

PROSPECT CAPITAL CORP  
Form 10-Q  
May 11, 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 March 31, 2009**

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR  
15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**  
**Commission File Number: 333-114552**

**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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer ☐ Accelerated Filer ☒ Non-Accelerated Filer ☐

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 May 11, 2009 was 35,180,584.

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**PROSPECT CAPITAL CORPORATION**  
**FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 2009**  
**TABLE OF CONTENTS**

**PART I. FINANCIAL INFORMATION**

Item 1. FINANCIAL STATEMENTS

Consolidated Statements of Assets and Liabilities - March 31, 2009 (Unaudited) and June 30, 2008 (Audited)

Consolidated Statements of Operations (Unaudited) - For the Three and Nine Months Ended March 31, 2009 and 2008

Consolidated Statements of Changes in Net Assets (Unaudited) - For the Nine Months Ended March 31, 2009 and 2008

Consolidated Statements of Cash Flows (Unaudited) - For the Nine Months Ended March 31, 2009 and 2008

Consolidated Schedule of Investments - March 31, 2009 (Unaudited) and June 30, 2008 (Audited)

Notes to Consolidated Financial Statements (Unaudited)

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Item 4. Controls and Procedures

**PART II. OTHER INFORMATION**

Item 1. Legal Proceedings

Item 1A. Risk Factors

Item 2. Unregistered Sales in Equity Securities and Use of Proceeds

Item 3. Defaults Upon Senior Securities

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

Item 5. Other Information

Item 6. Exhibits

Signatures

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**PART I: FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES**  
**March 31, 2009 and June 30, 2008**  
**(in thousands, except share and per share data)**

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|                                                                                                                                                                                | March 31,<br>2009<br>(Unaudited) | June 30,<br>2008<br>(Audited) |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------|-------------------------------|
| <b>Assets</b>                                                                                                                                                                  |                                  |                               |
| Investments at fair value (cost of \$567,306 and \$496,805, respectively, Note 3)                                                                                              |                                  |                               |
| Control investments (cost of \$221,744 and \$203,661, respectively)                                                                                                            | \$ 220,263                       | \$ 205,827                    |
| Affiliate investments (cost of \$33,546 and \$5,609, respectively)                                                                                                             | 30,819                           | 6,043                         |
| Non-control/Non-affiliate investments (cost of \$312,016 and \$287,535, respectively)                                                                                          | 303,959                          | 285,660                       |
| Total investments at fair value                                                                                                                                                | 555,041                          | 497,530                       |
| Investments in money market funds                                                                                                                                              | 39,254                           | 33,000                        |
| Cash                                                                                                                                                                           | 449                              | 555                           |
| Receivables for:                                                                                                                                                               |                                  |                               |
| Interest, net                                                                                                                                                                  | 5,929                            | 4,094                         |
| Dividends                                                                                                                                                                      | 16                               | 4,248                         |
| Loan principal                                                                                                                                                                 | □                                | 71                            |
| Managerial assistance                                                                                                                                                          | 473                              | 380                           |
| Prepaid prospective deal expenses                                                                                                                                              | 86                               | □                             |
| Other                                                                                                                                                                          | 109                              | 187                           |
| Prepaid expenses                                                                                                                                                               | 221                              | 273                           |
| Deferred financing costs                                                                                                                                                       | 1,228                            | 1,440                         |
| <b>Total Assets</b>                                                                                                                                                            | 602,806                          | 541,778                       |
| <b>Liabilities</b>                                                                                                                                                             |                                  |                               |
| Credit facility payable                                                                                                                                                        | 137,567                          | 91,167                        |
| Dividends payable                                                                                                                                                              | 12,671                           | 11,845                        |
| Due to Prospect Administration (Note 7)                                                                                                                                        | 742                              | 695                           |
| Due to Prospect Capital Management (Note 7)                                                                                                                                    | 5,813                            | 5,946                         |
| Accrued expenses                                                                                                                                                               | 1,324                            | 1,104                         |
| Other liabilities                                                                                                                                                              | 665                              | 1,398                         |
| <b>Total Liabilities</b>                                                                                                                                                       | 158,782                          | 112,155                       |
| <b>Net Assets</b>                                                                                                                                                              | \$ 444,024                       | \$ 429,623                    |
| <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; 31,286,128 and 29,520,379 issued and outstanding, respectively) | \$ 31                            | \$ 30                         |
| Paid-in capital in excess of par                                                                                                                                               | 456,398                          | 441,332                       |
| Undistributed net investment income                                                                                                                                            | 12,171                           | 1,508                         |
| Accumulated realized losses on investments                                                                                                                                     | (12,311)                         | (13,972)                      |
| Unrealized (depreciation) appreciation on investments                                                                                                                          | (12,265)                         | 725                           |
| <b>Net Assets</b>                                                                                                                                                              | \$ 444,024                       | \$ 429,623                    |
| <b>Net Asset Value Per Share</b>                                                                                                                                               | \$ 14.19                         | \$ 14.55                      |

See notes to consolidated financial statements.

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(in thousands, except share and per share data)  
(Unaudited)

|                                                                                                    | For The Three Months<br>Ended<br>March 31, |                   | For The Nine Months<br>Ended<br>March 31, |                 |
|----------------------------------------------------------------------------------------------------|--------------------------------------------|-------------------|-------------------------------------------|-----------------|
|                                                                                                    | 2009                                       | 2008              | 2009                                      | 2008            |
| <b>Investment Income</b>                                                                           |                                            |                   |                                           |                 |
| Interest Income                                                                                    |                                            |                   |                                           |                 |
| Control investments (Net of foreign withholding tax of \$28, \$35, \$137, and \$193, respectively) | \$ 5,503                                   | \$ 4,556          | \$ 17,300                                 | \$ 15,000       |
| Affiliate investments (Net of foreign withholding tax of \$0, \$0, \$0, and \$70, respectively)    | 730                                        | 290               | 2,365                                     | 1,000           |
| Non-control/Non-affiliate investments                                                              | 9,832                                      | 10,044            | 31,197                                    | 25,000          |
| Total interest income                                                                              | 16,065                                     | 14,890            | 50,862                                    | 42,000          |
| Dividend income                                                                                    |                                            |                   |                                           |                 |
| Control investments                                                                                | 4,400                                      | 3,300             | 13,568                                    | 6,000           |
| Money market funds                                                                                 | 45                                         | 123               | 265                                       | 0               |
| Total dividend income                                                                              | 4,445                                      | 3,423             | 13,833                                    | 7,000           |
| Other income: (Note 4)                                                                             |                                            |                   |                                           |                 |
| Control/Affiliate investments                                                                      | 0                                          | 200               | 831                                       | 0               |
| Non-control/Non-affiliate investments                                                              | 159                                        | 3,487             | 13,155                                    | 5,000           |
| Total other income                                                                                 | 159                                        | 3,687             | 13,986                                    | 5,000           |
| <b>Total Investment Income</b>                                                                     | <b>20,669</b>                              | <b>22,000</b>     | <b>78,681</b>                             | <b>55,000</b>   |
| <b>Operating Expenses</b>                                                                          |                                            |                   |                                           |                 |
| Investment advisory fees:                                                                          |                                            |                   |                                           |                 |
| Base management fee (Note 7)                                                                       | 2,977                                      | 2,388             | 8,740                                     | 6,000           |
| Income incentive fee (Note 7)                                                                      | 2,930                                      | 3,230             | 11,795                                    | 7,000           |
| Total investment advisory fees                                                                     | 5,907                                      | 5,618             | 20,535                                    | 14,000          |
| Interest and credit facility expenses                                                              | 1,345                                      | 1,863             | 4,828                                     | 4,000           |
| Sub-administration fees (including former Chief Financial Officer and Chief Compliance Officer)    | 177                                        | 228               | 644                                       | 0               |
| Legal fees                                                                                         | 107                                        | 449               | 590                                       | 2,000           |
| Valuation services                                                                                 | 139                                        | 198               | 561                                       | 0               |
| Audit, compliance and tax related fees                                                             | 219                                        | 45                | 848                                       | 0               |
| Allocation of overhead from Prospect Administration (Note 7)                                       | 588                                        | 588               | 1,764                                     | 1,000           |
| Insurance expense                                                                                  | 61                                         | 64                | 185                                       | 0               |
| Directors' fees                                                                                    | 61                                         | 55                | 204                                       | 0               |
| Other general and administrative expenses                                                          | 345                                        | (27)              | 807                                       | 0               |
| Excise taxes                                                                                       | 0                                          | 0                 | 533                                       | 0               |
| <b>Total Operating Expenses</b>                                                                    | <b>8,949</b>                               | <b>9,081</b>      | <b>31,499</b>                             | <b>24,000</b>   |
| <b>Net Investment Income</b>                                                                       | <b>11,720</b>                              | <b>12,919</b>     | <b>47,182</b>                             | <b>31,000</b>   |
| Net realized gain (loss) on investments                                                            | 0                                          | 208               | 1,661                                     | (18,000)        |
| Net change in unrealized appreciation/depreciation on investments                                  | 3,611                                      | (14,386)          | (12,990)                                  | (9,000)         |
| <b>Net Increase (Decrease) in Net Assets Resulting from Operations</b>                             | <b>\$ 15,331</b>                           | <b>\$ (1,259)</b> | <b>\$ 35,853</b>                          | <b>\$ 3,000</b> |

|                                                                 |    |      |    |        |         |
|-----------------------------------------------------------------|----|------|----|--------|---------|
| Net increase (decrease) in net assets resulting from operations |    |      |    |        |         |
| per share: (Note 6)                                             | \$ | 0.51 | \$ | (0.05) | \$ 1.21 |
| Dividends declared per share:                                   | \$ | 0.41 | \$ | 0.40   | \$ 1.21 |

See notes to consolidated financial statements.

4

**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS**  
**For The Nine Months Ended March 31, 2009 and 2008**  
**(in thousands, except share data)**  
**(Unaudited)**

|                                                                             | <b>For The Nine Months Ended<br/>March 31,</b> |                   |
|-----------------------------------------------------------------------------|------------------------------------------------|-------------------|
|                                                                             | <b>2009</b>                                    | <b>2008</b>       |
| <b>Increase in Net Assets from Operations:</b>                              |                                                |                   |
| Net investment income                                                       | \$ 47,182                                      | \$ 31,444         |
| Net realized gain (loss) on investments                                     | 1,661                                          | (18,413)          |
| Net change in unrealized appreciation/depreciation on investments           | (12,990)                                       | (9,426)           |
| <b>Net Increase in Net Assets Resulting from Operations</b>                 | <b>35,853</b>                                  | <b>3,605</b>      |
| <b>Dividends to Shareholders:</b>                                           | <b>(36,519)</b>                                | <b>(27,667)</b>   |
| <b>Capital Share Transactions:</b>                                          |                                                |                   |
| Net proceeds from capital shares sold                                       | 12,300                                         | 94,230            |
| Less: Offering costs of public share offerings                              | (513)                                          | (1,251)           |
| Reinvestment of dividends                                                   | 3,280                                          | 2,753             |
| <b>Net Increase in Net Assets Resulting from Capital Share Transactions</b> | <b>15,067</b>                                  | <b>95,732</b>     |
| <b>Total Increase in Net Assets:</b>                                        | <b>14,401</b>                                  | <b>71,670</b>     |
| Net assets at beginning of period                                           | 429,623                                        | 300,048           |
| <b>Net Assets at End of Period</b>                                          | <b>\$ 444,024</b>                              | <b>\$ 371,718</b> |
| <b>Capital Share Activity:</b>                                              |                                                |                   |
| Shares sold                                                                 | 1,500,000                                      | 6,150,000         |
| Shares issued through reinvestment of dividends                             | 265,749                                        | 171,314           |
| Net increase in capital share activity                                      | 1,765,749                                      | 6,321,314         |
| Shares outstanding at beginning of period                                   | 29,520,379                                     | 19,949,065        |
| <b>Shares Outstanding at End of Period</b>                                  | <b>31,286,128</b>                              | <b>26,270,379</b> |

See notes to consolidated financial statements.

5

**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For The Nine Months Ended March 31, 2009 and 2008**  
**(in thousands, except share data)**

(Unaudited)

|                                                                          | For The Nine Months Ended<br>March 31, |           |
|--------------------------------------------------------------------------|----------------------------------------|-----------|
|                                                                          | 2009                                   | 2008      |
| <b>Cash Flows from Operating Activities:</b>                             |                                        |           |
| Net increase in net assets resulting from operations                     | \$ 35,853                              | \$ 3,605  |
| Net realized (gain) loss on investments                                  | (1,661)                                | 18,413    |
| Net change in unrealized appreciation/depreciation on investments        | 12,990                                 | 9,426     |
| Accretion of original issue discount on investments                      | (2,323)                                | (1,785)   |
| Amortization of deferred financing costs                                 | 540                                    | 547       |
| Gain on settlement of net profits interest                               | (12,576)                               | □         |
| <b>Change in operating assets and liabilities:</b>                       |                                        |           |
| Payments for purchases of investments                                    | (89,052)                               | (192,311) |
| Payment-In-Kind interest                                                 | (1,324)                                | (722)     |
| Proceeds from sale of investments and collection of investment principal | 36,435                                 | 66,063    |
| Purchases of cash equivalents                                            | (29,999)                               | (229,955) |
| Sales of cash equivalents                                                | 29,999                                 | 229,938   |
| Net (increase) decrease investments in money market funds                | (6,254)                                | 14,511    |
| Increase in interest receivable, net                                     | (1,835)                                | (1,900)   |
| Decrease in dividends receivable                                         | 4,232                                  | 218       |
| Decrease (increase) in loan principal receivable                         | 71                                     | (107)     |
| Increase in receivable for securities sold                               | □                                      | (506)     |
| Decrease in receivable for structuring fees                              | □                                      | 1,625     |
| Increase in receivable for managerial assistance                         | (93)                                   | □         |
| Increase in receivable for potential deal expenses                       | (86)                                   | □         |
| Decrease (increase) in other receivables                                 | 78                                     | (148)     |
| Decrease in prepaid expenses                                             | 52                                     | 173       |
| Decrease in payables for securities purchased                            | □                                      | (70,000)  |
| Increase in due to Prospect Administration                               | 47                                     | 601       |
| (Decrease) increase in due to Prospect Capital Management                | (133)                                  | 1,054     |
| Increase (decrease) in accrued expenses                                  | 220                                    | (85)      |
| (Decrease) increase in other liabilities                                 | (733)                                  | 640       |
| <b>Net Cash Used In Operating Activities:</b>                            | (25,552)                               | (150,705) |
| <b>Cash Flows from Financing Activities:</b>                             |                                        |           |
| Borrowings under credit facility                                         | 54,500                                 | 184,992   |
| Payments under credit facility                                           | (8,100)                                | (94,325)  |
| Financing costs paid and deferred                                        | (328)                                  | (415)     |
| Net proceeds from issuance of common stock                               | 12,300                                 | 94,230    |
| Offering costs from issuance of common stock                             | (513)                                  | (1,251)   |
| Dividends paid                                                           | (32,413)                               | (15,956)  |
| <b>Net Cash Provided By Financing Activities:</b>                        | 25,446                                 | 167,275   |
| <b>Total (Decrease) Increase in Cash</b>                                 | (106)                                  | 16,570    |
| Cash balance at beginning of period                                      | 555                                    | □         |
| <b>Cash Balance at End of Period</b>                                     | \$ 449                                 | \$ 16,570 |
| <b>Cash Paid For Interest</b>                                            | \$ 4,015                               | \$ 1,825  |
| <b>Non-Cash Financing Activity:</b>                                      |                                        |           |
| Amount of shares issued in connection with dividend reinvestment plan    | \$ 3,280                               | \$ 2,753  |

See notes to consolidated financial statements.

**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS**  
**March 31, 2009 and June 30, 2008**  
**(in thousands, except share data)**

| Portfolio Investments (1)<br>Control Investments (25.00% or greater of voting control)                                                                  | Locale/<br>Industry              | Par<br>Value/<br>Shares<br>Ownership<br>% | March 31, 2009 (unaudited) |                      |   |
|---------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------|-------------------------------------------|----------------------------|----------------------|---|
|                                                                                                                                                         |                                  |                                           | Cost                       | Fair<br>Value<br>(2) | A |
| Ajax Rolled Ring & Machine                                                                                                                              | South Carolina/<br>Manufacturing |                                           |                            |                      |   |
| Unrestricted common shares (7 total unrestricted common shares issued and outstanding and 681.85 restricted common shares issued and outstanding)       |                                  | 6                                         | \$                         | \$                   | 0 |
| Series A convertible preferred shares (7,222.6 total preferred shares issued and outstanding)                                                           |                                  | 6,142.6                                   | 6,057                      | 1,100                | 0 |
| Senior secured note □ Tranche A, 10.50%, 4/01/2013 (4), (28)                                                                                            |                                  | \$ 21,597                                 | 21,597                     | 21,597               | 4 |
| Subordinated secured note □ Tranche B, 11.50% plus 6.00% PIK, 4/01/2013 (4), (29)                                                                       |                                  | \$ 11,500                                 | 11,500                     | 11,500               | 2 |
|                                                                                                                                                         |                                  |                                           | 39,154                     | 34,197               | 7 |
| C&J Cladding LLC (4)                                                                                                                                    | Texas/Metal<br>Services          |                                           |                            |                      |   |
| Warrant, common units, expiring 3/30/2014 (1,000 total company units outstanding)                                                                       |                                  | 400                                       | 580                        | 5,279                | 1 |
| Senior secured note, 14.00%, 3/30/2012 (12)                                                                                                             |                                  | \$ 3,900                                  | 3,434                      | 4,193                | 0 |
|                                                                                                                                                         |                                  |                                           | 4,014                      | 9,472                | 2 |
| Change Clean Energy Holdings, Inc. (□CCEHI□), Worcester Energy Co, Inc. (□WECO□), and Worcester Energy Holdings, Inc. (□WEHI□) (together □Biomass□) (9) | Maine/Biomass<br>Power           |                                           |                            |                      |   |
| CCEHI common shares (1,000 total common shares issued and outstanding)                                                                                  |                                  | 1,000                                     | 6,000                      | 6,000                | 1 |
| WECO common shares (552 total common shares issued and outstanding)                                                                                     |                                  | 282                                       | 1,625                      | □                    | 0 |
| WEHI common shares (100 total common shares issued and outstanding)                                                                                     |                                  | 100                                       | □                          | □                    | 0 |
| Senior secured note, stated rate 12.50% plus 5.00% default interest, in non-accrual status effective 7/01/2008, matures 12/31/2012                      |                                  | \$ 35,599                                 | 35,509                     | □                    | 0 |
|                                                                                                                                                         |                                  |                                           | 43,134                     | 6,000                | 1 |

See notes to consolidated financial statements.

**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)**  
**March 31, 2009 and June 30, 2008**  
**(in thousands, except share data)**

| Portfolio Investments (1)<br>Control Investments (25.00% or greater of voting control)                                                         | Locale/<br>Industry                        | Par<br>Value/<br>Shares<br>Ownership<br>% | March 31, 2009 (unaudited) |                      |
|------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------|-------------------------------------------|----------------------------|----------------------|
|                                                                                                                                                |                                            |                                           | Cost                       | Fair<br>Value<br>(2) |
| Gas Solutions Holdings, Inc. (3)                                                                                                               | Texas/Gas<br>Gathering and<br>Processing   |                                           |                            |                      |
| Common shares (100 total common shares<br>outstanding)                                                                                         |                                            | 100                                       | \$ 5,022                   | \$ 60,186            |
| Senior secured note, 18.00%, 12/22/2018 (4)                                                                                                    |                                            | \$ 25,000                                 | 25,000                     | 25,000               |
|                                                                                                                                                |                                            |                                           | 30,022                     | 85,186               |
| Integrated Contract Services, Inc. (5)                                                                                                         | North Carolina/<br>Contracting             |                                           |                            |                      |
| Common stock (100 total common shares<br>outstanding)                                                                                          |                                            | 49                                        | 717                        | □                    |
| Series A preferred shares (10 total Series A<br>preferred shares outstanding)                                                                  |                                            | 10                                        | □                          | □                    |
| Junior secured note, stated rate 7.00% plus 7.00%<br>PIK plus 6.00% default interest, in non-accrual<br>status effective 10/09/2007, past due  |                                            | \$ 14,003                                 | 14,003                     | 3,030                |
| Senior secured note, stated rate 7.00% plus 7.00%<br>PIK plus 6.00% default Interest, in non-<br>accrual status effective 10/09/2007, past due |                                            | \$ 800                                    | 800                        | 800                  |
| Senior demand note, 15.00%, 6/30/2009 (6)                                                                                                      |                                            | \$ 1,170                                  | 1,170                      | 1,170                |
|                                                                                                                                                |                                            |                                           | 16,690                     | 5,000                |
| Iron Horse Coiled Tubing, Inc.                                                                                                                 | Alberta, Canada/<br>Production<br>Services |                                           |                            |                      |
| Common shares (2,231 total class A<br>common shares outstanding)                                                                               |                                            | 1,781                                     | 268                        | □                    |
| Senior secured note, 15.00%, 4/30/2009                                                                                                         |                                            | \$ 9,250                                  | 9,234                      | 7,163                |
| Bridge Loan, 15.00% plus 3.00%<br>PIK, 4/30/2009                                                                                               |                                            | \$ 9,752                                  | 9,752                      | 9,602                |
|                                                                                                                                                |                                            |                                           | 19,254                     | 16,765               |
| NRG Manufacturing, Inc.                                                                                                                        | Texas/<br>Manufacturing                    |                                           |                            |                      |
| Common shares (1,000 total common shares                                                                                                       |                                            |                                           |                            |                      |

|                                                 |           |        |        |
|-------------------------------------------------|-----------|--------|--------|
| issued and outstanding)                         | 800       | 2,317  | 15,179 |
| Senior secured note, 16.50%, 8/31/2011 (4), (8) | \$ 13,080 | 13,080 | 13,080 |
|                                                 |           | 15,397 | 28,259 |

See notes to consolidated financial statements.

**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY  
CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)  
March 31, 2009 and June 30, 2008  
(in thousands, except share data)**

|                                                                                                                          |                                            | March 31, 2009 (unaudited)                |          |                      |
|--------------------------------------------------------------------------------------------------------------------------|--------------------------------------------|-------------------------------------------|----------|----------------------|
|                                                                                                                          | Locale/<br>Industry                        | Par<br>Value/<br>Shares<br>Ownership<br>% | Cost     | Fair<br>Value<br>(2) |
| <b>Portfolio Investments (1)</b>                                                                                         |                                            |                                           |          |                      |
| <b>Control Investments (25.00% or greater of voting control)</b>                                                         |                                            |                                           |          |                      |
| R-V Industries, Inc.                                                                                                     | Pennsylvania/<br>Manufacturing             |                                           |          |                      |
| Common shares (750,000 total common shares<br>issued and outstanding)                                                    |                                            | 545,107                                   | \$ 5,084 | \$ 6,976             |
| Warrants, common shares, expiring 6/30/2017<br>(200,000 total common shares outstanding)                                 |                                            | 200,000                                   | 1,682    | 2,560                |
|                                                                                                                          |                                            |                                           | 6,766    | 9,536                |
| Yatesville Coal Holdings, Inc. (23)                                                                                      | Kentucky/<br>Mining and Coal<br>Production |                                           |          |                      |
| Common stock (1,000 total common shares<br>outstanding)                                                                  |                                            | 1,000                                     | 422      | □                    |
| Junior secured note, 15.66%, 12/31/2010                                                                                  |                                            | \$ 36,891                                 | 36,891   | 15,848               |
| Senior secured note, 15.66%, 12/31/2010                                                                                  |                                            | \$ 10,000                                 | 10,000   | 10,000               |
|                                                                                                                          |                                            |                                           | 47,313   | 25,848               |
| <b>Total Control Investments</b>                                                                                         |                                            |                                           | 221,744  | 220,263              |
| <b>Affiliate Investments (5% to 24.99% of voting control)</b>                                                            |                                            |                                           |          |                      |
| Appalachian Energy Holdings LLC (10), (4)                                                                                | West Virginia/<br>Construction<br>Services |                                           |          |                      |
| Warrants - Class A common units,<br>expiring 2/13/2016 (64,968 total fully-<br>diluted class A common units outstanding) |                                            | 6,065                                     | 176      | □                    |
| Warrants - Class A common units,<br>expiring 6/17/2018 (64,968 total fully-<br>diluted class A common units outstanding) |                                            | 6,025                                     | 172      | □                    |
| Warrants □ Class A common units,                                                                                         |                                            |                                           |          |                      |

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|                                                                                                                                              |          |       |       |
|----------------------------------------------------------------------------------------------------------------------------------------------|----------|-------|-------|
| expiring 11/30/2018 (64,968 total fully-diluted class A common units outstanding)                                                            | 18,750   |       |       |
| Series A preferred equity (1,075 total series A preferred equity units outstanding)                                                          | 200      | 97    |       |
| Series B preferred equity (794 total series B preferred equity units outstanding)                                                            | 241      | 241   |       |
| Series C preferred equity (375 total series C preferred equity units outstanding)                                                            | 375      | 375   |       |
| 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 | \$ 2,080 | 2,080 | 1,925 |
| Senior Secured Debt Tranche B, 14.00% plus 3.00% PIK plus 3.00% default interest, non-accrual status effective 11/01/2008, matures 5/01/2009 | \$ 2,009 | 2,009 | 558   |
|                                                                                                                                              |          | 5,150 | 2,483 |

See notes to consolidated financial statements.

9

**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY  
CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)  
March 31, 2009 and June 30, 2008  
(in thousands, except share data)**

| Portfolio Investments (1)<br>Affiliate Investments (5.00% to 24.99% of voting control) | Locale/<br>Industry        | Par Value/<br>Shares<br>Ownership<br>% | March 31, 2009 (unaudited) |                |
|----------------------------------------------------------------------------------------|----------------------------|----------------------------------------|----------------------------|----------------|
|                                                                                        |                            |                                        | Cost                       | Fair Value (2) |
| Biotronic NeuroNetwork                                                                 | Michigan/<br>Healthcare    |                                        |                            |                |
| Preferred shares (85,000 total preferred shares outstanding) (26)                      |                            | 9,925.455                              | \$ 2,300                   | \$ 2,272       |
| Senior secured note, 11.50% plus 1.00% PIK, 2/21/2013 (4), (27)                        |                            | \$ 26,095                              | 26,096                     | 26,064         |
|                                                                                        |                            |                                        | 28,396                     | 28,336         |
| <b>Total Affiliate Investments</b>                                                     |                            |                                        | <b>33,546</b>              | <b>30,819</b>  |
| <b>Non-Control/Non-Affiliate Investments (less than 5.00% of voting control)</b>       |                            |                                        |                            |                |
| American Gilsonite Company                                                             | Utah/Specialty<br>Minerals |                                        |                            |                |
| Membership interest units in AGC\PEP, LLC (11)                                         |                            | 99.9999%                               | 1,031                      | 3,366          |
| Senior subordinated note, 12.00% plus 3.00% PIK, 3/14/2013 (4)                         |                            | \$ 14,783                              | 14,783                     | 15,073         |
|                                                                                        |                            |                                        | 15,814                     | 18,439         |

|                                                                |                                  |           |        |       |
|----------------------------------------------------------------|----------------------------------|-----------|--------|-------|
| Castro Cheese Company, Inc. (4)                                | Texas/Food Products              |           |        |       |
| Junior secured note, 11.00% plus 2.00% PIK, 2/28/2013          |                                  | \$ 7,500  | 7,370  | 7,175 |
| Conquest Cherokee, LLC (13), (4)                               | Tennessee/Oil and Gas Production |           |        |       |
| Senior secured note, 13.00%, 5/05/2009 (14)                    |                                  | \$ 10,200 | 10,191 | 8,807 |
| Deb Shops, Inc. (4)                                            | Pennsylvania/Retail              |           |        |       |
| Second lien debt, 9.26%, 10/23/2014 (25)                       |                                  | \$ 15,000 | 14,611 | 5,466 |
| Diamondback Operating, LP (4)                                  | Oklahoma/Oil and Gas Production  |           |        |       |
| Net profit interests, 15% payable on equity distributions (33) |                                  |           |        | 456   |

See notes to consolidated financial statements.

**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY  
CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)  
March 31, 2009 and June 30, 2008  
(in thousands, except share data)**

|                                                                           |                                   |                                        | March 31, 2009 (unaudited) |                      |
|---------------------------------------------------------------------------|-----------------------------------|----------------------------------------|----------------------------|----------------------|
| Portfolio Investments (1)                                                 | Locale/<br>Industry               | Par Value/<br>Shares<br>Ownership<br>% | Cost                       | Fair<br>Value<br>(2) |
| Non-Control/Non-Affiliate Investments (less than 5.00% of voting control) |                                   |                                        |                            |                      |
| Freedom Marine Services LLC (15), (4)                                     | Louisiana/<br>Shipping Vessels    |                                        |                            |                      |
| Subordinated secured note, 12.00%<br>plus 4.00% PIK, 12/31/2011 (17)      |                                   | \$ 7,162                               | \$ 7,081                   | \$ 7,151             |
| H&M Oil & Gas, LLC (15), (4)                                              | Texas/Oil and<br>Gas Production   |                                        |                            |                      |
| Senior secured note, 13.00%, 6/30/2010 (16)                               |                                   | \$ 50,500                              | 50,500                     | 52,804               |
| IEC Systems LP (IEC)/<br>Advanced Rig Services LLC (ARS) (4)              | Texas/<br>Oilfield<br>Fabrication |                                        |                            |                      |
| IEC senior secured note, 12.00% plus 3.00%<br>PIK, 11/20/2012 (30)        |                                   | \$ 22,011                              | 22,011                     | 22,890               |
| ARS senior secured note, 12.00% plus 3.00%                                |                                   |                                        |                            |                      |

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|                                                                                                            |                                         |           |        |        |
|------------------------------------------------------------------------------------------------------------|-----------------------------------------|-----------|--------|--------|
| PIK, 11/20/2012 (30)                                                                                       |                                         | \$ 13,189 | 13,189 | 13,625 |
|                                                                                                            |                                         |           | 35,200 | 36,515 |
| Maverick Healthcare, LLC (4)                                                                               | Arizona/<br>Healthcare                  |           |        |        |
| Common units (79,000,000 total class A common units outstanding)                                           |                                         | 1,250,000 | □      | □      |
| Preferred units (79,000,000 total preferred units outstanding)                                             |                                         | 1,250,000 | 1,252  | 1,333  |
| Second lien debt, 12.00% plus 1.50% PIK, 4/30/2014                                                         |                                         | \$ 12,643 | 12,643 | 12,823 |
|                                                                                                            |                                         |           | 13,895 | 14,156 |
| Miller Petroleum, Inc.                                                                                     | Tennessee/<br>Oil and Gas<br>Production |           |        |        |
| Warrants, common shares, expiring 5/04/2010 to 3/31/2014 (15,616,856 total common shares outstanding) (32) |                                         | 1,844,440 | 150    | 175    |
| Peerless Manufacturing Co. (4)                                                                             | Texas/<br>Manufacturing                 |           |        |        |
| Subordinated secured note, 11.50% plus 3.50% PIK, 4/29/2013                                                |                                         | \$ 20,000 | 20,000 | 20,000 |

See notes to consolidated financial statements.

**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY  
CONSOLIDATED SCHEDULE OF INVESTMENTS □ (CONTINUED)  
March 31, 2009 and June 30, 2008  
(in thousands, except share data)**

|                                                                                  |                                       | March 31, 2009 (unaudited)                |           |                      |              |
|----------------------------------------------------------------------------------|---------------------------------------|-------------------------------------------|-----------|----------------------|--------------|
| Portfolio Investments (1)                                                        | Locale/<br>Industry                   | Par<br>Value/<br>Shares<br>Ownership<br>% | Cost      | Fair<br>Value<br>(2) | %<br>N<br>As |
| <b>Non-Control/Non-Affiliate Investments (less than 5.00% of voting control)</b> |                                       |                                           |           |                      |              |
| Qualitest Pharmaceuticals, Inc. (4)                                              | Alabama/<br>Pharmaceuticals           |                                           |           |                      |              |
| Second lien debt, 8.96%, 4/30/2015 (18)                                          |                                       | \$ 12,000                                 | \$ 11,948 | \$ 10,250            | 2.           |
| Regional Management Corp. (4)                                                    | South Carolina/<br>Financial Services |                                           |           |                      |              |
| Second lien debt, 12.00% plus 2.00% PIK, 6/29/2012                               |                                       | \$ 25,296                                 | 25,296    | 21,839               | 4.           |

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|                                                                                                          |                                        |           |        |        |    |
|----------------------------------------------------------------------------------------------------------|----------------------------------------|-----------|--------|--------|----|
| Resco Products, Inc. (4)                                                                                 | Pennsylvania/<br>Manufacturing         |           |        |        |    |
| Second lien debt, 10.20%, 6/22/2014 (19)                                                                 |                                        | \$ 9,750  | 9,588  | 8,692  | 2. |
| Shearer's Foods, Inc.                                                                                    | Ohio/<br>Food Products                 |           |        |        |    |
| Membership interest units in Mistral Chip Holdings, LLC (45,300 total membership units outstanding) (24) |                                        | 2,000     | 2,000  | 4,210  | 0. |
| Second lien debt, 14.00%, 10/31/2013 (4)                                                                 |                                        | \$ 18,000 | 18,000 | 18,000 | 4. |
|                                                                                                          |                                        |           | 20,000 | 22,210 | 5. |
| Stryker Energy, LLC (20), (4)                                                                            | Ohio/<br>Oil and Gas<br>Production     |           |        |        |    |
| Subordinated secured revolving credit facility, 12.00%, 12/01/2011 (21)                                  |                                        | \$ 29,500 | 29,124 | 30,725 | 6. |
| TriZetto Group                                                                                           | California/<br>Healthcare              |           |        |        |    |
| Subordinated unsecured note, 12.00% plus 1.50% PIK, 10/01/2016 (4)                                       |                                        | \$ 15,036 | 14,893 | 15,095 | 3. |
| Unitek (4)                                                                                               | Pennsylvania/<br>Technical<br>Services |           |        |        |    |
| Second lien debt, 13.08%, 12/31/2013 (22)                                                                |                                        | \$ 11,500 | 11,355 | 11,500 | 2. |

See notes to consolidated financial statements.

12

**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY  
CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)  
March 31, 2009 and June 30, 2008  
(in thousands, except share data)**

| Portfolio Investments (1)<br>Non-Control/Non-Affiliate Investments (less than 5.00% of voting control)                                  | Locale/<br>Industry                | Par Value/<br>Shares<br>Ownership % | March 31, 2009 (unaudited) |                |           |
|-----------------------------------------------------------------------------------------------------------------------------------------|------------------------------------|-------------------------------------|----------------------------|----------------|-----------|
|                                                                                                                                         |                                    |                                     | Cost                       | Fair Value (2) | % N Ass   |
| Wind River Resources Corp. and Wind River II Corp. (4), (15)                                                                            | Utah/<br>Oil and Gas<br>Production |                                     |                            |                |           |
| Senior secured note, stated rate 13.00% plus 3.00% default interest, in non-accrual status effective 12/01/2008, matures 7/31/2010 (31) |                                    | \$ 15,000                           | \$ 15,000                  | \$ 12,504      | 2         |
| <b>Total Non-Control/Non-Affiliate Investments</b>                                                                                      |                                    |                                     | <b>312,016</b>             | <b>303,959</b> | <b>68</b> |

|                                                                                   |            |            |            |     |
|-----------------------------------------------------------------------------------|------------|------------|------------|-----|
| <b>Total Portfolio Investments</b>                                                |            | 567,306    | 555,041    | 125 |
| <b>Money Market Funds</b>                                                         |            |            |            |     |
| Fidelity Institutional Money Market Funds -<br>Government Portfolio (Class I)     | 36,875,316 | 36,876     | 36,876     | 8   |
| Fidelity Institutional Money Market Funds -<br>Government Portfolio (Class I) (4) | 2,378,260  | 2,378      | 2,378      | 0   |
| <b>Total Money Market Funds</b>                                                   |            | 39,254     | 39,254     | 8   |
| <b>Total Investments</b>                                                          |            | \$ 606,560 | \$ 594,295 | 133 |

See notes to consolidated financial statements.

13

**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY  
CONSOLIDATED SCHEDULE OF INVESTMENTS □ (CONTINUED)  
March 31, 2009 and June 30, 2008  
(in thousands, except share data)**

| Portfolio Investments (1)<br>Control Investments (25.00% or greater of voting control)                                                                     | Locale/<br>Industry              | Par<br>Value/<br>Shares<br>Ownership<br>% | June 30, 2008 (audited) |                      |                       |
|------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------|-------------------------------------------|-------------------------|----------------------|-----------------------|
|                                                                                                                                                            |                                  |                                           | Cost                    | Fair<br>Value<br>(2) | % of<br>Net<br>Assets |
| Ajax Rolled Ring & Machine                                                                                                                                 | South Carolina/<br>Manufacturing |                                           |                         |                      |                       |
| Unrestricted common shares (7 total<br>unrestricted common shares issued and<br>outstanding and 803.18 restricted common<br>shares issued and outstanding) |                                  | 6                                         | \$ □                    | \$ □                 | 0.0%                  |
| Series A convertible preferred shares<br>(7,222.6 total preferred shares issued<br>and outstanding)                                                        |                                  | 6,142.6                                   | 6,293                   | 6,293                | 1.5%                  |
| Senior secured note □ Tranche A, 10.50%,<br>4/01/2013 (4)                                                                                                  |                                  | \$ 21,890                                 | 21,890                  | 21,890               | 5.1%                  |
| Subordinated secured note □ Tranche B, 11.50%<br>plus 6.00% PIK, 4/01/2013 (4)                                                                             |                                  | \$ 11,500                                 | 11,500                  | 11,500               | 2.6%                  |
|                                                                                                                                                            |                                  |                                           | 39,683                  | 39,683               | 9.2%                  |
| C&J Cladding LLC (4)                                                                                                                                       | Texas/<br>Metal Services         |                                           |                         |                      |                       |
| Warrants, common units, expiring 3/30/2014<br>(600 total company units outstanding)                                                                        |                                  | 400                                       | 580                     | 2,222                | 0.5%                  |
| Senior secured note, 14.00%, 3/30/2012 (12)                                                                                                                |                                  | \$ 4,800                                  | 4,085                   | 4,607                | 1.1%                  |
|                                                                                                                                                            |                                  |                                           | 4,665                   | 6,829                | 1.6%                  |
| Gas Solutions Holdings, Inc. (3)                                                                                                                           | Texas/                           |                                           |                         |                      |                       |

Gas Gathering and  
Processing

|                                                     |           |        |        |       |
|-----------------------------------------------------|-----------|--------|--------|-------|
| Common shares (100 total common shares outstanding) | 100       | 5,221  | 41,542 | 9.7%  |
| Subordinated secured note, 18.00%, 12/22/2009 (4)   | \$ 20,000 | 20,000 | 20,000 | 4.7%  |
|                                                     |           | 25,221 | 61,542 | 14.4% |

See notes to consolidated financial statements.

14

**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY  
CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)  
March 31, 2009 and June 30, 2008  
(in thousands, except share data)**

| Portfolio Investments (1)<br>Control Investments (25.00% or greater of voting control)                       | Locale/<br>Industry                        | Par<br>Value/<br>Shares<br>Ownership<br>% | June 30, 2008 (audited) |                      |                       |
|--------------------------------------------------------------------------------------------------------------|--------------------------------------------|-------------------------------------------|-------------------------|----------------------|-----------------------|
|                                                                                                              |                                            |                                           | Cost                    | Fair<br>Value<br>(2) | % of<br>Net<br>Assets |
| Integrated Contract Services, Inc. (5)                                                                       | North Carolina/<br>Contracting             |                                           |                         |                      |                       |
| Common stock (100 total common shares outstanding)                                                           |                                            | 49                                        | \$ 491                  | \$                   | 0.0%                  |
| Series A preferred shares (10 total Series A preferred shares outstanding)                                   |                                            | 10                                        |                         |                      | 0.0%                  |
| Junior secured note, stated rate 7.00% plus 7.00% PIK, in non-accrual status effective 10/09/2007, 9/30/2010 |                                            | \$ 14,003                                 | 14,003                  | 3,030                | 0.7%                  |
| Senior secured note, stated rate 7.00% plus 7.00% PIK, in non-accrual status effective 10/09/2007, 9/30/2010 |                                            | \$ 800                                    | 800                     | 800                  | 0.2%                  |
| Senior demand note, 15.00%, 6/30/2009 (6)                                                                    |                                            | \$ 1,170                                  | 1,170                   | 1,170                | 0.3%                  |
|                                                                                                              |                                            |                                           | 16,464                  | 5,000                | 1.2%                  |
| Iron Horse Coiled Tubing, Inc.                                                                               | Alberta, Canada/<br>Production<br>Services |                                           |                         |                      |                       |
| Common shares (1,093 total common shares outstanding)                                                        |                                            | 643                                       | 268                     | 49                   | 0.0%                  |
| Warrants for common shares (7)                                                                               |                                            | 1,138                                     |                         |                      | 0.0%                  |
| Senior secured note, 15.00%, 4/19/2009                                                                       |                                            | \$ 9,250                                  | 9,094                   | 9,073                | 2.1%                  |
| Bridge Loan, 15.00% plus 3.00% PIK, 12/11/2008                                                               |                                            | \$ 2,103                                  | 2,103                   | 2,060                | 0.5%                  |
|                                                                                                              |                                            |                                           | 11,465                  | 11,182               | 2.6%                  |

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|                                                                  |                         |           |        |        |      |
|------------------------------------------------------------------|-------------------------|-----------|--------|--------|------|
| NRG Manufacturing, Inc.                                          | Texas/<br>Manufacturing |           |        |        |      |
| Common shares (1,000 total common shares issued and outstanding) |                         | 800       | 2,317  | 8,656  | 2.0% |
| Senior secured note, 16.50%, 8/31/2011 (4), (8)                  |                         | \$ 13,080 | 13,080 | 13,080 | 3.0% |
|                                                                  |                         |           | 15,397 | 21,736 | 5.0% |

|                                                                    |                                |          |        |        |      |
|--------------------------------------------------------------------|--------------------------------|----------|--------|--------|------|
| R-V Industries, Inc.                                               | Pennsylvania/<br>Manufacturing |          |        |        |      |
| Common shares (800,000 total common shares issued and outstanding) |                                | 545,107  | 5,031  | 8,064  | 1.9% |
| Warrants, common shares, expiring 6/30/2017                        |                                | 200,000  | 1,682  | 2,959  | 0.7% |
| Senior secured note, 15.00%, 6/30/2017 (4)                         |                                | \$ 7,526 | 5,912  | 7,526  | 1.8% |
|                                                                    |                                |          | 12,625 | 18,549 | 4.4% |

See notes to consolidated financial statements.

15

**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY  
CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)  
March 31, 2009 and June 30, 2008  
(in thousands, except share data)**

|                                                                  |                                            | June 30, 2008 (audited)                   |         |                      |                      |
|------------------------------------------------------------------|--------------------------------------------|-------------------------------------------|---------|----------------------|----------------------|
|                                                                  | Locale/<br>Industry                        | Par<br>Value/<br>Shares<br>Ownership<br>% | Cost    | Fair<br>Value<br>(2) | % of<br>Net<br>Asset |
| <b>Portfolio Investments (1)</b>                                 |                                            |                                           |         |                      |                      |
| <b>Control Investments (25.00% or greater of voting control)</b> |                                            |                                           |         |                      |                      |
| Worcester Energy Partners, Inc. (9)                              | Maine/<br>Biomass Power                    |                                           |         |                      |                      |
| Equity ownership                                                 |                                            | □                                         | \$ 457  | \$ 1                 | 0.                   |
| Senior secured note, 12.50%, 12/31/2012                          |                                            | \$ 37,388                                 | 37,264  | 15,579               | 3.                   |
|                                                                  |                                            |                                           | 37,721  | 15,580               | 3.                   |
| Yatesville Coal Holdings, Inc. (23)                              | Kentucky/<br>Mining and Coal<br>Production |                                           |         |                      |                      |
| Common stock (1,000 total common shares outstanding)             |                                            | 1,000                                     | 284     | □                    | 0.                   |
| Junior secured note, 15.43%, 12/31/2010                          |                                            | \$ 30,136                                 | 30,136  | 15,726               | 3.                   |
| Senior secured note, 15.43%, 12/31/2010                          |                                            | \$ 10,000                                 | 10,000  | 10,000               | 2.                   |
|                                                                  |                                            |                                           | 40,420  | 25,726               | 6.                   |
| <b>Total Control Investments</b>                                 |                                            |                                           | 203,661 | 205,827              | 48.                  |
| <b>Affiliate Investments (5.00% to 24.99% of voting control)</b> |                                            |                                           |         |                      |                      |

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|                                                                                                     |                                            |          |       |       |    |
|-----------------------------------------------------------------------------------------------------|--------------------------------------------|----------|-------|-------|----|
| Appalachian Energy Holdings LLC (10), (4)                                                           | West Virginia/<br>Construction<br>Services |          |       |       |    |
| Warrants - Class A common units, expiring 2/13/2016 (49,753 total class A common units outstanding) |                                            | 12,090   | 348   | 794   | 0. |
| Series A preferred equity (16,125 total series A preferred equity units outstanding)                |                                            | 3,000    | 72    | 162   | 0. |
| Series B preferred equity (794 total series B preferred equity units outstanding)                   |                                            | 241      | 241   | □     | 0. |
| Senior Secured Debt Tranche A, 14.00% plus 3.00% PIK, 1/31/2011                                     |                                            | \$ 3,003 | 3,003 | 3,003 | 0. |
| Senior Secured Debt Tranche B, 14.00% plus 3.00% PIK, 5/01/2009                                     |                                            | \$ 1,945 | 1,945 | 2,084 | 0. |
|                                                                                                     |                                            |          | 5,609 | 6,043 | 1. |
| <b>Total Affiliate Investments</b>                                                                  |                                            |          | 5,609 | 6,043 | 1. |

See notes to consolidated financial statements.

16

**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY  
CONSOLIDATED SCHEDULE OF INVESTMENTS □ (CONTINUED)  
March 31, 2009 and June 30, 2008  
(in thousands, except share data)**

| Portfolio Investments (1)<br>Non-Control/Non-Affiliate Investments (less than 5.00% of voting control) | Locale/<br>Industry                 | Par Value/<br>Shares<br>Ownership<br>% | June 30, 2008 (audited) |                      |               |
|--------------------------------------------------------------------------------------------------------|-------------------------------------|----------------------------------------|-------------------------|----------------------|---------------|
|                                                                                                        |                                     |                                        | Cost                    | Fair<br>Value<br>(2) | %<br>N<br>Ass |
| American Gilsonite Company                                                                             | Utah/Specialty<br>Minerals          |                                        |                         |                      |               |
| Membership interest in AGC\PEP, LLC (11)                                                               |                                     | 99.9999%                               | \$ 1,000                | \$ 1,000             |               |
| Subordinated secured note, 12.00% plus 3.00% PIK, 3/14/2013 (4)                                        |                                     | \$ 14,632                              | 14,632                  | 14,632               |               |
|                                                                                                        |                                     |                                        | 15,632                  | 15,632               |               |
| Conquest Cherokee, LLC (13), (4)                                                                       | Tennessee/Oil and<br>Gas Production |                                        |                         |                      |               |
| Senior secured note, 13.00%, 5/05/2009 (14)                                                            |                                     | \$ 10,200                              | 10,125                  | 9,923                |               |
| Deb Shops, Inc. (4)                                                                                    | Pennsylvania/<br>Retail             |                                        |                         |                      |               |
| Second lien debt, 10.69%, 10/23/2014 (25)                                                              |                                     | \$ 15,000                              | 14,577                  | 13,428               |               |
| Deep Down, Inc. (4)                                                                                    | Texas/<br>Production<br>Services    |                                        |                         |                      |               |
| Warrant, common shares, expiring 8/06/2012 (174,732,501 total common                                   |                                     |                                        |                         |                      |               |

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|                                                                      |                                        |           |        |        |
|----------------------------------------------------------------------|----------------------------------------|-----------|--------|--------|
| shares outstanding)                                                  |                                        | 4,960,585 |        | 2,856  |
| Diamondback Operating, LP (15), (4)                                  | Oklahoma/<br>Oil and Gas<br>Production |           |        |        |
| Senior secured note, 12.00% plus 2.00%<br>PIK, 8/28/2011             |                                        | \$ 9,200  | 9,200  | 9,108  |
| Freedom Marine Services LLC (15), (4)                                | Louisiana/<br>Shipping Vessels         |           |        |        |
| Subordinated secured note, 12.00% plus 4.00%<br>PIK, 12/31/2011 (17) |                                        | \$ 6,948  | 6,850  | 6,805  |
| H&M Oil & Gas, LLC (15), (4)                                         | Texas/<br>Oil and Gas<br>Production    |           |        |        |
| Senior secured note, 13.00%, 6/30/2010 (16)                          |                                        | \$ 50,500 | 50,500 | 50,500 |
| IEC Systems LP (IEC)/<br>Advanced Rig Services LLC (ARS) (4)         | Texas/<br>Oilfield<br>Fabrication      |           |        |        |
| IEC senior secured note, 12.00% plus 3.00%<br>PIK, 11/20/2012        |                                        | \$ 19,028 | 19,028 | 19,028 |
| ARS senior secured note, 12.00% plus 3.00%<br>PIK, 11/20/2012        |                                        | \$ 5,825  | 5,825  | 5,825  |
|                                                                      |                                        |           | 24,853 | 24,853 |
| See notes to consolidated financial statements.                      |                                        |           |        |        |

17

**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY  
CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)  
March 31, 2009 and June 30, 2008  
(in thousands, except share data)**

| Portfolio Investments (1)<br>Non-Control/Non-Affiliate Investments (less than 5.00% of voting control) | Locale/<br>Industry                     | Par Value/<br>Shares<br>Ownership<br>% | June 30, 2008 (audited) |                      |                       |
|--------------------------------------------------------------------------------------------------------|-----------------------------------------|----------------------------------------|-------------------------|----------------------|-----------------------|
|                                                                                                        |                                         |                                        | Cost                    | Fair<br>Value<br>(2) | % of<br>Net<br>Assets |
| Maverick Healthcare, LLC (4)                                                                           | Arizona/<br>Healthcare                  |                                        |                         |                      |                       |
| Common units (78,100,000 total common<br>units outstanding)                                            |                                         | 1,250,000                              | \$                      | \$                   | 0.                    |
| Preferred units (78,100,000 total preferred<br>units outstanding)                                      |                                         | 1,250,000                              | 1,252                   | 1,252                | 0.                    |
| Second lien debt, 12.00% plus 1.50%<br>PIK, 4/30/2014                                                  |                                         | \$ 12,500                              | 12,500                  | 12,500               | 2.                    |
|                                                                                                        |                                         |                                        | 13,752                  | 13,752               | 3.                    |
| Miller Petroleum, Inc.                                                                                 | Tennessee/<br>Oil and Gas<br>Production |                                        |                         |                      |                       |
| Warrants, common shares, expiring 5/04/2010                                                            |                                         |                                        |                         |                      |                       |

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|                                                                                                       |                                          |           |        |        |    |
|-------------------------------------------------------------------------------------------------------|------------------------------------------|-----------|--------|--------|----|
| to 3/31/2013 (14,566,856 total common shares outstanding)                                             |                                          | 1,571,191 | 150    | 111    | 0. |
| Peerless Manufacturing Co. (4)                                                                        | Texas/<br>Manufacturing                  |           |        |        |    |
| Subordinated secured note, 11.50% plus 3.50% PIK, 4/29/2013                                           |                                          | \$ 20,000 | 20,000 | 20,000 | 4. |
| Qualitest Pharmaceuticals, Inc. (4)                                                                   | Alabama/<br>Pharmaceuticals              |           |        |        |    |
| Second lien debt, 12.45% (18), 4/30/2015                                                              |                                          | \$ 12,000 | 11,944 | 11,523 | 2. |
| Regional Management Corp. (4)                                                                         | South Carolina/<br>Financial<br>Services |           |        |        |    |
| Subordinated secured note, 12.00% plus 2.00% PIK, 6/29/2012                                           |                                          | \$ 25,000 | 25,000 | 23,699 | 5. |
| Resco Products, Inc. (4)                                                                              | Pennsylvania/<br>Manufacturing           |           |        |        |    |
| Second lien debt, 11.06% (19), 6/24/2014                                                              |                                          | \$ 9,750  | 9,574  | 9,574  | 2. |
| Shearer's Foods, Inc.                                                                                 | Ohio/<br>Food Products                   |           |        |        |    |
| Membership interest units Mistral Chip Holdings, LLC (45,300 total membership units outstanding) (24) |                                          | 2,000     | 2,000  | 2,000  | 0. |
| Second lien debt, 14.00%, 10/31/2013 (4)                                                              |                                          | \$ 18,000 | 18,000 | 17,351 | 4. |
|                                                                                                       |                                          |           | 20,000 | 19,351 | 4. |
| See notes to consolidated financial statements.                                                       |                                          |           |        |        |    |

18

**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY  
CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)  
March 31, 2009 and June 30, 2008  
(in thousands, except share data)**

|                                                                            |                                        | June 30, 2008 (audited)             |           |                      |               |
|----------------------------------------------------------------------------|----------------------------------------|-------------------------------------|-----------|----------------------|---------------|
| Portfolio Investments (1)                                                  | Locale/<br>Industry                    | Par Value/<br>Shares<br>Ownership % | Cost      | Fair<br>Value<br>(2) | %<br>N<br>Ass |
| Non-Control/Non-Affiliate Investments (less than 5.00% of voting control)  |                                        |                                     |           |                      |               |
| Stryker Energy, LLC (20), (4)                                              | Ohio/<br>Oil and Gas<br>Production     |                                     |           |                      |               |
| Subordinated secured revolving credit facility,<br>12.00%, 11/30/2011 (21) |                                        | \$ 29,500                           | \$ 29,041 | \$ 28,518            | 6.            |
| Unitek (4)                                                                 | Pennsylvania/<br>Technical<br>Services |                                     |           |                      |               |
| Second lien debt, 12.75% (22), 12/27/2012                                  |                                        | \$ 11,500                           | 11,337    | 11,337               | 2.            |

|                                                                              |                                |    |            |            |            |
|------------------------------------------------------------------------------|--------------------------------|----|------------|------------|------------|
| Wind River Resources Corp. and<br>Wind River II Corp. (4)                    | Utah/Oil and Gas<br>Production |    |            |            |            |
| Senior secured note, 13.00%, 7/31/2010                                       |                                | \$ | 15,000     | 15,000     | 14,690     |
| <b>Total Non-Control/Non-Affiliate Investments</b>                           |                                |    |            | 287,535    | 285,660    |
| <b>Total Portfolio Investments</b>                                           |                                |    |            | 496,805    | 497,530    |
| <b>Money Market Funds</b>                                                    |                                |    |            |            |            |
| Fidelity Institutional Money Market Funds-<br>Government Portfolio (Class I) |                                |    | 25,954,531 | 25,954     | 25,954     |
| First American Funds, Inc.- Prime<br>Obligations Fund (Class A) (4)          |                                |    | 7,045,610  | 7,046      | 7,046      |
| <b>Total Money Market Funds</b>                                              |                                |    |            | 33,000     | 33,000     |
| <b>Total Investments</b>                                                     |                                |    |            | \$ 529,805 | \$ 530,530 |

See notes to consolidated financial statements.

**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY  
CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)  
March 31, 2009 and June 30, 2008  
(in thousands, except share data)**

**Endnote Explanations for the Consolidated Schedule of Investments as of March 31, 2009 and June 30, 2008**

- (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) Gas Solutions Holdings, Inc. is a wholly-owned investment of us.
- (4) 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 March 31, 2009 and June 30, 2008 were \$405,404 and \$369,418, respectively; they represent 73.0% and 74.3% of total investments at fair value, respectively.
- (5) 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 ICS purchased during the foreclosure process.

- (6) Loan is with The Healing Staff (f/k/a Lisamarie Fallon, Inc) and affiliate of Integrated Contract Services, Inc.
- (7) The number of these warrants which are exercisable is contingent upon the length of time that passes before the bridge loan is repaid, 224 shares on August 11, 2008, 340 additional shares on October 11, 2008 and 574 additional shares on December 11, 2008.
- (8) Interest rate is the greater of 16.5% or 12-Month LIBOR plus 11.0%; rate reflected is as of the reporting date - March 31, 2009 or June 30, 2008, as applicable.
- (9) 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, 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. (CCEH) and DownEast Power Company, LLC (DEPC). We own 1,000 shares of CCEH, 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 LLC are joint borrowers on the term note issued to Prospect Capital. Effective July 1, 2008, this loan was placed on non-accrual status.
- Biochips LLC, WECO, CCEI, Precision, WEHI and CCEH currently have no material operations. As of March 31, 2009, our Board of Directors assessed a fair value of \$0 for all of these equity positions and the loan position.

See notes to consolidated financial statements.

**Endnote Explanations for the Consolidated Schedule of Investments as of March 31, 2009 and June 30, 2008 (continued)**

- (10) 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 15,215 units of 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 62.5 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.
- (11) We own 99.9999% of AGC/PEP, LLC. AGC/PEP, LLC owns 2,038 out of a total of 65,232 shares of American Gilsonite Holding Company which owns 100% of American Gilsonite Company.
- (12) Interest rate is the greater of 14.0% or 12-Month LIBOR plus 7.5%; rate reflected is as of the reporting date - March 31, 2009 or June 30, 2008, as applicable.
- (13) In addition to the stated returns, we also hold overriding royalty interests on which we receive payment based upon operations of the borrower and net profit interests which will be realized upon sale of the borrower or a sale of the interests.
- (14) 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 - March 31, 2009 or June 30, 2008, as applicable.
- (15) In addition to the stated returns, we also hold net profit interests which will be realized upon sale of the borrower or a sale of the interests.
- (16) Interest rate is the greater of 13.0% or 12-Month LIBOR plus 7.5%; rate reflected is as of the reporting date - March 31, 2009 or June 30, 2008, as applicable.
- (17) Interest rate is the greater of 12.0% or 3-Month LIBOR plus 6.11%; rate reflected is as of the reporting date - March 31, 2009 or June 30, 2008, as applicable.
- (18) Interest rate is 3-Month LIBOR plus 7.5%; rate reflected is as of the reporting date - March 31, 2009 or June 30, 2008, as applicable.
- (19) Interest rate is 3-Month LIBOR plus 8.0%; rate reflected is as of the reporting date - March 31, 2009 or June 30, 2008, as applicable.
- (20) In addition to the stated returns, we also hold overriding royalty interests on which we receive payment based upon operations of the borrower.
- (21) Interest rate is the greater of 12.0% or 12-Month LIBOR plus 7.0%; rate reflected is as of the reporting date - March 31, 2009 or June 30, 2008, as applicable.
- (22) As of March 31, 2009 and June 30, 2008, interest rate is the greater of 13.08% and 12.75%, respectively, or 3-Month LIBOR plus 7.25%; rate reflected is as of the reporting date □ March 31, 2009 or June 30, 2008, as applicable.

- (23) 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.
- See notes to consolidated financial statements.

21

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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY  
CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)  
March 31, 2009 and June 30, 2008  
(in thousands, except share data)**

**Endnote Explanations for the Consolidated Schedule of Investments as of March 31, 2009 and June 30, 2008 (continued)**

- At March 31, 2009 and at June 30, 2008, Yatesville owned 100% of the membership interest of North Fork. In addition, Yatesville held a \$5,984 and \$5,721, respectively, note receivable from North Fork as of those two respective dates.
- At March 31, 2009 and at June 30, 2008, Yatesville owned 81% and 75%, respectively, of the common stock of Genesis and held a note receivable of \$19,802 and \$17,692, respectively, as of those two respective dates.
- Yatesville held a note receivable of \$4,078 and \$3,902, respectively, from Unity at March 31, 2009 and at June 30, 2008.
- There are several entities involved in Yatesville's investment in Whymore at March 31, 2009 and at June 30, 2008. As of those two respective dates, Yatesville owned 10,000 shares of common stock or 100% of the equity and held a \$13,805 and \$12,822, respectively, 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 owns 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. Additionally, Yatesville retains an option to purchase the remaining 51% of Whymore. Whymore and E&L are guarantors under the C&A credit agreement with Yatesville.
- (24) 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.
- (25) Interest rate is 3-Month LIBOR plus 8.0%; rate reflected is as of the reporting date - March 31, 2009 or June 30, 2008, as applicable.

- (26) On a fully diluted basis represents, 11.677% of voting common shares.
- (27) Interest rate is the greater of 11.5% or 6-month LIBOR plus 7.0%; rate reflected is as of the reporting date - March 31, 2009 or June 30, 2008, as applicable.
- (28) Interest rate is the greater of 10.5% or 3-month LIBOR plus 7.5%; rate reflected is as of the reporting date - March 31, 2009 or June 30, 2008, as applicable.
- (29) Interest rate is the greater of 11.5% or 3-month LIBOR plus 8.5%; rate reflected is as of the reporting date - March 31, 2009 or June 30, 2008, as applicable.
- (30) Interest rate is the greater of 12.0% or 12-month LIBOR plus 6.0%; rate reflected is as of the reporting date - March 31, 2009 or June 30, 2008, as applicable.
- (31) 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 - March 31, 2009 or June 30, 2008, as applicable.
- (32) Total common shares outstanding of 15,616,856 as of January 31, 2009 from Miller Petroleum, Inc.'s Quarterly Report on Form 10-Q filed on March 16, 2009.
- (33) In January 2009, our loan was repaid in full and we retained a 15% net profits interest payable on equity distributions.
- See notes to consolidated financial statements.

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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
March 31, 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*

These interim financial statements, which are not audited, have been prepared in conformity 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.

### *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.

23

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### *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;
- 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 Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" ("FAS 157"). FAS 157 defines fair value, establishes a framework for measuring fair value in GAAP and expands disclosures about fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods

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within those years. We have adopted this statement on a prospective basis beginning in the quarter ended September 30, 2008. Adoption of this statement did not have a material effect on our financial statements for the quarters ended September 30, 2008, and December 31, 2008, or for the current quarter ended March 31, 2009.

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

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

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

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

In all cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to each investment. The changes to GAAP from the application of FAS 157 relate to the definition of fair value, framework for measuring fair value, and the expanded disclosures about fair value measurements. FAS 157 applies to fair value measurements already required or permitted by other standards. In accordance with FAS 157, the fair value of our investments is defined as the price that we would receive upon selling an investment in an orderly transaction to an independent buyer in the principal or most advantageous market in which that investment is transacted.

In April 2009, FASB issued Staff Position No. 157-4, "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" (157-4). 157-4 provides further clarification for the application of FAS 157 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. 157-4 is effective for interim and annual reporting periods ending after June 15, 2009. Since 157-4 does not change the fair value measurement principles set forth in FAS 157, we are considering its adoption and estimate that it will not affect the our financial position or results of operations.

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

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

#### *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.

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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 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. During the quarter ended December 31, 2008, we elected to retain a portion of our annual taxable income and paid \$533 for the excise tax with the filing of the return in March 2009.

We adopted Financial Accounting Standards Board Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 provides guidance for how uncertain tax positions should be recognized, measured, presented, and disclosed in the financial statements. FIN 48 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 FIN 48 was applied to all open tax years as of July 1, 2007. The adoption of FIN 48 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 March 31, 2009 and for the three and nine months then ended, we did not have a liability for any unrecognized tax benefits. Management's determinations regarding FIN 48 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 straight-line 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, legal and accounting fees incurred through March 31, 2009 that are related to the shelf filings that will be charged to capital upon the receipt of the capital or charged to expense if not completed.

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#### *Guarantees and Indemnification Agreements*

We follow FASB Interpretation Number 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (FIN 45). FIN 45 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 FIN 45, the fair value of the obligation undertaken in issuing certain guarantees. FIN 45 did not have a material effect on the financial statements. Refer to Note 7 and Note 10 for further discussion of guarantees and indemnification agreements.

#### *Per Share Information*

Net increase 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 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 and nine months ended March 31, 2009.

*Recent Accounting Pronouncements*

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, "Disclosures about Derivative Instruments and Hedging Activities" an amendment of FASB Statement No. 133 ("FAS 161"). FAS 161 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. FAS 161 becomes effective for fiscal years beginning after November 15, 2008; therefore, is applicable for our fiscal year beginning July 1, 2009. Our management does not believe that the adoption of FAS 161 will have a material impact on our financial statements.

In March 2008, the FASB issued Statement of Financial Accounting Standards No.162, "The Hierarchy of Generally Accepted Accounting Principles" ("FAS 162"). FAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with GAAP. This statement is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. Our management does not believe that the adoption of FAS 162 will have a material impact on our financial statements.

**Note 3. Portfolio Investments**

At March 31, 2009, we had \$555,041 invested in 31 long-term portfolio investments (including a net profits interest in Charlevoix Energy Trading LLC) and at June 30, 2008, we had \$497,530 invested in 29 long-term portfolio investments (including a net profits interest in Charlevoix Energy Trading LLC).

As of March 31, 2009, we own controlling interests in Ajax Rolled Ring & Machine ("Ajax"), C&J Cladding, LLC ("C&J"), Change Clean Energy Holdings, Inc. ("CCEHI"), Worcester Energy Co, Inc. ("WECO"), and Worcester Energy Holdings, Inc. ("WEHI") (collectively "Biomass"), Gas Solutions Holdings, Inc. ("GSHI"), Integrated Contract Services, Inc. ("Integrated"), Iron Horse Coiled Tubing, Inc. ("Iron Horse"), NRG Manufacturing, Inc. ("NRG"), R-V Industries, Inc. ("R-V") and Yatesville Coal Holdings, Inc. ("Yatesville"). As of March 31, 2009, we also own affiliated interests in Appalachian Energy Holdings, LLC ("AEH") and Biotronic NeuroNetwork ("Biotronic"). As of June 30, 2008, we owned controlling interests in Ajax, C&J, Worcester Energy Partners, Inc., GSHI, Integrated, Iron Horse, NRG, R-V, and Yatesville. As of June 30, 2008, we also owned an affiliated interest in AEH.

27

The fair values of our portfolio investments as of March 31, 2009 disaggregated into the three levels of the FAS 157 valuation hierarchy are as follows:

|                                       | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Securities<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level<br>2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Total      |
|---------------------------------------|--------------------------------------------------------------------------------------|--------------------------------------------------------------|----------------------------------------------------|------------|
| Investments at fair value             |                                                                                      |                                                              |                                                    |            |
| Control investments                   | \$                                                                                   | \$                                                           | \$ 220,263                                         | \$ 220,263 |
| Affiliate investments                 |                                                                                      |                                                              | 30,819                                             | 30,819     |
| Non-control/Non-affiliate investments |                                                                                      |                                                              | 303,959                                            | 303,959    |
|                                       |                                                                                      |                                                              | 555,041                                            | 555,041    |
| Investments in money market funds     | 39,254                                                                               |                                                              |                                                    | 39,254     |
| Total assets reported at fair value   | \$ 39,254                                                                            | \$                                                           | \$ 555,041                                         | \$ 594,295 |

The aggregate values of Level 3 portfolio investments changed during the three and nine months ended March 31, 2009 as follows:

|                                                                                                                                                                                                                                                                                   | For The Periods Ended<br>March 31, 2009 |          |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------|----------|
|                                                                                                                                                                                                                                                                                   | Three<br>Months                         | Nine Mon |
| Change in Portfolio Valuations using Significant Unobservable Inputs (Level 3)                                                                                                                                                                                                    |                                         |          |
| Fair value at beginning of period: December 31, 2008 and June 30, 2008, respectively                                                                                                                                                                                              | \$ 555,661                              | \$ 497,5 |
| Total gains (losses) reported in the Consolidated Statement of Operations:                                                                                                                                                                                                        |                                         |          |
| Included in net investment income                                                                                                                                                                                                                                                 |                                         |          |
| Interest income - accretion of original issue discount on investments                                                                                                                                                                                                             | 195                                     | 2,3      |
| Included in realized gain/loss on investments                                                                                                                                                                                                                                     |                                         | 1,6      |
| Included in net change in unrealized appreciation/depreciation on investments                                                                                                                                                                                                     | 3,611                                   | (12,9    |
| Payments for purchases of investments, payment-in-kind interest, and net profits interests                                                                                                                                                                                        | 6,356                                   | 90,3     |
| Proceeds from sale of investments and collection of investment principal                                                                                                                                                                                                          | (10,782)                                | (23,8    |
| Fair value at March 31, 2009                                                                                                                                                                                                                                                      | \$ 555,041                              | \$ 555,0 |
| The amount of net unrealized gain (loss) included in the results of operations attributable to Level 3 assets still held at March 31, 2009 and reported within the caption <i>Net change in unrealized appreciation/depreciation</i> in the Consolidated Statement of Operations: | \$ 4,421                                | \$ (8,6  |

At March 31, 2009, four loan investments were on non-accrual status: Appalachian Energy Holdings LLC ( AEH ), Integrated Contract Services, Inc. ( Integrated  or  ICS ), Wind River Resources Corp. and Wind River II Corp. ( Wind River ), and Change Clean Energy, Inc. f/k/a Worcester Energy Partners, Inc., Worcester Energy Co., Inc., ( WECO ) and Biochips LLC (collectively  Biomass ). At June 30, 2008, the loans extended to Integrated were on non-accrual status.

28

The loan principal of these loans amounted to \$69,491 and \$14,803 as of March 31, 2009, and June 30, 2008, respectively. The fair values of these investments represent approximately 15.7% and 3.4% of our net assets as of March 31, 2009 and June 30, 2008, respectively. For the three months ended March 31, 2009, and March 31, 2008, the income foregone as a result of not accruing interest on these debt investments amounted to \$3,940 and \$748, respectively. For the nine months ended March 31, 2009, and March 31, 2008, the income foregone as a result of not accruing interest on these debt investments amounted to \$11,270 and \$1,431, respectively.

GSHI has indemnified us against any legal action arising from its investment in Gas Solutions, LP. We have incurred approximately \$2,677 from the inception of the investment in GSHI through March 31, 2009 for fees associated with a legal action, and GSHI has reimbursed us for the entire amount. Of the \$2,677 reimbursement, \$67 and \$23 are reflected as dividend income: control investments in the Consolidated Statements of Operations for the three months ended March 31, 2009 and March 31, 2008, respectively; \$249 and \$44 are reflected as dividend income: control investments for the nine months ended March 31, 2009 and March 31, 2008, respectively. 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 March 31, 2009 and March 31, 2008, such reimbursements totaled as \$1,878 and \$1,276, respectively. For the nine months ended March 31, 2009 and March 31, 2008, reimbursements totaled \$5,386 and \$2,995, respectively.

The original cost basis of debt placements and equity securities acquired totaled to approximately \$6,356 and \$31,794 during the three months ended March 31, 2009 and March 31, 2008, respectively. These placements and acquisitions totaled to approximately \$90,376 and \$193,033 during the nine months ended March 31, 2009 and March 31, 2008, respectively. Debt repayments and sales of equity securities with a cost basis of approximately \$10,782 and \$28,680 were received during the three months ended March 31, 2009 and March 31, 2008, respectively. These repayments and sales amounted to \$22,198 and \$84,458 during the nine months ended March 31, 2009 and March 31, 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 and nine months ended March 31, 2009 and March 31, 2008 were as follows:

| Income Source                       | For The Three Months Ended March 31, |          | For The Nine Months Ended March 31, |          |
|-------------------------------------|--------------------------------------|----------|-------------------------------------|----------|
|                                     | 2009                                 | 2008     | 2009                                | 2008     |
| Structuring fees                    | \$ □                                 | \$ 490   | \$ 774                              | \$ 2,430 |
| Overriding royalty interests        | 141                                  | 3,150    | 472                                 | 3,365    |
| Settlement of net profits interests | □                                    | □        | 12,576                              | □        |
| Deal deposit                        | □                                    | 36       | 62                                  | 72       |
| Administrative agent fee            | 18                                   | 11       | 53                                  | 32       |
| Miscellaneous                       | □                                    | □        | 49                                  | 10       |
| Other Investment Income             | \$ 159                               | \$ 3,687 | \$ 13,986                           | \$ 5,909 |

29

### Note 5. Sale and Purchases of Common Stock

We issued 1,500,000 shares of our common stock in a public offering during the three months and the nine months ended March 31, 2009. We issued 2,450,000 shares of common stock during the three months ended March 31, 2008 through a direct offering and through a public offering. For the nine months ended March 31, 2008, the total number of common shares sold equaled 6,150,000. The proceeds raised, the related underwriting fees, the offering expenses and the prices at which these shares were issued are as follows:

| Issuances of Common Stock                          | Number of Shares Issued | Gross Proceeds Raised | Underwriting Fees | Offering Expenses | Offering Price |
|----------------------------------------------------|-------------------------|-----------------------|-------------------|-------------------|----------------|
| <b>During the nine months ended March 31, 2009</b> |                         |                       |                   |                   |                |
| March 19, 2009                                     | 1,500,000               | \$ 12,300             | \$ □              | \$ 513            | \$ 8.200       |
| <b>During the nine months ended March 31, 2008</b> |                         |                       |                   |                   |                |
| March 31, 2008                                     | 1,150,000               | \$ 17,768             | \$ 759            | \$ 350            | \$ 15.450      |
| March 28, 2008                                     | 1,300,000               | 19,786                | □                 | 350               | 15.220         |
| November 13, 2007 over-allotment                   | 200,000                 | 3,268                 | 163               | □                 | 16.340         |
| October 17, 2007                                   | 3,500,000               | 57,190                | 2,860             | 551               | 16.340         |

Our shareholders' equity accounts at March 31, 2009 and June 30, 2008 reflect cumulative shares issued as of those respective dates. Our common stock has been issued through public offerings, a registered direct offering, the exercise of over-allotment options on the part of the underwriters and our dividend reinvestment plan. When our common stock is issued, the related offering expenses have been charged against paid-in capital in excess of par. All underwriting fees and offering expenses were borne by us.

On October 9, 2008, our Board of Directors approved a share repurchase plan under which we may repurchase up to \$20,000 of our common stock at prices below our net asset value as reported in our financial statements published for the year ended June 30, 2008. We have not made any purchases of our common stock during the period from October 9, 2008 to March 31, 2009 pursuant to this plan.

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

The following information sets forth the computation of net increase (decrease) in net assets resulting from operations per common share for the three and nine months ended March 31, 2009 and March 31, 2008, respectively.

|                                                                 | For The Three Months Ended March 31, |            | For The Nine Months Ended March 31, |          |
|-----------------------------------------------------------------|--------------------------------------|------------|-------------------------------------|----------|
|                                                                 | 2009                                 | 2008       | 2009                                | 2008     |
| Net increase (decrease) in net assets resulting from operations | \$ 15,331                            | \$ (1,259) | \$ 35,853                           | \$ 3,605 |

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|                                                                                  |            |            |            |            |
|----------------------------------------------------------------------------------|------------|------------|------------|------------|
| Weighted average common shares outstanding                                       | 29,971,508 | 23,858,492 | 29,708,458 | 22,349,987 |
| Net increase (decrease) in net assets resulting from operations per common share | \$ 0.51    | \$ (0.05)  | \$ 1.21    | \$ 0.16    |

30

### Note 7. Related Party Agreements and Transactions

#### *Investment Advisory Agreement*

We have entered into an investment advisory and management agreement (the "Investment Advisory Agreement") with Prospect Capital Management (the "Investment Adviser") 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.

The Investment Adviser'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. 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 March 31, 2009 and March 31, 2008 were \$2,977, and \$2,388, respectively. The fees incurred for the nine months ended March 31, 2009 and March 31, 2008 were \$8,740, and \$6,366, 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.

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 March 31, 2009 and March 31, 2008, \$2,930 and \$3,230, respectively, of income incentive fees were incurred. For the nine months ended March 31, 2009 and March 31, 2008, \$11,795 and \$7,861, respectively, of income incentive fees were incurred. No capital gains incentive fees were incurred for the three or nine months ended March 31, 2009 and March 31, 2008.

#### *Administration Agreement*

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

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.

Overhead expenses allocated to us by Prospect Administration amounted to \$588 and \$588 for the three months ended March 31, 2009 and March 31, 2008, respectively. These allocations totaled \$1,764 and \$1,108 for the nine months ended March 31, 2009 and March 31, 2008, respectively.

32

Prospect Administration, pursuant to the approval of our Board of Directors, has 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 provides us with office facilities, equipment, clerical, bookkeeping and record keeping services at such facilities. Vastardis also conducts relations with custodians, depositories, transfer agents, dividend disbursing agents, other stockholder servicing agents, accountants, 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 provides reports to the Administrator and the Directors of its performance of obligations and furnishes advice and recommendations with respect to such other aspects of our business and affairs as it shall determine to be desirable. Under the revised and renewed sub-administration agreement, Vastardis also provided the service of William E. Vastardis as our Chief Financial Officer ("CFO"). We compensate 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 24, 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.

Vastardis does not provide any advice or recommendation relating to the securities and other assets that we should purchase, retain or sell or any other investment advisory services to us. Vastardis is responsible for the financial and other records that either the Administrator on our behalf or we are required to maintain and prepares reports to stockholders, and reports and other materials filed with the SEC. In addition, Vastardis assists us in determining and publishing our net asset value, overseeing the preparation and filing of our tax returns, and the printing and dissemination of reports to our stockholders, and generally overseeing the payment of our expenses and the performance of administrative and professional services rendered to us by others.

Under the sub-administration agreement, Vastardis and its officers, partners, agents, employees, controlling persons, members, and any other person or entity affiliated with Vastardis, are not liable to the Administrator or us for any action taken or omitted to be taken by Vastardis in connection with the performance of any of its duties or obligations or otherwise as sub-administrator for the Administrator on our behalf. The agreement also provides that, absent willful misfeasance, bad faith or negligence in the performance of Vastardis' duties or by reason of the reckless disregard of Vastardis' duties and obligations, Vastardis and its officers, partners, agents, employees, controlling persons, members, and any other person or entity affiliated with Vastardis are entitled to indemnification from the Administrator and us. All damages, liabilities, costs and expenses (including reasonable attorneys' fees and amounts reasonably paid in settlement) incurred in or by reason of any pending, threatened or completed action, suit, investigation or other proceeding (including an action or suit by or in the right of the Administrator or us or our security holders) arising out of or otherwise based upon the performance of any of Vastardis' duties or obligations under the agreement or otherwise as sub-administrator for the Administrator on our behalf are subject to such indemnification.

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 anticipate entering into a new consulting services agreement for the period from July 1, 2009 until the filing our 10-K for the year ending on June 30, 2009. We anticipate paying Vastardis a total of \$30 for services in conjunction with preparation of the Form 10-K under the new agreement.

#### *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. For the three months ended March 31, 2009 and March 31, 2008, managerial assistance fees amounted to \$215 and \$245, respectively. For

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the nine months ended March 31, 2009 and March 31, 2008, managerial assistance fees amounted to \$631 and \$693, respectively. These fees are paid to the Administrator.

33

**Note 8. Financial Highlights**

|                                                                      | For The Three Months Ended |                | For The Nine Months Ended |                |
|----------------------------------------------------------------------|----------------------------|----------------|---------------------------|----------------|
|                                                                      | March 31, 2009             | March 31, 2008 | March 31, 2009            | March 31, 2008 |
| <b>Per Share Data (1):</b>                                           |                            |                |                           |                |
| Net asset value at beginning of period                               | \$ 14.43                   | \$ 14.58       | \$ 14.55                  | \$ 15.00       |
| Net investment income                                                | 0.39                       | 0.54           | 1.59                      | 1.40           |
| Net realized gain (loss)                                             | □                          | 0.01           | 0.06                      | (0.80)         |
| Net unrealized appreciation (depreciation)                           | 0.12                       | (0.60)         | (0.44)                    | (0.40)         |
| Shares issued for dividend reinvestments                             | (0.01)                     | □              | (0.02)                    | □              |
| Net (decrease) increase in net assets as a result of public offering | (0.33)                     | 0.02           | (0.34)                    | 0.10           |
| Dividends declared                                                   | (0.41)                     | (0.40)         | (1.21)                    | (1.10)         |
| Net asset value at end of period                                     | \$ 14.19                   | \$ 14.15       | \$ 14.19                  | \$ 14.10       |
| Per share market value at end of period                              | \$ 8.52                    | \$ 15.22       | \$ 8.52                   | \$ 15.20       |
| Total return based on market value (2)                               | (25.44%)                   | 19.69%         | (27.80%)                  | (5.70%)        |
| Total return based on net asset value (2)                            | 3.01%                      | (0.40%)        | 8.93%                     | 1.70%          |
| Shares outstanding at end of period                                  | 31,286,128                 | 26,270,379     | 31,286,128                | 26,270,379     |
| Average weighted shares outstanding for period                       | 29,971,508                 | 23,858,492     | 29,708,458                | 22,349,980     |
| <b>Ratio / Supplemental Data:</b>                                    |                            |                |                           |                |
| Net assets at end of period (in thousands)                           | \$ 444,024                 | \$ 371,718     | \$ 444,024                | \$ 371,718     |
| Average net assets (in thousands)                                    | \$ 435,914                 | \$ 358,771     | \$ 433,297                | \$ 329,900     |
| Annualized ratio of operating expenses to average net assets         | 8.34%                      | 10.17%         | 9.96%                     | 9.80%          |
| Annualized ratio of net operating income to average net assets       | 10.63%                     | 14.36%         | 14.25%                    | 12.70%         |

(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. The total returns are not annualized.

34

|                                              | For The Year Ended |               |               |               |
|----------------------------------------------|--------------------|---------------|---------------|---------------|
|                                              | June 30, 2008      | June 30, 2007 | June 30, 2006 | June 30, 2005 |
| <b>Per Share Data (1):</b>                   |                    |               |               |               |
| Net asset value at beginning of period       | \$ 15.04           | \$ 15.31      | \$ 14.59      | \$ (0.01)     |
| Costs related to the initial public offering | □                  | □             | 0.01          | (0.21)        |

35

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Costs related to the secondary

|                                            |            |            |            |            |
|--------------------------------------------|------------|------------|------------|------------|
| public offering                            | (0.07)     | (0.06)     | □          | □          |
| Net investment income                      | 1.91       | 1.47       | 1.21       | 0.34       |
| Realized (loss) gain                       | (0.69)     | 0.12       | 0.04       | □          |
| Net unrealized (depreciation) appreciation | (0.05)     | (0.52)     | 0.58       | 0.90       |
| Net increase in net assets as a result of  |            |            |            |            |
| public offering                            | □          | 0.26       | □          | 13.95      |
| Dividends declared and paid                | (1.59)     | (1.54)     | (1.12)     | (0.38)     |
| Net asset value at end of period           | \$ 14.55   | \$ 15.04   | \$ 15.31   | \$ 14.59   |
| Per share market value at end of period    | \$ 13.18   | \$ 17.47   | \$ 16.99   | \$ 12.60   |
| Total return based on market value (2)     | (15.90%)   | 12.65%     | 44.90%     | (13.46%)   |
| Total return based on net asset value (2)  | 7.84%      | 7.62%      | 12.76%     | 7.40%      |
| Shares outstanding at end of period        | 29,520,379 | 19,949,065 | 7,069,873  | 7,055,100  |
| Average weighted shares outstanding        |            |            |            |            |
| for period                                 | 23,626,642 | 15,724,095 | 7,056,846  | 7,055,100  |
| <b>Ratio / Supplemental Data:</b>          |            |            |            |            |
| Net assets at end of period (in thousands) | \$ 429,623 | \$ 300,048 | \$ 108,270 | \$ 102,967 |
| Annualized ratio of operating expenses     |            |            |            |            |
| to average net assets                      | 9.62%      | 7.36%      | 8.19%      | 5.52%      |
| Annualized ratio of net operating          |            |            |            |            |
| income to average net assets               | 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. The total returns are not annualized.

(3) Financial Highlights as of June 30, 2004 are considered not applicable as the initial offering of common stock did not occur as of this date.

35

## Note 9. 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. 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 (the "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. 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 our petition to confirm the award, confirmed the awards and subsequently entered judgment thereon in our favor 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 we 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.

#### **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, agreements for one guarantee and one contingent indemnification are outstanding which are related to two portfolio companies categorized as Control Investments - Whymore and North Fork; both of these companies have now been consolidated as part of Yatesville. The guarantee is related to Whymore. As of March 31, 2009, this guarantee may amount to \$4,300 for equipment leases. The contingent indemnification obligation arose from our acquisition of the assets of Traveler Coal, LLC (the "Traveler"), through our subsidiary, North Fork. Specifically, as part of that acquisition, we have agreed to indemnify the seller of those assets for personal guarantees that seller had extended on behalf of Traveler. As of March 31, 2009, the amount of this contingency is \$3,673.

We also provide indemnifications to Prospect Administration and to Vastardis in accordance with our respective agreements with those two service providers. These indemnifications are described in further detail in Note 7.

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#### **Note 11. Revolving Credit Agreements**

On June 6, 2007, we closed on a \$200,000 three-year revolving credit facility (as amended on December 31, 2007) with Rabobank Nederland as administrative agent and sole lead arranger (the "Rabobank Facility"). Interest on the Rabobank Facility is charged at LIBOR plus 175 basis points. Additionally, Rabobank charges a fee on the unused portion of the facility. Through November 30, 2007, this fee is assessed at the rate of 37.5 basis points per annum of the amount of that unused portion; after that date, this rate increases to 50.0 basis points per annum if that unused portion is greater than 50% of the total amount of the facility. On November 14, 2008, we entered into a commitment letter with Rabobank to arrange and structure a new dual-rated credit facility. Under the terms of the letter, we agreed to an immediate increase in the current borrowing rate on the Rabobank Facility to LIBOR plus 250 basis points. At March 31, 2009 and June 30, 2008, the investments used as collateral for the Rabobank Facility had aggregate market values of \$405,404 and \$369,418, respectively. These values represent 73.0% and 74.3% of total investments at fair value, respectively.

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We had drawn down \$137,567 and \$91,167 on the Rabobank Facility as of March 31, 2009 and June 30, 2008, respectively.

### Note 12. Selected Quarterly Financial Data (Unaudited)

| Quarter Ended      | Investment Income |               | Net Investment Income |               | Net Realized and Unrealized Gains (Losses) |               | Net Income |
|--------------------|-------------------|---------------|-----------------------|---------------|--------------------------------------------|---------------|------------|
|                    | Total             | Per Share (1) | Total                 | Per Share (1) | Total                                      | Per Share (1) |            |
| September 30, 2006 | \$ 6,432          | \$ 0.65       | \$ 3,274              | \$ 0.33       | \$ 690                                     | \$ 0.07       | \$ 3,9     |
| December 31, 2006  | 8,171             | 0.60          | 4,493                 | 0.33          | (1,553)                                    | (0.11)        | 2,9        |
| March 31, 2007     | 12,069            | 0.61          | 7,015                 | 0.36          | (2,039)                                    | (0.10)        | 4,9        |
| June 30, 2007      | 14,009            | 0.70          | 8,349                 | 0.42          | (3,501)                                    | (0.18)        | 4,8        |
| September 30, 2007 | 15,391            | 0.77          | 7,865                 | 0.39          | 685                                        | 0.04          | 8,5        |
| December 31, 2007  | 18,563            | 0.80          | 10,660                | 0.46          | (14,346)                                   | (0.62)        | (3,6       |
| March 31, 2008     | 22,000            | 0.92          | 12,919                | 0.54          | (14,178)                                   | (0.59)        | (1,2       |
| June 30, 2008      | 23,448            | 0.85          | 13,669                | 0.50          | 10,317                                     | 0.38          | 23,9       |
| September 30, 2008 | 35,799            | 1.21          | 23,502                | 0.80          | (9,504)                                    | (0.33)        | 13,9       |
| December 31, 2008  | 22,213            | 0.75          | 11,960                | 0.40          | (5,436)                                    | (0.18)        | 6,5        |
| March 31, 2009     | 20,669            | 0.69          | 11,720                | 0.39          | 3,611                                      | 0.12          | 15,3       |

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

### Note 13. Subsequent Events

On April 20, 2009, we issued 214,456 shares of our common stock in connection with the dividend reinvestment plan.

On April 27, 2009, we issued 3.68 million shares of our common stock in an underwritten equity offering at \$7.75 per share, raising \$28,520 in gross proceeds and \$27,166 of net proceeds after recognizing \$1,144 of underwriting discounts and commissions and \$210 of estimated offering costs.

## 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.

### **Market Conditions**

In 2008 and early 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 BDC, we are limited to a maximum 1 to 1 debt to equity ratio, and as of March 31, 2009, our debt to equity ratio was 0.31 to 1. As of March 31, 2009, we have borrowed \$137,567 against our credit facility with Rabobank Nederland. The revolving period for this facility continues until June 6, 2009, with a term out maturity on June 6, 2010, and we expect to enter into a new extended facility prior to this date. While we are optimistic, we cannot guarantee the completion of such extension.

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We also continue to generate liquidity through public stock offerings and the realization of portfolio investments. On March 19, 2009 and April 27, 2009, we completed public stock offerings for 1.5 million and 3.68 million shares of our common stock at \$8.20 per share and \$7.75 per share, raising \$12,300 and \$28,520 of gross proceeds, respectively. Our loan to Diamondback Operating L.P. was repaid in January 2009. As is typical for our portfolio, we currently have investments in various stages in the exit process that continue to draw interest from prospective buyers.

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

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

further described in the notes to the financial statements.

#### *Basis of Consolidation*

Under the 1940 Act rules, the regulations pursuant to Article 6 of Regulation S-X, and the American Institute of Certified Public Accountants' Audit and Accounting Guide for Investment Companies, we are precluded from consolidating any entity other than another investment company or an operating company which provides substantially all of its services and benefits to us. Our March 31, 2009, June 30, 2008, and March 31, 2008 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.

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

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

Investments are valued utilizing a market approach, an income approach, or both approaches, as appropriate. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities (including a business). The income approach uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present value amount (discounted) calculated based on an appropriate 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 issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those years. We have adopted this statement on a prospective basis beginning in the quarter ended September 30, 2008. Adoption of this statement did not have a material effect on our financial.

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

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

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

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

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

The changes to generally accepted accounting principles from the application of FAS 157 relate to the definition of fair value, framework for measuring fair value, and the expanded disclosures about fair value measurements. FAS 157 applies to fair value measurements already required or permitted by other standards. In accordance with FAS 157, the fair value of our investments is defined as the price that we would receive upon selling an investment in an orderly transaction to an independent buyer in the principal or most advantageous market in which that investment is transacted.

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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.

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. At March 31, 2009, four loan investments were on non-accrual status: Appalachian Energy Holdings LLC (["AEH"]), Integrated Contract Services, Inc. (["Integrated" or "ICS"]), Wind River Resources Corp. and Wind River II Corp. (["Wind River"]), and Change Clean Energy, Inc. f/k/a Worcester Energy Partners, Inc., Worcester Energy Co., Inc., (["WECO"]) and Biochips LLC (collectively ["Biomass"]). The loan principal of these loans amounted to \$69,491 at March 31, 2009.

## Introduction

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

We seek to be a long-term investor with our portfolio companies. 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.

## Statement of Assets and Liabilities Overview

During the nine months ended March 31, 2009, net assets have increased by \$14,401 from \$429,623 as of June 30, 2008 to \$444,024 as of March 31, 2009. This net increase in assets resulted from a \$35,853 increase from operations and \$15,067 from capital share transactions, offset by \$36,519 in dividends declared to our stockholders. During this nine-month period we recognized net investment income of \$47,182, net realized gains on investments of \$1,661 and a decrease in net assets due to changes in unrealized appreciation/depreciation of investments of \$12,990. The result was the \$35,853 increase in net assets resulting from operations.

The aggregate fair value of our portfolio investments was \$555,041 and \$497,530 as of March 31, 2009 and June 30, 2008, respectively. During the nine months ended March 31, 2009, our net cost of investments increased by \$70,501, or 14.2%, as we invested in three new investments and follow-on investments while we sold one investment, received repayment on another two investments, and settled the net profit interests on a third investment. This increased level of investment was financed primarily by increased borrowings on our credit facility. At March 31, 2009, we were invested in 31 long-term portfolio investments (including a net profits interest remaining in Charlevoix).

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## Investment Activity

During the nine months ended March 31, 2009, we completed three new investments and several follow-on investments in existing portfolio companies, totaling approximately \$89,052. The more significant of these investments are described briefly in the following:

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

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

On August 21, 2008, we provided a \$26,000 senior secured debt financing and co-invested \$2,300 in equity alongside Great Point Partners, LLC (["Great Point"]) in its growth recapitalization of BNN Holdings Corp. d/b/a Biotronic NeuroNetwork (["Biotronic"]), based in Ann Arbor, Michigan. Biotronic is the largest independent national provider of intra-operative neurophysiological monitoring services.

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On July 23, 2008, September 8, 2008, and November 7, 2008, and January 21, 2009, we made follow-on secured debt investments of \$400, \$2,700, and \$2,900, and \$1,500, respectively in Iron Horse Coiled Tubing, Inc. ("Iron Horse") in support of the build out of additional equipment.

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

During the nine months ended March 31, 2009, we closed-out three positions which are briefly described below.

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

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

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

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 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.

42

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

| Quarter-End        | Acquisitions<br>(1) | Dispositions<br>(2) |
|--------------------|---------------------|---------------------|
| 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    | \$ 802,600          | \$ 231,494          |

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

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

## Investment Holdings

As of March 31, 2009, we continue to pursue our investment strategy. Despite our name change to "Prospect Capital Corporation" and the termination of our policy to invest at least 80% of our net assets in energy companies in May 2007, we currently have a concentration of investments in companies in the energy and energy related industries. 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 15.1% and 16.8% across all our long-term debt and certain equity investments as of March 31, 2009 and March 31, 2008, respectively. This yield includes interest from all of our long-term investments as well as dividends from GSHI and NRG Manufacturing, Inc. ("NRG"). The 1.7% decrease is primarily due to non-accrual loans. For the three months ended March 31, 2009, total foregone interest related to loans on non-accrual status was \$3,940. As of March 31, 2009, we reversed \$322 of interest income recognized in prior periods related to AEH and Wind River. We expect the current yield to continue to decline over time as

43

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.

As of March 31, 2009, we own controlling interests in Ajax Rolled Ring & Machine ("Ajax"), C&J Cladding, LLC ("C&J"), GSHI, Integrated, Iron Horse, NRG, R-V, CCEI, and Yatesville. We also own affiliated interests in Appalachian Energy Holdings, LLC ("AEH") and Biotronic.

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

| Level of Control          | March 31, 2009 |                      | June 30, 2008 |                      |
|---------------------------|----------------|----------------------|---------------|----------------------|
|                           | Fair Value     | Percent of Portfolio | Fair Value    | Percent of Portfolio |
| Control                   | \$ 220,263     | 37.1%                | \$ 205,827    | 38.8%                |
| Affiliate                 | 30,819         | 5.2%                 | 6,043         | 1.2%                 |
| Non-control/Non-affiliate | 303,959        | 51.1%                | 285,660       | 53.8%                |
| Money Market Funds        | 39,254         | 6.6%                 | 33,000        | 6.2%                 |
| Total Portfolio           | \$ 594,295     | 100.0%               | \$ 530,530    | 100.0%               |

The following is our investment portfolio presented by type of investment at March 31, 2009 and June 30, 2008, respectively:

| Type of Investment          | March 31, 2009 |                      | June 30, 2008 |                      |
|-----------------------------|----------------|----------------------|---------------|----------------------|
|                             | Fair Value     | Percent of Portfolio | Fair Value    | Percent of Portfolio |
| Money Market Funds          | \$ 39,254      | 6.6%                 | \$ 33,000     | 6.2%                 |
| Senior Secured Debt         | 231,782        | 39.0%                | 199,946       | 37.7%                |
| Subordinated Secured Debt   | 199,072        | 33.5%                | 219,623       | 41.4%                |
| Subordinated Unsecured Debt | 15,095         | 2.5%                 | —             | 0.0%                 |
| Preferred Stock             | 4,705          | 0.8%                 | 7,707         | 1.4%                 |
| Common Stock                | 88,341         | 14.9%                | 58,312        | 11.0%                |

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|                      |            |        |            |        |
|----------------------|------------|--------|------------|--------|
| Membership Interests | 7,576      | 1.3%   | 3,000      | 0.6%   |
| Net Profit Interests | 456        | 0.1%   |            | 0.0%   |
| Warrants             | 8,014      | 1.3%   | 8,942      | 1.7%   |
| Total Portfolio      | \$ 594,295 | 100.0% | \$ 530,530 | 100.0% |

44

The following is our investment portfolio presented by geographic location of the investment at March 31, 2009 and June 30, 2008, respectively:

| Geographic Exposure | March 31, 2009 |                      | June 30, 2008 |                      |
|---------------------|----------------|----------------------|---------------|----------------------|
|                     | Fair Value     | Percent of Portfolio | Fair Value    | Percent of Portfolio |
| Canada              | \$ 16,765      | 2.8%                 | \$ 11,182     | 2.1%                 |
| Midwest US          | 81,271         | 13.7%                | 47,869        | 9.0%                 |
| Northeast US        | 41,194         | 6.9%                 | 68,468        | 12.9%                |
| Southeast US        | 115,750        | 19.5%                | 128,512       | 24.2%                |
| Southwest US        | 254,023        | 42.7%                | 211,177       | 39.9%                |
| Western US          | 46,038         | 7.8%                 | 30,322        | 5.7%                 |
| Money Market Funds  | 39,254         | 6.6%                 | 33,000        | 6.2%                 |
| Total Portfolio     | \$ 594,295     | 100.0%               | \$ 530,530    | 100.0%               |

The following is our investment portfolio presented by industry sector of the investment at March 31, 2009 and June 30, 2008, respectively:

| Industry Sector              | March 31, 2009 |                      | June 30, 2008 |                      |
|------------------------------|----------------|----------------------|---------------|----------------------|
|                              | Fair Value     | Percent of Portfolio | Fair Value    | Percent of Portfolio |
| Biomass Power                | \$ 6,000       | 1.0%                 | \$ 15,580     | 2.9%                 |
| Construction Services        | 2,483          | 0.4%                 | 6,043         | 1.1%                 |
| Contracting                  | 5,000          | 0.8%                 | 5,000         | 0.9%                 |
| Financial Services           | 21,839         | 3.7%                 | 23,699        | 4.5%                 |
| Food Products                | 29,385         | 5.0%                 | 19,351        | 3.7%                 |
| Gas Gathering and Processing | 85,186         | 14.3%                | 61,542        | 11.6%                |
| Healthcare                   | 57,587         | 9.7%                 | 13,752        | 2.6%                 |
| Manufacturing                | 100,684        | 16.9%                | 109,542       | 20.7%                |
| Metal Services               | 9,472          | 1.6%                 | 6,829         | 1.3%                 |
| Mining and Coal Production   | 25,848         | 4.4%                 | 25,726        | 4.9%                 |
| Oil and Gas Production       | 105,471        | 17.8%                | 112,850       | 21.3%                |
| Oilfield Fabrication         | 36,515         | 6.2%                 | 24,854        | 4.7%                 |
| Pharmaceuticals              | 10,250         | 1.7%                 | 11,523        | 2.2%                 |
| Production Services          | 16,765         | 2.8%                 | 14,038        | 2.6%                 |
| Retail                       | 5,466          | 0.9%                 | 13,428        | 2.5%                 |
| Shipping Vessels             | 7,151          | 1.2%                 | 6,804         | 1.3%                 |
| Specialty Minerals           | 18,439         | 3.1%                 | 15,632        | 2.9%                 |
| Technical Services           | 11,500         | 1.9%                 | 11,337        | 2.1%                 |
| Money Market Funds           | 39,254         | 6.6%                 | 33,000        | 6.2%                 |
| Total Portfolio              | \$ 594,295     | 100.0%               | \$ 530,530    | 100.0%               |

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## Investment Valuation

In determining the fair value of our portfolio investments at March 31, 2009, the Audit Committee considered valuations from the independent valuation firm and from management having an aggregate range of \$512,598 to \$583,857, excluding money market investments.

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

The Board of Directors looked at several factors in determining where within the range to value the asset including: recent operating and financial trends for the asset, independent ratings obtained from third parties and comparable multiples for recent sales of companies within the industry. The composite of all these analysis, applied to each investment, was a total valuation of \$555,041, excluding money market investments.

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

During the fiscal year ended June 30, 2008 and continuing through March 31, 2009, several general economic factors have occurred which have affected the valuation of our investment portfolio.

Generally, interest rates offered on loans similar to those that we have originated have changed since our investments were consummated. While we do not believe that there has been any diminution of credit quality, general changes in current interest rates would affect the price for which we could sell these assets and we have adjusted our fair value of these assets to reflect such changes. During the nine months ended March 31, 2009, we have adjusted the value of twelve debt investments based upon such general changes in market interest rates including: Biotronic, C&J, Castro, Freedom Marine Services LLC, H&M Oil & Gas, LLC, Maverick Healthcare, LLC, Qualitest Pharmaceuticals, Inc. ([Qualitest]), Regional Management Corp. ([RMC]), Resco Products, Inc. ([Resco]), Shearer's Foods, Inc., Stryker Energy, LLC, and TriZetto.

Five debt investments were made to companies that are not performing in line with budget expectations as of March 31, 2009. For these investments (AEH, Conquest Cherokee, LLC, Deb Shops, Inc. ([Deb Shops]), Iron Horse, and Wind River Resources Corp. and Wind River II Corp.) we expect full recovery. We used higher market interest rates to take into account the increased credit risk and general changes in current interest rates for similar assets to determine their fair value.

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

### *Gas Solutions Holdings, Inc.*

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

During the past year, we have been in discussions with multiple interested purchasers for Gas Solutions. While we wish to unlock the value in Gas Solutions, we do not wish to enter into any agreement at any time that does

not recognize the long term value we see in Gas Solutions. As a well hedged midstream asset, which will generate predictable and consistent cash flows to us, Gas Solutions is a valuable asset that we wish to sell

at a value-maximizing price, or not at all. We continue discussions with interested parties, but have a patient approach toward the process. In addition, a sale of the assets, rather than the stock of GSHI, might result in a significant tax liability at the GSHI level which will need to be paid prior to any distribution to us.

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

In early May 2008, Gas Solutions II Ltd purchased a series of propane puts at \$0.10 out of the money and at prices of \$1.53 per gallon and \$1.394 per gallon covering the periods May 1, 2008 through April 30, 2009 and May 1, 2009 through April 30, 2010, respectively. These hedges have been executed at close to the highest historical market propane prices ever achieved. Such hedges preserve the upside of Gas Solutions II Ltd to benefit from potential future changes in commodity prices. GSHI has generated approximately \$26,172 of EBITDA for the fiscal year ending December 31, 2008, an increase of 67.1% from the 2007 results.

In determining the value of GSHI, we have utilized several valuation techniques to determine the value of the investment. These techniques offer a wide range of values. Our Board of Directors has determined the value to be \$85,186 for our debt and equity positions at March 31, 2009 based upon a combination of a discounted cash flow analysis, a public comparables analysis and review of recent indications of interest. GSHI is valued \$55,164 above its amortized cost at March 31, 2009, compared to the \$36,321 unrealized gain recorded at June 30, 2008.

#### *Integrated Contract Services, Inc.*

Our investment in ICS is under enhanced review by our senior management team due to existing payment and covenant defaults under the contracts governing these investments. 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 reaffirmed the fair value of our investment in ICS at \$5,000, a reduction of \$11,690 from its amortized cost at March 31, 2009, compared to the \$11,464 unrealized loss recorded at June 30, 2008.

#### *Change Clean Energy Holdings Inc. ([CCEHI]) and Change Clean Energy, Inc. ([CCEI]), f/k/a Worcester Energy Partners, Inc.*

CCEI is under enhanced review by our senior management team due to poor operating results since investment. We have installed a new manager at CCEI. CCEI ceased operations temporarily in the first quarter of 2009. During the 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. CCEI ceased operations temporarily in the first quarter of 2009. During the nine months ended March 31, 2009, we provided additional funding of \$4,211 to Biomass to fund ongoing operations.

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Our Board of Directors, upon recommendation from senior management, has set the value of the CCEI investment based upon an enterprise valuation at \$6,000 at March 31, 2009, a reduction of \$37,134 from its amortized cost at March 31, 2009, compared to the \$22,141 unrealized loss recorded at June 30, 2008.

47

### *Yatesville Coal Holdings, Inc.*

As we previously discussed, all of our coal holdings are now held in one consolidated entity, Yatesville. Yatesville had begun to show improvement since the consolidation of the coal holdings in one entity under common management, but this came to a halt at the end of December 2008 when the company exhausted its permitted reserves. During the nine months ended March 31, 2009, we provided additional funding of \$7,570 to Yatesville to fund ongoing operations. We will continue to value Yatesville on an asset basis. Our Board of Directors, upon recommendation from senior management, has set the value of the Yatesville investment at \$25,848 at March 31, 2009, a reduction of \$21,465 from its amortized cost at March 31, 2009, compared to the \$14,694 unrealized loss recorded at June 30, 2008.

### **Capitalization**

Our investment activities are capital intensive and the availability and cost of capital is a critical component of our business. We capitalize our business with a combination of debt and equity. Our debt is currently consists of a revolving credit facility availing us of the ability to borrow up to \$200,000 of debt and our equity capital is currently comprised entirely of common equity.

We had \$137,567 and \$91,167 of borrowings at March 31, 2009 and June 30, 2008, respectively. These borrowings were made against a credit facility in place at Rabobank Nederland. The maintenance of this facility requires us to pay a fee for the amount not drawn upon. Through November 30, 2007, this fee is assessed at the rate of 37.5 basis points per annum of the amount of that unused portion; after that date, this rate increased to 50.0 basis points per annum if that unused portion was greater than 50% of the total amount of the facility. The following table shows the facility amounts and outstanding borrowings at March 31, 2009 and June 30, 2008:

|                           | <b>As of March 31, 2009</b> |                           | <b>As of June 30, 2008</b> |                           |
|---------------------------|-----------------------------|---------------------------|----------------------------|---------------------------|
|                           | <b>Facility Amount</b>      | <b>Amount Outstanding</b> | <b>Facility Amount</b>     | <b>Amount Outstanding</b> |
| Revolving Credit Facility | \$ 200,000                  | \$ 137,567                | \$ 200,000                 | \$ 91,167                 |

The following table shows the contractual maturity of our revolving credit facility at March 31, 2009:

|                         | <b>Payments Due By Period</b> |                    |                          |
|-------------------------|-------------------------------|--------------------|--------------------------|
|                         | <b>Less Than 1 Year</b>       | <b>1 - 3 Years</b> | <b>More Than 3 Years</b> |
| Credit Facility Payable | \$ 137,567                    | \$                 | \$ □                     |

During the quarter ended March 31, 2009, we completed a public offering and raised \$12,300 of additional equity by issuing 1.5 million shares of our common stock below net asset value diluting shareholder value by \$0.32 per share. . The following table shows the calculation of net asset value per share as of March 31, 2009 and June 30, 2008:

|                                    | <b>As of March 31, 2009</b> | <b>As of June 30, 2008</b> |
|------------------------------------|-----------------------------|----------------------------|
| Net Assets                         | \$ 444,024                  | \$ 429,623                 |
| Shares of common stock outstanding | 31,286,128                  | 29,520,379                 |
| Net asset value per share          | \$ 14.19                    | \$ 14.55                   |

At March 31, 2009, we had 31,286,128 of our common stock issued and outstanding.

## Results of Operations

For the three months ended March 31, 2009 and March 31, 2008, the net increase (decrease) in net assets resulting from operations was \$15,331 and (\$1,259), respectively, representing \$0.51 and (\$0.05) per share, respectively. We experienced a net realized and unrealized gain of \$3,611 or approximately \$0.12 per share in the three months ended March 31, 2009. This compares with the net realized and unrealized loss of \$14,178 during the three months ended March 31, 2008 or approximately \$0.59 per share.

For the nine months ended March 31, 2009 and March 31, 2008 (or for the periods since the beginning of our respective fiscal years) the net increase in net assets resulting from operations was \$35,853 and \$3,605, respectively, representing \$1.21 and \$0.16 per share, respectively. We experienced a net realized and unrealized loss of \$11,329 or approximately \$0.38 per share in the nine months ended March 31, 2009. This compares with the net realized and unrealized loss of \$27,839 during the nine months ended March 31, 2008 or approximately \$1.24 per share.

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

## Investment Income

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

Investment income consists of interest income, including accretion of loan origination fees and prepayment penalty fees, dividend income and other income, including net profits interest, overriding royalties interest and structuring fees. The following table details the various components of investment income and the related levels of debt investments for the three and nine months ended March 31, 2009 and March 31, 2008:

|                                       | For The Three Months Ended<br>March 31, |            | For The Nine Months Ended<br>March 31, |            |
|---------------------------------------|-----------------------------------------|------------|----------------------------------------|------------|
|                                       | 2009                                    | 2008       | 2009                                   | 2008       |
| Interest income                       | \$ 16,065                               | \$ 14,890  | \$ 50,862                              | \$ 42,538  |
| Dividend income                       | 4,445                                   | 3,423      | 13,833                                 | 7,507      |
| Other income                          | 159                                     | 3,687      | 13,986                                 | 5,909      |
| Total investment income               | \$ 20,669                               | \$ 22,000  | \$ 78,681                              | \$ 55,954  |
| Average debt principal of investments | \$ 537,277                              | \$ 422,474 | \$ 523,363                             | \$ 381,566 |
| Weighted-average interest rate earned | 11.96%                                  | 14.10%     | 12.77%                                 | 14.65%     |

Total investment income has decreased for the three months ended March 31, 2009 from the amount reported for the three months ended March 31, 2008 primarily due to a decrease in other income.

Income from other sources decreased from \$3,687 for the three months ended March 31, 2008 to \$159 for the three months ended March 31, 2009. This \$3,528 decrease was due primarily to the decrease in overriding royalty interests from Ken-Tex Energy Corp. (Ken-Tex).

While average principal balances of debt investments have increased from \$422,474 for the three months ended March 31, 2008 to \$537,277 for the three months ended March 31, 2009, the weighted-average interest rate earned decreased from 14.10% to 11.96%. During the three month period ended March 31, 2009, interest of \$3,940 was forgone on non-accrual debt investments compared to \$748 of forgone interest for the three months ended March 31, 2008. Without these adjustments, the weighted average interest rates earned on debt investments would have been 14.89% and 14.81% for the three months ended March 31, 2009 and 2008, respectively.

Dividend income has grown significantly from \$3,423 to \$4,445 for the three months ended March 31, 2008 and March 31, 2009, respectively. The increase in dividend income is attributable to dividends received from our investment in GSHI. We received dividends of \$3,000 and \$4,000 during the three months ended March 31, 2008 and March 31, 2009, respectively.

Total investment income has increased for the nine months ended March 31, 2009 from the amount reported for the nine months ended March 31, 2008 primarily due to an increase in interest and other income.

Interest income has increased from \$42,538 for the nine months ended March 31, 2008 to \$50,862 for the nine months ended March 31, 2009. While principal balances of debt investments have increased from \$381,566 for the nine months ended March 31, 2008 to \$523,363 for the nine months ended March 31, 2009, the weighted-average interest rate earned decreased from 14.65% to 12.77%. During the nine month period ended March 31, 2009, interest of \$11,270 was forgone on non-accrual debt investments compared to \$1,431 of forgone interest for the nine months ended March 31, 2008. We had previously accrued default interest on these assets of \$3,448 and \$433 for the nine months ended March 31, 2009 and 2008, respectively. Also, we recognized \$784 of prepayment penalty income from Ken-Tex and Arctic Acquisition Corp. during the nine months ending March 31, 2008. No prepayment penalties were received for the nine months ended March 31, 2009. With these adjustments, the weighted average interest rates earned on debt investments would have been 14.73% and 14.67% for the nine months ended March 31, 2009 and 2008.

Income from other sources increased from \$5,909 for the nine months ended March 31, 2008 to \$13,986 for the nine months ended March 31, 2009. This \$8,077 increase is primarily due to the settlement of our net profit interests in IEC/ARS for \$12,576. This \$12,576 increase from settlement of our net profit interests was partially offset by the decrease in overriding royalty interests related to Ken-Tex Energy Corp and the decrease in structuring fees.

Dividend income has grown significantly from \$7,507 to \$13,833 for the nine months ended March 31, 2008 and March 31, 2009, respectively. The increase in dividend income is attributable to dividends received from our investment in GSHI. We received dividends of \$5,450 and \$12,000 during the nine months ended March 31, 2008 and March 31, 2009, respectively. Dividends were also received from our investments in Ajax and NRG during the nine months ended March 31, 2009.

## **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 \$8,949 and \$9,081 for the three months ended March 31, 2009 and March 31, 2008, respectively. For the nine months ended March 31, 2009 and March 31, 2008, operating expenses were \$31,499 and \$24,510, respectively.

The base management fee was \$2,977 and \$2,388 for the three months ended March 31, 2009 and March 31, 2008, respectively. It was \$8,740 and \$6,366 for the nine months ended March 31, 2009 and March 31, 2008, respectively. The increase in this expense for the nine months ended March 31, 2009 is directly related to our growth in total assets. For the three months ended March 31, 2009 and March 31, 2008, we incurred \$2,930 and \$3,230, respectively, of income incentive fees. For the nine months ended March 31, 2009 and March 31, 2008, we incurred \$11,795 and \$7,861, respectively, of income incentive fees. The \$300 decrease in the income

incentive fee for the respective three-month periods is driven by a slight decrease in pre-management fee net investment income from

50

\$18,537 for the three months ended March 31, 2008 to \$17,627 for the three months ended March 31, 2009. Income incentive fee increased by \$3,934 on a nine-month basis as pre-management fee net investment income increased from \$45,671 for the nine months ended March 31, 2008 and to \$67,717 for the nine months ended March 31, 2009. No capital gains incentive fee has yet been incurred pursuant to the Investment Advisory Agreement.

During the three and nine months ended March 31, 2009, we incurred \$1,345 and \$4,828, respectively of expenses related to our credit facility. This compares with expenses of \$1,863 and \$4,719 incurred during the three and nine months ended March 31, 2008. These expenses are related directly to the leveraging capacity put into place for each of those periods and the levels of indebtedness actually undertaken during those quarters. The table below describes the various credit facility expenses and the related indicators of leveraging capacity and indebtedness during these periods.

|                                          | For The Three Months Ended<br>March 31, |            | For The Nine Months Ended<br>March 31, |            |
|------------------------------------------|-----------------------------------------|------------|----------------------------------------|------------|
|                                          | 2009                                    | 2008       | 2009                                   | 2008       |
| Interest expense                         | \$ 1,101                                | \$ 1,584   | \$ 4,043                               | \$ 3,781   |
| Amortization of deferred financing costs | 180                                     | 180        | 540                                    | 547        |
| Commitment and other fees                | 64                                      | 99         | 245                                    | 391        |
| Total                                    | \$ 1,345                                | \$ 1,863   | \$ 4,828                               | \$ 4,719   |
| Weighted-average debt outstanding        | \$ 144,887                              | \$ 110,792 | \$ 132,099                             | \$ 80,009  |
| Weighted-average interest rate incurred  | 3.08%                                   | 5.74%      | 4.08%                                  | 6.27%      |
| Facility amount at beginning of period   | \$ 200,000                              | \$ 200,000 | \$ 200,000                             | \$ 200,000 |

The decrease in our interest rate incurred is primarily due to a decrease in average LIBOR of approximately 2.8% for the three and nine months ended March 31, 2009 in comparison to the same periods ending March 31, 2008. This decrease is partially offset by an increase of 125 basis points in our current borrowing rate effective November 14, 2008.

As our asset base has grown and we have added complexity to our capital raising activities, due, in part, to our securitization credit facility initiated in June 2007, we have commensurately increased the size of our administrative and financial staff, accounting for a significant increase in the overhead allocation from Prospect Administration. Over the last year, Prospect Administration has added several additional staff members, including a senior finance professional, a treasurer, a corporate counsel and other finance professionals. As our portfolio continues to grow, we expect to continue to increase the size of our administrative and financial staff on a basis that provides increasing returns to scale. However, initial investments in administrative and financial staff may not provide returns to scale immediately, perhaps not until the portfolio increases to a greater size. Other allocated expenses from Prospect Administration have, as expected, increased alongside with the increase in staffing and asset base.

Legal costs decreased significantly from \$2,224 for the nine months ended March 31, 2008 to \$590 for the nine months ended March 31, 2009 as there were reduced costs for litigation.

#### Net Realized Gain (Loss)

Net realized gains were \$0 and \$208 for the three months ended March 31, 2009 and March 31, 2008, respectively. For the nine months ended March 31, 2009 and March 31, 2008, net realized gains (losses) were \$1,661 and \$(18,413), respectively. The net realized gain of \$1,661 for the nine months ended March 31, 2009 was due primarily to the sale of the warrant related to Deep Down, Inc. The net realized loss of \$18,413 for the nine months ended March 31, 2008 was attributable primarily to our disposition of our investments in Central Illinois Energy, LLC and Advantage Oilfield Group, Ltd. (AOG).

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

Increase (decrease) in net assets from changes in unrealized appreciation/depreciation was \$3,611 and \$(14,386) for the three months ended March 31, 2009 and March 31, 2008, respectively. For the three months ended March 31, 2009, the \$3,611 increase in net assets from the net change in unrealized appreciation/depreciation was driven primarily by write-ups of our investments in GSHI, H&M, and NRG which were partially offset by unrealized depreciation of our investments in Ajax, Deb Shops CCEI, and Yatesville. For the three months ended March 31, 2008, the \$14,386 decrease in net assets from such changes is attributable to write-downs of our investments in NRG and CCEI offset by a write-up of our investment in GSHI.

For the nine months ended March 31, 2009 and March 31, 2008, net assets decreased by \$12,990 and \$9,426, respectively from changes in unrealized appreciation/depreciation. The \$12,990 decrease occurring during the nine months ended March 31, 2009 was attributable to unrealized depreciation recognized for our investments in Ajax, AEH, R-V Industries, Deb Shops, CCEI, and Yatesville partially offset by write-ups of our investments in GSHI and NRG. The \$9,426 decrease from changes in unrealized appreciation/depreciation for the nine months ended March 31, 2008 was the net result of write-downs of our investments in Integrated and CCEI offset by the write-up of our investment in ESA Environmental Specialists, Inc. and by the disposition of AOG (which had been previously valued below cost).

**Financial Condition, Liquidity and Capital Resources**

For the three months ended March 31, 2009 and March 31, 2008, our operating activities (used) provided (\$2,426) and \$4,863 of cash, respectively. Financing activities provided \$437 and \$10,371 of cash during the three months ended March 31, 2009 and March 31, 2008, respectively which included the payments of dividends of \$10,192 and \$9,369, during the three months ended March 31, 2009 and March 31, 2008, respectively.

For the nine months ended March 31, 2009 and March 31, 2008, our operating activities used \$25,552 and \$150,705 of cash, respectively. Financing activities provided \$25,446 and \$167,275 of cash during the nine months ended March 31, 2009 and March 31, 2008, respectively which included the payments of dividends of \$32,413 and \$15,956, during the nine months ended March 31, 2009 and March 31, 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 March 31, 2009, we had a \$200,000 revolving credit facility on which \$137,567 was outstanding. This facility matures on June 6, 2009, and we are currently negotiating for an extension and expansion of the facility.

On September 6, 2007, our Registration Statement on Form N-2 was declared effective by the SEC. At March 31, 2009, under the Registration Statement, we had remaining availability to issue up to approximately \$341,000 of our equity securities over the next three years. In April 2009, we utilized an additional \$28,520 reducing our availability to issue to approximately \$313,000.

**Off-Balance Sheet Arrangements**

At March 31, 2009, we did not have any off-balance sheet liabilities or other contractual obligations that are reasonably likely to have a current or future material effect on our financial condition, other than those which originate from 1) the investment advisory and management agreement and the administration agreement and 2) the portfolio companies.

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

On April 20, 2009, we issued 214,456 shares of our common stock in connection with the dividend reinvestment plan.

On April 27, 2009, we issued 3.68 million shares of our common stock in an underwritten equity offering at \$7.75 per share, raising \$28,520 in gross proceeds and \$27,166 of net proceeds after recognizing \$1,144 of underwriting discounts and commissions and \$210 of estimated offering costs.

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

We are subject to financial market risks, including changes in interest rates. At March 31, 2009, most of the loans in our portfolio bore interest at fixed interest rates while our credit facility bears interest at a floating LIBOR rate. 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 March 31, 2009, the principal value of loans totaling \$36,750 bear interest at floating rates while all of the \$137,567 outstanding on our credit facility bears 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 nine months ended March 31, 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 March 31, 2009 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **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 Prospect Capital 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 Prospect Capital breached its fiduciary duty to DGP and tortiously interfered with DGP's contract to purchase Gas Solutions, Ltd. (a subsidiary of our portfolio company, GSHI) in connection with Prospect Capital's alleged agreement in September 2004 to loan DGP funds with which DGP intended to buy Gas Solutions, Ltd. for approximately \$26,000. The complaint seeks relief not limited to \$100,000. The Company believes that the DGP complaint is frivolous and without merit, and intend to defend the matter vigorously. On November 30, 2005, U.S. Magistrate Judge John R. Froeschner of the U.S. District Court for the Southern District of Texas, Galveston Division, issued a recommendation that the court grant Prospect Capital's Motion for

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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 Prospect Capital's Motion for Summary Judgment dismissing all claims by DGP, against Prospect Capital Corporation. On May 16, 2007, the Court also granted Prospect Capital summary judgment on DGP's liability to Prospect Capital on Prospect Capital's counterclaim for DGP's breach of a release and covenant not to sue. On January 4, 2008, the Court, Judge Melinda Harmon presiding, granted Prospect Capital's motion to dismiss all DGP's claims asserted against certain officers and affiliates of Prospect Capital. Prospect Capital's damage claims against DGP remain pending.

In May 2006, based in part on unfavorable due diligence and the absence of investment committee approval, the Company declined to extend a loan for \$10,000 to a potential borrower (the "plaintiff"). Plaintiff was subsequently sued by its own attorney in a local Texas court for plaintiff's failure to pay fees owed to its attorney. In December 2006, plaintiff filed a cross-action against the Company and certain affiliates (the "defendants") in the same local Texas court, alleging, among other things, tortious interference with contract and fraud. The Company 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, the Company's motions were granted. Plaintiff appealed that decision. The arbitration commenced in July 2007 and concluded in late November 2007. Post-hearing briefings were completed in February 2008. On April 14, 2008, the arbitrator rendered an award in favor of the Company, rejecting all of plaintiff's claims. On April 18, 2008, the Company filed a petition before the District Court to confirm the award. 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.

### Item 1A. Risk Factors

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

54

### 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:

| Record Date/Issuance Date               | Shares Issued | Aggregate Offering Price (in 000s) | % of Dividend |
|-----------------------------------------|---------------|------------------------------------|---------------|
| 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%         |

### Item 3. Defaults upon Senior Securities

Not applicable.

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

The 2008 Annual Meeting of the Stockholders of the Company ("Meeting") was convened at the offices of the Company on Friday, December 12, 2008, at 10:30 a.m. No business was conducted and the Meeting was adjourned until January 12, 2009 at 10:30 a.m. to provide additional time to solicit proxies. The Company continued to solicit proxies leading up to the reconvening of the Meeting. The Meeting was reconvened on January 12, 2009 at 10:30 a.m. No business was conducted and the Meeting was adjourned until January 20, 2009 at 10:30 a.m. The Meeting was reconvened on January 20, 2009 at 10:30 a.m. No business was conducted and the Meeting was adjourned until February 12, 2009. The Meeting was reconvened on Thursday, February 12, 2009 at 10:30 a.m. and it was determined that a quorum was established and that the proposals before the Company's stockholders were approved as follows:

To elect one Class I director of the Company, to serve for a term of two years, or until a successor is duly elected and qualified, and to elect one Class III directors of the Company, who will each serve for a term of three years, or until their successors are duly elected and qualified.

|                            |             | <b>Votes Cast</b> | <b>% of<br/>Shares<br/>Voted</b> |
|----------------------------|-------------|-------------------|----------------------------------|
| <b>Class I Director</b>    |             |                   |                                  |
| Graham D.S. Anderson       | Affirmative | 21,366,311        | 95.11%                           |
|                            | Withheld    | 1,099,673         | 4.89%                            |
| <b>Class III Directors</b> |             |                   |                                  |
| Eugene S. Stark            | Affirmative | 21,255,644        | 94.61%                           |
|                            | Withheld    | 1,210,340         | 5.39%                            |

55

To ratify the selection of BDO Seidman, LLP to serve as the Company's independent registered public accounting firm for the fiscal year ending June 30, 2009.

|         | <b>Votes Cast</b> | <b>% of<br/>Shares<br/>Voted</b> |
|---------|-------------------|----------------------------------|
| For     | 21,659,532        | 96.41%                           |
| Against | 408,658           | 1.82%                            |
| Abstain | 397,789           | 1.77%                            |

To approve a proposal to authorize flexibility for the Company, pursuant to approval of its Board of Directors, to sell shares of its common stock during the next year at a price below the Company's then current net asset value per share.

|                            | <b>Total Votes</b> | <b>% of<br/>Outstanding<br/>Shares</b> |
|----------------------------|--------------------|----------------------------------------|
| (Without affiliated votes) |                    |                                        |
| For                        | 14,336,711         | 50.14%                                 |
| Against                    | 4,406,800          | 15.41%                                 |
| Abstain                    | 571,007            | 2.00%                                  |
| Broker non-vote            | 2,225,830          | 7.78%                                  |
| Non-vote                   | 7,054,394          | 24.67%                                 |
| (With affiliated votes)    |                    |                                        |

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|                 |            |        |
|-----------------|------------|--------|
| For             | 15,262,348 | 51.70% |
| Against         | 4,406,800  | 14.93% |
| Abstain         | 571,007    | 1.93%  |
| Broker non-vote | 2,225,830  | 7.54%  |
| Non-vote        | 7,054,394  | 23.90% |

To approve a proposal to authorize flexibility for the Company, pursuant to approval of its Board of Directors, to issue warrants, options and rights to purchase shares of common stock.

|                 | <b>Votes Cast</b> | <b>% of<br/>Shares<br/>Voted</b> |
|-----------------|-------------------|----------------------------------|
| For             | 17,361,882        | 77.28%                           |
| Against         | 2,287,007         | 10.18%                           |
| Abstain         | 591,268           | 2.63%                            |
| Broker non-vote | 2,225,828         | 9.91%                            |

### Item 5. Other Information

None.

56

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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):

- 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 Rasseisen-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 Rasseisen-Boerenleenbank B.A., [Rabobank Nederland,] New York Branch (7).

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- 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.
- 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).

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\* 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.

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- (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 20, 2008.
  - (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 10, 2008.
- (10) Incorporated by reference from the Registrant's Quarterly Report on Form 10-Q filed on November 10, 2008.
- 58
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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 May 11, 2009.

**PROSPECT CAPITAL CORPORATION**

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