

SLM CORP
Form 4
January 03, 2014

FORM 4

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

OMB APPROVAL

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STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

(Print or Type Responses)

1. Name and Address of Reporting Person *
REMONDI JOHN F

(Last) (First) (Middle)
300 CONTINENTAL DRIVE
(Street)

NEWARK, DE 19713

(City) (State) (Zip)

2. Issuer Name and Ticker or Trading Symbol
SLM CORP [SLM]

3. Date of Earliest Transaction (Month/Day/Year)
12/20/2013

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

____ Director _____ 10% Owner
 Officer (give title below) _____ Other (specify below)
President & CEO

6. Individual or Joint/Group Filing(Check Applicable Line)
 Form filed by One Reporting Person
 Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

| 1. Title of Security (Instr. 3) | 2. Transaction Date (Month/Day/Year) | 2A. Deemed Execution Date, if any (Month/Day/Year) | 3. Transaction Code (Instr. 8) | 4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5) | 5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4) | 6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4) | 7. Nature of Ownership (Instr. 4) |
|---------------------------------|--------------------------------------|--|--------------------------------|---|---|--|-----------------------------------|
| | | | Code | V Amount (D) Price | | | |
| Common Stock | 12/20/2013 | | G | V 38,500 D \$ 0 | 763,570 ⁽¹⁾ | D | |

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned (e.g., puts, calls, warrants, options, convertible securities)

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| 1. Title of Derivative Security (Instr. 3) | 2. Conversion or Exercise Price of Derivative Security | 3. Transaction Date (Month/Day/Year) | 3A. Deemed Execution Date, if any (Month/Day/Year) | 4. Transaction Code (Instr. 8) | 5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5) | 6. Date Exercisable and Expiration Date (Month/Day/Year) | 7. Title and Amount of Underlying Securities (Instr. 3 and 4) | 8. Price of Derivative Security (Instr. 5) | 9. Number of Derivative Securities Owned Following Transaction (Instr. 5) |
|--|--|--------------------------------------|--|--------------------------------|---|--|---|--|---|
|--|--|--------------------------------------|--|--------------------------------|---|--|---|--|---|

Reporting Owners

| Reporting Owner Name / Address | Relationships | | | |
|---|---------------|-----------|-----------------|-------|
| | Director | 10% Owner | Officer | Other |
| REMONDI JOHN F 300 CONTINENTAL DRIVE NEWARK, DE 19713 | | | President & CEO | |

Signatures

/s/ Laurent C. Lutz (POA) /s/ John F. Remondi
 **Signature of Reporting Person
 Date: 01/03/2014

Explanation of Responses:

- * If the form is filed by more than one reporting person, see Instruction 4(b)(v).
- ** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. See 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) Dividend equivalent rights issued on RSUs and PSUs are included in Mr. Remondi's common stock holding balance.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, see Instruction 6 for procedure. Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. porting person's employment.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, see Instruction 6 for procedure. Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. times;"> 435 0.1%

Common Stock Class B (28 shares)

211 228 0.0%

588 663 0.1%

H&M Oil & Gas, LLC

Texas / Oil & Gas Production

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Senior Secured Note (13.00% plus 3.00% PIK, due 9/30/2010)

59,107 59,107 48,867 6.9%

Net Profits Interest (8.00% payable on Equity distributions)(7)

827 0.1%

59,107 49,694 7.0%

Hoffmaster Group, Inc.

Wisconsin / Durable Consumer Products

Second Lien Term Loan (13.50%, due 6/2/2017)(3)

20,000 20,000 20,000 2.8%

20,000 20,000 2.8%

Hudson Products Holdings, Inc.(17)

Texas / Manufacturing

Senior Secured Term Loan (8.00%, due 8/24/2015)(3)(4)

6,365 5,734 5,314 0.7%

5,734 5,314 0.7%

IEC-Systems, LP ("IEC") /Advanced Rig Services, LLC ("ARS")

Texas / Oilfield Fabrication

IEC Senior Secured Note (12.00% plus 3.00% PIK, due 11/20/2012)(3)(4)

19,008 19,008 19,008 2.7%

ARS Senior Secured Note (12.00% plus 3.00% PIK, due 11/20/2012)(3)(4)

11,421 11,421 11,421 1.6%

30,429 30,429 4.3%

See notes to consolidated financial statements.

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARY
CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)

June 30, 2011 and June 30, 2010

(in thousands, except share data)

| Portfolio Company | Locale / Industry | Investments(1) | June 30, 2010 | | | % of Net Assets |
|--|--|--|-----------------|---------------|---------------|-----------------|
| | | | Principal Value | Cost | Fair Value(2) | |
| LEVEL 3 PORTFOLIO INVESTMENTS: | | | | | | |
| Non-control/Non-affiliate Investments (less than 5.00% of voting control) | | | | | | |
| Impact Products, LLC | Ohio / Home & Office Furnishings, Housewares & Durable | Junior Secured Term Loan (6.38%, due 9/09/2012)(4) | \$ 7,300 | \$ 6,351 | \$ 7,290 | 1.0% |
| | | Senior Subordinated Debt (10.00% plus 5.00% PIK, due 9/09/2012) | 5,548 | 5,300 | 5,548 | 0.8% |
| | | | | 11,651 | 12,838 | 1.8% |
| Label Corp Holdings, Inc. | Nebraska / Printing & Publishing | Senior Secured Term Loan (8.50%, due 8/08/2014)(3)(4) | 5,794 | 5,222 | 5,284 | 0.7% |
| | | | | 5,222 | 5,284 | 0.7% |
| LHC Holdings Corp.(17) | Florida / Healthcare | Revolving Line of Credit \$750 Commitment (9.00%, due 11/30/2012)(26)(27) | | | | 0.0% |
| | | Senior Secured Term Loan A (9.00%, due 11/30/2012)(3)(4) | 2,015 | 2,015 | 1,839 | 0.3% |
| | | Senior Subordinated Debt (12.00% plus 2.50% PIK, due 5/31/2013)(3) | 4,565 | 4,199 | 4,220 | 0.6% |
| | | Membership Interest (125 units) | | 216 | 217 | 0.0% |
| | | | | 6,430 | 6,276 | 0.9% |
| Mac & Massey Holdings, LLC | Georgia / Food Products | Senior Subordinated Debt (10.00% plus 5.75% PIK, due 2/10/2013) | 8,671 | 7,351 | 8,643 | 1.2% |
| | | Membership Interest (250 units) | | 145 | 390 | 0.1% |
| | | | | 7,496 | 9,033 | 1.3% |
| Maverick Healthcare, LLC | Arizona / Healthcare | Second Lien Debt (12.50% plus 3.50% PIK, due 4/30/2014)(3) | 13,122 | 13,122 | 13,247 | 1.9% |
| | | Preferred Units (1,250,000 units) | | 1,252 | 2,025 | 0.2% |
| | | Common Units (1,250,000 units) | | | | 0.0% |
| | | | | 14,374 | 15,272 | 2.1% |
| Miller Petroleum, Inc. | Tennessee / Oil & Gas Production | Warrants, Common Stock (2,208,772 warrants, expiring 5/04/2010 to 3/31/2015)(14) | | 150 | 1,244 | 0.2% |
| | | | | 150 | 1,244 | 0.2% |
| Northwestern Management Services, LLC | Florida / Healthcare | Revolving Line of Credit \$1,000 Commitment (4.36%, due 12/13/2012)(26)(27) | 350 | 350 | 350 | 0.0% |
| | | Senior Secured Term Loan A (4.36%, due 12/13/2012)(3)(4) | 4,309 | 3,516 | 3,578 | 0.5% |

Explanation of Responses:

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| | | | | | | |
|-------------------------------------|--|--|--------|---------------|---------------|-------------|
| | | Senior Secured Term Loan B (4.86%, due 12/13/2012)(3)(4) | 1,219 | 904 | 956 | 0.1% |
| | | Subordinated Secured Term Loan (12.00% plus 3.00%, due 6/13/2013)(3) | 2,971 | 2,468 | 2,606 | 0.4% |
| | | Common Stock (50 shares) | | 371 | 564 | 0.1% |
| | | | | 7,609 | 8,054 | 1.1% |
| Prince Mineral Company, Inc. | New York / Metal Services and Minerals | Junior Secured Term Loan (9.00%, due 12/21/2012)(4) | 11,150 | 11,150 | 11,150 | 1.6% |
| | | Senior Subordinated Debt (13.00% plus 2.00%, due 7/21/2013) | 12,260 | 1,420 | 12,260 | 1.7% |
| | | | | 12,570 | 23,410 | 3.3% |
| Qualitest Pharmaceuticals, Inc.(17) | Alabama / Pharmaceuticals | Second Lien Debt (7.79%, due 4/30/2015)(3)(4) | 12,000 | 11,955 | 12,000 | 1.7% |
| | | | | 11,955 | 12,000 | 1.7% |

See notes to consolidated financial statements.

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARY
CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)

June 30, 2011 and June 30, 2010

(in thousands, except share data)

| Portfolio Company | Locale / Industry | Investments(1) | Principal Value | June 30, 2010 | | % of Net Assets |
|--|---------------------------------------|---|-----------------|---------------|---------------|-----------------|
| | | | | Cost | Fair Value(2) | |
| LEVEL 3 PORTFOLIO INVESTMENTS: | | | | | | |
| Non-control/Non-affiliate Investments (less than 5.00% of voting control) | | | | | | |
| Regional Management Corporation | South Carolina / Financial Services | Second Lien Debt (12.00% plus 2.00% PIK, due 6/29/2012)(3) | \$ 25,814 | \$ 25,814 | \$ 25,592 | 3.6% |
| | | | | 25,814 | 25,592 | 3.6% |
| Roll Coater Acquisition Corp | Indiana / Metal Services and Minerals | Subordinated Secured Debt (10.25%, due 9/30/2010) | 6,268 | 6,102 | 6,082 | 0.9% |
| | | | | 6,102 | 6,082 | 0.9% |
| ROM Acquisition Corporation | Missouri / Automobile | Revolving Line of Credit \$1,750 Commitment (4.50%, due 2/08/2013)(26)(27) | | | | 0.0% |
| | | Senior Secured Term Loan A (4.50%, due 2/08/2013)(3)(4) | 4,640 | 4,025 | 4,571 | 0.6% |
| | | Senior Secured Term Loan B (8.00%, due 5/08/2013)(3)(4) | 7,251 | 7,251 | 7,078 | 1.0% |
| | | Senior Subordinated Debt (12.00% plus 3.00% PIK due 8/08/2013)(3) | 7,118 | 6,799 | 6,392 | 0.9% |
| | | | | 18,075 | 18,041 | 2.5% |
| Seaton Corp | Illinois / Business Services | Subordinated Secured (12.50% plus 2.00% PIK, due 3/14/2011) | 12,296 | 12,060 | 12,132 | 1.7% |
| | | | | 12,060 | 12,132 | 1.7% |
| Shearer's Foods, Inc. | Ohio / Food Products | Junior Secured Debt (12.00% plus 3.00% PIK, due 3/31/2016)(3) | 35,266 | 35,266 | 36,119 | 5.1% |
| | | Membership Interest in Mistral Chip Holdings, LLC (2,000 units)(18) | | 2,560 | 6,136 | 0.9% |
| | | Membership Interest in Mistral Chip Holdings, LLC 2 (595 units)(18) | | 762 | 1,825 | 0.2% |
| | | | | 38,588 | 44,080 | 6.2% |
| Skillssoft Public Limited Company | Ireland / Prepackaged Software | Subordinated Unsecured (11.125%, due 06/01/2018) | 15,000 | 14,903 | 15,000 | 2.2% |
| | | | | 14,903 | 15,000 | 2.2% |
| Stryker Energy, LLC | Ohio / Oil & Gas Production | Subordinated Secured Revolving Credit Facility \$49,250 Commitment (12.00%, due 12/01/2012)(3)(4) | 29,724 | 29,507 | 29,624 | 4.2% |
| | | Overriding Royalty Interests(19) | | | 2,768 | 0.4% |

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| | | | | | | |
|------------------------------|-----------------------------------|--|--------|---------------|---------------|-------------|
| | | | | 29,507 | 32,392 | 4.6% |
| TriZetto Group(17) | California / Healthcare | Subordinated Unsecured Note (12.00% plus 1.50% PIK, due 10/01/2016)(3) | 15,434 | 15,306 | 15,895 | 2.2% |
| | | | | 15,306 | 15,895 | 2.2% |
| Unitek Acquisition, Inc.(17) | Pennsylvania / Technical Services | Second Lien Debt (13.08%, due 12/31/2013)(3)(4) | 11,500 | 11,387 | 11,615 | 1.7% |
| | | | | 11,387 | 11,615 | 1.7% |

See notes to consolidated financial statements.

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARY
CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)

June 30, 2011 and June 30, 2010

(in thousands, except share data)

| Portfolio Company | Locale / Industry | Investments(1) | Principal Value | June 30, 2010 | | % of Net Assets |
|--|-----------------------------------|---|-----------------|----------------|----------------|-----------------|
| | | | | Cost | Fair Value(2) | |
| LEVEL 3 PORTFOLIO INVESTMENTS: | | | | | | |
| Non-control/Non-affiliate Investments (less than 5.00% of voting control) | | | | | | |
| Wind River Resources Corp. and Wind River II Corp. | Utah / Oil & Gas Production | Senior Secured Note (13.00% plus 3.00% default interest, in non-accrual status effective 12/01/2008, due 7/31/2010)(4) Net Profits Interest (5.00% payable on Equity distributions)(7) | \$ 15,000 | \$ 15,000 | \$ 8,779 | 1.2% |
| | | | | | | 0.0% |
| | | | | 15,000 | 8,779 | 1.2% |
| | | Total Non-control/Non-affiliate Investments (Level 3 Investments) | | 476,441 | 477,417 | 67.1% |
| | | Total Level 3 Portfolio Investments | | 727,243 | 747,115 | 105.0% |
| LEVEL 1 PORTFOLIO INVESTMENTS: | | | | | | |
| Non-control/Non-affiliate Investments (less than 5.00% of voting control) | | | | | | |
| Allied Defense Group, Inc. | Virginia / Aerospace & Defense | Common Stock (10,000 shares) | | 56 | 38 | 0.0% |
| | | | | 56 | 38 | 0.0% |
| Dover Saddlery, Inc. | Massachusetts / Retail | Common Stock (30,974 shares) | | 63 | 97 | 0.0% |
| | | | | 63 | 97 | 0.0% |
| LyondellBasell Industries N.V. | Netherlands / Chemical Company | Class A Common Stock (26,961 shares) Class B Common Stock (49,421 shares) | | 874 523 | 435 798 | 0.2% 0.0% |
| | | | | 1,397 | 1,233 | 0.2% |
| | | Total Non-control/Non-affiliate Investments (Level 1 Investments) | | 1,516 | 1,368 | 0.2% |
| | | Total Portfolio Investments | | 728,759 | 748,483 | 105.2% |
| SHORT TERM INVESTMENTS: Money Market Funds (Level 2 Investments) | | | | | | |
| Fidelity Institutional Money Market Funds | Government Portfolio (Class I) | | | 62,183 | 62,183 | 8.8% |
| Fidelity Institutional Money Market Funds | Government Portfolio (Class I)(3) | | | 6,687 | 6,687 | 0.9% |
| Victory Government Money Market Funds | | | | 1 | 1 | 0.0% |
| | | Total Money Market Funds | | 68,871 | 68,871 | 9.7% |
| | | Total Investments | | 797,630 | 817,354 | 114.9% |

See notes to consolidated financial statements.

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARY
CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)

June 30, 2011 and June 30, 2010

(in thousands, except share data)

Endnote Explanations for the Consolidated Schedule of Investments as of June 30, 2011 and June 30, 2010

- (1) The securities in which Prospect Capital Corporation ("we", "us" or "our") has invested were acquired in transactions that were exempt from registration under the Securities Act of 1933, as amended, or the "Securities Act." These securities may be resold only in transactions that are exempt from registration under the Securities Act.
- (2) Fair value is determined by or under the direction of our Board of Directors. As of June 30, 2011, two of our portfolio investments, Allied Defense Group, Inc. ("Allied") and Dover Saddlery, Inc. ("Dover") were publically traded and classified as Level 1 within the valuation hierarchy established by Accounting Standards Codification 820, *Fair Value Measurements and Disclosures* ("ASC 820"). As of June 30, 2010, three of our portfolio investments, Allied, Dover and LyondellBasel Industries N.V., were publically traded and classified as Level 1 within the valuation hierarchy established by ASC 820. As of June 30 2011 and June 30, 2010, the fair value of our remaining portfolio investments was determined using significant unobservable inputs. ASC 820 classifies such inputs used to measure fair value as Level 3 within the valuation hierarchy. Our investments in money market funds are classified as Level 2. See Note 2 and Note 4 within the accompanying consolidated financial statements for further discussion.
- (3) Security, or portion thereof, is pledged as collateral for the revolving credit facility (See Note 5). The market values of these investments at June 30, 2011 and June 30, 2010 were \$700,321 and \$512,244, respectively; they represent 46.0% and 62.7% of total investments at fair value, respectively. Prospect Capital Funding, LLC (See Note 1), our wholly-owned subsidiary, holds an aggregate market value of \$631,915 and \$451,648 of these investments as of June 30, 2011 and June 30, 2010, respectively.
- (4) Security, or portion thereof, has a floating interest rate which may be subject to a Libor floor. Stated interest rate was in effect at June 30, 2011 and June 30, 2010.
- (5) There are several entities involved in the Biomass investment. We own 100 shares of common stock in Worcester Energy Holdings, Inc. ("WEHI"), representing 100% of the issued and outstanding common stock. WEHI, in turn, owns 51 membership certificates in Biochips LLC ("Biochips"), which represents a 51% ownership stake.

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

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

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARY
CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)

June 30, 2011 and June 30, 2010

(in thousands, except share data)

Endnote Explanations for the Consolidated Schedule of Investments as of June 30, 2011 and June 30, 2010 (Continued)

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. As a result of the foreclosure our direct ownership in CCEI increased to 3,265 shares of common stock. The assets were subsequently assigned to DEPC. WECO, CCEI and Biochips are joint borrowers on the term note issued to Prospect Capital. Effective July 1, 2008, this loan was placed on non-accrual status.

Biochips, WECO, CCEI, Precision and WEHI currently have no material operations and no significant assets. As of June 30, 2009, our Board of Directors assessed a fair value of \$0 for all of these equity positions and the loan position. We determined that the impairment of both CCEI and CCEHI as of June 30, 2009 was other than temporary and recorded a realized loss for the amount that the amortized cost exceeds the fair value at June 30, 2009. Our Board of Directors set value at zero for the CCEHI investment as of June 30, 2011 and June 30, 2010.

(6) During the quarter ended December 31, 2009, we created two new entities, Coalbed Inc. and Coalbed LLC, to foreclose on the outstanding senior secured loan and assigned rights and interests of Conquest Cherokee, LLC ("Conquest"), as a result of the deterioration of Conquest's financial performance and inability to service debt payments. We own 1,000 shares of common stock in Coalbed Inc., representing 100% of the issued and outstanding common stock. Coalbed Inc., in turn owns 100% of the membership interest in Coalbed LLC.

On October 21, 2009, Coalbed LLC foreclosed on the loan formerly made to Conquest. On January 19, 2010, as part of the Manx rollup, the Coalbed LLC assets and loan was assigned to Manx, the holding company. As of June 30, 2011, our Board of Directors assessed a fair value of zero for the loan position in Coalbed LLC, a decrease of \$1,414 from the fair value as of June 30, 2010.

(7) In addition to the stated returns, the net profits interest held will be realized upon sale of the borrower or a sale of the interests.

(8) Gas Solutions Holdings, Inc. is a wholly-owned investment of us.

(9) Entity was formed as a result of the debt restructuring of ESA Environmental Specialist, Inc. In early 2009, we foreclosed on the two loans on non-accrual status and purchased the underlying personal and real property. We own 1,000 shares of common stock in The Healing Staff ("THS"), f/k/a Lisamarie Fallon, Inc. representing 100% ownership. We own 1,500 shares of Vets Securing America, Inc. ("VSA"), representing 100% ownership. VSA is a holding company for the real property of Integrated Contract Services, Inc. ("ICS") purchased during the foreclosure process.

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

(11) On June 30, 2008, we consolidated our holdings in four coal companies into Yatesville Coal Holdings, Inc. ("Yatesville"), and consolidated the operations under one management team. As part of the transaction, the debt that we held of C&A Construction, Inc. ("C&A"), Genesis Coal Corp. ("Genesis"), North Fork Collieries LLC ("North Fork") and Unity Virginia Holdings LLC ("Unity") were exchanged for newly issued debt from Yatesville, and our ownership interests in

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARY
CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)

June 30, 2011 and June 30, 2010

(in thousands, except share data)

Endnote Explanations for the Consolidated Schedule of Investments as of June 30, 2011 and June 30, 2010 (Continued)

C&A, E&L Construction, Inc. ("E&L"), Whymore Coal Company Inc. ("Whymore") and North Fork were exchanged for 100% of the equity of Yatesville. This reorganization allows for a better utilization of the assets in the consolidated group.

At June 30, 2011 and at June 30, 2010, Yatesville owned 100% of the membership interest of North Fork. In addition, Yatesville held a \$9,325 note receivable from North Fork as of those two respective dates.

At June 30, 2011 and at June 30, 2010, we owned 96% and 87%, respectively, of the common stock of Genesis and held a note receivable of \$20,897 as of those two respective dates.

Yatesville held a note receivable of \$4,261 from Unity at June 30, 2011 and at June 30, 2010.

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

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

Yatesville currently has no material operations. During the quarter ended December 31, 2009, our Board of Directors determined that the impairment of Yatesville was other than temporary and we recorded a realized loss for the amount that the amortized cost exceeds the fair value. Our Board of Directors set the value of the remaining Yatesville investment at zero and \$808 as of June 30, 2011 and June 30, 2010, respectively.

- (12) On January 19, 2010, we modified the terms of our senior secured debt in AEH and Coalbed in conjunction with the formation of Manx Energy, a new entity consisting in the assets of AEH, Coalbed and Kinley Exploration. The assets of the three companies were brought under new common management. We funded \$2,800 at closing to Manx to provide for working capital. A portion of our loans to AEH and Coalbed was exchanged for Manx preferred equity, while our AEH equity interest was converted into Manx common stock. There was no change to fair value at the time of restructuring, and we continue to fully reserve any income accrued for Manx.
- (13) On a fully diluted basis represents 10.00% of voting common shares.
- (14) Total common shares outstanding of 33,389,383 as of July 22, 2010 from Miller's Annual Report on Form 10-K filed on July 28, 2010 as applicable to our June 30, 2010 reporting date.

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARY
CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)

June 30, 2011 and June 30, 2010

(in thousands, except share data)

Endnote Explanations for the Consolidated Schedule of Investments as of June 30, 2011 and June 30, 2010 (Continued)

- (15) A portion of the positions listed were issued by an affiliate of the portfolio company.
- (16) We own 99.9999% of AGC/PEP, LLC. AGC/PEP, LLC owns 2,037.65 out of a total of 83,818.69 shares (including 5,111 vested and unvested management options) of American Gilsonite Holding Company which owns 100% of American Gilsonite Company.
- (17) Syndicated investment which had been originated by another financial institution and broadly distributed.
- (18) At June 30, 2011 and June 30, 2010, Mistral Chip Holdings, LLC owns 44,800 shares of Chip Holdings, Inc. and Mistral Chip Holdings 2, LLC owns 11,975 shares in Chip Holdings, Inc. Chip Holdings, Inc. is the parent company of Shearer's Foods, Inc. and has 67,936 shares outstanding before adjusting for management options.
- (19) The overriding royalty interests held receive payments at the stated rates based upon operations of the borrower.
- (20) On December 31, 2009, we sold our investment in Aylward Enterprises, LLC. AWCNC, LLC is the remaining holding company with zero assets. Our remaining outstanding debt after the sale was written off on December 31, 2009 and no value has been assigned to the equity position as of June 30, 2011 and June 30, 2010.
- (21) We own 100% of Freedom Marine Holding, Inc., which owns 82.94% of the common units of Freedom Marine Services LLC.
- (22) We own warrants to purchase 33,750 shares of common stock in Metal Buildings Holding Corporation ("Metal Buildings"), the former holding company of Borga, Inc. Metal Buildings Holding Corporation owned 100% of Borga, Inc.

On March 8, 2010, we foreclosed on the stock in Borga, Inc. that was held by Metal Buildings, obtaining 100% ownership of Borga, Inc.
- (23) We own 100% of C&J Cladding Holding Company, Inc., which owns 40% of the membership interests in C&J Cladding, LLC.
- (24) On January 1, 2010, we restructured our senior secured and bridge loans investment in Iron Horse Coiled Tubing, Inc. ("Iron Horse") and we reorganized Iron Horse's management structure. The senior secured loan and bridge loan were replaced with three new tranches of senior secured debt. From June 30, 2009 to June 30, 2011, our total ownership of Iron Horse decreased from 80.0% to 57.8%, respectively, and we will continue to transfer ownership interests to Iron Horse's management as they repay our outstanding debt.

As of June 30, 2011 and June 30, 2010, our Board of Directors assessed a fair value in Iron Horse of \$15,357 and \$12,054, respectively.
- (25) On May 6, 2011, we made a secured first-lien \$24,250 debt investment to NMMB Acquisition, Inc., a \$2,800 secured debt and \$4,400 equity investment to NMMB Holdings, Inc. We own 100% of the

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARY
CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)

June 30, 2011 and June 30, 2010

(in thousands, except share data)

Endnote Explanations for the Consolidated Schedule of Investments as of June 30, 2011 and June 30, 2010 (Continued)

Series A Preferred Stock in NMMB Holdings, Inc. NMMB Holdings, Inc. owns 100% of the Convertible Preferred in NMMB Acquisition, Inc. NMMB Acquisition, Inc. has a 5.8% dividend rate which is paid to NMMB Holdings, Inc. Our fully diluted ownership in NMMB Holdings, Inc. is 100% as of June 30, 2011. Our fully diluted ownership in NMMB Acquisition, Inc. is 83.5% as of June 30, 2011.

- (26) Undrawn committed revolvers incur commitment fees ranging from 0.50% to 2.00%. As of June 30, 2011 and June 30, 2010, we have \$35,822 and \$29,908 of undrawn revolver commitments to our portfolio companies, respectively.
- (27) Stated interest rates are based on June 30, 2011 and June 30, 2010 one month Libor rates plus applicable spreads based on the respective credit agreements. Interest rates are subject to change based on actual elections by the borrower for a Libor rate contract or Base Rate contract when drawing on the revolver.
- (28) On July 30, 2010, we made a secured first-lien \$30,000 debt investment to AIRMALL USA, Inc., a \$12,500 secured second-lien to AMU Holdings, Inc., and 100% of the Convertible Preferred Stock and Common stock of AMU Holdings, Inc. Our Convertible Preferred Stock in AMU Holdings, Inc. has a 12.0% dividend rate which is paid from the dividends received from the underlying operating company, AIRMALL USA Inc. AMU Holdings, Inc. owns 100% of the common stock in AIRMALL USA, Inc.
- (29) Progrexion Marketing, Inc., Progrexion Teleservices, Inc., Progrexion ASG, Inc. Progrexion IP, Inc. and Efolks, LLC, are joint borrowers on our senior secured investment. Progrexion Holdings, Inc. and eFolks Holdings, Inc. are the guarantors of this debt investment.

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data)

Note 1. Organization

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

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

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

Note 2. Significant Accounting Policies

The following are significant accounting policies consistently applied by us:

Basis of Presentation

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

Use of Estimates

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

Basis of Consolidation

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

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(in thousands, except share and per share data)

Note 2. Significant Accounting Policies (Continued)

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 Risks

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

Market Risk

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

Credit Risk

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

Liquidity Risk

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

Interest Rate Risk

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

Prepayment Risk

Many of the Company's debt investments allow for prepayment of principal without penalty. Downward changes in interest rates may cause prepayments to occur at a faster than expected

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(in thousands, except share and per share data)

Note 2. Significant Accounting Policies (Continued)

rate, thereby effectively shortening the maturity of the security and making the security less likely to be an income producing instrument.

Investment Valuation

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

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

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

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

In September 2006, the Financial Accounting Standards Board ("FASB") issued ASC 820, *Fair Value Measurements and Disclosures* ("ASC 820"). ASC 820 defines fair value, establishes a framework

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(in thousands, except share and per share data)

Note 2. Significant Accounting Policies (Continued)

for measuring fair value in GAAP, and expands disclosures about fair value measurements. We adopted ASC 820 on a prospective basis beginning in the quarter ended September 30, 2008.

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

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

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

Level 3: Unobservable inputs for the asset or liability.

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

In April 2009, the FASB issued ASC Subtopic 820-10-65, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* ("ASC 820-10"). This update provides further clarification for ASC 820 in markets that are not active and provides additional guidance for determining when the volume of trading level of activity for an asset or liability has significantly decreased and for identifying circumstances that indicate a transaction is not orderly. ASC 820-10-65 is effective for interim and annual reporting periods ending after June 15, 2009. The adoption of ASC 820-10-65 for the years ended June 30, 2011 and 2010, did not have any effect on our net asset value, financial position or results of operations as there was no change to the fair value measurement principles set forth in ASC 820.

Valuation of Other Financial Assets and Financial Liabilities

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

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(in thousands, except share and per share data)

Note 2. Significant Accounting Policies (Continued)

Senior Convertible Notes

We have recorded the Senior Convertible Notes (See Note 6) at their contractual amounts. The Senior Convertible Notes were analyzed for any features that would require its accounting to be bifurcated and they were determined to be immaterial.

Revenue Recognition

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

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

Dividend income is recorded on the ex-dividend date.

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

Loans are placed on non-accrual status when there is reasonable doubt that principal or interest will not be collected in accordance with the terms of the investment. 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.

PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(in thousands, except share and per share data)

Note 2. Significant Accounting Policies (Continued)

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

If we fail to satisfy the Annual Distribution Requirement or otherwise fail to qualify as a RIC in any taxable year, we would be subject to tax on all of our taxable income at regular corporate rates. We would not be able to deduct distributions to stockholders, nor would we be required to make distributions. Distributions would generally be taxable to our individual and other non-corporate taxable stockholders as ordinary dividend income eligible for the reduced maximum rate for taxable years beginning before 2013 (but not for taxable years beginning thereafter, unless the relevant provisions are extended by legislation) to the extent of our current and accumulated earnings and profits, provided certain holding period and other requirements are met. Subject to certain limitations under the Code, corporate distributions would be eligible for the dividends-received deduction. To qualify again to be taxed as a RIC in a subsequent year, we would be required to distribute to our shareholders our accumulated earnings and profits attributable to non-RIC years reduced by an interest charge of 50% of such earnings and profits payable by us as an additional tax. In addition, if we failed to qualify as a RIC for a period greater than two taxable years, then, in order to qualify as a RIC in a subsequent year, we would be required to elect to recognize and pay tax on any net built-in gain (the excess of aggregate gain, including items of income, over aggregate loss that would have been realized if we had been liquidated) or, alternatively, be subject to taxation on such built-in gain recognized for a period of ten years.

We follow ASC 740, *Income Taxes* ("ASC 740"). ASC 740 provides guidance for how uncertain tax positions should be recognized, measured, presented, and disclosed in the financial statements. ASC 740 requires the evaluation of tax positions taken or expected to be taken in the course of preparing our tax returns to determine whether the tax positions are "more-likely-than-not" of being sustained by the applicable tax authority. Tax positions not deemed to meet the more-likely-than-not threshold are recorded as a tax benefit or expense in the current year. Adoption of ASC 740 was applied to all open tax years as of July 1, 2007. The adoption of ASC 740 did not have an effect on our net asset value, financial condition or results of operations as there was no liability for unrecognized tax benefits and no change to our beginning net asset value. As of June 30, 2011 and for the year then ended, we did not have a liability for any unrecognized tax benefits. Management's determinations regarding ASC 740 may be subject to review and adjustment at a later date based upon factors including, but not limited to, an on-going analysis of tax laws, regulations and interpretations thereof.

Dividends and Distributions

Dividends and distributions to common stockholders are recorded on the ex-dividend date. The amount, if any, to be paid as a monthly dividend or distribution is approved by our Board of Directors

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(in thousands, except share and per share data)

Note 2. Significant Accounting Policies (Continued)

quarterly 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 and the Senior Convertible Notes as deferred financing costs. These expenses are deferred and amortized as part of interest expense using the straight-line method for our revolving credit facility and the effective interest method for our Senior Convertible Notes, over the respective expected life.

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

Guarantees and Indemnification Agreements

We follow ASC 460, *Guarantees* ("ASC 460"). ASC 460 elaborates on the disclosure requirements of a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also requires a guarantor to recognize, at the inception of a guarantee, for those guarantees that are covered by ASC 460, the fair value of the obligation undertaken in issuing certain guarantees.

Per Share Information

Net increase or decrease in net assets resulting from operations per common share are calculated using the weighted average number of common shares outstanding for the period presented. In accordance with ASC 946, *Financial Services Investment Companies*, convertible securities are not considered in the calculation of net assets per share.

Recent Accounting Pronouncements

In January 2010, the FASB issued Accounting Standards Update 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements* ("ASC 2010-06"). ASU 2010-06 amends ASC 820-10 and clarifies and provides additional disclosure requirements related to recurring and non-recurring fair value measurements and employers' disclosures about postretirement benefit plan assets. ASU 2010-06 is effective December 15, 2009, except for the disclosure about purchase, sales, issuances and settlements in the roll forward of activity in level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 (or July 1, 2011 for us) and for interim periods within those fiscal years. Our management does not believe that the adoption of the amended guidance in ASC 820-10 will have a significant effect on our financial statements.

In February 2011, the FASB issued Accounting Standards Update 2011-02, *Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring* ("ASU 2011-02"). ASU 2011-02 clarifies which loan modifications constitute troubled debt restructurings. It is intended to assist creditors in determining whether a modification of the terms of a receivable meets the criteria to

Table of Contents**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(in thousands, except share and per share data)****Note 2. Significant Accounting Policies (Continued)**

be considered a troubled debt restructuring, both for purposes of recording an impairment loss and for disclosure of troubled debt restructurings. In evaluating whether a restructuring constitutes a troubled debt restructuring, a creditor must separately conclude that both of the following exist: (a) the restructuring constitutes a concession; and (b) the debtor is experiencing financial difficulties. ASU 2011-02 provides guidance to clarify whether the creditor has granted a concession and whether a debtor is experiencing financial difficulties. The new guidance is effective for interim and annual periods beginning on or after June 15, 2011, and applies retrospectively to restructurings occurring on or after the beginning of the fiscal year of adoption or July 1, 2011 for us. We do not believe that the adoption of the amended guidance in ASU 2011-02 will have a significant effect on our financial statements.

In May 2011, the FASB issued Accounting Standards Update 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* ("ASU 2011-04"). ASU 2011-04 amends Accounting Standards Codification Topic 820, "Fair Value Measurements" ("ASC 820") by: (1) clarifying that the highest-and-best-use and valuation-premise concepts only apply to measuring the fair value of non-financial assets; (2) allowing a reporting entity to measure the fair value of the net asset or net liability position in a manner consistent with how market participants would price the net risk position, if certain criteria are met; (3) providing a framework for considering whether a premium or discount can be applied in a fair value measurement; (4) providing that the fair value of an instrument classified in a reporting entity's shareholders' equity is estimated from the perspective of a market participant that holds the identical item as an asset; and (5) expanding the qualitative and quantitative fair value disclosure requirements. The expanded disclosures include, for Level 3 items, a description of the valuation process and a narrative description of the sensitivity of the fair value to changes in unobservable inputs and interrelationships between those inputs if a change in those inputs would result in a significantly different fair value measurement. ASU 2011-4 also requires disclosures about the highest-and-best-use of a non-financial asset when this use differs from the asset's current use and the reasons for such a difference. In addition, this ASU amends Accounting Standards Codification 820, "Fair Value Measurements," to require disclosures to include any transfers between Level 1 and Level 2 of the fair value hierarchy. These amendments are effective for fiscal years beginning after December 15, 2011 and for interim periods within those fiscal years. The amendments of ASU 2011-04, when adopted, are not expected to have a material impact on our consolidated financial statements.

Note 3. Patriot Acquisition

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

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

Table of Contents**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(in thousands, except share and per share data)****Note 3. Patriot Acquisition (Continued)**

The merger has been accounted for as an acquisition of Patriot by Prospect Capital Corporation ("Prospect") in accordance with acquisition method of accounting as detailed in ASC 805, *Business Combinations* ("ASC 805"). The fair value of the consideration paid was allocated to the assets acquired and liabilities assumed based on their fair values as the date of acquisition. As described in more detail in ASC 805, goodwill, if any, would have been recognized as of the acquisition date, if the consideration transferred exceeded the fair value of identifiable net assets acquired. As of the acquisition date, the fair value of the identifiable net assets acquired exceeded the fair value of the consideration transferred, and we recognized the excess as a gain. A preliminary gain of \$5,714 was recorded by Prospect in the quarter ended December 31, 2009 related to the acquisition of Patriot, which was revised in the fourth quarter of the fiscal year ended June 30, 2010 to \$7,708, when we settled severance accruals related to certain members of Patriot's top management and finalized during the first quarter of the fiscal year ended June 30, 2011, to \$8,632, when we settled the remaining severance accruals related to the last two members of Patriot's top management. Under ASC 805, the adjustments to our preliminary estimate were reflected in the three months ended December 31, 2009 (See Note 14). The acquisition of Patriot was negotiated in July 2009 with the purchase agreement being signed on August 3, 2009. Between July 2009 and December 2, 2009, our valuation of certain of the investments acquired from Patriot increased due to market improvement, which resulted in the recognition of the gain at closing.

Purchase Price Allocation

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

| | |
|---|-----------------|
| Cash (to repay Patriot debt) | \$ 107,313 |
| Cash (to fund purchase of restricted stock from former Patriot employees) | 970 |
| Common stock issued(1) | 92,800 |
| Total purchase price | 201,083 |
| Assets acquired: | |
| Investments(2) | 207,126 |
| Cash and cash equivalents | 1,697 |
| Other assets | 3,859 |
| Assets acquired | 212,682 |
| Other liabilities assumed | (2,967) |
| Net assets acquired | 209,715 |
| Gain on Patriot acquisition(3) | \$ 8,632 |

(1) The value of the shares of common stock exchanged with the Patriot common shareholders was based upon the closing price of our common stock on December 2, 2009, the price immediately prior to the closing of the transaction.

(2) The fair value of Patriot's investments were determined by the Board of Directors in conjunction with an independent valuation agent. This valuation resulted in a purchase

Table of Contents**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(in thousands, except share and per share data)****Note 3. Patriot Acquisition (Continued)**

price which was \$98,150 below the amortized cost of such investments. For those assets which are performing, Prospect will record the accretion to par value in interest income over the remaining term of the investment.

(3)

The gain has been determined after the final payments of certain liabilities have been settled.

Condensed Statement of Net Assets Acquired

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

| | |
|--|-------------------|
| Investment securities | \$ 207,126 |
| Cash and cash equivalents | 1,697 |
| Other assets | 3,859 |
| Total assets | 212,682 |
| Other liabilities | (2,967) |
| Final fair value of net assets acquired | \$ 209,715 |

The following unaudited pro forma condensed combined financial information does not purport to be indicative of actual financial position or results of our operations had the Patriot acquisition actually been consummated at the beginning of each year presented. Certain one-time charges have been eliminated. The pro forma adjustments reflecting the allocation of the purchase price of Patriot and the gain of \$8,632 recognized on the Patriot Acquisition have been eliminated from all periods presented. Management expects to realize net operating synergies from this transaction. The pro forma condensed combined financial information does not reflect the potential impact of these synergies and does not reflect any impact of additional accretion which would have been recognized on the transaction, except for that which was recorded after the transaction was consummated on December 2, 2009. There are no applicable pro-forma adjustments to the operating results for the year ended June 30, 2011 as the Patriot acquisition was consummated prior to the beginning of the fiscal year ended June 30, 2011.

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

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Table of Contents**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(in thousands, except share and per share data)

Note 4. Portfolio Investments

At June 30, 2011, we had invested in 72 long-term portfolio investments, which had an amortized cost of \$1,435,734 and a fair value of \$1,463,010 and at June 30, 2010, we had invested in 58 long-term portfolio investments, which had an amortized cost of \$728,759 and a fair value of \$748,483.

As of June 30, 2011, we own controlling interests in AIRMALL USA, Inc., Ajax Rolled Ring & Machine, Inc. ("Ajax"), AWCNC, LLC, Borga, Inc. ("Borga"), C&J Cladding, LLC, Change Clean Energy Holdings, Inc., Freedom Marine Services LLC ("Freedom Marine"), Gas Solutions Holdings, Inc. ("GSHI"), Integrated Contract Services, Inc. ("ICS"), Iron Horse Coiled Tubing, Inc. ("Iron Horse"), Manx Energy, Inc. ("Manx"), NMMB Holdings, Inc., NRG Manufacturing, Inc., Nupla Corporation ("Nupla"), R-V Industries, Inc. and Yatesville Coal Holdings, Inc. ("Yatesville"). We also own an affiliated interest in Biotronic NeuroNetwork, Boxercraft Incorporated, Smart, LLC, and Sport Helmets Holdings, LLC.

The composition of our investments as of June 30, 2011 and June 30, 2010 at cost and fair value was as follows:

| | June 30, 2011 | | June 30, 2010 | |
|----------------------------------|---------------|--------------|---------------|------------|
| | Cost | Fair Value | Cost | Fair Value |
| Money Market Funds | \$ 59,903 | \$ 59,903 | \$ 68,871 | \$ 68,871 |
| Investments in debt securities | 1,375,601 | 1,301,270 | 682,171 | 636,893 |
| Investments in equity securities | 60,133 | 161,740 | 46,588 | 111,590 |
| Total Portfolio | \$ 1,495,637 | \$ 1,522,913 | \$ 797,630 | \$ 817,354 |

The fair values of our portfolio investments as of June 30, 2011 disaggregated into the three levels of the ASC 820 valuation hierarchy are as follows:

| | Quoted Prices in Active Markets for Identical Securities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
|-----------------------------|---|---|--|--------------|
| Investments at fair value | | | | |
| Money Market Funds | \$ | \$ 59,903 | \$ | \$ 59,903 |
| Revolving Line of Credit | | | 7,278 | 7,278 |
| Senior Secured Debt | | | 789,981 | 789,981 |
| Subordinated Secured Debt | | | 448,675 | 448,675 |
| Subordinated Unsecured Debt | | | 55,336 | 55,336 |
| Equity | 180 | | 161,560 | 161,740 |
| Total Portfolio | \$ 180 | \$ 59,903 | \$ 1,462,830 | \$ 1,522,913 |

Table of Contents**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(in thousands, except share and per share data)

Note 4. Portfolio Investments (Continued)

| | Fair Value Hierarchy | | | Total |
|---------------------------------------|----------------------|-----------|--------------|--------------|
| | Level 1 | Level 2 | Level 3 | |
| Investments at fair value | | | | |
| Control investments | \$ | \$ | \$ 310,072 | \$ 310,072 |
| Affiliate investments | | | 72,337 | 72,337 |
| Non-control/non-affiliate investments | 180 | | 1,080,421 | 1,080,601 |
| | 180 | | 1,462,830 | 1,463,010 |
| Investments in money market funds | | 59,903 | | 59,903 |
| Total assets reported at fair value | \$ 180 | \$ 59,903 | \$ 1,462,830 | \$ 1,522,913 |

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

| | Quoted Prices in Active Markets for Identical Securities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
|-----------------------------|---|---|--|------------|
| Investments at fair value | | | | |
| Money Market Funds | \$ | \$ 68,871 | \$ | \$ 68,871 |
| Revolving Line of Credit | | | 5,017 | 5,017 |
| Senior Secured Debt | | | 287,470 | 287,470 |
| Subordinated Secured Debt | | | 313,511 | 313,511 |
| Subordinated Unsecured Debt | | | 30,895 | 30,895 |
| Equity | 1,368 | | 110,222 | 111,590 |
| Total Portfolio | \$ 1,368 | \$ 68,871 | \$ 747,115 | \$ 817,354 |

| | Quoted Prices in Active Markets for Identical Securities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
|---------------------------------------|---|---|--|------------|
| Investments at fair value | | | | |
| Control investments | \$ | \$ | \$ 195,958 | \$ 195,958 |
| Affiliate investments | | | 73,740 | 73,740 |
| Non-control/Non-affiliate investments | 1,368 | | 477,417 | 478,785 |
| | 1,368 | | 747,115 | 748,483 |
| Investments in money market funds | | 68,871 | | 68,871 |
| Total assets reported at fair value | \$ 1,368 | \$ 68,871 | \$ 747,115 | \$ 817,354 |

Explanation of Responses:

Table of Contents**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(in thousands, except share and per share data)****Note 4. Portfolio Investments (Continued)**

The aggregate values of Level 3 portfolio investments changed during the year ended June 30, 2011 as follows:

| | Fair Value Measurements Using Unobservable Inputs (Level 3) | | | |
|--|--|--------------------------|--|--------------|
| | Control Investments | Affiliate Investments | Non-Control/ Non-Affiliate Investments | Total |
| Fair value as of June 30, 2010 | \$ 195,958 | \$ 73,740 | \$ 477,417 | \$ 747,115 |
| Total realized (loss) gain, net | 8,558 | (549) | 8,052 | 16,061 |
| Change in unrealized appreciation (depreciation) | 37,165 | 7,398 | (23,160) | 21,403(1) |
| Net realized and unrealized gain (loss) | 45,723 | 6,849 | (15,108) | 37,464 |
| Purchases of portfolio investments | 92,662 | 1,380 | 840,464 | 934,506 |
| Payment-in-kind interest | 2,297 | 1,281 | 6,056 | 9,634 |
| Accretion of purchase discount | 244 | 2,630 | 20,161 | 23,035 |
| Repayments and sales of portfolio investments | (22,774) | (13,543) | (252,607) | (288,924)(2) |
| Transfers within Level 3 | (4,038) | | 4,038 | |
| Transfers in (out) of Level 3 | | | | |
| Fair value as of June 30, 2011 | \$ 310,072 | \$ 72,337 | \$ 1,080,421 | \$ 1,462,830 |

(1) Relates to assets held at June 30, 2011

(2) Includes change in unrealized appreciation (depreciation) of \$14,060.

| | Fair Value Measurements Using Unobservable Inputs (Level 3) | | | | | |
|--|---|---------------------------|---------------------------------|-----------------------------------|------------|--------------|
| | Revolving Line of Credit | Senior Secured Debt | Subordinated Secured Debt | Subordinated Unsecured Debt | Equity | Total |
| Fair value as of June 30, 2010 | \$ 5,017 | \$ 287,470 | \$ 313,511 | \$ 30,895 | \$ 110,222 | \$ 747,115 |
| Total realized (loss) gain, net | | (1,072) | | | 17,133 | 16,061 |
| Change in unrealized (depreciation) appreciation(1) | (34) | (6,174) | (9,618) | (37) | 37,266 | 21,403(1) |
| Net realized and unrealized (loss) gain | (34) | (7,246) | (9,618) | (37) | 54,399 | 37,464 |
| Purchases of portfolio investments | 9,385 | 572,637 | 294,331 | 39,410 | 18,743 | 934,506 |
| Payment-in-kind interest | | 1,406 | 7,834 | 394 | | 9,634 |
| Accretion of purchase discount | 184 | 5,119 | 17,563 | 169 | | 23,035 |
| | (7,274) | (69,405) | (174,946) | (15,495) | (21,804) | (288,924)(2) |

Explanation of Responses:

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Repayments and sales of portfolio
investments

Transfers within Level 3

Transfers in (out) of Level 3

| | | | | | | |
|--------------------------------|----------|------------|------------|-----------|------------|--------------|
| Fair value as of June 30, 2011 | \$ 7,278 | \$ 789,981 | \$ 448,675 | \$ 55,336 | \$ 161,560 | \$ 1,462,830 |
|--------------------------------|----------|------------|------------|-----------|------------|--------------|

(1)

Relates to assets held at June 30, 2011

(2)

Includes change in unrealized appreciation (depreciation) of \$14,060.

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Table of Contents**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(in thousands, except share and per share data)****Note 4. Portfolio Investments (Continued)**

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

| | Fair Value Measurements Using Unobservable Inputs (Level 3) | | | |
|--|--|--------------------------|--|--------------|
| | Control Investments | Affiliate Investments | Non-Control/ Non-Affiliate Investments | Total |
| Fair value as of June 30, 2009 | \$ 206,332 | \$ 32,254 | \$ 308,582 | \$ 547,168 |
| Total realized losses | (51,228) | | | (51,228) |
| Change in unrealized (depreciation) appreciation | (8,403) | 9,948 | 4,085 | 5,630(1) |
| Net realized and unrealized (loss) gain | (59,631) | 9,948 | 4,085 | (45,598) |
| Assets acquired in the Patriot acquisition | 10,534 | 36,400 | 160,073 | 207,007 |
| Purchases of portfolio investments | 16,240 | 2,800 | 126,788 | 145,828 |
| Payment-in-kind interest | 2,871 | 775 | 3,905 | 7,552 |
| Accretion of original issue discount | 3,535 | 1,475 | 15,303 | 20,313 |
| Dispositions of portfolio investments | (9,396) | (4,884) | (120,874) | (135,154)(2) |
| Transfers within Level 3 | 25,473 | (5,028) | (20,445) | |
| Transfers in (out) of Level 3 | | | | |
| Fair value as of June 30, 2010 | \$ 195,958 | \$ 73,740 | \$ 477,417 | \$ 747,115 |

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

(2) Includes change in unrealized appreciation (depreciation) of (\$1,502).

| | Fair Value Measurements Using Unobservable Inputs (Level 3) | | | | | |
|--|---|---------------------------|---------------------------------|-----------------------------------|------------------------|------------|
| | Revolving Line of Credit | Senior Secured Debt | Subordinated Secured Debt | Subordinated Unsecured Debt | Equity/ Equivalents | Total |
| Fair value as of June 30, 2009 | \$ | \$ 220,993 | \$ 194,547 | \$ 16,331 | \$ 115,297 | \$ 547,168 |
| Total realized (loss) gain, net | | (8,965) | (41,836) | | (427) | (51,228) |
| Change in unrealized (depreciation) appreciation(1) | 263 | (13,982) | 37,871 | (580) | (17,942) | 5,630(1) |
| Net realized and unrealized (loss) gain | 263 | (22,947) | (3,965) | (580) | (18,369) | (45,598) |
| Assets acquired in the Patriot acquisition | 8,979 | 98,310 | 94,369 | 14,902 | 5,349 | 207,007 |

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| | | | | | | |
|---|----------|------------|------------|-----------|------------|--------------|
| Purchases of portfolio investments | 3,745 | 31,607 | 86,195 | 232 | 9,379 | 145,828 |
| Payment-in-kind interest | | 552 | 6,767 | 10 | | 7,552 |
| Accretion of purchase discount | 2,526 | 9,793 | 7,984 | | | 20,313 |
| Repayments and sales of portfolio investments | (10,496) | (50,838) | (72,386) | | (1,434) | (135,154)(2) |
| Transfers within Level 3 | | | | | | |
| Transfers in (out) of Level 3 | | | | | | |
| Fair value as of June 30, 2010 | \$ 5,017 | \$ 287,470 | \$ 313,511 | \$ 30,895 | \$ 110,222 | \$ 747,115 |

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

(2) Includes change in unrealized appreciation (depreciation) of (\$1,502).

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Table of Contents**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(in thousands, except share and per share data)****Note 4. Portfolio Investments (Continued)**

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

At June 30, 2011, nine loan investments were on non-accrual status: Borga, Deb Shops, Inc. ("Deb Shops"), Freedom Marine, H&M Oil and Gas, LLC ("H&M"), ICS, Nupla, Manx, Wind River Resources Corp. and Wind River II Corp. ("Wind River"), and Yatesville. At June 30, 2010, nine loan investments were on non-accrual status: Borga, Deb Shops, ICS, Iron Horse, Nupla, Manx, Sidump'r Trailer Company, Inc., Wind River and Yatesville. The loan principal of these loans amounted to \$154,752 and \$163,653 as of June 30, 2011 and June 30, 2010, respectively. At June 30, 2011, H&M was placed on non-accrual status due to the inability of the company to service its debt and \$2,407 of income recognized during the quarter ended March 31, 2011 was reversed. The fair values of these investments represent approximately 4.8% and 5.6% of our net assets as of June 30, 2011 and June 30, 2010, respectively. For the years ended June 30, 2011, June 30, 2010 and June 30, 2009, the income foregone as a result of not accruing interest on non-accrual debt investments amounted to \$18,535, \$19,764 and \$18,746, respectively. At June 30, 2011, we held one asset on accrual status for which the payment of interest was past-due more than 60 days, Stryker Energy, LLC. The principal balance of this loan is \$30,699 and the accrued interest receivable is \$680 at June 30, 2011. The past due interest of \$680 was collected in full on July 27, 2011. We expect full repayment of principal and interest on this loan.

GSHI has indemnified us against any legal action arising from its investment in Gas Solutions, LP. We have incurred approximately \$2,093 from the inception of the investment in GSHI through June 30, 2011 for fees associated with a legal action, and GSHI has reimbursed us for the entire amount. Of the \$2,093 reimbursement, \$179 was reflected as dividend income: control investments in the Consolidated Statements of Operations for the year ended June 30, 2009. There were no such legal fees incurred or reimbursed for the years ended June 30, 2011 and June 30, 2010. Additionally, certain other expenses incurred by us which are attributable to GSHI have been reimbursed by GSHI and are reflected as dividend income: control investments in the Consolidated Statements of Operations. For the years ended June 30, 2011, June 30, 2010 and June 30, 2009, such reimbursements totaled as \$9,850, \$14,500 and \$20,500, respectively.

On May 2, 2011, we sold our membership interests in Fischbein, LLC ("Fischbein") for \$12,396 of gross proceeds, \$1,479 of which is deferred revenue held in escrow, realizing a gain of \$9,893, and received a repayment on the loan that was outstanding. We subsequently made a \$3,334 senior secured second-lien term loan and invested \$875 in the common equity of Fischbein with the new ownership group.

On December 3, 2010, we exercised our warrants in Miller Petroleum, Inc ("Miller") and received 2,013,814 shares of Miller common stock. On December 27, 2010, we sold 1,397,510 these shares receiving \$3.95 of net proceeds per share, realizing a gain of \$5,415. On January 10, 2011, we sold the remaining 616,304 shares of Miller common stock receiving \$4.23 of net proceeds per share, realizing an additional gain of \$2,561. The total gain was \$7,976 on the sale of the Miller common stock.

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(in thousands, except share and per share data)

Note 4. Portfolio Investments (Continued)

During the quarter ended March 31, 2009, we discontinued operations at CCEI. As of June 30, 2009, consistent with the decision to discontinue operations, we determined that the impairment of CCEI and CCEHI was other-than-temporary and recorded a realized loss of \$41,134 for the amount that the amortized cost exceeded the fair market value. As of June 30, 2011 and June 30, 2010, we set the value of the CCEHI investment at zero.

During the quarter ended December 31, 2009, we discontinued operations at Yatesville. As of December 31, 2009, consistent with the decision to discontinue operations, we determined that the impairment of Yatesville was other-than-temporary and recorded a realized loss of \$51,228 for the amount that the amortized cost exceeded the fair market value. As of June 30, 2011 and June 30, 2010, Yatesville is valued at zero and \$808, respectively.

The original cost basis of debt placements and equity securities acquired, including follow-on investments for existing portfolio companies, totaled \$953,337, \$364,788 and \$98,305 during the year ended June 30, 2011, June 30, 2010 and June 30, 2009, respectively. The \$364,788 for the year ended June 30, 2010 includes \$207,126 of portfolio investments acquired from Patriot. Debt repayments and sales of equity securities with a cost basis of approximately \$285,862, \$136,221 and \$27,007 were received during the year ended June 30, 2011, June 30, 2010 and June 30, 2009, respectively.

During the year ended June 30, 2011, we recognized \$22,084 of interest income due to purchase discount accretion from the assets acquired from Patriot. Included in the \$22,084 is \$4,912 of normal accretion, \$12,035 of accelerated accretion resulting from the repayment of Impact Products, LLC, Label Corp Holdings Inc. ("LHC") and Prince Mineral Company, Inc. ("Prince"), and \$4,968 of accelerated accretion resulting from the recapitalization of our debt investments in Arrowhead General Insurance Agency, Inc. ("Arrowhead"), The Copernicus Inc. ("Copernicus"), Fischbein and Northwestern Management Services, LLC ("Northwestern"). The restructured loans for Arrowhead, Copernicus, Fischbein and Northwestern were issued at market terms comparable other industry transactions. In accordance with ASC 320-20-35 the cost basis of the new loan was recorded at par value, which precipitated the acceleration of original purchase discount from the loan repayment which was recognized as interest income.

During the period from the acquisition of Patriot on December 2, 2009 to June 30, 2010, we recognized \$18,795 of interest income due to purchase discount accretion from the assets acquired from Patriot. Included in this amount \$4,579 of normal accretion and \$14,216 of accelerated accretion resulting from the early repayments of four loans, three revolving lines of credit, sale of one investment position and restructuring of our loans to Aircraft Fasteners International, LLC, EXL Acquisition Inc., LHC, Prince, ROM Acquisition Corporation. The revised terms were more favorable than the original terms and increased the present value of the future cash flows. In accordance with ASC 320-20-35 the cost basis of the new loans were recorded at par value, which precipitated the acceleration of original purchase discount from the loan repayment which was recognized as interest income.

As of June 30, 2011, \$8,634 of purchase discount from the assets acquired from Patriot remains to be accreted as interest income, of which \$837 is expected to be amortized during the three months ending September 30, 2011.

As of June 30, 2011, \$963,163 of our loans bear interest at floating rates, \$953,785 of which have Libor floors ranging from 1.00% to 6.00%.

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(in thousands, except share and per share data)

Note 5. Revolving Credit Agreements

On June 6, 2007, we closed on a \$200,000 three-year revolving credit facility (as amended on December 31, 2007) with Rabobank Nederland ("Rabobank") as administrative agent and sole lead arranger (the "Rabobank Facility").

On June 25, 2009, we completed a first closing on an expanded \$250,000 revolving credit facility. The new Syndicated Facility, which had \$175,000 total commitments as of June 30, 2009, included an accordion feature which allows the Syndicated Facility to accept up to an aggregate total of \$250,000 of commitments for which we solicited additional commitments from other lenders for an additional \$35,000 raising the commitments to \$210,000. The revolving period ended on June 11, 2010, when we closed on our expanded revolving credit facility. On June 11, 2010, we closed an extension and expansion of our revolving credit facility with a syndicate of lenders (the "Syndicated Facility"). The lenders have extended commitments of \$325,000 under the Syndicated Facility as of June 30, 2011; which was increased to \$375,000 on July 8, 2011 and \$400,000 on September 1, 2011. The Syndicated Facility includes an accordion feature which allows the facility to be increased to up to \$400,000 of commitments in the aggregate, a limit that was met with the September 1, 2011 commitments. As we pledge additional investments to the Syndicated Facility, we will generate additional availability to the extent such investments are eligible to be placed into the borrowing base. The revolving period of the Syndicated Facility extends through June 2012, with an additional one year amortization period (with distributions allowed) after the completion of the revolving period. During such one year amortization period, all principal payments on the pledged assets will be applied to reduce the balance. At the end of the one year amortization period, the remaining balance will become due if required by the lenders.

The Syndicated Facility contains restrictions pertaining to the geographic and industry concentrations of funded loans, maximum size of funded loans, interest rate payment frequency of funded loans, maturity dates of funded loans and minimum equity requirements. The Syndicated Facility also contains certain requirements relating to portfolio performance, including required minimum portfolio yield and limitations on delinquencies and charge-offs, violation of which could result in the early termination of the Syndicated Facility. The Syndicated Facility also requires the maintenance of a minimum liquidity requirement. At June 30, 2011, we were in compliance with the applicable covenants.

Interest on borrowings under the Syndicated Facility is one-month Libor plus 325 basis points, subject to a minimum Libor floor of 100 basis points. Additionally, the lenders charge a fee on the unused portion of the Syndicated Facility equal to either 75 basis points if at least half of the credit facility is used or 100 basis points otherwise. The Syndicated Facility requires us to pledge assets as collateral in order to borrow under the credit facility. As of June 30, 2011 and June 30, 2010, we had \$255,673 and \$180,678 available to us for borrowing under our Syndicated Facility, of which \$84,200 and \$100,300 was outstanding, respectively. As we make additional investments which are eligible to be pledged under the Syndicated Facility, we will generate additional availability to the extent such investments are eligible to be placed into the borrowing base. At June 30, 2011, the investments used as collateral for the Syndicated Facility had an aggregate market value of \$700,321 which represents 62.8% of net assets. Prospect Capital Funding, LLC, our wholly-owned subsidiary, holds \$631,915 of these investments at market value as of June 30, 2011. The release of any assets from Prospect Capital Funding, LLC requires the approval of Rabobank as facility agent.

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(in thousands, except share and per share data)

Note 5. Revolving Credit Agreements (Continued)

In connection with the origination and amendments of the Syndicated Facility, we incurred \$10,276 of fees, including \$3,224 of fees carried over from the previous facility, which are being amortized over the term of the facility in accordance with ASC 470-50, *Debt Modifications and Extinguishments*, of which \$5,430 remains to be amortized.

Note 6. Senior Convertible Notes

On December 21, 2010, we issued \$150,000 in aggregate principal amount of our 6.25% senior convertible notes due 2015 ("2010 Notes") for net proceeds (after deducting underwriting expenses) of approximately \$145,200. Interest on the 2010 Notes is paid semi-annually in arrears on June 15 and December 15, at a rate of 6.25% per year, commencing June 15, 2011. The 2010 Notes mature on December 15, 2015 unless converted earlier. The 2010 Notes are convertible into shares of common stock at an initial conversion rate and conversion rate at June 30, 2011 of 88.0902 and 88.0932 shares, respectively, of common stock per \$1,000 principal amount of 2010 Notes, which is equivalent to a conversion price of approximately \$11.352 per share of common stock, subject to adjustment in certain circumstances. The conversion rate for the 2010 Notes will be increased when monthly cash dividends paid to common shares exceed the monthly dividend rate of \$0.101125 per share, subject to adjustment.

On February 18, 2011, we issued \$172,500 in aggregate principal amount of our 5.50% senior convertible notes due 2016 ("2011 Notes") for net proceeds following underwriting expenses of approximately \$167,325. Interest on the 2011 Notes is paid semi-annually in arrears on February 15 and August 15, at a rate of 5.50% per year, commencing August 15, 2011. The 2011 Notes mature on August 15, 2016 unless converted earlier. The 2011 Notes are convertible into shares of common stock at an initial conversion rate and conversion rate at June 30, 2011 of 78.3699 and 78.3717 shares, respectively, of common stock per \$1,000 principal amount of 2011 Notes, which is equivalent to a conversion price of approximately \$12.76 per share of common stock, subject to adjustment in certain circumstances. The conversion rate for the 2011 Notes will be increased when monthly cash dividends paid to common shares exceed the monthly dividend rate of \$0.101150 per share.

In no event will the total number of shares of common stock issuable upon conversion exceed 96.8992 per \$1,000 principal amount of the 2010 Notes (the "conversion rate cap"), except that, to the extent we receive written guidance or a no-action letter from the staff of the Securities and Exchange Commission (the "Guidance") permitting us to adjust the conversion rate in certain instances without regard to the conversion rate cap and to make the 2010 Notes convertible into certain reference property in accordance with certain reclassifications, business combinations, asset sales and corporate events by us without regard to the conversion rate cap, we will make such adjustments without regard to the conversion rate cap and will also, to the extent that we make any such adjustment without regard to the conversion rate cap pursuant to the Guidance, adjust the conversion rate cap accordingly. We will use our commercially reasonable efforts to obtain such Guidance as promptly as practicable.

Prior to obtaining the Guidance, we will not engage in certain transactions that would result in an adjustment to the conversion rate increasing the conversion rate beyond what it would have been in the absence of such transaction unless we have engaged in a reverse stock split or share combination transaction such that in our reasonable best estimation, the conversion rate following the adjustment for such transaction will not be any closer to the conversion rate cap than it would have been in the absence of such transaction.

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(in thousands, except share and per share data)

Note 6. Senior Convertible Notes (Continued)

Upon conversion, unless a holder converts after a record date for an interest payment but prior to the corresponding interest payment date, the holder will receive a separate cash payment with respect to the Notes surrendered for conversion representing accrued and unpaid interest to, but not including the conversion date. Any such payment will be made on the settlement date applicable to the relevant conversion on the 2010 Notes and 2011 Notes (collectively, "Senior Convertible Notes").

No holder of Senior Convertible Notes will be entitled to receive shares of our common stock upon conversion to the extent (but only to the extent) that such receipt would cause such converting holder to become, directly or indirectly, a beneficial owner (within the meaning of Section 13(d) of the Securities Exchange Act of 1934 and the rules and regulations promulgated thereunder) of more than 5.0% of the shares of our common stock outstanding at such time. The 5.0% limitation shall no longer apply following the effective date of any fundamental change. We will not issue any shares in connection with the conversion or redemption of the Notes which would equal or exceed 20% of the shares outstanding at the time of the transaction in accordance with NASDAQ rules.

Subject to certain exceptions, holders may require us to repurchase, for cash, all or part of their Notes upon a fundamental change at a price equal to 100% of the principal amount of the Notes being repurchased plus any accrued and unpaid interest up to, but excluding, the fundamental change repurchase date. In addition, upon a fundamental change that constitutes a non-stock change of control we will also pay holders an amount in cash equal to the present value of all remaining interest payments (without duplication of the foregoing amounts) on such Senior Convertible Notes through and including the maturity date.

In connection with the issuance of the Senior Convertible Notes, we incurred \$10,562 of fees which are being amortized over the term of the facility in accordance with ASC 470-50, *Debt Modifications and Extinguishments*, of which \$9,845 remains to be amortized and is included within deferred financing costs of \$15,275 on the consolidated statements of assets and liabilities.

During the year ended June 30, 2011, we recorded \$17,598 of interest costs and amortization of financing costs as interest expense.

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We issued 38,519,828 and 16,683,197 shares of our common stock during the years ended June 30, 2011 and June 30, 2010, respectively. 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 | Average Offering Price |
|--|-------------------------|-----------------------|-------------------|-------------------|------------------------|
| During the year ended June 30, 2011: | | | | | |
| June 24, 2011 | 10,000,000 | \$ 101,500 | \$ 1,100 | \$ 227 | \$ 10.150 |
| April 7, 2011 | 9,000,000 | \$ 102,600 | \$ | \$ 436 | \$ 11.400 |
| November 16, 2010 - December 15, 2010(1) | 4,513,920 | \$ 45,147 | \$ 904 | \$ 459 | \$ 10.000 |
| September 29, 2010 - November 3, 2010(2) | 5,231,956 | \$ 51,597 | \$ 1,033 | \$ 163 | \$ 9.861 |
| July 22, 2010 - September 28, 2010(3) | 6,000,000 | \$ 58,403 | \$ 1,156 | \$ 103 | \$ 9.734 |
| July 1, 2010 - July 21, 2010(4) | 2,748,600 | \$ 26,799 | \$ 536 | \$ | \$ 9.749 |
| During the year ended June 30, 2010: | | | | | |
| March 23, 2010 - June 30, 2010(4) | 5,251,400 | \$ 60,378 | \$ 1,210 | \$ 624 | \$ 11.500 |
| September 24, 2009(5) | 2,807,111 | \$ 25,264 | \$ | \$ 840 | \$ 9.000 |
| August 20, 2009(5) | 3,449,686 | \$ 29,322 | \$ | \$ 117 | \$ 8.500 |
| July 7, 2009 | 5,175,000 | \$ 46,575 | \$ 2,329 | \$ 200 | \$ 9.000 |

- (1) On November 10, 2010, we established a fourth at-the-market program through which we could sell, from time to time and at our sole discretion 9,750,000 shares of our common stock. Through this program we issued 4,513,920 shares of our common stock at an average price of \$10.00 per share, raising \$45,147 of gross proceeds, from November 16, 2010 through December 15, 2010.
- (2) On September 24, 2010, we established a third at-the-market program through which we sold 5,231,956 shares of our common stock at an average price of \$9.86 per share, raising \$51,597 of gross proceeds, from September 29, 2010 through November 3, 2010.
- (3) On July 19, 2010, we established a second at-the-market program through which we sold 6,000,000 shares of our common stock at an average price of \$9.73 per share, raising \$58,403 of gross proceeds, from July 22, 2010 through September 28, 2010.
- (4) On March 17, 2010, we established an at-the-market program through which we sold 8,000,000 shares of our common stock. Through this program we issued 811,500 shares of our common stock at an average price of \$12.60 per share, raising \$10,230 of gross proceeds, from March 23, 2010 through March 31, 2010. Through this program we also issued 2,748,600 shares of our common stock at an average price of \$9.75 per share, raising \$26,799 of gross proceeds, from July 1, 2010 through July 21, 2010.
- (5) Concurrent with the sale of these shares, we entered into a registration rights agreement in which we granted the purchasers certain registration rights with respect to the shares. We have filed with the SEC a post-effective amendment to the registration statement on Form N-2 which has been declared effective by the SEC.

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(in thousands, except share and per share data)

Note 7. Equity Offerings, Offering Expenses, and Distributions (Continued)

Our shareholders' equity accounts at June 30, 2011 and June 30, 2010 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 December 2, 2009, we issued 8,444,068 shares of common stock to acquire Patriot. This transaction is described in further detail in Note 3.

On October 9, 2008, our Board of Directors approved a share repurchase plan under which we may repurchase up to \$20,000 of our common stock at prices below our net asset value as reported in our financial statements published for the year ended June 30, 2008. We have not made any purchases of our common stock during the period from October 9, 2008 to June 30, 2011 pursuant to this plan.

On May 9, 2011, we announced the declaration of monthly dividends in the following amounts and with the following dates:

\$0.101225 per share for May 2011 to holders of record on May 31, 2011 with a payment date of June 24, 2011;

\$0.101250 per share for June 2011 to holders of record on June 30, 2011 with a payment date of July 22, 2011;

\$0.101275 per share for July 2011 to holders of record on July 29, 2011 with a payment date of August 26, 2011;

\$0.101300 per share for August 2011 to holders of record on August 31, 2011 with a payment date of September 23, 2011.

During the years ended June 30, 2011 and June 30, 2010, we issued 1,025,352 and 1,016,513 shares, respectively, of our common stock in connection with the dividend reinvestment plan.

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

At June 30, 2011, we have reserved 26,732,449 shares of our common stock for issuance upon conversion of the Senior Convertible Notes (See Note 6).

Note 8. 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

Table of Contents**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(in thousands, except share and per share data)

Note 8. Other Investment Income (Continued)

receipts. Income from such sources was \$19,930, \$12,675 and \$14,762 for the years ended June 30, 2011, June 30, 2010 and June 30, 2009, respectively.

| Income Source | For The Year Ended | | |
|--------------------------------------|--------------------|---------------|---------------|
| | June 30, 2011 | June 30, 2010 | June 30, 2009 |
| Gain on Patriot acquisition (Note 3) | \$ | \$ | \$ |
| Structuring and amendment fees | 19,589 | 3,749 | 1,506 |
| Overriding royalty interests | 154 | 194 | 550 |
| Settlement of net profits interests | | | 12,651 |
| Administrative agent fee | 187 | 100 | 55 |
| Other Investment Income | \$ 19,930 | \$ 12,675 | \$ 14,762 |

Note 9. Net Increase in Net Assets per Common Share

The following information sets forth the computation of net increase in net assets resulting from operations per common share for the years ended June 30, 2011, 2010 and 2009, respectively.

| | For The Year Ended | | |
|---|--------------------|---------------|---------------|
| | June 30, 2011 | June 30, 2010 | June 30, 2009 |
| Net increase in net assets resulting from operations | \$ 118,238 | \$ 19,625 | \$ 35,104 |
| Weighted average common shares outstanding | 85,978,757 | 59,429,222 | 31,559,905 |
| Net increase in net assets resulting from operations per common share | \$ 1.38 | \$ 0.33 | \$ 1.11 |

Note 10. Related Party Agreements and Transactions*Investment Advisory Agreement*

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

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

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(in thousands, except share and per share data)

Note 10. Related Party Agreements and Transactions (Continued)

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

The total base management fees earned by and paid to Prospect Capital Management for the years ended June 30, 2011, June 30, 2010 and June 30, 2009 were \$22,496, \$13,929 and \$11,915, 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

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(in thousands, except share and per share data)

Note 10. Related Party Agreements and Transactions (Continued)

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, equal the sum of the differences between the aggregate net sales price of each investment and the aggregate cost basis of such investment when sold or otherwise disposed. Aggregate realized capital losses equal the sum of the amounts by which the aggregate net sales price of each investment is less than the aggregate cost basis of such investment when sold or otherwise disposed. Aggregate unrealized capital depreciation equals the sum of the differences, if negative, between the aggregate valuation of each investment and the aggregate cost basis of such investment as of the applicable calendar year-end. At the end of the applicable calendar year, the amount of capital gains that serves as the basis for our calculation of the capital gains incentive fee involves netting aggregate realized capital gains against aggregate realized capital losses on a since-inception basis and then reducing this amount by the aggregate unrealized capital depreciation. If this number is positive, then the capital gains incentive fee payable is equal to 20.00% of such amount, less the aggregate amount of any capital gains incentive fees paid since inception.

Income incentive fees totaling \$23,555, \$16,798 and \$14,790 were earned for the years ended June 30, 2011, June 30, 2010 and June 30, 2009, respectively. No capital gains incentive fees were earned for years ended June 30, 2011, June 30, 2010 and June 30, 2009, respectively.

Administration Agreement

We have also entered into an Administration Agreement with Prospect Administration, LLC ("Prospect Administration") under which Prospect Administration, among other things, provides (or arranges for the provision of) administrative services and facilities for us. For providing these services, we reimburse Prospect Administration for our allocable portion of overhead incurred by Prospect Administration in performing its obligations under the Administration Agreement, including rent and our allocable portion of the costs of our chief compliance officer and chief financial officer and his staff. For the years ended June 30, 2011, 2010 and 2009, the reimbursement was approximately \$4,979, \$3,361 and \$2,856, respectively. Under this agreement, Prospect Administration furnishes us with office facilities, equipment and clerical, bookkeeping and record keeping services at such facilities. Prospect Administration also performs, or oversees the performance of, our required administrative services, which include, among other things, being responsible for the financial records that we are required to maintain and preparing reports to our stockholders and reports filed with the SEC. In addition, Prospect Administration assists us in determining and publishing our net asset value, overseeing the preparation and filing of our tax returns and the printing and dissemination of reports to our stockholders, and generally oversees the payment of our expenses and the performance of administrative and professional services rendered to us by others. Under the Administration Agreement, Prospect Administration also provides on our behalf managerial assistance to those portfolio companies to which we are required to provide such assistance. The Administration

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(in thousands, except share and per share data)

Note 10. Related Party Agreements and Transactions (Continued)

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.

Prospect Administration, pursuant to the approval of our Board of Directors, engaged Vastardis Fund Services LLC ("Vastardis") to serve as our sub-administrator to perform certain services required of Prospect Administration. Under the sub-administration agreement, Vastardis provided us with office facilities, equipment, clerical, bookkeeping and record keeping services at such facilities. Vastardis also conducted relations with custodians, depositories, transfer agents, dividend disbursing agents, other stockholder servicing agents, accountants, attorneys, underwriters, brokers and dealers, corporate fiduciaries, insurers, banks and such other persons in any such other capacity deemed to be necessary or desirable.

On April 30, 2009 we gave a 60-day notice to Vastardis of termination of our agreement to provide sub-administration services effective June 30, 2009. We entered into a new consulting services agreement for the period from July 1, 2009 until the filing of our Form 10-K for the year ended June 30, 2009. We paid Vastardis a total of \$30 for services rendered in conjunction with preparation of Form 10-K under the new agreement. All services previously provided by Vastardis were assumed by Prospect Administration beginning on July 1, 2009.

Managerial Assistance

As a business development company, we offer, and must provide upon request, managerial assistance to certain of our portfolio companies. This assistance could involve, among other things, monitoring the operations of our portfolio companies, participating in board and management meetings, consulting with and advising officers of portfolio companies and providing other organizational and financial guidance. We billed \$1,325, \$892, and \$846 of managerial assistance fees for the years ended June 30, 2011, June 30, 2010, and June 30, 2009, respectively, of which \$128 and \$247 remains on the consolidated statement of assets and liabilities as of June 30, 2011, and June 30, 2010, respectively. These fees are paid to the Administrator so we simultaneously accrue a payable to the Administrator for the same amounts, which remain on the consolidated statements of assets and liabilities.

Note 11. Merger Proposal to Allied Capital Corporation

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

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(in thousands, except share and per share data)

Note 11. Merger Proposal to Allied Capital Corporation (Continued)

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

Note 12. 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. We are not aware of any such litigation as of June 30, 2011.

Table of Contents**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(in thousands, except share and per share data)

Note 13. Financial Highlights

| | Year Ended June 30, 2011 | Year Ended June 30, 2010 | Year Ended June 30, 2009 | Year Ended June 30, 2008 | Year Ended June 30, 2007 |
|---|--------------------------------|--------------------------------|--------------------------------|--------------------------------|--------------------------------|
| Per Share Data(1): | | | | | |
| Net asset value at beginning of period | \$ 10.30 | \$ 12.40 | \$ 14.55 | \$ 15.04 | \$ 15.31 |
| Costs related to the secondary public offering | | | | (0.07) | (0.06) |
| Net investment income | 1.10 | 1.13 | 1.87 | 1.91 | 1.47 |
| Realized gain (loss) | 0.19 | (0.87) | (1.24) | (0.69) | 0.12 |
| Net unrealized appreciation (depreciation) | 0.09 | 0.07 | 0.48 | (0.05) | (0.52) |
| Net (decrease) increase in net assets as a result of public offering | (0.08) | (0.85) | (2.11) | | 0.26 |
| Net increase in net assets as a result of shares issued for Patriot acquisition | | 0.12 | | | |
| Dividends to shareholders | (1.24) | (1.70) | (1.15) | (1.59) | (1.54) |
| Net asset value at end of period | \$ 10.36 | \$ 10.30 | \$ 12.40 | \$ 14.55 | \$ 15.04 |
| Per share market value at end of period | \$ 10.11 | \$ 9.65 | \$ 9.20 | \$ 13.18 | \$ 17.47 |
| Total return based on market value(2) | 17.22% | 17.66% | (18.60)% | (15.90)% | 12.65% |
| Total return based on net asset value(2) | 12.54% | (6.82)% | (0.61)% | 7.84% | 7.62% |
| Shares outstanding at end of period | 107,606,690 | 69,086,862 | 42,943,084 | 29,520,379 | 19,949,065 |
| Average weighted shares outstanding for period | 85,978,757 | 59,429,222 | 31,559,905 | 23,626,642 | 15,724,095 |
| Ratio / Supplemental Data: | | | | | |
| Net assets at end of period (in thousands) | \$ 1,114,357 | \$ 711,424 | \$ 532,596 | \$ 429,623 | \$ 300,048 |
| Annualized ratio of operating expenses to average net assets | 8.47% | 7.54% | 9.03% | 9.62% | 7.36% |
| Annualized ratio of net investment income to average net assets | 10.60% | 10.69% | 13.14% | 12.66% | 9.71% |

(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.

Table of Contents**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(in thousands, except share and per share data)

Note 14. Selected Quarterly Financial Data (Unaudited)

| Quarter Ended | Investment Income | | Net Investment Income | | Net Realized and Unrealized Gains (Losses) | | Net Increase (Decrease) in Net Assets from Operations | |
|-----------------------|-------------------|--------------|-----------------------|--------------|--|--------------|---|--------------|
| | Total | Per Share(1) | Total | Per Share(1) | Total | Per Share(1) | Total | Per Share(1) |
| September 30, 2007 | 15,391 | 0.77 | 7,865 | 0.39 | 685 | 0.04 | 8,550 | 0.43 |
| December 31, 2007 | 18,563 | 0.80 | 10,660 | 0.46 | (14,346) | (0.62) | (3,686) | (0.16) |
| March 31, 2008 | 22,000 | 0.92 | 12,919 | 0.54 | (14,178) | (0.59) | (1,259) | (0.05) |
| June 30, 2008 | 23,448 | 0.85 | 13,669 | 0.50 | 10,317 | 0.38 | 23,986 | 0.88 |
| September 30, 2008(2) | 35,799 | 1.21 | 23,502 | 0.80 | (9,504) | (0.33) | 13,998 | 0.47 |
| December 31, 2008 | 22,213 | 0.75 | 11,960 | 0.40 | (5,436) | (0.18) | 6,524 | 0.22 |
| March 31, 2009 | 20,669 | 0.69 | 11,720 | 0.39 | 3,611 | 0.12 | 15,331 | 0.51 |
| June 30, 2009 | 21,800 | 0.59 | 11,981 | 0.32 | (12,730) | (0.34) | (749) | (0.02) |
| September 30, 2009 | 21,517 | 0.43 | 12,318 | 0.25 | (18,696) | (0.38) | (6,378) | (0.13) |
| December 31, 2009(3) | 31,801 | 0.55 | 19,258 | 0.33 | (33,778) | (0.59) | (14,520) | (0.25) |
| March 31, 2010 | 32,005 | 0.50 | 18,974 | 0.30 | 6,966 | 0.11 | 25,940 | 0.41 |
| June 30, 2010 | 29,236 | 0.44 | 16,640 | 0.25 | (2,057) | (0.03) | 14,583 | 0.22 |
| September 30, 2010 | 35,212 | 0.47 | 20,995 | 0.28 | 4,585 | 0.06 | 25,580 | 0.34 |
| December 31, 2010 | 33,300 | 0.40 | 19,080 | 0.23 | 12,861 | 0.16 | 31,940 | 0.38 |
| March 31, 2011 | 44,573 | 0.51 | 23,956 | 0.27 | 9,803 | 0.11 | 33,759 | 0.38 |
| June 30, 2011 | 56,391 | 0.58 | 30,190 | 0.31 | (3,232) | (0.03) | 26,959 | 0.28 |

- (1) Per share amounts are calculated using weighted average shares during period.
- (2) Additional income for this quarter was driven by other investment income from the settlement of net profits interests on IEC-Systems, LP and Advanced Rig Services, LLC for \$12,576.
- (3) As adjusted for increase in earnings from Patriot. See Note 3.

Note 15. Subsequent Events

On July 1, 2011, we made a senior secured follow-on investment of \$2,500 in Boxercraft to support the acquisition of Jones & Mitchell, a supplier of college-licensed apparel.

On July 8, 2011, we made a secured senior lien investment of \$39,000 to support the recapitalization of Totes Isotoner Corporation.

On July 11, 2011, we announced an increase in commitments to our credit facility of \$50,000 to \$375,000 raising the total commitments in the aggregate.

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On July 18, 2011, we issued 1,500,000 shares in connection with the exercise of an overallotment option granted with the June 21, 2011 offering of 10,000,000 shares which were delivered June 24, 2011, raising an additional \$15,225 of gross proceeds and \$15,060 of net proceeds.

On July 22, 2011, we issued 102,890 shares of our common stock in connection with the dividend reinvestment plan.

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(in thousands, except share and per share data)

Note 15. Subsequent Events (Continued)

On August 5, 2011, we made a senior secured follow-on investment of \$3,850 in ROM to support the acquisition of Havis Lighting Solutions, a supplier of products primarily used by emergency response and police vehicles.

On August 9, 2011, we provided a \$15,000 term loan to support the acquisition of Nobel Learning Communities, Inc., a leading national operator of private schools.

On August 9, 2011, we made an investment of \$32,116 to purchase 66% of the unrated subordinated notes in Babson CLO Ltd. 2011-I.

On August 24, 2011, our Board of Directors approved a share repurchase plan under which we may repurchase up to \$100,000 of our common stock at prices below our net asset value.

On August 24, 2011, we announced the declaration of monthly dividends in the following amounts and with the following dates:

\$0.101325 per share for September 2011 to holders of record on September 30, 2011 with a payment date of October 25, 2011; and

\$0.101350 per share for October 2011 to holders of record on October 31, 2011 with a payment date of November 22, 2011.

On August 26, 2011, we issued 106,869 shares of our common stock in connection with the dividend reinvestment plan.

On September 1, 2011, we announced an increase in commitments to our credit facility of \$25,000 to \$400,000 raising the total commitments in the aggregate to the maximum of the accordion feature of the credit facility.

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PROSPECTUS SUPPLEMENT
February 16, 2012

Incapital LLC
