PROSPECT CAPITAL CORP
Form 497
May 28, 2008

Table of Contents

Filed Pursuant to Rule 497(h)
Registration No. 333-143819

PROSPECTUS SUPPLEMENT
(To Prospectus dated September 6, 2007)

3,250,000 Shares

Common Stock

$14.90 per share

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

We are offering for sale 3,250,000 shares of our common stock. We will use the proceeds to repay a portion of the amounts outstanding under our credit facility. We expect to use the remainder of the net proceeds to fund additional investments from our investment pipeline and for general corporate purposes.

Our common stock is traded on the NASDAQ Global Select Market under the symbol PSEC. The last reported closing price for our common stock on May 27, 2008 was $15.92 per share.

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

Investing in our common stock involves risks. See Risk Factors beginning on page S-6 of this prospectus supplement and on page 12 of the accompanying prospectus.

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

	Per Share	Total
Public offering price	$ 14.90	$ 48,425,000
Underwriting discounts and commissions (sales load)(1)	$ 0.74	$ 2,405,000
Proceeds to Prospect Capital Corporation, before expenses(2)	$ 14.16	$ 46,020,000

(1) We will reimburse a portion of the underwriters expenses in the amount of up to $150,000.

(2) Before deducting estimated offering expenses payable by us of approximately $200,000.

The underwriters have the option to purchase up to an additional 487,500 shares of common stock at the public offering price, less the underwriting discount, within 30 days from the date of this prospectus supplement solely to cover over-allotments. If the over-allotment option is exercised in full, the total public offering price will be $55,688,750, and the total underwriting discount (sales load) will be $2,765,750. The proceeds to us would be $52,923,000 , before deducting estimated offering expenses payable by us of approximately $200,000.

The underwriters expect to deliver the shares on or about June 2, 2008.

Joint Book-Running Managers

Citi **Wachovia Securities**

Oppenheimer & Co. **RBC Capital Markets**

Prospectus Supplement dated May 28, 2008

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

TABLE OF CONTENTS

PROSPECTUS SUPPLEMENT

PROSPECTUS

Table of Contents

PROSPECTUS SUMMARY

This summary highlights some information from this prospectus supplement and the accompanying prospectus, and it may not contain all of the information that is important to you. To understand the terms of the common stock offered hereby, you should read this prospectus supplement and the accompanying prospectus carefully. Together, these documents describe the specific terms of the shares we are offering. You should carefully read the sections titled Risk Factors in this prospectus supplement and in the accompanying prospectus and the documents identified in the section Available Information. Except as otherwise noted, all information in this prospectus supplement and the accompanying prospectus assumes no exercise of the underwriters over allotment option.

The terms we, us, our, and Company refer to Prospect Capital Corporation; Prospect Capital Management refers to Prospect Capital Management LLC; Prospect Administration or the Administrator refers to Prospect Administration LLC.

The Company

Prospect Capital Corporation is a financial services company that primarily lends to and invests in middle market privately held or thinly traded public companies. We are organized as an externally-managed, non-diversified closed-end management investment company that has elected to be treated as a business development company under the Investment Company Act of 1940, or the 1940 Act.

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

We seek to maximize total returns to our investors, including both current yield and equity upside, by applying rigorous credit analysis and asset-based and cash-flow based lending techniques to make and monitor our investments. A majority of our investments to date have been in energy-related industries, which are benefiting from commodity prices that have risen significantly in recent years. We have made no investments to date in the real estate or mortgage industries, and we do not intend to currently concentrate on such investments. We are currently benefiting from enhanced lending spreads made available by the credit dislocations in July and August of 2007 in the syndicated loan market, a market where we historically had not concentrated due to mispricing concerns, but where we currently see many attractive opportunities to deploy capital.

As of May 27, 2008, we held investments in 32 portfolio companies. The aggregate fair value as of March 31, 2008 of investments in 31 portfolio companies (including a net profits interest in Charlevoix Energy Trading, LLC, or Charlevoix) held on that date is approximately $429 million. Our portfolio across all our long-term debt and certain equity investments had an annualized current yield of 16.8% as of March 31, 2008. The yield includes interest from all our long-term investments as well as dividends from our two portfolio companies, Gas Solutions Holdings, Inc., or GSHI, and NRG Manufacturing, Inc., or NRG, as of March 31, 2008.

Recent Developments

In late December 2007, the Company s largest 100% controlled investment, GSHI, a midstream gathering and processing business in East Texas, engaged RBC Capital Markets Corporation as a financial advisor to explore strategic alternatives, including a potential sale. This monetization process is ongoing. Management can make no assurances as to the timing or success of the potential sale of GSHI, or as to any proceeds to be received from such sale. In late March 2008, Royal Bank of Canada provided a $38 million term loan to Gas Solutions II Ltd, a wholly owned subsidiary of GSHI, the proceeds of which were used to refinance all of Citibank s approximately $8 million of outstanding senior secured debt as well as to make a $30 million cash distribution to GSHI. The Company has non-recourse access to this cash at GSHI, in addition to the Company s other assets and undrawn revolving credit facility. In early May 2008, Gas Solutions II Ltd purchased a series of propane puts at $0.10 out of the money and at

Table of Contents

prices of $1.53 per gallon and $1.394 per gallon covering the periods May 1, 2008, through April 30, 2009, and May 1, 2009, through April 30, 2010, respectively. These hedges have been executed at close to the highest market propane prices ever achieved on an historical basis; such hedges preserve the upside of Gas Solutions II Ltd to benefit from potential future increases in commodity prices.

On April 3, 2008, we provided approximately $39.8 million first and second lien debt and equity for the recapitalization of Ajax Rolled Ring & Machine, or Ajax, a custom forger of seamless rolled steal rings located in York, South Carolina. Our debt is secured by a first lien on inventory, machinery, and certain other assets of Ajax. The equity interest purchased in Ajax is controlling in nature and was made alongside equity co-investments by Ajax s senior managers.

On April 30, 2008, we provided debt financing of $20.0 million to support the acquisition by Peerless Mfg Co., or Peerless, headquartered in Dallas, Texas, of Nitram Energy Inc., or Nitram. Peerless is a leading designer, manufacturer, and marketer of industrial environmental separation and filtration systems while Nitram focuses on separation, heat transfer, pulsation dampening, and industrial silencing products. Peerless and Nitram serve a diversified, global list of customers in industries such as oil and gas production, gas pipelines, chemical and petrochemical processing, and power generation.

On April 30, 2008, we fully exited out of our investment in Arctic Acquisition Corp., dba Cougar Pressure Control, or Arctic, through the sale of our equity interest in Arctic for approximately $3.4 million. We initially invested $9.25 million in Arctic in July 2005 in the form of a senior secured loan, which was subsequently increased by $6 million. We received the equity interest in Arctic as additional consideration for making the secured loan. The loan was fully repaid in August 2007.

Table of Contents

The Offering

Common stock offered by us	3,250,000 shares.
Common stock outstanding prior to this offering	26,270,379 shares.
Common stock outstanding after this offering	29,520,379 shares.
Use of proceeds	We expect to use a portion of the net proceeds of this offering to repay a portion of the amounts outstanding under our credit facility. We expect to use the remainder of the net proceeds to fund investments from our investment pipeline and for general corporate purposes. See Use of Proceeds in this prospectus supplement.
The NASDAQ Global Select Market symbol	PSEC
Risk factors	See Risk Factors in this prospectus supplement and the accompanying prospectus and other information in this prospectus supplement and the accompanying prospectus for a discussion of factors you should carefully consider before deciding to invest in shares of our common stock.
Current distribution rate	For our third fiscal quarter of 2008, our Board of Directors declared a quarterly dividend of $0.40 per share, representing our 14th consecutive quarterly dividend increase and an annualized dividend yield of approximately 10.1% based on our May 27, 2008 closing stock price of $15.92 per share. Our dividend is subject to change or discontinuance at any time in the discretion of our Board of Directors. Our future earnings and operating cash flow may not be sufficient to support a dividend.

Fees and Expenses

The following tables are intended to assist you in understanding the costs and expenses that an investor in this offering will bear directly or indirectly. In these tables, we assume that we have borrowed $200 million under our credit facility, which is the maximum amount available under the credit facility. Except where the context suggests otherwise, whenever this prospectus supplement contains a reference to fees or expenses paid by you, us or Prospect Capital, or that we will pay fees or expenses, the Company will pay such fees and expenses out of our net assets and, consequently, you will indirectly bear such fees or expenses as an investor in the Company. However, you will not be required to deliver any money or otherwise bear personal liability or responsibility for such fees or expenses.

Stockholder Transaction Expenses:

Sales load (as a percentage of offering price)(1)	5.00%
Offering expenses borne by us (as a percentage of offering price)(2)	0.40%

Dividend reinvestment plan expenses(3)	None
Total stockholder transaction expenses (as a percentage of offering price)	5.40%

Table of Contents

Annual Expenses (as a percentage of net assets attributable to common stock):[(4)]

Combined base management fee (3.17%(5)) and incentive fees payable under Investment Advisory Agreement (20% of realized capital gains and 20% of pre-incentive fee net investment income) (3.48%(6))	6.65%
Interest payments on borrowed funds	2.28(7)
Other expenses	1.93(8)
Total annual expenses (estimated)	10.86%(6)(8)

Example:

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

	1 Year	3 Years	5 Years	10 Years
You would pay the following expenses on a $1,000 investment, assuming a 5% annual return	$ 150.5	$ 350.2	$ 570.4	$ 1,224.8

While the table assumes, as required by the SEC, a 5% annual return, our performance will vary and may result in a return greater or less than 5%. The income incentive fee under our Investment Advisory Agreement with Prospect Capital Management would be zero at the 5% annual return assumption required by the SEC for this table, since no incentive fee is paid until the annual return exceeds 7%. However, we have reflected in the example the income incentive fee earned during our fiscal year ended June 30, 2007 as if the annual return were at the level recently achieved, which is higher than 5%. Accordingly, the resulting calculations overstate expenses at the 5% annual return as these calculations do not reflect the provisions of the Investment Advisory Agreement as it would actually be applied in the case of a 5% annual return (which would eliminate the income incentive fee, which is nevertheless not eliminated above). This table assumes that we will not realize any capital gains computed net of all realized capital losses and unrealized capital depreciation in any of the indicated time periods. If we achieve sufficient returns on our investments, including through the realization of capital gains, to trigger an incentive fee of a material amount, our expenses, and returns to our investors after such expenses, would be higher than shown above. If we only earn a 5% annual return, our expenses will be lower than shown above. In addition, while the example assumes reinvestment of all dividends and distributions at net asset value, or NAV, participants in our dividend reinvestment plan will receive a number of shares of our common stock, determined by dividing the total dollar amount of the dividend payable to a participant by the market price per share of our common stock at the close of trading on the valuation date for the dividend. See Dividend Reinvestment Plan in the accompanying prospectus for additional information regarding our dividend reinvestment plan.

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

(1) The underwriting discounts and commissions (sales load) with respect to our common stock sold in this offering, which is a one time fee, is the only sales load paid in connection with this offering.

(2) The offering expenses of this offering are estimated to be approximately $200,000.

(3) The expenses of the dividend reinvestment plan are included in other expenses.

(4) Net assets attributable to our common stock equal net assets (i.e., total assets less liabilities other than liabilities for money borrowed for investment purposes) at March 31, 2008. See Capitalization in this prospectus supplement.

(5) Our base management fee is 2% of our gross assets (which include any amount borrowed, i.e., total assets without deduction for any liabilities). Assuming that we have borrowed $200 million (the size of our credit facility), the 2% management fee of gross assets equals 3.17% of net assets. See Management Management services Investment Advisory Agreement in the accompanying prospectus and footnote 7 below.

Table of Contents

(6) Based on an annualized level of incentive fee paid during our quarter ended March 31, 2008, all of which consisted of an income incentive fee. For a more detailed discussion of the calculation of the two-part incentive fee, see Management Management services Investment Advisory Agreement in the accompanying prospectus.

(7) We may borrow additional money before and after the proceeds of this offering are substantially invested, but, in general, will utilize debt to the maximum extent reasonably possible before issuing additional equity. After this offering, we will have an increased amount available for us under our $200 million credit facility. For more information, see Risk Factors Risks Relating To Our Business And Structure Changes in interest rates may affect our cost of capital and net investment income below and Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Operating Expenses Financial Condition, Liquidity and Capital Resources in the accompanying prospectus. The table above assumes that we have borrowed $200 million under our credit facility, which is the maximum amount available under the credit facility. If we do not borrow amounts following this offering, our base management fee, as a percentage of net assets attributable to common stock, will decrease from the percentage shown in the table above, as borrowings will not represent a proportion of our overall assets.

(8) Other expense is based on our annualized expenses during our quarter ended March 31, 2008. See Management Management Services Administration Agreement in the accompanying prospectus.

Table of Contents

RISK FACTORS

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

Risks Relating To Our Business And Structure

A failure on our part to maintain our status as a business development company would significantly reduce our operating flexibility.

If we do not continue to qualify as a business development company, we might be regulated as a registered closed-end investment company under the 1940 Act, which would which make us subject to additional regulatory requirements, which may significantly decrease our operating flexibility by limiting our ability to employ leverage.

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

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

Prospect Capital Management and its senior management team have limited experience managing a business development company under the 1940 Act.

The 1940 Act imposes numerous constraints on the operations of business development companies. For example, business development companies are required to invest at least 70% of their total assets primarily in securities of privately held or thinly traded U.S. public companies, cash, cash equivalents, U.S. government securities and other high quality debt investments that mature in one year or less. Prospect Capital Management and its senior management team s limited experience in managing a portfolio of assets under such constraints may hinder their ability to take advantage of attractive investment opportunities and, as a result, achieve our investment objective. In addition, our investment strategies differ in some ways from those of other investment funds that have been managed in the past by the investment professionals.

We are a relatively new company with limited operating history.

We were incorporated in April 2004 and have conducted investment operations since July 2004. We are subject to all of the business risks and uncertainties associated with any new business enterprise, including the risk that we may not achieve our investment objective and that the value of your investment in us could decline substantially or fall to zero. We completed our initial public offering on July 27, 2004. As of March 31, 2008, we continue to pursue our investment strategy and 94% of our portfolio is invested in long-term investments, with the remainder invested in U.S. government and money market securities. Dividends that we pay prior to being fully invested may be substantially lower than the dividends that we expect to pay when our portfolio is fully invested. If we do not realize yields in excess of our expenses, we may incur operating losses and the market price of our shares may decline.

Table of Contents

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

Prospect Capital Management has been registered as an investment adviser since March 31, 2004, and the Company has been organized as a closed-end investment company since April 13, 2004. As such, each entity is subject to the business risks and uncertainties associated with any young business enterprise, including the limited experience in managing or operating a business development company under the 1940 Act. Our ability to achieve our investment objective depends on our ability to grow, which depends, in turn, on Prospect Capital Management s ability to continue to identify, analyze, invest in and monitor companies that meet our investment criteria. Accomplishing this result on a cost-effective basis is largely a function of Prospect Capital Management s structuring of investments, its ability to provide competent, attentive and efficient services to us and our access to financing on acceptable terms. As we grow, we and Prospect Capital Management need to continue to hire, train, supervise and manage new employees. Failure to manage our future growth effectively could have a material adverse effect on our business, financial condition and results of operations.

We operate in a highly competitive market for investment opportunities.

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

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

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

Regulations governing our operation as a business development company affect our ability to raise, and the way in which we raise, additional capital.

We may issue debt securities or preferred stock and/or borrow money from banks or other financial institutions, which we refer to collectively as senior securities, up to the maximum amount permitted by the 1940 Act. Under the provisions of the 1940 Act, we are permitted, as a business development company, to issue senior securities only in amounts such that our asset coverage, as defined in the 1940 Act, equals at least 200% after each issuance of senior securities. If the value of our assets declines, we may be unable to satisfy this test. If that happens, we may be required to sell a portion of our investments or sell additional shares of common stock and, depending on the nature of our leverage, to repay a portion of our indebtedness at a time when such sales may be disadvantageous. In addition, issuance of additional securities could dilute the percentage ownership of our current stockholders in us.

Table of Contents

As a business development company regulated under provisions of the 1940 Act, we are not generally able to issue and sell our common stock at a price below the current NAV per share. We may, however, sell our common stock, or warrants, options or rights to acquire our common stock, at a price below the current NAV of our common stock in a rights offering to our stockholders or if (1) our Board of Directors determines that such sale is in our and our stockholders best interests, (2) our stockholders approve the sale of our common stock at a price that is less than the current NAV, and (3) the price at which our common stock is to be issued and sold may not be less than a price which, in the determination of our Board of Directors, closely approximates the market value of these securities (less any sales load).

In addition, we may securitize our loans to generate cash for funding new investments. To securitize loans, we may create a wholly owned subsidiary and contribute a pool of loans to such subsidiary. This could include the sale of interests in the loans by the subsidiary on a nonrecourse basis to purchasers who we would expect to be willing to accept a lower interest rate to invest in investment grade loan pools. We would retain a portion of the equity in the securitized pool of loans. An inability to successfully securitize our loan portfolio could limit our ability to grow our business and fully execute our business strategy, and could decrease our earnings, if any. Moreover, the successful securitization of our loan portfolio exposes us to a risk of loss for the equity we retain in the securitized pool of loans and might expose us to losses because the residual loans in which we do not sell interests may tend to be those that are riskier and more likely to generate losses. A successful securitization may also impose financial and operating covenants that restrict our business activities and may include limitations that could hinder our ability to finance additional loans and investments or to make the distributions required to maintain our status as a RIC under Subchapter M of the Code. The 1940 Act may also impose restrictions on the structure of any securitizations.

If we fail to qualify as a Regulated Investment Company, or a RIC, we will have to pay corporate-level taxes on our income, and our income available for distribution would be reduced.

To maintain our qualification for federal income tax purposes as a RIC under Subchapter M of the Internal Revenue Code of 1986, as amended, and obtain RIC tax treatment, we must meet certain source-of-income, asset diversification and annual distribution requirements. The annual distribution requirement for a RIC is satisfied if we distribute at least 90% of our ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, to our stockholders on an annual basis. Because we expect to use debt financing in the future, we are subject to certain asset coverage ratio requirements under the 1940 Act and financial covenants that could, under certain circumstances, restrict us from making distributions necessary to qualify for RIC tax treatment. If we are unable to obtain cash from other sources, we may fail to qualify for RIC tax treatment and, thus, may be subject to corporate-level income tax. To maintain our qualification as a RIC, we must also meet certain asset diversification requirements at the end of each calendar quarter. Failure to meet these tests may result in our having to dispose of certain investments quickly in order to prevent the loss of RIC status. Because most of our investments are in private companies, any such dispositions could be made at disadvantageous prices and may result in substantial losses. If we fail to qualify as a RIC for any reason or become subject to corporate income tax, the resulting corporate taxes could substantially reduce our net assets, the amount of income available for distribution, and the actual amount of our distributions. Such a failure would have a material adverse effect on us and our shares. For additional information regarding asset coverage ratio and RIC requirements, see Regulation Senior Securities and Material U.S. Federal Income Tax Considerations in the accompanying prospectus.

We may have difficulty paying our required distributions if we recognize income before or without receiving cash representing such income.

For federal income tax purposes, we include in income certain amounts that we have not yet received in cash, such as original issue discount, which may arise if we receive warrants in connection with the making of a loan or possibly in other circumstances, or payment-in-kind interest, which represents contractual interest added to the loan balance and due at the end of the loan term. Such original issue discount, which could be significant relative to our overall investment activities, or increases in loan balances as a result of payment-in-kind arrangements, are included in our income before we receive any corresponding cash payments. We also may be required to include in income certain other amounts that we do not receive in cash. While we focus primarily on investments that will generate a current cash return, our investment portfolio may also include securities that do not pay some or all of their return in periodic current cash distributions.

Table of Contents

The income incentive fee payable by us is computed and paid on income that may include interest that has been accrued but not yet received in cash. If a portfolio company defaults on a loan that is structured to provide accrued interest, it is possible that accrued interest previously used in the calculation of the income incentive fee will become uncollectible.

Since in some cases we may recognize taxable income before or without receiving cash representing such income, we may have difficulty meeting the tax requirement to distribute at least 90% of our ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, to maintain RIC tax treatment. Accordingly, we may have to sell some of our investments at times we would not consider advantageous, raise additional debt or equity capital or reduce new investment originations to meet these distribution requirements. If we are not able to obtain cash from other sources, we may fail to qualify for RIC treatment and thus become subject to corporate-level income tax. See Material U.S. Federal Income Tax Considerations Taxation As A RIC in the accompanying prospectus.

If we issue senior securities, including debt, you will be exposed to additional risks, including the typical risks associated with leverage.

You will be exposed to increased risk of loss if we incur debt to make investments. If we do incur debt, a decrease in the value of our investments or in our revenues would have a greater negative impact on the value of our common stock than if we did not use debt.

Our ability to pay dividends would be restricted if our asset coverage ratio were not at least 200% and any amounts that we use to service our indebtedness would not be available for dividends to our common stockholders.

It is likely that any debt we incur will be governed by an indenture or other instrument containing covenants restricting our operating flexibility.

We and you will bear the cost of issuing and servicing our senior securities.

Any convertible or exchangeable securities that we issue in the future may have rights, preferences and privileges more favorable than those of our common stock.

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

We expect that a significant portion of our debt investments will bear interest at fixed rates and the value of these investments could be negatively affected by increases in market interest rates. In addition, an increase in interest rates would make it more expensive to use debt to finance our investments. As a result, a significant increase in market interest rates could both reduce the value of our portfolio investments and increase our cost of capital, which would reduce our net investment income.

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

We need additional capital to fund growth in our investments. A reduction in the availability of new capital could limit our ability to grow. We must distribute at least 90% of our ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, to our stockholders to maintain our RIC status. As a result, such earnings are not available to fund investment originations. We have sought additional capital by borrowing from financial institutions and may issue debt securities or additional equity securities. If we fail to obtain funds from such sources or from other sources to fund our investments, we could be limited in our ability to grow, which may have an adverse effect on the value of our Securities. In addition, as a business development company, we are generally required to maintain a ratio of at least 200% of total assets to total borrowings, which may restrict our ability to borrow in certain circumstances.

Table of Contents

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

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

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

We generally make investments in private companies. Substantially all of these securities are subject to legal and other restrictions on resale or are otherwise less liquid than publicly traded securities. The illiquidity of our investments may make it difficult for us to sell such investments if the need arises. In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the value at which we have previously recorded our investments. In addition, we may face other restrictions on our ability to liquidate an investment in a portfolio company to the extent that we or Prospect Capital Management have material non-public information regarding such portfolio company.

We may experience fluctuations in our quarterly results.

We could experience fluctuations in our quarterly operating results due to a number of factors, including the interest or dividend rates payable on the debt or equity securities we acquire, the default rate on debt securities, the level of our expenses, variations in and the timing of the recognition of realized and unrealized gains or losses, the degree to which we encounter competition in our markets, the seasonality of the energy industry, weather patterns, changes in energy prices and general economic conditions. As a result of these factors, results for any period should not be relied upon as being indicative of performance in future periods.

Potential conflicts of interest could impact our investment returns.

Our executive officers and directors, and the executive officers of Prospect Capital Management, may serve as officers, directors or principals of entities that operate in the same or related lines of business as we do or of investment funds managed by our affiliates. Accordingly, they may have obligations to investors in those entities, the fulfillment of which might not be in the best interests of us or our stockholders. Nevertheless, it is possible that new investment opportunities that meet our investment objective may come to the attention of one of these entities in connection with another investment advisory client or program, and, if so, such opportunity might not be offered, or otherwise made available, to us. However, as an investment adviser, Prospect Capital Management has a fiduciary obligation to act in the best interests of its clients, including us. To that end, if Prospect Capital Management or its affiliates manage any additional investment vehicles or client accounts in the future, Prospect Capital Management will endeavor to allocate investment opportunities in a fair and equitable manner over time so as not to discriminate unfairly against any client. If Prospect Capital Management chooses to establish another investment fund in the future, when the investment professionals of Prospect Capital Management identify an investment, they will have to choose which investment fund should make the investment.

Table of Contents

In the course of our investing activities, under the Investment Advisory Agreement we pay base management and incentive fees to Prospect Capital Management, and reimburse Prospect Capital Management for certain expenses it incurs. As a result of our Investment Advisory Agreement, there may be times when the senior management team of Prospect Capital Management has interests that differ from those of our stockholders, giving rise to a conflict.

Prospect Capital Management receives a quarterly income incentive fee based, in part, on our pre-incentive fee net investment income, if any, for the immediately preceding calendar quarter. This income incentive fee is subject to a fixed quarterly hurdle rate before providing an income incentive fee return to Prospect Capital Management. To the extent we or Prospect Capital Management are able to exert influence over our portfolio companies, the income incentive fee may provide Prospect Capital Management with an incentive to induce our portfolio companies to accelerate or defer interest or other obligations owed to us from one calendar quarter to another. This fixed hurdle rate was determined when then current interest rates were relatively low on a historical basis. Thus, if interest rates rise, it would become easier for our investment income to exceed the hurdle rate and, as a result, more likely that Prospect Capital Management will receive an income incentive fee than if interest rates on our investments remained constant or decreased. Subject to the receipt of any requisite stockholder approval under the 1940 Act, our Board of Directors may readjust the hurdle rate by amending the Investment Advisory Agreement.

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

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

Changes in laws or regulations governing our operations may adversely affect our business.

We and our portfolio companies are subject to regulation by laws at the local, state and federal levels. These laws and regulations, as well as their interpretation, may be changed from time to time. Accordingly, changes in these laws or regulations could have a material adverse effect on our business. For additional information regarding the regulations we are subject to, see Regulation in the accompanying prospectus.

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

We are prohibited under the 1940 Act from knowingly participating in certain transactions with our affiliates without the prior approval of our independent directors. Any person that owns, directly or indirectly, 5% or more of our outstanding voting securities is our affiliate for purposes of the 1940 Act and we are generally prohibited from buying or selling any security from or to such affiliate, absent the prior approval of our independent directors. The 1940 Act also prohibits joint transactions with an affiliate, which could include investments in the same portfolio company (whether at the same or different times), without prior approval of our independent directors. If a person acquires more than 25% of our voting securities, we are prohibited from buying or selling any security from or to such person, or entering into joint transactions with such person, absent the prior approval of the SEC.

Table of Contents

Risks Related To Our Investments

We may not realize gains or income from our investments.

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

Our portfolio is concentrated in a limited number of portfolio companies in the energy industry, which subject us to a risk of significant loss if any of these companies defaults on its obligations under any of the securities that we hold or if the energy industry experiences a downturn.

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

The energy industry is subject to many risks.

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

> *Commodity Pricing Risk.* While we generally do not invest in companies that accept completely unhedged commodity risk for an unlimited time, energy companies in general are directly affected by energy commodity prices, such as the market prices of crude oil, natural gas and wholesale electricity, especially for those that own the underlying energy commodity. In addition, the volatility of commodity prices can affect other energy companies due to the impact of prices on the volume of commodities transported, processed, stored or distributed and on the cost of fuel for power generation companies. The volatility of commodity prices can also affect energy companies ability to access the capital markets in light of market perception that their performance may be directly tied to commodity prices. Historically, energy commodity prices have been cyclical and exhibited significant volatility. Although we generally prefer risk controls, including appropriate commodity and other hedges, by each of our portfolio companies, some of our portfolio companies may not engage in hedging transactions to minimize their exposure to commodity price risk. For those companies that engage in such hedging transactions, they remain subject to market risks, including market liquidity and counterparty creditworthiness.
>
> *Regulatory Risk.* The profitability of energy companies could be adversely affected by changes in the regulatory environment. The businesses of energy companies are heavily regulated by federal, state and local

governments in diverse ways, such as the way in which energy assets are constructed, maintained and operated and the prices energy companies may charge for their products and services. Such regulation can change over time in scope and intensity. For example, a particular by-product of an energy process may be declared hazardous by a regulatory agency, which can unexpectedly increase production costs. Moreover, many state and federal environmental laws provide for civil penalties as well as regulatory remediation, thus adding to the potential liability an energy company may face. In addition, the deregulation of energy markets and the unresolved regulatory issues related to some power markets such as California create uncertainty in the regulatory environment as rules and regulations may be adopted on a transitional basis.

Table of Contents

We cannot assure you that the deregulation of energy markets will continue and if it continues, whether its impact on energy companies profitability will be positive.

Production Risk. The profitability of energy companies may be materially impacted by the volume of crude oil, natural gas or other energy commodities available for transporting, processing, storing, distributing or power generation. A significant decrease in the production of natural gas, crude oil, coal or other energy commodities, due to the decline of production from existing facilities, import supply disruption, depressed commodity prices, political events, actions of the Organization of the Petroleum Exporting Countries, or OPEC, or otherwise, could reduce revenue and operating income or increase operating costs of energy companies and, therefore, their ability to pay debt or dividends. In recent months, OPEC has announced changes in production quotas in response to changing market conditions, including near record high and volatile oil prices in the United States.

Demand Risk. A sustained decline in demand for crude oil, natural gas, refined petroleum products and electricity could materially affect revenues and cash flows of energy companies. Factors that could lead to a decrease in market demand include a recession or other adverse economic conditions, an increase in the market price of the underlying commodity, higher taxes or other regulatory actions that increase costs, or a shift in consumer demand for such products.

Depletion and Exploration Risk. A portion of any one energy company s assets may be dedicated to natural gas, crude oil and/or coal reserves and other commodities that naturally deplete over time. Depletion could have a material adverse impact on such company s ability to maintain its revenue. Further, estimates of energy reserves may not be accurate and, even if accurate, reserves may not be fully utilized at reasonable costs. Exploration of energy resources, especially of oil and gas, is inherently risky and requires large amounts of capital.

Weather Risk. Unseasonable extreme weather patterns could result in significant volatility in demand for energy and power. This volatility may create fluctuations in earnings of energy companies.

Operational Risk. Energy companies are subject to various operational risks, such as failed drilling or well development, unscheduled outages, underestimated cost projections, unanticipated operation and maintenance expenses, failure to obtain the necessary permits to operate and failure of third-party contractors (for example, energy producers and shippers) to perform their contractual obligations. In addition, energy companies employ a variety of means of increasing cash flow, including increasing utilization of existing facilities, expanding operations through new construction, expanding operations through acquisitions, or securing additional long-term contracts. Thus, some energy companies may be subject to construction risk, acquisition risk or other risk factors arising from their specific business strategies.

Competition Risk. The progress in deregulating energy markets has created more competition in the energy industry. This competition is reflected in risks associated with marketing and selling energy in the evolving energy market and a competitor s development of a lower-cost energy or power source, or of a lower cost means of operations, and other risks arising from competition.

Valuation Risk. Since mid-2001, excess power generation capacity in certain regions of the United States has caused substantial decreases in the market capitalization of many energy companies. While such prices have recovered to some extent, we can offer no assurance that such decreases in market capitalization will not recur, or that any future decreases in energy company valuations will be insubstantial or temporary in nature.

Terrorism Risk. Since the September 11th attacks, the United States government has issued public warnings indicating that energy assets, specifically those related to pipeline infrastructure, production facilities and transmission and distribution facilities, might be specific targets of terrorist activity. The continued threat of terrorism and related military activity will likely increase volatility for prices of natural gas and oil and could affect the market for products and services of energy companies. In addition, any future terrorist attack or armed conflict in the United States or elsewhere may undermine economic conditions in the United States in general.

Table of Contents

Financing Risk. Some of our portfolio companies rely on the capital markets to raise money to pay their existing obligations. Their ability to access the capital markets on attractive terms or at all may be affected by any of the risks associated with energy companies described above, by general economic and market conditions or by other factors. This may in turn affect their ability to satisfy their obligations with us.

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

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

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

these companies may have limited financial resources and may be unable to meet their obligations under their securities that we hold, which may be accompanied by a deterioration in the value of their securities or of any collateral with respect to any securities and a reduction in the likelihood of our realizing on any guarantees we may have obtained in connection with our investment;

they may have shorter operating histories, narrower product lines and smaller market shares than larger businesses, which tend to render them more vulnerable to competitors actions and market conditions, as well as general economic downturns;

because many of these companies are privately held companies, public information is generally not available about these companies. As a result, we will depend on the ability of Prospect Capital Management to obtain adequate information to evaluate these companies in making investment decisions. If Prospect Capital Management is unable to uncover all material information about these companies, it may not make a fully informed investment decision, and we may lose money on our investments;

they are more likely to depend on the management talents and efforts of a small group of persons; therefore, the death, disability, resignation or termination of one or more of these persons could have a material adverse impact on our portfolio company and, in turn, on us;

they may have less predictable operating results, may from time to time be parties to litigation, may be engaged in changing businesses with products subject to a risk of obsolescence and may require substantial additional capital to support their operations, finance expansion or maintain their competitive position. In addition, our executive officers, directors and Prospect Capital Management could, in the ordinary course of business, be named as defendants in litigation arising from proposed investments or from our investments in the portfolio companies.

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

Our portfolio companies will generally be affected by the conditions and overall strength of the national, regional and local economies, including interest rate fluctuations, changes in the capital markets and changes in the prices of their primary commodities and products. These factors also impact the amount of residential, industrial and commercial growth in the energy industry. Additionally, these factors could adversely impact the customer base and customer collections of our portfolio companies.

As a result, many of our portfolio companies may be susceptible to economic slowdowns or recessions and may be unable to repay our loans or meet other obligations during these periods. Therefore, our non-performing assets are likely to increase, and the value of our portfolio is likely to decrease, during these periods. Adverse economic conditions also may decrease the value of collateral securing some of our loans and the value of our equity investments. Economic slowdowns or recessions could lead to financial losses in our portfolio and a decrease in revenues, net income and assets. Unfavorable economic conditions also could increase our funding costs, limit our

Table of Contents

access to the capital markets or result in a decision by lenders not to extend credit to us. These events could prevent us from increasing investments and harm our operating results.

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

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

We invest primarily in mezzanine debt and dividend-paying equity securities issued by our portfolio companies. Our portfolio companies usually have, or may be permitted to incur, other debt, or issue other equity securities, that rank equally with, or senior to, the securities in which we invest. By their terms, such instruments may provide that the holders are entitled to receive payment of dividends, interest or principal on or before the dates on which we are entitled to receive payments in respect of the securities in which we invest. Also, in the event of insolvency, liquidation, dissolution, reorganization or bankruptcy of a portfolio company, holders of securities ranking senior to our investment in that portfolio company would typically be entitled to receive payment in full before we receive any distribution in respect of our investment. After repaying the senior security holders, the portfolio company may not have any remaining assets to use for repaying its obligation to us. In the case of securities ranking equally with securities in which we invest, we would have to share on an equal basis any distributions with other security holders in the event of an insolvency, liquidation, dissolution, reorganization or bankruptcy of the relevant portfolio company. In addition, we may not be in a position to control any portfolio company in which we invest. As a result, we are subject to the risk that a portfolio company in which we invest may make business decisions with which we disagree and the management of such company, as representatives of the holders of their common equity, may take risks or otherwise act in ways that do not serve our interests as debt or preferred equity investors.

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

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

- since our debt investments are primarily made in the form of mezzanine loans, our liens on the collateral, if any, are subordinated to those of the senior secured debt of the portfolio companies, if any. As a result, we may not be able to control remedies with respect to the collateral;

- the collateral may not be valuable enough to satisfy all of the obligations under our secured loan, particularly after giving effect to the repayment of secured debt of the portfolio company that ranks senior to our loan;

- bankruptcy laws may limit our ability to realize value from the collateral and may delay the realization process;

our rights in the collateral may be adversely affected by the failure to perfect security interests in the collateral;

how effectively the collateral would be liquidated and the value received could be impaired or impeded by the need to obtain regulatory and contractual consents; and by its nature, some or all of the collateral may be illiquid and may have no readily ascertainable market value. The liquidity and value of the collateral could be impaired as a result of changing economic conditions, competition, and other factors, including the availability of suitable buyers.

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

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

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

Our investments in foreign securities may involve significant risks in addition to the risks inherent in U.S. investments.

Our investment strategy contemplates potential investments in securities of foreign companies. Investing in foreign companies may expose us to additional risks not typically associated with investing in U.S. companies. These risks include changes in exchange control regulations, political and social instability, expropriation, imposition of foreign taxes, less liquid markets and less available information than is generally the case in the United States, higher transaction costs, less government supervision of exchanges, brokers and issuers, less developed bankruptcy laws, difficulty in enforcing contractual obligations, lack of uniform accounting and auditing standards and greater price volatility.

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

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

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

There can be no assurance as to the timing or success of the potential sale of GSHI, or as to any proceeds to be received from such sale.

In late December 2007, the Company s largest 100% controlled investment, GSHI, a midstream gathering and processing business in East Texas, engaged RBC Capital Markets Corporation as a financial advisor to explore strategic alternatives, including a potential sale. This monetization process is ongoing. Management can make no assurances as to the timing or success of the potential sale of GSHI, or as to any proceeds to be received from such sale.

Risks Relating To Our Securities

There is a risk that you may not receive dividends or that our dividends may not grow over time.

We have made and intend to continue to make distributions on a quarterly basis to our stockholders out of assets legally available for distribution. We cannot assure you that we will achieve investment results or maintain a tax status that will allow or require any specified level of cash distributions or year-to-year increases in cash distributions. In addition, due to the asset coverage test applicable to us as a business development company, we may be limited in our ability to make distributions. See Distributions in the accompanying prospectus.

Provisions of the Maryland General Corporation Law and of our charter and bylaws could deter takeover attempts and have an adverse impact on the price of our common stock.

The Maryland General Corporation Law and our charter and bylaws contain provisions that may have the effect of discouraging, delaying or making more difficult a change in control and preventing the removal of incumbent directors. We are covered by the Maryland Business Combination Act, or the Business Combination Act, to the extent such statute is not superseded by applicable requirements of the 1940 Act. However, our Board of Directors has adopted a resolution exempting any business combination between us and any other person from the Business Combination Act, subject to prior approval of such business combination by our Board of Directors, including a majority of our directors who are not interested persons as defined in the 1940 Act. In addition, the Maryland Control Share Acquisition Act, or the Control Share Act, provides that control shares of a Maryland corporation acquired in a control share acquisition have no voting rights except to the extent approved by a vote of two-thirds of the votes entitled to be cast on the matter. Our bylaws contain a provision exempting from the Control Share Act any and all acquisitions by any person of our shares of stock. If the applicable Board of Directors resolution is repealed or our Board of Directors does not otherwise approve a business combination, the Business Combination Act and the Control Share Act (if we amend our bylaws to be subject to that Act) may discourage others from trying to acquire control of us and increase the difficulty of consummating any offer.

Additionally, under our charter, our Board of Directors is divided into three classes serving staggered terms; our Board of Directors may, without stockholder action, authorize the issuance of shares of stock in one or more classes or series, including preferred stock; and our Board of Directors may, without stockholder action, amend our charter to increase the number of shares of stock of any class or series that we have authority to issue. The existence of these provisions, among others, may have a negative impact on the price of our common stock and may discourage third party bids for ownership of our Company. These provisions may prevent any premiums being offered to you for shares of our common stock.

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

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

The market price of our securities may fluctuate significantly.

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

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

We may allocate the net proceeds from any offering in ways with which you may not agree.

We will have significant flexibility in investing the net proceeds of any offering of our Securities. We may use the net proceeds from the offering in ways with which you may not agree or for investments other than those contemplated at the time of the offering, unless such change in the use of proceeds is subject to stockholders approval or prohibited by law.

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

As of May 27, 2008, we have 26,270,379 shares of common stock outstanding. Sales of substantial amounts of our securities or the availability of such securities for sale could adversely affect the prevailing market price for our securities. If this occurs and continues it could impair our ability to raise additional capital through the sale of securities should we desire to do so.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus supplement contains forward-looking statements that involve substantial risks and uncertainties. These forward-looking statements are not historical facts, but rather are based on current expectations, estimates and projections about our industry, our beliefs, and our assumptions. Words such as anticipates, expects, intends, plans, believes, seeks, and estimates and variations of these words and similar expressions are intended to identify forward-looking statements. These statements are not guarantees of future performance and are subject to risks, uncertainties, and other factors, some of which are beyond our control and difficult to predict and which could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements, including the risks, uncertainties and other factors we identify in Risk Factors in this prospectus supplement and the accompanying prospectus and in our filings with the SEC.

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

Table of Contents

USE OF PROCEEDS

The net proceeds from the sale of 3,250,000 shares of our common stock in this offering will be $45,820,000 after deducting underwriting discounts and commissions of $2,405,000 and estimated offering expenses of approximately $200,000 payable by us. We will also reimburse a portion of the underwriters expenses in the amount of up to $150,000.

We expect to use a portion of the net proceeds of this offering to repay a portion of the amounts outstanding under our credit facility. Our credit facility had approximately $91.0 million outstanding as of March 31, 2008, bearing interest at LIBOR plus 1.75%, and maturing in June 2010. We expect such repayment will occur within a reasonable time period after the closing of this offering. Once repaid, we will have an increased amount available under our credit facility to fund additional investments. We expect to use the remainder of the net proceeds of this offering to fund investments from our investment pipeline and for general corporate purposes.

Table of Contents

CAPITALIZATION

The following table sets forth our capitalization as of March 31, 2008:

on an actual basis;

on an as-adjusted basis giving effect to the sale of 3,250,000 shares of our common stock in this offering, at a public offering price of $14.90 per share, after deducting the underwriting discounts and commissions and estimated offering expenses of approximately $200,000 payable by us, and our receipt of the estimated net proceeds from that sale.

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

	As of March 31, 2008	
	Actual	**As adjusted for this offering(1)(2)**
	(Unaudited) (In 000s, except shares and per share data)	
Long-term debt, including current maturities:		
Borrowings under senior credit facility	$ 90,667	$ 138,167
Amount owed to affiliates	6,493	6,493
Total long-term debt	97,160	144,660
Stockholders equity:		
Common stock, par value $0.001 per share (100,000,000 common shares authorized; 26,270,379 shares outstanding actual, and 29,520,379 shares outstanding as adjusted	26	30
Paid-in capital in excess of par value	395,571	441,391
Distributions in excess of net investment income	(315)	(315)
Accumulated realized gains on investments	(16,163)	(16,163)
Net unrealized appreciation on investments	(7,401)	(7,401)
Total stockholders equity	371,718	417,542
Total capitalization	$ 468,878	$ 562,202

(1) As of May 27, 2008, we had approximately $138.2 million outstanding under our credit facility, representing an additional $47.5 million of borrowings subsequent to March 31, 2008.

(2)

The proceeds from the sale of our common stock in this offering will be used to repay in part amounts outstanding under the credit facility.

PRICE RANGE OF COMMON STOCK AND DISTRIBUTIONS

We have paid and intend to continue to distribute quarterly dividends to our stockholders out of assets legally available for distribution. Our dividends, if any, will be determined by our Board of Directors.

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

98% of our ordinary income for the calendar year;

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

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

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

We maintain an opt out dividend reinvestment plan for our common stockholders. As a result, if we declare a dividend, cash dividends payable to stockholders will be automatically reinvested in additional shares of our common stock, unless they (or the brokers holding their shares) specifically opt out of the dividend reinvestment plan so as to receive cash dividends. To the extent prudent and practicable, we intend to declare and pay dividends on a quarterly basis.

Income from origination, structuring, closing, commitment and other upfront fees associated with investments in portfolio companies has been treated as taxable income and, accordingly, distributed to stockholders. From our initial public offering through March 31, 2008, we have distributed over 100% of our taxable income to our stockholders. For the fiscal year ended June 30, 2007, we declared total dividends of $27.5 million.

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

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

	NAV(1)	Stock Price High(2)	Stock Price Low(2)	Premium (Discount) of High to NAV	Premium (Discount) of Low to NAV	Dividend Declared
Twelve Months Ending June 30, 2005						
First quarter	$ 13.67	$ 15.45	$ 14.42	13.0%	5.5%	
Second quarter	13.74	15.15	11.63	10.3%	(15.4)%	$ 0.100
Third quarter	13.74	13.72	10.61	(0.1)%	(22.8)%	0.125
Fourth quarter	14.59	13.47	12.27	(7.7)%	(15.9)%	0.150

	NAV(1)	Stock Price High(2)	Stock Price Low(2)	Premium (Discount) of High to NAV	Premium (Discount) of Low to NAV	Dividend Declared
Twelve Months Ending June 30, 2006						
First quarter	$ 14.60	$ 13.60	$ 11.06	(6.8)%	(24.2)%	$ 0.200
Second quarter	14.69	15.46	13.02	5.2%	(12.6)%	0.280
Third quarter	14.81	16.64	15.00	12.4%	1.3%	0.300
Fourth quarter	15.31	17.05	15.83	11.5%	3.4%	0.340
Twelve Months Ending June 30, 2007						
First quarter	$ 14.86	$ 16.77	$ 15.30	12.9%	2.3%	$ 0.380
Second quarter	15.24	18.79	15.60	24.5%	(0.9)%	0.385
Third quarter	15.18	17.68	16.40	16.5%	8.0%	0.3875
Fourth quarter	15.04	18.68	16.91	24.2%	12.4%	0.390
Twelve Months Ending June 30, 2008						
First quarter	$ 15.08	$ 18.68	$ 14.16	24.7%	(16.1)%	$ 0.3925
Second quarter	14.58	17.17	11.22	18.3%	(23.3)%	0.395
Third Quarter	14.15	16.00	13.55	13.1%	(4.2)%	0.400
Fourth Quarter	(3)	16.12	14.15	(2)	(2)	

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

(2) The High/Low Stock Price is calculated as of the closing price on a given day in the applicable quarter.

(3) NAV has not yet been finally determined for any day after March 31, 2008.

On May 27, 2008, the last reported sales price of our common stock was $15.92 per share. As of May 27, 2008, we had approximately 51 stockholders of record.

The below table sets forth each class of our outstanding securities as of March 31, 2008:

(1) Title of Class	(2) Amount Authorized	(3) Amount Held by Registrant or for its Account	(4) Amount Outstanding Exclusive of Amount Shown Under(3)
Common Stock	100,000,000	0	26,270,379

Table of Contents

SELECTED CONDENSED FINANCIAL DATA

You should read the condensed financial and other data below with the Financial Statements and Notes thereto and Management s Discussion and Analysis of Financial Condition and Results of Operations included in this prospectus supplement. Financial information for the twelve months ended June 30, 2007, 2006 and 2005 has been derived from the audited financial statements for that period. Quarterly financial information is derived from unaudited financial data, which in the opinion of management reflect all adjustments (consisting only of normal recurring adjustments) that are necessary to present fairly the results of such interim periods. Interim results for the three and nine months ended March 31, 2008 are not necessarily indicative of the results that may be expected for the year ending June 30, 2008. See Management s Discussion and Analysis of Financial Condition and Results of Operations on page S-25 of this prospectus supplement for more information.

(all figures in thousands except per share and other data)

	For the Three Months Ended March 31, 2008 (Unaudited)	For the Three Months Ended March 31, 2007 (Unaudited)	For the Nine Months Ended March 31, 2008 (Unaudited)	For the Nine Months Ended March 31, 2007 (Unaudited)	For the Year Ended June 30, 2007	For the Year Ended June 30, 2006	For the Year Ended June 30, 2005
tal estment ome	$ 22,000	$ 12,069	55,954	26,672	$ 40,681	$ 16,869	$ 8,09
tal expenses	(9,081)	(5,054)	(24,510)	(11,890)	(17,550)	(8,311)	(5,68
t investment ome	12,919	7,015	31,444	14,782	23,131	8,558	2,41
t increase crease) in assets ulting from erations	(1,259)	4,976	3,605	11,880	16,728	12,896	8,75
Share Data:							
t increase crease) in assets ulting from erations(1)	(0.05)	0.26	0.16	0.82	1.06	1.83	1.2
stributions clared per re	(0.40)	(0.39)	(1.18)	(1.16)	(1.54)	(1.12)	(0.3
ance Sheet ta:							
tal assets	480,007	314,561	480,007	314,561	376,502	138,480	103,90

tal liabilities	108,289	12,794	108,287	12,794	76,454	30,210	94
t assets	371,718	301,767	371,718	301,767	300,048	108,270	102,96
nount drawn credit ility	90,667		90,667			28,500	
her Data:							
mber of rtfolio npanies at iod end	31(2)	19(2)	31(2)	19(2)	24(2)	15	
erage eighted ares	23,858,492	19,697,473	22,439,987	14,341,811	15,724,095	7,056,846	7,055,10

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

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

Table of Contents

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

OVERVIEW AS OF MARCH 31, 2008

Prospect Capital Corporation is a publicly traded mezzanine debt and private equity firm that provides investment capital to micro to middle market companies. We invest primarily in senior and subordinated debt and equity of companies in need of capital for acquisitions, divestitures, growth, development, project financing and recapitalization. We work with the management teams or financial sponsors to seek investments with historical cash flows, asset collateral or contracted pro-forma cash flows.

The aggregate value of our portfolio investments was $429,156 and $328,222 as of March 31, 2008 and June 30, 2007, respectively. During the first three quarters of fiscal year 2008, our net cost of investments increased by $110,360, or 33.8%, as we invested in 12 new and follow-on investments while we sold three investments and three other investments repaid their loans.

Compared to the end of last fiscal year (ended June 30, 2007), net assets increased by $71,670 during the nine-month period ended March 31, 2008, from $300,048 to $371,718. This increase resulted from the issuance of new shares of our common stock (less offering costs) in the amount of $92,979, dividend re-investments of $2,753, and another $3,605 from operations. These increases, in turn, were offset by $27,667 in dividend distributions to our stockholders. The $3,605 increase in net assets resulting from operations is net of the following: Net investment income of $31,444, realized loss on investments of $18,413, and a net decrease in net assets due to changes in unrealized appreciation/depreciation of investments of $9,426. The realized losses were mainly due to the sale of Central Illinois Energy, LLC, or CIE, and Advantage Oilfield Group Ltd., or AOG. The net unrealized depreciation was driven by significant write-downs in our investments in, Integrated Contract Services, Inc., or ICS, Worcester Energy Company, Inc., or WECO, and Genesis Coal Corp., or Genesis, which, in turn, were partially offset by write-ups for our investments in GSHI, and by the disposition of previously written-down investments in AOG and in ESA Environmental Specialists, or ESA.

We seek to be a long-term investor with our investment companies. As of March 31, 2008, we continue to pursue our investment strategy, and 115.5% of our net assets are invested in long-term investments.

To date we have invested primarily in industries related to the industrial/energy economy. However, we continue to widen our strategy focus in other sectors of the economy to diversify our portfolio holdings. This is further evidenced by the change of our corporate name. Some of the companies in which we invest have relatively short or no operating histories. These companies are and will be subject to all of the business risks and uncertainties associated with any new business enterprise, including the risks that these companies may not reach their investment objective or the value of our investments in them may decline substantially or fall to zero.

After a robust global debt market during the earlier part of 2007, beginning in June 2007, signs of strain emerged as fears of increasing defaults in the subprime mortgage lending market caused a broader loss of investor confidence beyond the subprime mortgage lending market and into the corporate leveraged loan and high-yield debt markets. Collateralized Loan Obligations, or CLOs, and hedge funds, in particular, have been a driving force in the excess liquidity that existed in the debt capital markets. The loss of investor confidence in many of these highly-leveraged investment vehicles has significantly constrained the market for new CLO issuance, a consequence of limited relevance to our business historically.

Since June 2007, there has been a significant reduction in liquidity in the corporate debt capital markets and transactions in the high-yield and leveraged loan markets have recently been cancelled, postponed, or restructured, enhancing opportunities for us going forward. The extra supply and meaningfully less demand has shifted the dynamics between buyers and sellers and caused several hundred billion dollars of corporate loans and bridge loan commitments to remain on the balance sheets of financial institutions and remain undistributed. We believe that, as of today, this reduction in liquidity has caused increased market volatility in the secondary prices of existing leveraged loans and high yield bonds, driving many leveraged loan and bond market quotes to below the primary market offer price without necessarily reflecting a deterioration, if any, in underlying fundamental performance of many of these issuers. The valuation of securities held within our portfolio has not been materially affected in an adverse way by these events because we had not participated in the syndicated loan market prior to September 2007 to any meaningful extent. If we were to enter into these markets in a meaningful way, we would be able to lend money at higher rates of interest and would be able to purchase loans at greater discounts than prior to the occurrence of these events. We also expect that greater structural protection that lenders require for new loans, such as lower overall financial leverage and maintenance financial covenants, will increase the opportunities for us to invest since we have generally decided not to invest in highly leveraged or covenant light credit facilities. In turn, these events also could increase our cost of financing.

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

Recent Developments

On April 3, 2008, we provided approximately $39.8 million first and second lien debt and equity for the recapitalization of Ajax, a custom forger of seamless rolled steal rings located in York, South Carolina. Our debt is secured by a first lien on inventory, machinery, and certain other assets of Ajax. The equity interest purchased in Ajax is controlling in nature and was made alongside equity co-investments by Ajax s senior managers.

On April 30, 2008, we provided debt financing of $20.0 million to support the acquisition by Peerless headquartered in Dallas, Texas, of Nitram. Peerless is a leading designer, manufacturer, and marketer of industrial environmental separation and filtration systems while Nitram focuses on separation, heat transfer, pulsation dampening, and industrial silencing products. Peerless and Nitram serve a diversified, global list of customers in industries such as oil and gas production, gas pipelines, chemical and petrochemical processing, and power generation.

On April 30, 2008, we fully exited out of our investment in Arctic through the sale of our equity interest in Arctic for approximately $3.4 million. We initially invested $9.25 million in Artic in July 2005 in the form of a senior secured loan, which was subsequently increased by $6.0 million. We received the equity interest in Artic as additional consideration for making the secured loan. The loan was fully repaid in August 2007.

Significant Accounting Policies and Estimates

We believe that the estimates, assumptions and judgments involved in the accounting policies described below have the greatest potential impact on our financial statements. So we consider these to be our critical accounting policies, and they are consistently applied by us.

Investments:

(a) Security transactions are recorded on a trade-date basis.

(b) Valuation:

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

(2) Short-term investments that mature in 60 days or less, such as United States Treasury Bills, are valued at amortized cost, which approximates fair value. The amortized cost method involves recording a security at its cost (i.e., principal amount plus any premium and less any discount) on the date of purchase and thereafter amortizing/accreting that difference between the principal amount due at maturity and cost assuming a constant yield

to maturity as determined at time of purchase. Short-term securities that mature in more than 60 days are valued at current market quotations by an independent pricing service or at the mean between the bid and ask prices obtained from at least two brokers or dealers (if available, or otherwise by a principal market maker or a primary market dealer). Investments in money market mutual funds are valued at their net asset value as of the close of business on the day of valuation.

(3) It is expected that most of the investments in the Company s portfolio will not have readily available market values. Debt and equity securities whose market prices are not readily available are valued at fair value

Table of Contents

with the assistance of an independent valuation service using a documented valuation policy and a valuation process that is consistently applied under the direction of our Board of Directors. The factors that may be taken into account in fairly valuing investments include, as relevant, the portfolio company s ability to make payments, its estimated earnings and projected discounted cash flows, the nature and realizable value of any collateral, the sensitivity of the investments to fluctuations in interest rates, the financial environment in which the portfolio company operates, comparisons to securities of similar publicly traded companies and other relevant factors. Due to the inherent uncertainty of determining the fair value of investments that do not have a readily available market value, the fair value of these investments may differ significantly from the values that would have been used had a ready market existed for such investments, and any such differences could be material.

(4) In September 2006, FASB issued a new pronouncement addressing fair value measurements, Statement of Financial Accounting Standards Number 157, Fair Value Measurements, or SFAS 157. This statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 becomes effective for fiscal years beginning after November 15, 2007; therefore, its first applicability to the Company will be for the Company s upcoming fiscal year beginning July 1, 2008. The Company does not believe that the adoption of SFAS 157 will materially impact the amounts reported in its financial statements, however, additional disclosures will be required about the inputs used to develop the measurements and the effect of certain of the measurements reported to changes in net assets for a fiscal period.

(5) In February 2007, the FASB issued SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115 . SFAS 159 permits an entity to elect fair value as the initial and subsequent measurement attribute for many of assets and liabilities for which the fair value option has been elected and similar assets and liabilities measured using another measurement attribute. SFAS 159 becomes effective for fiscal years beginning after November 15, 2007 and, therefore, is applicable for the Company s upcoming fiscal year beginning July 1, 2008. The Company s management does not believe that the adoption of SFAS No. 159 will have a material impact on its financial statements.

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

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

(e) Dividend income is recorded on the ex-dividend date.

(f) Structuring fees and similar fees are recognized as income as earned. Structuring fees, excess deal deposits, net profits interests, overriding royalty interests, administrative agent fees and forbearance fees are included in other income.

In determining the fair value of our portfolio investments at March 31, 2008, the Audit Committee met on April 24, 2008, and considered valuations from the independent valuation firm and from management having an aggregate range of $416,608 to $437,988.

Our portfolio across all our long-term debt and certain equity investments had an annualized current yield of 16.8% and 17% as of March 31, 2008 and March 31, 2007, respectively. This yield includes interest from all of our long-term investments as well as dividends from GSHI and NRG, as of March 31, 2008 and from GSHI as of March 31, 2007. We expect the current yield to decline over time as we increase the size of the portfolio. Monetization of other equity positions that we hold is not included in this yield calculation. In each of our portfolio companies, we hold equity positions, ranging from minority interests to majority stakes, which we expect over time to contribute to our investment returns. Many of these equity positions include features such as contractual minimum internal rates of returns, preferred distributions, flip structures and other features expected to generate

Table of Contents

additional investment returns, as well as contractual protections and preferences over junior equity, in addition to the yield and security offered by our cash flow and collateral debt protections. Set forth below are several views of our investment portfolio, classified by type of investment, geographic diversification and sector diversification at March 31, 2008, and March 31, 2007, respectively:

Type of Investment	3/31/08 Fair Value (000s)	3/31/08 % of Portfolio	3/31/07 Fair Value (000s)	3/31/07 % of Portfolio
Money Market Funds	$ 27,249	6.0%	$ 99,584	32.0%
Senior Secured Debt	224,564	49.2%	135,736	43.7%
Subordinated Secured Debt	146,143	32.0%	48,586	15.6%
Membership Interests	3,000	0.7%		%
Common Stock	49,384	10.8%	24,902	8.0%
Preferred Stock	149	0.0%	65	0.0%
Warrants	5,916	1.3%	1,964	0.7%
Total Portfolio	$ 456,405	100.0%	$ 310,837	100.0%

Geographic Exposure	3/31/08 Fair Value (000s)	3/31/08 % of Portfolio	3/31/07 Fair Value (000s)	3/31/07 % of Portfolio
Midwest U.S.	$ 49,015	10.7%	$ 36,476	11.7%
Northeast U.S.	67,649	14.8%	24,898	8.0%
Southeast U.S.	83,628	18.3%	37,835	12.2%
Southwest U.S.	189,313	41.5%	85,793	27.6%
Western U.S.	30,500	6.7%		%
Canada	9,051	2.0%	26,251	8.5%
Money Market Funds	27,249	6.0%	99,584	32.0%
Total Portfolio	$ 456,405	100.0%	$ 310,837	100.0%

Sector	3/31/08 Fair Value (000s)	3/31/08 % of Portfolio	3/31/07 Fair Value (000s)	3/31/07 % of Portfolio
Biofuels/Ethanol	$	%	$ 8,000	2.6%
Biomass Power	19,580	4.3%	24,898	8.0%
Construction Services	5,582	1.2%	22,672	7.3%
Contracting	5,000	1.1%		%

Financial Services	25,000	5.5%		%
Food Products	20,000	4.4%		%
Gas Gathering and Processing	54,450	11.9%	37,900	12.2%
Healthcare	13,750	3.0%		%
Manufacturing	43,907	9.6%	14,676	4.7%
Metal Services	6,170	1.4%	5,820	1.9%
Mining and Coal Production	19,223	4.2%	15,718	5.1%
Natural Gas Marketing		%	4,782	1.5%
Oilfield Fabrication	108,321	23.7%		%
Oil and Gas Production	25,067	5.5%	49,358	15.9%
Pharmaceuticals	11,942	2.6%		%
Production Services	22,991	5.0%	20,947	6.7%
Retail	14,566	3.2%		%
Seismic Services		%		%
Shipping Vessels	6,775	1.5%	6,482	2.1%

Table of Contents

Sector	3/31/08 Fair Value (000s)	% of Portfolio	3/31/07 Fair Value (000s)	% of Portfolio
Specialty Minerals	15,500	3.4%		%
Technical Services	11,332	2.5%		%
Money Market Funds	27,249	6.0%	99,584	32.0%
Total Portfolio	$ 456,405	100.0%	$ 310,837	100.0%

RESULTS OF OPERATIONS

Comparison of the Nine Months Ended March 31, 2008 to the Nine Months Ended March 31, 2007

Investment Activity

We completed our 16th quarter, which was our 15th full quarter since completion of our initial public offering on July 27, 2004, with approximately 115.5% of our net assets or about $429,156 invested in 31 long-term portfolio investments (including a net profits interest remaining in Charlevoix) and 7.3% of our net assets invested in money market funds. The remaining 22.8% of our net assets represents liabilities in excess of other assets.

Long-Term Portfolio Investments

During the three months ended March 31, 2008, we completed two new investments and several follow-on investments in existing portfolio companies, totaling approximately $31,794. During the nine months ended March 31, 2008, we completed 14 new investments and follow-on investments in existing portfolio companies, totaling approximately $193,000. The more significant of these investments are described briefly in the following:

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

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

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

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

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

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

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

Table of Contents

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

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

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

On November 21, 2007, we provided combined debt financing of $25,600 to IEC Systems LP and Advanced Rig Services LLC, two related oilfield service companies based in Houston, Texas. This investment took the form of two separate senior secured instruments with cross-collateralized guarantees and a net profit interest in each company.

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

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

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

For the nine months ended March 31, 2008, we closed-out six positions which are briefly described below.

On August 16, 2007, Arctic, completely paid its loan with an additional prepayment penalty of $461 for the loan. We will maintain holdings in warrants in Arctic. Including the prepayment premium, we realized a 20% cash internal rate of return on this investment, representing 1.25 times cash on cash (not including the equity investments that we continue to hold).

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

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

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

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

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

Since inception, here is a quarter-by-quarter summary of the investment activity.

Quarter-End	Acquisitions (1)	Dispositions (2)
March 31, 2008	$ 31,794	$ 28,891
December 31, 2007	120,846	19,223
September 30, 2007	40,394	17,949

Quarter-End	Acquisitions (1)	Dispositions (2)
June 30, 2007	130,345	9,857
March 31, 2007	19,701	7,731
December 31, 2006	62,679	17,796
September 30, 2006	24,677	2,781
June 30, 2006	42,783	5,752
March 31, 2006	15,732	901
December 31, 2005		3,523
September 30, 2005	25,342	
June 30, 2005	17,544	
March 31, 2005	7,332	
December 31, 2004	23,771	32,083
September 30, 2004	30,371	

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

(2) Includes scheduled principal payments, prepayments and refinancings

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 owns 25% or more of the voting securities of an investee company. Affiliated investments and affiliated companies are defined by a lesser degree of influence. This lesser degree of influence is deemed to exist through ownership of 5% or more but less than 25% of the outstanding voting securities of another person. As of March 31, 2008, we held a controlling interest in GSHI, Genesis, ICS, Iron Horse Coiled Tubing, Inc., or Iron Horse, NRG, North Fork, R-V Industries, Inc., or R-V, Whymore Coal Company, Inc., or Whymore, and WECO. As of March 31, 2008, we held an affiliated interest in AEH Investment Corp.

Level of Control	3/31/08 Fair Value (000s)	% of Portfolio	3/31/07 Fair Value (000s)	% of Portfolio
Control	$ 141,631	31.0%	$ 110,268	35.5%
Affiliate	5,582	1.2%	14,751	4.8%
Non-Control/Non-Affiliate	281,943	61.8%	86,234	27.7%
Money Markets	27,249	6.0%	99,584	32.0%
Total Portfolio	$ 456,405	100.0%	$ 310,837	100.0%

Coal prices and forward curve prices continued to rise in Central Appalachia during the first quarter of 2008. However, marginal spot prices for coal remained below operating costs for many of the smaller coal producers in that region, including Genesis. Both Whymore and Genesis are selling coal under new contracts which expire December 31, 2008 and June 30, 2008, respectively. The cost cutting, productivity, and revenue enhancing efforts begun in 2007 at these portfolio companies have continued, including the purchase of additional equipment at Genesis and the acquisition of additional coal reserves at Whymore. We also continue looking at various opportunities to take advantage of acquisitions at favorable prices.

With respect to Unity Virginia Holdings LLC, or Unity, discussions continue between the Company (the second lien holder), the senior lender, Texas Capital (whose exposure is approximately $1,100), and Unity regarding next steps after liquidating the last remaining saleable property in the collateral package which consisted of land, coal inventory, and the refuse area. According to Unity, the sale of these assets was necessary to the remediation of the mine property, under the supervision of state and federal authorities. The Company believes that Unity principals have to pay-off the remaining debt to Texas Capital and would still be obligated to repay the outstanding debt to Prospect.

Table of Contents

ESA defaulted under our contract governing our investment in ESA, prompting us to commence foreclosure actions with respect to certain ESA assets in respect of which we have a priority lien. In response to our actions, ESA filed voluntarily for reorganization under the bankruptcy code. We have a senior-secured, first-lien debt position with collateral in the form of receivables, real estate, other assets, personal guaranties and the stock of ESA s subsidiary company, Lisamarie Fallon, Inc. (dba The Healing Staff). On September 20, 2007 the U.S. Bankruptcy Court approved a Section 363 Asset Sale for ESA to the Company. To complete this transaction, we contributed our ESA debt to a newly-formed entity, ICS and provided funds for working capital on October 9, 2007. In return for the ESA debt, we received senior secured debt in ICS of equal amount to our ESA debt, preferred stock of ICS, and 49% of the ICS common stock. ICS subsequently ceased operations and assigned the collateral back to us.

In late December 2007, the Company s largest 100% controlled investment, GSHI, a midstream gathering and processing business in East Texas, engaged RBC Capital Markets Corporation as a financial advisor to explore strategic alternatives, including a potential sale. This monetization process is ongoing. Management can make no assurances as to the timing or success of the potential sale of GSHI, or as to any proceeds to be received from such sale. In late March 2008, Royal Bank of Canada provided a $38 million term loan to Gas Solutions II Ltd, a wholly owned subsidiary of GSHI, the proceeds of which were used to refinance all of Citibank s approximately $8 million of outstanding senior secured debt as well as to make a $30 million cash distribution to GSHI. The Company has non-recourse access to this cash at GSHI, in addition to the Company s other assets and undrawn revolving credit facility. In early May 2008, Gas Solutions II Ltd purchased a series of propane puts at $0.10 out of the money and at prices of $1.53 per gallon and $1.394 per gallon covering the periods May 1, 2008, through April 30, 2009, and May 1, 2009, through April 30, 2010, respectively. These hedges have been executed at close to the highest market propane prices ever achieved on an historical basis; such hedges preserve the upside of Gas Solutions II Ltd to benefit from potential future increases in commodity prices.

Investment Income

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

Investment income, which consists of interest income, including accretion of loan origination fees, dividend income and other income, including net profits interests, overriding royalty interests and structuring fees, amounted to $22,000 and $12,069 for the three months ended March 31, 2008 and March 31, 2007, respectively and $55,954 and $26,672 for the nine months ended March 31, 2008 and March 31, 2007, respectively. Investment income increased as compared to the same period one year earlier as a direct result of the growth of our investment portfolio.

Operating Expenses

Our primary operating expenses consist of investment advisory fees (base and incentive fees), credit facility costs, legal and professional fees, insurance expenses, directors fees and other general and administrative expenses. Operating expenses were $9,081 and $5,054 for the three months ended March 31, 2008 and March 31, 2007, respectively and $24,510 and $11,890 for the nine months ended March 31, 2008 and March 31, 2007, respectively. These expenses include our allocable portion of overhead under the Administration Agreement with Prospect Administration under which Prospect Administration provides administrative services and facilities to us. We bear all other costs and expenses of our operations and transactions in accordance with our Administration Agreement with Prospect Administration.

The base investment advisory fees were $2,388 and $1,531 for the three months ended March 31, 2008 and March 31, 2007, respectively and $6,366 and $3,715 for the nine months ended March 31, 2008 and March 31, 2007, respectively. The income incentive fees were $3,230 and $1,754 for the three months ended March 31, 2008

Table of Contents

and March 31, 2007, respectively and $7,861 and $3,695 for the nine months ended March 31, 2008 and March 31, 2007, respectively. The increases are directly related to the growth of our investment portfolio as compared with the previous period. Our investment advisory fees compensate Prospect Capital Management for its work in identifying, evaluating, negotiating, closing and monitoring our investments. No capital gains incentive fee has yet been incurred pursuant to the Investment Advisory Agreement.

During the three months ended March 31, 2008 and March 31, 2007, the Company incurred $1,863 and $353, respectively of expenses related to its credit facilities. During the nine months ended March 31, 2008 and March 31, 2007, the Company incurred $4,719 and $1,385, respectively of expenses related to its credit facilities. The table below describes the components of the credit facility costs.

Item	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007	Nine Months Ended March 31, 2008	Nine Months Ended March 31, 2007
Interest expense	$ 1,584	$	$ 3,781	$ 357
Amortization of deferred financing costs	180	290	547	836
Commitment fees	85	63	348	192
Administrative Agent fees	14		43	
Total	$ 1,863	$ 353	$ 4,719	$ 1,385

The increase in interest expense for the three-month and nine-month periods ended March 31, 2008 relative to the comparable periods a year earlier is due to an increase in our weighted-average borrowings. Weighted-average borrowings for the three months and nine months ended March 31, 2008 were $112,023 and $80,301, respectively. Weighted-average borrowings for the three months and nine months ended March 31, 2007 were $0 and $5,709 respectively. The weighted-average interest rates on all of the borrowings were 4.80% and 8.37% over the nine-month periods ended, March 31, 2008 and 2007, respectively.

During the three months ended March 31, 2008 and March 31, 2007, the Company incurred legal expenses of $449 and $593, respectively. During the nine months ended March 31, 2008 and March 31, 2007, the Company incurred legal expenses of $2,224 and $970, respectively. A substantial amount of the legal expenses incurred in fiscal year 2008 (approximately $1,761) relate to one arbitration matter. The Company has prevailed in the aforesaid arbitration and believes that it is entitled to reimbursement of such expenses. The Company considers such expenses largely non-recurring items that it does not expect to occur to such a degree in subsequent quarters.

Net Investment Income, Net Realized Gains, Net Unrealized Appreciation and Net Increase in Net Assets Resulting from Operations

Our net investment income was $12,919 and $7,015 for the three months ended March 31, 2008 and March 31, 2007, respectively and $31,444 and $14,782 for the nine months ended March 31, 2008 and March 31, 2007, respectively. Net investment income represents the difference between investment income and operating expenses and is directly impacted by the items described above. Net realized gains (losses) were $208 and ($1) for the three months ended March 31, 2008 and March 31, 2007, respectively and ($18,413) and $1,949 for the nine months ended March 31, 2008 and March 31, 2007, respectively. The net increase (decrease) in net assets due to changes in unrealized appreciation/depreciation was ($14,386) and ($2,038) for the three months ended March 31, 2008, and March 31, 2007, respectively and ($9,426) and ($4,851) for the nine months ended March 31, 2008 and March 31, 2007, respectively. The increase (decrease) in net assets resulting from operations represents the sum of the returns generated from net investment income, realized gains (losses) and the changes in net assets as a result of changes in unrealized appreciation/depreciation.

Financial Condition, Liquidity and Capital Resources

Our cash flows provided by (used in) operating activities totaled ($150,705) and ($158,247) for the nine months ended March 31, 2008 and March 31, 2007, respectively. For the nine months ended March 31, 2008 dividends declared totaled $27,667 of which $15,956 has been paid and $2,753 were reinvested; March 31, 2008, $8,958 were still to be paid out.

Table of Contents

Our primary use of funds will be investments in portfolio companies and cash distributions to holders of our common stock. In the future, we may continue to fund a portion of our investments through borrowings from banks, issuances of senior securities or secondary offerings. We may also securitize a portion of our investments in mezzanine or senior secured loans or other assets. Our objective is to put in place such borrowings in order to expand our portfolio. On September 6, 2007, our Shelf Registration Statement on Form N-2 was declared effective by the SEC. Under the Registration Statement, we may issue up to approximately $400,000 in the aggregate of our common and preferred stock and debt securities over the next two-and-a-half years.

Borrowings

The Company had $90,667 and $0 in borrowings at March 31, 2008 and June 30, 2007, respectively. The following table shows the facility amounts and outstanding borrowings at March 31, 2008 and June 30, 2007:

	March 31, 2008		June 30, 2007	
	Facility Amount	Amount Outstanding	Facility Amount	Amount Outstanding
Senior Secured Revolving Credit Facility	$ 200,000	$ 90,667	$ 200,000	$

Off-Balance Sheet Arrangements

At March 31, 2008, we did not have any off-balance sheet liabilities or other contractual obligations that are reasonably likely to have a current or future material effect on our financial condition, other than those which originate from (1) the investment advisory and management agreement and the administration agreement and (2) the portfolio companies.

OVERVIEW AS OF JUNE 30, 2007

The aggregate value of our portfolio investments was $328,222 and $133,969 as of June 30, 2007 and June 30, 2006, respectively. During the fiscal year 2007, our net cost of investments increased by $202,604, or 164%, as we invested in 10 new investments, while two of our investments repaid their loans during the year.

For the fiscal year ended June 30, 2007, our net assets increased by $191,778 (or 177%). The change in net assets is as a result of an increase of $202,592 of proceeds from the issuance of new shares of our stock and $16,728 from net operations, offset by $27,542 in dividend distributions to our stockholders. Out of the $16,728 from net operations, our investment income accounted for $23,131 and realized gain on investments of $1,949 reduced by $8,352 in unrealized depreciation of investments. The decrease in unrealized value was mainly associated with write-downs in our investments in AOG, ESA, Genesis, Unity, Whymore and WECO. However, there were significant write-ups in our investments in GSHI and NRG.

We seek to be a long-term investor in our portfolio companies. As of June 30, 2007, we continue to pursue our investment strategy and 109.4% of our net assets are invested in long-term investments.

Estimates

In determining the fair value of our portfolio investments at June 30, 2007, the Audit Committee met on August 22, 2007, and considered valuations from the independent valuation firm and from management having an aggregate range of $310,250 to $330,876.

Our portfolio had an annualized current yield of 17.1% and 17% across all our long-term debt and certain equity investments as of June 30, 2007 and June 30, 2006, respectively. This yield includes interest from all of our long-term investments as well as dividends from GSHI. We expect the current yield to decline over time as we increase the size of the portfolio. Monetization of other equity positions that we hold is not included in this yield calculation. In each of our portfolio companies, we hold equity positions, ranging from minority interests to majority stakes, which we expect over time to contribute to our investment returns. Many of these equity positions include features such as contractual minimum internal rates of returns, preferred distributions, flip structures and other features expected to generate additional investment returns, as well as contractual protections and preferences over junior equity, in addition to the yield and security offered by our cash flow and collateral debt protections. Set

Table of Contents

forth below are several views of our investment portfolio, classified by type of investment, geographic diversification and energy sector diversification at June 30, 2007 and June 30, 2006, respectively:

Type of Investment	6/30/07 Fair Value (000s)	% of Portfolio	6/30/06 Fair Value (000s)	% of Portfolio
Cash and Cash Equivalents	$ 41,760	11.3%	$ 1,608	1.2%
Senior Secured Debt	202,243	54.7%	92,153	68.0%
Subordinated Secured Debt	78,905	21.3%	21,154	15.6%
Common Stock	43,517	11.8%	17,610	13.0%
Preferred Stock	106	0.0%	1,507	1.1%
Warrants	3,451	0.9%	1,545	1.1%
Total Portfolio	$ 369,982	100.0%	$ 135,577	100.0%

Geographic Exposure	6/30/07 Fair Value (000s)	% of Portfolio	6/30/06 Fair Value (000s)	% of Portfolio
Midwest U.S.	$ 36,942	10.0%	$ 28,030	20.7%
Northeast U.S.	44,558	12.0%	16,485	12.1%
Southeast U.S.	70,545	19.1%	19,849	14.6%
Southwest U.S.	157,097	42.5%	47,419	35.0%
Canada	19,080	5.1%	22,186	16.4%
Cash and Cash Equivalents	41,760	11.3%	1,608	1.2%
Total Portfolio	$ 369,982	100.0%	$ 135,577	100.0%

Energy Sector	6/30/07 Fair Value (000s)	% of Portfolio	6/30/06 Fair Value (000s)	% of Portfolio
Biofuels/Ethanol	$ 8,000	2.1%	$ 8,000	5.9%
Biomass Power	25,047	6.8%	16,485	12.2%
Construction Services	15,305	4.1%	19,242	14.2%
Contracting	5,000	1.3%		%
Financial Services	25,000	6.8%		%
Gas Gathering and Processing	44,500	12.0%	33,100	24.4%
Manufacturing	41,376	11.2%		%
Metal Services	5,829	1.6%		%
Mining and Coal Production	18,499	5.0%	15,876	11.7%
Natural Gas Marketing		%	5,422	4.0%
Oil and Gas Production	110,243	29.8%	20,661	15.2%

Production Services	22,870	6.2%	15,183	11.2%
Shipping	6,553	1.8%		%
Cash and Cash Equivalents	41,760	11.3%	1,608	1.2%
Total Portfolio	$ 369,982	100.0%	$ 135,577	100.0%

RESULTS OF OPERATIONS

Comparison of the Fiscal Year Ended June 30, 2007 to the Fiscal Year Ended June 30, 2006

Investment Activity

We completed our 13th quarter on June 30, 2007, which was our 12th full quarter since completion of our initial public offering on July 27, 2004, with approximately 109.4% of our net assets or about $328,222 invested in 24 long-term portfolio investments (including a net profits interest remaining in Charlevoix) and 13.9% of our net assets invested in money market funds. The remaining (23.3%) of our net assets represents liabilities in excess of other assets.

Long-Term Portfolio Investments

During the quarter ended June 30, 2007, we completed five new investments and follow on investments in existing portfolio companies, totaling approximately $130,409. Additionally, on June 6, 2007, Charlevoix completely repaid its loan plus a prepayment penalty of $352 for the loan. The Company will maintain a net profits interest in Charlevoix. Including the prepayment premium, the Company realized a 21% internal rate of return on this investment, representing 1.2 times cash on cash.

On April 11, 2007, we provided $12,200 acquisition and growth financing to ESA, a construction, engineering and environmental services firm located in Charlotte, North Carolina. The investment was in the form of senior secured notes and warrants. There were additional fundings in May of 2007.

On June 4, 2007, we provided $10,750 growth financing to Ken-Tex, an independent energy company engaged in the development and production of crude oil and natural gas hydrocarbons in East Texas. The investment was in the form of senior secured notes, as well as net profits interests and overriding royalty interests.

On June 26, 2007, we closed on a transaction that provided $19,511 for the acquisition of R-V, a diversified engineering and manufacturing company located in Honey Brook, Pennsylvania. The investment was in the form of senior secured notes, common shares and warrants. The investment was funded on June 28, 2007.

On June 29, 2007, we closed on a transaction that provided $45,000 growth financing to H&M Oil & Gas, LLC, an oil and gas production and development company located in Dallas, Texas. The investment was in the form of senior secured notes, as well as a net profits interest. The investment was funded on July 3, 2007.

On June 29, 2007, we closed on a transaction that provided $25,000 debt financing to Regional Management Corp, a consumer finance installment loan company located in Greenville, South Carolina. The investment was in the form of subordinated secured notes. The investment was funded on July 12, 2007.

The following is a quarter-by-quarter summary of our investment activity since inception.

Quarter-End	**Acquisitions(1)**	**Dispositions(2)**
June 30, 2007	$ 130,345	$ 9,857
March 31, 2007	19,701	7,731
December 31, 2006	62,679	17,796
September 30, 2006	24,677	2,781
June 30, 2006	42,783	5,752
March 31, 2006	15,732	901
December 31, 2005		3,523
September 30, 2005	25,342	
June 30, 2005	17,544	
March 31, 2005	7,332	
December 31, 2004	23,771	32,083
September 30, 2004	30,371	

(1) Includes new deals, additional fundings, refinancings and payment-in-kind, or PIK, interest.

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

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 owns more than 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 ownership of 5% or more of the outstanding voting securities of another person.

Table of Contents

As of June 30, 2007, we held a controlling interest in AOG, GSHI, Genesis, NRG, R-V, Whymore and WECO. As of June 30, 2007, we held an affiliated interest in Appalachian Energy Holdings LLC and Iron Horse.

Level of Control	6/30/07 Fair Value (000s)	% of Portfolio	6/30/06 Fair Value (000s)	% of Portfolio
Control	$ 139,292	37.6%	$ 49,585	36.6%
Affiliate	14,625	4.0%	25,329	18.7%
Non-Control/Non-Affiliate	174,305	47.1%	59,055	43.5%
Cash and Cash Equivalents	41,760	11.3%	1,608	1.2%
Total Portfolio	$ 369,982	100.0%	$ 135,577	100.0%

With respect to Unity, as of June 30, 2007, discussions were underway between the Company, the second lien holder, the senior lender Texas Capital Banc Shares, Inc., or Texas Capital, whose exposure has been reduced to $1,350, and Unity regarding liquidating the last remaining saleable property in the collateral package which consists of land, coal inventory, and the refuse area. According to Unity, the sale could yield up to $195. We believe that Unity principals would then have to pay off the remaining debt to Texas Capital, making us the senior most secured lender.

As of June 30, 2007, loans we have made to ESA and AOG are under enhanced scrutiny by our senior management team due to existing or potential payment and/or covenant defaults under the contracts governing these investments. ESA recently defaulted under our contract governing our investment in ESA, prompting us to commence foreclosure actions with respect to certain ESA assets in respect of which we have a priority lien. In response to our actions, ESA filed voluntarily for reorganization under the bankruptcy code. We have a senior-secured, first-lien debt position with collateral in the form of receivables, real estate, other assets, personal guaranties and the stock of ESA s subsidiary company, The Healing Staff. Our loan to ESA represents approximately 3.7% of our current asset base. At its August 22, 2007 meeting, our Board of Directors reduced the fair value of our investment in ESA as of June 30, 2007 from $13,800 to $5,000, negatively impacting our NAV per share by $0.44.

AOG provides construction services to the gas industry, primarily in Alberta, which has experienced a significant slowdown in gas related construction activity. At March 31, 2007, our investment in AOG was carried at approximately $17,100. We have a senior secured, first-lien debt position with collateral consisting of substantially all of AOG s assets. AOG has experienced a business slowdown and liquidity problems, and Prospect Capital Management believes AOG could continue to experience payment and covenant defaults. In addition, we may be required to provide additional capital to AOG to permit it to continue to operate until its liquidity improves and its business prospects are realized. Our investment in AOG represents approximately 4.6% of our current asset base. At its August 22, 2007 meeting referenced above, our Board of Directors reduced the fair value of our investment in AOG as of June 30, 2007 from $17,100 to $9,900, negatively impacting our NAV per share by $0.36.

Investment Income

Investment income, which consists of interest income, including accretion of loan origination fees and prepayment penalty fees, dividend income and other income, including net profits interest, overriding royalties interest and structuring fees, was $40,681, $16,869 and $8,093 for the years ended June 30, 2007, June 30, 2006 and June 30, 2005, respectively.

Operating Expenses

Operating expenses were $17,550, $8,311 and $5,682 for the years ended June 30, 2007, June 30, 2006 and June 30, 2005, respectively. These expenses consisted of investment advisory and administrative services fees, credit facility costs, professional fees, insurance expenses, directors fees and other general and administrative expenses. The base investment advisory fees were $5,445, $2,082 and $1,808 for the years ended June 30, 2007, June 30, 2006 and June 30, 2005, respectively. $5,781, $1,786 and $0 income incentive fees were earned for the years ended June 30, 2007, June 30, 2006 and June 30, 2005, respectively. No capital gains incentive fee has yet been incurred pursuant to the Investment Advisory Agreement.

Table of Contents

During the years ended June 30, 2007, June 30, 2006 and June 30, 2005, the Company incurred $1,903, $642 and $0, respectively of expenses related to its credit facilities. The table below describes the components of the credit facility costs.

Item	Year Ended June 30, 2007	Year Ended June 30, 2006	Year Ended June 30, 2005
Interest expense	$ 357	$ 422	$
Amortization of deferred financing costs	1,264	220	
Commitment fees	282		
Total	$ 1,903	$ 642	$

Net Investment Income, Net Realized Gains, Net Unrealized Appreciation and Net Increase in Net Assets Resulting from Operations

Our net investment income was $23,131, $8,558 and $2,411 for the years ended June 30, 2007, June 30, 2006 and June 30, 2005, respectively. Net investment income represents the difference between investment income and operating expenses and is directly impacted by the items described above. Net realized gains (losses) were $1,949, $303 and ($2) for the years ended June 30, 2007, June 30, 2006 and June 30, 2005, respectively. Net unrealized appreciation (depreciation) was ($8,352), $4,035 and $6,342 for the years ended June 30, 2007, June 30, 2006 and June 30, 2005, respectively. Net increase in net assets resulting from operations represents the sum of the returns generated from net investment income, realized gains (losses) and the change in unrealized appreciation (depreciation).

Financial Condition, Liquidity and Capital Resources

Our cash flows used in operating activities totaled ($143,890), ($29,919) and ($84,729) for the years ended June 30, 2007, June 30, 2006 and June 30, 2005, respectively. Financing activities provided cash flows of $143,890, $20,332 and $94,315 for the years ended June 30, 2007, June 30, 2006 and June 30, 2005, respectively. Dividends paid and declared were $21,634, $7,663 and $2,646 for the years ended June 30, 2007, June 30, 2006 and June 30, 2005, respectively.

Borrowings

The Company had $0 and $28,500 in borrowings at June 30, 2007 and June 30, 2006, respectively. The following table shows the facility amounts and outstanding borrowings at June 30, 2007 and June 30, 2006:

	June 30, 2007		June 30, 2006	
	Facility Amount	Amount Outstanding	Facility Amount	Amount Outstanding
Senior Secured Revolving Credit Facility	$ 200,000	$	$ 30,000	$ 28,500

Off-Balance Sheet Arrangements

At June 30, 2007, we did not have any off-balance sheet liabilities or other contractual obligations that are reasonably likely to have a current or future material effect on our financial condition, other than the investment advisory and management agreement and the administration agreement.

Table of Contents

REPORT OF MANAGEMENT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining adequate internal control over financial reporting, and for performing an assessment of the effectiveness of internal control over financial reporting as of June 30, 2007.

Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company s internal control over financial reporting includes those policies and procedures that (i) pertain to assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company s assets that could have a material effect on the financial statements.

Management performed an assessment of the effectiveness of the Company s internal control over financial reporting as of June 30, 2007 based upon criteria in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, or COSO. Based on our assessment, management determined that the Company s internal control over financial reporting was effective as of June 30, 2007 based on the criteria on Internal Control Integrated Framework issued by COSO. There were no material changes to the Company s internal controls over financial reporting during the year ended June 30, 2007.

BDO Seidman, LLP, the independent registered public accounting firm that audited our consolidated financial statements included in this report, has also audited the effectiveness of our internal control over financial reporting as stated in their report included herein.

Table of Contents

PORTFOLIO COMPANIES

The following is a listing of our portfolio companies, except for Charlevoix, in which we own a net profits interest, at March 31, 2008. Values are as of March 31, 2008.

The portfolio companies are presented in three categories: companies more than 25% owned are portfolio companies in which we directly or indirectly own more than 25% of the outstanding voting securities of such portfolio company and, therefore, are presumed to be controlled by us under the 1940 Act; companies owned 5% to 25% are portfolio companies where we directly or indirectly own 5% to 25% of the outstanding voting securities of such portfolio company and/or hold one or more seats on the portfolio company s Board of Directors and, therefore, are deemed to be an affiliated person under the 1940 Act; companies less than 5% owned are portfolio companies where we directly or indirectly own less than 5% of the outstanding voting securities of such portfolio company and where we have no other affiliations with such portfolio company. As of March 31, 2008, we owned 100% of the fully diluted common equity of GSHI, 69% of Genesis, 51% of the fully diluted common equity of WECO and certain of its affiliates, 49% of ICS, 58.8% of Iron Horse, 80% of the fully diluted common equity of NRG, 74.51% of the fully diluted equity of R-V and 49% of the fully diluted common equity of Whymore (as well as 100% of two of Whymore s affiliates C&A Construction, Inc. and E&L Construction, Inc.). We make available significant managerial assistance to our portfolio companies. We generally request and may receive rights to observe the meetings of our portfolio companies Boards of Directors.

Name of Portfolio Company	Nature of its Principal Business (Location)	Title and Class of Securities Held	Collateral Held	Investment Structure	Equity Securities Held, at Fair Value (In millions)	Fair Value of all Loans (In millions
ompanies more han 25% owned						
as Solutions oldings, Inc.	Gas gathering and processing (Texas)	Subordinated secured debt and common equity	Second priority lien on substantially all assets, subject to first priority lien of senior lender, Citibank Texas, N.A.	Common shares; Subordinated secured note, 18.00% due 12/22/2009	34.5	20.0
enesis Coal Corp.	Mining and coal production (Kentucky)	Senior secured debt, warrants and common equity	First priority lien on substantially all assets including	Common shares; warrants, Stock; senior secured note, 16.5% due 12/31/2010	0.0	8.0

			equipment, although Prospect s lien on certain equipment is second to $600,000 loan by First Tennessee Bank			
tegrated Contract ervices, Inc.	Contracting (North Carolina)	Senior and junior secured debt, preferred and common equity	First priority lien on substantially all assets	Common Shares; Series A preferred shares; Senior and junior secured note, 14% due 9/30/2010: Senior demand note, 15.00%	0.0	5.0
on Horse Coiled ubing, Inc.	Production services (Alberta, Canada)	Senior secured debt and common stock	First priority lien on substantially all assets	Common shares; Senior secured note, 15.00% due 4/19/2009	0.0	9.1
RG lanufacturing, nc.	Manufacturing (Texas)	Senior secured debt and common equity	First priority lien on substantially all assets	Common shares; Senior secured note, 16.5% due 8/31/2013 Preferred shares, convertible, Series A	8.7	13.1
orth Fork ollieries LC	Mining and coal production (Kentucky)	Senior secured debt and common equity	Second priority lien on substantially all assets	Membership interests, subordinated secured note, 18.00% due 3/31/2009	0.0	5.1
-V Industries, nc.	Manufacturing (Pennsylvania)	Senior secured debt, common equity and warrants	First priority lien on substantially all assets	Common shares; Warrants, common shares, expiring 6/30/2017; Senior secured note, 15.00% due 5/30/2009	6.9	5.7
'hymore Coal ompany	Mining and coal production (Kentucky)	Senior secured debt and preferred equity	First priority lien on substantially all assets	Senior secured note, 15.74% due 12/31/2010	0.0	6.1
'orcester Energy artners, Inc.	Biomass power (Maine)	Senior secured debt convertible preferred stock and common equity	First priority lien on substantially all assets	Common shares; Preferred stock, convertible, Series A; Senior secured note, 12.50% due 12/31/2012	0.0	19.6

ompanies 5% to
5% owned

Table of Contents

ame of Portfolio Company	Nature of its Principal Business (Location)	Title and Class of Securities Held	Collateral Held	Investment Structure	Equity Securities Held, at Fair Value (In millions)
chian Energy gs, LLC	Construction services (West Virginia)	Senior secured debt, preferred equity with penny warrants	First priority lien on substantially all assets	Preferred shares; Warrants, preferred shares, expiring 2/14/2016; Warrants, common shares, expiring 2/14/2016; Senior secured note, 14.00%, 3.00% PIK due 1/31/2011	0.5
nies less than ned					
an Gilsonite ny	Specialty Minerals (Utah)	Senior secured note and common equity	Second priority lien on substantially all assets	Membership interests; subordinated secured note, 12.00% plus 3.00% PIK due 3/14/2013	1.0
Acquisition	Production services (Texas)	Warrants for common and preferred shares	First priority lien on substantially all assets	Warrants, common shares, expiring 7/19/2012; Warrants, preferred shares, expiring 7/19/2012;	2.0
adding LLC	Metal services (Texas)	Senior secured debt and warrants	First priority lien on substantially all assets	Senior secured note, 14.00% due 03/31/2012; warrants, common shares, expiring 3/30/2014	1.8
st Cherokee	Oil and gas production (Tennessee)	Senior secured debt	First priority lien on substantially all assets	Overriding royalty interest, 5-10%; Senior secured note, 13.00% due 5/5/2009	0.0
ops, Inc.	Retail Apparel	Senior secured debt			0.0

			Second priority lien on substantially all assets	Senior secured note, 13.13% due 1/31/2015;	
own, Inc.	Production services (Texas)	Senior secured debt, common equity and warrants	First priority lien on substantially all assets	Warrants, common shares, expiring 8/06/2012; Senior secured note, 12.50% plus 3% PIK due 8/01/2011	0.0
dback Operating, LP	Oil and gas production (Oklahoma)	Senior secured debt	First priority lien on substantially all assets	Senior secured note, 12.00% plus 2% PIK due 8/28/2011	0.0
il & Gas, LLC	Oil and gas production (Texas)	Senior secured debt	First priority lien on substantially all assets	Senior secured note, 13.00% due 6/30/2010	0.0
stems LP ce Rig s LLC)	Oil and gas production (Texas)	Senior secured debt	First priority lien on substantially all assets	Senior secured notes 12.00% plus 3.00% PIK due 11/20/2012	0.0
Marine Services LLC	Shipping (Louisiana)	Subordinated secured debt	Second priority lien on substantially all assets	Subordinated secured note, 12.00% plus 4.00% PIK due 12/31/2011	0.0
ck Healthcare,	Medical Services (Arizona)	Senior secured debt, preferred and common equity	Second priority lien on substantially all assets	Senior secured note, 12.00% plus 1.5% PIK due 10/31/2014	1.25
Petroleum, Inc.	Oil and gas production (Tennessee)	Warrants	N/A loan repaid	Warrants, expiring 5/4/2010, through 9/30/2011	0.0
st	Pharmaceuticals (Alabama)	Second lien debt	Second priority lien on substantially all assets	Second lien debt, 12.50% due 4/30/2015	0.0
al Management Corp.	Financial services (South Carolina)	Subordinated secured debt	Second priority lien on substantially all assets	Subordinated secured note 12.00% plus 2.00% PIK due 6/29/2012	0.0
Products, Inc.	Manufacturing (Pennsylvania)	Second lien debt	Second priority lien on	Second lien debt, 13.13% due 6/24/2014	0.0

			substantially all assets		
s Foods, Inc.	Manufacturing (Ohio)	Second lien debt	Common equity; Second priority lien on substantially all assets	Membership interests; Second lien debt, 14.00% due 10/31/2013	2.0
Energy, LLC	Oil and gas production (Ohio)	Senior secured debt	First priority lien on substantially all assets	Senior revolving credit facility, 12.00% due 11/30/2011	0.0
	Technical Services (Pennsylvania)	Second lien debt	Second priority lien on substantially all assets	Second lien debt, 12.75% due 9/27/2013	0.0
'irginia gs LLC	Mining and coal production (Virginia)	Secured subordinated debt	Second priority lien on substantially all assets, subject to first priority lien of senior lender, Plains Capital Bank	Subordinated secured note, 15.00% plus 15.00% PIK, due 1/31/2009	0.0
iver Resources nd Wind Corp.	Oil and gas production (Utah)	Senior secured debt	First priority on oil and gas reserves	Senior secured note, 13.00% due 7/31/2009	0.0

Table of Contents

UNDERWRITING

Citigroup Global Markets Inc. and Wachovia Capital Markets, LLC are acting as representatives of the underwriters named below. Subject to the terms and conditions stated in the underwriting agreement dated the date of this prospectus, each underwriter named below has agreed to purchase, and we have agreed to sell to that underwriter, the number of shares set forth opposite the underwriter s name.

Underwriter	Number of Shares
Citigroup Global Markets Inc.	1,300,000
Wachovia Capital Markets, LLC	1,300,000
Oppenheimer & Co. Inc.	325,000
RBC Capital Markets Corporation	325,000
Total	3,250,000

The underwriting agreement provides that the obligations of the underwriters to purchase the shares included in this offering are subject to approval of legal matters by counsel and to other conditions. The underwriters are obligated to purchase all the shares (other than those covered by the over-allotment option described below) if they purchase any of the shares.

The underwriters propose to offer some of the shares directly to the public at the public offering price set forth on the cover page of this prospectus and some of the shares to dealers at the public offering price less a concession not to exceed $0.44 per share. If all of the shares are not sold at the initial offering price, the representatives may change the public offering price and the other selling terms. We have granted to the underwriters an option, exercisable for 30 days from the date of this prospectus, to purchase up to 487,500 additional shares of common stock at the public offering price less the underwriting discount. The underwriters may exercise the option solely for the purpose of covering over-allotments, if any, in connection with this offering. To the extent the option is exercised, each underwriter must purchase a number of additional shares approximately proportionate to that underwriter s initial purchase commitment.

We and our officers and directors have agreed that, subject to certain exceptions, for a period of 45 days from the date of this prospectus, we and they will not, without the prior written consent of Citigroup Global Markets Inc. and Wachovia Capital Markets, LLC, dispose of or hedge any shares of our common stock or any securities convertible into or exchangeable for our common stock. Citigroup Global Markets Inc. and Wachovia Capital Markets, LLC may release any of the securities subject to these lock-up agreements at any time without notice.

If, during the period that begins on the date that is 15 calendar days plus three business days before the last day of the 45-day lock-up period and ends on the last day of the 45-day lock-up period, (1) we issue an earnings release, or material news or a material event relating to us occurs, or (2) prior to the expiration of the 45-day lock-up period, we announce that we will release earnings results during the 16-day period beginning on the last day of the 45-day lock-up period, then the 45-day lock-up period will be extended until the expiration of the date that is 15 calendar days plus three business days after the date on which the issuance of the earnings release or the material news or material event occurs, unless we obtain a written waiver from the representatives.

Each of the underwriters may arrange to sell shares in certain jurisdictions outside the United States through affiliates, either directly where they are permitted to do so or through affiliates. In that regard, Wachovia Capital Markets, LLC may arrange to sell the shares in certain jurisdictions through an affiliate, Wachovia Securities International Limited or WSIL. WSIL is a wholly-owned indirect subsidiary of Wachovia Corporation and an affiliate of Wachovia Capital Markets, LLC. WSIL is a UK incorporated investment firm regulated by the Financial Services Authority. Wachovia Securities is the trade name for the corporate and investment banking services of Wachovia Corporation and its affiliates, including Wachovia Capital Markets, LLC and WSIL.

Notice to Prospective Investors in the European Economic Zone

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive each, a Relevant Member State, each underwriter has represented and agreed that, with effect from and

Table of Contents

including the date on which the Prospectus Directive is implemented in that Relevant Member State, or the Relevant Implementation Date, it has not made and will not make an offer of shares to the public in that Relevant Member State prior to the publication of a prospectus in relation to the shares which has been approved by the competent authority in that Relevant Member State or, where appropriate, approved in another Relevant Member State and notified to the competent authority in that Relevant Member State, all in accordance with the Prospectus Directive, except that it may, with effect from and including the Relevant Implementation Date, make an offer of shares to the public in that Relevant Member State at any time:

(a) to legal entities which are authorized or regulated to operate in the financial markets or, if not so authorized or regulated, whose corporate purpose is solely to invest in securities;

(b) to any legal entity which has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than 43,000,000 and (3) an annual net turnover of more than 50,000,000, as shown in its last annual or consolidated accounts; or

(c) in any other circumstances which do not require the publication by the issuer of a prospectus pursuant to Article 3 of the Prospectus Directive.

For the purposes of this provision, the expression an offer of shares to the public in relation to any shares in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the shares to be offered so as to enable an investor to decide to purchase or subscribe the shares, as the same may be varied in that Relevant Member State by any measure implementing the Prospectus Directive in that Relevant Member State and the expression Prospectus Directive means Directive 2003/71/EC and includes any relevant implementing measure in each Relevant Member State.

Each underwriter has represented and agreed that:

- it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) received by it in connection with the issue or sale of the shares in circumstances in which Section 21(1) of the FSMA does not apply to the issuer; and

- it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the shares in, from or otherwise involving the United Kingdom.

The offer in The Netherlands of the shares included in this offering is exclusively limited to persons who trade or invest in securities in the conduct of a profession or business (which include banks, stockbrokers, insurance companies, pension funds, other institutional investors and finance companies and treasury departments of large enterprises).

Finland

This prospectus supplement and the accompanying prospectus have not been prepared to comply with the standards and requirements regarding public offering set forth in the Finnish Securities Market Act (1989/495, as amended) and have not been approved by the Finnish Financial Supervision Authority. The securities may not be offered, sold, advertised or otherwise marketed in Finland under circumstances which constitute public offering of securities under Finnish law.

France

The securities (i) will not be offered or sold, directly or indirectly, to the public (appel public à l épargne) in the Republic of France and (ii) offers and sales of securities in the Republic of France (a) will only be made to qualified investors (investisseurs qualifiés) as defined in, and in accordance with, Articles L 411-1, L 411-2 and D 411-1 to D 411-3 of the French Code monétaire et financier or (b) will be made in any other circumstances which do not require the publication by the Issuer of a prospectus pursuant to Article L 411-2 of the Code monétaire et financier and Article 211-2 of the Règlement Général of the Autorité des marchés financiers.

Investors are informed that neither this prospectus supplement nor the accompanying prospectus has been admitted to the clearance procedures of the Autorité des marchés financiers, and that any subsequent direct or indirect circulation to the public of the securities so acquired may not occur without meeting the conditions provided for in Articles L 411-1, L 411-2, L 412-2 and L 621-8 to L 621-8-2 of the Code Monétaire et Financier.

In addition, the issuer represents and agrees that it has not distributed or caused to be distributed and will not distribute or cause to be distributed in the Republic of France, this prospectus supplement, the accompanying prospectus or any other offering material relating to the securities other than to those investors (if any) to whom offers and sales of the securities in the Republic of France may be made as described above.

Italy

The offering of the securities has not been registered pursuant to the Italian securities legislation and, accordingly, each Manager has represented and agreed that it has not offered or sold, and will not offer or sell, any securities in the Republic of Italy in a solicitation to the public, and that sales of the Securities in the Republic of Italy shall be effected in accordance with all Italian securities, tax and exchange control and other applicable laws and regulations. In any case, the Securities cannot be offered or sold to any individuals in the Republic of Italy either in the primary market or the secondary market.

Each of the underwriters has represented and agreed that it will not offer, sell or deliver any securities or distribute copies of this prospectus supplement or the accompanying prospectus or any other document relating to the securities in the Republic of Italy except:

(1) to **Professional Investors** , as defined in Article 31.2 of CONSOB Regulation No. 11522 of 2 July 1998 as amended (**Regulation No. 11522**), pursuant to Article 30.2 and 100 of Legislative Decree No. 58 of 24 February 1998 as amended (**Decree No. 58**), or in any other circumstances where an expressed exemption to comply with the solicitation restrictions provided by Decree No. 58 or Regulation No. 11971 of 14 May 1999 as amended applies, provided, however, that any such offer, sale or delivery of the Securities or distribution of copies of the Offering Circular or any other document relating to the Securities in the Republic of Italy must be:

(a) made by investment firms, banks or financial intermediaries permitted to conduct such activities in the Republic of Italy in accordance with Legislative Decree No. 385 of 1 September 1993 as amended (**Decree No. 385**), Decree No. 58, CONSOB Regulation No. 11522 and any other applicable laws and regulations;

(b) in compliance with Article 129 of Decree No. 385 and the implementing instructions of the Bank of Italy, pursuant to which the issue, trading or placement of securities in Italy is subject to a prior notification to the Bank of Italy, unless and exemption, depending, *inter alia*, on the aggregate amount and the characteristics of the Securities issued or offered in the Republic of Italy, applies; and

(c) in compliance with any other applicable notification requirement or limitation which may be imposed by CONSOB or the Bank of Italy.

Norway

The securities will not be offered in Norway other than (i) to investors who are deemed professional investors under Section 5-4 of the Norwegian Securities Trading Act of 1997 as defined in Regulation no. 1424 of 9 December 2005 (Professional Investors), (ii) to fewer than 100 investors that are not Professional Investors or with a total consideration of less than EUR 100,000 calculated over a period of 12 months, or (iii) with a minimum subscription amount of EUR 50,000. Consequently, no public offering will be made in Norway and the prospectus supplement has not been filed with or approved by any Norwegian authority. The prospectus supplement must not be reproduced or otherwise distributed to others by the recipient.

Table of Contents

Switzerland

This product has not been registered or approved for public distribution in Switzerland by the Swiss Federal Banking Commission under the Swiss Investment Fund Act. This product shall not be offered or sold to the public in or from Switzerland, directly or indirectly, and neither this prospectus supplement nor the accompanying prospectus may be distributed or published to the public in Switzerland and neither this prospectus supplement nor the accompanying prospectus shall constitute a prospectus in the sense of art. 652a or 1156 of the Swiss Code of Obligations.

Other

The common stock is listed on the Nasdaq Global Select Market under the symbol PSEC.

The following table shows the underwriting discounts and commissions that we are to pay to the underwriters in connection with this offering. These amounts are shown assuming both no exercise and full exercise of the underwriters option to purchase additional shares of common stock.

	No Exercise	Full Exercise
Per Share	$0.74	$0.74
Total	$2,405,000	$2,765,750

In connection with the offering, Citigroup Global Markets Inc. and Wachovia Capital Markets, LLC, on behalf of the underwriters, may purchase and sell shares of common stock in the open market. These transactions may include short sales, syndicate covering transactions and stabilizing transactions. Short sales involve syndicate sales of common stock in excess of the number of shares to be purchased by the underwriters in the offering, which creates a syndicate short position. Covered short sales are sales of shares made in an amount up to the number of shares represented by the underwriters over-allotment option. In determining the source of shares to close out the covered syndicate short position, the underwriters will consider, among other things, the price of shares available for purchase in the open market as compared to the price at which they may purchase shares through the overallotment option. Transactions to close out the covered syndicate short involve either purchases of the common stock in the open market after the distribution has been completed or the exercise of the over-allotment option. The underwriters may also make naked short sales of shares in excess of the over-allotment option. The underwriters must close out any naked short position by purchasing shares of common stock in the open market. A naked short position is more likely to be created if the underwriters are concerned that there may be downward pressure on the price of the shares in the open market after pricing that could adversely affect investors who purchase in the offering. Stabilizing transactions consist of bids for or purchases of shares in the open market while the offering is in progress.

The underwriters also may impose a penalty bid. Penalty bids permit the underwriters to reclaim a selling concession from a syndicate member when Citigroup Global Markets Inc. or Wachovia Capital Markets, LLC repurchase shares originally sold by that syndicate member in order to cover syndicate short positions or make stabilizing purchases.

Any of these activities may have the effect of preventing or retarding a decline in the market price of the common stock. They may also cause the price of the common stock to be higher than the price that would otherwise exist in the open market in the absence of these transactions. The underwriters may conduct these transactions on the Nasdaq Global Select Market or in the over-the-counter market, or otherwise. If the underwriters commence any of these transactions, they may discontinue them at any time.

In addition, in connection with this offering, some of the underwriters (and selling group members) may engage in passive market making transactions in the common stock on the Nasdaq Global Select Market, prior to the pricing and completion of the offering. Passive market making consists of displaying bids on the Nasdaq Global Select Market no higher than the bid prices of independent market makers and making purchases at prices no higher than those independent bids and effected in response to order flow. Net purchases by a passive market maker on each day are limited to a specified percentage of the passive market maker s average daily trading volume in the common stock during a specified period and must be discontinued when that limit is reached. Passive market making may cause the price of the common stock to be higher than the price that otherwise would exist in the open market in the

Table of Contents

absence of those transactions. If the underwriters commence passive market making transactions, they may discontinue them at any time.

We estimate that our portion of the total expenses of this offering will be $200,000. We will also reimburse a portion of the underwriters expenses in the amount of up to $150,000.

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

A prospectus in electronic format may be made available on the websites maintained by one or more of the underwriters. The representatives may agree to allocate a number of shares to underwriters for sale to their online brokerage account holders. The representatives will allocate shares to underwriters that may make Internet distributions on the same basis as other allocations. In addition, shares may be sold by the underwriters to securities dealers who resell shares to online brokerage account holders.

We have agreed to indemnify the underwriters against certain liabilities, including liabilities under the Securities Act of 1933, or to contribute to payments the underwriters may be required to make because of any of those liabilities.

This offering is being conducted in accordance with Rule 2810 of the Conduct Rules of the FINRA.

The addresses of the underwriters are: Citigroup Global Markets Inc., 388 Greenwich Street, New York, NY 10013; Wachovia Capital Markets, LLC, One Wachovia Center, 301 South College Street, Charlotte, NC 28288; Oppenheimer & Co. Inc., 125 Broad Street, 16th Floor, New York, NY 10004; and RBC Capital Markets Corporation, One Liberty Plaza, New York, NY 10006.

LEGAL MATTERS

Certain legal matters regarding the common stock offered hereby will be passed upon for the Company by Clifford Chance US LLP, New York, New York, and Venable LLP as special Maryland counsel. Certain legal matters will be passed upon for the underwriters by Davis Polk & Wardwell.

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

BDO Seidman LLP is the independent registered public accounting firm for the Company.

AVAILABLE INFORMATION

We have filed with the SEC a registration statement on Form N-2, together with all amendments and related exhibits, under the Securities Act, with respect to our common stock offered by this prospectus supplement. The registration statement contains additional information about us and the common stock being registered by this prospectus supplement. We file with or submit to the SEC annual, quarterly and current periodic reports, proxy statements and other information meeting the informational requirements of the Exchange Act. This information and the information specifically regarding how we voted proxies relating to portfolio securities for the period ended March 31, 2008, are available free of charge by contacting us at 10 East 40th Street, 44th floor, New York, NY 10016 or by telephone at toll-free (888) 748-0702. You may inspect and copy these reports, proxy statements and other information, as well as the registration statement and related exhibits and schedules, at the Public Reference Room of the SEC at 100 F Street NE, Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at (202) 551-8090. The SEC maintains an Internet site that contains reports, proxy and information statements and other information filed electronically by us with the SEC which are available on the SEC s Internet site at http://www.sec.gov. Copies of these reports, proxy and information statements and other information may be obtained, after paying a duplicating fee, by electronic request at the following E-mail address: publicinfo@sec.gov, or by writing the SEC s Public Reference Section, Washington, D.C. 20549-0102.

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

INDEX TO AUDITED FINANCIAL STATEMENTS

Table of Contents

PROSPECT CAPITAL CORPORATION
CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES
(in 000s, except shares and per share data)

	March 31, 2008 (Unaudited)	June 30, 2007 (Audited)
Assets		
Investments at fair value (cost of $436,557 and $326,197, respectively) (Note 3):		
Control investments (cost of $147,142 and $124,664, respectively)	$ 141,631	$ 139,292
Affiliate investments (cost of $5,582 and $14,821, respectively)	5,582	14,625
Non-control/Non-affiliate investments (cost of $283,833 and $186,712, respectively)	281,943	174,305
Total investments at fair value	429,156	328,222
Investments in money market funds	27,249	41,760
Cash	16,570	
Receivables for:		
Interest	4,039	2,139
Dividends	45	263
Loan principal	107	
Structuring fees		1,625
Investments sold	506	
Other	419	271
Prepaid expenses	298	471
Deferred financing costs	1,618	1,751
Total Assets	480,007	376,502
Liabilities		
Credit facility payable (Note 9)	90,667	
Payable for investments purchased		70,000
Dividends payable	8,958	
Due to Prospect Administration (Note 5)	931	330
Due to Prospect Capital Management (Note 5)	5,562	4,508
Accrued expenses	1,227	1,312
Other liabilities	944	304
Total Liabilities	108,289	76,454
Net Assets	$ 371,718	$ 300,048

Components of Net Assets (Note 4)				
Common stock, par value $0.001 per share (100,000,000 and 100,000,000 common shares authorized, respectively; 26,270,379 and 19,949,065 issued and outstanding, respectively)	$	26	$	20
Paid-in capital in excess of par		395,571		299,845
Distributions in excess of net investment income		(315)		(4,092)
Accumulated realized gains (losses) on investments		(16,163)		2,250
Unrealized appreciation (depreciation) on investments		(7,401)		2,025
Net Assets	$	371,718	$	300,048
Net Asset Value Per Share	$	14.15	$	15.04

See notes to consolidated financial statements.

Table of Contents

PROSPECT CAPITAL CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(in 000s, except per share data)
(Unaudited)

	Three Months Ended March 31, 2008		March 31, 2007	
Investment Income				
Interest income:				
Control investments (Net of foreign withholding tax of $35 and $67, respectively)	$	4,556	$	3,845
Affiliate investments (Net of foreign withholding tax of $0 and $35, respectively)		290		800
Non-control/Non-affiliate investments		10,044		4,025
Total interest income		14,890		8,670
Dividend income:				
Control investments		3,300		850
Money market funds		123		1,245
Total dividend income		3,423		2,095
Other income[(2)]:				
Control investments		200		8
Non-control/Non-affiliate investments		3,487		1,296
Total other income		3,687		1,304
Total Investment Income		22,000		12,069
Operating Expenses				
Investment advisory fees:				
Base management fee (Note 5)		2,388		1,531
Income incentive fee (Note 5)		3,230		1,754
Total investment advisory fees		5,618		3,285
Interest expense and credit facility costs		1,863		353
Chief Compliance Officer and Sub-administration fees		228		164
Legal fees		449		593
Valuation services		198		92
Audit and tax related fees		45		43
Recruitment and other professional fees		18		4
Insurance expense		64		72
Directors fees		55		55

Other general and administrative expenses		543		393
Total Operating Expenses		9,081		5,054
Net Investment Income		12,919		7,015
Net realized gain (loss) on investments		208		(1)
Increase (decrease) in net assets from net change in unrealized appreciation/depreciation on investments		(14,386)		(2,038)
Increase (Decrease) in Net Assets Resulting from Operations	$	(1,259)	$	4,976
Earnings(loss) per common share (Note 6)	$	(0.05)	$	0.26

(1) Certain amounts have been reclassified to conform to the current period s presentation.

(2) Includes Structuring Fees of $490, Overriding Royalty Interests of $3,150, Deal Deposit Income of $36 and Administrative Agent Fees of $11 for the three months ended March 31, 2008 and Prepayment Penalty on Net Profits Interest of $960, Deal Deposit Income of $292, and Overriding Royalty Interests of $52 for the three months ended March 31, 2007.

See notes to consolidated financial statements.

Table of Contents

PROSPECT CAPITAL CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(in 000s, except per share data)
(Unaudited)

	Nine Months Ended March 31, 2008		March 31, 2007	
Investment Income				
Interest income:				
Control investments (Net of foreign withholding tax of $193 and $112, respectively)	$	14,689	$	9,455
Affiliate investments (Net of foreign withholding tax of $70 and $202, respectively)		1,612		2,837
Non-control/Non-affiliate investments		26,237		8,656
Total interest income		42,538		20,948
Dividend income:				
Control investments		6,950		2,550
Money market funds		557		1,839
Total dividend income		7,507		4,389
Other income(2):				
Control investments				8
Affiliate investments		210		3
Non-control/Non-affiliate investments		5,699		1,324
Total Other income		5,909		1,335
Total Investment Income		55,954		26,672
Operating Expenses				
Investment advisory fees:				
Base management fee (Note 5)		6,366		3,715
Income incentive fee (Note 5)		7,861		3,695
Total investment advisory fees		14,227		7,410
Interest expense and credit facility costs		4,719		1,385
Chief Compliance Officer and Sub-administration fees		620		402
Legal fees		2,224		970
Valuation services		431		285
Sarbanes-Oxley compliance expenses		10		46
Audit and tax related fees		338		382
Recruitment and other professional fees		53		4

Insurance expense		192		219
Directors fees		165		175
Other general and administrative expenses		1,531		612
Total Operating Expenses		24,510		11,890
Net Investment Income		31,444		14,782
Net realized (loss) gain on investments		(18,413)		1,949
Increase (decrease) in net assets from net change in unrealized appreciation/depreciation on investments		(9,426)		(4,851)
Increase (Decrease) in Net Assets Resulting from Operations	$	3,605	$	11,880
Earnings (loss) per common share (Note 6)	$	0.16	$	0.82

(1) Certain amounts have been reclassified to conform to the current period s presentation.

(2) Includes Structuring Fees of $2,431, Deal Deposit Income of $72, Overriding Royalty Interests of $3,364, Forbearance Fees of $10 and Administrative Agent Fees of $32 for the nine months ended March 31, 2008 and Prepayment Penalty on Net Profits Interest of $960, Net Profits Interests of $26, Deal Deposit Income of $292 and Overriding Royalty Interests of $57 for the nine months ended March 31, 2007.

See notes to consolidated financial statements.

Table of Contents

PROSPECT CAPITAL CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS
(in 000s, except share data)
(Unaudited)

	Nine Months Ended March 31, 2008	March 31, 2007
Increase in Net Assets from Operations:		
Net investment income	$ 31,444	$ 14,782
Net realized (loss) gain on investments	(18,413)	1,949
Increase (decrease) in net assets from net change in unrealized appreciation/depreciation on investments	(9,426)	(4,851)
Increase (Decrease) in Net Assets Resulting from Operations	3,605	11,880
Dividends to Shareholders:	(27,667)	(19,790)
Capital Share Transactions:		
Net proceeds from capital shares sold	94,230	197,557
Less: Offering costs of public share offerings	(1,251)	(869)
Reinvestment of dividends	2,753	4,719
Net Increase in Net Assets Resulting from Capital Share Transactions	95,732	201,407
Total Increase (Decrease) in Net Assets:	71,670	193,497
Net assets at beginning of period	300,048	108,270
Net Assets at End of Period	$ 371,718	$ 301,767
Capital Share Activity:		
Shares sold	6,150,000	12,526,650
Shares issued through reinvestment of dividends	171,314	282,708
Net increase in capital shares	6,321,314	12,809,358
Shares outstanding at beginning of period	19,949,065	7,069,873
Shares Outstanding at End of Period	26,270,379	19,879,231

See notes to consolidated financial statements.

F-5

Table of Contents

PROSPECT CAPITAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in 000s)
(Unaudited)

	Nine Months Ended March 31, 2008	March 31, 2007[1]
Cash Flows from Operating Activities:		
Increase (decrease) in net assets resulting from operations	$ 3,605	$ 11,880
Adjustments to reconcile net increase (decrease) in net assets resulting from operations to net cash provided by (used in) operating activities:		
Net (increase) decrease in net assets from net change in unrealized appreciation/depreciation on investments	9,426	4,851
Net realized (gain) loss on investments	18,413	(1,949)
Accretion of original issue discount on investments	(1,785)	(1,436)
Amortization of deferred financing costs	547	836
Change in operating assets and liabilities:		
Payments for purchases of investments	(193,033)	(106,846)
Proceeds from sale of investments	66,063	28,096
Purchases of cash equivalents	(229,955)	(249,895)
Sales of cash equivalents	229,938	249,893
Net investments in money market funds	14,511	(97,976)
(Increase) decrease in interest receivable	(1,900)	(329)
(Increase) decrease in dividends receivable	218	(435)
(Increase) decrease in loan principal receivable	(107)	(119)
(Increase) decrease in receivable for structuring fees	1,625	
(Increase) decrease in receivables for securities sold	(506)	369
(Increase) decrease in other receivables	(148)	(254)
(Increase) decrease in due from Prospect Administration		28
(Increase) decrease in due from Prospect Capital Management		5
(Increase) decrease in prepaid expenses	173	(86)
Increase (decrease) in payables for securities purchased	(70,000)	1,666
Increase (decrease) in due to Prospect Administration	601	286
Increase (decrease) in due to Prospect Capital Management	1,054	2,723
Increase (decrease) in accrued expenses	(85)	3
Increase (decrease) in other liabilities	640	442
Net Cash Used In Operating Activities	(150,705)	(158,247)
Cash Flows from Financing Activities:		
Borrowings under credit facility	184,992	
Payments under credit facility	(94,325)	(28,500)
(Increase) decrease in deferred financing costs	(415)	(868)
(Increase) decrease in deferred offering costs		32
Net proceeds from issuance of common stock	94,230	197,557

Offering costs from issuance of common stock		(1,251)		(869)
Dividends paid		(15,956)		(15,071)
Net Cash Provided By Financing Activities		167,275		152,281
Net Increase (decrease) in Cash		16,570		(5,964)
Cash, beginning of period				
Cash (bank overdraft), End of Period	$	16,570	$	(5,964)
Cash Paid For Interest	$	1,825	$	526
Non-Cash Financing Activity:				
Amount of shares issued in connection with dividend reinvestment plan	$	2,753	$	4,719

(1) Certain amounts have been reclassified to conform to the current period s presentation.

See notes to consolidated financial statements.

F-6

PROSPECT CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS
March 31, 2008
(in 000s except share amounts and percentages)
(Unaudited)

Portfolio Investments[1]	Locale/ Industry	Par Value/ Shares/ Ownership%	Cost	Fair Value[2]	% of Net Assets
Control Investments (25.00% or greater of voting control)					
Gas Solutions Holdings, Inc.[3]	Texas/Gas Gathering and Processing				
Common shares		100	$ 4,897	$ 34,450	9.3%
Subordinated secured note, 18.00% due 12/22/2009[4]		$ 20,000	20,000	20,000	5.4%
Total			24,897	54,450	14.7%
Genesis Coal Corp.	Kentucky/ Mining and Coal Production				
Common shares		72	29	1	0.0%
Warrants, preferred shares, expiring 2/9/2016		1,000	33	1	0.0%
Senior secured note, 15.00%[5] **due 12/31/2010**		$ 16,462	16,377	8,026	2.2%
Total			16,439	8,028	2.2%
Integrated Contract Services, Inc.[6]	North Carolina/ Contracting				
Common shares		49	127		0.0%
Series A preferred shares		10			0.0%
Junior secured note, 14.00% due 9/30/2010		$ 14,003	14,003		0.0%
Senior secured note, 14.00% due 9/30/2010		$ 800	800	5,000	1.3%
Senior demand note, 15.00%[7] **due 4/11/2011**		$ 1,170	1,170		0.0%
Total			16,100	5,000	1.3%
Iron Horse Coiled Tubing, Inc.[4]					

	Alberta, Canada/ Production services					
Common shares			643	268		0.0%
Senior secured note, 15.00% due 4/19/2009		$	9,250	9,051	9,051	2.4%
Total				9,319	9,051	2.4%

See notes to consolidated financial statements.

F-7

Table of Contents

PROSPECT CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS
March 31, 2008
(in 000s except share amounts and percentages)
(Unaudited)

Portfolio Investments[1]	Locale/ Industry	Par Value/ Shares/ Ownership %	Cost	Fair Value[2]	% of Net Assets
NRG Manufacturing, Inc.	Texas/ Manufacturing				
Common shares		800	$ 2,317	$ 8,656	2.3%
Senior secured note, 16.50%[8] due 8/31/2013[4]		$ 13,080	13,080	13,080	3.5%
Total			15,397	21,736	5.8%
North Fork Collieries LLC	Kentucky/ Mining and Coal Production				
Membership Interests		100%			0.0%
Senior secured note, 18.00% due 3/31/2009		$ 5,121	5,121	5,121	1.4%
Total			5,121	5,121	1.4%
R-V Industries, Inc.	Pennsylvania/ Manufacturing				
Common shares		545,107	5,025	5,025	1.4%
Warrants, common shares, expiring 6/30/2017		200,000	1,681	1,829	0.5%
Senior secured note, 15.00% due 6/30/2017[4]		$ 7,526	5,894	5,747	1.5%
Total			12,600	12,601	3.4%
Whymore Coal Company, Inc.[9]	Kentucky/ Mining and Coal Production				
Equity ownership		Various	209	1	0.0%
Senior secured note, 15.00%[10] due 12/31/2010		$ 12,510	12,510	6,063	1.6%
Total			12,719	6,064	1.6%

Worcester Energy Company, Inc.[11]	Maine/Biomass Power				
Equity ownership		Various	303	1	0.0%
Senior secured note, 12.50% due 12/31/2012		$ 34,383	34,247	19,579	5.3%
Total			$ 34,550	$ 19,580	5.3%
Total Control Investments			147,142	141,631	38.1%

See notes to consolidated financial statements.

Table of Contents

PROSPECT CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS
March 31, 2008
(in 000s except share amounts and percentages)
(Unaudited)

Portfolio Investments[1]	Locale/ Industry	Par Value/ Shares/ Ownership%	Cost	Fair Value[2]	% of Net Assets
Affiliate Investments (5.00% to 24.99% of voting control)					
Appalachian Energy Holdings LLC [12][4]	West Virginia/ Construction Services				
Common shares		100			0.0%
Series A preferred shares		200	149	149	0.0%
Warrants, expiring 2/14/2016		6,065	348	348	0.1%
Senior secured note, 14.00%, plus 3.00% PIK due 1/31/2011		$ 5,224	5,085	5,085	1.4%
Total Affiliate Investments			5,582	5,582	1.5%
Non-Control/Non-Affiliate Investments (less than 5.00% of voting control)					
American Gilsonite Company	Utah/Specialty Minerals				
Membership Interests in AGC/PEP, LLC		99.999%	1,000	1,000	0.3%
Senior secured note, 12.00% plus 3.00% due 3/14/2013[4]		$ 14,500	14,500	14,500	3.9%
Total			15,500	15,500	4.2%
Arctic Acquisition Corp.[13][4]	Texas/ Production services				
Warrants, common shares, expiring 7/19/2012		596,251	507	970	0.3%
Warrants, Series A redeemable preferred shares, expiring 7/19/2012		1,054	507	970	0.3%
Total			1,014	1,940	0.6%
C&J Cladding LLC[4]					

Texas/Metal Services					
Warrants, common shares, expiring 3/30/2014		510	580	1,795	0.5%
Senior secured note, 14.00% (14) due 3/31/2012	$	5,100	4,375	4,375	1.2%
Total			$ 4,955	$ 6,170	1.7%

See notes to consolidated financial statements.

Table of Contents

PROSPECT CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS
March 31, 2008
(in 000s except share amounts and percentages)
(Unaudited)

Portfolio Investments(1)	Locale/ Industry	Par Value/Shares/ Ownership%		Cost	Fair Value(2)	% of Net Assets
Conquest Cherokee, LLC(15)(4)	Tennessee/Oil and Gas Production					
Senior secured note, 13.00% (16) due 5/5/2009		$	10,200	10,104	10,104	2.7%
Deb Shops, Inc.(4)	Pennsylvania/ Retail Apparel					
Senior secured note, 10.69% due 1/31/2015		$	15,000	14,566	14,566	3.9%
Deep Down, Inc.(4)	Texas/ Production Services					
Warrants, common shares, expiring 8/6/2012			4,960,585			0.0%
Senior secured note, 12.50%, plus 3.00% PIK due 8/1/2011		$	12,000	12,000	12,000	3.2%
Total				12,000	12,000	3.2%
Diamondback Operating, LP (17)(4)	Oklahoma/ Oil and Gas Production					
Senior secured note, 12.00%, plus 2.00% PIK due 8/28/2011		$	9,200	9,200	9,200	2.5%
H&M Oil & Gas, LLC (17)(4)	Texas/Oil and Gas Production					
Senior secured note, 13.00% (18) due 6/30/2010		$	45,000	45,000	45,000	12.1%
IEC Systems LP/Advance Rig Services LLC (ARS(4))	Texas/Oilfield Fabrication					
IEC senior secured note, 12.00%, plus 3.00% PIK due 11/20/2012		$	19,192	19,192	19,192	5.2%

ARS senior secured note, 12.00%, plus 3.00% PIK due 11/20/2012		$	5,875	5,875	5,875	1.6%
Total				25,067	25,067	6.8%
Jettco Marine Services LLC (17)(4)	Louisiana/ Shipping					
Subordinated secured note, 12.00% (19), plus 4.00% PIK due 12/31/2011$6,878		$	6,878	6,775	6,775	1.8%

See notes to consolidated financial statements.

Table of Contents

PROSPECT CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS
March 31, 2008
(in 000s except share amounts and percentages)
(Unaudited)

Portfolio Investments[1]	Locale/Industry	Par Value/Shares/ Ownership%	Cost	Fair Value[2]	% of Net Assets
Maverick Healthcare, Inc.[4]	Arizona/Medical Services				
Common shares		1,250,000	1,250	1,250	0.3%
Preferred shares		1,250,000			0.0%
Senior secured note, 12.00%, plus 1.50% PIK due 10/31/2014		$ 12,500	12,500	12,500	3.4%
Total			13,750	13,750	3.7%
Miller Petroleum, Inc.	Tennessee/ Oil and Gas Production				
Warrants, common shares, expiring 5/4/2010 to 3/31/2013		1,480,108	$ 150	2	0.0%
Qualitest Pharmaceuticals, Inc.[4]	Alabama/ Pharmaceuticals				
Second lien debt, 12.45% [20]due 4/30/2015		$ 12,000	11,942	11,942	3.2%
Regional Management Corp.[4]	South Carolina/ Financial Services				
Subordinated secured note, 12.00%, plus 2.00% PIK due 6/29/2012		$ 25,000	25,000	25,000	6.7%
Resco Products, Inc.[4]	Pennsylvania/ Manufacturing				
Second lien debt, 11.06% [21] due 6/24/2014		$ 9,750	9,570	9,570	2.6%
Shearer s Foods, Inc.[4]	Ohio/Food Products				
Mistral Chip Holdings, LLC membership units		4.415%	2,000	2,000	0.5%
Second lien debt, 14.00% due 10/31/2013		$ 18,000	18,000	18,000	4.9%

Total				20,000	20,000	5.4%
Stryker Energy, LLC (22)(4)	Ohio/Oil and Gas Production					
Subordinated revolving credit facility, 12.00% (23) due 11/30/2011		$	29,500	29,015	29,015	7.8%

See notes to consolidated financial statements.

Table of Contents

PROSPECT CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS
March 31, 2008
(in 000s except share amounts and percentages)
(Unaudited)

Portfolio Investments[1]	Locale/Industry	Par Value/Shares/ Ownership%	Cost	Fair Value[2]	% of Net Assets
Unitek[4]	Pennsylvania/ Technical Services				
Second lien debt, 12.75% [24] due 9/27/2013		$ 11,500	11,332	11,332	3.0%
Unity Virginia Holdings, LLC	Virginia/Mining and Coal Production				
Subordinated secured note, 15.00%, plus 15.00% PIK due 1/31/2009		$ 3,580	3,893	10	0.0%
Wind River Resources Corp. and Wind River II Corp. [17][4]	Utah/Oil and Gas Production				
Senior secured note, 13.00%, Due 7/31/2009		$ 15,000	15,000	15,000	4.0%
Total Non-Control/Non-Affiliate Investments			$ 283,833	281,943	75.9%
Total Portfolio Investments			$ 436,557	429,156	115.5%
Money Market Funds					
Fidelity Institutional Money Market Funds Government Portfolio (Class I)		23,142,184	$ 23,142	$ 23,142	6.2%
First American Funds, Inc. Prime Obligations Fund (Class A) [4]		4,106,793	4,107	4,107	1.1%
Total Money Market Funds			$ 27,249	$ 27,249	7.3%
Total Investments			$ 463,806	$ 456,405	122.8%

(1)

The securities in which Prospect Capital 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 the Board of Directors of Prospect Capital (Note 2).

(3) Gas Solutions Holdings, Inc. is a wholly-owned investment of Prospect Capital.

(4) Security, or portion thereof, is held as collateral for the credit facility with Rabobank Nederland (See Note 9). At March 31, 2008, the value of these investments was $338,498 which represents 91.1% of net assets.

(5) Interest rate is the greater of 15.0% or 6-Month LIBOR plus 11.0%; rate reflected is as of March 31, 2008.

(6) Entity was formed as a result of the debt restructuring of ESA Environmental Specialist, Inc.

(7) Loan is with Lisamarie Fallon, Inc., (d/b/a The Healing Staff) an affiliate of the Integrated Contract Services, Inc.

(8) Interest rate is the greater of 16.5% or 12-Month LIBOR plus 11.0%; rate reflected is as of March 31, 2008.

(9) There are several entities involved in the Whymore investment. Prospect Capital has provided senior secured debt financing to C&A Construction, Inc. (C&A), which owns the equipment. E&L Construction, Inc. (E&L) 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. Whymore Coal Company, Inc. (Whymore) applies for and holds permits, pays royalties to landowners, and holds escrow funds for reclamation expenses following mining operations. Whymore and E&L are guarantors under the C&A credit agreement with Prospect Capital. Prospect Capital owns 10,000 shares of common stock of C&A (100% ownership), 10,000 shares of common stock of E&L (100% ownership), and 4,900 shares of common stock of Whymore (49% ownership). Prospect Capital owns 4,285 Series A convertible preferred shares in each of C&A, E&L and Whymore. Additionally, Prospect Capital retains an option to purchase the remaining 51% of Whymore. As of March 31, 2008, the Board of Directors of Prospect Capital assessed a fair value of $1 for the preferred equity.

Table of Contents

(10) Interest rate is the greater of 15.0% or 5-Year US Treasury Note plus 11.5%; rate reflected is as of March 31, 2008.

(11) There are several entities involved in the Worcester Energy Company, Inc. investment. Prospect Capital owns 100 shares of common stock in Worcester Energy Holdings, Inc. (WEHI) representing 100%. WEHI, in turn, owns 51 membership certificates in Biochips LLC, which represents 51% ownership. Prospect Capital also owns 282 shares of common stock in Worcester Energy Co., Inc. (WECO), which represents 51% ownership. Prospect Capital also owns 1,665 shares of common stock in Worcester Energy Partners, Inc. (WEPI), which represents 51% ownership. Prospect Capital also owns 1,000 of series A convertible preferred shares in WEPI. WECO, WEPI and Biochips LLC are joint borrowers on the term note issued to Prospect Capital. WEPI owns the equipment and operates the biomass generation facility. Biochips LLC currently has no material operations. WEPI owns 100 shares of common stock in Precision Logging and Landclearing, Inc. (Precision), which represents 100% ownership. Precision conducts all logging, processing and delivery operations to supply fuel to the biomass generation facility. As of March 31, 2008, the Board of Directors of Prospect Capital assessed a fair value of $1 for all of these equity positions.

(12) There are several entities involved in the Appalachian Energy Holdings (Appalachian Energy) investment. Prospect Capital owns 100 shares of Class A common stock of AEH Investment Corp. (AEH), 200 shares of Series A preferred stock of AEH and 6,065 warrants, expiring 2/14/2016 to purchase Class A common stock. The senior secured note is with C & S Operating LLC and East Cumberland L.L.C., both operating companies owned by Appalachian Energy Holdings LLC. AEH owns Appalachian Energy.

(13) The Portfolio Investment does business as Cougar Pressure Control.

(14) Interest rate is the greater of 14.0% or 12-Month LIBOR plus 7.5%; rate reflected is as of March 31, 2008.

(15) Prospect Capital has an overriding royalty interest and net profits interest in the Portfolio Investment.

(16) Interest rate is the greater of 13.0% or 12-Month LIBOR plus 7.5%; rate reflected is as of March 31, 2008.

(17) Prospect Capital has a net profits interest in the Portfolio Investment.

(18) Interest rate is the greater of 13.0% or 12-Month LIBOR plus 7.5%; rate reflected is as of March 31, 2008.

(19) Interest rate is the greater of 13.0% or 3-Month LIBOR plus 6.11%; rate reflected is as of March 31, 2008.

(20) Interest rate is the greater of 12.5% or 3-Month LIBOR plus 7.5%; rate reflected is as of March 31, 2008.

(21) Interest rate is 3-Month LIBOR plus 8.0%; rate reflected is as of March 31, 2008.

(22) Prospect Capital has an overriding royalty interest in the Portfolio Investment.

(23) Interest rate is the greater of 12.0% or 12-Month LIBOR plus 7.0%; rate reflected is as of March 31, 2008.

(24) Interest rate is the greater of 12.75% or 3-Month LIBOR plus 7.25%; rate reflected is as of March 31, 2008.

See notes to consolidated financial statements.

Table of Contents

PROSPECT CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS
June 30, 2007
(in 000s except share amounts and percentages)
(Audited)

Portfolio Investments[1]	Locale/Industry	Par Value/Shares	Cost	Fair Value[2]	% of Net Assets
Control Investments (25.00% or greater of voting control)					
Advantage Oilfield Group Ltd.[23]	Alberta, Canada/ Construction Services				
Common shares, Class A[3]		33	$ 220	$	0.0%
Senior secured note, 15.00% due 5/30/2009		$ 17,321	16,930	9,880	3.3%
Total			17,150	9,880	3.3%
Gas Solutions Holdings, Inc.[4]	Texas/Gas Gathering and Processing				
Common shares		100	4,878	26,100	8.7%
Subordinated secured note, 18.00% due 12/22/2011[23]		$ 18,400	18,400	18,400	6.1%
Total			23,278	44,500	14.8%
Genesis Coal Corp.	Kentucky/ Mining and Coal Production				
Common shares		63	23	1	0.0%
Warrants, preferred shares, expiring 2/9/2016		1,000	33	1	0.0%
Senior secured note, 16.40%[5] due 12/31/2010		$ 14,533	14,408	11,423	3.8%
Total			14,464	11,425	3.8%
NRG Manufacturing, Inc.	Texas/ Manufacturing				
Common shares		800	2,315	11,785	3.9%
Senior secured note, 16.50%[6] due 8/31/2013[23]		$ 10,080	10,080	10,080	3.4%
Total			12,395	21,865	7.3%

See notes to consolidated financial statements.

Table of Contents

PROSPECT CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS
June 30, 2007
(in 000s except share amounts and percentages)
(Audited)

Portfolio Investments[1]	Locale/Industry	Par Value/Shares	Cost	Fair Value[2]	% of Net Assets
R-V Industries, Inc.	Pennsylvania/ Manufacturing				
Common shares		545,107	4,985	4,985	1.6%
Warrants, common shares, expiring 6/30/2017		200,000	$ 1,682	$ 1,682	0.6%
Senior secured note, 15.00% due 6/30/2017[23]		$ 14,526	12,844	12,844	4.3%
Total			19,511	19,511	6.5%
Whymore Coal Company, Inc.[7]	Kentucky/ Mining and Coal Production				
Equity ownership		Various	111	1	0.0%
Senior secured note, 16.42%[8] due 12/31/2010		$ 11,022	11,022	7,063	2.4%
Total			11,133	7,064	2.4%
Worcester Energy Company, Inc.[9]	Maine/ Biomass Power				
Equity ownership		Various	137	1	0.0%
Senior secured note, 12.50% due 12/31/2012		$ 26,774	26,596	25,046	8.3%
Total			26,733	25,047	8.3%
Total Control Investments			124,664	139,292	46.4%
Affiliate Investments (5.00% to 24.99% of voting control)					
Appalachian Energy Holdings LLC[10][23]	West Virginia/ Construction Services				
Series A preferred shares		200	104	104	0.0%
Warrants, expiring 2/14/2016		6,065	348	152	0.1%
Senior secured note, 14.00%, plus 3.00% PIK due 1/31/2011		$ 5,358	5,169	5,169	1.7%

Total	5,621	5,425	1.8%

See notes to consolidated financial statements.

Table of Contents

PROSPECT CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS
June 30, 2007
(in 000s except share amounts and percentages)
(Audited)

Portfolio Investments[1]	Locale/ Industry	Par Value/ Shares	Cost	Fair Value[2]	% of Net Assets
Iron Horse Coiled Tubing, Inc. [23]	Alberta, Canada/ Production services				
Common shares		93	268	268	0.1%
Senior secured note, 15.00% due 4/19/2009		$ 9,250	8,932	8,932	3.0%
Total			9,200	9,200	3.1%
Total Affiliate Investments			$ 14,821	$ 14,625	4.9%
Non-Control/Non-Affiliate Investments (less than 5.00% of voting control)					
Arctic Acquisition Corp.[11][23]	Texas/Production services				
Warrants, common shares, expiring 7/19/2012		596,251	507	507	0.2%
Warrants, Series A redeemable preferred shares, expiring 7/19/2012		1,054	507	507	0.2%
Senior secured note, 13.00% due 7/19/2009		$ 13,301	12,656	12,656	4.2%
Total			13,670	13,670	4.6%
C&J Cladding LLC[23]	Texas/Metal Services				
Warrants, common shares, expiring 3/30/2014		510	580	580	0.2%
Senior secured note, 14.00%[12] due 3/31/2012		$ 6,000	5,249	5,249	1.7%
Total			5,829	5,829	1.9%
Central Illinois Energy, LLC [23]	Illinois/ Biofuels/Ethanol				
Senior secured note, 15.35%[13] due 3/31/2014		$ 8,000	8,000	8,000	2.7%

See notes to consolidated financial statements.

Table of Contents

PROSPECT CAPITAL CORPORATION
CONSOLIDATED SCHEDULE OF INVESTMENTS
June 30, 2007
(in 000s except share amounts and percentages)
(Audited)

Portfolio Investments[1]	**Locale/ Industry**	**Par Value/ Shares**	**Cost**	**Fair Value**[2]	**% of Net Assets**
Conquest Cherokee, LLC[14][23]	Tennessee/ Oil and Gas Production				
Senior secured note, 13.00%[15] due 5/5/2009		$ 10,200	10,046	10,046	3.3%
ESA Environmental Specialist, Inc.[23]	North Carolina/ Contracting				
Warrants, common shares, expiring 4/11/2017		1,059	1		0.0%
Senior secured note, 14.00%[16] due 4/11/2011		$ 12,200	12,200	4,428	1.5%
Senior secured note, 14.00%[16] due 6/7/2008		$ 1,575	$ 1,575	$ 572	0.2%
Total			13,776	5,000	1.7%
Evolution Petroleum Corp.[17]	Texas/Oil and Gas Production				
Common shares, unregistered		139,926	20	378	0.1%
H&M Oil & Gas, LLC[18][23]	Texas/Oil and Gas Production				
Senior secured note, 13.00%[19] due 6/30/2010		$ 45,000	45,000	45,000	15.0%
Jettco Marine Services LLC[18][23]	Louisiana/ Shipping				
Subordinated secured note, 12.00%[20], plus 4.0% PIK		$ 6,671	6,553	6,553	2.2%

due 12/31/2011

Ken-Tex Energy Corp.(14)(23) Senior secured note, 13.00% due 6/4/2010	Texas/Oil and Gas Production	$ 10,750	10,750	10,750	3.6%
Miller Petroleum, Inc. Warrants, common shares, expiring 5/4/2010 to 6/30/2012	Tennessee/ Oil and Gas Production	1,206,859	150	22	0.0%

See notes to consolidated financial statements.

Table of Contents

PROSPECT CAPITAL CORPORATION

CONSOLIDATED SCHEDULE OF INVESTMENTS
June 30, 2007
(in 000s except share amounts and percentages)
(Audited)

Portfolio Investments[1]	Locale/ Industry	Par Value/ Shares	Cost	Fair Value[2]	% of Net Assets
Regional Management Corp.[23]	South Carolina/ Financial Services				
Subordinated secured note, 12.00%, plus 2.0% PIK due 6/29/2012		$ 25,000	25,000	25,000	8.3%
Stryker Energy, LLC[21]	Ohio/Oil and Gas Production				
Subordinated revolvingcredit facility, 12.43%[22] due 11/30/2011		$ 29,500	28,942	28,942	9.7%
TLOGH, L.P.[21]	Texas/Oil and Gas Production				
Senior secured note,13.00%, due 10/23/2009		$ 15,291	15,105	15,105	5.0%
Unity Virginia Holdings, LLC	Virginia/Mining and Coal Production				
Subordinated secured note, 15.00%, plus 15.00% PIK due 1/31/2009		$ 3,580	$ 3,871	$ 10	0.0%
Total Non-Control/Non-Affiliate Investments			186,712	174,305	58.1%
Total Portfolio Investments			326,197	328,222	109.4%
Money Market Funds					
Fidelity Institutional Money Market Funds Government Portfolio (Class I)		38,227,118	38,227	38,227	12.7%
First American Funds, Inc. Prime Obligations Fund (Class A)[23]		289,000	289	289	0.1%

First American Funds, Inc. Prime Obligations Fund (Class Y)	3,243,731	3,244	3,244	1.1%
Total Money Market Funds		41,760	41,760	13.9%
Total Investments		$ 367,957	$ 369,982	123.3%

(1) The securities in which Prospect Capital 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 the Board of Directors of Prospect Capital (Note 2).

(3) Prospect Capital has the right to purchase 184 shares of Class A common shares at a purchase price of $1.00 per share in the event of a default under the credit agreement.

(4) Gas Solutions Holdings, Inc. is a wholly-owned investment of Prospect Capital.

(5) Interest rate is the greater of 15.0% or 6-Month LIBOR plus 11.0%; rate reflected is as of June 30, 2007.

Table of Contents

(6) Interest rate is the greater of 16.5% or 12-Month LIBOR plus 11.0%; rate reflected is as of June 30, 2007.

(7) There are several entities involved in the Whymore investment. Prospect Capital has provided senior secured debt financing to C&A Construction, Inc. (C&A), which owns the equipment. E&L Construction, Inc. (E&L) 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. Whymore Coal Company, Inc. (Whymore) applies for and holds permits on behalf of E&L. Whymore and E&L are guarantors under the C&A credit agreement with Prospect Capital. Prospect Capital owns 10,000 shares of common stock of C&A (100% ownership), 10,000 shares of common stock of E&L (100% ownership), and 4,900 shares of common stock of Whymore (49% ownership). Prospect Capital owns 4,285 Series A convertible preferred shares in each of C&A, E&L and Whymore. Additionally, Prospect Capital retains an option to purchase the remaining 51% of Whymore. As of June 30, 2007, the Board of Directors of Prospect Capital assessed a fair value of $1 for all of these equity positions.

(8) Interest rate is the greater of 15.0% or 5-Year US Treasury Note plus 11.5%; rate reflected is as of June 30, 2007.

(9) There are several entities involved in the Worcester Energy Company, Inc. investment. Prospect Capital owns 100 shares of common stock in Worcester Energy Holdings, Inc. (WEHI) representing 100%. WEHI, in turn, owns 51 membership certificates in Biochips LLC, which represents 51% ownership. Prospect Capital also owns 282 shares of common stock in Worcester Energy Co., Inc. (WECO), which represents 51% ownership. Prospect Capital also owns 1,665 shares of common stock in Worcester Energy Partners, Inc. (WEPI), which represents 51% ownership. Prospect Capital also owns 1,000 of series A convertible preferred shares in WEPI. WECO, WEPI and Biochips LLC are joint borrowers on the term note issued to Prospect Capital. WEPI owns the equipment and operates the biomass generation facility. Biochips LLC currently has no material operations. As of June 30, 2007, the Board of Directors of Prospect Capital assessed a fair value of $1 for all of these equity positions.

(10) There are several entities involved in the Appalachian Energy Holdings (Appalachian Energy) investment. Prospect Capital owns 100 shares of Class A common stock of AEH Investment Corp. (AEH), 200 shares of Series A preferred stock of AEH and 6,065 warrants, expiring 2/14/2016 to purchase Class A common stock. The senior secured note is with C & S Operating LLC and East Cumberland L.L.C., both operating companies owned by Appalachian Energy Holdings LLC. AEH owns Appalachian Energy.

(11) The Portfolio Investment does business as Cougar Pressure Control.

(12) Interest rate is the greater of 14.0% or 12-Month LIBOR plus 7.5%; rate reflected is as of June 30, 2007.

(13) Interest rate is LIBOR plus 10.0%; rate reflected is as of June 30, 2007.

(14) Prospect Capital has an overriding royalty interest and net profits interest in the Portfolio Investment.

(15) Interest rate is the greater of 13.0% or 12-Month LIBOR plus 7.5%; rate reflected is as of June 30, 2007.

(16) Interest rate is the greater of 14.0% or 1-Month LIBOR plus 8.5%; rate reflected is as of June 30, 2007.

(17) Formerly known as Natural Gas Systems, Inc.

(18) Prospect Capital has a net profits interest in the Portfolio Investment.

(19) Interest rate is the greater of 13.0% or 12-Month LIBOR plus 7.5%; rate reflected is as of June 30, 2007.

(20) Interest rate is the greater of 13.0% or 3-Month LIBOR plus 6.11%; rate reflected is as of June 30, 2007.

(21) Prospect Capital has an overriding royalty interest in the Portfolio Investment.

(22) Interest rate is the greater of 12.0% or 12-Month LIBOR plus 7.0%; rate reflected is as of June 30, 2007.

(23) Security, or portion thereof, is held as collateral for the credit facility with Rabobank Nederland (See Note 9). At June 30, 2007, the value of these investments was $195,966, which represents 65.3% of net assets.

See notes to consolidated financial statements.

Table of Contents

PROSPECT CAPITAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2008
(Unaudited)
(in 000s except share and per share amounts)

Note 1. Organization

Prospect Capital Corporation (Prospect Capital or the Company), formerly known as Prospect Energy Corporation, a Maryland corporation, was organized on April 13, 2004 and was funded in an initial public offering (IPO) completed on July 27, 2004. Prospect Capital is 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, Prospect Capital has qualified and has elected to be treated as a regulated investment company, or RIC, under Subchapter M of the Internal Revenue Code. The Company invests primarily in senior and subordinated debt and equity of companies in need of capital for acquisitions, divestitures, growth, development, project financings, recapitalizations, and other purposes.

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

Note 2. Significant Accounting Policies

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

Interim financial statements, which are not audited, are prepared in accordance with GAAP for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 6 or 10 of Regulation S-X, as appropriate.

The following are significant accounting policies consistently applied by Prospect Capital:

Consolidation:

As an investment company, Prospect Capital only consolidates wholly-owned, closely-managed subsidiaries that are also investment companies. At March 31, 2008, the financial statements include the accounts of Prospect Capital and its wholly-owned subsidiary, Prospect Capital Funding, LLC. All intercompany balances and transactions have been eliminated in consolidation.

Investments:

The Consolidated Statements of Assets and Liabilities include portfolio investments reported at fair values of $429,156 and $328,222 at March 31, 2008 and June 30, 2007, respectively. At March 31, 2008 and June 30, 2007, 115.5% and 109.4%, respectively, of the Company s net assets represented portfolio investments whose fair values have been determined by the Board of Directors in good faith in the absence of active markets for those investments. Because of the inherent uncertainty of valuation, the Board of Directors determined values may differ significantly from the values that would have been used had such active markets existed for the investments, and the differences could be material.

a) Security transactions are recorded on a trade-date basis.

b) Valuation:

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

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

3) It is expected that most of the investments in the Company s portfolio will not have actively traded markets. Debt and equity securities which do not have actively traded markets are valued with the assistance of an independent valuation service using a documented valuation policy and a valuation process that is consistently applied under the direction of our Board of Directors. The factors that may be taken into account in fairly valuing investments include, as relevant, the portfolio company s ability to make payments, its estimated earnings and projected discounted cash flows, the nature and realizable value of any collateral, the sensitivity of the investments to fluctuations in interest rates, the financial environment in which the portfolio company operates, comparisons to securities of similar publicly traded companies and other relevant factors. Due to the inherent uncertainty of determining the fair value of investments that are not actively traded, the fair value of these investments may differ significantly from the values that would have been used had an actively traded market existed for such investments, and any such differences could be material.

4) In September 2006, the Financial Accounting Standards Board (FASB) issued a new pronouncement addressing fair value measurements, Statement of Financial Accounting Standards Number 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 becomes effective for fiscal years beginning after November 15, 2007; therefore, its first applicability to the Company will be for the Company s upcoming fiscal year beginning July 1, 2008. The Company does not believe that the adoption of SFAS 157 will materially impact the amounts reported in its financial statements, however, additional disclosures will be required about the inputs used to develop the measurements and the effect of certain of the measurements reported to changes in net assets for a fiscal period.

5) In February 2007, FASB issued SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115 . SFAS 159 permits an entity to elect fair value as the initial and subsequent measurement attribute for many of assets and liabilities for which the fair value option has been elected and similar assets and liabilities measured using another measurement attribute. SFAS 159 becomes effective for fiscal years beginning after November 15, 2007 and, therefore, is applicable for the Company s upcoming fiscal year beginning July 1, 2008. The Company s management does not believe that the adoption of SFAS No. 159 will have a material impact on its financial statements.

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

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

e) Dividend income is recorded on the ex-dividend date.

f) Structuring fees and similar fees are recognized as income as earned. Structuring fees, excess deal deposits, net profits interests, overriding royalty interests, administrative agent fees and forbearance fees are included in other income.

g) Loans are placed on non-accrual status when principal or interest payments are past due 90 days or more or when there is reasonable doubt that principal or interest will be collected. Accrued interest is generally reversed when a loan is placed on non-accrual status. Interest payments received on non-accrual loans may be recognized as

Table of Contents

income or applied to principal depending upon management s judgment. Non-accrual loans are restored to accrual status when past due principal and interest is paid and in management s judgment, are likely to remain current. As of March 31, 2008, approximately 1.0% of the Company s net assets are in non-accrual status.

Federal and State Income Taxes:

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

If the Company does not distribute (or is not deemed to have distributed) at least 98% of its annual taxable income in the year earned, the Company will generally be required to pay an excise tax equal to 4% of the amount by which 98% of the Company s annual taxable income exceeds the distributions from such taxable income for the year. To the extent that the Company determines that its estimated current year annual taxable income will be in excess of estimated current year dividend distributions from such taxable income, the Company accrues 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.

The Company adopted Financial Accounting Standards Board Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes. FIN 48 provides guidance for how uncertain tax positions should be recognized, measured, presented, and disclosed in the financial statements. FIN 48 requires the evaluation of tax positions taken or expected to be taken in the course of preparing the Company s tax returns to determine whether the tax positions are more-likely-than-not of being sustained by the applicable tax authority. Tax positions not deemed to meet the more-likely-than-not threshold are recorded as a tax benefit or expense in the current year. Adoption of FIN 48 was applied to all open tax years as of July 1, 2007. The adoption of FIN 48 did not have an effect on the net asset value, financial condition or results of operations of the Company as there was no liability for unrecognized tax benefits and no change to the beginning net asset value of the Company. As of March 31, 2008 and for the nine-month period then ended the Company did not have a liability for any unrecognized tax benefits. Management s determinations regarding FIN 48 may be subject to review and adjustment at a later date based upon factors including, but not limited to, an on-going analysis of tax laws, regulations and interpretations thereof.

Dividends and Distributions:

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

Financing Costs:

The Company records origination expenses related to its credit facility as deferred financing costs. These expenses are deferred and amortized as part of interest expense using the straight-line method over the stated life of the facility.

The Company records registration expenses related to shelf filings as prepaid assets. These expenses consist principally of SEC registration, legal and accounting fees incurred through March 31, 2008 that are related to the shelf filings that will be charged to capital upon the receipt of the capital or charged to expense if not completed.

Table of Contents

Guarantees and Indemnification Agreements:

The Company follows FASB Interpretation Number 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. (FIN 45). FIN 45 elaborates on the disclosure requirements of a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also requires a guarantor to recognize, at the inception of a guarantee, for those guarantees that are covered by FIN 45, the fair value of the obligation undertaken in issuing certain guarantees. FIN 45 did not have a material effect on the financial statements of the Company. Refer to Note 3 and Note 5 for further discussion of guarantees and indemnification agreements.

Per Share Information:

Basic earnings per common share are calculated using the weighted average number of common shares outstanding for the period presented.

Note 3. Portfolio Investments

At March 31, 2008, 115.5% of our net assets or about $429,156 was invested in 31 long-term portfolio investments (including a net profits interest in Charlevoix Energy Trading LLC) and 7.3% of our net assets was invested in money market funds. The remainder (22.8%) of our net assets represented liabilities in excess of other assets. At June 30, 2007, 109.4% of our net assets or about $328,222 was invested in 24 long-term portfolio investments (including a net profits interest in Charlevoix Energy Trading LLC) and 13.9% of our net assets was invested in money market funds. The remainder (23.3%) of our net assets represented liabilities in excess of other assets. Prospect Capital is 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 owns 25% or more of the voting securities of an investee company. Affiliated investments and affiliated companies are defined by a lesser degree of influence. This lesser degree of influence is deemed to exist through ownership of 5% or more but less than 25% of the outstanding voting securities of another person. As of March 31, 2008, the Company owns a controlling interest in Gas Solutions Holdings, Inc. (GSHI), Genesis Coal Corp. (Genesis), Integrated Contract Services, Inc. (Integrated), Iron Horse Coiled Tubing, Inc. (Iron Horse), NRG Manufacturing, Inc. (NRG), North Fork Collieries LLC (North Fork), R-V Industries, Inc. (R-V), Whymore Coal Company, Inc. (Whymore), and Worcester Energy Company, Inc. (WECO). The Company also owns an affiliated interest in Appalachian Energy Holdings, LLC (AEH). The Company has no other controlled or affiliated investments.

GSHI has indemnified Prospect Capital against any legal action arising from its investment in Gas Solutions, LP. Prospect Capital has incurred approximately $1,841 from the inception of the investment in GSHI through March 31, 2008 for fees associated with a legal action, and GSHI has reimbursed Prospect Capital for the entire amount. Of the $1,841 reimbursement, $23 and $15 are reflected as Dividend income: Control Investments on the accompanying Consolidated Statements of Operations for the three months ended March 31, 2008 and March 31, 2007, respectively, and $44 and $411 for the nine months ended March 31, 2008 and March 31, 2007, respectively. Additionally, certain other expenses incurred by Prospect Capital which are attributable to GSHI have been reimbursed to Prospect Capital by GSHI and are reflected as Dividend income: Control Investments on the accompanying Consolidated Statements of Operations as $1,276 and $631 for the three months ended March 31, 2008 and March 31, 2007, respectively, and $2,995 and $631 for the nine months ended March 31, 2008 and March 31, 2007, respectively.

Debt placements and interests in equity securities with an original cost basis of approximately $31,794 and $193,033 were acquired during the respective three-month and nine-month periods ended March 31, 2008. Debt repayments and sales of equity securities generated proceeds of approximately $28,891 and $66,063 during the respective three-month and nine-month periods ended March 31, 2008.

From time to time, the Company provides guarantees for portfolio companies for payments to counterparties, usually as an alternative to investing additional capital. Currently, agreements for two guarantees and one indemnification are outstanding which are related to two portfolio companies categorized as Control

F-23

Table of Contents

Investments Whymore Coal Company, Inc. (Whymore) and North Fork Collieries LLC (North Fork). The two guarantees are related to Whymore with one in the amount of $3,478 for equipment leases and another of $416 for a payment-over-time contract for coal purchases. The contingent indemnification obligation arose from the Company s acquisition of the assets of Traveler Coal, LLC (Traveler) through the Company s subsidiary North Fork. Specifically, as part of that acquisition, the Company has agreed to indemnify the seller of those assets for personal guarantees that that seller had extended on behalf of Traveler. The amount of this contingency may reach $5,000.

Note 4. Equity Offerings and Related Expenses

On March 28, 2008, the Company completed a registered direct offering of 1,300,000 shares of its common stock. On March 31, 2008, the Company completed a public offering of 1,150,000 shares of its common stock. The proceeds raised, the related underwriting fees, the offering expenses, and the prices at which common stocks were issued since inception are detailed in the table which follows:

Issuances of Common Stock	Number of Shares Issued	Gross Proceeds Raised	Underwriting Fees	Offering Expenses	Offering Price
March 31, 2008	1,150,000	$ 17,768	$ 759	$ 350	$ 15.450
March 28, 2008	1,300,000	19,786		350	15.220