated December 31, 2007 among Prospect Capital Funding LLC, Prospect Capital Corporation, and Coöperative Centrale Raisseisen-Boerenleenbank B.A., Rabobank Nederland, New York Branch (7).
- 10.9 Amended and Restated Loan and Servicing Agreement dated June 25, 2009 among Prospect Capital Funding LLC, Prospect Capital Corporation and Coöperative Centrale Raiffeisen-Boerenleenbank B.A., Rabobank Nederland, New York Branch (11).
- 10.10 Stock Purchase Agreement, dated as of August 17, 2009, among Prospect Capital Corporation and the purchasers named therein (13).
- 10.11 Registration Rights Agreement, dated as of August 17, 2009, among Prospect Capital Corporation and the purchasers named therein (13).
- 11 Computation of Per Share Earnings (included in the notes to the financial statements contained in this report).
- 12 Computation of Ratios (included in the notes to the financial statements contained in this report).
- 14 Code of Conduct (10)

|       |   |
|-------|---|
| 16    | Letter regarding change in certifying accountant (4).   |
| 21    | Subsidiaries of the Registrant: (included in the notes to the consolidated financial statements contained in this annual report). (8) |
| 22.1  | Proxy Statement (5).  |
| 31.1* | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.               |

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- 31.2\* Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
- 32.1\* Certification of Chief Executive Officer pursuant to Section 906 of The Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
- 32.2\* Certification of Chief Financial Officer pursuant to Section 906 of The Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).

\* Filed herewith.

(1) Incorporated by reference to Pre-Effective Amendment No. 2 to the Registrant's Registration Statement on Form N-2 (File No. 333-114522), filed on July 6, 2004.

(2) Incorporated by reference to Pre-Effective Amendment No. 3 to the Registrant's Registration Statement on Form N-2 (File No. 333-114522), filed on July 23, 2004.

(3) Incorporated by reference from the Registrant's Form 10-K filed on September 28, 2006.

(4) Incorporated by reference to the form 8-K/A (File No. 814-00659), filed on

January 21, 2005.

- (5) Incorporated by reference from the Registrant's Proxy Statement filed on October 16, 2009.
- (6) Incorporated by reference from the Registrant's Registration Statement on Form N-2 (File No. 333-143819) filed on September 5, 2007.
- (7) Incorporated by reference from the Registrant's Quarterly Report on Form 10-Q filed on February 11, 2008.
- (8) Incorporated by reference from the Registrant's Form 10-K filed on September 28, 2007.
- (9) Incorporated by reference from the Registrant's Form 8-K filed on September 21, 2009.
- (10) Incorporated by reference from the Registrant's Quarterly Report on Form 10-Q filed on November 10, 2008.

- (11) Incorporated by reference to Exhibit 99.1 of the Registrant's Form 8-K filed on June 26, 2009.
- (12) Incorporated by reference to Exhibit 2.1 of the Registrant's Form 8-K filed on August 5, 2009
- (13) Incorporated by reference to Exhibit 10.1 and 10.2 of the Registrant's Form 8-K filed on August 21, 2009.

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**SIGNATURE**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on November 9, 2009.

**PROSPECT CAPITAL CORPORATION**

By: /s/ John F. Barry III  
John F. Barry III  
Chief Executive Officer and Chairman of the  
Board