VERIFONE SYSTEMS, INC.
Form 10-Q
September 10, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q
(Mark One)

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended July 31, 2012

Or

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number: 001-32465
VERIFONE SYSTEMS, INC.
(Exact name of registrant as specified in its charter)

Delaware	04-3692546
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2099 Gateway Place, Suite 600
San Jose, CA 95110
(Address of principal executive offices with zip code)
(408) 232-7800
(Registrant's telephone number, including area code)
N/A
(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨

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

Large accelerated filer þ	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

At August 31, 2012, the number of shares outstanding of the registrant's common stock, $0.01 par value was 107,811,832.

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PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (Unaudited)

VERIFONE SYSTEMS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2012	2011	2012	2011
	(Unaudited) (In thousands, except per share data)			
Net revenues:				
System solutions	$350,230	$253,659	$1,003,314	$714,700
Services	138,820	63,292	377,278	178,462
Total net revenues	489,050	316,951	1,380,592	893,162
Cost of net revenues:				
System solutions	206,213	150,621	607,238	428,357
Services	75,330	34,718	217,050	99,117
Total cost of net revenues	281,543	185,339	824,288	527,474
Gross margin	207,507	131,612	556,304	365,688
Operating expenses:				
Research and development	38,657	27,457	111,585	74,501
Sales and marketing	46,182	32,769	132,309	92,214
General and administrative	43,414	28,657	138,148	79,716
Patent litigation loss contingency expense	—	—	17,632	—
Amortization of purchased intangible assets	23,177	1,980	60,549	5,959
Total operating expenses	151,430	90,863	460,223	252,390
Operating income	56,077	40,749	96,081	113,298
Interest expense	(16,374)	(7,963)	(49,644)	(22,998)
Interest income	1,110	479	3,260	1,049
Other income (expense), net	(721)	6,313	(23,350)	6,152
Income before income taxes	40,092	39,578	26,347	97,501
Provision for (benefit from) income taxes	2,313	13,072	(12,068)	13,702
Consolidated net income	37,779	26,506	38,415	83,799
Net income attributable to noncontrolling interests	(84)	(159)	(366)	(221)
Net income attributable to VeriFone Systems, Inc. stockholders	$37,695	$26,347	$38,049	$83,578
Net income per share attributable to VeriFone Systems, Inc. stockholders:				
Basic	$0.35	$0.29	$0.36	$0.95
Diluted	$0.34	$0.28	$0.34	$0.90
Weighted average shares used in computing earnings per share:				

Basic	107,568	89,602	106,768	88,368
Diluted	110,384	93,322	110,305	92,690

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

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VERIFONE SYSTEMS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	July 31, 2012	October 31, 2011
	(Unaudited)	
	(In thousands, except par value)	
ASSETS		
Current assets:		
Cash and cash equivalents	$409,807	$594,562
Accounts receivable, net of allowance of $6,585 and $5,658	371,170	294,440
Inventories	164,873	144,316
Prepaid expenses and other current assets	153,167	127,130
Total current assets	1,099,017	1,160,448
Fixed assets, net	137,159	83,634
Purchased intangible assets, net	748,892	263,767
Goodwill	1,159,651	561,414
Deferred tax assets	213,676	205,496
Other assets	81,965	38,802
Total assets	$3,440,360	$2,313,561
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$183,601	$144,278
Accruals and other current liabilities	252,280	218,123
Deferred revenue, net	101,089	68,824
Senior convertible notes	—	266,981
Short-term debt	53,329	5,074
Total current liabilities	590,299	703,280
Deferred revenue, net	30,070	31,467
Deferred tax liabilities	228,192	92,594
Long-term debt	1,268,510	211,756
Other long-term liabilities	69,586	78,971
Total liabilities	2,186,657	1,118,068
Redeemable noncontrolling interest in subsidiary	893	855
Stockholders' equity:		
VeriFone Systems, Inc. stockholders' equity:		
Preferred Stock: 10,000 shares authorized as of July 31, 2012 and October 31, 2011; no shares issued and outstanding as of July 31, 2012 and October 31, 2011	—	—
Common stock: $0.01 par value, 200,000 shares authorized as of July 31, 2012 and October 31, 2011; 107,920 and 105,826 shares issued and 107,791 and 105,697 outstanding as of July 31, 2012 and October 31, 2011	1,079	1,058
Additional paid-in capital	1,529,311	1,468,862
Accumulated deficit	(231,007)	(269,056)
Accumulated other comprehensive loss	(82,583)	(6,671)

Total stockholders' equity	1,216,800	1,194,193
Noncontrolling interest in subsidiaries	36,010	445
Total liabilities and equity	$3,440,360	$2,313,561

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

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VERIFONE SYSTEMS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended July 31	
	2012	2011
	(Unaudited)	
	(In thousands)	
Cash flows from operating activities		
Consolidated net income	$38,415	$83,799
Adjustments to reconcile consolidated net income to net cash provided by operating activities:		
Depreciation and amortization, net	129,819	24,205
Stock-based compensation expense	34,171	25,107
Non-cash interest expense	12,405	11,560
Deferred income taxes	(15,576)	1,744
Other	102	(4,375)
Net cash provided by operating activities before changes in operating assets and liabilities	199,336	142,040
Changes in operating assets and liabilities, net of effects of business acquisitions:		
Accounts receivable, net	(59,562)	(62,866)
Inventories, net	(4,233)	8,280
Prepaid expenses and other assets	(26,664)	(17,388)
Accounts payable	23,371	31,975
Deferred revenue, net	31,758	5,468
Other current and long term liabilities	(18,643)	14,145
Net change in operating assets and liabilities	(53,973)	(20,386)
Net cash provided by operating activities	145,363	121,654
Cash flows from investing activities		
Capital expenditures	(44,555)	(9,288)
Acquisitions of businesses, net of cash and cash equivalents acquired	(1,069,412)	(10,756)
Collection of other notes receivable	12,595	—
Other investing activities, net	1,111	750
Net cash used in investing activities	(1,100,261)	(19,294)
Cash flows from financing activities		
Proceeds from debt, net of issue costs	1,414,447	73
Repayments of debt	(357,198)	(8,024)
Repayment of senior convertible notes, including interest	(279,159)	—
Proceeds from issuance of common stock through employee equity incentive plans	28,683	41,152
Payments of acquisition related contingent considerations	(23,804)	—
Distribution to non-controlling interest stockholders	(1,543)	(280)
Tax benefit from stock-based compensation	—	556
Net cash provided by financing activities	781,426	33,477
Effect of foreign currency exchange rate changes on cash and cash equivalents	(11,283)	3,226
Net increase (decrease) in cash and cash equivalents	(184,755)	139,063
Cash and cash equivalents, beginning of period	594,562	445,137
Cash and cash equivalents, end of period	$409,807	$584,200

Schedule of non-cash transactions		
Issuance of common stock for business acquisition	$—	$51,090

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

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VERIFONE SYSTEMS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
Note 1. Principles of Consolidation and Summary of Significant Accounting Policies

Basis of Presentation
The accompanying unaudited condensed consolidated financial statements of VeriFone Systems, Inc. (“we,” “us,” “our,” "VeriFone," and “the Company” refer to VeriFone Systems, Inc. and its consolidated subsidiaries) as of July 31, 2012 and October 31, 2011, and for the three and nine months ended July 31, 2012 and 2011, have been prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") for interim financial information and with the instructions on Form 10-Q pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). In accordance with those rules and regulations, we have omitted certain information and notes normally provided in our annual consolidated financial statements. In the opinion of management, the unaudited condensed consolidated financial statements contain all adjustments, consisting only of normal recurring items necessary for the fair presentation of our financial position and results of operations for the interim periods. These unaudited condensed consolidated financial statements should be read in conjunction with the audited Consolidated Financial Statements and Notes thereto included in our Annual Report on Form 10-K for the fiscal year ended October 31, 2011. The results of operations for the three and nine months ended July 31, 2012 are not necessarily indicative of the results expected for the entire fiscal year. All significant inter-company accounts and transactions have been eliminated. Amounts pertaining to the noncontrolling ownership interests held by third parties in the operating results and financial position of our majority-owned subsidiaries are reported as 'net income attributable to noncontrolling interests' in our Condensed Consolidated Statements of Operations and as 'redeemable noncontrolling interest in subsidiary' on our Condensed Consolidated Balance Sheets when the third party ownership interest is redeemable at the option of the stockholder, outside of our control, and as 'noncontrolling interest in subsidiaries' on our Condensed Consolidated Balance Sheets in all other cases.
The condensed consolidated balance sheet at October 31, 2011 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements.
Certain prior period amounts reported in our Condensed Consolidated Financial Statements and notes thereto have been reclassified to conform to the current period presentation, with no impact on previously reported operating results or financial position.
Use of Estimates

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. The estimates and judgments affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent liabilities.

On an ongoing basis, we evaluate our estimates including those related to product returns, bad debts, inventories, goodwill and intangible assets, income taxes, warranty obligations, contingencies, stock-based compensation and litigation, among others. We base our estimates on historical experience and information available to us at the time that these estimates are made. Actual results could differ materially from these estimates.
Summary of Significant Accounting Policies

There have been no changes to our significant accounting policies during the nine months ended July 31, 2012 as compared with the significant accounting policies described in our audited consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended October 31, 2011, except for the two additions below.
Debt Issuance Costs

Debt issuance costs are stated at cost, net of accumulated amortization in Other assets on the Condensed Consolidated Balance Sheets. Amortization expense is calculated using the effective interest method over the period of the loans and is recorded in Interest expense in the accompanying Condensed Consolidated Statements of Operations. At July 31, 2012, interest amortization periods range from 5 to 7 years based upon the maturity date of the related outstanding debt.

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Revenue Generating Assets, Net

Revenue generating assets are comprised of tangible assets that we have placed at third party locations for the purpose of generating revenues, such as in taxi cabs, at gas stations and in small merchant locations, under rental or service based arrangements. Revenue generating assets are stated at cost, net of accumulated depreciation, and are depreciated on a straight-line basis over the estimated useful lives of the assets, generally five years. Payments to acquire revenue generating assets are included in capital expenditures as a cash flow from investing activities on our Condensed Consolidated Statements of Cash Flows.

Concentrations of Credit Risk

No customer accounted for more than 10% of net revenues in any of our reportable segments for the three and nine months ended July 31, 2012 and 2011. As of July 31, 2012, one customer, Redecard S/A, accounted for 10% of total accounts receivable in our International segment. At October 31, 2011, one customer, Cielo S.A. and its affiliates, accounted for 10% of our total accounts receivable in our International segment. No customer accounted for more than 10% of accounts receivable in our North America segment or total accounts receivable as of July 31, 2012 or October 31, 2011.

Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standard Board (“FASB”) issued Accounting Standards Update (“ASU”) 2011-05, Comprehensive Income (Topic 220)—Presentation of Comprehensive Income, which requires an entity to present the total comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of equity. In December 2011, the FASB issued ASU 2011-12, Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05. ASU 2011-12 defers the effective date of the requirement in ASU 2011-05 to disclose on the face of the financial statements the effects of the reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income. All other requirements in ASU 2011-05 are not affected by ASU 2011-12. ASU 2011-05 and ASU 2011-12 are effective for us in our first quarter of fiscal year 2013. We have historically presented the components of other comprehensive income as part of our Consolidated Statements of Equity, and therefore adoption of this guidance will change our financial statement presentation.

Note 2. Business Combinations

Point Acquisition

On December 30, 2011, we completed our acquisition of Electronic Transaction Group Nordic Holding AB, a Swedish company operating the Point International business (collectively, "Point"), Northern Europe's largest provider of payment and gateway services and solutions for retailers. The purchase price was approximately €600.0 million, plus repayment of Point's outstanding debt, for a total cash purchase price of $1,024.5 million. The source of funds for the cash consideration was a new credit agreement provided by a syndicate of banks ("the 2011 Credit Agreement"). See Note 5. Financings for information on the 2011 Credit Agreement.

As a result of the acquisition, Point became a wholly-owned subsidiary of VeriFone. The acquisition was accounted for using the acquisition method of accounting. One subsidiary of Point, Babs Paylink AB, is owned 51% by Point and 49% by a third party that has a noncontrolling interest. The results of operations for the acquired businesses have been included in our financial results since the acquisition date.

We acquired Point to, among other things, provide a broader set of product and service offerings to customers globally, including expansion in the Northern European markets. For the three and nine months ended July 31, 2012, we estimate that our total net revenues increased by approximately $55.9 million and $131.3 million, respectively, due to the sale of products and services by Point entities. For the three and nine months ended July 31, 2012, the acquired Point business negatively impacted our earnings by approximately $7.0 million and $29.0 million, respectively, which included management's allocations and estimates of expenses that were not separately identifiable due to our integration activities, non-recurring charges associated with the fair value decrease ("step-down") in deferred revenue, amortization, and acquisition and integration expenses.

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The fair value of consideration transferred for Point was comprised of (in thousands):	
Cash paid to Point stockholders	$774,268
Cash for repayment of long-term debt	250,264
Total	$1,024,532

Recording of Assets Acquired and Liabilities Assumed

The assets acquired and liabilities assumed as part of our acquisition of Point were recognized at their fair values as of the acquisition date, December 30, 2011. We recorded the net tangible and intangible assets acquired and liabilities assumed based upon their preliminary fair values as of the acquisition date, as set forth below. The fair values were based upon a preliminary valuation, and our estimates and assumptions are subject to change within the measurement period (up to one year from the acquisition date). The primary areas of the preliminary purchase price allocation that are not yet finalized are the fair values of certain acquired tangible and intangible assets and liabilities, such as inventories and fixed assets, as well as pre-acquisition contingencies including acquisition and divestiture related claims, income and non-income based taxes, and residual goodwill. We expect to continue to obtain information during the measurement period to assist us in determining the fair values assigned to the assets acquired and liabilities assumed at the acquisition date.

The following table summarizes the estimated fair values assigned to the assets acquired and liabilities assumed, as of the acquisition date, which are considered preliminary and thus subject to change (in thousands):

Cash and cash equivalents	$25,314	
Accounts receivable (gross contractual value of $24.5 million, of which $1.7 million is not expected to be collected)	22,691	
Inventories	25,543	
Deferred tax assets	13,020	
Prepaid expenses and other assets	48,304	
Property, plant and equipment	10,350	
Intangible assets	567,007	
Accounts payable and other liabilities	(51,564	)
Contingent consideration payable	(21,233	)
Deferred revenue, net	(2,169	)
Deferred tax liabilities	(157,411	)
Noncontrolling interest in subsidiary	(36,764	)
Total identifiable net assets	443,088	
Goodwill	581,444	
Total consideration transferred	$1,024,532	

During the six months ended July 31, 2012, new information was obtained about the acquisition date fair values of certain of the above assets acquired and liabilities assumed. As a result, we have increased our fair value estimates for acquired intangible assets by $16.5 million, decreased the fair value estimate of non-controlling interests by $0.4 million, and decreased the fair value estimates of other net tangible assets acquired by $3.8 million. Goodwill decreased by $13.1 million due to these changes in fair value estimates.

Goodwill is calculated as the excess of the consideration transferred over the identifiable net assets and represents future benefits arising from other assets acquired that could not be individually identified and separately recognized. Specifically, the goodwill recorded as part of the acquisition of Point includes the expected synergies and other benefits that we believe will result from combining the operations of Point with the operations of VeriFone and the value of the going-concern element of Point's business (which represents the higher rate of return on the assembled collection of net assets versus if VeriFone acquired all of the net assets separately). We generally do not expect the goodwill recognized to be deductible for income tax purposes.

The estimated fair value of acquired contingent consideration owed by Point related to its prior acquisitions was $21.2 million as of the acquisition date. This contingent consideration will be payable in cash if certain operating and financial targets are achieved in the two years following the dates of those acquisitions. The payout criteria for the contingent consideration contains provisions for prorated payouts if the target criteria are not met, provided that certain minimum thresholds are achieved. The U.S. dollar equivalent maximum payout for this contingent consideration as of the acquisition date was $24.4 million.

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The fair value of the noncontrolling interest in Babs Paylink AB of $36.8 million was estimated by employing an income approach based on an assumed discount rate of 17% and an estimated terminal value derived from terminal stabilized cash flow multiples ranging from 8 to 9.

Valuations of Intangible Assets Acquired

The following table sets forth the components of intangible assets acquired in connection with the Point acquisition (in thousands, except for estimated useful lives):

	Fair Value	Estimated Useful Life (Years)
Customer relationships	$498,503	9.5
Developed software technology	54,783	4.4
Trade names	13,721	4.0
Total	$567,007	

Customer relationships represent the fair value of the underlying relationship and agreement with Point customers.

Developed software technology represents the fair values of Point's proprietary technologies, processes, patents and trade secrets related to the design of Point's products that have reached technological feasibility and are a part of Point's product lines.

Trade names represent the fair value of the Point and other trademarks owned by Point.

Some of the more significant estimates and assumptions inherent in the estimates of the fair values of identifiable intangible assets include all assumptions associated with forecasting product profitability from the perspective of a market participant. Specifically:

- Revenue - we use historical, forecast, and industry or other sources of market data, including the number of units to be sold, selling prices, market penetration, market share, and year-over-year growth rates over the product life cycles.

- Cost of sales, research and development expenses, sales and marketing expenses and general administrative expenses - we use historical, forecast, industry, or other sources of market data, including any expected synergies that can be realized by a market participant.

- Estimated life of the asset - we assess the asset's life cycle by considering the impact of technology changes and applicable payment security compliance and regulatory requirements.

- Discount rates - we use a discount rate that is based on the weighted average cost of capital with adjustments to reflect the risks associated with the specific intangible assets, such as country risks and commercial risks.

- Customer attrition rates - we use historical and forecast data to determine the customer attrition rates and the expected customer life.

The discount rates used in the intangible asset valuations ranged from 14% to 20%. The customer attrition rates used in our valuation of customer relationship intangible assets ranged from zero to 7% depending on the geographic region. The estimated life of developed software technology intangible assets ranged from 2 years to 10 years. The royalty rate used in the valuation of the trade names intangible asset ranged from 1% to 2%. All of these judgments and estimates can materially impact the fair values of intangible assets.

Preliminary Pre-Acquisition Contingencies Assumed

We have evaluated and will continue to evaluate pre-acquisition contingencies relating to Point that existed as of the acquisition date. We have preliminarily determined that certain of these pre-acquisition contingencies are probable in

nature and estimable as of the acquisition date and, accordingly, have preliminarily recorded our best estimates for these contingencies. If we make changes to the amounts recorded or identify additional pre-acquisition contingencies during the remainder of the measurement period, such amounts recorded will be included in the purchase price allocation during the measurement period and, subsequently, in our results of operations. The largest recorded contingent obligations relate to earn-out obligations associated with Point's prior acquisitions.

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Other Fiscal Year 2012 Acquisitions

During the nine months ended July 31, 2012, in addition to Point, we completed the acquisitions of other businesses and net assets as described in the table below for an aggregate purchase price of $81.5 million. The $81.5 million aggregate purchase price includes $6.4 million of holdback payments that will be paid between 12 to 15 months after the date the respective acquisitions closed, and contingent consideration having a total fair value of $4.4 million. The holdback amounts will be paid out to selling stockholders unless the general representations and warranties made by the sellers as of the acquisition date were invalid. The contingent consideration will be payable in cash for the ChargeSmart (now known as VeriFone Commerce Solutions, Inc.) and LIFT acquisitions, if certain operating and financial targets are achieved in the first three years of operations after the acquisition. The payout criteria for the contingent consideration contain provisions for prorated payouts if the target criteria are not met, provided that certain minimum thresholds are achieved. The contingent consideration was valued at $0.4 million and $4.0 million for the ChargeSmart and LIFT acquisitions, respectively. The maximum payouts for the contingent consideration under the purchase agreements are $11.0 million and $8.0 million for the ChargeSmart and LIFT acquisitions, respectively. The acquisition of each company was accounted for using the acquisition method of accounting. No VeriFone equity interests were issued, and in each transaction 100% of the voting equity interests of the applicable business was acquired except for Show Media, which was structured as an acquisition of assets and assumption of certain liabilities. The results of operations for the acquired businesses have been included in our financial results since their respective acquisition dates.

The below table summarizes the estimated fair values of the assets acquired and liabilities assumed at the acquisition date of each transaction. Certain fair values assigned are preliminary and thus subject to change. In particular, the estimated fair values of income and non-income based taxes, LIFT contingent consideration, and residual goodwill are preliminary.

(in thousands)	LIFT	ChargeSmart	Show Media	Global Bay	Total
Acquisition date	March 1, 2012	January 3, 2012	November 1, 2011	November 1, 2011	
Assets acquired (liabilities assumed), net	$(10)	$(4,225)	$1,593	$(5,028)	$(7,670)
Intangible assets (1)	1,600	9,770	6,660	14,490	32,520
Goodwill (2)	4,904	13,829	19,871	18,050	56,654
Total purchase price	$6,494	$19,374	$28,124	$27,512	$81,504

Explanatory notes:

(1) Intangible assets included developed technology, customer relationships, non-compete agreement, trademarks and in-process research and development of $21.3 million, $6.5 million, $3.0 million, $0.9 million and $0.8 million, respectively, which are amortized over their estimated useful lives of 1 to 10 years.

(2) Goodwill is generally not expected to be tax deductible for LIFT, ChargeSmart and Global Bay, but is expected to be deductible for tax purposes for Show Media. The amount of goodwill resulted primarily from our expectation of increased value resulting from the integration of the acquired businesses' product offerings with our product offerings.

Fiscal Year 2011 Acquisitions

Hypercom Corporation

On August 4, 2011, we completed our acquisition of Hypercom, a provider of electronic payment solutions and value-added services at the point of transaction, by means of a merger of one of our wholly-owned subsidiaries with and into Hypercom such that Hypercom became a wholly-owned subsidiary of VeriFone following the merger. We acquired Hypercom to, among other things, provide a broader set of product and service offerings to customers globally. We have included the financial results of Hypercom in our Condensed Consolidated Financial Statements from the date of acquisition.

For the three and nine months ended July 31, 2012, we estimate that our total net revenues increased by approximately $68.5 million and $223.0 million, respectively, due to the sale of Hypercom products and services. Other revenues and earnings contributions from Hypercom were not separately identifiable due to our integration activities.

The total fair value of consideration transferred was $644.6 million which consisted of $557.1 million of VeriFone stock issued, $16.2 million for the fair value of stock options assumed, and $71.2 million for the cash used to repay Hypercom's long-term debt. We recorded the preliminary fair value of assets acquired and liabilities assumed of approximately $363.5 million of goodwill, $210.7 million of intangible assets and $70.4 million of net tangible assets. During the nine months ended July 31, 2012, we adjusted the

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preliminary valuation of the acquired net tangible assets of Hypercom based upon information that was gathered about acquisition date fair values. The adjustments primarily related to finalizing the fair value assessment of sales-type lease receivables, which resulted in a $2.4 million increase in the value of those lease receivables, recording a tax receivable of $2.6 million for tax refunds related to pre-acquisition tax periods, reflecting a $3.3 million increase in the fair value estimate for pre-acquisition liabilities associated with Hypercom's divestitures of its UK and Spain operations, reducing the fair value estimate for certain fixed assets by $2.1 million following completion of the fair value assessment, recording a legal accrual of $2.1 million related to a pre-acquisition claim, increasing the deferred tax asset by $0.5 million related to the fair value adjustments and completion of the pre-acquisition U.S. income tax return, and decreasing the fair value of other liabilities by $0.3 million. As a result of these changes and other immaterial items, goodwill increased by $1.7 million. As of July 31, 2012, we have completed our fair value assessment of Hypercom's acquired assets and assumed liabilities.

Pro Forma Financial Information

The supplemental pro forma financial information below was prepared using the acquisition method of accounting and is based on the historical financial information of VeriFone, Point, Hypercom and other acquired businesses, reflecting results of operations for the three and nine month periods ended July 31, 2012 and 2011 on a comparative basis as though the aforementioned companies were combined as of the beginning of fiscal year 2011. The pro forma financial information includes adjustments to reflect one time charges and amortization of fair value adjustments in the appropriate pro forma periods as though the companies were combined as of the beginning of fiscal year 2011. These adjustments include:

- Net adjustments to amortization expense related to the fair value of acquired identifiable intangible assets totaling $(1.6) million and $4.4 million for the three and nine months ended July 31, 2012, respectively, and $25.7 million and $83.7 million for the three and nine months ended July 31, 2011, respectively.

- Additional interest expense of $4.1 million for the period from November 2011 through December 2011, and $3.7 million and $11.8 million for the three and nine months ended July 31, 2011, respectively, that would be incurred on additional borrowings made to fund the acquisitions, offset by elimination of acquired business interest expense on borrowings that were settled as part of the acquisitions. No adjustment is included for interest after December 2011 as the additional interest is reflected in our operating results following the date the borrowings actually occurred.

- Adjustments for other (charges) benefits, such as closing costs, one time professional fees, foreign currency losses related to deal consideration, amortization of fair market value adjustments and net tax effect of all of these, totaling $(5.6) million and $(55.7) million for the three and nine months ended July 31, 2012, respectively, and $(3.9) million and $25.1 million for the three and nine months ended July 31, 2011, respectively.

The supplemental pro forma financial information for the three and nine months ended July 31, 2012 combines the historical results of VeriFone for the three and nine months ended July 31, 2012, the historical results of Point and ChargeSmart for the two months ended December 31, 2011, the historical results of LIFT for the four months ended February 29, 2012, and the effects of the pro forma adjustments listed above. The results of each acquired company is included as part of VeriFone historical results following the closing date of the particular acquisition.

The supplemental pro forma financial information for the three and nine months ended July 31, 2011 combines the historical results of VeriFone for the three and nine months ended July 31, 2011, the historical results of all fiscal year 2011 and fiscal year 2012 acquired businesses for the three and nine months ended July 31, 2011 based upon their respective previous reporting periods, the dates that these companies were acquired by us, and the effects of the pro forma adjustments listed above.

The following table presents supplemental pro forma financial information as if all acquisitions since the beginning of fiscal year 2011 occurred on November 1, 2010 (unaudited; in thousands except per share data):

	For the Three Months Ended July 31,		For the Nine Months Ended July 31,	
	2012	2011	2012	2011
Total revenues	$492,205	$465,891	$1,431,101	$1,348,337
Net income	$44,865	$(9,594)	$86,437	$(56,249)
Net income per share attributable to VeriFone Systems, Inc. stockholders - basic	$0.42	$(0.09)	$0.81	$(0.54)
Net income per share attributable to VeriFone Systems, Inc. stockholders - diluted	$0.41	$(0.09)	$0.78	$(0.54)

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Acquisition-related Costs

Acquisition-related costs consist of (i) transaction costs, which represent external costs directly related to our acquisitions and primarily include expenditures for professional fees such as banking, legal, accounting and other directly related incremental costs incurred to close the acquisition and (ii) integration costs, which represent personnel related costs for transitional and certain other employees, integration related professional services, additional asset write offs and other integration activity related expenses. The following table presents a summary of acquisition-related costs for the three and nine months ended July 31, 2012 (in thousands):

	For the three months ended July 31, 2012			For the nine months ended July 31, 2012		
	Transaction Costs	Integration Costs	Total	Transaction Costs	Integration Costs	Total
Cost of net revenues	$3	$1,026	$1,029	$12	$5,699	$5,711
Research and development	—	1,060	1,060	—	3,962	3,962
Sales and marketing	12	695	707	195	1,735	1,930
General and administrative	505	2,613	3,118	8,094	15,678	23,772
	$520	$5,394	$5,914	$8,301	$27,074	$35,375

The following table presents a summary of acquisition-related costs for the three and nine months ended July 31, 2011 (in thousands):

	For the three months ended July 31, 2011			For the nine months ended July 31, 2011		
	Transaction Costs	Integration Costs	Total	Transaction Costs	Integration Costs	Total
Cost of net revenues	$23	$27	$50	$151	$226	$377
Research and development	8	33	41	14	51	65
Sales and marketing	476	283	759	669	308	977
General and administrative	2,920	2,422	5,342	8,015	3,626	11,641
	$3,427	$2,765	$6,192	$8,849	$4,211	$13,060

Note 3. Goodwill and Purchased Intangible Assets

Goodwill

Activity related to goodwill consisted of the following (in thousands):

	Nine Months Ended July 31, 2012	Year Ended October 31, 2011
Balance at beginning of period	$561,414	$169,322
Additions related to current period acquisitions	638,117	392,723
Adjustments related to prior fiscal year acquisitions	1,347	622
Currency translation adjustments	(41,227)	(1,253)
Balance at end of period	$1,159,651	$561,414

Based on our review for potential indicators of impairment performed during the nine months ended July 31, 2012 and the fiscal year ended October 31, 2011, there were no indicators of impairment.

As of July 31, 2012, we had accumulated goodwill impairment losses of $372.4 million and $65.5 million in our International and North America segments, respectively, excluding impacts of foreign currency fluctuations. As of October 31, 2011, we had accumulated goodwill impairment losses of $372.4 million and $65.5 million in our International and North America segments, respectively, excluding impacts of foreign currency fluctuations.

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Purchased Intangible Assets

Purchased intangible assets consisted of the following (in thousands, except weighted-average useful life):

	July 31, 2012			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted-Average Useful Life
Customer relationships	$672,632	$(75,556)	$597,076	8.4
Developed and core technology	152,163	(35,576)	116,587	4.0
In-process research and development	18,018	—	18,018	Indefinite
Trade names	17,675	(3,569)	14,106	4.0
Other	4,885	(1,780)	3,105	6.0
	$865,373	$(116,481)	$748,892	

	October 31, 2011			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted-Average Useful Life
Customer relationships	$185,872	$(16,615)	$169,257	5.5
Developed and core technology	187,193	(114,112)	73,081	4.0
In-process research and development	19,021	—	19,021	Indefinite
Trade names	2,692	(897)	1,795	3.3
Other	3,031	(2,418)	613	3.6
	$397,809	$(134,042)	$263,767	

Amortization of purchased intangible assets for the three and nine months ended July 31, 2012 and 2011 was allocated as follows (in thousands):

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2012	2011	2012	2011
Included in cost of net revenues	$10,582	$2,687	$29,782	$10,713
Included in operating expenses	23,177	1,980	60,552	5,959
	$33,759	$4,667	$90,334	$16,672

Total future amortization expense for purchased intangible assets that have finite lives, based on our existing intangible assets and their current estimated useful lives as of July 31, 2012, is estimated as follows (in thousands):

Fiscal Years Ending October 31:	Cost of Net Revenues	Operating Expenses	Total
Remainder of fiscal 2012	$10,037	$22,929	$32,966
2013	38,548	89,413	127,961
2014	37,737	88,802	126,539
2015	17,687	87,548	105,235
2016	10,409	83,032	93,441
Thereafter	1,104	243,628	244,732
	$115,522	$615,352	$730,874

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Note 4. Balance Sheet and Statement of Income Details
Restricted Cash

The 2011 Credit Agreement required that we fund an escrow account to repay, at maturity, the principal and interest of our 1.375% senior convertible notes due June 2012. As a result, at the closing of our 2011 Credit Agreement in December 2011, we deposited $279.2 million in an escrow account. These escrowed funds were used to repay the senior convertible notes in full upon their maturity in June 2012.

Inventories
Inventories consisted of the following (in thousands):

	July 31, 2012	October 31, 2011
Raw materials	$50,927	$45,716
Work-in-process	2,357	859
Finished goods	111,589	97,741
Total inventories	$164,873	$144,316

Prepaid Expenses and Other Current Assets
Prepaid expenses and other current assets consisted of the following (in thousands):

	July 31, 2012	October 31, 2011
Deferred income taxes	$45,018	$39,040
Prepaid taxes	44,891	18,490
Prepaid expenses	41,649	34,115
Other receivables	15,477	27,020
Investments in equity securities and warrants	2,947	6,132
Other current assets	3,185	2,333
Total prepaid expenses and other current assets	$153,167	$127,130

Fixed Assets, Net
Fixed assets, net consisted of the following (in thousands):

	July 31, 2012	October 31, 2011
Revenue generating assets	$88,834	$32,531
Computer hardware and software	61,193	59,056
Machinery and equipment	30,630	27,952
Leasehold improvements	18,956	17,060
Office equipment, furniture and fixtures	6,863	6,278
Buildings	5,997	6,083
Depreciable fixed assets, at cost	212,473	148,960
Accumulated depreciation	(99,278)	(74,696)
Depreciable fixed assets, net	113,195	74,264
Construction in progress	22,939	8,345
Land	1,025	1,025
Fixed assets, net	$137,159	$83,634

Other Assets

Other assets consisted of the following (in thousands):

	July 31, 2012	October 31, 2011
Debt issuance costs, net	$36,386	$2,749
Long-term restricted cash	12,621	4,804
Capitalized software development costs, net	10,520	6,795
Deposits	8,755	8,662
Other long-term receivables	8,592	8,275
Other long-term assets	5,091	7,517
Total other assets	$81,965	$38,802

Long-term restricted cash consisted mainly of deposits pledged for bank guarantees and irrevocable standby letters of credit.

Accrued Warranty

Activity related to Accrued warranty consisted of the following (in thousands):

	Nine Months Ended July 31, 2012	Year Ended October 31, 2011
Balance at beginning of period	$22,032	$12,747
Warranty charged to cost of net revenues	9,486	17,888
Utilization of warranty accrual	(17,356)	(16,573)
Acquired warranty obligations	348	7,139
Change in estimates	(797)	831
Balance at end of period	13,713	22,032
Less: current portion	(12,842)	(20,358)
Long-term portion	$871	$1,674

Deferred Revenue, net

Deferred revenue, net consisted of the following (in thousands):

	July 31, 2012	October 31, 2011
Deferred revenue	$148,851	$113,154
Deferred cost of revenue	(17,692)	(12,863)
	131,159	100,291
Less: current portion	(101,089)	(68,824)
Long-term portion	$30,070	$31,467

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Accruals and Other Current Liabilities

Accruals and other current liabilities consisted of the following (in thousands):

	July 31, 2012	October 31, 2011
Accrued expenses	$77,735	$74,775
Accrued compensation	49,920	51,515
Accrued liabilities for contingencies	24,115	30,561
Accrued patent litigation loss contingency, including interest (Note 13)	18,619	—
Sales and VAT taxes payable	18,366	6,725
Deferred acquisition consideration payable - current portion	16,299	5,681
Accrued warranty	12,842	20,358
Deferred tax liabilities	9,564	4,960
Income taxes payable	8,866	9,116
Other current liabilities	15,954	14,432
Total accruals and other current liabilities	$252,280	$218,123

Other Long-Term Liabilities

Other long-term liabilities consisted of the following (in thousands):

	July 31, 2012	October 31, 2011
Long-term tax liabilities	$43,762	$51,918
Statutory retirement and pension obligations	9,513	10,292
Deferred acquisition consideration payable - non-current portion	3,043	5,125
Other liabilities	13,268	11,636
Total other long-term liabilities	$69,586	$78,971

Noncontrolling Interest in Subsidiaries

Changes in Noncontrolling interest in subsidiaries are set forth below (in thousands):

	Nine Months Ended July 31, 2012	Year Ended October 31, 2011
Noncontrolling interest in subsidiaries at beginning of period	$445	$572
Additions due to acquisitions	36,793	—
Distributions to non-controlling interest stockholders	(1,543)	(418)
Net income attributable to noncontrolling interest in subsidiaries, net	315	291
Noncontrolling interest in subsidiaries at end of period	$36,010	$445

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Other Income (Expense), net

Other income (expense), net consisted of the following (in thousands):

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2012	2011	2012	2011
Foreign currency exchange gains (losses), net	$1,095	$(488)	$(21,341)	$(3,466)
Gain on convertible notes call option hedge settlement	—	4,554	—	4,554
Gain (loss) on adjustments to acquisition related liabilities	(93)	1,200	(292)	2,591
Gain on bargain purchase of a business, net	—	45	—	1,772
Other income (expense), net	(1,723)	1,002	(1,717)	701
Total other income (expense), net	$(721)	$6,313	$(23,350)	$6,152

We recorded a $22.5 million foreign currency loss in December 2011 related to the difference between the forward rate on contracts purchased to fix the U.S. dollar equivalent of the purchase price for our Point acquisition, and the actual rate on the date of derivative settlement. This loss was partially offset by a $1.5 million gain on the currency we held from the date of the derivative settlement until the funds were transferred to purchase Point.

Note 5. Financings

Borrowings under our financing arrangements as of July 31, 2012 and October 31, 2011 consisted of the following (in thousands):

	July 31, 2012	October 31, 2011
2011 Credit Agreement		
Term A loan	$895,538	$—
Term B loan	230,342	—
Revolving loan	190,000	—
2006 Credit Agreement - Term B loan	—	216,250
Senior convertible notes	—	266,981
Point overdraft facility	4,886	—
Other	1,073	580
Total borrowings	1,321,839	483,811
Less: current portion	(53,329)	(272,055)
Long-term portion	$1,268,510	$211,756

2011 Credit Agreement

On December 28, 2011 (the "Effective Date"), VeriFone, Inc. entered into the 2011 Credit Agreement, which initially consisted of a $918.5 million Term A loan, $231.5 million Term B loan, and $350.0 million Revolving loan, of which $300.0 million was initially funded. As of July 31, 2012, our outstanding borrowings under the 2011 Credit Agreement consisted of a $895.5 million Term A loan, $230.3 million Term B loan and $350.0 million Revolving loan, of which $190.0 million was drawn and outstanding. In August 2012, we drew $100 million under the Revolving loan to repay $100 million of the Term B loan, which carries a higher interest rate.

The key terms of the 2011 Credit Agreement are as follows:

- At VeriFone, Inc.'s option, the Term A loan, Term B loan and Revolving loan bear interest at a “Base Rate” or “Eurodollar Rate” plus an applicable margin, as described below. Base Rate loans bear interest at a per annum rate equal to a margin over the greater of the Federal Funds rate plus 0.50% or the JP Morgan prime rate or the one-, two-, three-

or six-month (or, in certain circumstances, nine-, twelve- or less than one month) LIBOR rate plus 1.00%. For the Base Rate Term A loan and Revolving loan, the margin varies between 1.00% to 2.00%

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depending upon our consolidated leverage ratio. For the Base Rate Term B loan, the margin varies between 2.00% to 2.25% depending upon our consolidated leverage ratio with a minimum floor rate of 1.00%. Eurodollar Rate loans bear interest at a margin over the one-, two-, three- or six-month LIBOR rate. For the Eurodollar Term A Loan and Revolving loan, the margin varies between 2.00% to 3.00% depending upon our consolidated leverage ratio. The margin for the Eurodollar Rate Term B loan varies between 3.00% to 3.25% depending upon our consolidated leverage ratio with a minimum LIBOR floor rate of 1.00%.

The terms of the 2011 Credit Agreement require VeriFone, Inc. to comply with financial maintenance covenants. VeriFone, Inc. may not permit its total Leverage Ratio to exceed (i) 4.25 to 1.00, in the case of any fiscal quarter ending on or after November 1, 2011, but prior to November 1, 2012, (ii) 3.75 to 1.00 in the case of any fiscal quarter ending on or after November 1, 2012, but prior to November 1, 2013 and (iii) 3.50 to 1.00, in the case of any fiscal quarter ending on or after November 1, 2013. In addition, VeriFone, Inc. must maintain an interest coverage ratio of at least (i) 3.50 to 1.00, in the case of any fiscal quarter ending prior to November 1, 2012 and (ii) 4.00 to 1.00, in the case of any fiscal quarter ending thereafter. Noncompliance with any of the financial covenants without cure or waiver would constitute an event of default under the 2011 Credit Agreement. The 2011 Credit Agreement also contains customary events of default that include, among others, non-payment of principal, interest or fees, violation of covenants, inaccuracy of representations and warranties, bankruptcy and insolvency events, material judgments, cross defaults to material indebtedness and events constituting a change of control. The occurrence of an event of default could result in the termination of commitments under the 2011 Credit Agreement, the declaration that all outstanding loans are immediately due and payable in whole or in part and the requirement of cash collateral deposits in respect of outstanding letters of credit.

The 2011 Credit Agreement contains certain representations and warranties, certain affirmative covenants, certain negative covenants, certain financial covenants and certain conditions that are customarily required for similar financings. These covenants include, among others:

- A restriction on incurring additional indebtedness, subject to specified permitted debt;
- A restriction on creating certain liens;
- A restriction on mergers and consolidations, subject to specified exceptions;
- A restriction on certain investments, subject to certain exceptions and a suspension if VeriFone, Inc. achieves certain credit ratings; and
- A restriction on entering into certain transactions with affiliates.

Pursuant to a Guaranty, dated as of December 28, 2011 (the "Guaranty"), among certain wholly-owned domestic subsidiaries of VeriFone, Inc. identified therein (the "Guarantors"), obligations under the 2011 Credit Agreement are guaranteed by the Guarantors. Pursuant to a Security Agreement and a Pledge Agreement, each dated as of December 28, 2011 (the "Collateral Agreements") among VeriFone, Inc. and the Guarantors on the one hand and JPMorgan, as collateral agent, on the other hand, obligations under the 2011 Credit Agreement, and the guarantees of such obligations are also secured by a first priority lien and security interest, subject to customary exceptions, in certain assets of VeriFone, Inc. and the Guarantors and equity interests owned by VeriFone, Inc. and the Guarantors in certain of their respective domestic and foreign subsidiaries (limited, in the case of foreign subsidiaries, to 65% of the voting stock of such subsidiaries). Certain equity interests owned by existing and subsequently acquired subsidiaries may also be pledged in the future. Other existing and subsequently acquired or newly-formed domestic subsidiaries of VeriFone, Inc. and the Guarantors, may become Guarantors in the future.

VeriFone, Inc. will pay an undrawn commitment fee ranging from 0.25% to 0.50% per annum (depending on VeriFone, Inc.'s leverage ratio) on the unused portion of the Revolving loan. For letters of credit issued under the Revolving loan, VeriFone, Inc. will pay upon the aggregate face amount of each letter of credit a fronting fee to be agreed to the issuer of the letter of credit together with a fee on all outstanding letters of credit at a per annum rate

equal to the margin then in effect with respect to LIBOR-based loans under the Revolving loan.

The outstanding principal balance of the Term A loan is required to be repaid in quarterly installments of the following percentages of the original balance outstanding under the Term A loan: 1.25% for each of the first eight calendar quarters after the Effective Date through the quarter ending December 31, 2013; 2.50% for each of the next eight calendar quarters through the quarter ending December 31, 2015 and 5.00% for each of the calendar quarters ending March 31, 2016, June 30, 2016 and September 30, 2016 with the balance being due at maturity on December 28, 2016. The outstanding principal balance of the Term B loan is required to be repaid in equal quarterly installments of 0.25% with the balance being due at maturity on December 28, 2018. The Revolving loan will terminate on December 28, 2016. Outstanding amounts may also be subject to mandatory prepayment

with the proceeds of certain asset sales and debt issuances and, in the case of the Term B loan only, from a portion of annual excess cash flows (as determined under the 2011 Credit Agreement) depending on VeriFone, Inc.'s leverage ratio.

On December 28, 2011, VeriFone, Inc. utilized a portion of the proceeds from the 2011 Credit Agreement to repay in full, prior to maturity, all of its previously outstanding loans, together with accrued interest and all other amounts due in connection with such repayment, under the credit agreement entered into on October 31, 2006. The amount of this repayment totaled $216.8 million and following such repayment this credit agreement was terminated. No penalties were due in connection with such repayments.

In addition, the 2011 Credit Agreement required that we fund an escrow account to repay at maturity, or upon earlier conversion at the option of the holders thereof, our 1.375% senior convertible notes due June 15, 2012. As a result, in December 2011, $279.2 million was deposited in the escrow account. This amount was used to repay, in full, the senior convertible notes in June 2012. See "Senior Convertible Notes" below.

We incurred $41.6 million of issuance costs in connection with the 2011 Credit Agreement. These costs were capitalized in Other assets on the Condensed Consolidated Balance Sheets, and the costs are being amortized to interest expense using the effective interest method over the term of the credit facilities, which is 5 or 7 years.

As of July 31, 2012, VeriFone has elected the "Eurodollar Rate" margin option under our borrowings under the 2011 Credit Agreement. As such, the interest rate on the Term A and Revolving loan was 2.75%, which was one month LIBOR plus 2.50% margin, and the interest rate on the Term B loan was 4.25%, which was the higher of one month LIBOR or 1.00% plus 3.25% margin. The unused revolving loan facility's commitment fee was 0.375% and the amount available to draw under the Revolving loan was $160.0 million. In August 2012, we drew $100 million under the Revolving loan to repay $100 million of the Term B loan, which carries a higher interest rate.

As of July 31, 2012, interest margins are 2.50% for the Term A loan and the Revolving loan, and 3.25% for the Term B loan.

We were in compliance with all financial covenants under the 2011 Credit Agreement as of July 31, 2012.

On March 23, 2012, we entered into a number of interest rate swap agreements to effectively convert $500.0 million of the Term Loan A from a floating rate to a 0.71% fixed rate plus applicable margin. The interest rate swaps qualify for hedge accounting treatment as cash flow hedges. The interest rate swaps are effective for the period from March 30, 2012 to March 31, 2015 or 36 months.

Senior Convertible Notes

On June 22, 2007, we issued and sold $316.2 million aggregate principal amount of 1.375% senior convertible notes due June 15, 2012 (the "Notes"). The net proceeds from the offering, after deducting transaction costs, were approximately $307.9 million. We incurred approximately $8.3 million of debt issuance costs. The transaction costs, consisting of the initial purchasers' discounts and offering expenses, were primarily recorded in debt issuance costs, net and were amortized to interest expense using the effective interest method over five years.

The Notes matured on June 15, 2012. Prior to June 15, 2012, we had repurchased and extinguished $38.9 million in aggregate principal amount of our outstanding Notes. Holders of the Notes had the right under certain conditions to convert their Notes prior to maturity at any time on or after March 15, 2012. There were no such conversions of the Notes. Upon maturity of the Notes on June 15, 2012, we repaid the remaining principal amount of $277.3 million, together with accrued and unpaid interest of $4.0 million, in cash.

During the term of the Notes, we paid 1.375% interest per annum on the principal amount of the Notes, semi-annually in arrears on June 15 and December 15 of each year, subject to increase in certain circumstances.

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A summary of interest expense and interest rate on the liability component related to the Notes for the three and nine months ended July 31, 2012 and 2011 is as follows (in thousands, except percentages):

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2012	2011	2012	2011
Interest rate on the liability component	7.6 %	7.6 %	7.6 %	7.6 %
Interest expense related to contractual interest coupon	$466	$953	$2,372	$2,859
Interest expense related to amortization of debt discount	2,087	3,948	10,269	11,502
Total interest expense recognized	$2,553	$4,901	$12,641	$14,361

In connection with the offering of the Notes, we entered into note hedge transactions with affiliates of the initial purchasers (the "Counterparties"), consisting of Lehman Brothers OTC Derivatives ("Lehman Derivatives") and JPMorgan Chase Bank, National Association, London Branch. These note hedge transactions served to reduce the potential dilution upon conversion of the outstanding Notes in the event that the volume weighted average price of our common stock on each trading day of the relevant conversion period or other relevant valuation period for the Notes was greater than $44.02 per share. We terminated the note hedge transaction with Lehman Derivatives in June 2011. The note hedge transactions with the Counterparties other than Lehman Derivatives expired unused on June 15, 2012.

In addition, we sold warrants to the Counterparties whereby they have the option to purchase up to approximately 7.2 million shares of our common stock at a price of $62.356 per share. The warrants expire in equal amounts on each trading day from December 19, 2013 to February 3, 2014.

The cost incurred in connection with the note hedge transactions and the proceeds from the sale of the warrants are included as a net reduction in Additional paid-in capital in the accompanying Condensed Consolidated Balance Sheets as of July 31, 2012 and October 31, 2011.

Point Overdraft Facility

Our 51% majority owned subsidiary of Point, Babs Paylink AB, has an unsecured overdraft facility with Swedbank, the 49% stockholder of Babs Paylink AB, that terminates in December 2012. The overdraft facility limit is Swedish Krona ("SEK") 60.0 million (approximately $8.7 million). The interest rate is the bank's published rate plus a margin of 2.55%. At July 31, 2012, the interest rate was 4.3%. There is a 0.25% commitment fee payable annually in advance, and the overdraft facility is renewable annually on December 31. As of July 31, 2012, SEK 33.6 million (approximately $4.9 million) was outstanding and SEK 26.4 million (approximately $3.8 million) was available.

Other

In July 2011 we entered into an agreement with a bank in Mexico pursuant to which we jointly operate certain automated teller machines ("ATMs") in Mexico. In connection with this agreement, we agreed to install and maintain these ATMs at third party locations and the bank agreed to provide interest-free cash funding for those ATMs. In connection with this agreement, we were required to provide an irrevocable standby letter of credit in favor of the bank to guarantee our performance under the agreement. During our fiscal quarter ended January 31, 2012, we deposited $2.0 million as collateral for this letter of credit, which is classified as restricted cash on our Condensed Consolidated Balance Sheets as of July 31, 2012. The initial term of the agreement ended on July 14, 2012 and the agreement automatically renewed under its terms for another one-year period. Thereafter, this agreement automatically renews for successive one year periods unless either party gives notice of its intent not to renew as required under the agreement.

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Principal Payments

As of July 31, 2012, principal payments due for financings over the next five years, based on the maturity dates of the debt, are as follows (in thousands):

Fiscal Years Ending October 31:	
2012 (Remainder of the fiscal year)	$12,668
2013	53,176
2014	82,708
2015	94,191
2016	163,070
Thereafter	916,026
	$1,321,839

Note 6. Fair Value Measurements

For assets and liabilities measured at fair value such amounts are based on an expected exit price, representing the amount that would be received on the sale of an asset or paid to transfer a liability, as the case may be, in an orderly transaction between market participants. As such, fair value may be based on assumptions that market participants would use in pricing an asset or liability. The authoritative guidance on fair value measurements, including Accounting Standards Codification 820 Fair Value Measurement and Disclosures and ASU 2011-04, Fair Value Measurement (Topic 820)- Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs establishes a consistent framework for measuring and disclosing fair value on either a recurring or nonrecurring basis whereby inputs, used in valuation techniques, are assigned a hierarchical level. The following are the hierarchical levels of inputs to measure fair value:

Level 1 -	Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
Level 2 -	Observable inputs that reflect quoted prices for identical assets or liabilities in markets that are not active; quoted prices for similar assets or liabilities in active markets; inputs other than quoted prices that are observable for the assets or liabilities; or inputs that are derived principally from or corroborated by observable market data by correlation or other means.
Level 3 -	Unobservable inputs reflecting our own assumptions incorporated in valuation techniques used to determine fair value. These assumptions are required to be consistent with market participant assumptions that are reasonably available.

Assets and Liabilities Measured and Recorded at Fair Value on a Recurring Basis

There were no transfers between fair value measurement levels during the nine months ended July 31, 2012. The following table presents our assets and liabilities that were measured at fair value on a recurring basis as of July 31, 2012 and October 31, 2011, classified by the level within the fair value hierarchy (in thousands):

	July 31, 2012			
	Carrying Value	Quoted Price in Active Market for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Current assets:				
Cash and cash equivalents				
Money market funds (1)	$77,519	$ 77,519	$—	$—
Prepaid expenses and other current assets				
Marketable equity investment (2)	2,715	2,715	—	—
Equity warrants (3)	232	—	232	—
	11	—	11	—

Foreign exchange forward contracts designated
as cash flow hedges (4)

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Foreign exchange forward contracts not designated as cash flow hedges (4)	304	—	304	—
Other assets				
Israeli severance funds (5)	1,607	$ —	1,607	$—
Total assets measured and recorded at fair value	$82,388	$ 80,234	$ 2,154	$—
Liabilities				
Current liabilities:				
Accruals and other current liabilities				
Acquisition related earn-out payables (6)	$8,325	$ —	$ —	$8,325
Interest rate swaps designated as cash flow hedges (7)	2,511	—	2,511	—
Foreign exchange forward contracts designated as cash flow hedges (4)	77	—	77	—
Foreign exchange forward contracts not designated as cash flow hedges (4)	255	—	255	—
Other long-term liabilities				
Acquisition related earn-out payables (6)	3,044	—	—	3,044
Interest rate swaps designated as cash flow hedges(7)	2,635	—	2,635	—
Total liabilities measured and recorded at fair value	$16,847	$ —	$ 5,478	$11,369

	October 31, 2011			
	Carrying Value	Quoted Price in Active Market for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Current assets:				
Cash and cash equivalents				
Money market funds (1)	$186,530	$ 186,530	$ —	$—
Prepaid expenses and other current assets				
Marketable equity investment (2)	5,450	5,450	—	—
Equity warrants (3)	682	—	682	—
Foreign exchange forward contracts not designated as cash flow hedges (4)	58	—	58	—
Other assets				
Israeli severance funds (5)	2,097	—	2,097	—
Total assets measured and recorded at fair value	$194,817	$ 191,980	$ 2,837	$—
Liabilities				
Current liabilities:				
Accruals and other current liabilities				
Acquisition related earn-out payables (6)	$3,603	$ —	$ —	$3,603
Foreign exchange forward contracts not designated as cash flow hedges (4)	314	—	314	—
Other long-term liabilities				

Acquisition related earn-out payables (6)	3,125	—	—	3,125
Total liabilities measured and recorded at fair value	$7,042	$ —	$ 314	$6,728

Explanatory footnotes:

1.Money market funds are classified as Level 1 because we determine the fair value of the funds using quoted market prices in markets that are active.

2.The marketable equity investment is classified as Level 1 because we determine the fair value using quoted market

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prices in markets that are active.
3.The equity warrants are classified as Level 2 because we determine the fair value using the Black-Scholes-Merton valuation model considering quoted market prices for the underlying shares, the treasury risk free interest rate, historic volatility and the remaining contractual term of the warrant.
4.The foreign exchange forward contracts are classified as Level 2 because we determine the fair value using quoted market prices and other observable data for similar instruments in an active market.
5.The Israeli severance funds are classified as Level 2 because there are no quoted market prices, but the fund managers provide a daily redemption value for each of the investments that make up the funds.
6.The acquisition related earn-out payables are classified as Level 3 because we use a probability-weighted expected payout model to determine the expected payout and an appropriate discount rate to calculate the fair value. The key assumptions in applying the approach are the internally forecasted sales and contributions for the acquired businesses, the probability of achieving the sales and contribution targets and an appropriate discount rate. Significant increases in the probability of achieving sales and contribution targets in isolation would result in a significantly higher fair value measurement while significant decreases in the probability of success in isolation would result in a significantly lower fair value measurement. Similarly, significant increases in the discount rate in isolation would result in a significantly lower fair value measurement while significant decreases in the discount rate in isolation would result in a significantly higher fair value measurement. We evaluate changes in each of the assumptions used to calculate fair values of our earn-out payable at the end of each period.
7. Interest rate swaps are classified as Level 2 because we determine the fair value using observable market inputs, such as the one month LIBOR forward pricing curve, as well as credit default spreads reflecting nonperformance risks of VeriFone and that of its counterparties.

Fair Value of Acquisition-Related Earn-out Payables

The following table presents a reconciliation for our earn-out payables measured and recorded at fair value on a recurring basis, using Level 3 significant unobservable inputs (in thousands):

	Nine Months Ended July 31, 2012	Fiscal Year Ended October 31, 2011
Balance at beginning of period	$6,728	$2,960
Additions related to current period business acquisitions	25,651	7,334
Changes in estimates, included in Other income (expense), net	292	(2,443)
Interest expense	400	120
Foreign currency adjustments	213	(743)
Payments	(21,915)	(500)
Balance at end of period	$11,369	$6,728

As of July 31, 2012, the total gross earn-out payable, if all the financial performance targets were met as of July 31, 2012, would have been $29.3 million.

Fair Value of Other Financial Instruments

Other financial instruments consist principally of cash, accounts receivable, accounts payable and long-term debt. The estimated fair value of cash, accounts receivable, and accounts payable approximates their carrying value. The estimated fair value of our Term A loan, Term B loan, and Revolving loan approximates the carrying value because the interest rate on such debt adjusts to market rates on a periodic basis. The Notes, which were carried at cost and were repaid in full at maturity on June 15, 2012, had a fair value of $304.6 million as of October 31, 2011, based on the closing trading price of the Company's stock on October 31, 2011.

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Note 7. Investment in Equity Securities

On February 9, 2010, we invested in Trunkbow International Holdings Ltd. (“Trunkbow”), a Jinan, People’s Republic of China-based mobile payments and value-added service applications company. We paid $5.0 million for 2.5 million shares of common stock and warrants to purchase 500,000 shares of common stock. The warrants have a strike price of $2.00 per share and are exercisable anytime up to 5 years from the closing date. The investment was originally accounted for using the cost method and reflected in Other assets in our Condensed Consolidated Balance Sheets. The allocated costs of the shares and warrants were approximately $4.7 million and $0.3 million, respectively.

On February 3, 2011, Trunkbow's shares began trading on the NASDAQ Global Market. As a result, our investment in Trunkbow shares became marketable, and we reclassified this investment as available-for-sale. Accordingly, our investment in the Trunkbow shares is recorded at fair value which is the quoted market price of the shares. Unrealized gains on the shares and unrealized losses judged to be temporary are included in Accumulated other comprehensive income, a component of Stockholders' equity. Realized gains (losses) on the sale of available-for-sale securities, which will be calculated based on the specific identification method, and declines in value below cost judged to be other-than-temporary, if any, will be recorded in Other income (expense), net in our Condensed Consolidated Statements of Operations, as incurred.

Trunkbow Shares: The fair value of our Trunkbow shares as of July 31, 2012 and October 31, 2011 was estimated at $2.7 million and $5.5 million, respectively. The net unrealized loss included in Accumulated other comprehensive loss as of July 31, 2012 was $1.7 million. We increased the unrealized loss in Accumulated other comprehensive income by $1.9 million and $2.5 million during the three and nine months ended July 31, 2012, respectively.

Trunkbow Warrants: The Trunkbow warrants are derivatives. Accordingly, the warrants are recorded at fair value. We estimated the fair value of the warrants using the Black-Scholes-Merton valuation model. The changes in fair value are recorded as Other income (expense), net, in our Condensed Consolidated Statements of Operations. The fair value of our Trunkbow warrants as of July 31, 2012 and October 31, 2011 was estimated at $0.2 million and $0.7 million, respectively. We reflected a $0.3 million and $0.5 million mark-to-market loss in Other income (expense), net in our Condensed Consolidated Statements of Operations for the three and nine months ended July 31, 2012, respectively.

Note 8. Derivative Financial Instruments

We use derivative financial instruments, primarily forward contracts and swaps, to manage our exposure to foreign currency exchange rate and interest rate risks. Our primary objective in holding derivatives is to reduce the volatility of earnings and cash flows associated with changes in foreign currency exchange rates and interest rates.

Our derivatives expose us to credit risk to the extent that the counterparties may be unable to meet the terms of the agreement. However, we do seek to mitigate such risks by limiting our counterparties to major financial institutions. We do not expect losses as a result of defaults by counterparties. We do not use derivative financial instruments for speculative or trading purposes, nor do we hold or issue leveraged derivative financial instruments.

We recognize the fair value of our outstanding derivative financial instruments at the end of each reporting period as either assets or liabilities on the Condensed Consolidated Balance Sheets. See Note 6. Fair Value Measurements for a presentation of the fair value of our outstanding derivative instruments as of July 31, 2012 and October 31, 2011.

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The following tables present the amounts of gains and losses on our outstanding derivative instruments for the three and nine months ended July 31, 2012 and July 31, 2011 (in thousands):

	Three months ended July 31, 2012			Nine months ended July 31, 2012		
	Net amount of gain (loss) deferred as a component of accumulated other comprehensive loss	Amount of gain (loss) reclassified from accumulated other comprehensive loss into income	Amount of gain (loss) recognized in income immediately	Net amount of gain (loss) deferred as a component of accumulated other comprehensive loss	Amount of gain (loss) reclassified from accumulated other comprehensive loss into income	Amount of gain (loss) recognized in income immediately
Derivatives designated as hedging instruments:						
Interest rate swap agreements (1)	$(2,042)	$ (597)	$—	$(5,145)	$ (798)	$—
Foreign exchange forward contracts (2)	(31)	48	(214)	(31)	48	(214)
	(2,073)	(549)	(214)	(5,176)	(750)	(214)
Derivatives not designated as hedging instruments:						
Foreign exchange forward contracts (3)	—	—	4,940	—	—	(19,451)
Equity warrants (3)	—	—	(303)	—	—	(450)
	—	—	4,637	—	—	(19,901)
	$(2,073)	$ (549)	$4,423	$(5,176)	$ (750)	$(20,115)

	Three months ended July 31, 2011			Nine months ended July 31, 2011		
	Net amount of gain (loss) deferred as a component of accumulated other comprehensive loss	Amount of gain (loss) reclassified from accumulated other comprehensive loss into income	Amount of gain (loss) recognized in income immediately	Net amount of gain (loss) deferred as a component of accumulated other comprehensive loss	Amount of gain (loss) reclassified from accumulated other comprehensive loss into income	Amount of gain (loss) recognized in income immediately
Derivatives designated as hedging instruments:						
Interest rate swap agreements (1)	$—	$ —	$—	$—	$ —	$—
Foreign exchange forward contracts (2)	—	—	—	—	—	—
	—	—	—	—	—	—
Derivatives not designated as hedging instruments:						

Foreign exchange forward contracts (3)	—	—	520	—	—	(2,709)
Equity warrants (3)	—	—	642	—	—	642
	—	—	1,162	—	—	(2,067)
	$—	$ —	$1,162	$—	$ —	$(2,067)

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(1) The effective portion of gains or losses on interest rate swap agreements designated as hedging instruments are recognized in Interest expense on the Condensed Consolidated Statements of Income.
(2) The effective portion of gains or losses on foreign exchange forward contracts designated as hedging instruments as recognized in Cost of net revenues on the Condensed Consolidated Statements of Income. The ineffective portion of gains or losses on foreign exchange forward contracts designated as hedging instruments are recognized in Other income (expense), net on the Condensed Consolidated Statements of Income.
(3) Gains or losses on foreign exchange forward contracts not designated as hedging instruments and on equity warrants are recognized in Other income (expense), net on the Condensed Consolidated Statements of Income.

Interest Rate Swap Agreements Designated as Cash Flow Hedges

We use interest rate swap agreements to hedge the variability in cash flows related to interest rate payments. On March 23, 2012, we entered into a number of interest rate swap agreements to effectively convert $500.0 million of the Term A Loan from a floating rate to a 0.71% fixed rate plus applicable margin as described in Note 5. Financings. The interest rate swaps qualify for hedge accounting treatment as cash flow hedges. The interest rate swaps are effective for the period from March 30, 2012 to March 31, 2015, or 36 months. The notional amounts of interest rate swap agreements outstanding as of July 31, 2012 were $500.0 million. There were no interest rate swap agreements outstanding as of October 31, 2011.

Foreign Exchange Forward Contracts Designated as Cash Flow Hedges

From time to time, we enter into foreign exchange forward contracts to hedge against our exposure to changes in foreign exchange rates related to certain of our anticipated sales or purchases denominated in foreign currencies. These contracts generally mature within 30 days. Contracts outstanding as of July 31, 2012 relate to anticipated purchases of inventory in Brazil and had notional amounts totaling $9.4 million. There were no outstanding foreign exchange forward contracts designated as cash flow hedges as of October 31, 2011.

Foreign Exchange Forward Contracts Not Designated as Hedging Instruments

We primarily utilize foreign exchange forward contracts to offset the risks associated with certain foreign currency balance sheet exposures. The foreign exchange forward contracts are arranged and maintained so as to yield gains or losses to offset changes in foreign currency denominated assets or liabilities due to movements in foreign exchange rates, in an attempt to mitigate the volatility associated with foreign currency transaction gains or losses. Our foreign currency exposures are predominantly inter-company receivables and payables arising from product sales from one of our entities to another. Our foreign exchange forward contracts generally mature within 90 days. We do not use these foreign exchange forward contracts for trading purposes. The notional amounts of such contracts outstanding as of July 31, 2012 and October 31, 2011 were $175.7 million and $87.3 million, respectively.

Equity Warrants

As described in Note 7. Investment in Equity Securities, we hold warrants to purchase 500,000 shares of Trunkbow common stock. These warrants are derivative financial instruments, and are reported at fair value.

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Note 9. Comprehensive Income (Loss)

The components of comprehensive income (loss), consisted of the following (in thousands)

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2012	2011	2012	2011
Net income attributable to VeriFone Systems, Inc. stockholders	$37,695	$26,347	$38,049	$83,578
Other comprehensive income (loss):				
Foreign currency translation adjustments, net of tax	(75,848)	824	(70,424)	10,888
Loss on derivatives designated as cash flow hedges, net of tax	(1,307)	—	(3,231)	—
Unrealized gain (loss) on marketable equity investment, net of tax	(1,859)	(2,100)	(2,460)	3,650
Benefit plan adjustments	29	—	203	—
Total comprehensive income (loss) before allocation to noncontrolling interests	(41,290)	25,071	(37,863)	98,116
Less: comprehensive income (loss) attributable to noncontrolling interests	(959)	4	66	88
Other comprehensive income (loss) attributable to VeriFone Systems, Inc. stockholders	$(40,331)	$25,067	$(37,929)	$98,028

Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive loss, net of tax, consisted of the following (in thousands):

	July 31, 2012	October 31, 2011
Foreign currency translation adjustments	$(76,361)	$(5,937)
Unrealized gain (loss) on marketable equity investment	(1,710)	750
Unrealized gain (loss) on derivatives designated as cash flow hedges, net of tax	(3,231)	—
Unfunded portion of pension plan obligations	(1,281)	(1,484)
Accumulated other comprehensive loss	$(82,583)	$(6,671)

Note 10. Income Taxes

We recorded an income tax provision of $2.3 million and an income tax benefit of $12.1 million for the three and nine months ended July 31, 2012, respectively. We recorded income tax provisions of $13.1 million and $13.7 million for the three and nine months ended July 31, 2011, respectively. The effective tax rates for the three and nine months ended July 31, 2012 and 2011 are lower than the U.S. statutory tax rate due to earnings in countries where we are taxed at lower rates compared to the U.S. federal and state statutory rates and reversal of uncertain tax position liabilities as statutes of limitations expired. The income tax benefit for the nine months ended July 31, 2012 includes a discrete tax benefit of $8.5 million related to the foreign exchange loss on futures contracts which was incurred during December 2011 and $6.6 million related to a patent litigation loss contingency expense which was incurred during June 2012.

During January 2012, the Company entered into a formal settlement with the Israeli tax authorities for the calendar year 2006 audit and, accordingly, has released $2.6 million of excess accrued tax liabilities associated with this audit.

As of July 31, 2012, we remain in a net deferred tax asset position. The realization of our deferred tax assets depends primarily on our ability to generate sufficient U.S. and foreign taxable income in future periods. The amount of deferred tax assets considered realizable may increase or decrease in subsequent quarters as we reevaluate the underlying basis for our estimates of future U.S. and foreign taxable income.

Our unrecognized tax benefits increased by approximately $5.5 million during the three months ended July 31, 2012 as a result of tax positions taken in prior periods. A significant portion of the increase was due to an increase to our uncertain tax positions related to our prior year acquisitions. We have recorded our uncertain tax position liability as a long-term liability as we do not expect significant payments to occur over the next twelve months. The amount of unrecognized tax benefits could be reduced upon closure of tax examinations or if the statute of limitations on certain tax filings expire without assessment from

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the relevant tax authorities. We believe that it is reasonably possible that there could be a reduction in unrecognized tax benefits due to statute of limitation expirations in multiple tax jurisdictions during the next twelve months of approximately $1.6 million. Interest and penalties accrued on these uncertain tax positions will also be released upon the expiration of statutes of limitations.

Note 11. Stock-based Compensation

We grant stock awards, including stock options, restricted stock units (“RSUs”) and restricted stock awards (“RSAs”) pursuant to stockholder approved equity incentive plans. These equity incentive plans are described in further detail in Note 12. Stockholders’ Equity, of Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended October 31, 2011. All stock awards granted during the nine months ended July 31, 2012 were granted under the 2006 Equity Incentive Plan, as amended.

Valuation Assumptions

The grant-date fair value of RSUs is equal to the market value of our common stock on the date of grant. The grant-date fair value of stock options is estimated using the Black-Scholes-Merton valuation model. We used the following weighted-average assumptions for the three and nine months ended July 31, 2012 and 2011:

	Three Months Ended July 31,				Nine Months Ended July 31,			
	2012		2011		2012		2011	
Expected term of the options (in years)	3.6		4.0		3.6		4.0	
Risk-free interest rate	0.1	%	1.3	%	0.1	%	1.4	%
Expected stock price volatility	69.6	%	70.0	%	68.3	%	70.1	%
Expected dividend rate	0.0	%	0.0	%	0.0	%	0.0	%

The Black-Scholes-Merton valuation model incorporates several subjective assumptions including expected term and expected volatility. The expected term of options granted is derived from the historical actual term of option grants and an estimate of future exercises during the remaining contractual period of the option. In determining expected stock price volatility for options, we consider the historical volatility of common stock for the then expected term of the options, and include the elements listed below at the weighted percentages presented:

	Three Months Ended July 31,				Nine Months Ended July 31,			
	2012		2011		2012		2011	
Historical volatility of our common stock	95.0	%	60.0	%	81.7	%	60.0	%
Historical volatility of comparable companies' common stock	0.0	%	35.0	%	13.3	%	35.0	%
Implied volatility of our traded common stock options	5.0	%	5.0	%	5.0	%	5.0	%

We placed the greatest weighting on the historic volatility of our common stock because we believe that, in general, it is representative of our expected volatility. However, our stock price during the second half of calendar year 2007 and most of calendar year 2008 was significantly impacted by our announcement on December 3, 2007 of a restatement of certain of our financial statements. Our restated financial statements were filed on August 19, 2008. Given that the historic volatility of our common stock over the then expected term of the options included the volatility during this restatement period, which we do not believe is representative of our expected volatility, we also used peer group data and implied volatility in our stock price volatility calculation during fiscal quarters ended prior to July 31, 2012. We included peer group data in an effort to capture a broader view of the marketplace over the expected term of the options. We included the implied volatility of our traded options to capture market expectations regarding our stock price. In determining the weighting between our peer group data and implied volatility, we accorded less weighting to

our implied volatility because there is a relatively low volume of trades and the terms of the traded options are shorter than the expected term of our share options. Beginning with our fiscal quarter ended July 31, 2012, we have historical volatility data for our common stock for a period of time that covers the length of our expected term of 3.6 years, and that we believe provides a reasonable basis for an estimation of our expected volatility. Accordingly, we no longer use historic volatility of comparable companies' common stock in our weighting percentages. As of the fiscal quarter ended July 31, 2012, we increased the weighting of the historical volatility of our common stock from 75.0% to 95.0%, with the remaining 5.0% based on the implied volatility of our traded common stock options.

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Stock-based Compensation Expense

The following table presents the stock-based compensation expense recognized during the three and nine months ended July 31, 2012 and 2011 (in thousands):

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2012	2011	2012	2011
Cost of net revenues	$560	$433	$1,501	$1,224
Research and development	1,497	1,001	3,951	2,816
Sales and marketing	5,177	3,330	13,844	9,909
General and administrative	5,211	3,586	14,875	11,158
Total stock-based compensation	$12,445	$8,350	$34,171	$25,107

As of July 31, 2012, total unrecognized compensation expense adjusted for estimated forfeitures related to unvested stock options, and RSUs and RSAs was $49.6 million and $34.0 million, respectively, which is expected to be recognized over the remaining weighted-average vesting periods of 2.2 years for stock options and 2.7 years for RSUs and RSAs.

Stock Option Activity

The following table provides a summary of stock option activity under our equity incentive plans for the nine months ended July 31, 2012:

	Number of Shares (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Balance at October 31, 2011	8,201	$18.38		
Granted	2,208	$35.65		
Exercised	(1,921)	$14.93		
Canceled	(272)	$22.87		
Expired	(47)	$24.21		
Balance at July 31, 2012	8,169	$23.68	4.8	$113,092
Vested or expected to vest at July 31, 2012	7,727	$23.05	4.7	$111,472
Exercisable at July 31, 2012	3,246	$16.77	3.7	$65,700

The total proceeds received as a result of stock option exercises under all plans for each of the nine months ended July 31, 2012 and 2011 were $28.7 million and $41.2 million, respectively. We recognized $0.1 million of tax benefits in the nine months ended July 31, 2012. We did not recognize any tax benefits in connection with the exercises during the nine months ended July 31, 2011.

The weighted average fair value per share of options granted during the nine months ended July 31, 2012 and 2011 was $17.32 and $23.64, respectively. The total intrinsic value of options exercised was $61.3 million and $83.7 million during the nine months ended July 31, 2012 and 2011, respectively.

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Restricted Stock Units and Restricted Stock Awards

The following table summarizes RSU and RSA activity for the nine months ended July 31, 2012:

	Shares (in thousands)	Aggregate Intrinsic Value (in thousands)
Outstanding at October 31, 2011	1,398	
Granted	874	
Vested	(296)	
Outstanding at July 31, 2012	1,976	$71,709
Vested and expected to vest at July 31, 2012	1,643	$59,624
Ending exercisable (vested and deferred)	579	$21,012

The weighted average grant date fair value per share of RSUs granted during the nine months ended July 31, 2012 and 2011 was $39.08 and $39.99, respectively. The total fair value of RSUs that vested in the nine months ended July 31, 2012 and 2011 was $11.0 million and $13.3 million, respectively. All RSAs were granted on April 1, 2010 with a grant date fair value of $20.35.

Note 12. Net Income Per Common Share

Basic net income per share of common stock is computed by dividing net income by the weighted average number of shares of common stock outstanding for the period. Diluted net income per share of common stock is computed using the weighted average number of shares of common stock outstanding plus the effect of common stock equivalents, unless the common stock equivalents are anti-dilutive. The potential dilutive shares of our common stock resulting from the assumed exercise of outstanding stock options and equivalents and the assumed exercise of the warrants relating to the convertible senior notes are determined using the treasury stock method. Under the treasury stock method, an increase in the fair market value of our common stock can result in a greater number of dilutive securities.

The following details the computation of net income per common share (in thousands, except per share data):

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2012	2011	2012	2011
Basic and diluted net income per share attributable to VeriFone Systems, Inc. stockholders:				
Numerator:				
Net income attributable to VeriFone Systems, Inc. stockholders	$37,695	$26,347	$38,049	$83,578
Denominator:				
Weighted average shares attributable to VeriFone Systems, Inc. stockholders - basic	107,568	89,602	106,768	88,368
Weighted average effect of dilutive securities:				
Stock options, RSUs and RSAs	2,816	3,658	3,290	4,043
Notes	—	62	247	279
Weighted average shares attributable to VeriFone Systems, Inc. stockholders - diluted	110,384	93,322	110,305	92,690
Net income per share attributable to VeriFone Systems, Inc. stockholders:				
Basic	$0.35	$0.29	$0.36	$0.95
Diluted	$0.34	$0.28	$0.34	$0.90

For both the three and nine months ended July 31, 2012, stock awards to purchase 4.0 million shares of common stock were excluded from the calculation of earnings per share as they were anti-dilutive. For both the three and nine months ended July 31, 2011 stock awards to purchase 1.4 million shares of common stock were excluded from the calculation of earnings per share as they were anti-dilutive. These awards could be included in future calculations if the market value of the common shares increases.

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The Notes, which were repaid in full in June 2012 without any conversion rights having been exercised, were considered to be Instrument C securities, and therefore, only the conversion spread relating to the Notes was included in our diluted earnings per share calculation, if dilutive. Under such method, the settlement of the conversion spread of the Notes had a dilutive effect when the average share price of our common stock during any quarter in the fiscal years exceeded $44.02. The average share prices of our common stock during the three months ended July 31, 2012 and 2011 were $37.42 and $44.45, respectively, and therefore, the Notes were anti-dilutive for the three and nine months ended July 31, 2012 and dilutive for the three and nine months ended July 31, 2011.

Warrants to purchase 7.2 million shares of our common stock were outstanding at July 31, 2012 and October 31, 2011 but were not included in the computation of diluted earnings per share because the warrants' exercise price of $62.36 was greater than the average share price of our common stock during the three and nine months ended July 31, 2012 and 2011, and therefore, the warrants were anti-dilutive for those periods.

Note 13. Commitments and Contingencies

Commitments

Lease commitments

We lease certain facilities under non-cancelable operating leases that contain free rent periods, leasehold improvement rebates and/or rent escalation clauses. Rent expense under these leases has been recorded on a straight-line basis over the lease term. We are committed to pay a portion of the related actual operating expenses under certain of these lease agreements. These operating expenses are not included in the table below. The difference between amounts paid and rent expense is recorded as deferred rent and the short-term and long-term portions are included in Accruals and other current liabilities and Other long-term liabilities, respectively, in the Condensed Consolidated Balance Sheets. Additionally, we sublease certain real property to third parties.

In connection with our taxi media businesses, we enter into operating lease arrangements for the right to place advertising in and/or on taxicabs. In general, these lease arrangements are non-cancelable for terms ranging from 3 to 10 years, require us to pay minimum lease amounts based on the type and locations of the advertising displays in and/or on the taxicabs and are subject to fee escalation clauses. Considering the advertising on operational taxicabs at July 31, 2012, we had total lease commitments of $95.0 million relating to such lease arrangements. This amount includes one significant lease with a total minimum commitment of $40.6 million as of July 31, 2012 based on the number of operational taxicabs as of that date. This lease has a 10 year term expiring October 31, 2021 and provides us, among other things, exclusive rights to place advertising on the taxicabs subject to the lease.

Future minimum lease payments and sublease rental income under operating leases as of July 31, 2012 were as follows (in thousands):

Fiscal Years Ending October 31:	Minimum Lease Payments	Sublease Rental Income		Net Minimum Lease Payments
2012 (remaining 3 months)	$13,731	$(77	)	$13,654
2013	39,610	(316	)	39,294
2014	28,609	(326	)	28,283
2015	19,876	(336	)	19,540
2016	15,317	(259	)	15,058
Thereafter	45,135	—		45,135
Total	$162,278	$(1,314	)	$160,964

Rent expense for the three and nine months ended July 31, 2012 and 2011 was as follows (in thousands):

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2012	2011	2012	2011
Rent expense for non-cancelable taxi operating leases	$7,093	$5,717	$20,809	$17,082
Other rent expense	7,546	4,127	20,810	11,381
Total rent expense	$14,639	$9,844	$41,619	$28,463

Manufacturing Agreements

We work on a purchase order basis with our primary electronic manufacturing services providers, which are located in China, Singapore, Malaysia, Brazil, Germany, France, Romania, and Israel, and component suppliers located throughout the world to supply nearly all of our finished goods inventories, spare parts, and accessories. We generally provide each such supplier with a purchase order to cover the manufacturing requirements, which, subject to the underlying terms and conditions, constitutes a binding commitment by us to purchase materials and finished goods produced by the manufacturer as specified in the purchase order. Most of these purchase orders are considered to be non-cancelable and are expected to be paid within one year of the date we issue the respective purchase order. As of July 31, 2012, the amount of purchase commitments issued to contract manufacturers and component suppliers totaled approximately $141.4 million. Of this amount, $16.0 million has been recorded in Accruals and other current liabilities in the accompanying Condensed Consolidated Balance Sheets because these commitments are not expected to have future value to us.

We utilize a limited number of third parties to manufacture our products and rely upon these contract manufacturers to produce and deliver products to our customers on a timely basis and at an acceptable cost. Furthermore, a majority of our manufacturing activities are concentrated in China. As a result, disruptions to the business or operations of the contract manufacturers or to their ability to produce the required products in a timely manner, and particularly disruptions to the manufacturing facilities located in China, could significantly impact our business and operations. In addition, a number of components that are necessary to manufacture and assemble our systems are specifically customized for use in our products and are obtained from sole source suppliers on a purchase order basis. Because of the customized nature of these components and the limited number of available suppliers, if we were to experience a supply disruption, it would be difficult and costly to find alternative sources in a timely manner.

Employee Health and Dental Costs

We are primarily self-insured for employee health and dental costs, but have stop-loss insurance coverage to limit per-incident liability. We believe that adequate accruals are maintained to cover the retained liability. The accrual for self-insurance is determined based on claims filed and an estimate of claims incurred but not yet reported.

Bank guarantees

We have issued bank guarantees to certain of our customers and vendors as required in some countries to support certain of our performance obligations under our service or other agreements with these respective customers or vendors. As of July 31, 2012, the maximum amounts that may become payable under these guarantees was $5.0 million.

Contingencies

We evaluate the circumstances regarding outstanding and potential litigation and other contingencies on a quarterly basis to determine whether there is at least a reasonable possibility that a loss exists requiring accrual or disclosure, and if so, whether an estimate of the possible loss or range of loss can be made or whether such an estimate cannot be made. When loss is probable and reasonably estimable, we accrue for such amount based on our estimate of the probable loss considering information available at the time. When loss is reasonably possible, we disclose the estimated possible loss or range of loss in excess of amounts accrued. Except as otherwise disclosed below, we did not believe that loss is probable or that there was a reasonable possibility that a material loss may have been incurred with respect to the matters disclosed.

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Fire Loss

In July 2012 a fire occurred in one of our repair and staging facilities in Brazil. As of July 31, 2012 we have recorded an $8.3 million insurance receivable in Prepaid and other current assets in our Condensed Consolidated Balance Sheets, which represents the expected probable recoverable amounts for quantified losses. Although final determination of the losses incurred and the actual insurance coverage under our policies are not yet complete, we expect our losses associated with this event to be substantially covered, and therefore we have recorded no net loss related to the fire during the three months ended July 31, 2012. We do not expect this event to have a material impact on our results of operations or ongoing business operations.

Accrued Warranty

We provide reserves for the estimated costs of product warranty obligations based on a number of factors including the size of the installed base of products subject to warranty protection, historical and projected warranty claim rates, historical and projected costs associated with claims, and knowledge of specific product failures that are outside of our typical experience. We assess the adequacy of our recorded warranty liabilities and adjust the amounts as necessary based on our actual experience and any changes in future estimates. As of July 31, 2012 and October 31, 2011, our warranty accrual included product specific warranty accruals of approximately $2.1 million and $7.9 million, respectively, related to specific issues with our products. The amount accrued represents our best estimate of the costs expected to be incurred based on currently available information. We may incur additional warranty expense related to these products in future periods.

Brazilian State Tax Assessments

State Value Added Tax

The Brazilian subsidiary we acquired as part of our acquisition of Hypercom in August 2011 received an unfavorable administrative decision on a tax enforcement action against it filed by the São Paulo State Revenue Department for collection of state sales taxes related to purported sales of software for the 1998 and 1999 tax years. In 2004 an appeal against this unfavorable administrative decision was filed in a judicial proceeding. The first level decision in the judicial proceeding was issued in our favor. The São Paulo State Revenue Department has filed an appeal of this decision and the proceeding is now pending second level decision. Based on our current understanding of the underlying facts of this matter, we believe it is reasonably possible that we may receive an unfavorable decision in this proceeding. The tax assessment including estimated interest through July 31, 2012 for this matter totals approximately 5.5 million Brazilian reais (approximately $2.7 million). As of July 31, 2012, we have not accrued for this matter.

Importation of Goods Assessments

Two of our Brazilian subsidiaries that were acquired as a part of the November 2006 Lipman Electronic Engineering Ltd ("Lipman") acquisition have been notified of assessments regarding Brazilian customs penalties that relate to alleged infractions in the importation of goods. The assessments were issued by the Federal Revenue Department in the City of Vitória, the City of São Paulo, and the City of Itajai. In each of these cases, the tax authorities allege that the structure used for the importation of goods was simulated with the objective of evading taxes levied on the importation by under-invoicing the imported goods. The tax authorities allege that the simulation was created through a fraudulent interposition of parties, where the real sellers and buyers of the imported goods were hidden.

In the Vitória tax assessment, the fines were reduced from 4.7 million Brazilian reais (approximately $2.3 million) to 1.5 million Brazilian reais (approximately $0.7 million) on a first level administrative decision on January 26, 2007.

Both the tax authorities and the Company filed appeals of the first level administrative decision. In this appeal, we argued that the tax authorities did not have enough evidence to determine that the import transactions were indeed fraudulent and that, even if there were some irregularities in such importations, they could not be deemed to be our responsibility since all the transactions were performed by the third-party importer of the goods. On June 30, 2010, the Taxpayers Administrative Council of Tax Appeals decided to reinstate the original claim amount of 4.7 million Brazilian reais (approximately $2.3 million) against us. A formal ruling on the decision of the Administrative Council has not yet been issued. In addition, the federal attorney in this proceeding has filed a motion to clarify, which is also pending a decision. Once a formal ruling is issued by the Administrative Council, we will decide whether or not to appeal to the judicial level. Based on our current understanding of the underlying facts, we believe that it is probable that our Brazilian subsidiary will be required to pay some amount of fines. At July 31, 2012, we have accrued 4.7 million Brazilian reais (approximately $2.3 million) for this matter, plus interest.

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On July 12, 2007, we were notified of a first administrative level decision rendered in the São Paulo tax assessment, which maintained the total fine of 20.2 million Brazilian reais (approximately $10.0 million) as imposed. On August 10, 2007, we appealed the first administrative level decision to the Taxpayers Council. A hearing was held on August 12, 2008 before the Taxpayers Council, and on October 14, 2008, the Taxpayers Council granted our appeal and dismissed the São Paulo assessment based upon the assessment being erroneously calculated on the value of the sale of the products in question to end customers in the local market rather than on the declared importation value of such products. We were subsequently notified of the Taxpayers Council's decision and the case was dismissed on May 19, 2009. In August 2009, the Brazilian tax authorities requested additional materials from us. In October 2009, we received a revised assessment in this matter of $1.9 million Brazilian reais (approximately $0.9 million). On May 20, 2010, we were notified of a first level decision canceling the revised tax assessment. This decision is currently pending second level review. The administrative proceeding for judgment before the Administrative Council of Tax Appeals was originally scheduled for May 24, 2012, but has been postponed pending personal inspection of the records at the request of one of the council members. At July 31, 2012, we have accrued 1.6 million Brazilian reais (approximately $0.8 million) for this matter.

On January 18, 2008, we were notified of a first administrative level decision rendered in the Itajai assessment, which maintained the total fine of 2.0 million Brazilian reais (approximately $1.0 million) as imposed, excluding interest. On May 27, 2008, we appealed the first level administrative level decision to the Taxpayers Council. This matter is currently pending second level decision. Based on our current understanding of the underlying facts, we believe that it is probable that our Brazilian subsidiary will be required to pay some amount of fines. Accordingly, at July 31, 2012, we have accrued 2.0 million Brazilian reais (approximately $1.0 million) for this matter, plus interest.

Municipality Tax on Services Assessment

In December 2009, one of the Brazilian subsidiaries that was acquired as part of the Lipman acquisition was notified of a tax assessment regarding alleged nonpayment of tax on services rendered for the period from September 2004 to December 2004. This assessment was issued by the municipality of São Paulo (the “municipality”), and asserts a services tax deficiency and related penalties totaling 0.9 million Brazilian reais (approximately $0.4 million) excluding interest. The municipality claims that the Brazilian subsidiary rendered certain services within the municipality of São Paulo but simulated that those services were rendered in another city. At the end of December 2010 the municipality issued further tax assessments alleging the same claims for 2005 through June 2007. These additional subsequent claims assert services tax deficiencies and related penalties totaling 5.9 million Brazilian reais (approximately $2.9 million) excluding interest. We received unfavorable decisions from the administrative courts, which ruled to maintain the tax assessments for each of these matters. No further grounds of appeal are available to us for these assessments within the administrative courts. We intend to appeal the tax assessment at the judicial level in the civil courts. Based on our understanding of the underlying facts and our evaluation of the potential outcome at the judicial level, we believe it is reasonably possible that our Brazilian subsidiary will be required to pay some amount of fines related to these matters.

The Brazilian subsidiary we acquired as part of our acquisition of Hypercom in August 2011 received an unfavorable administrative decision on a tax enforcement action against it filed by the municipality of Curitiba for collection of alleged services tax deficiency. An appeal against this unfavorable administrative decision was filed in a judicial proceeding and currently the case is pending the municipality of Curitiba's compliance with the writ of summons. The underlying assessment including estimated interest as of July 31, 2012 is approximately 5.9 million Brazilian reais (approximately $2.9 million). Based on our current understanding of the underlying facts of this matter, we believe it is reasonably possible that we may receive an unfavorable decision in this proceeding. As of July 31, 2012, we have not accrued for this matter.

Brazilian Federal Tax Assessments

The Brazilian subsidiary we acquired as part of our acquisition of Hypercom in August 2011 is the subject of outstanding tax assessments by the federal tax authorities alleging unpaid IRPJ, CSL, COFINS and PIS taxes from 2002 and 2003. Three of the four claims for the 2002 assessments were previously settled, prior to our acquisition of Hypercom. The first level administrative court issued an unfavorable decision for the remaining claim related to the 2002 tax assessments, which we have appealed to the Administrative Tax Appeals Council. This claim is currently pending judgment by the Appeals Council. We received a partially favorable outcome with respect to the 2003 tax assessments. Our appeal of the partial unfavorable ruling for the 2003 assessments is currently pending decision in the civil courts. Based on our current understanding of the underlying facts of this matter, we believe it is reasonably possible we may receive an unfavorable decision related to these proceedings. The outstanding tax assessments for these proceedings total 10.1 million Brazilian reais (approximately $5.0 million), including estimated penalties and interest.

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Patent Infringement and Commercial Litigation

Cardsoft, Inc. et al v. VeriFone Holdings, Inc., VeriFone, Inc., Hypercom Corporation, et al.

On March 6, 2008, Cardsoft, Inc. and Cardsoft (Assignment for the Benefit of Creditors), LLC ("Cardsoft") commenced an action in the United States District Court for the Eastern District of Texas, Marshall Division, against us and Hypercom Corporation, among others, alleging infringement of U.S. Patents No. 6,934,945 and No. 7,302,683 purportedly owned by Cardsoft. Cardsoft sought, in its complaint, a judgment of infringement, and an injunction against further infringement, damages, interest and attorneys' fees. The Markman hearing was held on August 8, 2011. Based on the court's ruling after the Markman hearing we filed motions for summary judgment on the claims prior to the scheduled trial, moving that, based on the court's construction of the key claims of the patents-in-suit, our products do not infringe on the patents-in-suit and moving for summary judgment based on our contentions the patents-in-suit are invalid. However, the court did not rule on these motions before trial, nor did the court rule on Cardsoft's summary judgment motions. Similarly, the court did not rule on the substantive pre-trial motions in favor of ruling on the matters at trial. The jury trial for this case commenced on June 4, 2012. On June 8, 2012, the jury completed its deliberations and returned an unfavorable verdict finding that Cardsoft's patents were valid and were infringed by the accused VeriFone and Hypercom devices, and further determined that a royalty rate of $3 per unit should be applied. Accordingly, the jury awarded Cardsoft infringement damages and royalties of $15.4 million covering past sales of the accused devices by VeriFone and Hypercom. The jury concluded there was no willful infringement by either VeriFone or Hypercom. We moved for judgment as a matter of law prior to the submission of the case to the jury, but the District Court did not rule on those motions.

Judgment has not yet been entered in this case, and we and Cardsoft are currently in the process of filing our post-verdict briefings with the District Court. We have filed our motions for judgment as a matter of law to overturn the jury's verdict and motions for a new trial. Cardsoft has filed a motion for permanent injunction or in the alternative for a future royalty of $8 per unit on our future U.S. sales of the accused products through the March 16, 2018 expiration date of the patents. Cardsoft has also filed a motion seeking pre-judgment interest at a rate of 5%. We believe that there is a remote chance of the District Court granting an injunction under relevant U.S. Supreme Court case law. We cannot at this time estimate the per unit future royalty that the District Court will order in its final judgment, but it is probable the court will order a future royalty of at least $3 per unit based on the jury's verdict. Given that an ongoing royalty is probable and estimable, effective in the third quarter of fiscal 2012 when the jury verdict was issued, we have accrued $3 per unit to cost of net revenues for potential ongoing royalties. In addition, based on our discussions with our litigation counsel for this matter, it is possible the court may order a future royalty that is higher than the per unit royalty awarded by the jury for future sales of the products determined by the jury to be infringing. The District Court is expected to rule on these matters before it enters judgment. We are currently in the process of re-designing the accused products. If we are successful in re-designing our products and it is determined that the products, as re-designed, do not infringe, the re-designed products would not be subject to the future royalty. We also intend to vigorously appeal any unfavorable judgment issued by the District Court.

We have determined that it is probable we will incur a loss on this litigation based on the jury's verdict and current status of the litigation proceedings. As a result, we have accrued an estimated loss through July 31, 2012, including estimated pre-judgment interest and potential ongoing royalties, totaling $18.6 million as of July 31, 2012 related to this ongoing litigation. Our estimate of pre-judgment interest applies a rate of 4.12% which represents the seven year Treasury rate as of August 23, 2005, the date of the relevant hypothetical negotiation of the underlying claims. As noted above, Cardsoft has filed a motion claiming royalties on our future U.S. sales of the accused products at a royalty rate higher than the rate awarded by the jury and prejudgment interest at a rate higher than used in our estimates. In addition to the higher royalty rate and higher rate of prejudgment interest sought by Cardsoft, it is possible that, notwithstanding the jury's finding of no willful infringement, Cardsoft may seek to recover its attorneys' fees or other amounts in this lawsuit or may appeal the finding of non-willful infringement. Any damages award that

is maintained after appeal would be additionally subject to post-judgment interest. We intend to vigorously pursue our appeal of this verdict and to defend any further claims related to this litigation. At this time we are unable to estimate the range of additional loss exceeding amounts already recognized, if any, related to any further amounts Cardsoft may seek and the District Court may award in post-trial motions. Unfavorable rulings on such motions could have a material adverse effect on our business, financial condition, results of operations, and cash flows.

Swipe Innovations, LLC v. VeriFone, Inc. and VeriFone Systems, Inc., Hypercom Corporation, et al.

On August 8, 2012, Swipe Innovations, LLC ("Swipe") commenced actions in the United States District Court for the Eastern District of Texas, Lufkin Division, against us and Hypercom among others, alleging infringement of U.S. Patent No. 5,351,296, issued September 27, 1994, titled "Financial Transmission System" purportedly owned by Swipe. The complaint does not specify the allegedly infringing products but seeks to assert infringement against payment terminal products and/or systems including at least products and/or systems with encrypting pin pads. This matter is currently in the early stages

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of litigation.

Class Action and Derivative Lawsuits

On or after December 4, 2007, several securities class action claims were filed against us and certain of our officers, former officers, and a former director. These lawsuits were consolidated in the U.S. District Court for the Northern District of California as In re VeriFone Holdings, Inc. Securities Litigation, C 07-6140 MHP. The original actions were: Eichenholtz v. VeriFone Holdings, Inc. et al., C 07-6140 MHP; Lien v. VeriFone Holdings, Inc. et al., C 07-6195 JSW; Vaughn et al. v. VeriFone Holdings, Inc. et al., C 07-6197 VRW (Plaintiffs voluntarily dismissed this complaint on March 7, 2008); Feldman et al. v. VeriFone Holdings, Inc. et al., C 07-6218 MMC; Cerini v. VeriFone Holdings, Inc. et al., C 07-6228 SC; Westend Capital Management LLC v. VeriFone Holdings, Inc. et al., C 07-6237 MMC; Hill v. VeriFone Holdings, Inc. et al., C 07-6238 MHP; Offutt v. VeriFone Holdings, Inc. et al., C 07-6241 JSW; Feitel v. VeriFone Holdings, Inc., et al., C 08-0118 CW. On August 22, 2008, the court appointed plaintiff National Elevator Fund lead plaintiff and its attorneys lead counsel. Plaintiff filed its consolidated amended class action complaint on October 31, 2008, which asserts claims under the Securities Exchange Act Sections 10(b), 20(a), and 20A and Securities and Exchange Commission Rule 10b-5 for securities fraud and control person liability against us and certain of our current and former officers and directors, based on allegations that we and the individual defendants made false or misleading public statements regarding our business and operations during the putative class periods and seeks unspecified monetary damages and other relief. We filed our motion to dismiss on December 31, 2008. The court granted our motion on May 26, 2009 and dismissed the consolidated amended class action complaint with leave to amend within 30 days of the ruling. The proceedings were stayed pending a mediation held in October 2009 at which time the parties failed to reach a mutually agreeable settlement. Lead plaintiff's first amended complaint was filed on December 3, 2009 followed by a second amended complaint filed on January 19, 2010. We filed a motion to dismiss the second amended complaint and the hearing on our motion was held on May 17, 2010. In July 2010, prior to any court ruling on our motion, lead plaintiff filed a motion for leave to file a third amended complaint on the basis that it had newly discovered evidence. Pursuant to a briefing schedule issued by the court we submitted our motion to dismiss the third amended complaint and lead plaintiff filed its opposition, following which the court took the matter under submission without further hearing. On March 8, 2011, the court ruled in our favor and dismissed the consolidated securities class action without leave to amend. On April 5, 2011, lead plaintiff filed its notice of appeal of the district court's ruling to the U.S. Court of Appeals for the Ninth Circuit. On June 24 and June 27, 2011, lead plaintiff dismissed its appeal as against defendants Paul Periolat, William Atkinson, and Craig Bondy. Lead plaintiff filed its opening brief on appeal on July 28, 2011. We filed our answering brief on September 28, 2011 and lead plaintiff filed its reply brief on October 31, 2011. A hearing on oral arguments for this appeal was held before a judicial panel of the Ninth Circuit on May 17, 2012. There has been no ruling on this appeal to date.

Beginning on December 13, 2007, several actions were also filed against certain current and former directors and officers derivatively on our behalf. These derivative lawsuits were filed in: (1) the U.S. District Court for the Northern District of California, as In re VeriFone Holdings, Inc. Shareholder Derivative Litigation, Lead Case No. C 07-6347 MHP, which consolidates King v. Bergeron, et al. (Case No. 07-CV-6347), Hilborn v. VeriFone Holdings, Inc., et al. (Case No. 08-CV-1132), Patel v. Bergeron, et al. (Case No. 08-CV-1133), and Lemmond, et al. v. VeriFone Holdings, Inc., et al. (Case No. 08-CV-1301); and (2) California Superior Court, Santa Clara County, as In re VeriFone Holdings, Inc. Derivative Litigation, Lead Case No. 1-07-CV-100980, which consolidates Catholic Medical Mission Board v. Bergeron, et al. (Case No. 1-07-CV-100980), and Carpel v. Bergeron, et al. (Case No. 1-07-CV-101449). On May 15, 2008, the court in the federal derivative action appointed Charles R. King as lead plaintiff and his attorneys as lead counsel. On October 31, 2008, lead plaintiff in the federal action filed this consolidated amended derivative complaint, which names us as a nominal defendant and brings claims for insider selling, breach of fiduciary duty, unjust enrichment, waste of corporate assets and aiding and abetting breach of fiduciary duty against us and certain of our current and former officers and directors. On December 15, 2008, we and the other defendants filed a motion to dismiss. The parties agreed by stipulation that briefing on this motion would

relate only to the issue of lead plaintiff's failure to make a pre-suit demand on our Board of Directors. The court granted our motion on May 26, 2009 and dismissed the consolidated amended derivative complaint with leave to amend within 30 days of the ruling. The proceedings were stayed pending a mediation held in October 2009 at which time the parties failed to reach a mutually agreeable settlement. Lead plaintiff's second amended complaint was filed on December 10, 2009. We filed our motion to dismiss the second amended complaint on January 25, 2010 and a hearing on our motion to dismiss was held on May 17, 2010. On August 25, 2010, the federal district court ruled in our favor and dismissed lead plaintiff's second amended derivative complaint without leave to amend. Lead plaintiff appealed the District Court's judgment to the U.S. Court of Appeal for the Ninth Circuit, filing his opening brief on April 14, 2011. We filed our answering brief on May 31, 2011 and lead plaintiff filed his reply on July 1, 2011, following which the Ninth Circuit took the matter under submission without oral argument. On November 28, 2011, the Ninth Circuit issued an order in our favor, and entered judgment affirming the District Court's dismissal of lead plaintiff's second amended complaint. Lead plaintiff did not appeal the Ninth Circuit's judgment and this federal derivative action is now closed.

On June 9, 2009, lead plaintiff in the federal derivative action made a demand to inspect certain of our books and records. In response to this demand, we provided certain of our books and records, including minutes and materials for our Board of Directors, Audit Committee and Compensation Committee meetings for the relevant period. We produced documents responsive to each category of lead plaintiff's request except that we withheld production, on the basis of privilege, of the Audit Committee's report of the independent investigation into the events leading to the restatement of our fiscal year 2007 interim financial statements. On November 6, 2009, lead plaintiff filed a complaint in Delaware Chancery Court seeking to compel production of the independent investigation report. We filed a motion to dismiss this complaint on December 3, 2009, and briefs on this motion were submitted during January 2010. A hearing on our motion to dismiss was held on March 10, 2010 and on May 12, 2010, the court issued an opinion dismissing with prejudice lead plaintiff's complaint seeking to compel production of the independent investigation report. Lead plaintiff appealed the dismissal. The parties filed their respective briefs on the appeal and a hearing on the appeal was held November 17, 2010 before the Delaware Supreme Court. The case was submitted before the Delaware Supreme Court en Banc without further briefing or oral argument. In January 2011, the Delaware Supreme Court issued a ruling which accepted certain legal arguments made by lead plaintiff, reversed the order of the Chancery Court, and remanded the case to the Chancery Court for further proceedings, while noting that lead plaintiff's claim may still be subject to dismissal under the applicable legal standard because the underlying derivative complaint in the federal district court had been dismissed with prejudice. On December 12, 2011, the Delaware Chancery Court entered an order dismissing the action by stipulation of the parties in light of the Ninth Circuit's November 28, 2011 order affirming the dismissal of the federal derivative action.

On October 31, 2008, the state derivative plaintiffs filed their consolidated derivative complaint in California Superior Court for the County of Santa Clara naming us as a nominal defendant and bringing claims for insider selling, breach of fiduciary duty, unjust enrichment, waste of corporate assets and aiding and abetting breach of fiduciary duty against certain of our current and former officers and directors and our largest stockholder as of October 31, 2008, GTCR Golder Rauner LLC. In November 2008, we filed a motion to stay the state court action pending resolution of the parallel federal actions, and the parties have agreed by stipulation to delay briefing on the motion to stay until after the issue of demand futility is resolved in the federal derivative case. On June 2, 2011, the court entered a stipulated order requiring the parties to submit a case status report on August 1, 2011 and periodically thereafter. The parties submitted status reports to the court through August 3, 2012 as requested by the court, and have also begun to meet and confer regarding next steps in the state derivative action in light of the final dismissal of the federal derivative action. The next status report is due October 2, 2012.

On January 27, 2008, a class action complaint was filed against us in the Central District Court in Tel Aviv, Israel on behalf of purchasers of our stock on the Tel Aviv Stock Exchange. The complaint seeks compensation for damages allegedly incurred by the class of plaintiffs due to the publication of erroneous financial reports. We filed a motion to stay the action, in light of the proceedings already filed in the United States, on March 31, 2008. A hearing on the motion was held on May 25, 2008. Further briefing in support of the stay motion, specifically with regard to the threshold issue of applicable law, was submitted on June 24, 2008. On September 11, 2008, the Israeli District Court ruled in our favor, holding that U.S. law would apply in determining our liability. On October 7, 2008, plaintiffs filed a motion for leave to appeal the District Court's ruling to the Israeli Supreme Court. Our response to plaintiffs' appeal motion was filed on January 18, 2009. The District Court has stayed its proceedings until the Supreme Court rules on plaintiffs' motion for leave to appeal. On January 27, 2010, after a hearing before the Supreme Court, the court dismissed the plaintiffs' motion for leave to appeal and addressed the case back to the District Court. The Supreme Court instructed the District Court to rule whether the Israeli class action should be stayed, under the assumption that the applicable law is U.S. law. Plaintiffs subsequently filed an application for reconsideration of the District Court's ruling that U.S. law is the applicable law. Following a hearing on plaintiffs' application, on April 12, 2010, the parties agreed to stay the proceedings pending resolution of the U.S. securities class action, without prejudice to plaintiffs' right to appeal the District Court's decision regarding the applicable law to the Supreme Court. On May 25, 2010, plaintiff filed a motion for leave to appeal the decision regarding the applicable law with the Israeli Supreme Court. In

August 2010, plaintiff filed an application to the Israeli Supreme Court arguing that the U.S. Supreme Court's decision in Morrison et al. v. National Australia Bank Ltd., 561 U.S. __, 130 S. Ct. 2869 (2010), may affect the outcome of the appeal currently pending before the Court and requesting that this authority be added to the Court's record. Plaintiff concurrently filed an application with the Israeli District Court asking that court to reverse its decision regarding the applicability of U.S. law to the Israeli class action, as well as to cancel its decision to stay the Israeli proceedings in favor of the U.S. class action in light of the U.S. Supreme Court's decision in Morrison. On August 25, 2011, the Israeli District Court issued a decision denying plaintiff's application and reaffirming its ruling that the law applicable to the Israeli class action is U.S. law. The Israeli District Court also ordered that further proceedings in the case be stayed pending the decision on appeal in the U.S. class action.

Certain of the foregoing cases are still in the preliminary stages, and we are not able to quantify the extent of our potential liability, if any. An unfavorable outcome in any of these matters could have a material adverse effect on our business, financial condition, results of operations, and cash flows. In addition, defending these legal proceedings is likely to be costly, which may have a material adverse effect on our financial condition, results of operations and cash flows, and may divert

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management's attention from the day-to-day operations of our business.

Litigation Related to Acquisition of Hypercom

In connection with the announcement of our merger with Hypercom, several purported class action lawsuits were filed in Arizona and Delaware state courts alleging variously, among other things, that the board of directors of Hypercom breached its fiduciary duties in not securing a higher price in the merger and that VeriFone, Hypercom, FP Hypercom Holdco, LLC and Francisco Partners II, L.P. aided and abetted that alleged breach. The actions seek injunctive relief and unspecified damages. An agreement in principle has been reached to resolve the litigation based on confirmatory discovery, enhanced public disclosures, and, reimbursement by Hypercom of a portion of the plaintiffs' attorneys fees which we do not expect to be material to our results of operations. The terms of settlement between the parties are subject to court approval.

On May 30, 2012, we were notified by the Spanish competition authority (La Comisión Nacional de la Competencia, or "CNC") that CNC intends to formally review our completion of our merger with Hypercom for alleged non-compliance with notification requirements under Spanish merger control law.

Other Litigation

We are subject to various other legal proceedings related to commercial, customer, and employment matters that have arisen during the ordinary course of business, including a number of pending labor-related claims that arose in the ordinary course of business against the Hypercom Brazilian subsidiary prior to our acquisition of Hypercom. The outcome of such legal proceedings is inherently unpredictable and subject to significant uncertainties. Although there can be no assurance as to the ultimate disposition of these matters, our management has determined, based upon the information available at the date of these financial statements, that the expected outcome of these matters, individually or in the aggregate, will not have a material adverse effect on our consolidated financial position, results of operations or cash flows.

Note 14. Segment and Geographic Information

Segment Information

We operate in two business segments: International and North America. International segment is defined as our operations in countries other than the United States of America and Canada, and North America segment is defined as our operations in the United States of America and Canada. Our reporting segments are the same as our operating segments. Total assets and goodwill by segment are based on the location of the assets. Point and the other entities we have acquired have been assimilated into our existing segments based on the countries in which the entities' derive revenues.

Net revenues and operating income of each business segment reflect net revenues and expenses that directly benefit only that segment. Examples of these segment expenses are: standard inventory costs of System solutions net revenues, costs of Services net revenues, distribution center costs, royalty expense and warranty expense.

Corporate net revenues and operating loss reflect amortization of purchased intangible assets, increase to fair value (step-up) of inventory at acquisition, fair value decrease (step-down) in deferred revenue at acquisition, impairment, stock-based compensation, acquisition, integration and restructuring costs, and other Corporate charges, including inventory obsolescence and scrap, rework, specific warranty provisions, non-standard freight, and over-and-under absorption of materials management overhead. Since Corporate costs are generally incurred on a company-wide basis, it is impractical to allocate them to either the International or North America segments.

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The following table sets forth net revenues and operating income for our segments (in thousands):

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2012	2011	2012	2011
Net revenues:				
International	$354,785	$195,321	$1,010,182	$522,930
North America	138,434	121,835	387,603	370,941
Corporate	(4,169)	(205)	(17,193)	(709)
Total net revenues	$489,050	$316,951	$1,380,592	$893,162
Operating income:				
International	$101,820	$53,699	$289,560	$143,460
North America	49,237	45,820	134,690	135,821
Corporate	(94,980)	(58,770)	(328,169)	(165,983)
Total operating income	$56,077	$40,749	$96,081	$113,298

Our goodwill by segment was as follows (in thousands):

	July 31, 2012	October 31, 2011
International	$941,510	$398,855
North America	218,141	162,559
Total goodwill	$1,159,651	$561,414

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Our total assets by segment were as follows (in thousands):

	July 31, 2012	October 31, 2011
International	$2,627,087	$1,362,402
North America	813,273	951,159
Total assets	$3,440,360	$2,313,561

Geographic Information

The net revenues by geographic area were as follows (in thousands):

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2012	2011	2012	2011
United States and Canada	$138,162	$121,807	$386,699	$370,845
Europe, Middle East and Africa	199,992	97,032	553,840	269,002
Latin America	94,378	64,961	290,872	171,309
Asia	56,518	33,151	149,181	82,006
Total net revenues	$489,050	$316,951	$1,380,592	$893,162

Revenues are allocated to the geographic areas based on the shipping destination of customer orders.

Note 15. Restructuring Charges

There were no new restructuring plans approved during the three and nine months ended July 31, 2012.

The following table summarizes restructuring expenses under existing restructuring plans during the three and nine months ended July 31, 2012 (in thousands):

	Three months ended July 31		Nine months ended July 31	
	2012	2011	2012	2011
Cost of net revenues	$120	$53	$626	$20
Research and development	38	(28)	38	(42)
Sales and marketing	—	337	(126)	378
General and administrative	(275)	192	823	176
Total restructuring expense	$(117)	$554	$1,361	$532

During the fourth quarter of fiscal year 2011, our management approved, committed to, and initiated a plan estimated to cost up to $14.7 million to restructure our operations due to our acquisition of Hypercom in order to improve the cost efficiencies in our merged operations. During the three months ended July 31, 2012, we recorded a reduction of $0.1 million of employee restructuring expense and paid another $0.6 million under this plan. Since the inception of this plan, we have expensed $9.8 million and paid $9.1 million.

The Hypercom-related restructuring liability was $0.6 million and $4.8 million as of July 31, 2012 and October 31, 2011, respectively.

Other prior years' restructuring plans liabilities as of July 31, 2012 and October 31, 2011 were $0.9 million and $1.3 million, respectively. The change in the liability for those plans was mainly due to payments for facilities-related restructuring costs.

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Restructuring activity for the nine months ended July 31, 2012 was as follows (in thousands):

	Employee Severance and Benefit Arrangements	Facilities Related Costs	Total
Balance at October 31, 2011	$4,864	$1,291	$6,155
Current year charges and adjustments	1,208	153	1,361
Other adjustments	(147)	(5)	(152)
Cash payments	(5,278)	(527)	(5,805)
Balance at July 31, 2012	$647	$912	$1,559

As of July 31, 2012, $0.9 million of restructuring accruals were included in Accruals and other current liabilities and $0.7 million of restructuring accruals were included in Other long-term liabilities in the Condensed Consolidated Balance Sheets.

Note 16. Related-Party Transactions

For the three months ended July 31, 2012 and 2011, we recorded $2.6 million and $2.3 million, respectively, of sales to certain companies of which members of our Board of Directors also serve on the board. For the nine months ended July 31, 2012 and 2011, we recorded $7.7 million and $10.9 million, respectively, of net revenues on sales to certain companies of which members of our Board of Directors also serve on the board of directors of such companies. As of July 31, 2012 and October 31, 2011, we have outstanding accounts receivable balances of $1.6 million and $1.8 million, respectively, related to such companies.

Our 51% majority owned subsidiary of Point, Babs Paylink AB, has an unsecured overdraft facility with Swedbank, the 49% stockholder of Babs Paylink AB. As of July 31, 2012, SEK 33.6 million (approximately $4.9 million) was outstanding and SEK 26.4 million (approximately $3.8 million) was available. See Note 5. Financings for further information on the Point Overdraft Facility. In addition, in the normal course of business, we have other immaterial transactions with Swedbank.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This section and other parts of this Quarterly Report on Form 10-Q contain forward-looking statements that involve risks and uncertainties. In some cases, forward-looking statements can be identified by words such as “anticipates,” “expects,” “believes,” “intends,” “potential,” “continues,” “plans,” “predicts,” and similar terms. Such forward-looking stateme based on current expectations, estimates, and projections about our business and industry, and management's beliefs and assumptions, and do not reflect the potential impact of any mergers, acquisitions, or other business combinations or divestitures, that have not been completed. Forward-looking statements are not guarantees of future performance and our actual results may differ significantly from the results discussed in the forward-looking statements. Our statements regarding future performance also incorporate our estimates, projections and assumptions concerning the performance of recently acquired businesses, including Electronic Transaction Group Nordic Holding AB which operates the Point International business (“Point"), which we acquired on December 30, 2011, as described in Note 2, Business Combinations, in the Notes to Condensed Consolidated Financial Statements of this Quarterly Report on Form 10-Q, including assumptions about the prospects for the acquired businesses' products and markets, the ability to retain customer relationships and key employees, successful integration of key technologies and operations, and the potential for unexpected liabilities. In addition, as we integrate these businesses into our operations, our understanding of the financial and operational performance of the acquired businesses may change. Factors that might cause such differences include, but are not limited to, those discussed in Part I, Item 1A Risk Factors in our 2011 Annual Report on Form 10-K and in Part II, Item 1A Risk Factors of this Quarterly Report on Form 10-Q. The following discussion should be read in conjunction with our consolidated financial statements and related notes included in our 2011 Annual Report on Form 10-K and the Condensed Consolidated Financial Statements and Notes thereto included in Part I, Item I of this Quarterly Report on Form 10-Q. Unless required by law, we expressly disclaim any obligation to update publicly any forward-looking statements, whether as result of new information, future events, or otherwise. When we use the terms “VeriFone,” “we,” “us,” "the Company," and “our” in this item, we mean VeriFone Systems, Inc., a Delaware corporation, and its consolidated subsidiaries.

Overview

Our Business

We are a global leader in secure electronic payment solutions and services. We provide expertise, solutions, and services that add value to the point of sale with merchant-operated, consumer-facing, and self-service payment systems for the financial, retail, hospitality, petroleum, government, transportation, and healthcare vertical markets.

Our system solutions consist of point of sale ("POS") electronic payment devices that run our proprietary and third-party operating systems, security and encryption software, and certified payment software as well as other third-party value-added applications, and that are able to process a wide range of payment types designed to meet the demanding requirements of our direct and indirect customers. We are an industry leader in multi-application payment system deployments and we believe we have the largest selection of certified value-added applications. An increasing number of our electronic payment devices are directly connected to VeriFone operated processing gateways where we integrate traditional payment and non-payment functionality such as couponing, advertising and mobile near field communications ("NFC") based services for our customers.

Services are an increasingly important part of our overall revenue mix. Our offerings include new services such as Point's "All in One" payment solution (sometimes referred to as "Payment-as-a-service"), our SAIL micro-merchant payment acceptance service, our GlobalBay mobile retailing service, and our services deploying media-related equipment and content such as our V-NET service in taxis and PAYmedia and LiftRetail services deployed at gas station/convenience stores. Additionally, existing service offerings span different aspects of the payments ecosystem,

including equipment repair/maintenance, advertising publishing, gateway processing, remote terminal management, software maintenance, customized application development, helpdesk, customer service, and encryption/tokenization. We also offer our customers support for installed systems, consulting and project management services for system deployment, and customization of integrated software solutions.

Our customers include, among others, financial institutions, payment processors, petroleum companies, large retailers, taxi fleets, merchants, government organizations, healthcare companies, independent sales organizations (“ISO”) and advertisers. The functionality of our system solutions includes the capture of electronic payment data, certified transaction security, connectivity, compliance with regulatory standards and the flexibility to execute a variety of payment and nonpayment

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applications on a single system solution.

We believe that we benefit from a number of competitive advantages gained through our over 30-year history in our industry. These advantages include our globally trusted brand name, large installed base, significant involvement in the development of industry standards, security infrastructure, global operating scale, customizable platforms, and investment in research and development. We believe that these advantages position us well to capitalize on the continuing global shift toward electronic payment transactions.

Our Industry Trends

Our industry's growth continues to be driven by the long-term shift toward electronic payment transactions and away from cash and checks, the rapid penetration of electronic payments in emerging markets as those economies modernize, the potential expansion of EMV Smartcard-based payments into the United States, increasing proliferation of Internet connectivity and wireless communication, an increasing focus on security to reduce fraud and identity theft, and a growing emphasis on contactless payments and mobile phone initiated payments, as well as unattended self-service kiosks and outdoor payment systems and the merging of marketing capabilities such as advertising and couponing with payment devices. We believe that these trends will continue to drive demand for electronic payment systems.

Mobile phone initiated payments through "mobile wallets" have garnered significant industry attention and with a number of announced pilots recently initiated by many third parties. Mobile wallets allow the consumer to pay for goods and services, while at the same time providing access to value-added services such as instantly redeemable coupons, electronic receipt data, alternative payment schemes, and other applications. A number of different technological implementations are currently being tested, such as NFC, where sensitive cardholder information is stored in a "Secure Element" of the mobile device, 2D barcodes, high-frequency sound, or payment using the payee's name or phone number. As these changes are implemented, the POS infrastructure will need to adapt to new payment systems and processes and provide merchants and consumers with a seamless experience.

Internationally, growth rates have generally been higher than in the United States ("US") because of the relatively lower penetration rates of electronic payment transactions in many countries, as well as increasing governmental efforts to modernize economies and to encourage electronic payments as a means of improving collection of value-added tax (“VAT”) and sales tax.

Security is a driving factor in our business as our customers endeavor to meet escalating governmental requirements directed toward the prevention of identity theft as well as operating safeguards imposed by the credit and debit card associations, members of which include Visa International (“Visa”), MasterCard Worldwide (“MasterCard”), American Express, Discover Financial Services, and JCB Co., Ltd. In September 2006, these card associations established the Payment Card Industry Security Standards Council (“PCI SSC”) to oversee and unify industry standards in the areas of payment card data security, referred to as the PCI standards, which consist of PIN Transaction Security (“PTS”), the PCI Data Security Standard (“PCI-DSS”) for enterprise data security, and the Payment Application Data Security Standard (“PA-DSS”) for payment application data security. These standards continually evolve to become more stringent and increasingly dependent on complex hardware-based measures to protect all payment related data, not just PIN data as in previous versions of these standards.

Our Operating Segments

We operate in two business segments: North America and International. We define North America as the United States and Canada, and International as all other countries from which we derive revenues. Our reportable segments are the same as our operating segments.

Net revenues and operating income (loss) of each business segment reflect net revenues and expenses that directly benefit only that segment. Corporate net revenues and operating income (loss) generally reflect costs incurred on a company-wide basis and it is impractical to allocate them to either the North America or International segments.

During the past year we completed acquisitions for the purpose of expanding our product and service offerings, as well as expanding our geographic reach. We expect that our two largest acquisitions, Hypercom in August 2011 and Point in December 2011, will significantly increase our International segment revenues and operating results. Additionally, our other acquisitions during fiscal year 2012 are expected to contribute to future North America results through new product and service offerings that we intend to also expand internationally. These acquisitions are discussed further below.

We are experiencing revenue growth in both developed and emerging countries. In developed countries, we experience revenue growth driven mainly by customers upgrading and replacing their systems to address best-practice security in more stable

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economic conditions. We experience revenue growth in emerging geographies, such as Latin America, especially Brazil, certain countries in the Middle East and Africa, and Russia, due to factors including growing demand as a result of improvements in economic conditions and efforts to modernize. We expect demand to continue to grow in the remainder of fiscal year 2012, with particular strength in emerging economies. We continue to devote research and development ("R&D") resources to address the market needs of both emerging and developed economies.

Cardsoft patent litigation

On June 8, 2012, we received an unfavorable jury verdict in a patent infringement litigation captioned Cardsoft, Inc. and Cardsoft (Assignment for the Benefit of Creditors), LLC v. VeriFone Holdings, Inc. et al., in which the jury awarded infringement damages of approximately $15 million based on the jury's determination to apply a $3 per unit royalty on those of our terminals that were subject to the infringement claim. In addition, although the district court has not yet issued judgment in this matter, Cardsoft has filed a motion seeking a future royalty higher than the rate awarded by the jury. See further discussion in Note 13. Commitments and Contingencies in the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q. Based on our assessment of probable loss associated with this litigation, including our determination that it is probable the court will award a future royalty of at least $3 per unit for shipments of accused terminals based on the jury's verdict, we have recorded an aggregate contingent loss of approximately $19 million representing estimated probable loss through July 31, 2012. The court may order a royalty on our future sales of the accused products in the U.S. at the $3 per unit applied by the jury or at such other rate as the court may determine. If the court were to order a royalty for future periods at a rate of $3 per unit of U.S. sales, we would expect our earnings per diluted share may be negatively impacted by one-half cent per quarter.

Our Revenue Timing

Timing of our revenue recognition may cause our revenue to vary from quarter to quarter. Specifically, revenues recognized in our fiscal quarters can be back-end weighted when we receive sales orders and deliver a higher proportion of our System solutions toward the end of such fiscal quarters. This back-end weighting of orders may adversely affect our results of operations in a number of ways and could negatively impact revenues and profits. First, the product mix of orders may not align with manufacturing forecasts, which could result in a shortage of the components needed for production. Second, existing manufacturing capacity may not be sufficient to deliver the desired volume of orders in a concentrated time at quarter-end. Third, back-end weighted demand could negatively impact gross margins through higher labor, delivery and other manufacturing and distribution costs. If, on the other hand, we were to seek to manage the fulfillment of back-end weighted orders through holding increased inventory levels, we would risk higher inventory obsolescence charges if our sales fall short of our expectations.

Because our revenue recognition depends, among other things, on timing of product shipments, decisions we make about product shipments, particularly toward the end of a fiscal quarter, may impact our reported revenues. The timing of product shipments may depend on a number of factors, including price discussions with our customers, operating costs, including costs of air shipments if required, the delivery date requested by customers and our operating capacity to fill orders and ship products, as well as our own long and short-term business planning. These factors may affect timing of shipments and consequently revenues recognized for a particular period.

Fire Loss

In July 2012 a fire occurred in one of our repair and staging facilities in Brazil. As of July 31, 2012 we have recorded an $8.3 million insurance receivable in Prepaid and other current assets in our Condensed Consolidated Balance Sheets, which represents the expected probable recoverable amounts for quantified losses. Although final determination of the losses incurred and the actual insurance coverage under our policies are not yet complete, we

expect our losses associated with this event to be substantially covered, and therefore we have recorded no net loss related to the fire during the three months ended July 31, 2012. We do not expect this event to have a material impact on our results of operations or ongoing business operations.

Our Business Acquisitions

During the first half of fiscal year 2012, we completed several acquisitions of businesses and assets. See Note 2. Business Combinations, in the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q. The results of operations from each of these acquisitions have been included in our Condensed Consolidated Financial Statements from the date of acquisition. These acquisitions and their respective purchase prices were:

- On November 1, 2011, we completed the acquisition of assets and assumed certain liabilities of the Show Media taxi advertising business based in New York City ("Show Media"). The total purchase price for Show Media was $28 million.

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- On November 1, 2011, we completed the acquisition of Global Bay, a mobile point of sale software business ("Global Bay") based in South Plainfield, New Jersey. The total purchase price for Global Bay was $28 million.
- On December 30, 2011 we completed our acquisition of Electronic Transaction Group Nordic Holding AB, a Swedish company operating the Point International business (collectively, "Point"). Point was previously one of our distributors and is Northern Europe's largest provider of payment and gateway services and solutions for retailers. The purchase price was approximately €600 million plus payment of Point's then outstanding debt (total purchase price of $1,025 million at the close date.)
- On January 3, 2012, we completed our acquisition of the ChargeSmart (now known as VeriFone Commerce Solutions, Inc.) payments solutions business ("ChargeSmart") based in San Francisco, California. The total purchase price for ChargeSmart was $19 million.
- On March 1, 2012, we completed our acquisition of the Lift Retail Marketing Technology, Inc. digital marketing business ("LIFT") based in Atlanta, Georgia. The total purchase price for LIFT was $6 million.

Critical Accounting Policies and Estimates

Management's discussion and analysis of financial condition and results of operations is based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP").

An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been used, or changes in the accounting estimates that are reasonably likely to occur periodically, could materially impact our consolidated financial statements. Our critical accounting policies include our more significant estimates and assumptions used in the preparation of our consolidated financial statements. Our critical accounting policies are described in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations of our Annual Report on Form 10-K.

There were no significant changes to our critical accounting policies during the three and nine months ended July 31, 2012.

On an ongoing basis, we evaluate our critical accounting policies and estimates, including those related to revenue recognition, inventory valuation, allowance for doubtful accounts, warranty reserves, contingencies and litigation, income taxes, accounting for goodwill and long-lived assets, stock-based compensation, business combinations and restructuring. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Results of Operations

Net Revenues

We generate net revenues through the sale of our electronic payment systems and solutions that enable electronic payment transactions, which we identify as System solutions. Additionally, we generate net revenues through our managed service offerings such as our Point "All-In-One" payment solution, warranty and support services, field deployment, advertising, transaction fees, installation and upgrade services, and customer-specific application development, which we identify as Services.

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Net revenues, which include System solutions and Services, are summarized in the following table (in thousands, except percentages):

	Three Months Ended July 31,				Nine Months Ended July 31,			
	2012	2011	Net Change	% Change	2012	2011	Net Change	% Change
System solutions	$350,230	$253,659	$96,571	38.1 %	$1,003,314	$714,700	$288,614	40.4 %
Services	138,820	63,292	75,528	119.3 %	377,278	178,462	198,816	111.4 %
Total net revenues	$489,050	$316,951	$172,099	54.3 %	$1,380,592	$893,162	$487,430	54.6 %

Total net revenues for the three months ended July 31, 2012 compared with the three months ended July 31, 2011 increased by $172 million, or 54.3%, and for the nine months ended July 31, 2012 compared with the nine months ended July 31, 2011 increased by $487 million, or 54.6%, due primarily to our expanded global reach and product and service offerings, which were driven partly by net revenue contributions from "acquired businesses" and also by fluctuations in currency rates in certain geographies where we conduct business. "Acquired businesses" and "excluding acquisitions" refers to net revenues from businesses acquired during the past 12 months, as further defined in Definitions of non-GAAP net revenue measures at the end of this Net Revenues section of Management's Discussion and Analysis.

Growth in net revenues by geography with and without the impact of acquired businesses and foreign currency fluctuations for the three and nine months ended July 31, 2012 compared to the three and nine months ended July 31, 2011, respectively, is as follows:

	For the three months ended July 31, 2012 compared to July 31, 2011					For the nine months ended July 31, 2012 compared to July 31, 2011				
	Net revenues growth	Impact due to acquired businesses	Organic net revenues growth	Impact due to foreign currency	Organic net revenues at constant currency growth	Net revenues growth	Impact due to acquired businesses	Organic net revenues growth	Impact due to foreign currency	Organic net revenues at constant currency growth
United States and Canada	13.4 %	4.7 pts	8.7 %	0.2 pts	8.9 %	4.3 %	5.5 pts	(1.2)%	0.0 pts	(1.2)%
Europe, Middle East and Africa	106.1 %	89.7 pts	16.4 %	7.7 pts	24.1 %	105.9 %	90.6 pts	15.3 %	4.9 pts	20.2 %
Latin America	45.3 %	15.3 pts	30.0 %	9.9 pts	39.9 %	69.8 %	24.4 pts	45.4 %	6.2 pts	51.6 %
Asia	70.5 %	57.3 pts	13.2 %	2.7 pts	15.9 %	81.9 %	67.0 pts	14.9 %	2.3 pts	17.2 %
Total international	79.8 %	59.3 pts	20.5 %	7.6 pts	28.1 %	90.3 %	64.9 pts	25.4 %	4.9 pts	30.3 %
Total	54.3 %	38.4 pts	15.9 %	4.6 pts	20.5 %	54.6 %	40.4 pts	14.2 %	2.8 pts	17.0 %

During the three and nine months ended July 31, 2012 net revenues included $134 million and $396 million, respectively, of net revenues from businesses acquired during the past 12 months.

Excluding net revenues from businesses acquired in the past 12 months, our year-over-year growth rate was 15.9% for the three month periods and 14.2% for the nine month periods, compared to 54.3% and 54.6%, respectively, including the impact of acquired businesses.

Our year over year growth rate for organic net revenues at constant currency was 20.5% for the three month periods and 17.0% for the nine month periods. Foreign currency had the most significant impact on our Europe and Latin America net revenues due to greater fluctuations in the values of the Euro, British Pound and Brazilian Reais during the fiscal 2012 periods presented.

We expect that growth rates for the remainder of fiscal year 2012 and for fiscal year 2013 will continue to be impacted by our recent acquisitions and foreign currency fluctuations, as well as the mix of our product sales.

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The measures of organic net revenues and organic net revenues at constant currency discussed in this Form 10-Q are non-GAAP measures. We define organic net revenues as GAAP net revenues less net revenues from businesses acquired in the past 12 months and less corporate net revenues. We calculate organic net revenues at constant currency by applying a constant currency exchange rate to organic net revenues from one period to another, thereby eliminating the impact of foreign exchange rate fluctuations between the two periods. See Definitions of non-GAAP net revenue measures at the end of this Net Revenues section of Management's Discussion and Analysis for additional information about these non-GAAP measures.

Net revenues product mix

For the three and nine months ended July 31, 2012 System solutions net revenues comprised 71.6% and 72.6% of total net revenues, respectively, compared to 80% for both the three and nine months ended July 31, 2011. The lower proportion of System solutions net revenues reflects growth in our Services revenues primarily as a result of acquiring the Point business, which has a significant proportion of Services business, in addition to our increased efforts selling our other service-based solutions.

We expect to see a continued shift towards a higher proportion of Services revenues in the remainder of fiscal year 2012 and fiscal year 2013 due to the acquisition of Point and our continued development and sales of our Services business offerings. We plan to expand the roll out of Point's "All-In-One" payment solution beyond Point's traditional markets and also expect to expand programs, such as continue to deploy media related equipment in taxis and gas pumps, designed to generate advertising and other service fee or rental revenue streams.

System Solutions Net Revenues

System solutions net revenues are summarized in the following table (in thousands, except percentages):

	Three Months Ended July 31,				Nine Months Ended July 31,			
	2012	2011	Net Change	% Change	2012	2011	Net Change	% Change
International	$258,200	$169,907	$88,293	52.0 %	758,477	$454,227	$304,250	67.0 %
North America	92,759	83,753	9,006	10.8 %	250,903	260,473	(9,570)	(3.7)%
Corporate	(729)	(1)	(728)	nm	(6,066)	—	(6,066)	nm
Total	$350,230	$253,659	$96,571	38.1 %	1,003,314	$714,700	$288,614	40.4 %

nm - not meaningful

System solutions net revenues increased due to the growth in our international operations and the acquisition and growth of businesses in new international geographies. Economic improvements in certain territories are driving infrastructure development initiatives, and new product launches are increasing demand as our Vx Evolution products become certified in new geographies. For the three months ended July 31, 2012, System solutions net revenue contributions from acquired businesses were $49 million for Hypercom (which we acquired on August 4, 2011), $12 million for Point (which we acquired on December 30, 2011) and $1 million for other fiscal year 2011 and fiscal year 2012 acquisitions.

For the nine months ended July 31, 2012, System solutions net revenue contributions from acquired businesses were $163 million for Hypercom, $33 million for Point and $12 million for other fiscal year 2011 and fiscal year 2012 acquisitions.

International System Solutions Net Revenues

International System solutions net revenues increased $88 million, or 52.0%, for the three months ended July 31, 2012 compared with the three months ended July 31, 2011. On a regional basis, Europe, Middle East and Africa increased $44 million, Latin America increased $25 million, and Asia increased $19 million. International System solutions net revenues in the three months ended July 31, 2011 included $6 million of sales to Point and $1 million of sales to a company we acquired during fiscal 2011, that will not recur because the acquired company was formerly a customer.

System solutions net revenues for Europe, Middle East and Africa increased $44 million, or 52.9%, and $1 million, or 1%, excluding acquisitions, for the three months ended July 31, 2012 compared with the three months ended July 31, 2011. This $1 million increase in net revenues was primarily due to a $10 million increase in demand as countries in this region, primarily Nigeria, move towards a less cash-dominant economy, offset by an $8 million decrease in southeast Europe primarily due to the timing of large orders from distributors.

Latin America System solutions net revenues increased $25 million, or 44.2%, and $21 million, or 36.4%, excluding acquisitions, for the three months ended July 31, 2012 compared with the three months ended July 31, 2011. The $21 million increase is primarily a result of increased demand throughout the region driven by continued economic growth and the expansion of the electronic payment card industry. In particular we won new bids in Mexico and Central America that shipped during the quarter ended July 31, 2012.

Asia System solutions net revenues increased $19 million, or 64.5%, and $6 million, or 19.7%, excluding acquisitions, for the three months ended July 31, 2012 compared with the three months ended July 31, 2011. The $6 million increase in net revenues excluding acquisitions was due to $8 million of increased demand as a result of our efforts to develop markets within the region primarily in China and Greater Asia, partially offset by a $2 million decrease in India due to a slowdown in demand as a result of the Reserve Bank of India's directive to cap processing fees for debit transactions.

International System solutions net revenues increased $304 million, or 67.0%, for the nine months ended July 31, 2012 compared with the nine months ended July 31, 2011. On a regional basis, excluding historical sales to acquired businesses, Europe, Middle East and Africa increased $146 million, Latin America increased $105 million, and Asia increased $53 million. International System solutions net revenues for the nine months ended July 31, 2011 included $15 million of sales to Point and $1 million of sales to a company we acquired during fiscal year 2011.

For the nine months ended July 31, 2012 compared with the nine months ended July 31, 2011, International Systems solutions net revenues for Europe, Middle East and Africa increased $146 million, or 63.3%, excluding historical sales to acquired businesses noted above and increased $4 million, or 1.9% excluding acquisitions. The increase in revenue excluding acquisitions was mainly due to a $16 million increase in the Middle East and Africa, primarily Nigeria, United Arab Emirates, and South Africa, resulting from our efforts to develop markets within the region and growing demand as the region moves towards a less cash-dominant society, partially offset by a $11 million decrease in southeast Europe due to the timing of orders from customers.

Latin America System solutions net revenues increased $105 million, or 70.4%, and increased $80 million, or 53.8%, excluding acquisitions, for the nine months ended July 31, 2012 compared with the nine months ended July 31, 2011, primarily as a result of increased demand throughout the region driven by continued economic growth and the expansion of the electronic payment card industry.

Asia System solutions net revenues increased $53 million, or 71.5%, and increased $12 million, or 16.9%, excluding acquisitions, for the nine months ended July 31, 2012 compared with the nine months ended July 31, 2011, primarily due to $17 million of increased demand as a result of our efforts to develop markets within the region partially offset by $6 million in lower sales in Australia and New Zealand.

North America System Solutions Net Revenues

North America System solutions net revenues increased $9 million, or 10.8%, and $7 million, or 8.3%, excluding acquisitions, for the three months ended July 31, 2012 compared with the three months ended July 31, 2011. During the three months ended July 31, 2012, we had a $8 million increase in our vertical markets and Petroleum businesses driven by adoption of newer technologies and timing of customer upgrades which was partially offset by a $3 million decrease in net revenues from our North American financial solutions business, which sells payment systems to small and medium-sized businesses through ISOs and payment processors.

For the nine months ended July 31, 2012 compared with the nine months ended July 31, 2011, North America Systems Solutions net revenues decreased $10 million, or 3.7%, and decreased $17 million, or 6.4%, excluding

acquisitions. Net revenues in our North American financial solutions business decreased by $22 million primarily due to the timing of our distributors' purchases, which generally varies based on distributor decisions on inventory levels, desired product mix, and timing of new product introductions, and stronger sales in Canada a year ago due to a mandated EMV upgrade cycle. Net revenues in our Petroleum business decreased by $4 million, primarily driven by the timing of PCI compliance efforts of later adopting customers to address the July 2010 PCI-PED (PIN Entry Device) compliance deadlines which benefited our fiscal year 2011 revenues. These declines were partially offset by a $7 million increase in our vertical markets driven by adoption of newer technologies and timing of customer upgrades.

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Outlook for System Solutions Net Revenues

Over the last several quarters, improving economic conditions in some parts of the world have favorably impacted demand for our products, particularly in Latin America, especially Brazil, the Middle East and Africa, and Russia. We are unable to predict whether this demand will be sustained. We have also experienced fluctuations in our revenue due to the impact of foreign currency changes, and are unable to predict how currency rates may change in the future. Moreover, many economies that have experienced economic improvements since the global recession in 2008, including the U.S., continue to experience some volatility and challenges in achieving sustained economic growth. In particular, Europe, continues to experience significant economic volatility and uncertainty, including restrictive credit conditions due to the ongoing European sovereign debt crisis. Any sustained economic weakness or deterioration in economic conditions, particularly if persistent, would adversely affect our business, operating results, and financial condition.

We expect International System solutions net revenues to benefit from the addition of our global acquisitions, as well as continued overall demand for our products internationally, including growth in emerging markets that continue to adopt electronic payments and create retail establishments, as they expand their middle class.

We expect growth in North America System solutions net revenues over the next several years to be driven by anticipated customer refreshes to replace aging terminals and merchant purchases of more advanced systems in anticipation of the adoption of new technologies such as NFC and other mobile device enabled payments at the point of sale. North America net revenues are also anticipated to grow as a result of the EMV standard that we expect will be adopted in the U.S. over the next several years, as the petroleum market continues to adopt new and more secure payment devices for gasoline dispensers, and as revenues from our acquired businesses continue to benefit from cross selling to legacy VeriFone customers.

Globally we expect that changes in payment technologies, our ability to develop and release new products, the timing of customer orders, as well as competitive pressures, may influence our net revenues in the future.
Services Net Revenues

Services net revenues are summarized in the following table (in thousands, except percentages):

	Three Months Ended July 31,				Nine Months Ended July 31,			
	2012	2011	Net Change	% Change	2012	2011	Net Change	% Change
International	$96,585	$25,412	$71,173	280.1 %	$251,705	$68,701	$183,004	266.4 %
North America	45,675	38,082	7,593	19.9 %	136,700	110,467	26,233	23.7 %
Corporate	(3,440)	(202)	(3,238)	nm	(11,127)	(706)	(10,421)	nm
Total	$138,820	$63,292	$75,528	119.3 %	$377,278	$178,462	$198,816	111.4 %

nm – not meaningful

International Services Net Revenues

For the three months ended July 31, 2012, compared to the three months ended July 31, 2011 International Services net revenues increased $71 million, or 280.1%, due primarily to our acquisition of service oriented businesses in global territories, as well as, to a lesser extent, growth of various of our legacy service initiatives in our existing regions. Contributions to International Services net revenues for this period from acquired businesses were as follows: Point (which we acquired on December 30, 2011) added $40 million including their "All-In-One" payment solution, Hypercom (which we acquired on August 4, 2011) added $19 million primarily consisting of terminal maintenance services, and other acquisitions added $8 million, primarily taxi advertising revenues and maintenance revenues. Due to, among other things, the effects of cross selling acquired services to our legacy customers and our legacy products

to customers of our acquired businesses, our stated growth of net revenues from our acquired businesses does not necessarily reflect what the results from the acquired businesses would have been on a standalone and non-integrated basis.

International Services net revenues excluding revenue from acquired businesses increased $4 million, or 16.6%, for the three months ended July 31, 2012 compared with the three months ended July 31, 2011 as we continue to develop our services offerings and expand them globally.

For the nine months ended July 31, 2012 compared with the nine months ended July 31, 2011, International Services net

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revenues increased $183 million, or 266.4%, due to our acquisition of service oriented businesses in global territories, as well as growth of managed service initiatives in our existing regions. Contributions to International Services net revenues for this period from acquired businesses were as follows: Point added $86 million, Hypercom added $56 million and other acquisitions added $28 million.

International Services net revenues excluding acquisitions increased $15 million, or 22.3%, for the nine months ended July 31, 2012 compared with the nine months ended July 31, 2011, as we continued to develop our Services offerings and expand them globally.

North America Services Net Revenues

For the three months ended July 31, 2012, North America Services net revenues increased $8 million, or 19.9%, due to U.S. businesses that we acquired and grew, as well as growth of various legacy service initiatives across North America. Net revenue contributions from acquired businesses were $4 million, primarily $3 million of taxi advertising from our Show Media acquisition.

North America Services net revenues increased $4 million, or 9.7% excluding acquisitions, as a result of our efforts to increase service offerings, such as software maintenance programs that were launched in our Petroleum Services market during fiscal year 2011.

For the nine months ended July 31, 2012 compared to the nine months ended July 31, 2011, North America Services net revenues increased $26 million, or 23.7%, due to U.S. businesses that we acquired and grew, as well as growth of managed service initiatives across North America. Net revenue contributions from acquired businesses were $14 million, primarily related to taxi advertising, mobile point of sale and payment solutions business.

North America Services net revenues increased $12 million, or 11.0%, excluding acquisitions, during the nine months ended July 31, 2012 compared to the nine months ended July 31, 2011 as a result of our efforts to increase service offerings. Taxi payments and advertising services net revenues increased $5 million due to additional advertising revenue and higher transaction revenue. Additionally, software maintenance programs launched in the Petroleum Services business contributed an additional $7 million. North America Services net revenues were also impacted by the timing of customer orders for deployment and other services, which increased vertical solutions revenue by $3 million and decreased financial solutions revenue by $3 million.

Outlook for Services Net Revenues

Worldwide, we have a number of programs underway which we believe will continue to grow Services revenues. Internationally, we expect increased transaction and advertising revenues in our VeriFone media and taxi payments businesses as they expand. We expect Services revenues in North America to be driven by continued growth in software maintenance programs, our media solutions business, system deployment projects, and our expanded deployment of media related equipment at gas pumps to generate advertising and other service fee or rental revenue streams. In addition, we expect incremental Services net revenues as a result of the inclusion of a full year of results and growth from acquired businesses, and continued development and sales of our Services business offerings with an emphasis on expanding the roll out of Point's All-In-One payment solution beyond Point's traditional markets.

Definitions of Non-GAAP net revenue measures

We refer to our net revenues excluding the impact of foreign currency exchange rates as net revenues at constant currency. We refer to our net revenues excluding the impact of businesses acquired in the past 12 months as organic net revenues.

We determine organic net revenues at constant currency by recomputing organic net revenues denominated in currencies other than U.S. dollars in the current fiscal year using average exchange rates for that particular currency during the corresponding quarter of the prior year. We use this non-GAAP measure to evaluate performance on a comparable basis excluding the impact of foreign currency fluctuations.

We define organic net revenues as net revenues excluding net revenues from businesses acquired in the past 12 months and corporate net revenues. Net revenues from businesses acquired in the past 12 months consists of net revenues derived from the sales channels of acquired resellers and distributors, and net revenues from system solutions and services attributable to businesses acquired in the 12 months preceding the financial periods presented. For acquisitions of small businesses that are

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integrated within a relatively short time after the close of the acquisition, we assume quarterly net revenues attributable to such acquired businesses during the 12 months following acquisition remain at the same level as in the first full quarter after the acquisition closed. During periods prior to each acquisition, net revenues from businesses acquired in the past 12 months consists of sales by VeriFone to that acquired company prior to our acquisition of the company. Corporate net revenues represent the reduction in net revenues post-acquisition resulting from the fair value decrease (step-down) in acquired deferred revenue. Organic net revenues and net revenues from acquired businesses do not necessarily reflect what net revenues would have been for our business without the acquired businesses, or for the acquired businesses had we not acquired them, due to, among other things the effects of cross selling acquired services to our legacy customers and our legacy products to customers of our acquired businesses and other changes to our businesses during the course of integrating the acquired businesses.

Organic net revenues and organic net revenues at constant currency are non-GAAP financial measures, which is information derived from consolidated financial information but not presented in our financial statements prepared in accordance with GAAP. Our management uses these non-GAAP measures to evaluate VeriFone's performance and operations, and to compare VeriFone's current results with those for prior periods as well as with the results of peer companies. These non-GAAP measures are also used in VeriFone's budget and planning process. These non-GAAP financial measures contain limitations, as they are not based on any comprehensive set of accounting rules or principles and may therefore differ from similar non-GAAP financial measures used by other companies. As a result, these non-GAAP measures should be considered as a supplement to, and not as a substitute for, or superior to, disclosures made in accordance with GAAP.

Gross Margin

The following table shows the gross margin for System solutions and Services (in thousands, except percentages):

	Three Months Ended July 31,				Nine Months Ended July 31,			
	Amount		Gross Margin		Amount		Gross Margin	
	2012	2011	2012	2011	2012	2011	2012	2011
System solutions	$144,017	$103,038	41.1 %	40.6 %	$396,076	$286,343	39.5 %	40.1 %
Services	63,490	28,574	45.7 %	45.1 %	160,228	79,345	42.5 %	44.5 %
Total	$207,507	$131,612	42.4 %	41.5 %	556,304	365,688	40.3 %	40.9 %

System Solutions

Gross margin on System solutions increased 0.5 points to 41.1%, for the three months ended July 31, 2012, compared with the three months ended July 31, 2011. International System solutions gross margin increased 0.4 points, while North American System solutions gross margin increased 1.0 point over the same period. These increases were partially offset by increased Corporate costs. Our System solutions gross margin benefited from a favorable product mix impact due to a proportional increase in the sales of the Vx Evolution product solutions, which carry higher margins compared with certain previous generation solutions, as well as an improved geographic and customer mix in some regions.

Gross margin on System solutions decreased 0.6 points to 39.5%, for the nine months ended July 31, 2012 compared with the nine months ended July 31, 2011. International System solutions gross margin increased 2.0 points over the same period, mainly driven by a favorable product mix impact due to increased sales of the Vx Evolution product solutions, as well as an improved geographic and customer mix in some regions. North America System solutions gross margin remained relatively unchanged, increasing only 0.4 points in the nine months ended July 31, 2012 compared with the nine months ended July 31, 2011. These increases were offset by Corporate costs, including acquisition related charges, which increased in absolute dollars and as a percentage of total System solutions net revenues.

As described above in the Overview to this Item 2, as a result of the unfavorable verdict we received in the ongoing Cardsoft patent litigation, the court for the Cardsoft matter may order that a royalty be applied to our future sales of

the accused products in the U.S., which may be at the $3 per unit applied by the jury or at such higher rate as the court may determine. Although we have estimated that a future royalty of $3 per unit is probable, Cardsoft has filed a motion seeking a higher royalty rate. See further discussion in Note 13. Commitments and Contingencies in the Notes to Condensed Consolidated Financial Statements included in this report on Form 10-Q. If the court decides to order such a royalty, the cost per unit of our sales in the U.S. of the products subject to this litigation would be increased by the royalty ordered by the court, which may be the $3 per unit applied by the jury or such higher rate as the court may determine, and our gross margin may be materially adversely impacted.

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Services

Services gross margin increased 0.6 points and decreased 2.0 points to 45.7% and 42.5%, respectively, for the three and nine months ended July 31, 2012 compared with the three and nine months ended July 31, 2011.

International Services gross margin increased 9.9 and 10.1 points during the three and nine months ended July 31, 2012 compared with the comparable prior year periods, primarily driven by the higher service margins associated with the Point "All-In-One" payment solution. These increases were partially offset by lower margins associated with the Hypercom services business in Latin America, Australia and Asia.

North America Services gross margin decreased 5.0 and 2.6 points during the three and nine months ended July 31, 2012 compared with the comparable prior year periods, primarily driven by reduced gross margin in our media business due to the higher costs on renewed taxi leases and in new advertising markets where revenues have not yet ramped. North America Services gross margin was also impacted by increased gross margin in our Petroleum businesses following the launch of new software maintenance programs in the third quarter of 2011, and by an unfavorable mix of services sold in our vertical markets.

Research and Development Expenses

Research and development ("R&D") expenses for the three and nine months ended July 31, 2012 and 2011 are summarized in the following table (in thousands, except percentages):

	Three Months Ended July 31,				Nine Months Ended July 31,			
	2012	2011	Net Change	Percentage Change	2012	2011	Net Change	Percentage Change
Research and development	$38,657	$27,457	$11,200	40.8 %	$111,585	$74,501	$37,084	49.8 %
Percentage of net revenues	7.9 %	8.7 %			8.1 %	8.3 %		

R&D expenses for the three months ended July 31, 2012 increased $11 million, or 40.8%, compared with the three months ended July 31, 2011. This increase was primarily due to $8 million of increased personnel related expenses associated with year over year headcount growth from acquired businesses and hiring to expand development of new products on new platforms and in new geographies, a $1 million increase in outside services to assist in developing our product portfolio and a $1 million increase in integration related costs as a result of our acquisitions of Point and Hypercom.

R&D expenses for the nine months ended July 31, 2012 increased $37 million, or 49.8%, compared with the nine months ended July 31, 2011. This increase was primarily due to a $26 million increase in personnel related expenses associated with year over year headcount growth from acquired businesses and hiring to expand development of new products on new platforms and in new geographies. In addition, R&D expenses increased $4 million for outside development services to assist in developing our product portfolio, and $4 million due to an increase in transition costs associated with the integration of our acquisitions.

We expect R&D expenses, assuming a stable currency environment, to grow in absolute amounts primarily as a result of the additional costs of businesses acquired during 2012, and higher product development activities for a larger portfolio of product and service offerings.

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Sales and Marketing Expenses

Sales and marketing expenses for the three and nine months ended July 31, 2012 and 2011 are summarized in the following table (in thousands, except percentages):

	Three Months Ended July 31,				Nine Months Ended July 31,			
	2012	2011	Net Change	Percentage Change	2012	2011	Net Change	Percentage Change
Sales and marketing Expenses	$46,182	$32,769	$13,413	40.9 %	$132,309	$92,214	$40,095	43.5 %
Percentage of net revenues	9.4 %	10.3 %			9.6 %	10.3 %		

Sales and marketing expenses for the three months ended July 31, 2012 increased $13 million, or 40.9%, compared with the three months ended July 31, 2011. This increase was primarily due to a $9 million increase in personnel related expenses and facilities costs associated with year over year headcount growth from acquired businesses and hiring to support general business growth, including in new geographies, and the launch of new products and initiatives, such as the launch of our new Sail service. In addition, sales and marketing expenses increased $3 million due to increased expenses for marketing programs as our business expands globally, and increased $2 million due to increased stock-based compensation expense.

Sales and marketing expenses for the nine months ended July 31, 2012 increased $40 million, or 43.5%, compared with the nine months ended July 31, 2011. This increase was primarily due to a $29 million increase in personnel related expenses and facilities costs associated with year over year headcount growth from acquired businesses and hiring to support general business growth, including in new geographies, and the launch of new products and initiatives. In addition, sales and marketing expenses increased $7 million due to increased expenses for global marketing programs as our business expands globally, and $4 million due to increased stock-based compensation.

We expect sales and marketing expenses, assuming a stable currency environment, to grow in absolute amounts as the result of the additional costs of businesses acquired during 2012, and, as required, to launch and support new business initiatives.

General and Administrative Expenses

General and administrative expenses for the three and nine months ended July 31, 2012 and 2011 are summarized in the following table (in thousands, except percentages):

	Three Months Ended July 31,				Nine Months Ended July 31,			
	2012	2011	Net Change	Percentage Change	2012	2011	Net Change	Percentage Change
General and administrative	$43,414	$28,657	$14,757	51.5 %	$138,148	$79,716	$58,432	73.3 %
Percentage of net revenues	8.9 %	9.0 %			10.0 %	8.9 %		

General and administrative expenses for the three months ended July 31, 2012 increased $15 million, or 51.5%, compared with the three months ended July 31, 2011. This increase was primarily due to $11 million of additional personnel costs as a result of year over year headcount growth from acquisitions and hiring to support our growing business requirements, a $5 million increase in outside services such as legal, accounting and IT services to support business growth, and a $2 million increase in stock-based compensation. These increases were partially offset by a $3

million decrease in professional fees related to the non-recurrence of acquisition-related costs incurred in the prior period in connection with our acquisition of Hypercom.

General and administrative expenses for the nine months ended July 31, 2012 increased $58 million, or 73.3%, compared with the nine months ended July 31, 2011. This increase was primarily due to a $24 million increase in personnel related expenses associated with year over year headcount growth from acquisitions and hiring to support general business growth, $13

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million of additional acquisition and integration related charges primarily for professional and outside services fees, such as legal, accounting, and IT services, a $10 million increase in non-acquisition related outside services such as legal, accounting and IT services to support the growing business, and a $4 million increase in stock-based compensation.

We expect general and administrative expenses, assuming a stable currency environment, to vary depending on the additional costs of businesses acquired during 2012, and changes in acquisition related charges.

Patent Litigation Loss Contingency Expense

We recognized a patent litigation loss contingency expense of $18 million in the three months ended April 30, 2012 as a result of an unfavorable jury verdict issued on June 8, 2012 against VeriFone and Hypercom in an ongoing patent infringement action that was filed in 2008 and which alleges patent infringement by certain VeriFone and Hypercom products. In addition to the unfavorable jury verdict, we believe it is probable that the district court in this matter will order an ongoing royalty on sales of the accused devices in the U.S. of at least $3 per unit. Effective in the third quarter of fiscal year 2012 when the jury verdict was issued, we have accrued $3 per unit to cost of net revenues for potential ongoing royalties on shipments of our terminals that were subject to the infringement claim. See further discussion in Note 13, Commitments and Contingencies, in the Notes to Condensed Consolidated Financial Statements included in this report on Form 10-Q.

Amortization of Purchased Intangible Assets

Amortization of purchased intangible assets expenses for the three and nine months ended July 31, 2012 and 2011 are summarized in the following table (in thousands, except percentages):

	Three Months Ended July 31,				Nine Months Ended July 31,			
	2012	2011	Net Change	Percentage Change	2012	2011	Net Change	Percentage Change
Cost of net revenues	$10,582	$2,687	$7,895	293.8 %	$29,782	$10,713	$19,069	178.0 %
Operating expenses	23,177	1,980	21,197	nm	60,549	5,959	54,590	nm
Total amortization of purchased intangible assets	$33,759	$4,667	$29,092	nm	$90,331	$16,672	$73,659	nm

nm – not meaningful

Amortization of purchased intangible assets increased $29 million in the three months ended July 31, 2012 compared with the three months ended July 31, 2011, and $74 million for the nine months ended July 31, 2012 compared to the nine months ended July 31, 2011, as a result of amortization of new intangible assets from fiscal year 2012 and 2011 acquisitions.

We expect amortization of purchased intangible assets to increase in future reporting periods due to the full year impact of amortization of intangible assets related to businesses acquired in fiscal years 2011 and 2012, as well as future acquisitions, offset partially by previously acquired intangibles reaching the end of their respective useful lives.

Operating Income

Operating income of the International and North America segments reflects net revenues and expenses that directly benefit only that segment. Examples of these segment expenses are: standard inventory costs of System solutions net revenues, cost of Services net revenues, distribution center costs, royalty expense and warranty expense.

Corporate operating loss reflects amortization of purchased intangible assets, fair value increase (step-up) of inventory at acquisition, fair value decrease (step-down) in deferred revenue at acquisition, impairment, stock-based compensation, acquisition and restructuring costs, and other Corporate charges, including inventory obsolescence and scrap, rework, specific warranty provisions, non-standard freight, and over-and-under absorption of materials management overhead. Since Corporate costs are generally incurred on a company-wide basis, it is impractical to allocate them to either the International or North America segments.

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The following table sets forth operating income (loss) for our segments (in thousands, except percentages):

	Three Months Ended July 31,				Nine Months Ended July 31,			
	2012	2011	Net Change	Percentage Change	2012	2011	Net Change	Percentage Change
Operating income (loss):								
International	$101,820	$53,699	$48,121	89.6 %	$289,560	$143,460	$146,100	101.8 %
North America	49,237	45,820	3,417	7.5 %	134,690	135,821	(1,131)	(0.8)%
Corporate	(94,980)	(58,770)	(36,210)	61.6 %	(328,169)	(165,983)	(162,186)	97.7 %
Total operating income	$56,077	$40,749	$15,328	37.6 %	$96,081	$113,298	$(17,217)	(15.2)%

International Segment

For the three and nine months ended July 31, 2012, International operating income increased $48 million and $146 million, or 89.6% and 101.8%, respectively, compared with the three and nine months ended July 31, 2011. The increases were primarily due to net revenues from businesses acquired in fiscal year 2012, as well as improved gross margin related to Services net revenues compared with the prior year periods, and growth in net revenues from acquired businesses.

North America Segment

For the three months ended July 31, 2012, North America operating income increased $3 million, or 7.5%, compared with the three months ended July 31, 2011. Increased System solutions and Services net revenues were offset by increased operating expenses. For the nine months ended July 31, 2012, North America operating income decreased $1 million, or 0.8%, compared with the nine months ended July 31, 2011. Gross margin increased due to net revenues from business acquisitions and growth in Services net revenue, but these increases were more than offset by a decline in System solutions net revenues and increased operating expenses.

In addition, as described above in the Overview to this Item 2, as a result of the unfavorable verdict we received in the ongoing Cardsoft patent litigation, the district court in the Cardsoft matter may order that a royalty be applied to our future sales of the accused products in the U.S. Although we have estimated that a future royalty of $3 per unit is probable, Cardsoft has filed a motion seeking a higher royalty rate. See further discussion in Note 13. Commitments and Contingencies in the Notes to Condensed Consolidated Financial Statements included in this report on Form 10-Q. If the court decides to order such a royalty, the cost per unit of our sales in the U.S. of the products subject to this litigation would be increased by the royalty ordered by the court, which may be the $3 per unit applied by the jury or such higher rate as the court may determine, and our operating income may be materially adversely impacted.

Corporate

Corporate operating loss increased $36 million, or 61.6%, for the three months ended July 31, 2012 compared with the three months ended July 31, 2011, primarily due to $29 million in amortization of purchased intangible assets, $4 million related to amortization of the step-down in deferred revenue resulting from acquisition accounting, and a $4 million increase in stock-based compensation expense.

For the nine months ended July 31, 2012 compared with the nine months ended July 31, 2011, the Corporate operating loss increased $162 million, or 97.7%. Our acquisition activities resulted in $74 million of increased amortization of

purchased intangible assets, a $24 million increase in acquisition, integration, and restructuring-related expenses, a $16 million increase related to amortization of the step-down in deferred revenue and a $7 million increase in amortization of the step-up in inventory resulting from acquisition accounting. In addition, stock-based compensation expense increased $9 million for the nine month period ended July 31, 2012 compared with the nine months ended July 31, 2011, and we recognized a patent litigation loss contingency of $18 million during the second quarter of fiscal year 2012. These increases were partially offset by a decrease of $11 million in warranty and royalty expenses.

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Interest Expense

Interest expense for the three and nine months ended July 31, 2012 and 2011 is summarized in the following table (in thousands, except percentages):

	Three Months Ended July 31,				Nine Months Ended July 31,			
	2012	2011	Net Change	Percentage Change	2012	2011	Net Change	Percentage Change
Interest expense	$16,374	$7,963	$8,411	105.6 %	$49,644	$22,998	$26,646	115.9 %

Interest expense increased $8 million, or 105.6%, in the three months ended July 31, 2012 compared with the three months ended July 31, 2011 primarily as the result of interest expense related to the 2011 Credit Agreement, which was entered into in December 2011 in connection with the Point acquisition. Interest expense increased $27 million, or 115.9%, in the nine months ended July 31, 2012 compared with the nine months ended July 31, 2011, primarily as a result of interest on the 2011 Credit Agreement, and the acceleration of debt issue cost amortization associated with the payment prior to maturity of our previous secured credit Facility that was repaid in December 2011 from the proceeds of the 2011 Credit Agreement.

We expect interest expense to increase in the remainder of fiscal year 2012 compared with fiscal year 2011 as a result of the higher outstanding borrowings under the 2011 Credit Agreement.

Interest Income

Interest income for the three and nine months ended July 31, 2012 and 2011 is summarized in the following table (in thousands, except percentages):

	Three Months Ended July 31,				Nine Months Ended July 31,			
	2012	2011	Net Change	Percentage Change	2012	2011	Net Change	Percentage Change
Interest income	$1,110	$479	$631	131.7 %	$3,260	$1,049	$2,211	210.8 %

Interest income increased in the three months ended July 31, 2012 compared with the three months ended July 31, 2011 primarily due to higher average interest rates earned on our cash and cash equivalents. For the nine months ended July 31, 2012 compared with the same period in 2011, interest income increased $2.2 million, or 210.8%, primarily due to higher interest earned on our short-term investments in Brazil, where interest rates have been over 7.5%, and an increase in average interest-earning cash balances in Singapore.

Other Income (Expense), Net

Other income (expense), net for the three and nine months ended July 31, 2012 and 2011 is summarized in the following table (in thousands, except percentages):

	Three Months Ended July 31,				Nine Months Ended July 31,			
	2012	2011	Net Change	Percentage Change	2012	2011	Net Change	Percentage Change
Other income (expense), net	$(721)	$6,313	$(7,034)	nm	$(23,350)	$6,152	$(29,502)	nm

nm – not meaningful

Other income (expense), net declined $7 million during the three months ended July 31, 2012 compared with the three months ended July 31, 2011, primarily due to transactions that occurred in the three months ended July 31, 2011, but not in the three months ended July 31, 2012, such as a $5 million gain from the convertible note call option settlement and a $1 million gain from adjustments to acquisition-related balances. Other income (expense), net declined $30 million in the nine months ended July 31, 2012 compared with the nine months ended July 31, 2011, primarily due to a $22 million foreign currency loss

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recognized in December 2011 related to the difference between the forward rate on contracts purchased to lock in the U.S. dollar equivalent purchase price for our Point acquisition and the actual rate on the date of derivative settlement, as well as the gains related to the discrete transactions described above that occurred in the three months ended July 31, 2011.

Provision for Income Tax

We recorded an income tax provision of $2 million and an income tax benefit of $12 million for the three and nine months ended July 31, 2012, respectively. We recorded income tax provisions of $13 million and $14 million for the three and nine months ended July 31, 2011, respectively. The effective tax rates for the three and nine months ended July 31, 2012 and 2011 are lower than the U.S. statutory tax rate due to earnings in countries where we are taxed at lower rates compared to the U.S. federal and state statutory rates and reversal of uncertain tax position liabilities as statutes of limitations expired. The income tax benefit for the nine months ended July 31, 2012 includes a discrete tax benefit of $9 million related to the foreign exchange loss on futures contracts which was incurred during December 2011, and $7 million related to a patent litigation loss contingency expense which was incurred during June 2012.

During January 2012, we entered into a formal settlement with the Israeli tax authorities for the calendar year 2006 audit and, accordingly, have released $3 million of excess accrued tax liabilities associated with this audit.

As of July 31, 2012, we remain in a net deferred tax asset position. The realization of our deferred tax assets depends primarily on our ability to generate sufficient U.S. and foreign taxable income in future periods. The amount of deferred tax assets considered realizable may increase or decrease in subsequent quarters as we reevaluate the underlying basis for our estimates of future U.S. and foreign taxable income.

We have a Singapore Pioneer Tax Holiday for fiscal years 2006 through 2011, with a one year extension through our fiscal year 2012. At the expiration of the tax holiday, our income in Singapore will be taxed at the statutory rate of 17% instead of the agreed Pioneer Tax Holiday rate of 0%, which may impact our effective tax rate. Currently, Singapore is the foreign jurisdiction that has a material impact on our effective tax rate. Any shifts in the mix of pretax profits and losses by tax jurisdiction may also impact our effective tax rate.
Our unrecognized tax benefits increased by approximately $6 million during the three months ended July 31, 2012 as a result of tax positions taken in prior periods. A significant portion of the increase was due to an increase to our uncertain tax positions related to our prior year acquisitions. We have recorded our uncertain tax position liability as a long-term liability, as we do not expect significant payments to occur over the next twelve months. The amount of unrecognized tax benefits could be reduced upon closure of tax examinations or if the statute of limitations on certain tax filings expire without assessment from the relevant tax authorities. We believe that it is reasonably possible that there could be a reduction in unrecognized tax benefits due to statute of limitation expirations in multiple tax jurisdictions during the next twelve months of approximately $2 million. Interest and penalties accrued on these uncertain tax positions will also be released upon the expiration of statutes of limitations.
Liquidity and Capital Resources

	Nine Months Ended July 31,			
(in thousands)	2012	2011	Net Change	Percentage Change
Net cash provided by (used in):				
Operating activities	$145,363	$121,654	$23,709	19.5 %
Investing activities	(1,100,261)	(19,294)	(1,080,967)	nm
Financing activities	781,426	33,477	747,949	nm
Effect of foreign currency exchange rate changes on cash	(11,283)	3,226	(14,509)	nm
Net increase (decrease) in cash and cash equivalents	$(184,755)	$139,063	$(323,818)	(232.9)%

nm – not meaningful

Our primary liquidity and capital resource needs are to service our debt, finance working capital, and to make capital expenditures and investments. As of July 31, 2012, our primary sources of liquidity were $410 million of cash and cash equivalents, as well as amounts available to us under the Revolving loan, which is part of our 2011 Credit Agreement. Cash and cash equivalents included $340.0 million held by our foreign subsidiaries as of July 31, 2012. If we decide to distribute or use

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such cash and cash equivalents outside those foreign jurisdictions, including a distribution to the United States, we may be subject to additional taxes or costs.

On December 28, 2011, VeriFone Inc. entered into the 2011 Credit Agreement, which initially consisted of a $919 million Term A loan, $232 million Term B loan, and $350 million Revolving loan, of which $300 million was initially funded. This financing, supplemented by our cash on hand, was used to fund the acquisition of Point for €600 million (approximately USD $777 million at closing), repay Point's outstanding debt of approximately €190 million (approximately $248 million), repay our previously outstanding loans, fund an escrow account to pay the interest and principal of the 1.375% senior convertible notes (the "Notes") that matured in June 2012, and fund certain financing costs. See Note 5. Financings, in the Notes to Condensed Consolidated Financial Statements of this Quarterly Report on Form 10-Q. Our Revolving loan under the 2011 Credit Agreement expires on December 28, 2016. At July 31, 2012, our outstanding borrowings under the 2011 Credit Agreement consisted of an $896 million Term A loan, a $230 million Term B loan and a $350 million Revolving loan, of which $190 million was drawn and outstanding. During August 2012, we drew an additional $100 million under this Revolving loan and used those proceeds to repay $100 million of the amount owed under our Term B loan because it carries a higher interest rate. This transaction had no net impact on our total outstanding borrowings under the 2011 Credit Agreement.

Our future capital requirements may vary significantly from prior periods as well as from those currently planned. These requirements will depend on a number of factors, including operating factors such as our terms and payment experience with customers and investments we may make in product or market development, as well as timing and availability of financing. Finally, our capital needs may be significantly affected by any acquisition we may make in the future due to any cash consideration in the purchase price, transaction costs and restructuring costs. Based upon our current level of operations, we believe that we have the financial resources to meet our business requirements for the next year, including capital expenditures, working capital requirements, future strategic investments, and to comply with our financial covenants.

Operating Activities

Net cash provided by operating activities increased $24 million during the nine months ended July 31, 2012 compared with the nine months ended July 31, 2011 due to a $57 million increase in net cash provided by operations before changes in operating assets and liabilities, partially offset by a $34 million decrease in cash flows that resulted from changes in operating assets and liabilities.

The $57 million increase in net cash provided by operations before changes in operating assets and liabilities compared with the prior nine-month period primarily resulted from an increase of $106 million related to depreciation and amortization given higher fixed asset and intangible balances, an increase of $9 million due to the increase in non-cash stock-based compensation expense consistent with increased headcount, and a $4 million increase in non-cash interest and other items. These increases were partially offset by a net change of $17 million in deferred income tax balances and a $45 million reduction in net income.

Cash flows from changes in operating assets and liabilities decreased $34 million, net, during the nine months ended July 31, 2012 compared with the nine months ended July 31, 2011 primarily due to a $26 million increase in deferred revenue, a $3 million increase related to accounts receivable, net and $9 million decrease related to trade accounts payable, in each case due to timing of receipts and payments, a $13 million increase from lower inventory balances, a $12 million increase in sales and value-added taxes and the addition of an $18 million accrual related to the ongoing Cardsoft patent litigation described in Note 13, Commitments and Contingencies, in the Notes to Condensed Consolidated Financial Statements included in this report on Form 10-Q.

We expect to continue to generate increasing quarterly amounts of cash from operating activities as operating profits expand with the growth of the business and as acquisition and integration costs diminish. Excluding the impact of any future acquisitions we might do, we expect acquisition and integration costs to decrease as we complete integration of past acquisitions. Working capital levels can fluctuate significantly from quarter to quarter depending on the timing of cash receipts and payments.

Investing Activities

Net cash used in investing activities increased $1,081 million in the nine months ended July 31, 2012 compared with the nine months ended July 31, 2011 primarily as a result of our acquisition of Point in December 2011 for a net cash outlay of $999 million ($1,024 million in cash consideration paid, offset by $25 million in cash acquired), an increase in net cash outlays for other acquisitions of $59 million, investments in $21 million of revenue generating assets to support our growing Services businesses a $15 million increase in other capital expenditures, offset by $13 million of cash received during fiscal 2012 upon

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collection of other receivables acquired as part of our acquisition of Hypercom.

We expect that cash flows for investing activities will continue for transactions such as business acquisitions, capital expenditures for new service infrastructure to support our global business, and revenue generating assets as we expand further. In particular, we expect to make additional investments in revenue generating assets as we expand the roll out of Point's "All-In-One" payment solution beyond Point's traditional markets, and as we expand deployment of media-related equipment.

Financing Activities

Net cash provided by financing activities increased $748 million in the nine months ended July 31, 2012 compared with the nine months ended July 31, 2011 primarily due to $1,414 million of net proceeds from borrowings under the 2011 Credit Agreement, of which $279 million was used to redeem the Notes, including interest, upon their maturity in June 2012, and $217 million was used to repay prior debt in December 2011 when the 2011 Credit Agreement was funded.

In addition, during the nine months ended July 31, 2012, we made $110 million of voluntary repayments of the Revolving loan and $24 million of scheduled debt repayments on the Term A and Term B loans. We have chosen to voluntarily repay the Revolving loan with available cash on hand in order to minimize our interest cost, while preserving the ability to re-borrow funds under the Revolving loan. In August 2012, we drew $100 million under the Revolving loan to repay $100 million of the Term B loan, which carries a higher interest rate.

Net proceeds received from issuance of common stock through equity incentive plans decreased by $12 million in the nine months ended July 31, 2012 compared with 2011. During the nine months ended July 31, 2012, we also paid $24 million for acquisition related contingent consideration and hold-back amounts related to past acquisitions.

We expect future cash outflows related to financing activities as we make voluntary and scheduled payments on borrowings under the 2011 Credit Agreement, and settle acquisition-related contingent obligations, which we expect will exceed future proceeds received from issuance of common stock through equity incentive plans.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of Regulation S-K.

Contractual Commitments

The following table summarizes our contractual obligations as of July 31, 2012 (in thousands):

	For the Fiscal Years Ending October 31,						
	2012 (Remaining 3 months)	2013	2014	2015	2016	Thereafter	Total
2011 Credit Agreement (1)	$21,967	$86,689	$119,297	$128,154	$193,552	$938,771	$1,488,430
Capital lease obligations and other loans	672	5,018	48	48	38	487	6,311
Operating leases	13,731	39,610	28,609	19,876	15,317	45,135	162,278
Minimum purchase obligations	125,966	15,411	—	—	—	—	141,377
	$162,336	$146,728	$147,954	$148,078	$208,907	$984,393	$1,798,396

(1) Interest in the above table has been calculated using the rate in effect at July 31, 2012.

We expect that we will be able to fund our remaining obligations and commitments with future cash flows from our ongoing operations and our $410 million of cash and cash equivalents as of July 31, 2012. To the extent we are unable to fund these obligations and commitments with existing cash and cash flows from operations, we can draw upon the additional amounts available under our 2011 Credit Agreement or future debt or equity financings.

Bank guarantees

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We have issued bank guarantees to certain of our customers and vendors as required in some countries to support certain of our performance obligations under our service or other agreements with these respective customers or vendors. As of July 31, 2012, the maximum amounts that may become payable under these guarantees was $5 million.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk related to changes in interest rates and foreign currency exchange rates. To mitigate some of these risks, we utilize derivative financial instruments to hedge these exposures. We do not use derivative financial instruments for speculative or trading purposes nor do we issue or hold leveraged derivative financial instruments.

Interest Rate Risk

We are exposed to interest rate risk related to our borrowings. These borrowings generally bear interest based upon the one-month LIBOR rate. As of July 31, 2012, a 25 basis point increase in interest rates on our borrowings subject to variable interest rate fluctuations would increase our interest expense by approximately $2 million annually. We generally invest most of our cash in overnight and short-term instruments, which would earn more interest income if market interest rates rise and less interest income if market interest rates fall.

On March 23, 2012, we entered into a number of interest rate swap agreements to effectively convert $500.0 million of the Term Loan A from a floating LIBOR rate to a 0.71% fixed rate. The interest rate swaps qualify for hedge accounting treatment as cash flow hedges. The interest rate swaps are effective for the period from March 30, 2012 to March 31, 2015 or 36 months.

Foreign Currency Risk

A substantial majority of our sales are made to customers outside the United States, and our international sales as a percentage of our total net revenues has increased in recent periods including as a result of growth and our acquisitions of Hypercom and Point. A substantial portion of the net revenues we generate from international sales is denominated in currencies other than the U.S. dollar. Additionally, portions of our cost of net revenues and operating expenses are incurred by our international operations and are denominated in local currencies, particularly the Euro, Brazilian Real, Swedish Krona and British Pound. For consolidated reporting, net revenues and expenses denominated in non-U.S. currencies are translated to U.S. dollars at average currency exchange rates for the period (“P&L Exposures”). Thus, even if foreign operations results were stable, fluctuating currency rates may produce volatile reported results. We have made limited efforts to mitigate P&L Exposures by hedging with currency derivatives. As of July 31, 2012, we have three foreign exchange forward contracts designated as a cash flow hedge. As of October 31, 2011, we had no foreign exchange forward contracts designated as a cash flow hedge.

We may in the future use foreign exchange forward contracts or other derivatives to hedge P&L Exposures, depending upon the risks of the exposures, the costs of hedging, and other considerations. However, hedges of P&L Exposures will only mitigate a portion of our risk and only for a short period.

The balance sheets of our U.S. and international businesses have monetary assets and liabilities denominated in currencies other than the primary currency of such business (“Balance Sheet Exposures”), such as Canadian dollar receivables held by our U.S. business, or U.S. dollar payables of our U.K. business. As exchange rates fluctuate, Balance Sheet Exposures generate foreign currency transaction gains and losses, which are included in other income (expense), net in the Condensed Consolidated Statements of Income. Most Balance Sheet Exposures will settle in local currency or convert from a foreign currency to a local currency in the foreseeable future, at which time the impact of rate fluctuations will be realized and we will receive or dispense more or less cash than the value originally recorded. Such exposures are termed “Near-Term Balance Sheet Exposures.” Some Balance Sheet Exposures may not be settled in the foreseeable future in management's estimation and thus the cash impact of their currency gains or losses is not expected to be felt in the foreseeable future.

We have in the past run and expect to continue to run a hedging program to mitigate the risk of Near-Term Balance Sheet Exposures by entering into foreign exchange forward contracts. Therefore, the hedging program's objective is to have gains or losses of the foreign exchange forward contracts largely offset the losses or gains of the Near-Term Balance Sheet Exposures. The unrealized gains of foreign exchange forward contracts are included in Prepaid expenses and other current assets in the Condensed Consolidated Balance Sheets; the unrealized losses are included in Other current liabilities in the Condensed Consolidated Balance Sheets. The contracts are marked-to-market on a monthly basis with gains and losses included in Other income (expense), net in the Condensed Consolidated Statements of Income. In some instances, we seek to hedge transactions that are expected to become Near-Term Balance Sheet Exposures in the very short-term, generally within one month. We do not use foreign exchange forward contracts or other derivatives for speculative or trading purposes.

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Our outstanding foreign exchange forward contracts as of July 31, 2012 are presented in the table below. The fair market value of the contracts represents the difference between the spot currency rate at July 31, 2012 and the contracted rate. All of these forward contracts mature within 35 days of July 31, 2012 (in thousands):

	Currency	Local Currency Contract Amount	Currency	Contracted Amount	Fair Market Value at July 31, 2012
Contracts to buy U.S. dollar					
Argentine peso	ARS	(23,000)	USD	4,877	$(14)
Australian dollar	AUD	(8,000)	USD	8,336	(17)
Canadian dollar	CAD	(2,200)	USD	2,186	(6)
Chilean peso	CLP	(1,400,000)	USD	2,870	(18)
Chinese yuan	CNY	(130,000)	USD	20,487	127
Euro	EUR	(27,050)	USD	33,439	134
British pound	GBP	(31,000)	USD	48,724	(17)
Israeli shekel	ILS	(35,000)	USD	8,629	(22)
Indian rupee	INR	(350,000)	USD	6,258	(67)
Korean won	KRW	(2,500,000)	USD	2,186	(9)
Mexican peso	MXN	(88,000)	USD	6,601	(48)
Polish zloty	PLN	(30,500)	USD	9,119	42
Singapore dollar	SGD	(3,000)	USD	2,404	(2)
Thai bhat	THB	(50,000)	USD	1,583	(1)
SA rand	ZAR	(70,000)	USD	8,515	(33)
Contract to sell U.S. dollar					
Swedish krona	SEK	65,000	USD	(9,452)	—
					$49

As of July 31, 2012, our Balance Sheet Exposures, which is the sum of the absolute value of the net assets for each of our foreign subsidiaries with U.S. dollar functional currency which can be net assets or net liabilities, amounted to $238 million and were partially offset by forward contracts with a notional amount of $176 million. Based on our net exposures as of July 31, 2012, a 10% movement in currency rates would result in a gain or loss of approximately $6 million.

As of July 31, 2012, we had one exposure not expected to be paid in the near term, an Israeli shekel payable equivalent to $49 million, which when excluded from the Israel subsidiary's net exposure of $40 million liability, leaves a $9 million asset position. Deducting the $31 million absolute value difference from Balance Sheet Exposures of $238 million renders the Near-Term Balance Sheet Exposures at $207 million and, thus a 10% movement in currency rates would result in a gain or loss of approximately $3 million that we would expect to be realized in the foreseeable future.

Hedging of our Balance Sheet Exposures may not always be effective to protect us against currency exchange rate fluctuations, particularly in the event of imprecise forecasts of non-U.S. denominated assets and liabilities. In addition, at times we have not fully hedged our Balance Sheet Exposures, leaving us at risk to foreign exchange gains and losses on the un-hedged amounts. Furthermore, historically we have not consistently hedged our P&L Exposures. Accordingly, if there were an adverse movement in exchange rates, we might suffer significant losses.

Equity Price Risk

We have outstanding warrants to purchase 7.2 million shares of our common stock at a price of approximately $62.356 per share in equal share amounts on each trading day from December 19, 2013 to February 3, 2014. For every $1 that the share price of our common stock exceeds $62.356, we will be required to issue the equivalent of $7 million worth of shares of our common stock.

Information on the share price of our common stock may be found under Part II Item 5, Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities, of our Annual Report on Form 10-K for the fiscal

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year ended October 31, 2011.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Based on management's evaluation (with the participation of our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO")), as of the end of the period covered by this report, our CEO and CFO have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)), are designed to and are effective to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and is accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Controls and Procedures

There were no changes to our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Our management, including the CEO and CFO, does not expect that our disclosure controls or our internal control over financial reporting will prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, have been detected. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of the effectiveness of controls to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Our disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and is accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

PART II — OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Information with respect to this Item may be found in Note 13. Commitments and Contingencies of Notes to Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q, which is incorporated into this Item 1 by reference.

ITEM 1A. RISK FACTORS

Risks Related to Our Business

The risks set forth below may adversely affect our business, financial condition, and operating results. In addition to the risks set forth below and the factors affecting specific business operations identified with the description of these operations elsewhere in this report, there may also be risks of which we are currently not aware, or that we currently regard as immaterial based on the information available to us, that later prove to be material.

We routinely engage in acquisitions, divestitures, and other strategic transactions which involve numerous enterprise risks and could disrupt our ongoing business and harm our results of operations. We may not be able to address these risks without substantial expense, delay or other operational or financial problems.

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In pursuing our business strategy, we routinely conduct discussions, evaluate opportunities, and enter into agreements regarding possible acquisitions or strategic investments in related businesses, technologies, or products.

For example, on December 30, 2011, we completed our acquisition of Point, a Stockholm-based provider of point-of-sale technology and support, gateway services, card encryption services, and multi-channel e-commerce processing network encompassing almost 475,000 merchant contracts throughout Northern Europe, and on August 4, 2011 we completed our acquisition of Hypercom.

Acquisitions or investments, including the recent acquisitions of Point and Hypercom, both of which were material to our business and operations, involve significant challenges and potential business risks, and we may not realize the expected benefits of any of our recent or future acquisitions. These challenges and risks include:

- the difficulty of integrating the technologies, operations, business systems, and personnel of the acquired business, technology or product;
- the potential disruption of our ongoing business, including the diversion of management attention to issues related to integration and administration, particularly given the number, size and varying scope of our recent completed acquisitions;
- entering markets in which we have limited prior experience;
- in the case of international acquisitions, which include both the Point and Hypercom acquisitions, the need to integrate operations across different cultures and languages and to address the particular economic, foreign currency, political, legal and regulatory risks, including with respect to countries where we previously had limited operations;
- the possible inability to obtain the desired financial and strategic benefits from the acquisition or investment, as discussed further in “We may not realize the expected benefits of our acquisitions, including Hypercom and Point” below;
- the loss of all or part of our investment;
- the loss of customers and partners of acquired businesses;
- the need to integrate each company's accounting, legal, management, information, human resource and other administrative systems to permit effective management, and the lack of control if such integration is delayed or not implemented;
- the need to implement controls, procedures and policies appropriate for a larger public company at companies that prior to acquisition had lacked such controls, procedures and policies;
- the risk that increasing complexity inherent in operating a larger business and managing a broader range of solutions and service offerings may impact the effectiveness of our internal controls and adversely affect our financial reporting processes;
- the assumption of unanticipated liabilities and the incurrence of unforeseen expenditures;
- the failure to identify or assess the magnitude of certain liabilities, shortcomings or other circumstances prior to acquiring a company, which could result in unexpected litigation, unanticipated liabilities, additional costs, unfavorable accounting treatment or other adverse effects; and
- the loss of key employees of an acquired business.

These risks are heightened and more prevalent in acquisitions of larger businesses, such as the Point acquisition in December 2011 and the Hypercom acquisition in August 2011. Further, in connection with the Point acquisition we incurred substantial additional debt, which has increased our leverage and debt service requirements. Future acquisitions and investments could also result in substantial cash expenditures, potentially dilutive issuances of our equity securities and incurrence of additional debt, contingent liabilities and amortization expenses related to other intangible assets that could adversely affect our business, operating results, and financial condition. Moreover, we may not realize the anticipated benefits of any or all of our acquisitions, or may not realize them in the timeframe expected. We will depend on the retention and performance of existing management and employees of acquired businesses for the day-to-day management and future operating results of these businesses.

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We may not realize the expected benefits of our acquisitions, including Hypercom and Point.

Achieving the expected benefits of our acquisitions, including Hypercom and Point, depends in large part on our successful completion of our integration of the acquired businesses' operations and personnel with our own in a timely and efficient manner. We cannot assure you, however, that all of our integration efforts will be completed as quickly as expected or that our acquisitions will achieve the expected benefits. The risks and challenges involved in the integration of Hypercom and Point include:

- Both Hypercom and Point have significant international operations; we may have difficulty integrating the international operations of Hypercom and Point, including coordinating the efforts of Hypercom's and Point's sales operations with those of VeriFone;
- We may have difficulties successfully managing Hypercom's or Point's technologies or lines of businesses, particularly those lines of business with which we have limited operational experience;
- We may not be able to adequately demonstrate to customers that the acquisitions will not result in adverse changes in client service standards or product support, in particular where the acquired business, such as Hypercom, has products that compete with existing VeriFone products;
- Some of Hypercom's suppliers, distributors, customers, and licensors are VeriFone's competitors or work with VeriFone's competitors and may terminate their business relationships with Hypercom as a result of the acquisition;
- We may not be able to successfully persuade the employees in various jurisdictions that the companies' business cultures are compatible, maintain employee morale, and retain key employees;
- We may have difficulties integrating or migrating the information technology infrastructures of Hypercom and Point into our information technology systems and resources in an effective and timely manner;
- We may be unable to cost-effectively and timely migrate Hypercom and Point to our common enterprise resource planning information system and to integrate all operations, sales, accounting, and administrative activities for the combined company;
- We may have difficulties integrating Hypercom's supply chain operations with ours while ensuring that products continue to be manufactured and delivered on a timely basis, with superior quality to customers and at a cost acceptable to us;
- We may have higher than anticipated costs in coordinating research and development and support activities across our existing and newly acquired products and services; and
- We may not be able to successfully incorporate acquired technologies, products and service offerings into our next generation of products and solutions or to enhance introduction of new products, services, and technologies, while ensuring timely release of products to market.

The integration of Hypercom and Point is international in scope, complex, time-consuming, and expensive, and has disrupted and may continue to disrupt our business or result in the loss of customers or key employees or the diversion of the attention of management. Our operating results or financial condition may be adversely impacted by pre-existing claims or liabilities, both known and unknown, of an acquired company, including claims from current or former customers, terminated employees or other third parties; pre-existing contractual relationships of an acquired company that may contain unfavorable terms; unfavorable revenue recognition or other accounting treatment as a result of an acquired company's pre-existing contractual arrangements; and intellectual property claims or disputes. In addition, the integration process may strain the combined company's financial and managerial controls and reporting systems and procedures and may result in the diversion of management and financial resources from the combined company's core business objectives.

There can be no assurance that we will successfully integrate our businesses or that we will realize the anticipated benefits of the acquisitions after we complete our integration efforts. One of our key strategies of the Point acquisition is to implement Point's Payment-as-a-Service model into new markets. Implementing a new business model involves significant risk and costs, including, in the case of our Payment-as-a-Service model, up front capital expenditures. The

markets where we seek to implement the Payment-as-a-Service model may take longer to adopt a payment as a service model than we anticipate or may choose not to adopt this model. Continued weakness in the global economy may also negatively impact our ability to implement our payment as a service solution within the time frames we desire. If we do not execute successfully on the implementation of our Payment-as-a-Service model and achieve the anticipated benefits of the Point acquisition, our revenues, profitability and net income may be negatively impacted.

Costs associated with the acquisitions may be higher than expected and may harm our financial results. We have incurred substantial direct transaction costs associated with the acquisitions, and expect to incur additional costs associated with consolidation and integration of operations. We have also incurred post-closing costs and continue to devote resources related to Hypercom's divestiture of its U.S., Spain and U.K. payment terminal businesses. For example, as part of the divestitures the

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buyers are entitled to certain post-closing administrative and operating support services for various periods following the closing date of the merger and indemnification for certain liabilities associated with the divested businesses. In addition, although we believe that the merger was not subject to regulatory approval requirements in Spain because Hypercom divested its business in Spain before the merger was completed, the Spanish regulatory authorities disagree with this position, although following submission of additional information by VeriFone, they subsequently approved the merger. On May 28, 2012, we were notified by the Spanish competition authority (La Comisión Nacional de la Competencia, or "CNC") that CNC intends to formally review our completion of our merger with Hypercom for alleged non-compliance with notification requirements under Spanish merger control law. There can be no assurance that the Spanish regulatory authorities will not seek to impose a fine for alleged non-compliance with Spanish merger control law. If the total costs of the acquisitions and integration efforts exceed estimates or the benefits related to the acquisitions do not exceed our total costs, our financial results could be adversely affected.

If we do not continually enhance our existing solutions and develop and market new solutions and enhancements responsive to technological advancements in our industry, our net revenues and income will be adversely affected.

The market for electronic payment systems is characterized by:

- rapid technological advancements;
- frequent product introductions and enhancements;
- evolving industry and government performance and security standards;
- increasingly, introductions of alternative payment solutions, such as mobile payments and processing, at the point of sale; and
- changes in customer and end-user preferences or requirements.

Because of these factors, we must continually enhance our existing solutions and develop and market new solutions, and we must anticipate and respond to these industry and customer changes in order to remain competitive. If we are unable to timely and adequately respond to new competitors and technological advancements our net revenues and results of operations could be adversely affected. These efforts require significant investment in research and development as well as increased costs of manufacturing and distributing our system solutions, and we may not necessarily be able to increase or maintain prices to account for these costs.

We cannot be sure that we will successfully complete the development and introduction of new solutions or enhancements or that our new solutions will be accepted in the marketplace. We may also fail to develop and deploy new solutions and enhancements on a timely basis. In either case, we may lose market share to our competitors, our solutions could become obsolete and our net revenues and results of operations could suffer.

A majority of our net revenues are generated outside of the United States and we intend to continue to expand our operations internationally including through acquisitions and strategic partnerships. Our results of operations could suffer if we are unable to manage our international expansion and operations effectively.

During the nine months ended July 31, 2012, approximately 73.7% of our net revenues were generated outside of the United States. During the fiscal year ended October 31, 2011, approximately 65.6% of our net revenues were generated outside of the United States. We expect our percentage of net revenues generated outside of the United States to increase over time. In particular, our acquisition of Point has increased our business in the Nordic regions and elsewhere in Northern Europe and our acquisition of Hypercom has increased our business significantly in Europe, the Middle East, Africa and Asia. Part of our strategy is to expand our penetration in existing foreign markets and to enter new foreign markets and in particular to enter new emerging markets where we expect to see growth in electronic payments and related services. Our ability to penetrate some international markets may be limited due to different technical standards, protocols or product requirements. Expansion of our international business will require

significant management attention and financial resources. Our international net revenues will depend on our continued success in the following areas:

- securing commercial relationships to help establish or increase our presence in new and existing international markets;
- hiring and training personnel capable of marketing, installing and integrating our solutions, supporting customers, and effectively managing operations in foreign countries;
- adapting our solutions to meet local requirements and to target the specific needs and preferences of foreign customers, which may differ from our traditional customer base in the markets we currently serve;
- building our brand name and awareness of our services among foreign customers in new and existing

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international markets;
- enhancing our business infrastructure to enable us to efficiently manage the higher costs of operating across a larger span of geographic regions and international jurisdictions; and
- implementing new systems, procedures, and controls to monitor our operations in new international markets.

In addition, we are subject to risks and costs associated with operating in foreign countries, including:

- multiple, changing, and often inconsistent enforcement of laws and regulations;
- satisfying local regulatory or industry imposed requirements, including security or other certification requirements;
- competition from existing market participants, including strong local competitors, that may have a longer history in and greater familiarity with the international markets we enter;
- tariffs and trade barriers;
- higher costs and complexities of compliance with international and U.S. laws and regulations such as import and trade regulations and embargoes, export requirements and local tax laws;
- laws and business practices that may favor local competitors;
- restrictions on the repatriation of funds, including remittance of dividends by foreign subsidiaries, foreign currency exchange restrictions, and currency exchange rate fluctuations;
- extended payment terms and the ability to collect accounts receivable;
- different and/or more stringent labor laws and practices such as the use of workers' councils and labor unions;
- different and/or more stringent data protection, privacy and other laws;
- economic and political instability in certain foreign countries;
- changes in a specific country's or region's political or economic conditions; and
- greater difficulty in safeguarding intellectual property in areas such as China, India, Russia, and Latin America.

Many of these factors typically become more prevalent during periods of economic stress, such as the ongoing weakness in the economies of the euro zone countries and volatility in global financial markets that have caused declines in the value of the euro and other currencies impacted by the European sovereign debt crisis, or disruptive events such as natural or man-made disasters and military or terrorist actions. The persistence or occurrence of weakened global economic conditions in one or more regions where we do business may exacerbate certain of these risks. We are subject to foreign currency risk including from economic and political instability which can lead to significant and unpredictable volatility in currency rates, including significant currency devaluations, which may negatively impact our revenues, gross margins, results of operations and financial position. Although we engage in some hedging of our foreign currency exposures, we do not hedge all such exposures and our hedging arrangements may not always be effective. See Part I Item 3. Quantitative and Qualitative Disclosures About Market Risk - Foreign Currency Risk of this Form 10-Q. In addition, compliance with foreign and U.S. laws and regulations that are applicable to our international operations is complex and may increase our cost of doing business in international jurisdictions and our international operations could expose us to fines and penalties if we fail to comply with these regulations. These laws and regulations include import and export requirements, trade restrictions and embargoes, exchange control regulations, data privacy requirements, labor laws, tax laws, anti-competition regulations, U.S. laws such as the Foreign Corrupt Practices Act, and local laws prohibiting corrupt payments to governmental officials and other improper payments or inducements, such as the U.K. Bribery Act. Although we have implemented policies, procedures and training designed to ensure compliance with these laws, there can be no assurance that our employees, contractors, distributors, suppliers and agents will not take actions in violation of our policies, particularly as we expand our operations through organic growth and acquisitions, including acquisitions of businesses that were not previously subject to and may not have familiarity with U.S. and other laws and regulations applicable to us or compliance policies similar to ours. For example, two of our Brazilian subsidiaries that were acquired as a part of the Lipman acquisition have been notified of a number of assessments regarding Brazilian customs penalties that relate to alleged infractions in the importation of goods as well as certain tax assessments and penalties. Similarly, the Brazilian subsidiary we acquired in August 2011 as part of the Hypercom acquisition has a number of pending

assessments related to local tax assessments and penalties. See Part II Item 1. Legal Proceedings of this Form 10-Q. Defending such assessments can be costly and divert management time. Any such violations could subject us to civil or criminal penalties, including the imposition of substantial fines and interest or prohibitions on our ability to offer our products and services to one or more countries, and could also materially damage our reputation, our brand, our international expansion efforts, our business, and negatively impact our operating results. In addition, if we fail to address the challenges and risks associated with international expansion and acquisitions, we may encounter difficulties implementing our strategy, which could impede our growth or harm our operating results.

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Macroeconomic conditions and economic volatility could materially and adversely affect our business and results of operations.

Our operations and performance depend significantly on worldwide economic conditions. For example, the significant slowdown and volatility in the U.S. and international economy and financial markets which began in the latter half of 2008 resulted in reduced demand for our products, which in turn adversely impacted our revenues, business, financial condition and results of operations. In particular, the slowdown and volatility in the global markets resulted in softer demand in the financial and retail sectors, pricing pressures and more conservative purchasing decisions by customers, including a tendency toward lower-priced products and lower volume of purchases during the economic downturn. In some countries where we do business the weakened economy has resulted in economic instability which has had negative effects, including a decrease in purchasing power due to currency devaluations.

While we have experienced overall sequential growth in revenues and earnings and stronger demand in some of our recent quarters, certain markets such as parts of Europe where we conduct business continue to experience weakened or uncertain economic conditions, including the recent ongoing difficulties in the credit markets in the euro zone. Some of our customers, suppliers and partners may continue to be negatively impacted by the continued global weakness in the economy. We cannot predict whether growth will continue, or whether our results of operations will be negatively impacted by the recent renewed global market turmoil, or whether any other future decline or volatility in global conditions could negatively impact our business, operating results and financial condition. There is no assurance that actions taken by governments and central banks to stimulate the economy will have positive impacts. Further, conditions such as political unrest or terrorist actions in other parts of the world and reports of continued high unemployment rates in the U.S. and elsewhere may negatively impact global economic conditions, including corporate spending and liquidity of capital markets. Continued volatility in market conditions, such as fluctuations in foreign currency rates relative to the U.S. dollar, make it difficult to forecast earnings and if we fail to meet our financial guidance or the expectations of investment analysts or investors in any period, the market price of our common stock could decline.

Fluctuations in currency exchange rates may adversely affect our results of operations.

A substantial portion of our business consists of sales made to customers outside the United States. A portion of the net revenues we receive from such sales is denominated in currencies other than the U.S. dollar, primarily the British pound, the euro and the Brazilian real, and the amount of net revenues in foreign currencies has increased with our recent acquisitions of Point and Hypercom. Additionally, portions of our cost of net revenues and our other operating expenses are incurred by our International operations and denominated in local currencies, primarily the British pound, the euro and the Brazilian real. In particular, our net revenues, cost of net revenues and operating expense denominated in the euro and the Dutch Kroner and Swedish Kroner, which are impacted by the European sovereign debt crisis, have increased with the Point and Hypercom acquisitions. Fluctuations in the value of these net revenues, costs and expenses as measured in U.S. dollars have historically affected our results of operations, and adverse currency exchange rate fluctuations may have a material impact in the future. Further, changes in exchange rates that strengthen the U.S. dollar could increase the price of our products in the local currencies of the foreign markets we serve. For example, in recent periods the euro has declined substantially relative to the U.S. dollar and, given the ongoing European sovereign debt crises, may further decline. Declines in foreign currencies relative to the U.S. dollar would result in making our products relatively more expensive than products that are denominated in local currencies, leading to a reduction in sales and profitability in those foreign markets. In addition, our balance sheet contains monetary assets and liabilities denominated in currencies other than the U.S. dollar, such as cash, intercompany balances, trade receivables and payables, and fluctuations in the exchange rates for these currencies could adversely affect our results of operations. We have, to some extent, entered into foreign exchange forward contracts intended to hedge our balance sheet exposure to adverse fluctuations in exchange rates. We have also effectively priced our System solutions products in U.S. dollars in certain countries. Nevertheless, these hedging arrangements may not

always be effective, particularly in the event of imprecise forecasts of non-U.S. denominated assets and liabilities. Additionally, our efforts to effectively price products in U.S. dollars may have disadvantages as they may affect demand for our products if the local currency strengthens relative to the U.S. dollar. We could be adversely affected when the U.S. dollar strengthens relative to the local currency between the time of a sale and the time we receive payment, which would be collected in the devalued local currency. Accordingly, if there is an adverse movement in one or more exchange rates, we might suffer significant losses and our results of operations may otherwise be adversely affected. Uncertainty in the global market conditions have resulted in and may continue to cause significant volatility in foreign currency exchange rates which could increase these risks. As our international operations expand, our exposure to these risks also increases. Additionally, hedging programs expose us to risks that could adversely affect our operating results, including the following:

- we may be unable to hedge currency risk for some transactions because of a high level of uncertainty or the inability to reasonably estimate our foreign exchange exposures; and

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- we may be unable to acquire foreign exchange hedging instruments in some of the geographic areas where we do business, or, where these derivatives are available, we may choose not to hedge because of the high cost of the derivatives.

Our markets are highly competitive and subject to price erosion and rapidly evolving technologies and customer preferences.

The markets for our system solutions and services are highly competitive, and we have been subject to price pressures. Competition from manufacturers, distributors, new technologies or providers of products similar to or competitive with our system solutions or services could result in price reductions, reduced margins, and a loss of market share or could render our solutions obsolete. For example, First Data Corporation, a leading provider of payments processing services, and one of our largest customers, has developed and continues to develop a series of proprietary electronic payment systems for the U.S. market. Internationally, we face significant downward pressures on prices in China, India and other regions where competition is increasingly fierce in the point-of-sale hardware market including aggressive pricing by some local competitors. Any decrease in our selling prices in order to compete in these markets will negatively impact our revenues, gross margins and results of operations.

We expect to continue to experience significant and increasing levels of competition in the future, from both new and existing competitors and a variety of technologies, many of which are rapidly evolving. We compete with suppliers of cash registers that provide built-in electronic payment capabilities and producers of software that facilitates electronic payment over the internet, as well as other manufacturers or distributors of electronic payment systems. Increasingly, new competitors are entering the payments market with alternative payment solutions at the point of sale, such as mobile device-based card payment and processing solutions. Some of these alternative solutions enable payment and processing at the point of sale without use of a traditional payment terminal at the point of sale, such as the payment terminals we manufacture and sell. Our revenues, profits and net income will be negatively impacted if we do not effectively compete with new market entrants, including by offering alternative solutions that align with shifts to payment on devices other than the traditional POS terminal. We must also compete with smaller companies that have been able to develop strong local or regional customer bases. In certain foreign countries, some competitors are more established, benefit from greater name recognition and have greater resources within those countries than we do. Further, in certain international markets, such as Brazil, we may face competition from refurbished units which could result in reduced demand and pricing pressures.

A component of the cost of providing some of our newer product offerings, including the Payment-as-a-Service solution, in-taxi payments solutions and our SAIL product, are credit card interchange and assessment fees, which are set by the card networks. Any increase in such fees could have a material negative impact on our profitability, results of operations and cash flows.

We depend on a limited number of customers, including distributors and resellers, for a large percentage of our System solutions sales. If we do not effectively manage our relationships with them, our net revenues and operating results will suffer.

A significant percentage of our net revenues are attributable to a limited number of customers, including distributors and independent sales organizations (“ISOs”). For example, for the three months ended July 31, 2012, three customers accounted for 12.2% of our total net revenues and our ten largest customers accounted for approximately 24.3% of our net revenues. For the twelve months ended October 31, 2011, one customer, Cielo S.A. and its affiliates accounted for approximately 12.4% of net revenues of our International segment, and one customer, First Data and its affiliates accounted for approximately 13.0% of net revenues of our North America segment. Our ten largest customers accounted for approximately 27.4% of our net revenues for the fiscal year ended October 31, 2011. Our net revenues are dependent in part on the timing of purchases by these large customers. If any of our large customers significantly

reduces or delays purchases from us or if we are required to sell products to them at reduced prices or on other terms less favorable to us, our revenues and income could be materially and adversely affected.

We sell a significant portion of our solutions through third-party resellers such as independent distributors, ISOs, value-added resellers, and payment processors. We depend on their active marketing and sales efforts. These resellers also provide after-sales support and related services to end user customers. When we introduce new applications and solutions, these resellers also provide critical support for developing and supporting the custom software applications to run on our various electronic payment systems and, internationally, in obtaining requisite certifications in the markets in which they are active. Accordingly, the pace at which we are able to introduce new solutions in markets in which these resellers are active depends on the resources they dedicate to these tasks. Moreover, our arrangements with these resellers typically do not prevent them from

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selling products of other companies, including our competitors, and such resellers may elect to market our competitors' products and services in preference to our system solutions. If one or more of our major resellers terminates or otherwise adversely changes its relationship with us, we may be unsuccessful in replacing such relationship. The loss of one of our major resellers could impair our ability to sell our solutions and result in lower revenues and income. It could also be time-consuming and expensive to replicate, either directly or through other resellers, the certifications and the custom applications owned by these resellers.

In addition, orders from our distributors and resellers depend on their sales volumes and inventory management decisions. For example, during the fiscal quarter ended January 31, 2012, we experienced a $13 million year-over-year decrease in our North America Financial Solutions business based on timing of orders from our distributors, which generally varies based on distributor decisions on inventory levels, desired product mix and timing of new product introductions. At the end of 2008, in response to the global economic downturn a number of distributors and resellers experienced weakened demand and slower sales, which in turn resulted in declines in order volume and deferrals of orders for our products. Declines or deferral of orders could materially and adversely affect our revenues, operating results and cash flows.

We have experienced rapid and significant growth in our operations, and if we cannot adequately manage our growth, our results of operations will suffer.

We have experienced rapid and significant growth in our operations in certain periods, both organically and from acquisitions. We cannot be sure that we have made adequate allowances for the costs and risks associated with our expansion, or that our systems, procedures, business processes, and managerial controls will be adequate to support the rapid and significant expansion in our operations, including expansion into new vertical markets, expansion into a number of additional international markets and a broader range of payment services offerings globally. Any delay in implementing, or transitioning to, new or enhanced systems, procedures, or controls to accommodate and support the requirements of our business and operations and to effectively and efficiently integrate acquired operations may adversely affect our ability to meet customer requirements, manage our product inventory, and record and report financial and management information on a timely and accurate basis. If we are unable to successfully manage our expansion, our results of operations may be adversely affected.

Our internal processes and control over financial reporting have in prior periods been deemed inadequate.

In certain prior periods we reported material weaknesses in our internal control over financial reporting, which we have remedied. See Item 9A. Controls and Procedures in our Annual Report on Form 10-K for the fiscal year ended October 31, 2010. These material weaknesses in our internal control over financial reporting contributed to our need to restate previously reported interim financial information for each of the first three quarters of our fiscal year ended October 31, 2007, and to the delays in the filing of our Annual Report on Form 10-K for fiscal year 2007. We also were unable to file our quarterly reports on Form 10-Q for our fiscal quarters ended January 31, 2008 and April 30, 2008 on a timely basis. We have implemented a number of additional and enhanced processes and controls to improve our internal control over financial reporting.

Although we have implemented improved controls and remedied these material weaknesses, these controls may not be sufficient to detect or prevent errors in financial reporting in future periods and will require continued enhancement to accommodate our rapid growth in operations both organically and from acquisitions. We have devoted additional resources to our financial control and reporting requirements, including hiring additional qualified employees in these areas. We may hire additional employees and may also engage additional consultants in these and other key areas. Competition for qualified financial control and accounting professionals in the geographic areas in which we operate is intense and there can be no assurance that we will be able to hire and retain these individuals.

We may not be able to attract, integrate, manage, and retain qualified personnel.

Our success depends to a significant degree upon the continued contributions of our key senior management, engineering, sales and marketing, and manufacturing personnel, many of whom would be difficult to replace. In addition, our future success also depends on our ability to attract, integrate, manage, and retain highly skilled employees throughout our business. Competition for some of these personnel is intense, and in the past, we have had difficulty hiring, in our desired time frame, employees that have the specific qualifications required for a particular position. Additionally, we may be unsuccessful in attracting and retaining personnel. The loss of the services of any of our key personnel, the inability to attract or retain qualified personnel in the future, or delays in hiring required personnel, particularly engineers and sales personnel, could make it difficult for us to manage our business and meet key objectives, such as timely product introductions.

During the last several fiscal years, we implemented work force reduction plans reducing the number of employees and contractors in certain areas due to redundancies and shifting business needs, as well as in connection with acquisition-

related integration efforts. These reductions have also required that we reassign certain employee duties. Workforce reductions and job reassignments could negatively affect employee morale, and make it difficult to motivate and retain our remaining employees and contractors, which would affect our ability to deliver our products in a timely fashion and otherwise negatively affect our business.

Our solutions may have defects or experience field failures that could delay sales, harm our brand, increase costs and result in product recalls and additional warranty expense.

We offer complex solutions that are susceptible to undetected hardware and software errors or failures. Our solutions may experience failures when first introduced, as new versions are released, or at any time during their lifecycle. We cannot assure you that, despite our testing procedures and controls over manufacturing quality, errors will not be found in our products. Field failure may result from usage with third-party issued payment cards, for example, if such usage generates excess electrostatic discharge. Defects may also arise from third-party components that are incorporated into our products, such as hardware modules, chipsets or battery cells. Any product recalls as a result of errors or failures could result in the loss of or delays in market acceptance of our solutions, diversion of the attention of our research and development personnel from product development efforts, harm to our relationships with our customers, adversely affect our business and reputation and increase our product costs which could negatively impact our margins, profitability and results of operations. Any significant returns or warranty claims for any of our products, including products that we have added to our product offerings from acquisitions, could result in significant additional costs to us, such as costs to implement modifications to correct defects, recall and replace products and defending against litigation related to defective products or related property damage or personal injury, and could adversely affect our results of operations. Our customers may also run third-party software applications on our electronic payment systems. Errors in third-party applications could adversely affect the performance of our solutions.

The existence of defects and delays in correcting them could result in negative consequences, including the following: harm to our brand; delays in shipping system solutions; loss of market acceptance for our system solutions; additional warranty and other expenses associated with correcting or resolving defects; diversion of resources from product development; and loss of credibility with distributors, customers and partners. Identifying and correcting defects can be time consuming, costly and in some circumstances extremely difficult. Software errors may take several months to correct, and hardware defects may take even longer to correct.

We may suffer losses due to credit card fraud or similar fraudulent activities.

We are expanding our service solutions offerings. Some of our service solutions offerings include our services as a payment processor of credit card transactions for merchants. We may be subject to losses in the provision of such services in the event of credit card fraud or other fraudulent activities or errors in connection with such transactions. As we expand such service solutions offerings, we increase our exposure to such risks, and our business, results of operations and financial condition may be negatively impacted by such loss if material. Further, the occurrence of fraud perpetrated on our solutions may result in negative publicity and user sentiment which could harm our reputation and reduce our ability to retain or attract users of our solutions.

Security is vital to our customers and end users and therefore breaches in the security of our solutions could adversely affect our reputation and results of operations.

Protection against fraud is of key importance to the purchasers and end users of our solutions. The protection of sensitive data, such as customer, company, employee and consumer data is critical to our business. The regulatory environment surrounding information security and privacy is increasingly demanding, with the frequent imposition of new and constantly changing requirements. We rely on electronic networks, computers, systems and programs to run

our business and operations and, as a result, are exposed to risks of system errors or unauthorized cyber attacks on our systems which could result in the loss or misappropriation of sensitive data, corruption of business data or other disruption to our operations despite the security measures, processes and technologies we have in place to protect and secure our networks and systems. Further, our expansion of our service solutions offerings increases the types of confidential and consumer or personal data that may be processed or stored by us. We incorporate security features, such as encryption software and secure hardware, into our solutions and services offerings to protect against fraud in electronic payment transactions and to ensure the privacy and integrity of consumer data. Our solutions may be vulnerable to breaches in security due to defects in the security mechanisms, the operating system and applications, or the hardware platform. Security vulnerabilities could jeopardize the security of information transmitted or stored using our solutions. We also provide our customers with repair, encryption key loading and helpdesk services, and we intend to increase our services offerings including through managed services programs. We have in the past experienced and may in the future experience security breaches or fraudulent activities related to unauthorized access

to sensitive customer information. If the security of our solutions is compromised, our reputation and marketplace acceptance of our solutions will be adversely affected, which would cause our business to suffer, and may subject us to damages claims. A significant breach of customer or company data could attract a substantial amount of media attention, damage our customer relationships and reputation and result in lost sales, fines, or lawsuits.

We are party to a number of lawsuits and tax assessments and we may be named in additional litigation and assessments, all of which are likely to require significant management time and attention and expenses and may result in unfavorable outcomes that could have a material adverse effect on our business, financial condition, and results of operations.

We are currently a party in several litigation proceedings. For example, in connection with the restatement of our historical interim financial statements during fiscal year 2007, a number of securities class action complaints were filed against us and certain of our officers, and purported derivative actions have also been filed against certain of our current and former directors and officers. We are also subject to a number of pending tax assessment matters. Further, our operating results or financial condition may also be adversely impacted by claims or liabilities that we assume from an acquired company or that are otherwise related to an acquisition. For example, in connection with our acquisition of Hypercom, we have, except for certain exceptions related to the businesses divested by Hypercom, generally assumed all of Hypercom's litigation proceedings and tax assessments, and may also be liable for certain matters arising following closing of the Hypercom divestitures but related to pre-closing operations. For a description of our material pending litigation, see Part II Item 1. Legal Proceedings of this Form 10-Q.

The amount of time and resources required to resolve these lawsuits is unpredictable, and defending ourselves is likely to divert management's attention from the day-to-day operations of our business, which could adversely affect our business, financial condition, and results of operations. The outcome of litigation and tax assessments is inherently difficult to predict. In addition, an unfavorable outcome in such litigation or a decision by us to settle such lawsuits to avoid the distraction and expense of continued litigation even if we deem the claims to be without merit could have a material adverse effect on our business, financial condition, and results of operations. An adverse outcome in any of our pending tax assessment matters also could have a material adverse effect on our business, financial condition, and results of operations.

Our insurance policies may not cover certain claims that are filed against us or may not be sufficient to cover all of our costs for defending such actions or paying any damages in the event of an unfavorable outcome. In addition, we may be obligated to indemnify (and advance legal expenses to) both current and former officers, employees and directors in connection with the securities class action and derivative action matters. We currently hold insurance policies for the benefit of our directors and officers, although our insurance coverage may not be sufficient in some or all of these matters. Furthermore, our insurance carriers may seek to deny coverage in some or all of these matters, in which case we may have to fund the indemnification amounts owed to such directors and officers ourselves.

We are subject to the risk of additional litigation and regulatory proceedings or actions in connection with the restatement of our financial statements. We have responded to inquiries and provided information and documents related to the restatement to the SEC, the U.S. Department of Justice, the New York Stock Exchange, and the Chicago Board Options Exchange. We were the subject of a Wells Notice from the SEC stating that the staff of the SEC's Division of Enforcement (the “Staff”) intends to recommend that the SEC bring a civil injunctive action against us, alleging violations of the federal securities laws arising from the restatement, which we settled in November 2009. See Part II Item 1. Legal Proceedings of this Form 10-Q. Although we have settled this matter with the SEC, additional regulatory inquiries may also be commenced by other U.S. federal, state or foreign regulatory agencies. In addition, we may in the future be subject to additional litigation or other proceedings or actions arising in relation to the restatement of our historical interim financial statements. Litigation and any regulatory proceeding or action may be time consuming, expensive and distracting from the conduct of our business. The adverse resolution of any specific

lawsuit or any potential regulatory proceeding or action could have a material adverse effect on our business, financial condition, and results of operations.

These litigation proceedings could result in substantial additional costs and expenses and adversely affect our cash flows, and may adversely affect our business, financial condition, and results of operations. We have in the past incurred and expect to continue to incur significant expenses in connection with these matters. Many members of our senior management team and our Board of Directors have been and will be required to devote a significant amount of time to the litigation related to the restatement. In addition, certain of these individuals are named defendants in the litigation related to the restatement. If our senior management is unable to devote sufficient time in the future to developing and pursuing our strategic business initiatives and running ongoing business operations, there may be a material adverse effect on our business, financial condition and results of operations.

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Our business may suffer if we are sued for infringing the intellectual property rights of third parties, or if we are unable to obtain rights to third-party intellectual property on which we depend.

Third parties have in the past asserted and may in the future assert claims that our system solutions infringe their proprietary rights. Such infringement claims, even if meritless, may cause us to incur significant costs in defending against those claims. We may be required to discontinue using and selling any infringing technology and services, to expend resources to develop non-infringing technology or to purchase licenses or pay royalties for other technology. Similarly, we depend on our ability to license intellectual property from third parties. The third parties from which we currently license technology or other third parties may become unwilling to license to us on acceptable terms intellectual property that is necessary to our business. In either case, we may be unable to acquire licenses for other technology on reasonable commercial terms or at all. As a result, we may find that we are unable to continue to offer the solutions and services upon which our business depends.

We have received, and have currently pending, third-party infringement claims and may receive additional notices of claims of infringement in the future. As we expand into other payment technologies and as competition in this area increases, it is possible that the rate at which third parties bring claims will increase. Infringement claims may cause us to incur significant costs in defending against those claims or to settle claims to avoid costly or protracted litigation even if we deem those claims to be without merit. For example, in March 2008, Cardsoft, Inc. and Cardsoft (Assignment for the Benefit of Creditors), LLC commenced an infringement action against us and others. On June 8, 2012, following a jury trial in the Eastern District of Texas, Marshall Division, the jury issued a verdict against us and awarded Cardsoft infringement damages and royalties. Judgment has not yet been issued, and additional amounts could be ordered against us by the court. See Note 13. Commitments and Contingencies, in the Notes to Condensed Consolidated Financial Statements of this Quarterly Report on Form 10-Q. Infringement claims are expensive and time consuming to defend against, regardless of the merits or ultimate outcome. Similar claims may result in additional protracted and costly litigation. There can be no assurance that we will prevail in any such actions or that any license required under any such patent or other intellectual property would be made available on commercially acceptable terms, if at all. An unfavorable outcome in any such litigation, including the post-trial rulings and final judgment in the Cardsoft litigation, could result in a significant judgment of damages against us, which could materially and adversely impact our financial results, financial condition and cash flows. See Note 13. Commitments and Contingencies, in the Notes to Condensed Consolidated Financial Statements of this Quarterly Report on Form 10-Q.

Our North American and international operations are not equally profitable, which may promote volatility in our earnings and may adversely impact future growth in our earnings.

Our international sales of System solutions and Services have tended to carry lower average selling prices and therefore have lower gross margins than our sales in North America. We also face increased downward pressure on prices in international markets such as China where local competition has intensified and in India where we continue to expand our business. As a result, any improvement in our results of operations from our expansion internationally will likely not be as favorable or profitable as an expansion of similar magnitude in the United States and Canada. In addition, we are unable to predict for any future period our proportion of revenues that will result from international sales versus sales in North America. Variations in this proportion from period to period may lead to volatility in our results of operations which, in turn, may depress the trading price of our common stock.

We have experienced some fiscal quarters in which a significant percentage of the business for the quarter is executed towards the end of the fiscal quarter. This could negatively impact our business and results of operations.

Revenues recognized in our fiscal quarters can be back-end weighted meaning that during a particular fiscal quarter the timing of orders could be such that a substantial portion of sales orders are received, product is shipped, and

revenue is recognized towards the end of the fiscal quarter, for various reasons. The occurrence of such back-end loading could adversely affect our business and results of operations due to a number of factors including the following:

- the manufacturing processes at our third-party contract manufacturers could become concentrated in a shorter time period. This concentration of manufacturing could increase manufacturing costs, such as costs associated with the expediting of orders, and negatively impact gross margins. The risk of higher levels of obsolete or excess inventory write-offs would also increase if we were to hold higher inventory levels to counteract this effect;
- the higher concentration of orders may make it difficult to accurately forecast component requirements and, as a result, we could experience a shortage of the components needed for production, possibly delaying shipments and causing lost orders;
- if we are unable to fill orders at the end of a quarter, shipments may be delayed. This could cause us to fail to meet our revenue and operating profit expectations for a particular quarter and could increase the fluctuation of quarterly results if shipments are delayed from one fiscal quarter to the next or orders are canceled by customers;

and

- in order to fulfill orders at the end of a quarter, we may be forced to deliver our products using air freight which would result in increased distribution costs.

We are exposed to credit risk with some of our customers and to credit exposures and currency controls in certain markets, which could result in material losses.

A significant portion of our sales are on an open credit basis, with typical payment terms of up to 60 days in the United States and, because of local customs or conditions, longer in some international markets. In the past, there have been bankruptcies among our customer base. Although credit losses have not been material to date, future losses, if incurred, could harm our business and have a materially adverse effect on our operating results and financial condition. Also, certain customers that are invoiced in U.S. dollars, such as those based in Venezuela, have experienced and may continue to experience difficulties in obtaining U.S. dollars due to local currency controls, and therefore may not be able to remit timely payment to us. Additionally, to the extent that the ongoing uncertainty in the global economy continues to make it more difficult for some customers to obtain financing or access U.S. dollar currency, our customers' ability to pay could be adversely impacted, which in turn could have a material adverse impact on our business, cash flows, operating results and financial condition.

We depend upon third parties to manufacture our systems and to supply the components necessary to manufacture our products.

We utilize a limited number of third parties to manufacture our hardware products pursuant to our specifications and rely upon these contract manufacturers to produce and deliver products to our customers on a timely basis and at an acceptable cost or to otherwise meet our product demands. Further, a material portion of these third party manufacturing activities are concentrated in China. Disruptions to the business, financial stability or operations, including due to strikes, labor disputes or other disruptions to the workforce, of these contract manufacturers, or to their ability to produce the products we require in accordance with our and our customers' requirements, and particularly disruptions to the manufacturing operations in China including due to geological disruptions such as earthquakes, could significantly affect our ability to fulfill customer demand on a timely basis which could materially harm our revenues and results of operations. We also rely on our contract manufacturer's facility in Israel for certain of our product lines and therefore are subject to the political disruptions or economic instability in that region. Substantially all of our manufacturing is currently handled by our third party contract manufacturers and our dependency on our third party contract manufacturers could exacerbate these risks.

Components such as application specific integrated circuits, or ASICs, microprocessors, wireless modules, modems and printer mechanisms that are necessary to manufacture and assemble our systems are sourced either directly by us or on our behalf by our contract manufacturers from a variety of component suppliers selected by us. Certain of the components are specifically customized for use in our products and are obtained from sole source suppliers on a purchase order basis. Disruptions to the business, financial stability or operations, including due to strikes, labor disputes or other disruptions to the workforce, of our suppliers, and particularly sole source suppliers, may also impact the availability of components to us in the quantities we require and on a timely basis. In March 2011 we experienced some component shortages due to the severe earthquake and tsunami in Japan which together with resulting damage to certain nuclear power plants, had resulted in widespread destruction and economic uncertainty in that region. Although we have to date been able to manage component supply adequately to meet our product demands, any prolonged component shortage as a result of similar events could materially and adversely affect our business and results of operations. Component shortages have resulted in increased costs for certain components and continued cost increases, particularly for critical components, could negatively impact our gross margins and profitability. If our suppliers are unable or unwilling to deliver the quantities that we require within the timeframe that we require, we would be faced with a shortage of critical components. We also experience from time to time an increase in the lead

time for delivery of some of our key components. We may not be able to find alternative sources in a timely manner if suppliers of our key components become unwilling or unable to provide us with adequate supplies of these key components when we need them or if they increase their prices. If we are unable to obtain sufficient key required components, or to develop alternative sources if and as required in the future, or to replace our component and factory tooling for our products in a timely manner if they are damaged or destroyed, we could experience delays or reductions in product shipments. This could harm our relationships with our customers and cause our revenues to decline. Even if we are able to secure alternative sources or replace our tooling in a timely manner, our costs could increase. Any of these events could adversely affect our results of operations.

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The value of our deferred tax assets may not be realizable to the extent our future profits are less than we have projected and we may be required to record valuation allowances against previously-booked deferred tax assets, which may have a material adverse effect on our results of operations and our financial condition.

As of July 31, 2012, on a worldwide basis we had net deferred tax assets of $21 million. Our income tax expense includes deferred income taxes arising from temporary differences between the financial reporting and tax bases of assets and liabilities, capital loss carry-forwards and net operating losses. We evaluate the realizability of our deferred income tax assets and assess the need for a valuation allowance on an ongoing basis. In evaluating our deferred income tax assets, we consider whether it is more likely than not that the deferred income tax assets will be realized. The ultimate realization of our deferred income tax assets depends upon generating sufficient future taxable income during the periods in which our temporary differences become deductible and before our capital loss carry-forwards and net operating losses expire. Our assessment of the realizability of our deferred income tax assets requires significant judgment. Failure to achieve our projections may result in an increase in the valuation allowance in a future period. Any future increase in the valuation allowance would result in additional income tax expense which could have a material adverse effect on our results of operations and financial condition.

The government tax benefits that our subsidiaries have previously received or currently receive require them to meet several conditions and may be terminated or reduced in the future, which could require us to pay increased taxes or refund tax benefits received in the past.

Israel

Our subsidiary in Israel (formerly Lipman) previously received tax benefits under Israeli law for capital investments that are designated as “Approved Enterprises.” We received such tax benefits of approximately $0.4 million during the twelve months ended October 31, 2009. Due to our restructuring and contract manufacturing arrangements entered into during the twelve months ended October 31, 2010 we no longer meet the requirements necessary to maintain the tax benefit status in Israel. As of November 1, 2009, we have been taxed at the full statutory rate in Israel and no future tax benefit has been recorded. This Israel subsidiary has undistributed earnings of approximately $184 million, the vast majority of which are attributable to Lipman's historic Approved Enterprise programs. As such, these earnings were not subject to Israeli statutory corporate tax at the time they were generated. Distribution or use of these funds outside Israel would subject us to payment of corporate and withholding taxes. For example, to the extent that these earnings are distributed to the United States in the future, our Israeli subsidiary would be required to pay corporate tax at the rate ordinarily applicable to such earnings, currently between 12.5% and 36.25%, which includes the withholding tax between the United States and Israel. We have accrued approximately $50 million for taxes associated with potential future distributions of our Israeli subsidiary's approximately $184 million in earnings.

Singapore

Our principal subsidiary in Singapore has received tax benefits under the Singapore Pioneer Tax Holiday provision. We received tax benefits of approximately $13.6 million during the twelve months ended October 31, 2011 and $8.3 million during the twelve months ended October 31, 2010. To maintain our eligibility for these benefits, we must meet certain agreed conditions, including maintaining agreed levels of Singapore employees and incurring and documenting total local business spend levels as agreed with the Singapore Economic Development Board. During 2010 we renegotiated the terms and conditions of the Tax Holiday, including an extension of our Tax Holiday through our fiscal year 2012. Although we expect to be able to meet the terms and conditions to maintain our Tax Holiday, if we are not able to achieve or maintain the required conditions, we may lose our eligibility for such benefits. In addition, this Tax Holiday expires October 31, 2012. If we are not able to extend such Tax Holiday beyond the current expiration date our income in Singapore would be taxed at the statutory rate of 17% instead of the agreed Pioneer Tax Holiday rate of 0%. A loss of all or part of these tax benefits would adversely affect our results of operations and cash

flows.

Changes in our effective tax rate could adversely affect results of operations.

Our effective tax rate could be adversely affected by a number of factors, including shifts in the mix of pretax profits and losses by tax jurisdiction, loss of tax holidays or other tax benefit in one or more jurisdictions, our ability to use tax credits, changes in tax laws or related interpretations in the jurisdictions in which we operate, and tax assessments and related interest and penalties resulting from income tax audits. We are subject to ongoing tax audits in various jurisdictions. Although we regularly assess the likely outcomes of such audits in order to determine the appropriateness of our tax provision, there can be no assurance that we will accurately predict the outcomes of these audits, and the actual outcomes of these audits could have a material impact on our net income or financial condition. We have not provided for U.S. federal and state income taxes or foreign withholding taxes that may result from future remittances of undistributed earnings of foreign subsidiaries. Recently,

there have been proposals to reform U.S. tax rules including proposals which may result in a reduction or elimination of the deferral of U.S. income tax on our foreign earnings, in which case our effective tax rate could be adversely affected. Any of these changes could have an adverse effect on our results of operations.

Our quarterly operating results may fluctuate significantly as a result of factors outside of our control, which could cause the market price of our common stock to decline.

We expect our revenues and operating results to vary from quarter to quarter. As a consequence, our operating results in any single quarter may not meet the expectations of securities analysts and investors, which could cause the price of our common stock to decline. Factors that may affect our operating results include:

- the type, timing, and size of orders and shipments;
- demand for and acceptance of our new product and services offerings;
- changes in competitive conditions, including from traditional payment solution providers, as well as from alternative payment solution providers;
- customers' willingness to maintain inventories and/or increased overall channel inventories held by customers in a particular quarter;
- fluctuations in currency exchange rates;
- delays in the implementation and delivery of our products and services, which may impact the timing of our recognition of revenues;
- variations in product mix and cost during any period;
- development of new relationships, penetration of new markets and maintenance and enhancement of existing relationships with customers and strategic partners;
- component supply, manufacturing, or distribution difficulties;
- deferral of customer contracts in anticipation of product or service enhancements;
- timing of commencement, implementation, or completion of major implementation projects;
- timing of governmental, statutory and industry association requirements, such as PCI compliance deadlines;
- the relative geographic mix of net revenues;
- the fixed nature of many of our expenses; and
- industry and economic conditions, including competitive pressures and inventory obsolescence.

In particular, differences in relative growth rates between our businesses in North America and internationally may have a significant effect on our operating results, particularly our reported gross profit percentage, in any individual quarter, with International sales carrying lower margins.

In addition, we have in the past and may continue to experience periodic variations in sales to our key vertical and international markets. These periodic variations occur throughout the year and may lead to fluctuations in our quarterly operating results depending on the impact of any given market during that quarter and could lead to volatility in our stock price.

We may accumulate excess or obsolete inventory that could result in unanticipated price reductions and write-downs and adversely affect our financial condition.

In formulating our solutions, we have focused our efforts on providing our customers with solutions that have high levels of functionality, which requires us to develop and incorporate new and evolving technologies. This approach tends to increase the risk of obsolescence for products and components we hold in inventory and may compound the difficulties posed by other factors that affect our inventory levels, including the following:

- the need to maintain significant inventory of components that are in limited supply;

- buying components in bulk for the best pricing;
- responding to the unpredictable demand for products;
- cancellation of customer orders;
- responding to customer requests for quick delivery schedules; and
- timing of end-of-life decisions regarding products, including of acquired product lines.

The accumulation of excess or obsolete inventory has in the past resulted in and may in future periods result in price reductions and inventory write-downs and scrap, which could adversely affect our business, results of operations and financial condition. As an example, for the fiscal year ended October 31, 2009, we incurred costs for obsolete inventory, scrap, and purchase commitments for excess components at contract manufacturers of $23.0 million due to changing demand we experienced in fiscal year 2009 as a result of the severe deterioration in the macroeconomic environment.

If we do not accurately forecast customer demand and effectively manage our product mix and inventory levels, we may lose sales from having too few or the wrong mix of products or incur costs associated with excess inventory.

If we improperly forecast demand for our products we could end up with too many products and be unable to sell the excess inventory in a timely manner, if at all, or, alternatively we could end up with too few products and not be able to satisfy demand. This problem is exacerbated because our attempt to closely match inventory levels with product demand leaves limited margin for error, and we generally receive a significant volume of customer orders towards the end of each fiscal quarter which leaves us little room to adjust inventory mix to match demand. For example, the shortages of certain components due to the March 2011 earthquake and tsunami in Japan exacerbated our ability to match inventory to customer demand. Also, during the transition from an existing product to a new replacement product, we must accurately predict the demand for the existing and the new product. Our inability to properly manage our inventory levels could cause us to incur increased expenses associated with writing off excessive or obsolete inventory or lose sales or have to ship products by air freight to meet immediate demand, incurring incremental freight costs above sea freight costs, a preferred method, and suffering a corresponding decline in gross margins. If we do not accurately predict demand, we could also incur increased expenses associated with binding commitments to certain third-party contract manufacturers and suppliers which would negatively impact our gross margins and operating results. See Note 13. Commitments and Contingencies, in the Notes to Condensed Consolidated Financial Statements of this Quarterly Report on Form 10-Q. During times of economic uncertainty, such as that of the recent global economic recession, it becomes more difficult to accurately forecast demand and manage our inventory levels. Deteriorating market conditions have in the past and can in future periods cause us to incur additional costs associated with excess and obsolete inventory, scrap, and excess inventory held by our contract manufacturers.

We may be subject to additional impairment charges due to potential declines in the fair value of our assets.

As a result of our acquisitions, particularly that of Lipman in November 2006, Hypercom in August 2011 and Point in December 2011, we have recorded significant goodwill and intangible assets on our balance sheet. We test goodwill and intangible assets for impairment on a periodic basis as required, and whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The events or changes that could require us to test our goodwill and intangible assets for impairment include a reduction in our stock price and market capitalization and changes in our estimated future cash flows, as well as changes in rates of growth in our industry or in any of our reporting units. In the fourth fiscal quarter of 2008, we recorded an impairment charge of $289.1 million for goodwill and developed technology intangible assets due to lower revenue expectations in light of current operating performance and future operating expectations. During the first fiscal quarter of 2009, we concluded that the carrying amount of the North America and Asia reporting units exceeded their implied fair values and recorded an estimated impairment charge of $178.2 million. We finalized the goodwill evaluation process and recorded a $2.7 million reduction of impairment charge during the second quarter of fiscal year 2009, resulting in a final goodwill impairment charge of $175.5 million as of April 30, 2009 associated with the North America and Asia reporting units. We have not recorded any further impairment charges since the fiscal quarter ended April 30, 2009.

We will continue to evaluate the carrying value of our goodwill and intangible assets and if we determine in the future that there is a potential further impairment in any of our reporting units, we may be required to record additional charges to earnings which could materially and adversely affect our financial results and could also materially and adversely affect our business. The process of evaluating the potential impairment of goodwill and intangible assets is subjective and requires significant judgment at many points during the analysis and includes estimates of our future cash flows attributable to a reporting unit or asset over its estimated remaining useful life. Any changes in our estimates, such as our estimates of the future cash flows attributable to a reporting unit or asset, or a longer or more significant decline in our market capitalization or the macroeconomic environment, could require us to record

additional impairment charges which could materially and adversely affect our financial results. See Note 2. Goodwill and Purchased Intangible Assets, in the Notes to Condensed Consolidated Financial Statements of this Quarterly Report on Form 10-Q for additional information related to impairment of goodwill and intangible assets.

Our proprietary technology is difficult to protect and unauthorized use of our proprietary technology by third parties may impair our ability to compete effectively.

We may not be able to protect our proprietary technology, which could enable competitors to develop services that compete with our own. We rely on patent, copyright, trademark, and trade secret laws, as well as confidentiality, licensing and other contractual arrangements to establish and protect the proprietary aspects of our solutions. Institution of legal proceedings to enforce our intellectual property rights could be costly and divert the efforts and attention of our management and technical personnel from other business operations. In addition, there can be no assurance that such proceedings would be determined in our favor. We do not have patent protection for certain important aspects of our current solutions. The laws of some countries in

which we sell our solutions and services may not protect software and intellectual property rights to the same extent as the laws in the United States. If we are unable to prevent misappropriation of our technology, competitors may be able to use and adapt our technology. Our failure to protect our technology could diminish our competitive advantage and cause us to lose customers to competitors.

Shipments of electronic payment systems may be delayed by factors outside of our control, which can harm our reputation and our relationships with our customers.

The shipment of payment systems requires us or our manufacturers, distributors, or other agents to obtain customs or other government certifications and approvals, and, on occasion, to submit to physical inspection of our systems in transit. Failure to satisfy these requirements, and the very process of trying to satisfy them, can lead to lengthy delays in the delivery of our solutions to our direct or indirect customers. Because we depend upon third-party carriers for the timely delivery of our products we may face delays in delivery due to reasons outside our control. Delays and unreliable delivery by us may harm our reputation in the industry and our relationships with our customers.

Force majeure events, such as terrorist attacks, other acts of violence or war and political instability may adversely affect us.

Terrorist attacks, war and international political instability may disrupt our ability to generate revenues. Such events may negatively affect our ability to maintain sales revenues and to develop new business relationships. Because a substantial and growing part of our revenues is derived from sales and services to customers outside of the United States and we have our electronic payment systems manufactured outside the United States, terrorist attacks, war and international political instability anywhere may decrease international demand for our products and inhibit customer development opportunities abroad, disrupt our supply chain and impair our ability to deliver our electronic payment systems, which could materially and adversely affect our net revenues or results of operations. Economic and political instability, particularly in the Middle East or OPEC member countries, may also disrupt the cost or supply of fuel which could increase our costs related to shipment and distribution of our products. Any of these events may also disrupt global financial markets and precipitate a decline in the price of our common stock.

Natural or man-made disasters, business interruptions and health epidemics could delay our ability to receive or ship our products, or otherwise disrupt our business.

Our worldwide operations could be subject to earthquakes, power shortages, telecommunications failures, water shortages, tsunamis, floods, hurricanes, typhoons, fires, extreme weather conditions, health epidemics and other natural or man-made disasters or business interruptions. For example, the March 2011 earthquake and tsunami in Japan had a material negative impact in our components supply which resulted in some order fulfillment delays in that quarter. The occurrence of any of these business disruptions could seriously harm our business, our revenue and financial condition and increase our costs and expenses. If our manufacturers' or warehousing facilities are damaged or destroyed, we would be unable to distribute our products on a timely basis, which could harm our business. Our corporate headquarters, and a portion of our research and development activities, are located in California, and other critical business operations and some of our suppliers are located in California and Asia, near major earthquake faults. Certain key servers and information systems are located in Florida, which has in the past experienced major hurricanes and similar extreme weather. Any disruption of our Florida operations could materially affect our operations and harm our business. Moreover, if our computer information systems or communication systems, or those of our vendors or customers, are subject to hacker attacks or other disruptions, our business could suffer. We have not established a comprehensive disaster recovery plan. Our back-up operations may be inadequate and our business interruption insurance may not be enough to compensate us for any losses that may occur. A significant business interruption could result in losses or damages and harm our business since much of our order fulfillment process is automated and the order information is stored on our servers. In addition, we increasingly rely on our

computer systems and servers to conduct our business. If our computer systems and servers go down, even for a short period, our ability to serve our customers and fulfill orders would be disrupted and our revenues could be materially and adversely affected, which could cause our stock price to decline significantly.

We have significant operations in Israel and therefore our results of operations may be adversely affected by political or economic instability or military operations in or around Israel.

We have offices and personnel in Israel. In addition, certain of our products are manufactured by our contract manufacturer in facilities located in Israel and some of our suppliers are located in Israel. Therefore, political, economic, and military conditions in Israel directly affect our operations. The future of peace efforts between Israel and its Arab neighbors remains uncertain. Any armed conflicts or further political instability in the region is likely to negatively affect business conditions and materially harm our results of operations. Furthermore, several countries continue to restrict or ban business

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with Israel and Israeli companies. These restrictive laws and policies may seriously limit our ability to make sales in those countries.

In addition, many employees in Israel are obligated to perform at least 30 days and up to 40 days, depending on rank and position, of military reserve duty annually and are subject to being called for active duty under emergency circumstances. If a military conflict arises, these individuals could be required to serve in the military for extended periods of time. Our operations in Israel could be disrupted by the absence for a significant period of one or more key employees or a significant number of other employees due to military service. Any disruption in our operations in Israel could materially and adversely affect our business.

In addition, disruption of the manufacturing process of our Israeli contract manufacturer or damage to its facility, whether as a result of fire, natural disaster, act of war, terrorist attack, or otherwise, could materially affect our ability to deliver products on a timely basis and could materially and adversely affect our results of operations.

While we believe we comply with environmental laws and regulations, we are still exposed to potential risks associated with environmental laws and regulations.

We are subject to other legal and regulatory requirements, including a European Union directive that places restrictions on the use of hazardous substances (RoHS) in electronic equipment, a European Union (EU) directive on Waste Electrical and Electronic Equipment (WEEE), the EU's Registration, Evaluation, Authorization and Restriction of Chemicals (REACH), and the environmental regulations promulgated by China's Ministry of Information Industry (China RoHS). RoHS sets a framework for producers' obligations in relation to manufacturing (including the amounts of named hazardous substances contained in products sold) and WEEE sets a framework for treatment, labeling, recovery, and recycling of electronic products in the European Union which may require us to alter the manufacturing of the physical devices that include our solutions and/or require active steps to promote recycling of materials and components. REACH imposes chemicals regulation and controls including requirements for registration of chemicals on the EU market. In addition, similar legislation could be enacted in other jurisdictions, including in the United States. Many states in the United States have enacted state-level programs and requirements for recycling of certain electronic goods. In addition, climate change legislation in the United States is a significant topic of discussion and may generate federal or other regulatory responses in the near future. If we do not comply with environmental law and regulations, we may suffer a loss of revenue, be unable to sell in certain markets or countries, be subject to penalties and enforced fees, and/or suffer a competitive disadvantage. Customers may impose certain requirements or levels of compliance due to these regulations and programs that may increase our costs of doing business with such customers. Furthermore, the costs to comply with RoHS, WEEE, REACH and China RoHS, or with current and future environmental and worker health and safety laws may have a material adverse effect on our business, results of operations and financial condition.

We must adhere to industry and government regulations and standards and therefore sales will suffer if we cannot comply with them.

Our system solutions must meet industry standards imposed by payment systems standards setting organizations such as EMVCo LLC, credit card associations such as Visa, MasterCard, and other credit card associations and standard setting organizations such as PCI SSC, Intermec and the U.K. Cards Association and other local organizations. New standards are continually being adopted or proposed as a result of worldwide anti-fraud initiatives, encryption of cardholder data, the increasing need for system compatibility and technology developments such as wireless and wireline IP communication. Our solutions also must comply with government regulations, including those imposed by telecommunications authorities and independent standards groups worldwide regarding emissions, radiation, and connections with telecommunications and radio networks, as well as data privacy laws which regulate the collection,

compilation, aggregation, sharing or use of consumer information. We cannot be sure that we will be able to design our solutions to comply with future standards or regulations on a timely basis, if at all. Compliance with these standards could increase the cost of developing or producing our solutions. New products designed to meet any new standards need to be introduced to the market and ordinarily need to be certified by the credit card associations and our customers before being purchased. The certification process is costly and time consuming and increases the amount of time it takes to sell our products. Moreover, certain uses of our products may subject us to additional regulations and licensing requirements. For example, use of our products in taxis requires additional licensing and may subject us to certain taxi business regulations. Our business, revenues and financial condition could be adversely affected if we cannot comply with new or existing industry standards, or obtain or retain necessary regulatory approval or certifications in a timely fashion, or if compliance results in increasing the cost of our products. Selling products that are non-compliant may result in fines against us or our customers, which we may be liable to pay. In addition, even if our products are designed to be compliant, compliance with certain security standards is determined based on the merchant's or service provider's network environment in which our systems are installed and, therefore, is dependent upon a number of additional factors such as proper installation of

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the components of the environment including our systems, compliance of software and system components provided by other vendors, implementation of compliant security processes and business practices and adherence to such processes and practices. Our business and financial condition could be adversely affected if we do not comply with new or existing industry standards and regulations, or obtain or retain necessary regulatory approval or certifications in a timely fashion, or if compliance results in increasing the cost of our products.

Risks Related to Our Capital Structure

Our secured credit facility contains restrictive and financial covenants. If we are unable to comply with these covenants, we will be in default. A default could result in the acceleration of our outstanding indebtedness, which would have an adverse effect on our business and stock price.

On December 28, 2011, our principal subsidiary, VeriFone, Inc., entered into a secured credit agreement (the "2011 Credit Agreement") consisting of total senior secured credit facilities of $1.5 billion. The 2011 Credit Agreement consists of a Term A loan facility of $919 million (the "Term A Loan"), a Term B loan facility of $232 million (the "Term B Loan") and a revolving credit facility permitting borrowings of up to $350 million (the "Revolving Facility"). These credit facilities were made available (i) to fund a portion of the cash consideration for our acquisition of Point, (ii) to refinance certain existing debt at Point, (iii) to repay all outstanding amounts under our senior secured credit agreement entered into as of October 31, 2006, (iv) to fund an escrow to repay at maturity or upon earlier conversion at the option of the holders thereof our 1.375% senior convertible notes due June 2012, and (v) to pay related fees and expenses as well as for working capital requirements and for other general corporate purposes. As of July 31, 2012, we had outstanding loan balances of $896 million under our Term A Loan, $230 million under our Term B Loan, and $190 million drawn on the Revolving Facility. See Note 5. Financings, in the Notes to Condensed Consolidated Financial Statements of this Quarterly Report on Form 10-Q.

Our 2011 Credit Agreement contains customary covenants that require maintenance of certain specified financial ratios and restrict the ability of certain of our subsidiaries to make certain distributions with respect to their capital stock, prepay other debt, encumber their assets, incur additional indebtedness, make capital expenditures above specified levels, engage in certain business combinations, or undertake various other corporate activities. Therefore, as a practical matter, these covenants restrict our ability to engage in or benefit from such activities. Further, VeriFone, Inc. must achieve certain credit ratings, limit its leverage ratio and maintain interest coverage ratio at or above specified thresholds. In addition, we have, in order to secure repayment of the Term A Loan, Term B Loan and Revolving Facility, pledged a substantial amount of our assets and properties. This pledge may reduce our operating flexibility because it restricts our ability to dispose of these assets or engage in other transactions that may be beneficial to us.

If we are unable to comply with the covenants in our 2011 Credit Agreement, we will be in default, which could result in the acceleration of our outstanding indebtedness. In addition, if our leverage exceeds a certain level set out in our 2011 Credit Agreement, a portion of our excess cash flow must be used to pay down our outstanding Term B loan. If acceleration occurs, we may not be able to repay our debt and we may not be able to borrow sufficient additional funds to refinance our debt. In addition, under the terms of the 2011 Credit Agreement, increases in our leverage ratio could result in increased interest rates and therefore result in higher debt service costs. If we were to default in performance under the 2011 Credit Agreement, we may pursue an amendment or waiver from our lenders, but there can be no assurance that the lenders would grant such an amendment or waiver and, in light of current credit market conditions, any such amendment or waiver requested is likely to be on terms, including additional fees, as well as increased interest rates and other more stringent terms and conditions that would be materially disadvantageous to us. For example, as a result of the delay in our financial reports for the 2007 fiscal year and the first two fiscal quarters of 2008, we were required to obtain amendments to our former credit facility that resulted in an increase in the interest

rate payable on our term loan and revolving commitments, as well as increases in the commitment fee for unused revolving commitments and letter of credit fees. We also paid the consenting lenders amendment fees in connection with the amendments.

Our indebtedness and debt service obligations under our 2011 Credit Facility are substantial and may adversely affect our cash flow, cash position, and stock price.

Following our acquisition of Point and the related entry into the 2011 Credit Agreement, our outstanding indebtedness and debt service obligations are substantial. As of July 31, 2012, we had total indebtedness outstanding of $1.3 billion related to our Term A Loan, Term B Loan and Revolving Facility. Principal payments on our Term A Loan facility are required to be repaid in quarterly installments of the following percentages of the original balance outstanding under the Term A Facility: 1.25% for each of the first eight calendar quarters after the closing date of the Credit Facility on December 28, 2011 through the quarter ending December 31, 2013; 2.50% for each of the next eight calendar quarters through the quarter ending

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December 31, 2015 and 5.00% for each of the calendar quarters ending March 31, 2016, June 30, 2016 and September 30, 2016 with the balance being due at maturity on December 28, 2016. The outstanding principal balance of the Term B Loan is required to be repaid in equal quarterly installments of 0.25% with the balance being due at maturity on December 28, 2018. Outstanding amounts may also be subject to mandatory prepayment with the proceeds of certain asset sales and debt issuances and, in the case of the Term B Loan, from a portion of annual excess cash flows (as determined under the 2011 Credit Agreement). See Note 5. Financings, in the Notes to Condensed Consolidated Financial Statements of this Quarterly Report on Form 10-Q for a schedule of the principal payments due under our financings.

We intend to fulfill our debt service obligations from existing cash, investments and operations. A substantial portion of our cash balances and cash generated from operations are held by our foreign subsidiaries. If we decide to distribute or use such cash and cash equivalents outside those foreign jurisdictions, including a distribution to the United States we may be subject to additional taxes or costs. In the future, if we are unable to generate or raise additional cash sufficient to meet our debt service obligations and need to use more of our existing cash than planned or to liquidate investments in order to fund these obligations, we may have to delay or curtail the development and/or the sales and marketing of new payment systems as well as dividends, capital expenditures, investments and acquisitions. If we are unable to generate sufficient cash flows or other sources of liquidity to meet our debt service requirements our lenders may declare a default on the 2011 Credit Agreement which could result in the termination of commitments under the Credit Facilities, the declaration that all outstanding loans are immediately due and payable in whole or in part and the requirement of cash collateral deposits in respect of outstanding letters of credit.

Interest rates applicable to our debt are expected to fluctuate based on economic and market factors that are beyond our control. In particular, all of the outstanding debt under our Credit Facility have a floating interest rate. Any significant increase in market interest rates, and in particular the short-term LIBOR rates, would result in a significant increase in interest expense on our debt, which could negatively impact our net income and cash flows. In addition, interest rates under the 2011 Credit Agreement will fluctuate to some extent based on our leverage ratios.

Our indebtedness could have significant additional negative consequences, including, without limitation:

- requiring the dedication of a significant portion of our expected cash flow to service the indebtedness, thereby reducing the amount of expected cash flow available for other purposes, including dividends, capital expenditures, investments and acquisitions;
- increasing our vulnerability to general adverse economic conditions;
- limiting our ability to obtain additional financing on acceptable terms; and
- placing us at a possible competitive disadvantage to less leveraged competitors and competitors that have better access to capital resources.

The conditions of the U.S. and international capital markets may have an adverse effect on other financial transactions.

Deterioration in the U.S. and international capital markets has in the past had an adverse effect of certain of our financial transactions. The filing by Lehman Brothers of a voluntary Chapter 11 bankruptcy petition in September 2008 constituted an “event of default” under our note hedge transaction with Lehman Derivatives (which has also filed a voluntary Chapter 11 bankruptcy petition) and the related guaranty by Lehman Brothers. Lehman Commercial Paper, Inc. (“Lehman CP”) was, at the time of its filing of a voluntary Chapter 11 bankruptcy petition in October 2008, a lender to us under a revolving credit facility. As a result of Lehman CP's filing of a voluntary Chapter 11 bankruptcy petition, the revolving credit facility was reduced by the amount of Lehman CP's commitment. Although this revolving credit facility has since been terminated, if other financial institutions that have extended credit commitments to us, including under the Credit Facility, or have entered into hedge, insurance or similar transactions with us are adversely

affected by the conditions of the U.S. and international capital markets, they may become unable to fund borrowings under their credit commitments to us or otherwise fulfill their obligations under the relevant transactions, which could have a material and adverse impact on our financial condition and our ability to borrow additional funds, if needed, for working capital, capital expenditures, acquisitions and other corporate purposes.

Some provisions of our certificate of incorporation and bylaws may delay or prevent transactions that many stockholders may favor.

Some provisions of our certificate of incorporation and bylaws may have the effect of delaying, discouraging or preventing a merger or acquisition that our stockholders may consider favorable, including transactions in which stockholders might receive a premium for their shares. These provisions include:

- authorization of the issuance of “blank check” preferred stock without the need for action by stockholders;
- the amendment of our organizational documents only by the affirmative vote of the holders of two-thirds of the

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shares of our capital stock entitled to vote;

- provision that any vacancy on the board of directors, however occurring, including a vacancy resulting from an enlargement of the board, may only be filled by vote of the directors then in office;
- inability of stockholders to call special meetings of stockholders, although stockholders are permitted to act by written consent; and
- advance notice requirements for board nominations and proposing matters to be acted on by stockholders at stockholder meetings.

Our share price has been volatile and we expect that the price of our common stock may continue to fluctuate substantially.

Our stock price has fluctuated substantially since our initial public offering in 2005, for example, due to the announcement of our restatement in December 2007 and during the recent turmoil in the worldwide financial markets. In addition to fluctuations related to VeriFone-specific factors, broad market and industry factors may adversely affect the market price of our common stock, regardless of our actual operating performance. Factors that could cause fluctuations in our stock price may include, among other things:

- actual or anticipated variations in quarterly operating results;
- changes in financial estimates by us or by any securities analysts who might cover our stock, or our failure to meet the estimates made by securities analysts;
- uncertainty about current global economic conditions;
- changes in the market valuations of other companies operating in our industry;
- announcements by us or our competitors related to significant acquisitions, strategic partnerships or divestitures;
- additions or departures of key personnel; and
- sales or purchases of our common stock, including sales or purchases of our common stock by our directors and officers or by our principal stockholders.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

The following documents are filed as Exhibits to this report:

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Exhibit Number	Description
31.1*	Certification of the Chief Executive Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of the Chief Financial Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of the Chief Executive Officer and the Chief Financial Officer as required by Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS **	XBRL Instance Document
101.SCH **	XBRL Taxonomy Extension Schema Document
101.CAL **	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF **	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB **	XBRL Taxonomy Extension Label Linkbase Document
101.PRE **	XBRL Taxonomy Extension Presentation Linkbase Document

* Filed herewith.

** XBRL (eXtensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

VERIFONE SYSTEMS, INC.

By: /S/ DOUGLAS G. BERGERON
Douglas G. Bergeron
Chief Executive Officer

By: /S/ ROBERT DYKES
Robert Dykes
Executive Vice President and Chief Financial Officer

Date: September 10, 2012

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EXHIBIT INDEX

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" SIZE="2">(1) For a discussion of the independent directors compensation, see below.

(2) We do not maintain a stock or option plan, non-equity incentive plan or pension plan for our directors. However, our independent directors have the option to receive all or a portion of the directors fees to which they would otherwise be entitled in the form of shares of our common stock issued at a price per share equal to the greater of our then-current net asset value per share or the market price at the time of payment. No shares were issued to any of our independent directors in lieu of cash during 2011.

Our independent directors annual fee is $100,000. The independent directors also receive $2,500 ($1,500 if participate telephonically) plus reimbursement of reasonable out-of-pocket expenses incurred in connection with attending each board meeting and $1,000 plus reimbursement of reasonable out-of-pocket expenses incurred in connection with each committee meeting attended. In addition, the chairman of the audit committee receives an annual fee of $7,500 and the chairman of the nominating and corporate governance committee receives an annual fee of $2,500. Further, we purchase directors and officers liability insurance on behalf of our directors and officers. Our independent directors also have the option to receive all or a portion of the directors fees to which they would otherwise be entitled in the form of shares of our common stock issued at a price per share equal to the greater of our then-current net asset value per share or the market price at the time of payment. No shares were issued to any of our independent directors in lieu of cash during 2011. In addition, no compensation was paid to directors who are interested persons of Solar Capital as defined in the 1940 Act.

Compensation of Executive Officers

None of our officers receives direct compensation from Solar Capital. Mr. Gross, our chief executive officer and president, and Mr. Spohler, our chief operating officer, through their ownership interest in Solar Capital Partners, our investment adviser, are entitled to a portion of any profits earned by Solar Capital Partners, which includes any fees payable to Solar Capital Partners under the terms of our Investment Advisory and Management Agreement, less expenses incurred by Solar Capital Partners in performing its services under the Investment Advisory and Management Agreement. Messrs. Gross and Spohler do not receive any additional compensation from Solar Capital Partners in connection with the management of our portfolio.

Mr. Peteka, our chief financial officer and, through Alaric Compliance Services, LLC, Guy Talarico, our chief compliance officer, are paid by Solar Capital Management, our administrator, subject to reimbursement by us of an allocable portion of such compensation for services rendered by such persons to Solar Capital. To the extent that Solar Capital Management outsources any of its functions we will pay the fees associated with such functions on a direct basis without profit to Solar Capital Management.

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Indemnification Agreements

We have entered into indemnification agreements with our directors. The indemnification agreements are intended to provide our directors the maximum indemnification permitted under Maryland law and the 1940 Act. Each indemnification agreement provides that Solar Capital shall indemnify the director who is a party to the agreement (an Indemnitee), including the advancement of legal expenses, if, by reason of his or her corporate status, the Indemnitee is, or is threatened to be, made a party to or a witness in any threatened, pending, or completed proceeding, to the maximum extent permitted by Maryland law and the 1940 Act.

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PORTFOLIO MANAGEMENT

The management of our investment portfolio is the responsibility of our investment adviser, Solar Capital Partners, and its investment committee, which is led by Messrs. Gross and Spohler. For more information regarding the business experience of Messrs. Gross and Spohler, see Management Board of Directors and Executive Officers Interested Directors. Solar Capital Partners investment committee must approve each new investment that we make. The members of Solar Capital Partners investment committee are not employed by us, and receive no compensation from us in connection with their portfolio management activities. However, Messrs. Gross and Spohler, through their financial interests in Solar Capital Partners, will be entitled to a portion of any investment advisory fees paid by Solar Capital to Solar Capital Partners.

Investment Personnel

Solar Capital Partners senior investment team currently consists of its senior investment professionals, Messrs. Gross, Spohler, Gerson, Henley, Mait and Shaikh, and a team of additional experienced investment professionals. We consider Messrs. Gross and Spohler, who lead Solar Capital Partners investment committee, to be our portfolio managers.

In addition to managing our investments, our portfolio managers also currently manage the following entity:

Name	Entity	Investment Focus	Gross Assets
Solar Senior Capital Ltd.	BDC	Senior secured loans and other senior debt instruments	$ 218.7 million(1)

(1) As of March 31, 2012.

The table below shows the dollar range of shares of our common stock to be beneficially owned by each of our portfolio managers.

Name of Portfolio Manager	Dollar Range of Equity Securities in Solar Capital(1)(2)
Michael S. Gross	Over $1 million
Bruce Spohler	Over $1 million

(1) Dollar ranges are as follows: None, $1 $10,000, $10,001 $50,000, $50,001 $100,000, $100,001 $500,000; $500,001 $1,000,000 or Over $1,000,000.
(2) The dollar range of equity securities beneficially owned in us is based on the closing price for our common stock of $22.79 on July 3, 2012 on the NASDAQ Global Select Market.

Compensation

None of Solar Capital Partners investment professionals receive any direct compensation from us in connection with the management of our portfolio. Messrs. Gross and Spohler, through their financial interests in Solar Capital Partners, are entitled to a portion of any profits earned by Solar Capital Partners, which includes any fees payable to Solar Capital Partners under the terms of our Investment Advisory and Management Agreement, less expenses incurred by Solar Capital Partners in performing its services under our Investment Advisory and Management Agreement.

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INVESTMENT ADVISORY AND MANAGEMENT AGREEMENT

Management Services

Solar Capital Partners serves as our investment adviser. Solar Capital Partners is an investment adviser that is registered as an investment adviser under the Advisers Act. Subject to the overall supervision of our board of directors, our investment adviser manages the day-to-day operations of, and provides investment advisory and management services to, Solar Capital. Under the terms of our Investment Advisory and Management Agreement, Solar Capital Partners:

determines the composition of our portfolio, the nature and timing of the changes to our portfolio and the manner of implementing such changes;

identifies, evaluates and negotiates the structure of the investments we make (including performing due diligence on our prospective portfolio companies);

closes and monitors the investments we make; and

provides us with other investment advisory, research and related services as we may from time to time require.

Solar Capital Partners services under the Investment Advisory and Management Agreement are not exclusive, and it is free to furnish similar services to other entities so long as its services to us are not impaired. For example, Solar Capital Partners presently serves as investment adviser to Solar Senior Capital Ltd., a publicly-traded BDC which focuses on investing primarily in senior secured loans, including first lien, unitranche and second lien debt instruments.

Management Fee

Pursuant to the Investment Advisory and Management Agreement, we have agreed to pay Solar Capital Partners a fee for investment advisory and management services consisting of two components a base management fee and an incentive fee.

The base management fee is calculated at an annual rate of 2.00% of our gross assets. For services rendered under the Investment Advisory and Management Agreement, the base management fee is payable quarterly in arrears. The base management fee is calculated based on the average value of our gross assets at the end of the two most recently completed calendar quarters, and appropriately adjusted for any share issuances or repurchases during the current calendar quarter.

The incentive fee has two parts, as follows: one is calculated and payable quarterly in arrears based on our pre-incentive fee net investment income for the immediately preceding calendar quarter. For this purpose, pre-incentive fee net investment income means interest income, dividend income and any other income (including any other fees (other than fees for providing managerial assistance), such as commitment,

origination, structuring, diligence and consulting fees or other fees that we receive from portfolio companies) accrued during the calendar quarter, minus our operating expenses for the quarter (including the base management fee, expenses payable under the Administration Agreement to Solar Capital Management, and any interest expense and dividends paid on any issued and outstanding preferred stock, but excluding the incentive fee). Pre-incentive fee net investment income includes, in the case of investments with a deferred interest feature (such as original issue discount, debt instruments with pay in kind interest and zero coupon securities), accrued income that we have not yet received in cash. Pre-incentive fee net investment income does not include any realized capital gains, computed net of all realized capital losses or unrealized capital appreciation or depreciation. Pre-incentive fee net

investment income, expressed as a rate of return on the value of our net assets at the end of the immediately preceding calendar quarter, is compared to a hurdle of 1.75% per quarter (7.00% annualized). Our net investment income used to calculate this part of the incentive fee is also included in the amount of our gross assets used to calculate the 2.00% base management fee. We pay Solar Capital Partners an incentive fee with respect to our pre-incentive fee net investment income in each calendar quarter as follows:

no incentive fee in any calendar quarter in which our pre-incentive fee net investment income does not exceed the hurdle of 1.75%;

100% of our pre-incentive fee net investment income with respect to that portion of such pre-incentive fee net investment income, if any, that exceeds the hurdle but is less than 2.1875% in any calendar quarter (8.75% annualized). We refer to this portion of our pre-incentive fee net investment income (which exceeds the hurdle but is less than 2.1875%) as the catch-up. The catch-up is meant to provide our investment adviser with 20% of our pre-incentive fee net investment income as if a hurdle did not apply if this net investment income exceeds 2.1875% in any calendar quarter; and

20% of the amount of our pre-incentive fee net investment income, if any, that exceeds 2.1875% in any calendar quarter (8.75% annualized) is payable to Solar Capital Partners (once the hurdle is reached and the catch-up is achieved, 20% of all pre-incentive fee investment income thereafter is allocated to Solar Capital Partners).

The following is a graphical representation of the calculation of the income-related portion of the incentive fee:

Quarterly Incentive Fee Based on Net Investment Income

Pre-incentive fee net investment income

(expressed as a percentage of the value of net assets)

Percentage of pre-incentive fee net investment income

allocated to Solar Capital Partners

These calculations are appropriately pro-rated for any period of less than three months and adjusted for any share issuances or repurchases during the relevant quarter. You should be aware that a rise in the general level of interest rates can be expected to lead to higher interest rates applicable to our debt investments. Accordingly, an increase in interest rates would make it easier for us to meet or exceed the incentive fee hurdle rate and may result in a substantial increase of the amount of incentive fees payable to our investment adviser with respect to pre-incentive fee net investment income.

The second part of the incentive fee is determined and payable in arrears as of the end of each calendar year (or upon termination of the Investment Advisory and Management Agreement, as of the termination date), and equals 20% of our realized capital gains, if any, on a

cumulative basis from inception through the end of each calendar year, computed net of all realized capital losses and unrealized capital depreciation on a cumulative basis, less the aggregate amount of any previously paid capital gain incentive fees with respect to each of the investments in our portfolio.

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Examples of Quarterly Incentive Fee Calculation

Example 1: Income Related Portion of Incentive Fee (*):

Alternative 1:

Assumptions

Investment income (including interest, dividends, fees, etc.) = 1.25%

Hurdle rate (1) = 1.75%

Management fee (2) = 0.50%

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

Pre-incentive fee net investment income

(investment income (management fee + other expenses)) = 0.55%

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

Alternative 2:

Assumptions

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

Hurdle rate (1) = 1.75%

Management fee (2) = 0.50%

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

Pre-incentive fee net investment income

(investment income (management fee + other expenses)) = 2.00%

Incentive fee = 100% × pre-incentive fee net investment income, subject to the catch-up (4)

= 100% × (2.00%   1.75%)

= 0.25%

Alternative 3:

Assumptions

Investment income (including interest, dividends, fees, etc.) = 3.00%

Hurdle rate (1) = 1.75%

Management fee (2) = 0.50%

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

Pre-incentive fee net investment income

(investment income   (management fee + other expenses)) = 2.30%

Incentive fee = 20% × pre-incentive fee net investment income, subject to catch-up (4)

Incentive fee = 100% × catch-up + (20% × (pre-incentive fee net investment income   2.1875%))

Catch-up = 2.1875%   1.75%

= 0.4375%

Incentive fee = (100% × 0.4375%) + (20% × (2.3%   2.1875%))

= 0.4375% + (20% × 0.1125%)

= 0.4375% + 0.0225%

= 0.46%

(*) The hypothetical amount of pre-incentive fee net investment income shown is based on a percentage of total net assets.
(1) Represents 7% annualized hurdle rate.
(2) Represents 2% annualized management fee.
(3) Excludes organizational and offering expenses.
(4) The catch-up provision is intended to provide our investment adviser with an incentive fee of 20% on all of our pre-incentive fee net investment income as if a hurdle rate did not apply when our net investment income exceeds 2.1875% in any calendar quarter.

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Example 2: Capital Gains Portion of Incentive Fee:

Alternative 1:

Assumptions

Year 1: $20 million investment made in Company A (Investment A), and $30 million investment made in Company B (Investment B)

Year 2: Investment A sold for $50 million and fair market value (FMV) of Investment B determined to be $32 million

Year 3: FMV of Investment B determined to be $25 million

Year 4: Investment B sold for $31 million

The capital gains portion of the incentive fee would be:

Year 1: None

Year 2: Capital gains incentive fee of $6 million ($30 million realized capital gains on sale of Investment A multiplied by 20%)

Year 3: None

$5 million (20% multiplied by ($30 million cumulative capital gains less $5 million cumulative capital depreciation)) less $6 million (previous capital gains fee paid in Year 2)

Year 4: Capital gains incentive fee of $200,000

$6.2 million ($31 million cumulative realized capital gains multiplied by 20%) less $6 million (capital gains fee taken in Year 2)

Alternative 2:

Assumptions

Year 1: $20 million investment made in Company A (Investment A), $30 million investment made in Company B (Investment B) and $25 million investment made in Company C (Investment C)

Year 2: Investment A sold for $50 million, FMV of Investment B determined to be $25 million and FMV of Investment C determined to be $25 million

Year 3: FMV of Investment B determined to be $27 million and Investment C sold for $30 million

Year 4: FMV of Investment B determined to be $24 million

Year 5: Investment B sold for $20 million

The capital gains incentive fee, if any, would be:

Year 1: None

Year 2: $5 million capital gains incentive fee

20% multiplied by $25 million ($30 million realized capital gains on Investment A less unrealized capital depreciation on Investment B)

Year 3: $1.4 million capital gains incentive fee[(1)]

$6.4 million (20% multiplied by $32 million ($35 million cumulative realized capital gains less $3 million unrealized capital depreciation)) less $5 million capital gains fee received in Year 2

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(1) As illustrated in Year 3 of Alternative 2 above, if Solar Capital were to be wound up on a date other than December 31 of any year, Solar Capital may have paid aggregate capital gain incentive fees that are more than the amount of such fees that would be payable if Solar Capital had been wound up on December 31 of such year.

Year 4: None

Year 5: None

$5 million (20% multiplied by $25 million (cumulative realized capital gains of $35 million less realized capital losses of $10 million)) less $6.4 million cumulative capital gains fee paid in Year 2 and Year 3

Payment of Our Expenses

All investment professionals of the investment adviser and their respective staffs, when and to the extent engaged in providing investment advisory and management services, and the compensation and routine overhead expenses of such personnel allocable to such services, are provided and paid for by Solar Capital Partners. We bear all other costs and expenses of our operations and transactions, including (without limitation):

- the cost of our organization and public offerings;
- the cost of calculating our net asset value, including the cost of any third-party valuation services;
- the cost of effecting sales and repurchases of our shares and other securities;
- interest payable on debt, if any, to finance our investments;
- fees payable to third parties relating to, or associated with, making investments, including fees and expenses associated with performing due diligence reviews of prospective investments and advisory fees;
- transfer agent and custodial fees;
- fees and expenses associated with marketing efforts;
- federal and state registration fees, any stock exchange listing fees;
- federal, state and local taxes;

independent directors fees and expenses;

brokerage commissions;

fidelity bond, directors and officers errors and omissions liability insurance and other insurance premiums;

direct costs and expenses of administration, including printing, mailing, long distance telephone and staff;

fees and expenses associated with independent audits and outside legal costs;

costs associated with our reporting and compliance obligations under the 1940 Act and applicable federal and state securities laws; and

all other expenses incurred by either Solar Capital Management or us in connection with administering our business, including payments under the Administration Agreement that will be based upon our allocable portion of overhead and other expenses incurred by Solar Capital Management in performing its obligations under the Administration Agreement, including rent, the fees and expenses associated with performing compliance functions, and our allocable portion of the costs of compensation and related expenses of our chief compliance officer and our chief financial officer and any administrative support staff.

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Duration and Termination

The Investment Advisory and Management Agreement was initially approved by the board of directors of Solar Capital LLC on March 6, 2007 and subsequently approved in its current form by our board of directors on September 29, 2009. Unless earlier terminated as described below, the Investment Advisory and Management Agreement will remain in effect from year to year if approved annually by our board of directors or by the affirmative vote of the holders of a majority of our outstanding voting securities, including, in either case, approval by a majority of our directors who are not parties to such agreement or who are not interested persons of Solar Capital, as such term is defined in Section 2(a)(19) of the 1940 Act. The Investment Advisory and Management Agreement will automatically terminate in the event of its assignment. The Investment Advisory and Management Agreement may also be terminated by either party without penalty upon 60 days written notice to the other. See Risk Factors Risks Relating to Our Business and Structure Our investment adviser can resign on 60 days notice, and we may not be able to find a suitable replacement within that time, resulting in a disruption in our operations that could adversely affect our financial condition, business and results of operations.

Indemnification

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

Organization of the Investment Adviser

Solar Capital Partners is a Delaware limited liability company. The principal executive offices of Solar Capital Partners are located at 500 Park Avenue, New York, New York 10022.

Board Approval of the Investment Advisory and Management Agreement

A discussion regarding the basis for our board of director s approval of our Investment Advisory and Management Agreement will be included in our first annual report on Form 10-K filed subsequent to any such board approval, or incorporated by reference therein.

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ADMINISTRATION AGREEMENT

Solar Capital Management, LLC, a Delaware limited liability company, serves as our administrator. The principal executive offices of Solar Capital Management are located at 500 Park Avenue, New York, New York 10022. Pursuant to an Administration Agreement, Solar Capital Management furnishes us with office facilities, equipment and clerical, bookkeeping and record keeping services at such facilities. Under the Administration Agreement, Solar Capital Management also performs, or oversees the performance of, our required administrative services, which include, among other things, being responsible for the financial records which we are required to maintain and preparing reports to our stockholders. In addition, Solar Capital Management assists us in determining and publishing our net asset value, oversees the preparation and filing of our tax returns and the printing and dissemination of reports to our stockholder, and generally oversees the payment of our expenses and the performance of administrative and professional services rendered to us by others. Payments under the Administration Agreement are equal to an amount based upon our allocable portion of Solar Capital Management s overhead in performing its obligations under the Administration Agreement, including rent, the fees and expenses associated with performing compliance functions and our allocable portion of the compensation of our chief financial officer and any administrative support staff. Under the Administration Agreement, Solar Capital Management will also provide on our behalf managerial assistance to those portfolio companies that request such assistance. The Administration Agreement may be terminated by either party without penalty upon 60 days written notice to the other party.

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

LICENSE AGREEMENT

We have entered into a license agreement with Solar Capital Partners pursuant to which Solar Capital Partners has agreed to grant us a non-exclusive, royalty-free license to use the name Solar Capital. Under this agreement, we have a right to use the Solar Capital name for so long as the Investment Advisory and Management Agreement with our investment adviser is in effect. Other than with respect to this limited license, we will have no legal right to the Solar Capital name.

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CERTAIN RELATIONSHIPS AND TRANSACTIONS

We have entered into the Investment Advisory and Management Agreement with Solar Capital Partners. Mr. Gross, our chairman and chief executive officer, is the managing member and a senior investment professional of, and has financial and controlling interests in, Solar Capital Partners. In addition, Mr. Spohler, our chief operating officer and board member and Mr. Peteka, our chief financial officer, serve as a partner and chief financial officer, respectively, for Solar Capital Partners. Mr. Spohler also has financial interests in Solar Capital Partners.

Solar Capital Partners and it affiliates may also manage other funds in the future that may have investment mandates that are similar, in whole and in part, with ours. For example, Solar Capital Partners presently serves as investment adviser to Solar Senior Capital Ltd., a publicly-traded BDC which focuses on investing primarily in senior secured loans, including first lien, unitranche and second lien debt instruments. In addition, Michael S. Gross, our chairman and chief executive officer, Bruce Spohler, our chief operating officer, and Richard Peteka, our chief financial officer, serve in similar capacities for Solar Senior Capital Ltd. Solar Capital Partners and its affiliates may determine that an investment is appropriate for us and for one or more of those other funds. In such event, depending on the availability of such investment and other appropriate factors, Solar Capital Partners or its affiliates may determine that we should invest side-by-side with one or more other funds. Any such investments will be made only to the extent permitted by applicable law and interpretive positions of the SEC and its staff, and consistent with Solar Capital Partners allocation procedures.

We have entered into a license agreement with Solar Capital Partners, pursuant to which Solar Capital Partners has agreed to grant us a non-exclusive, royalty-free license to use the name Solar Capital. In addition, pursuant to the terms of the Administration Agreement, Solar Capital Management provides us with the office facilities and administrative services necessary to conduct our day-to-day operations. Solar Capital Partners is the sole member of and controls Solar Capital Management.

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CONTROL PERSONS AND PRINCIPAL STOCKHOLDERS

The following table sets forth certain ownership information as of July 3, 2012 with respect to Solar Capital Ltd. s common stock for those persons who, directly or indirectly, own, control or hold with the power to vote, 5% or more of Solar Capital Ltd. s common stock, and all officers and directors as a group.

Name	Type of Ownership	Shares Owned(1)	Percentage(2)
Thornburg Investment Management Inc.(3)	Indirect	3,750,000	10.23%
Clough Capital Partners L.P.(4)	Indirect	1,845,264	5.03%
Michael S. Gross(5)	Direct and Indirect	2,121,844	5.79%
Bruce J. Spohler(5)	Indirect	2,055,649	5.61%
All officers and directors as a group (7 persons)(6)	Direct and Indirect	2,154,844	5.88%

(1) Beneficial ownership is determined in accordance with Rule 13d-3 under the Securities Exchange Act of 1934. Assumes no other purchases or sales of our common stock since the most recently available SEC filings. This assumption has been made under the rules and regulations of the SEC and does not reflect any knowledge that we have with respect to the present intent of the beneficial owners of our common stock listed in this table.
(2) Percentages are based on 36,667,197 shares of common stock outstanding as of July 3, 2012.
(3) Such securities are held by certain investment vehicles controlled and/or managed by Thornburg Investment Management Inc. or its affiliates. The address for Thornburg Investment Management Inc. is 2300 North Ridgetop Road, Santa Fe, New Mexico 87506.
(4) Such securities are held by certain investment vehicles controlled and/or managed by Clough Capital Partners L.P. or its affiliates. The address for Clough Capital Partners L.P. is One Post Office Square, 40th Floor, Boston, MA, 02109.
(5) Includes 1,340,649 shares held by Solar Capital Investors, LLC and 715,000 shares held by Solar Capital Investors II, LLC, both of which may be deemed to be beneficially owned by Michael S. Gross and by Bruce J. Spohler by virtue of their collective ownership interest therein. The address for each of Solar Capital Investors, LLC and Solar Capital Investors II, LLC is 500 Park Avenue, New York, NY 10022.
(6) The address for all officers and directors is 500 Park Avenue, New York, NY 10022.

The following table sets forth the dollar range of our equity securities beneficially owned by each of our directors as of July 3, 2012.

Name of Director	Dollar Range of Equity Securities in Solar Capital(1)(2)
Interested Directors	
Michael S. Gross	Over $100,000
Bruce Spohler	Over $100,000
Independent Directors	
Steven Hochberg	Over $100,000
David S. Wachter	Over $100,000
Leonard A. Potter	Over $100,000

(1) The dollar ranges are: None, $1-$10,000, $10,001-$50,000, $50,001-$100,000, or Over $100,000.

(2) The dollar range of equity securities beneficially owned in us is based on the closing price for our common stock of $22.79 on July 3, 2012 on the NASDAQ Global Select Market. Beneficial ownership has been determined in accordance with Rule 16a-1(a)(2) of the Securities Exchange Act of 1934.

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REGULATION AS A BUSINESS DEVELOPMENT COMPANY

General

A BDC is regulated by the 1940 Act. A BDC must be organized in the United States for the purpose of investing in or lending to primarily private companies and making significant managerial assistance available to them. A BDC may use capital provided by public stockholders and from other sources to make long-term, private investments in businesses. A business development company provides stockholders the ability to retain the liquidity of a publicly-traded stock while sharing in the possible benefits, if any, of investing in primarily privately owned companies.

We may not change the nature of our business so as to cease to be, or withdraw our election as, a BDC unless authorized by vote of a majority of the outstanding voting securities, as required by the 1940 Act. A majority of the outstanding voting securities of a company is defined under the 1940 Act as the lesser of: (a) 67% or more of such company s voting securities present at a meeting if more than 50% of the outstanding voting securities of such company are present or represented by proxy, or (b) more than 50% of the outstanding voting securities of such company. We do not anticipate any substantial change in the nature of our business.

As with other companies regulated by the 1940 Act, a BDC must adhere to certain substantive regulatory requirements. A majority of our directors must be persons who are not interested persons, as that term is defined in the 1940 Act. Additionally, we are required to provide and maintain a bond issued by a reputable fidelity insurance company to protect the BDC. Furthermore, as a BDC, we are prohibited from protecting any director or officer against any liability to us or our stockholders arising from willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of such person s office.

As a BDC, we are required to meet a coverage ratio of the value of total assets to total senior securities, which include all of our borrowings and any preferred stock we may issue in the future, of at least 200%. We may also be prohibited under the 1940 Act from knowingly participating in certain transactions with our affiliates without the prior approval of our directors who are not interested persons and, in some cases, prior approval by the SEC.

We are generally not be able to issue and sell our common stock at a price below net asset value per share. See Risk Factors Risks Relating to Our Business and Structure Regulations governing our operation as a BDC affect our ability to, and the way in which we, raise additional capital. As a BDC, the necessity of raising additional capital may expose us to risks, including the typical risks associated with leverage. We may, however, sell our common stock, or warrants, options or rights to acquire our common stock, at a price below the then-current net asset value of our common stock if our board of directors determines that such sale is in our best interests and the best interests of our stockholders, and our stockholders approve such sale. In addition, we may generally issue new shares of our common stock at a price below net asset value in rights offerings to existing stockholders, in payment of dividends and in certain other limited circumstances.

As a BDC, we are generally limited in our ability to invest in any portfolio company in which our investment adviser or any of its affiliates currently have an investment or to make any co-investments with our investment adviser or its affiliates without an exemptive order from the SEC, subject to certain exceptions. We may seek an order from the SEC to permit us to co-invest with certain of our affiliates under certain circumstances. There can be no assurance when, or if, such an order may be obtained.

We are periodically examined by the SEC for compliance with the 1940 Act.

As a BDC, we are subject to certain risks and uncertainties. See Risk Factors Risks Relating to Our Business and Structure.

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Qualifying Assets

Under the 1940 Act, a BDC may not acquire any asset other than assets of the type listed in Section 55(a) of the 1940 Act, which are referred to as qualifying assets, unless, at the time the acquisition is made, qualifying assets represent at least 70% of the BDC s total assets. The principal categories of qualifying assets relevant to our proposed business are the following:

(1) Securities purchased in transactions not involving any public offering from the issuer of such securities, which issuer (subject to certain limited exceptions) is an eligible portfolio company, or from any person who is, or has been during the preceding 13 months, an affiliated person of an eligible portfolio company, or from any other person, subject to such rules as may be prescribed by the SEC. An eligible portfolio company is defined in the 1940 Act as any issuer which:

(a) is organized under the laws of, and has its principal place of business in, the United States;

(b) is not an investment company (other than a small business investment company wholly owned by the BDC); and

(c) satisfies any of the following:

i. does not have any class of securities that is traded on a national securities exchange;

ii. has a class of securities listed on a national securities exchange, but has an aggregate market value of outstanding voting and non-voting common equity of less then $250 million;

iii. is controlled by a BDC or a group of companies including a BDC and the BDC has an affiliated person who is a director of the eligible portfolio company; or

iv. is a small and solvent company having total assets of not more than $4.0 million and capital and surplus of not less than $2.0 million.

(2) Securities of any eligible portfolio company which we control.

(3) Securities purchased in a private transaction from a U.S. issuer that is not an investment company or from an affiliated person of the issuer, or in transactions incident thereto, if the issuer is in bankruptcy and subject to reorganization or if the issuer, immediately prior to the purchase of its securities, was unable to meet its obligations as they came due without material assistance other than conventional lending or financing arrangements.

(4) Securities of an eligible portfolio company purchased from any person in a private transaction if there is no ready market for such securities and we already own 60% of the outstanding equity of the eligible portfolio company.

(5) Securities received in exchange for or distributed on or with respect to securities described in (1) through (4) above, or pursuant to the exercise of warrants or rights relating to such securities.

(6) Cash, cash equivalents, U.S. government securities or high-quality debt securities maturing in one year or less from the time of investment.

Managerial Assistance to Portfolio Companies

In addition, a BDC must have been organized and have its principal place of business in the United States and must be operated for the purpose of making investments in the types of securities described in (1), (2) or (3) above. However, in order to count portfolio securities as qualifying assets for the purpose of the 70% test, the BDC must either control the issuer of the securities or must offer to make available to the issuer of the securities (other than small and solvent companies described above) significant managerial assistance; except that, where the BDC purchases such securities in conjunction with one or more other persons acting together, one of the other persons in the group may make available such managerial assistance. Making available managerial

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assistance means, among other things, any arrangement whereby the BDC, through its directors, officers or employees, offers to provide, and, if accepted, does so provide, significant guidance and counsel concerning the management, operations or business objectives and policies of a portfolio company.

Temporary Investments

Pending investment in other types of qualifying assets, as described above, our investments may consist of cash, cash equivalents, U.S. government securities or high-quality debt securities maturing in one year or less from the time of investment, which we refer to, collectively, as temporary investments, so that 70% of our assets are qualifying assets. Typically, we will invest in U.S. Treasury bills or in repurchase agreements, provided that such agreements are fully collateralized by cash or securities issued by the U.S. government or its agencies. A repurchase agreement involves the purchase by an investor, such as us, of a specified security and the simultaneous agreement by the seller to repurchase it at an agreed-upon future date and at a price which is greater than the purchase price by an amount that reflects an agreed-upon interest rate. There is no percentage restriction on the proportion of our assets that may be invested in such repurchase agreements. However, if more than 25% of our total assets constitute repurchase agreements from a single counterparty, we would not meet the diversification tests in order to qualify as a RIC for federal income tax purposes. Thus, we do not intend to enter into repurchase agreements with a single counterparty in excess of this limit. Our investment adviser will monitor the creditworthiness of the counterparties with which we enter into repurchase agreement transactions.

Senior Securities

We are permitted, under specified conditions, to issue multiple classes of indebtedness and one class of stock senior to our common stock if our asset coverage, as defined in the 1940 Act, is at least equal to 200% immediately after each such issuance. In addition, while any senior securities remain outstanding, we must make provisions to prohibit any distribution to our stockholders or the repurchase of such securities or shares unless we meet the applicable asset coverage ratios at the time of the distribution or repurchase. We may also borrow amounts up to 5% of the value of our total assets for temporary or emergency purposes without regard to asset coverage. For a discussion of the risks associated with leverage, see Risk Factors Risks Relating to Our Business and Structure We may borrow money, which would magnify the potential for gain or loss on amounts invested and may increase the risk of investing in us.

Code of Ethics

We and Solar Capital Partners have each adopted a code of ethics pursuant to Rule 17j-1 under the 1940 Act and Rule 204A-1 under the Advisers Act, respectively, that establishes procedures for personal investments and restricts certain transactions by our personnel. Our codes of ethics generally do not permit investments by our employees in securities that may be purchased or held by us. You may read and copy these codes of ethics at the SEC s Public Reference Room in Washington, D.C. You may obtain information on the operation of the Public Reference Room by calling the SEC at (202) 551-8090. In addition, each code of ethics is attached as an exhibit to the registration statement of which this prospectus is a part, and is available on the EDGAR Database on the SEC s Internet site at *http://www.sec.gov*. You may also obtain copies of the codes of ethics, after paying a duplicating fee, by electronic request at the following Email address: publicinfo@sec.gov, or by writing the SEC s Public Reference Section, 100 F Street, N.E., Washington, D.C. 20549.

Compliance Policies and Procedures

We and our investment adviser have adopted and implemented written policies and procedures reasonably designed to detect and prevent violation of the federal securities laws and are required to review these compliance policies and procedures annually for their adequacy and the effectiveness of their implementation and designate a chief compliance officer to be responsible for administering the policies and procedures. Guy Talarico currently serves as our chief compliance officer.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 imposes a wide variety of new regulatory requirements on publicly-held companies and their insiders. Many of these requirements affect us. For example:

- pursuant to Rule 13a-14 of the Exchange Act, our chief executive officer and chief financial officer must certify the accuracy of the financial statements contained in our periodic reports;

- pursuant to Item 307 of Regulation S-K, our periodic reports must disclose our conclusions about the effectiveness of our disclosure controls and procedures;

- pursuant to Rule 13a-15 of the Exchange Act, our management is required to prepare an annual report regarding its assessment of our internal control over financial reporting and to obtain an audit of the effectiveness of internal control over financial reporting performed by our independent registered public accounting firm; and

- pursuant to Item 308 of Regulation S-K and Rule 13a-15 of the 1934 Act, our periodic reports must disclose whether there were significant changes in our internal controls over financial reporting or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

The Sarbanes-Oxley Act requires us to review our current policies and procedures to determine whether we comply with the Sarbanes-Oxley Act and the regulations promulgated thereunder. We will continue to monitor our compliance with all regulations that are adopted under the Sarbanes-Oxley Act and will take actions necessary to ensure that we are in compliance therewith.

Proxy Voting Policies and Procedures

We have delegated our proxy voting responsibility to our investment adviser. The Proxy Voting Policies and Procedures of our investment adviser are set forth below. The guidelines will be reviewed periodically by our investment adviser and our non-interested directors, and, accordingly, are subject to change. For purposes of these Proxy Voting Policies and Procedures described below, we, our and us refers to our investment adviser.

Introduction

An investment adviser registered under the Advisers Act has a fiduciary duty to act solely in the best interests of its clients. As part of this duty, we recognize that we must vote client securities in a timely manner free of conflicts of interest and in the best interests of our clients.

These policies and procedures for voting proxies for our investment advisory clients are intended to comply with Section 206 of, and Rule 206(4)-6 under, the Advisers Act.

Proxy Policies

We will vote proxies relating to our portfolio securities in what we perceive to be the best interest of our clients stockholders. We will review on a case-by-case basis each proposal submitted to a stockholder vote to determine its impact on the portfolio securities held by our clients. Although we will generally vote against proposals that may have a negative impact on our clients portfolio securities, we may vote for such a proposal if there exist compelling long-term reasons to do so.

Our proxy voting decisions will be made by the senior officers who are responsible for monitoring each of the clients investments. To ensure that our vote is not the product of a conflict of interest, we will require that: (1) anyone involved in the decision making process disclose to our managing member any potential conflict that

he or she is aware of and any contact that he or she has had with any interested party regarding a proxy vote; and (2) employees involved in the decision making process or vote administration are prohibited from revealing how we intend to vote on a proposal in order to reduce any attempted influence from interested parties.

Proxy Voting Records

You may obtain information about how we voted proxies by making a written request for proxy voting information to: Solar Capital Partners at 500 Park Avenue, New York, New York 10022.

Privacy Principles

We are committed to maintaining the privacy of our stockholders and to safeguarding their non-public personal information. The following information is provided to help you understand what personal information we collect, how we protect that information and why, in certain cases, we may share information with select other parties.

Generally, we do not receive any non-public personal information relating to our stockholders, although certain non-public personal information of our stockholders may become available to us. We do not disclose any non-public personal information about our stockholders or former stockholders to anyone, except as permitted by law or as is necessary in order to service stockholder accounts (for example, to a transfer agent or third party administrator).

We restrict access to non-public personal information about our stockholders to employees of our investment adviser and its affiliates with a legitimate business need for the information. We will maintain physical, electronic and procedural safeguards designed to protect the non-public personal information of our stockholders.

DETERMINATION OF NET ASSET VALUE

We determine the net asset value of our investment portfolio each quarter by subtracting our total liabilities from the fair value of our total assets.

We conduct the valuation of our assets, pursuant to which our net asset value shall be determined, at all times consistent with GAAP and the 1940 Act. Our valuation procedures are set forth in more detail below:

Securities for which market quotations are readily available on an exchange shall be valued at such price as of the closing price on the day of valuation. We may also obtain quotes with respect to certain of our investments from pricing services or brokers or dealers in order to value assets. When doing so, we determine whether the quote obtained is sufficient according to GAAP to determine the fair value of the security. If determined adequate, we use the quote obtained.

Securities for which reliable market quotations are not readily available or for which the pricing source does not provide a valuation or methodology or provides a valuation or methodology that, in the judgment of our investment adviser or board of directors, does not represent fair value, shall each be valued as follows: (i) each portfolio company or investment is initially valued by the investment professionals responsible for the portfolio investment; (ii) preliminary valuation conclusions are documented and discussed with our senior management; (iii) independent third-party valuation firms engaged by, or on behalf of, the board of directors will conduct independent appraisals and review management s preliminary valuations and make their own assessment for all material assets; and (iv) the board of directors will discuss valuations and determine the fair value of each investment in our portfolio in good faith based on the input of the investment adviser and, where appropriate, the respective third-party valuation firms.

The recommendation of fair value will generally be based on the following factors, as relevant:

- the nature and realizable value of any collateral;
- the portfolio company s ability to make payments;
- the portfolio company s earnings and discounted cash flow;
- the markets in which the issuer does business; and
- comparisons to publicly traded securities.

Securities for which market quotations are not readily available or for which a pricing source is not sufficient may include, but are not limited to, the following:

- private placements and restricted securities that do not have an active trading market;
- securities whose trading has been suspended or for which market quotes are no longer available;
- debt securities that have recently gone into default and for which there is no current market;
- securities whose prices are stale;
- securities affected by significant events; and
- securities that the investment adviser believes were priced incorrectly.

Determination of fair value involves subjective judgments and estimates. Accordingly, the notes to our financial statements express the uncertainty with respect to the possible effect of such valuations, and any change in such valuations, on our financial statements.

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Determinations in Connection with Offerings

In connection with future offering of shares of our common stock, to the extent we do not have stockholder approval to sell below NAV, our board of directors or a committee thereof will be required to make the determination that we are not selling shares of our common stock at a price below the then current net asset value of our common stock at the time at which the sale is made. Our board of directors will consider the following factors, among others, in making such determination:

- the net asset value of our common stock disclosed in the most recent periodic report that we filed with the SEC;
- our management s assessment of whether any material change in the net asset value of our common stock has occurred (including through the realization of gains on the sale of our portfolio securities) during the period beginning on the date of the most recently disclosed net asset value of our common stock and ending two days prior to the date of the sale of our common stock; and
- the magnitude of the difference between (i) the net asset value of our common stock disclosed in the most recent periodic report that we filed with the SEC and our management s assessment of any material change in the net asset value of our common stock since the date of the most recently disclosed net asset value of our common stock, and (ii) the offering price of the shares of our common stock in the proposed offering.

Importantly, this determination will not require that we calculate the net asset value of our common stock in connection with each offering of shares of our common stock, but instead it will involve the determination by our board of directors or a committee thereof that we are not selling shares of our common stock at a price below the then current net asset value of our common stock at the time at which the sale is made.

Moreover, to the extent that there is even a remote possibility that we may (i) issue shares of our common stock at a price below the then current net asset value of our common stock at the time at which the sale is made or (ii) trigger the undertaking (which we provide in certain registration statements we file with the SEC) to suspend the offering of shares of our common stock pursuant to this prospectus if the net asset value of our common stock fluctuates by certain amounts in certain circumstances until the prospectus is amended, our board of directors will elect, in the case of clause (i) above, either to postpone the offering until such time that there is no longer the possibility of the occurrence of such event or to undertake to determine the net asset value of our common stock within two days prior to any such sale to ensure that such sale will not be below our then current net asset value, and, in the case of clause (ii) above, to comply with such undertaking or to undertake to determine the net asset value of our common stock to ensure that such undertaking has not been triggered.

These processes and procedures are part of our compliance policies and procedures. Records will be made contemporaneously with all determinations described in this section and these records will be maintained with other records that we are required to maintain under the 1940 Act.

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DIVIDEND REINVESTMENT PLAN

We have adopted a dividend reinvestment plan that provides for reinvestment of our dividends and other distributions on behalf of our stockholders, unless a stockholder elects to receive cash as provided below. As a result, if our board of directors authorizes, and we declare, a cash distribution, then our stockholders who have not opted out of our dividend reinvestment plan will have their cash distributions automatically reinvested in additional shares of our common stock, rather than receiving the cash distributions.

No action will be required on the part of a registered stockholder to have his cash distribution reinvested in shares of our common stock. A registered stockholder may elect to receive an entire distribution in cash by notifying American Stock Transfer & Trust Company, the plan administrator and our transfer agent and registrar, in writing so that such notice is received by the plan administrator no later than the record date for distributions to stockholders. The plan administrator will set up an account for shares acquired through the plan for each stockholder who has not elected to receive distributions in cash and hold such shares in non-certificated form. Upon request by a stockholder participating in the plan, received in writing not less than 10 days prior to the record date, the plan administrator will, instead of crediting shares to the participant s account, issue a certificate registered in the participant s name for the number of whole shares of our common stock and a check for any fractional share.

Those stockholders whose shares are held by a broker or other financial intermediary may receive distributions in cash by notifying their broker or other financial intermediary of their election.

We may use newly issued shares to implement the plan, whether our shares are trading at a premium or at a discount to our net asset value per share. However, we reserve the right to purchase shares in the open market in connection with our implementation of the plan. If we declare a distribution to stockholders, the plan administrator may be instructed not to credit accounts with newly-issued shares and instead to buy shares in the market if (i) the price at which newly-issued shares are to be credited does not exceed 110% of the last determined net asset value of the shares; or (ii) we have advised the plan administrator that since such net asset value was last determined, we have become aware of events that indicate the possibility of a material change in per share net asset value as a result of which the net asset value of the shares on the payment date might be higher than the price at which the plan administrator would credit newly-issued shares to stockholders. The number of shares to be issued to a stockholder is determined by dividing the total dollar amount of the distribution payable to such stockholder by the market price per share of our common stock at the close of regular trading on the valuation date for such distribution. Market price per share on that date will be the closing price for such shares on the national securities exchange on which our shares are then listed or, if no sale is reported for such day, at the average of their reported bid and asked prices. The number of shares of our common stock to be outstanding after giving effect to payment of the distribution cannot be established until the value per share at which additional shares will be issued has been determined and elections of our stockholders have been tabulated.

There will be no brokerage charges or other charges to stockholders who participate in the plan. The plan administrator s fees under the plan will be paid by us. If a participant elects by written notice to the plan administrator to have the plan administrator sell part or all of the shares held by the plan administrator in the participant s account and remit the proceeds to the participant, the plan administrator is authorized to deduct a transaction fee of $15 plus a per share brokerage commissions from the proceeds.

Stockholders who receive distributions in the form of stock are subject to the same federal, state and local tax consequences as are stockholders who elect to receive their distributions in cash. A stockholder s basis for determining gain or loss upon the sale of stock received in a distribution from us will be equal to the amount of cash they would have received if they had elected to receive the distribution in cash, or the fair market value of the distributed shares if such shares have a fair market value equal to or greater than net asset value. Any stock

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received in a distribution will have a new holding period for tax purposes commencing on the day following the day on which the shares are credited to the U.S. stockholder s account.

The plan may be terminated by us upon notice in writing mailed to each participant at least 30 days prior to any record date for the payment of any distribution by us. All correspondence concerning the plan should be directed to the plan administrator by mail at 6201 15th Avenue, Brooklyn, NY 11219 or by phone at (800) 937-5449.

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MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS

The following discussion is a general summary of the material U.S. federal income tax considerations applicable to us and to an investment in our common stock. This summary does not purport to be a complete description of the income tax considerations applicable to such an investment. For example, we have not described tax consequences that we assume to be generally known by investors or certain considerations that may be relevant to certain types of holders subject to special treatment under U.S. federal income tax laws, including stockholders subject to the alternative minimum tax, tax-exempt organizations, insurance companies, dealers in securities, pension plans and trusts, and financial institutions. This summary assumes that investors hold our common stock as capital assets (within the meaning of the Code). The discussion is based upon the Code, Treasury regulations, and administrative and judicial interpretations, each as in effect as of the date of this registration statement and all of which are subject to change, possibly retroactively, which could affect the continuing validity of this discussion. We have not sought and will not seek any ruling from the Internal Revenue Service regarding this offering. This summary does not discuss any aspects of U.S. estate or gift tax or foreign, state or local tax. It does not discuss the special treatment under U.S. federal income tax laws that could result if we invested in tax-exempt securities or certain other investment assets in which we do not currently intend to invest.

This summary does not discuss the consequences of an investment in shares of our preferred stock, debt securities or warrants representing rights to purchase shares of our common stock, preferred stock or debt securities. The U.S. federal income tax consequences of such an investment will be discussed in a relevant prospectus supplement.

A U.S. stockholder generally is a beneficial owner of shares of our common stock who is for U.S. federal income tax purposes:

- a citizen or individual resident of the United States including an alien individual who is a lawful permanent resident of the United States or meets the substantial presence test under Section 7701(b) of the Code;
- a corporation or other entity taxable as a corporation, for U.S. federal income tax purposes, created or organized in or under the laws of the United States or any political subdivision thereof;
- a trust, if a court in the United States has primary supervision over its administration and one or more U.S. persons have the authority to control all decisions of the trust, or the trust has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person; or
- an estate, the income of which is subject to U.S. federal income taxation regardless of its source.

A non-U.S. stockholder is a beneficial owner of shares of our common stock that is an individual, corporation, trust or estate and is not a U.S. stockholder.

If a partnership (including an entity treated as a partnership for U.S. federal income tax purposes) holds shares of our common stock, the tax treatment of a partner in the partnership will generally depend upon the status of the partner and the activities of the partnership. A prospective stockholder who is a partner of a partnership holding shares of our common stock should consult its tax advisors with respect to the purchase, ownership and disposition of shares of our common stock.

Tax matters are very complicated and the tax consequences to an investor of an investment in our shares will depend on the facts of its particular situation. We encourage investors to consult their own tax advisors regarding the specific consequences of such an investment, including tax reporting requirements, the applicability of federal, state, local and foreign tax laws, eligibility for the benefits of any applicable tax treaty and the effect of any possible changes in the tax laws.

As a BDC, we have elected to be treated, and intend to qualify annually thereafter, as a RIC under Subchapter M of the Code, beginning with our 2010 taxable year. As a RIC, we generally will not have to pay corporate-level federal income taxes on any ordinary income or capital gains that we distribute to our stockholders as dividends. To continue to qualify as a RIC, we must, among other things, meet certain source-of-income and asset diversification requirements (as described below). In addition, to qualify for RIC tax treatment we must distribute to our stockholders, for each taxable year, at least 90% of our investment company taxable income, which is generally our ordinary income plus the excess of our realized net short-term capital gains over our realized net long-term capital losses (the Annual Distribution Requirement).

Taxation as a Regulated Investment Company

If we:

- qualify as a RIC; and
- satisfy the Annual Distribution Requirement;

then we will not be subject to federal income tax on the portion of our investment company taxable income and net capital gain (i.e., realized net long-term capital gains in excess of realized net short-term capital losses) we distribute to stockholders. We will be subject to U.S. federal income tax at the regular corporate rates on any income or capital gain not distributed (or deemed distributed) to our stockholders.

We will be subject to a 4% nondeductible federal excise tax on certain undistributed income unless we distribute in a timely manner an amount at least equal to the sum of (1) 98% of our ordinary income for each calendar year, (2) 98.2% of our capital gain net income for the one-year period ending October 31 in that calendar year and (3) any income realized, but not distributed, and on which we paid no federal income tax, in preceding years (the Excise Tax Avoidance Requirement).

In order to qualify as a RIC for federal income tax purposes, we must, among other things:

- at all times during each taxable year, have in effect an election to be treated as a BDC under the 1940 Act;
- derive in each taxable year at least 90% of our gross income from (a) dividends, interest, payments with respect to certain securities loans, gains from the sale of stock or other securities or currencies, or other income derived with respect to our business of investing in such stock, securities or currencies and (b) net income derived from an interest in a qualified publicly traded partnership; and
- diversify our holdings so that at the end of each quarter of the taxable year:
  - at least 50% of the value of our assets consists of cash, cash equivalents, U.S. government securities, securities of other RICs, and other securities if such other securities of any one issuer do not represent more than 5% of the value of our assets or more than 10% of the outstanding voting securities of the issuer; and

no more than 25% of the value of our assets is invested in (i) the securities, other than U.S. government securities or securities of other RICs, of one issuer, (ii) the securities of two or more issuers that are controlled, as determined under applicable tax rules, by us and that are engaged in the same or similar or related trades or businesses or (iii) the securities of one or more qualified publicly traded partnerships.

We may be required to recognize taxable income in circumstances in which we do not receive cash. For example, if we hold debt obligations that are treated under applicable tax rules as having original issue discount (such as debt instruments with PIK interest or, in certain cases, increasing interest rates or debt instruments issued with warrants), we must include in income each year a portion of the original issue discount that accrues over the life of the obligation, regardless of whether cash representing such income is received by us in the same

taxable year. Because any original issue discount accrued will be included in our investment company taxable income for the year of accrual, we may be required to make a distribution to our stockholders in order to satisfy the Annual Distribution Requirement, even though we will not have received any corresponding cash amount.

Because we may use debt financing, we will be subject to certain asset coverage ratio requirements under the 1940 Act and financial covenants under loan and credit agreements that could, under certain circumstances, restrict us from making distributions necessary to satisfy the Annual Distribution Requirement. If we are unable to obtain cash from other sources or are otherwise limited in our ability to make distributions, we could fail to qualify for RIC tax treatment and thus become subject to corporate-level income tax.

Certain of our investment practices may be subject to special and complex U.S. federal income tax provisions that may, among other things: (i) disallow, suspend or otherwise limit the allowance of certain losses or deductions; (ii) convert lower taxed long-term capital gain into higher taxed short-term capital gain or ordinary income; (iii) convert an ordinary loss or a deduction into a capital loss (the deductibility of which is more limited); (iv) cause us to recognize income or gain without a corresponding receipt of cash; (v) adversely affect the time as to when a purchase or sale of securities is deemed to occur; (vi) adversely alter the characterization of certain complex financial transactions; and (vii) produce income that will not be qualifying income for purposes of the 90% gross income test described above. We will monitor our transactions and may make certain tax elections in order to mitigate the potential adverse effect of these provisions.

Gain or loss realized by us from the sale or exchange of warrants acquired by us as well as any loss attributable to the lapse of such warrants generally will be treated as capital gain or loss. The treatment of such gain or loss as long-term or short-term will depend on how long we held a particular warrant. Upon the exercise of a warrant acquired by us, our tax basis in the stock purchased under the warrant will equal the sum of the amount paid for the warrant plus the strike price paid on the exercise of the warrant. Except as set forth below in Failure to Qualify as a Regulated Investment Company, the remainder of this discussion assumes we will qualify as a RIC for each taxable year.

Taxation of U.S. Stockholders

Distributions by us generally will be taxable to U.S. stockholders as ordinary income or capital gains. Distributions of our investment company taxable income will be taxable as ordinary income to U.S. stockholders to the extent of our current or accumulated earnings and profits, whether paid in cash or reinvested in additional common stock. Distributions of our net capital gains (that is, the excess of our realized net long-term capital gains in excess of realized net short-term capital losses) properly reported by us as capital gain dividends will be taxable to a U.S. stockholder as long-term capital gains, regardless of the U.S. stockholder s holding period for its common stock and regardless of whether paid in cash or reinvested in additional common stock. For taxable years beginning on or before December 31, 2012, distributions of investment company taxable income that are reported by us as being derived from qualified dividend income will be taxed in the hands of non-corporate stockholders at the rates applicable to long-term capital gain, provided that holding period and other requirements are met by both the stockholders and us. Dividends distributed by us will generally not be attributable to qualified dividend income. Distributions in excess of our current and accumulated earnings and profits first will reduce a U.S. stockholder s adjusted tax basis in such U.S. stockholder s common stock and, after the adjusted basis is reduced to zero, will constitute capital gains to such U.S. stockholder. For a summary of the tax rates applicable to capital gains, including capital gain dividends, see the discussion below.

Under the dividend reinvestment plan, if a U.S. stockholder owns shares of common stock registered in its own name, the U.S. stockholder will have all cash distributions automatically reinvested in additional shares of common stock unless the U.S. stockholder opts out of our dividend reinvestment plan by delivering a written notice to our dividend paying agent prior to the record date of the next dividend or distribution. See Dividend Reinvestment Plan. Any distributions reinvested under the plan will nevertheless remain taxable to the U.S. stockholder. The U.S. stockholder will have an adjusted basis in the additional common shares purchased

through the plan equal to the amount of cash they would have received if they had elected to receive the distribution in cash, or the fair market value of the distributed shares if such shares have a fair market value equal to or greater than net asset value. The additional shares will have a new holding period commencing on the day following the day on which the shares are credited to the U.S. stockholder s account.

Although we currently intend to distribute realized net capital gains (i.e., net realized long-term capital gains in excess of net realized short-term capital losses), if any, at least annually, we may in the future decide to retain some or all of our net capital gains, but to designate the retained amount as a deemed distribution. In that case, among other consequences, we will pay corporate-level tax on the retained amount, each U.S. stockholder will be required to include its share of the deemed distribution in income as if it had been actually distributed to the U.S. stockholder, and the U.S. stockholder will be entitled to claim a credit or refund equal to its allocable share of the corporate-level tax we pay on the retained capital gain. The amount of the deemed distribution net of such tax will be added to the U.S. stockholder s cost basis for its common stock. Since we expect to pay tax on any retained capital gains at our regular corporate capital gain tax rate, and since that rate is in excess of the maximum rate currently payable by non-corporate U.S. stockholders on long-term capital gains, the amount of tax that non-corporate U.S. stockholders will be treated as having paid will exceed the tax they owe on the capital gain dividend. Such excess generally may be claimed as a credit or refund against the U.S. stockholder s other U.S. federal income tax obligations. A U.S. stockholder that is not subject to U.S. federal income tax or otherwise required to file a U.S. federal income tax return would be required to file a U.S. federal income tax return on the appropriate form in order to claim a refund for the taxes we paid. In order to utilize the deemed distribution approach, we must provide written notice to our stockholders prior to the expiration of 60 days after the close of the relevant tax year.

As a RIC, we will be subject to the alternative minimum tax (AMT), but any items that are treated differently for AMT purposes must be apportioned between us and our stockholders and this may affect the stockholders AMT liabilities. Although regulations explaining the precise method of apportionment have not yet been issued by the Internal Revenue Service, we intend in general to apportion these items in the same proportion that dividends paid to each stockholder bear to our taxable income (determined without regard to the dividends paid deduction), unless we determine that a different method for a particular item is warranted under the circumstances.

For purposes of determining (i) whether the Annual Distribution Requirement is satisfied for any year and (ii) the amount of dividends paid for that year, we may, under certain circumstances, elect to treat a dividend that is paid during the following taxable year as if it had been paid during the taxable year in question. If we make such an election, the U.S. stockholder generally will still be treated as receiving the dividend in the taxable year in which the distribution is made. However, any dividend declared by us in October, November, or December of any calendar year, payable to stockholders of record on a specified date in such a month and actually paid during January of the following year, will be treated as if it had been received by our U.S. stockholders on December 31 of the year in which the dividend was declared.

You should consider the tax implications of buying common stock just prior to a distribution. Even if the price of the common stock includes the amount of the forthcoming distribution, and the distribution economically represents a return of your investment, you will be taxed upon receipt of the distribution and will not be entitled to offset the distribution against the tax basis in your common stock.

You may recognize taxable gain or loss if you sell or exchange your common stock. The amount of the gain or loss will be measured by the difference between your adjusted tax basis in your common stock and the amount of the proceeds you receive in exchange for such stock. Any gain or loss arising from the sale or exchange of our common stock (or, in the case of distributions in excess of the sum of our current and accumulated earnings and profits and your tax basis in the stock, treated as arising from the sale or exchange of our common stock) generally will be a capital gain or loss if the common stock is held as a capital asset. This capital gain or loss normally will be treated as a long-term capital gain or loss if you have held your common stock for more than

one year. Otherwise, it will be classified as short-term capital gain or loss. However, any capital loss arising from the sale or exchange of common stock held for six months or less generally will be treated as a long-term capital loss to the extent of the amount of capital gain dividends received, or treated as deemed distributed, with respect to such stock. For this purpose, certain special rules, including rules relating to periods when your risk of loss with respect to your common stock has been diminished, generally apply in determining the holding period of such stock. The ability to deduct capital losses may be subject to other limitations under the Code.

In addition, all or a portion of any loss recognized upon a disposition of shares of our common stock may be disallowed if other shares of our common stock are purchased (whether through reinvestment of distributions or otherwise) within 30 days before or after the disposition. In such a case, the basis of the newly purchased shares will be adjusted to reflect the disallowed loss. In general, individual U.S. stockholders currently are subject to a maximum U.S. federal income tax rate of 15% (20% for years beginning after December 31, 2012) on their net capital gain, i.e., the excess of net long-term capital gain over net short-term capital loss for a taxable year, including a long-term capital gain derived from an investment in our common stock. In addition, for taxable years beginning after December 31, 2012, individuals with income in excess of $200,000 ($250,000 in the case of married individuals filing jointly or $125,000 in the case of married individuals filing separately) and certain estates and trusts are subject to an additional 3.8% tax on their net investment income, which generally includes net income from interest, dividends, annuities, royalties, and rents, and net capital gains (other than certain amounts earned from trades or businesses). Corporate U.S. stockholders currently are subject to U.S. federal income tax on net capital gain at the maximum 35% rate also applied to ordinary income. Dividends distributed by us to corporate stockholders generally will not be eligible for the dividends-received deduction. Tax rates imposed by states and local jurisdictions on capital gain and ordinary income may differ.

We will send to each of our U.S. stockholders, as promptly as possible after the end of each calendar year, a report detailing the amounts includible in such U.S. stockholder s taxable income for such year as ordinary income, long-term capital gain and qualified dividend income, if any. In addition, the U.S. federal tax status of each year s distributions generally will be reported to the Internal Revenue Service. Distributions may also be subject to additional state, local, and foreign taxes depending on a U.S. stockholder s particular situation.

Backup withholding may apply to distributions on the common stock with respect to certain non-exempt U.S. stockholders. Such U.S. stockholders generally will be subject to backup withholding unless the U.S. stockholder provides its correct taxpayer identification number and certain other information, certified under penalties of perjury, to the dividend paying agent, or otherwise establishes an exemption from backup withholding. Any amount withheld under backup withholding is allowed as a credit against the U.S. stockholder s U.S. federal income tax liability, provided the proper information is provided to the Internal Revenue Service.

Taxation of Non-U.S. Stockholders

Whether an investment in our common stock is appropriate for a non-U.S. stockholder will depend upon that stockholder s particular circumstances. Non-U.S. stockholders should consult their tax advisors before investing in our common stock.

Distributions of our investment company taxable income to stockholders that are non-U.S. stockholders will currently be subject to withholding of U.S. federal income tax at a 30% rate (or lower rate provided by an applicable treaty) to the extent of our current and accumulated earnings and profits unless the distributions are effectively connected with a U.S. trade or business of the non-U.S. stockholders, and, if an income tax treaty applies, attributable to a permanent establishment in the United States. In that case, the distributions will be subject to U.S. federal income tax at the ordinary income rates applicable to U.S. stockholders and we will not have to withhold U.S. federal withholding tax if the non-U.S. stockholder complies with applicable certification and disclosure requirements. Special certification requirements apply to a non-U.S. stockholder that is a foreign partnership or a foreign trust and such entities are urged to consult their own tax advisors.

In addition, for taxable years beginning prior to January 1, 2012, U.S. source withholding taxes were not imposed on dividends paid by us to the extent the dividends were reported as interest-related dividends or short-term capital gain dividends. Under this exemption, interest-related dividends and short-term capital gain dividends generally represented distributions of interest or short-term capital gains that would not have been subject to U.S. withholding tax at the source if they had been received directly by a foreign person, and that satisfied certain other requirements. No assurance can be given, however, as to whether this exemption will be extended for tax years beginning on or after January 1, 2012 or whether any of our distributions will be reported as eligible for this exemption (if extended) from withholding tax.

Actual or deemed distributions of our net capital gains to a stockholder that is a non-U.S. stockholder, and gains realized by a non-U.S. stockholder upon the sale or redemption of our common stock, will not be subject to U.S. federal income tax unless the distributions or gains, as the case may be, are effectively connected with a U.S. trade or business of the non-U.S. stockholder and, if an income tax treaty applies, are attributable to a permanent establishment maintained by the non-U.S. stockholder in the United States, or, in the case of an individual, the non-U.S. stockholder was present in the United States for 183 days or more during the taxable year and certain other conditions are met.

If we distribute our net capital gains in the form of deemed rather than actual distributions, a non-U.S. stockholder will be entitled to a U.S. federal income tax credit or tax refund equal to the stockholder s allocable share of the corporate-level tax we pay on the capital gains deemed to have been distributed; however, in order to obtain the refund, the non-U.S. stockholder must obtain a U.S. taxpayer identification number and file a U.S. federal income tax return even if the non-U.S. stockholder would not otherwise be required to obtain a U.S. taxpayer identification number or file a U.S. federal income tax return.

For a corporate non-U.S. stockholder, distributions (both actual and deemed), and gains realized upon the sale or redemption of our common stock that are effectively connected to a U.S. trade or business may, under certain circumstances, be subject to an additional branch profits tax at a 30% rate (or at a lower rate if provided for by an applicable treaty). Accordingly, investment in our stock may not be appropriate for a non-U.S. stockholder.

Under our dividend reinvestment plan, if a non-U.S. stockholder owns shares of common stock registered in its own name, the non-U.S. stockholder will have all cash distributions automatically reinvested in additional shares of common stock unless it opts out of our dividend reinvestment plan by delivering a written notice to our dividend paying agent prior to the record date of the next dividend or distribution. See Dividend Reinvestment Plan. If the distribution is a distribution of our investment company taxable income, is not reported by us as a short-term capital gains dividend or interest-related dividend and it is not effectively connected with a U.S. trade or business of the non-U.S. stockholder (or, if a treaty applies, is not attributable to a permanent establishment), the amount distributed (to the extent of our current and accumulated earnings and profits) will be subject to withholding of U.S. federal income tax at a 30% rate (or lower rate provided by an applicable treaty) and only the net after-tax amount will be reinvested in common shares. If the distribution is effectively connected with a U.S. trade or business of the non-U.S. stockholder, generally the full amount of the distribution will be reinvested in the plan and will nevertheless be subject to U.S. federal income tax at the ordinary income rates applicable to U.S. persons. The non-U.S. stockholder will have an adjusted basis in the additional common shares purchased through the plan equal to the amount of cash that they would have received if they had elected to receive the distribution in cash, or the fair market value of the distributed shares if such shares have a fair market value equal to or greater than net asset value. The additional shares will have a new holding period commencing on the day following the day on which the shares are credited to the non-U.S. stockholder s account.

Recently enacted legislation generally imposes a 30% withholding tax on payments of certain types of income to foreign financial institutions that fail to enter into an agreement with the United States Treasury to report certain required information with respect to accounts held by United States persons (or held by foreign entities that have U.S. persons as substantial owners). The types of income subject to the tax include U.S. source

interest and dividends paid after December 31, 2013, and the gross proceeds from the sale of any property that could produce U.S. source interest or dividends received after December 31, 2014. The information required to be reported includes the identity and taxpayer identification number of each account holder that is a U.S. person and transaction activity within the holder s account. In addition, subject to certain exceptions, this legislation also imposes a 30% withholding on payments to foreign entities that are not financial institutions unless the foreign entity certifies that it does not have a greater than 10% U.S. owner or provides the withholding agent with identifying information on each greater than 10% U.S. owner. When these provisions become effective, depending on the status of a Non-U.S. Holder and the status of the intermediaries through which they hold their units, Non-U.S. Holders could be subject to this 30% withholding tax with respect to distributions on their units and proceeds from the sale of their units. Under certain circumstances, a Non-U.S. Holder might be eligible for refunds or credits of such taxes.

A non-U.S. stockholder who is a nonresident alien individual, and who is otherwise subject to withholding of U.S. federal income tax, may be subject to information reporting and backup withholding of U.S. federal income tax on dividends unless the non-U.S. stockholder provides us or the dividend paying agent with an Internal Revenue Service Form W-8BEN (or an acceptable substitute form) or otherwise meets documentary evidence requirements for establishing that it is a non-U.S. stockholder or the non-U.S. stockholder otherwise establishes an exemption from backup withholding.

You are urged to consult your own tax advisor regarding the specific tax consequences of the purchase, ownership and sale of our common stock.

Failure to Qualify as a Regulated Investment Company

If we were unable to qualify for treatment as a RIC, we would be subject to tax on all of our taxable income at regular corporate rates. We would not be able to deduct distributions to stockholders, nor would they be required to be made. Such distributions would be taxable to our stockholders as dividends and, if made in a taxable year beginning on or before December 31, 2012 and provided certain holding period and other requirements were met, could qualify for treatment as qualified dividend income in the hands of non-corporate stockholders (and thus eligible for the current 15% maximum rate) to the extent of our current and accumulated earnings and profits. Subject to certain limitations under the Code, corporate distributees would be eligible for the dividends received deduction. Distributions in excess of our current and accumulated earnings and profits would be treated first as a return of capital to the extent of the stockholder s tax basis, and any remaining distributions would be treated as a capital gain. To requalify as a RIC in a subsequent taxable year, we would be required to satisfy the RIC qualification requirements for that year and dispose of any earnings and profits from any year in which we failed to qualify as a RIC. Subject to a limited exception applicable to RICs that qualified as such under Subchapter M of the Code for at least one year prior to disqualification and that requalify as a RIC no later than the second year following the non-qualifying year, we could be subject to tax on any unrealized net built-in gains in the assets held by us during the period in which we failed to qualify as a RIC that are recognized within the subsequent 10 years, unless we made a special election to pay corporate-level tax on such built-in gain at the time of our requalification as a RIC.

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SALES OF COMMON STOCK BELOW NET ASSET VALUE

At our 2012 Annual Stockholders Meeting, subject to certain determinations required to be made by our board of directors, our stockholders approved our ability to sell or otherwise issue shares of our common stock, not exceeding 25% of our then outstanding common stock immediately prior to each such offering, at a price below the then current net asset value per share during a period beginning on May 3, 2012 and expiring on the earlier of the one-year anniversary of the date of the 2012 Annual Stockholders Meeting and the date of our 2013 Annual Stockholders Meeting, which is expected to be held in May 2013 (the Stockholder Approval). However, notwithstanding Stockholder Approval, since our initial public offering on February 9, 2010, we have not sold any shares of our common stock at a price below our then current net asset value per share.

In order to sell shares of common stock pursuant to this authorization, no further authorization from our stockholders will need to be solicited, but a majority of our directors who have no financial interest in the sale and a majority of our independent directors will have to (a) find that the sale is in our best interests and in the best interests of our stockholders and (b) in consultation with any underwriter or underwriters of the offering, make a good faith determination as of a time either immediately prior to the first solicitation by us or on our behalf of firm commitments to purchase such shares of common stock, or immediately prior to the issuance of such common stock, that the price at which such shares of common stock are to be sold is not less than a price which closely approximates the market value of those shares of common stock, less any distributing commission or discount.

Any offering of common stock below its net asset value per share will be designed to raise capital for investment in accordance with our investment objective.

In making a determination that an offering of common stock below its net asset value per share is in our and our stockholders best interests, our board of directors will consider a variety of factors including:

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

- the anticipated rate of return on and quality, type and availability of investments; and

- the leverage available to us.

Our board of directors will also consider the fact that sales of shares of common stock at a discount will benefit our investment adviser as the investment adviser will earn additional investment management fees on the proceeds of such offerings, as it would from the offering of any other of our securities or from the offering of common stock at a premium to net asset value per share.

We will not sell shares of our common stock under this prospectus or an accompanying prospectus supplement pursuant to the Stockholder Approval without first filing a new post-effective amendment to the registration statement if the cumulative dilution to our net asset value per share from offerings under the registration statement, as amended by any post-effective amendments, exceeds 15%. This would be measured separately for each offering pursuant to the registration statement, as amended by any post-effective

amendments, by calculating the percentage dilution or accretion to aggregate net asset value from that offering and then summing the percentage from each offering. For example, if our most recently determined NAV per share at the time of the first offering is $23.00 and we have 37 million shares outstanding, the sale of 9.25 million shares at net proceeds to us of $11.50 per share (a 50% discount) would produce dilution of 10.0%. If we subsequently determined that our NAV per share increased to $24.00 on the then 46.25 million shares outstanding and then made an additional offering, we could, for example, sell approximately an additional 5.15 million shares at net proceeds to us of $12.00 per share, which would produce dilution of 5.0%, before we would reach the aggregate 15% limit. If we file a new post-effective amendment, the threshold would reset.

In addition, it should be noted that under the Stockholder Approval the maximum number of shares issuable below NAV per share that could result in such dilution is limited to 25% of our then outstanding common stock. As a result, the maximum amount of dilution to existing stockholders under the Stockholder Approval will be limited to no more than 20% of our then current NAV per share, assuming we were to issue the maximum number of shares at no more than par value, or $0.01 per share.

Sales by us of our common stock at a discount from net asset value per share pose potential risks for our existing stockholders whether or not they participate in the offering, as well as for new investors who participate in the offering. Any sale of common stock at a price below net asset value per share would result in an immediate dilution to existing common stockholders who do not participate in such sale on at least a pro-rata basis. See Risk Factors Risks Relating to an Investment in Our Securities The net asset value per share of our common stock may be diluted if we sell shares of our common stock in one or more offerings at prices below the then current net asset value per share of our common stock or securities to subscribe for or convertible into shares of our common stock.

The following three headings and accompanying tables explain and provide hypothetical examples on the impact of an offering of our common stock at a price less than net asset value per share on three different types of investors:

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

Impact On Existing Stockholders Who Do Not Participate in the Offering

Our current stockholders who do not participate in an offering below net asset value per share or who do not buy additional shares in the secondary market at the same or lower price as we obtain in the offering (after expenses and commissions) face the greatest potential risks. These stockholders will experience an immediate dilution in the net asset value of the shares of common stock they hold and their net asset value per share. These stockholders will also experience a disproportionately greater decrease in their participation in our earnings and assets and their voting power than the increase we will experience in our assets, potential earning power and voting interests due to such offering. These stockholders may also experience a decline in the market price of their shares, which often reflects to some degree announced or potential increases and decreases in net asset value per share. This decrease could be more pronounced as the size of the offering and level of discounts increases. Further, if current stockholders do not purchase any shares to maintain their percentage interest, regardless of whether such offering is above or below the then current net asset value, their voting power will be diluted.

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

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The examples assume that the issuer has 30 million shares outstanding, $600 million in total assets and $150 million in total liabilities. The current net asset value and net asset value per share are thus $450 million and $15.00. The chart illustrates the dilutive effect on Stockholder A of (a) an offering of 1.5 million shares of common stock (5% of the outstanding shares) at $14.25 per share after offering expenses and commissions (a 5% discount from net asset value), (b) an offering of 3 million shares of common stock (10% of the outstanding shares) at $13.50 per share after offering expenses and commissions (a 10% discount from net asset value), (c) an offering of 6 million shares of common stock (20% of the outstanding shares) at $12.00 per share after offering expenses and commissions (a 20% discount from net asset value), and (d) an offering of 7.5 million shares of common stock (25% of the outstanding shares) at $0.01 per share, the par value of our common stock (a 100% discount from net asset value). The prospectus supplement pursuant to which any discounted offering is made will include a chart based on the actual number of shares of common stock in such offering and the actual discount to the most recently determined net asset value. For example, if we issue 9,152,010 shares of our common stock (25% of our currently outstanding shares) at $0.01 per share, the par value of our common stock (a 100% discount from net asset value), then our net asset value per share following such offering will be $18.14, which will reflect a 20.00% decrease in net asset value per share to those stockholders who do not participate in this offering. It is not possible to predict the level of market price decline that may occur.

		Example 1 5% Offering at 5% Discount		Example 2 10% Offering at 10% Discount		Example 3 20% Offering at 20% Discount		Example 4 25% Offering at 100% Discount	
	Prior to Sale	Following Sale	% Change	Following Sale	% Change	Following Sale	% Change	Following Sale	% Change
Offering Price									
Price per Share to Public		$ 22.68		$ 21.49		$ 19.10		$ 0.01	
Net Proceeds per Share to Issuer		$ 21.55		$ 20.41		$ 18.14		$ 0.01	
Decrease to Net Asset Value									
Total Shares Outstanding	36,608,038	38,438,440	5.00%	40,268,842	10.00%	43,929,646	20.00%	45,760,048	25.00%
Net Asset Value per Share	$ 22.68	$ 22.63	(0.24)%	$ 22.47	(0.91)%	$ 21.92	(3.33)%	$ 18.15	(19.99)%
Dilution to Nonparticipating Stockholder									
Shares Held by Stockholder A	36,608	36,608	%	36,608	%	36,608	%	36,608	%
Percentage Held by Stockholder A	0.10%	0.10%	(4.76)%	0.09%	(9.09)%	0.08%	(16.67)%	0.08%	(20.00)%
Total Net Asset Value Held by Stockholder A	$ 830,270	$ 828,293	(0.24)%	$ 822,722	(0.91)%	$ 802,595	(3.33)%	$ 664,289	(19.99)%
Total Investment by Stockholder A (Assumed to be Current NAV per Share)	$ 830,270	$ 830,270		$ 830,270		$ 830,270		$ 830,270	
Total Dilution to Stockholder A (Total Net Asset Value Less Total Investment)		$ (1,977)		$ (7,548)		$ (27,676)		$ (165,981)	
Investment per Share Held by Stockholder A (Assumed to be NAV per Share on Shares Held Prior to Sale)	$ 22.68	$ 22.68		$ 22.68		$ 22.68		$ 22.68	
Net Asset Value per Share Held by Stockholder A		$ 22.63		$ 22.47		$ 21.92		$ 18.15	
Dilution per Share Held by Stockholder A (Net Asset Value per Share Less Investment per Share)		$ (0.05)		$ (0.21)		$ (0.76)		$ (4.53)	
Percentage Dilution to Stockholder A (Dilution per Share Divided by Investment per Share)			(0.24)%		(0.91)%		(3.33)%		(19.99)%

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Impact On Existing Stockholders Who Do Participate in the Offering

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

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

		50% Participation		150% Participation	
	Prior to Sale	Following Sale	% Change	Following Sale	% Change
Offering Price					
Price per Share to Public		$ 19.10		$ 19.10	
Net Proceeds per Share to Issuer		$ 18.14		$ 18.14	
Decrease/Increase to Net Asset Value					
Total Shares Outstanding	36,608,038	43,929,646	20.00%	43,929,646	20.00%
Net Asset Value per Share	$ 22.68	$ 21.92	(3.33)%	$ 21.92	(3.33)%
Dilution/Accretion to Participating Stockholder					
Shares Held by Stockholder A	36,608	40,269	10.00%	47,590	30.00%
Percentage Held by Stockholder A	0.10%	0.09%	(8.33)%	0.11%	8.33%
Total Net Asset Value Held by Stockholder A	$ 830,270	$ 882,854	6.33%	$ 1,043,373	25.67%
Total Investment by Stockholder A (Assumed to be Current NAV per Share on Shares Held Prior to Sale)		$ 900,188		$ 1,040,023	
Total Dilution/Accretion to Stockholder A (Total Net Asset Value Less Total Investment)		$ (17,334)		$ 3,350	
Investment per Share Held by Stockholder A (Assumed to be Net Asset Value on Shares Held Prior to Sale)	$ 22.68	$ 22.35	(1.44)%	$ 21.85	(3.64)%
Net Asset Value per Share Held by Stockholder A		$ 21.92		$ 21.92	
Dilution/Accretion per Share Held by Stockholder A (Net Asset Value per Shares Less Investment per Share)		$ (0.43)		$ 0.07	
Percentage Dilution/Accretion to Stockholder A (Dilution per Share Divided by Investment per Share)			(1.96)%		0.32%

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Impact On New Investors

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

The following chart illustrates the level of dilution or accretion for new investors that would be experienced by a new investor in the same hypothetical 5%, 10%, 20% and 25% discounted offerings as described in the first chart above. The illustration is for a new investor who purchases the same percentage (0.10%) of the shares in the offering as Stockholder A in the prior examples held immediately prior to the offering. The prospectus supplement pursuant to which any discounted offering is made will include a chart for these examples based on the actual number of shares in such offering and the actual discount from the most recently determined net asset value per share. It is not possible to predict the level of market price decline that may occur.

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	Prior to Sale	Example 1 5% Offering at 5% Discount		Example 2 10% Offering at 10% Discount		Example 3 20% Offering at 20% Discount		Example 4 25% Offering at 100% Discount	
		Following Sale	% Change	Following Sale	% Change	Following Sale	% Change	Following Sale	% Change
Price per Share to Public		$ 22.68		$ 21.49		$ 19.10		$ 0.01	
Net Proceeds per Share to Issuer		$ 21.55		$ 20.41		$ 18.14		$ 0.01	
Total Shares Outstanding	36,608,038	38,438,440	5.00%	40,268,842	10.00%	43,929,646	20.00%	45,760,048	25.00%
Net Asset Value per Share	$ 22.68	$ 22.63	(0.24)%	$ 22.47	(0.91)%	$ 21.92	(3.33)%	$ 18.15	(19.99)%
Dilution/Accretion to New Investor A									
Shares Held by Investor A		1,830		3,661		7,322		9,152	
Percentage Held by Stockholder A		0.00%		0.01%		0.02%		0.02%	
Total Net Asset Value Held by Investor A		$ 41,415		$ 82,272		$ 160,519		$ 166,072	
Total Investment by Investor A (At Price to Public)	$	$ 41,514		$ 78,657		$ 139,835		$ 92	
Total Dilution/Accretion to Investor A (Total Net Asset Value Less Total Investment)		$ (99)		$ 3,615		$ 20,684		$ 165,981	
Investment per Share Held by Investor A	$	$ 22.68		$ 21.49		$ 19.10		$ 0.01	
Net Asset Value per Share Held by Investor A		$ 22.63		$ 22.47		$ 21.92		$ 18.15	
Dilution/Accretion per Share Held by Investor A (Net Asset Value per Share Less Investment per Share)		$ (0.05)		$ 0.99		$ 2.83		$ 18.14	
Percentage Dilution/Accretion to Investor A (Dilution per Share Divided by Investment per Share)			(0.24)%		4.60%		14.79%		181,360%

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ISSUANCE OF WARRANTS OR SECURITIES TO SUBSCRIBE FOR OR CONVERTIBLE INTO SHARES OF OUR COMMON STOCK

At our 2011 Annual Stockholders Meeting, our stockholders authorized us to sell or otherwise issue warrants or securities to subscribe for or convertible into shares of our common stock, not exceeding 25% of our then outstanding common stock, at an exercise or conversion price that, at the date of issuance, will not be less than the market value per share of our common stock. Such authorization has no expiration. Any exercise of warrants or securities to subscribe for or convertible into shares of our common stock at an exercise or conversion price that is below net asset value at the time of such exercise or conversion would result in an immediate dilution to existing common stockholders. This dilution would include reduction in net asset value as a result of the proportionately greater decrease in the stockholders interest in our earnings and assets and their voting interest than the increase in our assets resulting from such offering.

In order to sell or issue warrants or securities to subscribe for or convertible into shares of our common stock, (a) the exercise, conversion or subscription rights in such securities must expire by their terms within 10 years, (b) with respect to any warrants, options or rights to subscribe or convert to our common stock that are issued along with other securities, such warrants, options or rights must not be separately transferable, (c) the exercise or conversion price of such securities must not be less than the greater of the market value per share of our common stock and the net asset value per share of our common stock at the date of issuance of such securities, (d) the issuance of such securities must be approved by a majority of the board of directors who have no financial interest in the transaction and a majority of the non-interested directors on the basis that such issuance is in the best interests of the Company and its stockholders and (e) the number of shares of our common stock that would result from the exercise or conversion of such securities and all other securities convertible, exercisable or exchangeable into shares of our common stock outstanding at the time of issuance of such securities must not exceed 25% of our outstanding common stock at such time.

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DESCRIPTION OF OUR CAPITAL STOCK

The following description is based on relevant portions of the Maryland General Corporation Law and on our charter and bylaws. This summary is not necessarily complete, and we refer you to the Maryland General Corporation Law and our charter and bylaws for a more detailed description of the provisions summarized below.

Stock

The authorized stock of Solar Capital Ltd. consists of 200,000,000 shares of stock, par value $0.01 per share, all of which are initially designated as common stock. Our common stock is listed on the NASDAQ Global Select Market under the ticker symbol SLRC . There are no outstanding options or warrants to purchase our stock. No stock has been authorized for issuance under any equity compensation plans. Under Maryland law, our stockholders generally are not personally liable for our debts or obligations.

The following are our outstanding classes of securities as of July 3, 2012:

(1) Title of Class	(2) Amount Authorized	(3) Amount Held by Us or for Our Account	(4) Amount Outstanding Exclusive of Amounts Shown Under(3)
Common stock	200,000,000		36,667,197

Under our charter our board of directors is authorized to classify and reclassify any unissued shares of stock into other classes or series of stock without obtaining stockholder approval. As permitted by the Maryland General Corporation Law, our charter provides that the board of directors, without any action by our stockholders, may amend the charter from time to time to increase or decrease the aggregate number of shares of stock or the number of shares of stock of any class or series that we have authority to issue.

Common Stock

All shares of our common stock have equal rights as to earnings, assets, voting, and dividends and, when they are issued, will be duly authorized, validly issued, fully paid and nonassessable. Distributions may be paid to the holders of our common stock if, as and when authorized by our board of directors and declared by us out of assets legally available therefor. Shares of our common stock have no preemptive, conversion or redemption rights and are freely transferable, except where their transfer is restricted by federal and state securities laws or by contract. In the event of our liquidation, dissolution or winding up, each share of our common stock would be entitled to share ratably in all of our assets that are legally available for distribution after we pay all debts and other liabilities and subject to any preferential rights of holders of our preferred stock, if any preferred stock is outstanding at such time. Each share of our common stock is entitled to one vote on all matters submitted to a vote of stockholders, including the election of directors. Except as provided with respect to any other class or series of stock, the holders of our common stock will possess exclusive voting power. There is no cumulative voting in the election of directors, which means that holders of a majority of the outstanding shares of common stock can elect all of our directors, and holders of less than a majority of such shares

will be unable to elect any director.

Preferred Stock

Our charter authorizes our board of directors to classify and reclassify any unissued shares of stock into other classes or series of stock, including preferred stock. The cost of any such reclassification would be borne by our existing common stockholders. Prior to issuance of shares of each class or series, the board of directors is required by Maryland law and by our charter to set the terms, preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms or conditions of

redemption for each class or series. Thus, the board of directors could authorize the issuance of shares of preferred stock with terms and conditions which could have the effect of delaying, deferring or preventing a transaction or a change in control that might involve a premium price for holders of our common stock or otherwise be in their best interest. You should note, however, that any issuance of preferred stock must comply with the requirements of the 1940 Act. The 1940 Act requires, among other things, that (1) immediately after issuance and before any dividend or other distribution is made with respect to our common stock and before any purchase of common stock is made, such preferred stock together with all other senior securities must not exceed an amount equal to 50% of our total assets after deducting the amount of such dividend, distribution or purchase price, as the case may be, and (2) the holders of shares of preferred stock, if any are issued, must be entitled as a class to elect two directors at all times and to elect a majority of the directors if dividends on such preferred stock are in arrears by two full years or more. Certain matters under the 1940 Act require the separate vote of the holders of any issued and outstanding preferred stock. For example, holders of preferred stock would vote separately from the holders of common stock on a proposal to cease operations as a BDC. We believe that the availability for issuance of preferred stock will provide us with increased flexibility in structuring future financings and acquisitions. However, we do not currently have any plans to issue preferred stock.

Limitation on Liability of Directors and Officers; Indemnification and Advance of Expenses

Maryland law permits a Maryland corporation to include in its charter a provision limiting the liability of its directors and officers to the corporation and its stockholders for money damages except for liability resulting from (a) actual receipt of an improper benefit or profit in money, property or services or (b) active and deliberate dishonesty established by a final judgment as being material to the cause of action. Our charter contains such a provision which eliminates directors and officers liability to the maximum extent permitted by Maryland law, subject to the requirements of the 1940 Act.

Our charter authorizes us, to the maximum extent permitted by Maryland law and subject to the requirements of the 1940 Act, to indemnify any present or former director or officer or any individual who, while serving as our director or officer and at our request, serves or has served another corporation, real estate investment trust, partnership, joint venture, trust, employee benefit plan or other enterprise as a director, officer, partner or trustee, from and against any claim or liability to which that person may become subject or which that person may incur by reason of his or her service in any such capacity and to pay or reimburse their reasonable expenses in advance of final disposition of a proceeding. Our bylaws obligate us, to the maximum extent permitted by Maryland law and subject to the requirements of the 1940 Act, to indemnify any present or former director or officer or any individual who, while serving as our director or officer and at our request, serves or has served another corporation, real estate investment trust, partnership, joint venture, trust, employee benefit plan or other enterprise as a director, officer, partner or trustee and who is made, or threatened to be made, a party to the proceeding by reason of his or her service in that capacity from and against any claim or liability to which that person may become subject or which that person may incur by reason of his or her service in any such capacity and to pay or reimburse his or her reasonable expenses in advance of final disposition of a proceeding. The charter and bylaws also permit us to indemnify and advance expenses to any person who served a predecessor of us in any of the capacities described above and any of our employees or agents or any employees or agents of our predecessor. In accordance with the 1940 Act, we will not indemnify any person for any liability to which such person would be subject by reason of such person s willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his or her office.

Maryland law requires a corporation (unless its charter provides otherwise, which our charter does not) to indemnify a director or officer who has been successful in the defense of any proceeding to which he or she is made, or threatened to be made, a party by reason of his or her service in that capacity. Maryland law permits a corporation to indemnify its present and former directors and officers, among others, against judgments, penalties, fines, settlements and reasonable expenses actually incurred by them in connection with any proceeding to which they may be made, or threatened to be made, a party by reason of their service in those or

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other capacities unless it is established that (a) the act or omission of the director or officer was material to the matter giving rise to the proceeding and (1) was committed in bad faith or (2) was the result of active and deliberate dishonesty, (b) the director or officer actually received an improper personal benefit in money, property or services or (c) in the case of any criminal proceeding, the director or officer had reasonable cause to believe that the act or omission was unlawful. However, under Maryland law, a Maryland corporation may not indemnify for an adverse judgment in a suit by or in the right of the corporation or for a judgment of liability on the basis that a personal benefit was improperly received unless, in either case, a court orders indemnification, and then only for expenses. In addition, Maryland law permits a corporation to advance reasonable expenses to a director or officer in advance of final disposition of a proceeding upon the corporation s receipt of (a) a written affirmation by the director or officer of his or her good faith belief that he or she has met the standard of conduct necessary for indemnification by the corporation and (b) a written undertaking by him or her or on his or her behalf to repay the amount paid or reimbursed by the corporation if it is ultimately determined that the standard of conduct was not met.

We have entered into indemnification agreements with our directors. The indemnification agreements provide our directors the maximum indemnification permitted under Maryland law and the 1940 Act.

Our insurance policy does not currently provide coverage for claims, liabilities and expenses that may arise out of activities that our present or former directors or officers have performed for another entity at our request. There is no assurance that such entities will in fact carry such insurance. However, we note that we do not expect to request our present or former directors or officers to serve another entity as a director, officer, partner or trustee unless we can obtain insurance providing coverage for such persons for any claims, liabilities or expenses that may arise out of their activities while serving in such capacities.

Certain Provisions of the Maryland General Corporation Law and Our Charter and Bylaws

The Maryland General Corporation Law and our charter and bylaws contain provisions that could make it more difficult for a potential acquiror to acquire us by means of a tender offer, proxy contest or otherwise. These provisions are expected to discourage certain coercive takeover practices and inadequate takeover bids and to encourage persons seeking to acquire control of us to negotiate first with our board of directors. We believe that the benefits of these provisions outweigh the potential disadvantages of discouraging any such acquisition proposals because, among other things, the negotiation of such proposals may improve their terms.

Classified Board of Directors

Our board of directors is divided into three classes of directors serving staggered three-year terms. The current terms of the first, second and third classes expire in 2013, 2014 and 2015, respectively, and in each case, those directors will serve until their successors are elected and qualify. Upon expiration of their current terms, directors of each class will be elected to serve for three-year terms and until their successors are duly elected and qualify and each year one class of directors will be elected by the stockholders. A classified board may render a change in control of us or removal of our incumbent management more difficult. We believe, however, that the longer time required to elect a majority of a classified board of directors will help to ensure the continuity and stability of our management and policies.

Election of Directors

Our charter and bylaws provide that the affirmative vote of the holders of a plurality of the outstanding shares of stock entitled to vote in the election of directors cast at a meeting of stockholders duly called and at which a quorum is present will be required to elect a director. Pursuant to our charter our board of directors may amend the bylaws to alter the vote required to elect directors.

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Number of Directors; Vacancies; Removal

Our charter provides that the number of directors will be set only by the board of directors in accordance with our bylaws. Our bylaws provide that a majority of our entire board of directors may at any time increase or decrease the number of directors. However, unless our bylaws are amended, the number of directors may never be less than one nor more than twelve. Our charter provides that, at such time as we have at least three independent directors and our common stock is registered under the Securities Exchange Act of 1934, as amended, we elect to be subject to the provision of Subtitle 8 of Title 3 of the Maryland General Corporation Law regarding the filling of vacancies on the board of directors. Accordingly, at such time, except as may be provided by the board of directors in setting the terms of any class or series of preferred stock, any and all vacancies on the board of directors may be filled only by the affirmative vote of a majority of the remaining directors in office, even if the remaining directors do not constitute a quorum, and any director elected to fill a vacancy will serve for the remainder of the full term of the directorship in which the vacancy occurred and until a successor is elected and qualifies, subject to any applicable requirements of the 1940 Act.

Our charter provides that a director may be removed only for cause, as defined in our charter, and then only by the affirmative vote of at least two-thirds of the votes entitled to be cast in the election of directors.

Action by Stockholders

Under the Maryland General Corporation Law, stockholder action can be taken only at an annual or special meeting of stockholders or (unless the charter provides for stockholder action by less than unanimous written consent, which our charter does not) by unanimous written consent in lieu of a meeting. These provisions, combined with the requirements of our bylaws regarding the calling of a stockholder-requested special meeting of stockholders discussed below, may have the effect of delaying consideration of a stockholder proposal until the next annual meeting.

Advance Notice Provisions for Stockholder Nominations and Stockholder Proposals

Our bylaws provide that with respect to an annual meeting of stockholders, nominations of persons for election to the board of directors and the proposal of business to be considered by stockholders may be made only (1) pursuant to our notice of the meeting, (2) by the board of directors or (3) by a stockholder who is entitled to vote at the meeting and who has complied with the advance notice procedures of our bylaws. With respect to special meetings of stockholders, only the business specified in our notice of the meeting may be brought before the meeting. Nominations of persons for election to the board of directors at a special meeting may be made only (1) pursuant to our notice of the meeting, (2) by the board of directors or (3) provided that the board of directors has determined that directors will be elected at the meeting, by a stockholder who is entitled to vote at the meeting and who has complied with the advance notice provisions of the bylaws.

The purpose of requiring stockholders to give us advance notice of nominations and other business is to afford our board of directors a meaningful opportunity to consider the qualifications of the proposed nominees and the advisability of any other proposed business and, to the extent deemed necessary or desirable by our board of directors, to inform stockholders and make recommendations about such qualifications or business, as well as to provide a more orderly procedure for conducting meetings of stockholders. Although our bylaws do not give our board of directors any power to disapprove stockholder nominations for the election of directors or proposals recommending certain action, they may have the effect of precluding a contest for the election of directors or the consideration of stockholder proposals if proper procedures are not followed and of discouraging or deterring a third party from conducting a solicitation of proxies to elect its own slate of directors or to approve its own proposal without regard to whether consideration of such nominees or proposals might be harmful or beneficial to us and our stockholders.

Calling of Special Meetings of Stockholders

Our bylaws provide that special meetings of stockholders may be called by our board of directors and certain of our officers. Additionally, our bylaws provide that, subject to the satisfaction of certain procedural and informational requirements by the stockholders requesting the meeting, a special meeting of stockholders will be called by the secretary of the corporation upon the written request of stockholders entitled to cast not less than a majority of all the votes entitled to be cast at such meeting.

Approval of Extraordinary Corporate Action; Amendment of Charter and Bylaws

Under Maryland law, a Maryland corporation generally cannot dissolve, amend its charter, merge, sell all or substantially all of its assets, engage in a share exchange or engage in similar transactions outside the ordinary course of business, unless approved by the affirmative vote of stockholders entitled to cast at least two-thirds of the votes entitled to be cast on the matter. However, a Maryland corporation may provide in its charter for approval of these matters by a lesser percentage, but not less than a majority of all of the votes entitled to be cast on the matter. Our charter generally provides for approval of charter amendments and extraordinary transactions by the stockholders entitled to cast at least a majority of the votes entitled to be cast on the matter. Our charter also provides that certain charter amendments, any proposal for our conversion, whether by charter amendment, merger or otherwise, from a closed-end company to an open-end company and any proposal for our liquidation or dissolution requires the approval of the stockholders entitled to cast at least 80% of the votes entitled to be cast on such matter. However, if such amendment or proposal is approved by a majority of our continuing directors (in addition to approval by our board of directors), such amendment or proposal may be approved by a majority of the votes entitled to be cast on such a matter. The continuing directors are defined in our charter as (1) our current directors, (2) those directors whose nomination for election by the stockholders or whose election by the directors to fill vacancies is approved by a majority of our current directors then on the board of directors or (3) any successor directors whose nomination for election by the stockholders or whose election by the directors to fill vacancies is approved by a majority of continuing directors or the successor continuing directors then in office.

Our charter and bylaws provide that the board of directors will have the exclusive power to make, alter, amend or repeal any provision of our bylaws.

No Appraisal Rights

Except with respect to appraisal rights arising in connection with the Control Share Act discussed below, as permitted by the Maryland General Corporation Law, our charter provides that stockholders will not be entitled to exercise appraisal rights unless a majority of the board of directors shall determine such rights apply.

Control Share Acquisitions

The Maryland General Corporation Law 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 (the Control Share Act). Shares owned by the acquiror, by officers or by directors who are employees of the corporation are excluded from shares entitled to vote on the matter. Control shares are voting shares of stock which, if aggregated with all other shares of stock owned by the acquiror or in respect of which the acquiror is able to exercise or direct the exercise of voting power (except solely by virtue of a revocable proxy), would entitle the acquiror to

exercise voting power in electing directors within one of the following ranges of voting power:

- one-tenth or more but less than one-third;
- one-third or more but less than a majority; or
- a majority or more of all voting power.

The requisite stockholder approval must be obtained each time an acquiror crosses one of the thresholds of voting power set forth above. Control shares do not include shares the acquiring person is then entitled to vote as a result of having previously obtained stockholder approval. A control share acquisition means the acquisition of control shares, subject to certain exceptions.

A person who has made or proposes to make a control share acquisition may compel the board of directors of the corporation to call a special meeting of stockholders to be held within 50 days of demand to consider the voting rights of the shares. The right to compel the calling of a special meeting is subject to the satisfaction of certain conditions, including an undertaking to pay the expenses of the meeting. If no request for a meeting is made, the corporation may itself present the question at any stockholders meeting.

If voting rights are not approved at the meeting or if the acquiring person does not deliver an acquiring person statement as required by the statute, then the corporation may redeem for fair value any or all of the control shares, except those for which voting rights have previously been approved. The right of the corporation to redeem control shares is subject to certain conditions and limitations, including, as provided in our bylaws compliance with the 1940 Act. Fair value is determined, without regard to the absence of voting rights for the control shares, as of the date of the last control share acquisition by the acquiror or of any meeting of stockholders at which the voting rights of the shares are considered and not approved. If voting rights for control shares are approved at a stockholders meeting and the acquiror becomes entitled to vote a majority of the shares entitled to vote, all other stockholders may exercise appraisal rights. The fair value of the shares as determined for purposes of appraisal rights may not be less than the highest price per share paid by the acquiror in the control share acquisition.

The Control Share Act does not apply (a) to shares acquired in a merger, consolidation or share exchange if the corporation is a party to the transaction or (b) to acquisitions approved or exempted by the charter or bylaws of the corporation. Our bylaws contain a provision exempting from the Control Share Act any and all acquisitions by any person of our shares of stock. There can be no assurance that such provision will not be amended or eliminated at any time in the future. However, we will amend our bylaws to be subject to the Control Share Act only if the board of directors determines that it would be in our best interests and if the SEC staff does not object to our determination that our being subject to the Control Share Act does not conflict with the 1940 Act.

Business Combinations

Under Maryland law, business combinations between a Maryland corporation and an interested stockholder or an affiliate of an interested stockholder are prohibited for five years after the most recent date on which the interested stockholder becomes an interested stockholder (the Business Combination Act). These business combinations include a merger, consolidation, share exchange or, in circumstances specified in the statute, an asset transfer or issuance or reclassification of equity securities. An interested stockholder is defined as:

- any person who beneficially owns 10% or more of the voting power of the corporation s outstanding voting stock; or
- an affiliate or associate of the corporation who, at any time within the two-year period prior to the date in question, was the beneficial owner of 10% or more of the voting power of the then outstanding voting stock of the corporation.

A person is not an interested stockholder under this statute if the board of directors approved in advance the transaction by which the stockholder otherwise would have become an interested stockholder. However, in approving a transaction, the board of directors may provide that its approval is subject to compliance, at or after the time of approval, with any terms and conditions determined by the board.

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After the five-year prohibition, any business combination between the Maryland corporation and an interested stockholder generally must be recommended by the board of directors of the corporation and approved by the affirmative vote of at least:

80% of the votes entitled to be cast by holders of outstanding shares of voting stock of the corporation; and

two-thirds of the votes entitled to be cast by holders of voting stock of the corporation other than shares held by the interested stockholder with whom or with whose affiliate the business combination is to be effected or held by an affiliate or associate of the interested stockholder.

These super-majority vote requirements do not apply if the corporation s common stockholders receive a minimum price, as defined under Maryland law, for their shares in the form of cash or other consideration in the same form as previously paid by the interested stockholder for its shares.

The statute permits various exemptions from its provisions, including business combinations that are exempted by the board of directors before the time that the interested stockholder becomes an interested stockholder. Our board of directors has adopted a resolution that any business combination between us and any other person is exempted from the provisions of the Business Combination Act, provided that the business combination is first approved by the board of directors, including a majority of the directors who are not interested persons as defined in the 1940 Act. This resolution may be altered or repealed in whole or in part at any time; however, our board of directors will adopt resolutions so as to make us subject to the provisions of the Business Combination Act only if the board of directors determines that it would be in our best interests and if the SEC staff does not object to our determination that our being subject to the Business Combination Act does not conflict with the 1940 Act. If this resolution is repealed, or the board of directors does not otherwise approve a business combination, the statute may discourage others from trying to acquire control of us and increase the difficulty of consummating any offer.

Conflict with 1940 Act

Our bylaws provide that, if and to the extent that any provision of the Maryland General Corporation Law, including the Control Share Act (if we amend our bylaws to be subject to such Act) and the Business Combination Act, or any provision of our charter or bylaws conflicts with any provision of the 1940 Act, the applicable provision of the 1940 Act will control.

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DESCRIPTION OF OUR PREFERRED STOCK

In addition to shares of common stock, our charter authorizes the issuance of preferred stock. We may issue preferred stock from time to time, although we have no immediate intention to do so. If we offer preferred stock under this prospectus, we will issue an appropriate prospectus supplement. We may issue preferred stock from time to time in one or more classes or series, without stockholder approval. Prior to issuance of shares of each class or series, our board of directors is required by Maryland law and by our charter to set the terms, preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms or conditions of redemption for each class or series. Any such an issuance must adhere to the requirements of the 1940 Act, Maryland law and any other limitations imposed by law.

The following is a general description of the terms of the preferred stock we may issue from time to time. Particular terms of any preferred stock we offer will be described in the prospectus supplement relating to such preferred stock.

If we issue preferred stock, it will pay dividends to the holders of the preferred stock at either a fixed rate or a rate that will be reset frequently based on short-term interest rates, as described in a prospectus supplement accompanying each preferred share offering.

The 1940 Act requires, among other things, that (1) immediately after issuance and before any distribution is made with respect to common stock, the liquidation preference of the preferred stock, together with all other senior securities, must not exceed an amount equal to 50% of our total assets (taking into account such distribution), (2) the holders of shares of preferred stock, if any are issued, must be entitled as a class to elect two directors at all times and to elect a majority of the directors if dividends on the preferred stock are in arrears by two years or more and (3) such shares be cumulative as to dividends and have a complete preference over our common stock to payment of their liquidation preference in the event of a dissolution.

For any series of preferred stock that we may issue, our board of directors or a committee thereof will determine and the articles supplementary and prospectus supplement relating to such series will describe:

- the designation and number of shares of such series;
- the rate, whether fixed or variable, and time at which any dividends will be paid on shares of such series, as well as whether such dividends are participating or non-participating;
- any provisions relating to convertibility or exchangeability of the shares of such series;
- the rights and preferences, if any, of holders of shares of such series upon our liquidation, dissolution or winding up of our affairs;
- the voting powers, if any, of the holders of shares of such series;
- any provisions relating to the redemption of the shares of such series;

- any limitations on our ability to pay dividends or make distributions on, or acquire or redeem, other securities while shares of such series are outstanding;

- any conditions or restrictions on our ability to issue additional shares of such series or other securities;

- if applicable, a discussion of certain U.S. federal income tax considerations; and

- any other relative powers, preferences and participating, optional or special rights of shares of such series, and the qualifications, limitations or restrictions thereof.

All shares of preferred stock that we may issue will be identical and of equal rank except as to the particular terms thereof that may be fixed by our board of directors, and all shares of each series of preferred stock will be identical and of equal rank except as to the dates from which dividends, if any, thereon will be cumulative.

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DESCRIPTION OF OUR WARRANTS

The following is a general description of the terms of the warrants we may issue from time to time. Particular terms of any warrants we offer will be described in the prospectus supplement relating to such warrants.

We may issue warrants to purchase shares of our common stock. Such warrants may be issued independently or together with shares of common stock and may be attached or separate from such shares of common stock. We will issue each series of warrants under a separate warrant agreement to be entered into between us and a warrant agent. The warrant agent will act solely as our agent and will not assume any obligation or relationship of agency for or with holders or beneficial owners of warrants.

A prospectus supplement will describe the particular terms of any series of warrants we may issue, including the following:

- the title of such warrants;
- the aggregate number of such warrants;
- the price or prices at which such warrants will be issued;
- the currency or currencies, including composite currencies, in which the price of such warrants may be payable;
- the number of shares of common stock issuable upon exercise of such warrants;
- the price at which and the currency or currencies, including composite currencies, in which the shares of common stock purchasable upon exercise of such warrants may be purchased;
- the date on which the right to exercise such warrants shall commence and the date on which such right will expire;
- whether such warrants will be issued in registered form or bearer form;
- if applicable, the minimum or maximum amount of such warrants which may be exercised at any one time;
- if applicable, the number of such warrants issued with each share of common stock;
- if applicable, the date on and after which such warrants and the related shares of common stock will be separately transferable;

information with respect to book-entry procedures, if any;

if applicable, a discussion of certain U.S. federal income tax considerations; and

any other terms of such warrants, including terms, procedures and limitations relating to the exchange and exercise of such warrants.

We and the warrant agent may amend or supplement the warrant agreement for a series of warrants without the consent of the holders of the warrants issued thereunder to effect changes that are not inconsistent with the provisions of the warrants and that do not materially and adversely affect the interests of the holders of the warrants.

Under the 1940 Act, we may generally only offer warrants provided that (1) the warrants expire by their terms within ten years; (2) the exercise or conversion price is not less than the current market value at the date of issuance; (3) our stockholders authorize the proposal to issue such warrants, and our board of directors approves such issuance on the basis that the issuance is in the best interests of Solar Capital and its stockholders; and (4) if the warrants are accompanied by other securities, the warrants are not separately transferable unless no class of such warrants and the securities accompanying them has been publicly distributed. The 1940 Act also provides that the amount of our voting securities that would result from the exercise of all outstanding warrants at the time of issuance may not exceed 25% of our outstanding voting securities.

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DESCRIPTION OF OUR DEBT SECURITIES

We may issue debt securities in one or more series. The specific terms of each series of debt securities will be described in the particular prospectus supplement relating to that series. The prospectus supplement may or may not modify the general terms found in this prospectus and will be filed with the SEC. For a complete description of the terms of a particular series of debt securities, you should read both this prospectus and the prospectus supplement relating to that particular series.

As required by federal law for all bonds and notes of companies that are publicly offered, the debt securities are governed by a document called an indenture. An indenture is a contract between us and a financial institution acting as trustee on your behalf, and is subject to and governed by the Trust Indenture Act of 1939, as amended. The trustee has two main roles. First, the trustee can enforce your rights against us if we default. There are some limitations on the extent to which the trustee acts on your behalf, described in the second paragraph under Events of Default Remedies if an Event of Default Occurs. Second, the trustee performs certain administrative duties for us.

Because this section is a summary, it does not describe every aspect of the debt securities and the indenture. We urge you to read the indenture because it, and not this description, defines your rights as a holder of debt securities. A copy of the form of indenture is attached as an exhibit to the registration statement of which this prospectus is a part. We will file a supplemental indenture with the SEC prior to the commencement of any debt offering, at which time the supplemental indenture would be publicly available. See Available Information for information on how to obtain a copy of the indenture.

The prospectus supplement, which will accompany this prospectus, will describe the particular series of debt securities being offered by including:

- the designation or title of the series of debt securities;
- the total principal amount of the series of debt securities;
- the percentage of the principal amount at which the series of debt securities will be offered;
- the date or dates on which principal will be payable;
- the rate or rates (which may be either fixed or variable) and/or the method of determining such rate or rates of interest, if any;
- the date or dates from which any interest will accrue, or the method of determining such date or dates, and the date or dates on which any interest will be payable;
- whether any interest may be paid by issuing additional securities of the same series in lieu of cash (and the terms upon which any such interest may be paid by issuing additional securities);

the terms for redemption, extension or early repayment, if any;

the currencies in which the series of debt securities are issued and payable;

whether the amount of payments of principal, premium or interest, if any, on a series of debt securities will be determined with reference to an index, formula or other method (which could be based on one or more currencies, commodities, equity indices or other indices) and how these amounts will be determined;

the place or places, if any, other than or in addition to the Borough of Manhattan in the City of New York, of payment, transfer, conversion and/or exchange of the debt securities;

the denominations in which the offered debt securities will be issued (if other than $1,000 and any integral multiple thereof for registered securities or $500 for bearer securities);

the provision for any sinking fund;

any restrictive covenants;

- any Events of Default;
- whether the series of debt securities are issuable in certificated form;
- any provisions for defeasance or covenant defeasance;
- any special federal income tax implications, including, if applicable, federal income tax considerations relating to original issue discount;
- whether and under what circumstances we will pay additional amounts in respect of any tax, assessment or governmental charge and, if so, whether we will have the option to redeem the debt securities rather than pay the additional amounts (and the terms of this option);
- any provisions for convertibility or exchangeability of the debt securities into or for any other securities;
- whether the debt securities are subject to subordination and the terms of such subordination;
- whether the debt securities are secured and the terms of any security interests;
- the listing, if any, on a securities exchange; and
- any other terms.

The debt securities may be secured or unsecured obligations. Under the provisions of the 1940 Act, we are permitted, as a BDC, to issue debt only in amounts such that our asset coverage, as defined in the 1940 Act, equals at least 200% after each issuance of debt. Unless the prospectus supplement states otherwise, principal (and premium, if any) and interest, if any, will be paid by us in immediately available funds.

General

The indenture provides that any debt securities proposed to be sold under this prospectus and the accompanying prospectus supplement (offered debt securities) and any debt securities issuable upon the exercise of warrants or upon conversion or exchange of other offered securities (underlying debt securities), may be issued under the indenture in one or more series.

For purposes of this prospectus, any reference to the payment of principal of or premium or interest, if any, on debt securities will include additional amounts if required by the terms of the debt securities.

The indenture does not limit the amount of debt securities that may be issued thereunder from time to time. Debt securities issued under the indenture, when a single trustee is acting for all debt securities issued under the indenture, are called the indenture securities . The indenture also provides that there may be more than one trustee thereunder, each with respect to one or more different series of indenture securities. See Resignation of Trustee below. At a time when two or more trustees are acting under the indenture, each with respect to only certain series, the term indenture securities means the one or more series of debt securities with respect to which each respective trustee is acting. In the event that there is more than one trustee under the indenture, the powers and trust obligations of each trustee described in this prospectus will extend only to the one or more series of indenture securities for which it is trustee. If two or more trustees are acting under the indenture, then the indenture securities for which each trustee is acting would be treated as if issued under separate indentures.

The indenture does not contain any provisions that give you protection in the event we issue a large amount of debt or we are acquired by another entity.

We refer you to the prospectus supplement for information with respect to any deletions from, modifications of or additions to the Events of Default or our covenants that are described below, including any addition of a covenant or other provision providing event risk or similar protection.

We have the ability to issue indenture securities with terms different from those of indenture securities previously issued and, without the consent of the holders thereof, to reopen a previous issue of a series of indenture securities and issue additional indenture securities of that series unless the reopening was restricted when that series was created.

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Conversion and Exchange

If any debt securities are convertible into or exchangeable for other securities, the prospectus supplement will explain the terms and conditions of the conversion or exchange, including the conversion price or exchange ratio (or the calculation method), the conversion or exchange period (or how the period will be determined), if conversion or exchange will be mandatory or at the option of the holder or us, provisions for adjusting the conversion price or the exchange ratio and provisions affecting conversion or exchange in the event of the redemption of the underlying debt securities. These terms may also include provisions under which the number or amount of other securities to be received by the holders of the debt securities upon conversion or exchange would be calculated according to the market price of the other securities as of a time stated in the prospectus supplement.

Issuance of Securities in Registered Form

We may issue the debt securities in registered form, in which case we may issue them either in book-entry form only or in certificated form. Debt securities issued in book-entry form will be represented by global securities. We expect that we will usually issue debt securities in book-entry only form represented by global securities.

We also will have the option of issuing debt securities in non-registered form as bearer securities if we issue the securities outside the United States to non-U.S. persons. In that case, the prospectus supplement will set forth the mechanics for holding the bearer securities, including the procedures for receiving payments, for exchanging the bearer securities, including the procedures for receiving payments, for exchanging the bearer securities for registered securities of the same series, and for receiving notices. The prospectus supplement will also describe the requirements with respect to our maintenance of offices or agencies outside the United States and the applicable U.S. federal tax law requirements.

Book-Entry Holders

We will issue registered debt securities in book-entry form only, unless we specify otherwise in the applicable prospectus supplement. This means debt securities will be represented by one or more global securities registered in the name of a depositary that will hold them on behalf of financial institutions that participate in the depositary s book-entry system. These participating institutions, in turn, hold beneficial interests in the debt securities held by the depositary or its nominee. These institutions may hold these interests on behalf of themselves or customers.

Under the indenture, only the person in whose name a debt security is registered is recognized as the holder of that debt security. Consequently, for debt securities issued in book-entry form, we will recognize only the depositary as the holder of the debt securities and we will make all payments on the debt securities to the depositary. The depositary will then pass along the payments it receives to its participants, which in turn will pass the payments along to their customers who are the beneficial owners. The depositary and its participants do so under agreements they have made with one another or with their customers; they are not obligated to do so under the terms of the debt securities.

As a result, investors will not own debt securities directly. Instead, they will own beneficial interests in a global security, through a bank, broker or other financial institution that participates in the depositary s book-entry system or holds an interest through a participant. As long as the debt securities are represented by one or more global securities, investors will be indirect holders, and not holders, of the debt securities.

Street Name Holders

In the future, we may issue debt securities in certificated form or terminate a global security. In these cases, investors may choose to hold their debt securities in their own names or in street name. Debt securities held in

street name are registered in the name of a bank, broker or other financial institution chosen by the investor, and the investor would hold a beneficial interest in those debt securities through the account he or she maintains at that institution.

For debt securities held in street name, we will recognize only the intermediary banks, brokers and other financial institutions in whose names the debt securities are registered as the holders of those debt securities and we will make all payments on those debt securities to them. These institutions will pass along the payments they receive to their customers who are the beneficial owners, but only because they agree to do so in their customer agreements or because they are legally required to do so. Investors who hold debt securities in street name will be indirect holders, and not holders, of the debt securities.

Legal Holders

Our obligations, as well as the obligations of the applicable trustee and those of any third parties employed by us or the applicable trustee, run only to the legal holders of the debt securities. We do not have obligations to investors who hold beneficial interests in global securities, in street name or by any other indirect means. This will be the case whether an investor chooses to be an indirect holder of a debt security or has no choice because we are issuing the debt securities only in book-entry form.

For example, once we make a payment or give a notice to the holder, we have no further responsibility for the payment or notice even if that holder is required, under agreements with depositary participants or customers or by law, to pass it along to the indirect holders but does not do so. Similarly, if we want to obtain the approval of the holders for any purpose (for example, to amend an indenture or to relieve us of the consequences of a default or of our obligation to comply with a particular provision of an indenture), we would seek the approval only from the holders, and not the indirect holders, of the debt securities. Whether and how the holders contact the indirect holders is up to the holders.

When we refer to you, we mean those who invest in the debt securities being offered by this prospectus, whether they are the holders or only indirect holders of those debt securities. When we refer to your debt securities, we mean the debt securities in which you hold a direct or indirect interest.

Special Considerations for Indirect Holders

If you hold debt securities through a bank, broker or other financial institution, either in book-entry form or in street name, we urge you to check with that institution to find out:

- how it handles securities payments and notices,
- whether it imposes fees or charges,
- how it would handle a request for the holders consent, if ever required,

whether and how you can instruct it to send you debt securities registered in your own name so you can be a holder, if that is permitted in the future for a particular series of debt securities,

how it would exercise rights under the debt securities if there were a default or other event triggering the need for holders to act to protect their interests, and

if the debt securities are in book-entry form, how the depositary s rules and procedures will affect these matters.

Global Securities

As noted above, we usually will issue debt securities as registered securities in book-entry form only. A global security represents one or any other number of individual debt securities. Generally, all debt securities represented by the same global securities will have the same terms.

Each debt security issued in book-entry form will be represented by a global security that we deposit with and register in the name of a financial institution or its nominee that we select. The financial institution that we select for this purpose is called the depositary. Unless we specify otherwise in the applicable prospectus supplement, The Depository Trust Company, New York, New York, known as DTC, will be the depositary for all debt securities issued in book-entry form.

A global security may not be transferred to or registered in the name of anyone other than the depositary or its nominee, unless special termination situations arise. We describe those situations below under Special Situations when a Global Security Will Be Terminated . As a result of these arrangements, the depositary, or its nominee, will be the sole registered owner and holder of all debt securities represented by a global security, and investors will be permitted to own only beneficial interests in a global security. Beneficial interests must be held by means of an account with a broker, bank or other financial institution that in turn has an account with the depositary or with another institution that has an account with the depositary. Thus, an investor whose security is represented by a global security will not be a holder of the debt security, but only an indirect holder of a beneficial interest in the global security.

Special Considerations for Global Securities

As an indirect holder, an investor s rights relating to a global security will be governed by the account rules of the investor s financial institution and of the depositary, as well as general laws relating to securities transfers. The depositary that holds the global security will be considered the holder of the debt securities represented by the global security.

If debt securities are issued only in the form of a global security, an investor should be aware of the following:

- An investor cannot cause the debt securities to be registered in his or her name, and cannot obtain certificates for his or her interest in the debt securities, except in the special situations we describe below.

- An investor will be an indirect holder and must look to his or her own bank or broker for payments on the debt securities and protection of his or her legal rights relating to the debt securities, as we describe under Issuance of Securities in Registered Form above.

- An investor may not be able to sell interests in the debt securities to some insurance companies and other institutions that are required by law to own their securities in non-book-entry form.

- An investor may not be able to pledge his or her interest in a global security in circumstances where certificates representing the debt securities must be delivered to the lender or other beneficiary of the pledge in order for the pledge to be effective.

- The depositary s policies, which may change from time to time, will govern payments, transfers, exchanges and other matters relating to an investor s interest in a global security. We and the trustee have no responsibility for any aspect of the depositary s actions or for its records of ownership interests in a global security. We and the trustee also do not supervise the depositary in any way.

- If we redeem less than all the debt securities of a particular series being redeemed, DTC s practice is to determine by lot the amount to be redeemed from each of its participants holding that series.

An investor is required to give notice of exercise of any option to elect repayment of its debt securities, through its participant, to the applicable trustee and to deliver the related debt securities by causing its participant to transfer its interest in those debt securities, on DTC s records, to the applicable trustee.

DTC requires that those who purchase and sell interests in a global security deposited in its book-entry system use immediately available funds. Your broker or bank may also require you to use immediately available funds when purchasing or selling interests in a global security.

Financial institutions that participate in the depositary s book-entry system, and through which an investor holds its interest in a global security, may also have their own policies affecting payments, notices and other matters relating to the debt securities. There may be more than one financial intermediary in the chain of ownership for an investor. We do not monitor and are not responsible for the actions of any of those intermediaries.

Special Situations when a Global Security will be Terminated

In a few special situations described below, a global security will be terminated and interests in it will be exchanged for certificates in non-book-entry form (certificated securities). After that exchange, the choice of whether to hold the certificated debt securities directly or in street name will be up to the investor. Investors must consult their own banks or brokers to find out how to have their interests in a global security transferred on termination to their own names, so that they will be holders. We have described the rights of legal holders and street name investors under Issuance of Securities in Registered Form above.

The prospectus supplement may list situations for terminating a global security that would apply only to the particular series of debt securities covered by the prospectus supplement. If a global security is terminated, only the depositary, and not we or the applicable trustee, is responsible for deciding the names of the institutions in whose names the debt securities represented by the global security will be registered and, therefore, who will be the holders of those debt securities.

Payment and Paying Agents

We will pay interest (either in cash or by delivery of additional indenture securities, as applicable) to the person listed in the applicable trustee s records as the owner of the debt security at the close of business on a particular day in advance of each due date for interest, even if that person no longer owns the debt security on the interest due date. That day, usually about two weeks in advance of the interest due date, is called the record date. Because we will pay all the interest for an interest period to the holders on the record date, holders buying and selling debt securities must work out between themselves the appropriate purchase price. The most common manner is to adjust the sales price of the debt securities to prorate interest fairly between buyer and seller based on their respective ownership periods within the particular interest period. This prorated interest amount is called accrued interest.

Payments on Global Securities

We will make payments on a global security in accordance with the applicable policies of the depositary as in effect from time to time. Under those policies, we will make payments directly to the depositary, or its nominee, and not to any indirect holders who own beneficial interests in the global security. An indirect holder s right to those payments will be governed by the rules and practices of the depositary and its participants, as described under Special Considerations for Global Securities.

Payments on Certificated Securities

We will make payments on a certificated debt security as follows. We will pay interest that is due on an interest payment date by check mailed (or additional securities issued) on the interest payment date to the holder at his or her address shown on the trustee s records as of the close of

business on the regular record date. We will make all payments of principal and premium, if any, by check at the office of the applicable trustee in New York, NY and/or at other offices that may be specified in the prospectus supplement or in a notice to holders against surrender of the debt security.

Alternatively, if the holder asks us to do so, we will pay any cash amount that becomes due on the debt security by wire transfer of immediately available funds to an account at a bank in the United States, on the due date.

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Payment When Offices Are Closed

If any payment is due on a debt security on a day that is not a business day, we will make the payment on the next day that is a business day. Payments made on the next business day in this situation will be treated under the indenture as if they were made on the original due date, except as otherwise indicated in the attached prospectus supplement. Such payment will not result in a default under any debt security or the indenture, and no interest will accrue on the payment amount from the original due date to the next day that is a business day.

Book-entry and other indirect holders should consult their banks or brokers for information on how they will receive payments on their debt securities.

Events of Default

You will have rights if an Event of Default occurs in respect of the debt securities of your series and is not cured, as described later in this subsection.

The term Event of Default in respect of the debt securities of your series means any of the following:

- We do not pay the principal of, or any premium on, a debt security of the series on its due date.
- We do not pay interest on a debt security of the series within 30 days of its due date.
- We do not deposit any sinking fund payment in respect of debt securities of the series within 2 business days of its due date.
- We remain in breach of a covenant in respect of debt securities of the series for 60 days after we receive a written notice of default stating we are in breach. The notice must be sent by either the trustee or holders of at least 25% of the principal amount of debt securities of the series.
- We file for bankruptcy or certain other events of bankruptcy, insolvency or reorganization occur.
- Any class of securities has an asset coverage of less than 100 per centum on the last business day of each twenty-four consecutive calendar months.
- Any other Event of Default in respect of debt securities of the series described in the prospectus supplement occurs.

An Event of Default for a particular series of debt securities does not necessarily constitute an Event of Default for any other series of debt securities issued under the same or any other indenture. The trustee may withhold notice to the holders of debt securities of any default, except in the payment of principal, premium or interest, if it in good faith considers the withholding of notice to be in the best interests of the holders.

Remedies if an Event of Default Occurs

If an Event of Default has occurred and has not been cured, the trustee or the holders of at least 25% in principal amount of the debt securities of the affected series may declare the entire principal amount of all the debt securities of that series to be due and immediately payable. This is called a declaration of acceleration of maturity. A declaration of acceleration of maturity may be canceled by the holders of a majority in principal amount of the debt securities of the affected series if (1) we have deposited with the trustee all amounts due and owing with respect to the securities, and (2) no other Events of Default are continuing.

Except in cases of default, where the trustee has some special duties, the trustee is not required to take any action under the indenture at the request of any holders unless the holders offer the trustee reasonable protection from expenses and liability (called an indemnity). If reasonable indemnity is provided, the holders of a majority in principal amount of the outstanding debt securities of the relevant series may direct the time, method and place of conducting any lawsuit or other formal legal action seeking any remedy available to the trustee. The trustee may refuse to follow those directions in certain circumstances. No delay or omission in exercising any right or remedy will be treated as a waiver of that right, remedy or Event of Default.

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Before you are allowed to bypass your trustee and bring your own lawsuit or other formal legal action or take other steps to enforce your rights or protect your interests relating to the debt securities, the following must occur:

You must give your trustee written notice that an Event of Default has occurred and remains uncured.

The holders of at least 25% in principal amount of all outstanding debt securities of the relevant series must make a written request that the trustee take action because of the default and must offer reasonable indemnity to the trustee against the cost and other liabilities of taking that action.

The trustee must not have taken action for 60 days after receipt of the above notice and offer of indemnity.

The holders of a majority in principal amount of the debt securities must not have given the trustee a direction inconsistent with the above notice during that 60-day period.

However, you are entitled at any time to bring a lawsuit for the payment of money due on your debt securities on or after the due date.

Holders of a majority in principal amount of the debt securities of the affected series may waive any past defaults other than

the payment of principal, any premium or interest or

in respect of a covenant that cannot be modified or amended without the consent of each holder.

Book-entry and other indirect holders should consult their banks or brokers for information on how to give notice or direction to or make a request of the trustee and how to declare or cancel an acceleration of maturity.

Each year, we will furnish to each trustee a written statement of certain of our officers certifying that to their knowledge we are in compliance with the indenture and the debt securities or else specifying any default.

Merger or Consolidation

Under the terms of the indenture, we are generally permitted to consolidate or merge with another entity. We are also permitted to sell all or substantially all of our assets to another entity. However, we may not take any of these actions unless all the following conditions are met:

Where we merge out of existence or sell our assets, the resulting entity must agree to be legally responsible for our obligations under the debt securities.

The merger or sale of assets must not cause a default on the debt securities and we must not already be in default (unless the merger or sale would cure the default). For purposes of this no-default test, a default would include an Event of Default that has occurred and has not been cured, as described under Events of Default above. A default for this purpose would also include any event that would be an Event of Default if the requirements for giving us a notice of default or our default having to exist for a specific period of time were disregarded.

We must deliver certain certificates and documents to the trustee.

We must satisfy any other requirements specified in the prospectus supplement relating to a particular series of debt securities.

Modification or Waiver

There are three types of changes we can make to the indenture and the debt securities issued thereunder.

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Changes Requiring Your Approval

First, there are changes that we cannot make to your debt securities without your specific approval. The following is a list of those types of changes:

- change the stated maturity of the principal of, or interest on, a debt security;
- reduce any amounts due on a debt security;
- reduce the amount of principal payable upon acceleration of the maturity of a security following a default;
- adversely affect any right of repayment at the holder s option;
- change the place (except as otherwise described in the prospectus or prospectus supplement) or currency of payment on a debt security;
- impair your right to sue for payment;
- adversely affect any right to convert or exchange a debt security in accordance with its terms;
- modify the subordination provisions in the indenture in a manner that is adverse to holders of the debt securities;
- reduce the percentage of holders of debt securities whose consent is needed to modify or amend the indenture;
- reduce the percentage of holders of debt securities whose consent is needed to waive compliance with certain provisions of the indenture or to waive certain defaults;
- modify any other aspect of the provisions of the indenture dealing with supplemental indentures, modification and waiver of past defaults, changes to the quorum or voting requirements or the waiver of certain covenants; and
- change any obligation we have to pay additional amounts.

Changes Not Requiring Approval

The second type of change does not require any vote by the holders of the debt securities. This type is limited to clarifications and certain other changes that would not adversely affect holders of the outstanding debt securities in any material respect. We also do not need any approval to make any change that affects only debt securities to be issued under the indenture after the change takes effect.

Changes Requiring Majority Approval

Any other change to the indenture and the debt securities would require the following approval:

- If the change affects only one series of debt securities, it must be approved by the holders of a majority in principal amount of that series.

- If the change affects more than one series of debt securities issued under the same indenture, it must be approved by the holders of a majority in principal amount of all of the series affected by the change, with all affected series voting together as one class for this purpose.

In each case, the required approval must be given by written consent.

The holders of a majority in principal amount of all of the series of debt securities issued under an indenture, voting together as one class for this purpose, may waive our compliance with some of our covenants in that indenture. However, we cannot obtain a waiver of a payment default or of any of the matters covered by the bullet points included above under Changes Requiring Your Approval.

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Further Details Concerning Voting

When taking a vote, we will use the following rules to decide how much principal to attribute to a debt security:

For original issue discount securities, we will use the principal amount that would be due and payable on the voting date if the maturity of these debt securities were accelerated to that date because of a default.

For debt securities whose principal amount is not known (for example, because it is based on an index), we will use the principal face amount at original issuance or a special rule for that debt security described in the prospectus supplement.

For debt securities denominated in one or more foreign currencies, we will use the U.S. dollar equivalent.

Debt securities will not be considered outstanding, and therefore not eligible to vote, if we have deposited or set aside in trust money for their payment or redemption or if we, any other obligor, or any affiliate of us or any obligor own such debt securities. Debt securities will also not be eligible to vote if they have been fully defeased as described later under Defeasance Full Defeasance.

We will generally be entitled to set any day as a record date for the purpose of determining the holders of outstanding indenture securities that are entitled to vote or take other action under the indenture. However, the record date may not be more than 30 days before the date of the first solicitation of holders to vote on or take such action. If we set a record date for a vote or other action to be taken by holders of one or more series, that vote or action may be taken only by persons who are holders of outstanding indenture securities of those series on the record date and must be taken within eleven months following the record date.

Book-entry and other indirect holders should consult their banks or brokers for information on how approval may be granted or denied if we seek to change the indenture or the debt securities or request a waiver.

Defeasance

The following provisions will be applicable to each series of debt securities unless we state in the applicable prospectus supplement that the provisions of covenant defeasance and full defeasance will not be applicable to that series.

Covenant Defeasance

Under current United States federal tax law and the indenture, we can make the deposit described below and be released from some of the restrictive covenants in the indenture under which the particular series was issued. This is called covenant defeasance . In that event, you would lose the protection of those restrictive covenants but would gain the protection of having money and government securities set aside in trust to repay your debt securities. If applicable, you also would be released from the subordination provisions described under Indenture Provisions

Subordination below. In order to achieve covenant defeasance, we must do the following:

If the debt securities of the particular series are denominated in U.S. dollars, we must deposit in trust for the benefit of all holders of such debt securities a combination of money and United States government or United States government agency notes or bonds that will generate enough cash to make interest, principal and any other payments on the debt securities on their various due dates and any mandatory sinking fund payments or analogous payments.

We must deliver to the trustee a legal opinion of our counsel confirming that, under current United States federal income tax law, we may make the above deposit without causing you to be taxed on the debt securities any differently than if we did not make the deposit and just repaid the debt securities ourselves at maturity.

We must deliver to the trustee a legal opinion of our counsel stating that the above deposit does not require registration by us under the 1940 Act, as amended, and a legal opinion and officers certificate stating that all conditions precedent to covenant defeasance have been complied with.

Defeasance must not result in a breach of the indenture or any of our other material agreements.

Satisfy the conditions for covenant defeasance contained in any supplemental indentures.

If we accomplish covenant defeasance, you can still look to us for repayment of the debt securities if there were a shortfall in the trust deposit or the trustee is prevented from making payment. In fact, if one of the remaining Events of Default occurred (such as our bankruptcy) and the debt securities became immediately due and payable, there might be a shortfall. Depending on the event causing the default, you may not be able to obtain payment of the shortfall.

Full Defeasance

If there is a change in United States federal tax law, as described below, we can legally release ourselves from all payment and other obligations on the debt securities of a particular series (called full defeasance) if we put in place the following other arrangements for you to be repaid:

If the debt securities of the particular series are denominated in U.S. dollars, we must deposit in trust for the benefit of all holders of such debt securities a combination of money and United States government or United States government agency notes or bonds that will generate enough cash to make interest, principal and any other payments on the debt securities on their various due dates and any mandatory sinking fund payments or analogous payments.

We must deliver to the trustee a legal opinion confirming that there has been a change in current United States federal tax law or an IRS ruling that allows us to make the above deposit without causing you to be taxed on the debt securities any differently than if we did not make the deposit and just repaid the debt securities ourselves at maturity. Under current United States federal tax law, the deposit and our legal release from the debt securities would be treated as though we paid you your share of the cash and notes or bonds at the time the cash and notes or bonds were deposited in trust in exchange for your debt securities and you would recognize gain or loss on the debt securities at the time of the deposit.

We must deliver to the trustee a legal opinion of our counsel stating that the above deposit does not require registration by us under the 1940 Act, as amended, and a legal opinion and officers certificate stating that all conditions precedent to defeasance have been complied with.

Defeasance must not result in a breach of the indenture or any of our other material agreements.

Satisfy the conditions for covenant defeasance contained in any supplemental indentures.

If we ever did accomplish full defeasance, as described above, you would have to rely solely on the trust deposit for repayment of the debt securities. You could not look to us for repayment in the unlikely event of any shortfall. Conversely, the trust deposit would most likely be protected from claims of our lenders and other creditors if we ever became bankrupt or insolvent. If applicable, you would also be released from the subordination provisions described later under Indenture Provisions Subordination .

Form, Exchange and Transfer of Certificated Registered Securities

If registered debt securities cease to be issued in book-entry form, they will be issued:

- only in fully registered certificated form,
- without interest coupons, and
- unless we indicate otherwise in the prospectus supplement, in denominations of $1,000 and amounts that are multiples of $1,000.

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Holders may exchange their certificated securities for debt securities of smaller denominations or combined into fewer debt securities of larger denominations, as long as the total principal amount is not changed and as long as the denomination is greater than the minimum denomination for such securities.

Holders may exchange or transfer their certificated securities at the office of their trustee. We have appointed the trustee to act as our agent for registering debt securities in the names of holders transferring debt securities. We may appoint another entity to perform these functions or perform them ourselves.

Holders will not be required to pay a service charge to transfer or exchange their certificated securities, but they may be required to pay any tax or other governmental charge associated with the transfer or exchange. The transfer or exchange will be made only if our transfer agent is satisfied with the holder s proof of legal ownership.

If we have designated additional transfer agents for your debt security, they will be named in your prospectus supplement. We may appoint additional transfer agents or cancel the appointment of any particular transfer agent. We may also approve a change in the office through which any transfer agent acts.

If any certificated securities of a particular series are redeemable and we redeem less than all the debt securities of that series, we may block the transfer or exchange of those debt securities during the period beginning 15 days before the day we mail the notice of redemption and ending on the day of that mailing, in order to freeze the list of holders to prepare the mailing. We may also refuse to register transfers or exchanges of any certificated securities selected for redemption, except that we will continue to permit transfers and exchanges of the unredeemed portion of any debt security that will be partially redeemed.

If a registered debt security is issued in book-entry form, only the depositary will be entitled to transfer and exchange the debt security as described in this subsection, since it will be the sole holder of the debt security.

Resignation of Trustee

Each trustee may resign or be removed with respect to one or more series of indenture securities provided that a successor trustee is appointed to act with respect to these series and has accepted such appointment. In the event that two or more persons are acting as trustee with respect to different series of indenture securities under the indenture, each of the trustees will be a trustee of a trust separate and apart from the trust administered by any other trustee.

Indenture Provisions Subordination

Upon any distribution of our assets upon our dissolution, winding up, liquidation or reorganization, the payment of the principal of (and premium, if any) and interest, if any, on any indenture securities denominated as subordinated debt securities is to be subordinated to the extent provided in the indenture in right of payment to the prior payment in full of all Designated Senior Indebtedness (as defined below), but our

obligation to you to make payment of the principal of (and premium, if any) and interest, if any, on such subordinated debt securities will not otherwise be affected. In addition, no payment on account of principal (or premium, if any), sinking fund or interest, if any, may be made on such subordinated debt securities at any time unless full payment of all amounts due in respect of the principal (and premium, if any), sinking fund and interest on Designated Senior Indebtedness has been made or duly provided for in money or money s worth.

In the event that, notwithstanding the foregoing, any payment by us is received by the trustee in respect of subordinated debt securities or by the holders of any of such subordinated debt securities before all Designated Senior Indebtedness is paid in full, the payment or distribution must be paid over to the holders of the Designated Senior Indebtedness or on their behalf for application to the payment of all the Designated Senior Indebtedness remaining unpaid until all the Designated Senior Indebtedness has been paid in full, after giving effect to any

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concurrent payment or distribution to the holders of the Designated Senior Indebtedness. Subject to the payment in full of all Designated Senior Indebtedness upon this distribution by us, the holders of such subordinated debt securities will be subrogated to the rights of the holders of the Designated Senior Indebtedness to the extent of payments made to the holders of the Designated Senior Indebtedness out of the distributive share of such subordinated debt securities.

By reason of this subordination, in the event of a distribution of our assets upon our insolvency, certain of our senior creditors may recover more, ratably, than holders of any subordinated debt securities or the holders of any indenture securities that are not Designated Senior Indebtedness or subordinated debt securities. The indenture provides that these subordination provisions will not apply to money and securities held in trust under the defeasance provisions of the indenture.

Designated Senior Indebtedness is defined in the indenture as the principal of (and premium, if any) and unpaid interest on:

- our indebtedness (including indebtedness of others guaranteed by us), whenever created, incurred, assumed or guaranteed, for money borrowed, that we have designated as Designated Senior Indebtedness for purposes of the indenture and in accordance with the terms of the indenture (including any indenture securities designated as Designated Senior Indebtedness), and

- renewals, extensions, modifications and refinancings of any of this indebtedness.

If this prospectus is being delivered in connection with the offering of a series of indenture securities denominated as subordinated debt securities, the accompanying prospectus supplement will set forth the approximate amount of our Designated Senior Indebtedness and of our other indebtedness outstanding as of a recent date.

Secured Indebtedness

Certain of our indebtedness, including certain series of indenture securities, may be secured. The prospectus supplement for each series of indenture securities will describe the terms of any security interest for such series and will indicate the approximate amount of our secured indebtedness as of a recent date. In the event of a distribution of our assets upon our insolvency, the holders of unsecured indenture securities may recover less, ratably, than holders of any of our secured indebtedness.

The Trustee under the Indenture

U.S. Bank National Association will serve as the trustee under the indenture.

Certain Considerations Relating to Foreign Currencies

Debt securities denominated or payable in foreign currencies may entail significant risks. These risks include the possibility of significant fluctuations in the foreign currency markets, the imposition or modification of foreign exchange controls and potential illiquidity in the secondary market. These risks will vary depending upon the currency or currencies involved and will be more fully described in the applicable prospectus supplement.

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DESCRIPTION OF OUR UNITS

As may be specified in a prospectus supplement, we may issue units comprised of one or more of the other securities described in this prospectus in any combination. Each unit will be issued so that the holder of the unit is also the holder of each security included in the unit. Thus, the holder of a unit will have the rights and obligations of a holder of each included security. The applicable prospectus supplement will describe:

- the designation and terms of the units and of the securities comprising the units, including whether and under what circumstances the securities comprising the units may be held or transferred separately;
- a description of the terms of any unit agreement governing the units;
- a description of the provisions for the payment, settlement, transfer or exchange of the units; and
- whether the units will be issued in fully registered or global form.

The descriptions of the units and any applicable underlying security or pledge or depositary arrangements in this prospectus and in any prospectus supplement are summaries of the material provisions of the applicable agreements and are subject to, and qualified in their entirety by reference to, the terms and provisions of the applicable agreements, forms of which have been or will be filed as exhibits to the registration statement of which this prospectus forms a part.

SHARES ELIGIBLE FOR FUTURE SALE

The shares of our common stock beneficially owned by each of Messrs. Gross and Spohler immediately prior to completion of our initial public offering, including any shares that are attributable to such shares issued pursuant to our dividend reinvestment plan, are no longer subject to lock-up restrictions that each of Messrs. Gross and Spohler agreed to in connection with our initial public offering, and are generally available for resale without restriction, subject to the provisions of Rule 144 promulgated under the Securities Act. In addition, on November 30, 2010, Messrs. Gross and Spohler jointly acquired 115,000 shares of our common stock in a private placement transaction conducted in accordance with Regulation D under the Securities Act. Such shares have been registered with the SEC and are generally available for resale.

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PLAN OF DISTRIBUTION

We may offer, from time to time, in one or more offerings or series, up to $1,000,000,000 of our common stock, preferred stock, debt securities, units or warrants representing rights to purchase shares of our common stock, preferred stock or debt securities, in one or more underwritten public offerings, at-the-market offerings, negotiated transactions, block trades, best efforts or a combination of these methods. We may sell the securities through underwriters or dealers, directly to one or more purchasers through agents or through a combination of any such methods of sale. Any underwriter or agent involved in the offer and sale of the securities will be named in the applicable prospectus supplement. A prospectus supplement or supplements will also describe the terms of the offering of the securities, including: the purchase price of the securities and the proceeds we will receive from the sale; any over-allotment options under which underwriters may purchase additional securities from us; any agency fees or underwriting discounts and other items constituting agents or underwriters compensation; the public offering price; any discounts or concessions allowed or re-allowed or paid to dealers; and any securities exchange or market on which the securities may be listed. Only underwriters named in the prospectus supplement will be underwriters of the securities offered by the prospectus supplement.

The distribution of the securities may be effected from time to time in one or more transactions at a fixed price or prices, which may be changed, at prevailing market prices at the time of sale, at prices related to such prevailing market prices, or at negotiated prices. The price at which securities may be distributed may represent a discount from prevailing market prices.

In connection with the sale of the securities, underwriters or agents may receive compensation from us or from purchasers of the securities, for whom they may act as agents, in the form of discounts, concessions or commissions. Underwriters may sell the securities to or through dealers and such dealers may receive compensation in the form of discounts, concessions or commissions from the underwriters and/or commissions from the purchasers for whom they may act as agents. Underwriters, dealers and agents that participate in the distribution of the securities may be deemed to be underwriters under the Securities Act, and any discounts and commissions they receive from us and any profit realized by them on the resale of the securities may be deemed to be underwriting discounts and commissions under the Securities Act. Any such underwriter or agent will be identified and any such compensation received from us will be described in the applicable prospectus supplement. The maximum aggregate commission or discount to be received by any member of FINRA or independent broker-dealer will not be greater than 10% of the gross proceeds of the sale of securities offered pursuant to this prospectus and any applicable prospectus supplement. We may also reimburse the underwriter or agent for certain fees and legal expenses incurred by it.

Any underwriter may engage in over-allotment, stabilizing transactions, short-covering transactions and penalty bids in accordance with Regulation M under the Exchange Act. Over-allotment involves sales in excess of the offering size, which create a short position. Stabilizing transactions permit bids to purchase the underlying security so long as the stabilizing bids do not exceed a specified maximum price. Syndicate-covering or other short-covering transactions involve purchases of the securities, either through exercise of the over-allotment option or in the open market after the distribution is completed, to cover short positions. Penalty bids permit the underwriters to reclaim a selling concession from a dealer when the securities originally sold by the dealer are purchased in a stabilizing or covering transaction to cover short positions. Those activities may cause the price of the securities to be higher than it would otherwise be. If commenced, the underwriters may discontinue any of the activities at any time.

Any underwriters that are qualified market makers on the NASDAQ Global Select Market may engage in passive market making transactions in our common stock on the NASDAQ Global Select Market in accordance with Regulation M under the Exchange Act, during the business day prior to the pricing of the offering, before the commencement of offers or sales of our common stock. Passive market makers must comply with applicable volume and price limitations and must be identified as passive market makers. In general, a passive market maker must display its bid at a price not in excess of the highest independent bid for such security; if all

independent bids are lowered below the passive market maker s bid, however, the passive market maker s bid must then be lowered when certain purchase limits are exceeded. Passive market making may stabilize the market price of the securities at a level above that which might otherwise prevail in the open market and, if commenced, may be discontinued at any time.

We may sell securities directly or through agents we designate from time to time. We will name any agent involved in the offering and sale of securities and we will describe any commissions we will pay the agent in the prospectus supplement. Unless the prospectus supplement states otherwise, our agent will act on a best-efforts basis for the period of its appointment.

Unless otherwise specified in the applicable prospectus supplement, each class or series of securities will be a new issue with no trading market, other than our common stock, which is traded on the NASDAQ Global Select Market. We may elect to list any other class or series of securities on any exchanges, but we are not obligated to do so. We cannot guarantee the liquidity of the trading markets for any securities.

Under agreements that we may enter, underwriters, dealers and agents who participate in the distribution of shares of our securities may be entitled to indemnification by us against certain liabilities, including liabilities under the Securities Act, or contribution with respect to payments that the agents or underwriters may make with respect to these liabilities. Underwriters, dealers and agents may engage in transactions with, or perform services for, us in the ordinary course of business.

If so indicated in the applicable prospectus supplement, we will authorize underwriters or other persons acting as our agents to solicit offers by certain institutions to purchase our securities from us pursuant to contracts providing for payment and delivery on a future date. Institutions with which such contracts may be made include commercial and savings banks, insurance companies, pension funds, investment companies, educational and charitable institutions and others, but in all cases such institutions must be approved by us. The obligations of any purchaser under any such contract will be subject to the condition that the purchase of our securities shall not at the time of delivery be prohibited under the laws of the jurisdiction to which such purchaser is subject. The underwriters and such other agents will not have any responsibility in respect of the validity or performance of such contracts. Such contracts will be subject only to those conditions set forth in the prospectus supplement, and the prospectus supplement will set forth the commission payable for solicitation of such contracts.

We may enter into derivative transactions with third parties, or sell securities not covered by this prospectus to third parties in privately negotiated transactions. If the applicable prospectus supplement indicates, in connection with those derivatives, the third parties may sell securities covered by this prospectus and the applicable prospectus supplement, including in short sale transactions. If so, the third party may use securities pledged by us or borrowed from us or others to settle those sales or to close out any related open borrowings of stock, and may use securities received from us in settlement of those derivatives to close out any related open borrowings of stock. The third parties in such sale transactions will be underwriters and, if not identified in this prospectus, will be identified in the applicable prospectus supplement.

In order to comply with the securities laws of certain states, if applicable, our securities offered hereby will be sold in such jurisdictions only through registered or licensed brokers or dealers.

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CUSTODIAN, TRANSFER AND DISTRIBUTION PAYING AGENT AND REGISTRAR

Our securities are held under a custody agreement by The Bank of New York Mellon Corporation. The address of the custodian is One Wall Street, New York, New York 10286. American Stock Transfer & Trust Company will act as our transfer agent, distribution paying agent and registrar. The principal business address of our transfer agent is 6201 15th Avenue, Brooklyn, NY 11219, telephone number: (800) 937-5449.

BROKERAGE ALLOCATION AND OTHER PRACTICES

Since we will generally acquire and dispose of our investments in privately negotiated transactions, we will infrequently use brokers in the normal course of our business. Subject to policies established by our board of directors, our investment adviser will be primarily responsible for the execution of the publicly traded securities portion of our portfolio transactions and the allocation of brokerage commissions. Our investment adviser does not expect to execute transactions through any particular broker or dealer, but will seek to obtain the best net results for Solar Capital, taking into account such factors as price (including the applicable brokerage commission or dealer spread), size of order, difficulty of execution, and operational facilities of the firm and the firm s risk and skill in positioning blocks of securities. While our investment adviser generally will seek reasonably competitive trade execution costs, Solar Capital will not necessarily pay the lowest spread or commission available. Subject to applicable legal requirements, our investment adviser may select a broker based partly upon brokerage or research services provided to the investment adviser and Solar Capital and any other clients. In return for such services, we may pay a higher commission than other brokers would charge if the investment adviser determines in good faith that such commission is reasonable in relation to the services provided.

LEGAL MATTERS

Certain legal matters in connection with the securities offered hereby will be passed upon for us by Sutherland Asbill & Brennan LLP, Washington, DC, and Venable LLP, Baltimore Maryland. Certain legal matters in connection with the offering will be passed upon for the underwriters, if any, by the counsel named in the applicable prospectus supplement.

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

KPMG LLP, our independent registered public accounting firm located at 345 Park Avenue, New York, New York 10154, has audited our financial statements as of December 31, 2011 and 2010 and for the years ended December 31, 2011, 2010 and 2009, as set forth in their reports. We have included our financial statements in this prospectus and elsewhere in the registration statement in reliance on such reports, given on their authority as experts in accounting and auditing.

With respect to the unaudited interim financial information for the periods ended March 31, 2012 and 2011, included herein, the independent registered public accounting firm has reported that they applied limited procedures in accordance with professional standards for a review of such information. However, their separate report included in our quarterly report on Form 10-Q for the quarter ended March 31, 2012, and included herein, states that they did not audit and they do not express an opinion on that interim financial information. Accordingly, the degree of reliance on their report on such information should be restricted in light of the limited nature of the review procedures applied. The accountants are not subject to the liability provisions of Section 11 of the Securities Act for their report on the unaudited interim financial information because that report is not a report or a part of the registration statement prepared or certified by the accountants within the meaning

of Sections 7 and 11 of the Securities Act.

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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 the securities offered by this prospectus. The registration statement contains additional information about us and the securities being offered by this prospectus.

We are required to 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. 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 1-800-SEC-0330. 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 website 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 to the SEC s Public Reference Section, Washington, D.C. 20549. This information will also be available free of charge by contacting us at Solar Capital Ltd., 500 Park Avenue, New York, NY 10022, by telephone at (212) 993-1670, or on our website at *http://www.solarcapltd.com*.

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders

Solar Capital Ltd.:

We have audited the accompanying consolidated statements of assets and liabilities, including the consolidated schedules of investments, of Solar Capital Ltd. (the Company) as of December 31, 2011 and 2010, and the related consolidated statements of operations, changes in net assets and cash flows for each of the years in the three-year period ended December 31, 2011. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosure in the financial statements. Our procedures included confirmation of securities owned as of December 31, 2011, by correspondence with the custodian or by other appropriate auditing procedures. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Solar Capital Ltd. as of December 31, 2011 and 2010, and the results of its operations, the changes in its net assets and cash flows for each of the years in the three-year period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Solar Capital Ltd. s internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 22, 2012 expressed an unqualified opinion on the effectiveness of the Company s internal control over financial reporting.

/s/ KPMG LLP

New York, New York

February 22, 2012

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Report of Independent Registered Public Accounting Firm

On Internal Control Over Financial Reporting

The Board of Directors and Shareholders

Solar Capital Ltd.:

We have audited Solar Capital Ltd. s (the Company) internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Management of the Company is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the Annual Report on Form 10-K, and Item 9A, Controls and Procedures Management s Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s 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 U.S. generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) 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 (3) 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.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Solar Capital Ltd. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statements of assets and liabilities of Solar Capital Ltd. as of December 31, 2011 and 2010, and the related consolidated statements of operations, changes in net assets and cash flows for each of the years in the three-year period ended December 31, 2011, and our report dated February 22, 2012 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

New York, New York

February 22, 2012

SOLAR CAPITAL LTD.

CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES

(in thousands, except per share amounts)

	December 31, 2011	December 31, 2010
Assets		
Investments at fair value:		
Companies more than 25% owned (cost: $47,910 and $20,511, respectively)	$ 53,454	$ 20,508
Companies 5% to 25% owned (cost: $41,819 and $34,806, respectively)	35,820	29,235
Companies less than 5% owned (cost: $1,062,844 and $1,008,244, respectively)	955,769	926,478
Total investments (cost: $1,152,573 and $1,063,561, respectively)	1,045,043	976,221
Cash and cash equivalents	11,787	288,732
Interest and dividends receivable	9,763	5,592
Deferred credit facility costs	3,635	5,904
Fee revenue receivable	4,379	3,935
Derivative assets (cost $2,938 and $0, respectively)	649	604
Receivable for investments sold	3,225	10,560
Deferred offering costs	469	
Prepaid expenses and other receivables	481	243
Total Assets	1,079,431	1,291,791
Liabilities		
Credit facilities payable	201,355	400,000
Term loan	35,000	35,000
Payable for investments purchased	22,443	14,625
Due to Solar Capital Partners LLC:		
Investment advisory and management fee payable	5,277	4,892
Performance-based incentive fee payable	5,203	4,347
Interest payable	1,063	597
Deferred fee revenue	318	1,242
Due to Solar Capital Management LLC	1,069	773
Derivative liabilities		1,539
Income taxes payable	720	329
Other accrued expenses and payables	1,042	1,453
Total Liabilities	273,490	464,797
Net Assets		
Common stock, par value $0.01 per share 36,608,038 and 36,383,158 shares issued and outstanding, respectively, 200,000,000 shares authorized	366	364
Paid-in capital in excess of par	928,180	926,991
Under (over) distributed net investment income	2,245	(1,545)
Accumulated net realized losses	(18,379)	(10,541)
Net unrealized depreciation	(106,471)	(88,275)
Total Net Assets	$ 805,941	$ 826,994
Number of shares outstanding	36,608,038	36,383,158
Net Asset Value Per Share	$ 22.02	$ 22.73

See notes to consolidated financial statements.

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SOLAR CAPITAL LTD.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except shares)

	Year ended December 31, 2011	Year ended December 31, 2010	Year ended December 31, 2009
INVESTMENT INCOME:			
Interest and dividends:			
Companies more than 25% owned	$ 6,963	$ 670	$
Companies 5% to 25% owned		7,673	9,190
Other interest and dividend income	131,937	116,298	100,480
Total investment income	138,900	124,641	109,670
EXPENSES:			
Investment advisory and management fees	20,596	18,296	16,738
Performance-based incentive fee	20,476	17,305	16,815
Interest and other credit facility expenses	9,212	14,276	2,636
Administrative service fee	1,638	1,294	2,020
Other general and administrative expenses	4,326	3,930	3,971
Total operating expenses	56,248	55,101	42,180
Net investment income before income tax expense	82,652	69,540	67,490
Income tax expense	748	328	228
Net investment income	81,904	69,212	67,262
REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS, DERIVATIVES AND FOREIGN CURRENCIES:			
Net realized gain (loss):			
Investments:			
Companies more than 25% owned			(30)
Companies 5% to 25% owned	784	16,397	
Companies less than 5% owned	3,092	(55,762)	(253,364)
Net realized gain (loss) on investments	3,876	(39,365)	(253,394)
Derivatives	(5,620)	(3,124)	(12,608)
Foreign currency exchange	(418)	3,521	1,104
Net realized loss before income taxes	(2,162)	(38,968)	(264,898)
Income tax expense	231		
Net realized loss	(2,393)	(38,968)	(264,898)
Net change in unrealized gain (loss):			
Investments:			
Companies more than 25% owned	5,547	997	(3,900)

Companies 5% to 25% owned	(428)	(13,892)	3,823
Companies less than 5% owned	(25,309)	126,403	287,748
Net unrealized gain (loss) on investments	(20,190)	113,508	287,671
Derivatives	(1,354)	(1,204)	(2,583)
Foreign currency exchange	3,348	(663)	(516)
Net change in unrealized gain (loss)	(18,196)	111,641	284,572
Net realized and unrealized gain (loss) on investments, derivatives and foreign currencies	(20,589)	72,673	19,674
Net increase in net assets resulting from operations	$ 61,315	$ 141,885	$ 86,936
Earnings per share	$ 1.68	$ 4.27	$ 2.65

See notes to consolidated financial statements.

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SOLAR CAPITAL LTD.

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS

(in thousands except shares)

	Year ended December 31, 2011	Year ended December 31, 2010	Year ended December 31, 2009
Increase (decrease) in net assets resulting from operations:			
Net investment income	$ 81,904	$ 69,212	$ 67,262
Net realized loss	(2,393)	(38,968)	(264,898)
Net change in unrealized gain (loss)	(18,196)	111,641	284,572
Net increase in net assets resulting from operations	61,315	141,885	86,936
Dividends to shareholders declared(1)	(87,532)	(72,657)	(241,706)
Capital transactions:			
Proceeds from shares sold		184,215	
Common stock offering costs		(10,198)	
Senior notes issued in Solar Capital Merger		(125,000)	
Reinvestment of dividends	5,164	10,846	
Net increase in net assets resulting from capital transactions	5,164	59,863	
Net increase (decrease) in net assets	(21,053)	129,091	(154,770)
Net assets at beginning of year	826,994	697,903	852,673
Net assets at end of year	$ 805,941	$ 826,994	$ 697,903

(1) For the year ended December 31, 2009, represents distributions to Solar Capital LLC unit holders declared.

See notes to consolidated financial statements

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SOLAR CAPITAL LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands except shares)

	Year ended December 31, 2011	Year ended December 31, 2010	Year ended December 31, 2009
Cash Flows from Operating Activities:			
Net increase in net assets from operations	$ 61,315	$ 141,885	$ 86,936
Adjustments to reconcile net increase in net assets from operations to net cash provided by operating activities:			
Net realized (gain) loss from investments	(3,876)	39,365	253,394
Net realized (gain) loss from foreign currency exchange	418	(3,521)	(1,104)
Net change in unrealized (gain) loss on investments	20,190	(113,508)	(287,671)
Net change in unrealized loss on derivatives	1,354	1,204	2,583
(Increase) decrease in operating assets:			
Purchase of investment securities	(433,637)	(381,521)	(214,109)
Proceeds from disposition of investment securities	348,083	342,582	153,461
Receivable for investments sold	7,335	(10,560)	
Interest and dividends receivable	(4,171)	1,955	3,194
Purchase of interest rate caps	(2,938)		
Fee revenue receivable	(444)	1,889	(829)
Deferred offering costs	(469)	1,478	(772)
Deferred credit facility costs	2,269	(4,990)	549
Foreign tax receivable			101
Withholding tax receivable			16,505
Prepaid expenses and other receivables	(238)	306	(308)
Increase (decrease) in operating liabilities:			
Payable for investments purchased	7,818	14,625	
Investment advisory and management fee payable	385	(3,771)	3,369
Performance-based incentive fee payable	856	(4,170)	3,012
Deferred fee revenue	(924)	(2,290)	(460)
Due to Solar Capital Management LLC	296	(139)	(173)
Income taxes payable	391	(206)	(1,200)
Interest payable	466	444	153
Other accrued expenses and payables	(411)	(478)	555
Net Cash Provided by Operating Activities	4,068	20,579	17,186
Cash Flows from Financing Activities:			
Proceeds from shares sold		184,215	
Common stock offering costs		(10,198)	
Cash dividends paid	(82,368)	(61,811)	
Distributions to Solar Capital LLC unit holders paid in cash		(75,136)	(166,570)
Proceeds from borrowings on term loan		35,000	
Repayments of borrowings on senior notes		(125,000)	
Proceeds from borrowings on credit facilities	1,316,760	845,000	383,034
Repayments of borrowings on credit facilities	(1,515,405)	(529,592)	(293,816)
Net Cash Provided by (Used in) Financing Activities	(281,013)	262,478	(77,352)
	(276,945)	283,057	(60,166)

NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS						
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		288,732		5,675		65,841
CASH AND CASH EQUIVALENTS AT END OF YEAR	$	11,787	$	288,732	$	5,675
Supplemental disclosure of cash flow information:						
Cash paid for interest	$	6,038	$	11,454	$	1,410
Cash paid for income taxes	$	588	$	534	$	1,428
Non-cash financing activity:						
Reinvestment of dividends	$	5,164	$	10,846	$	
Issuance of Senior Notes	$		$	125,000	$	
Distributions payable	$		$		$	75,136

See notes to consolidated financial statements.

SOLAR CAPITAL LTD.

CONSOLIDATED SCHEDULE OF INVESTMENTS

December 31, 2011

(in thousands, except shares)

Description(1)	Industry	Interest(2)	Maturity	Par Amount/ Shares	Cost	Fair Value
Bank Debt/Senior Secured Loans 39.46%						
Asurion Corporation(18)	Insurance	9.00%	5/24/2019	$ 40,000	$ 39,811	$ 39,517
Airvana Network Solutions Inc.	Telecommunications	10.00%	3/25/2015	8,324	8,186	8,324
AviatorCap SII, LLC I(10)	Aerospace & Defense	12.00%	12/31/2014	3,728	3,678	3,671
AviatorCap SII, LLC II(10)	Aerospace & Defense	11.00%	12/31/2014	5,697	5,618	5,611
AviatorCap SII, LLC III(10)	Aerospace & Defense	13.00%	12/31/2014	8,856	8,696	8,724
Direct Buy Inc.(20)	Home, Office Furnishing & Durable Consumer Prds	12.00%	2/1/2017	25,000	24,332	5,875
Fulton Holding Corp(18)	Retail Stores	13.74%	5/28/2016	35,000	34,155	35,000
Grakon, LLC	Machinery	12.00%	12/31/2015	9,524	7,610	9,286
Good Sam Enterprise, LLC	Insurance	11.50%	12/1/2016	7,000	6,523	6,860
Grocery Outlet Inc.	Grocery	10.50%	12/15/2017	33,600	32,599	32,592
Isotoner Corporation	Personal & Nondurable Consumer Products	10.75%	1/8/2018	39,000	37,895	37,830
Interactive Health Solutions, Inc.(18)(19)	Healthcare, Education & Childcare	11.50%	10/4/2016	20,131	19,691	19,930
MYI Acquiror Corporation(3)(4)(8)	Insurance	13.00%(7)	3/13/2017	31,500	30,899	31,500
Roundy s Supermarkets, Inc. 2nd Lien(18)	Grocery	10.00%	4/16/2016	22,000	21,685	22,069
Southern Auto Finance Company	Banking	13.50%	10/19/2017	25,000	24,453	24,437
Spencer Spirit Holdings, Inc.	Retail Stores	11.00%	5/1/2017	10,000	10,000	10,000
Transplace Texas, LP(18)	Cargo Transport	11.00%	4/12/2017	20,000	19,533	19,500
USAW 767(10)	Aerospace & Defense	14.50%	12/31/2012	4,904	4,850	4,831
ViaWest Inc(18)	Personal, Food & Misc. Services	13.50%(7)	5/20/2016	33,255	32,520	32,756
Vision Holding Corp.(18)	Healthcare, Education & Childcare	12.00%	11/23/2016	37,500	36,869	37,125
VPSI, Inc.(17)	Personal Transportation	12.00%	12/23/2015	16,958	16,598	16,958
Total Bank Debt/Senior Secured Loans				**$ 436,977**	**$ 426,201**	**$ 412,396**
Subordinated Debt/Corporate Notes 52.33%						
Adams Outdoor Advertising	Diversified/Conglomerate Service	18.00%	12/8/2015	$ 42,500	$ 41,878	$ 42,075
AMC Entertainment Holdings, Inc.	Leisure, Amusement, Entertainment	5.55%(7)	6/13/2012	27,141	27,086	26,462
CIBT Solutions	Leisure, Amusement, Entertainment	13.50%	6/15/2018	36,200	35,389	35,386
Crosman Corporation	Leisure, Amusement, Entertainment	13.00%(7)	10/15/2016	15,219	14,808	14,762
DSW Group, Inc.	Beverage, Food & Tobacco	15.00%(7)	4/24/2012	125,106	124,972	106,340
Earthbound Farm(18)	Farming & Agriculture	14.25%	6/21/2017	58,947	57,739	56,590
Grakon Holdings LLC Sr	Machinery	14.00%(7)	12/31/2015	1,588	1,588	1,469
Grakon Holdings LLC Jr	Machinery	12.00%(7)	12/31/2015	15,118	12,344	7,710
Granite Global Solutions Corp.(3)(16)	Insurance	13.50%	5/31/2016	29,983	30,234	29,121
Magnolia River, LLC	Hotels, Motels, Inns and Gaming	14.00%	4/28/2014	19,064	18,664	19,064
Midcap Financial Intermediate Holdings, LLC(18)	Banking	14.25%	7/9/2015	75,000	73,542	75,000
ProSieben Sat.1 Media AG(3)(6)	Broadcasting & Entertainment	8.83%(7)	3/6/2017	21,125	20,261	10,508

Richelieu Foods, Inc.(17)	Beverage, Food & Tobacco	13.75%	5/18/2016	22,500	21,972	21,150
Rug Doctor L.P.(18)	Personal, Food & Misc. Services	15.50% to 20.00%(7) (wtd. avg. 17.54%)	10/31/2014	51,225	48,034	47,383
Shoes For Crews, LLC(17)	Textiles & Leather	13.75%(7)	7/23/2016	15,650	15,318	15,650
Weetabix Group(3)(5)	Beverage, Food & Tobacco	9.22%(7)	9/14/2016	15,986	18,589	12,469
Weetabix Group(3)(5)	Beverage, Food & Tobacco	10.03%(7)	5/3/2017	34,294	41,739	25,720
Total Subordinated Debt/Corporate Notes				**$ 606,646**	**$ 604,157**	**$ 546,859**

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SOLAR CAPITAL LTD.

CONSOLIDATED SCHEDULE OF INVESTMENTS (continued)

December 31, 2011

(in thousands, except shares)

Description(1)	Industry	Interest(2)	Maturity	Par Amount/ Shares	Cost	Fair Value
Preferred Equity 1.40%						
SODO Corp.(10)(13)	Aerospace & Defense	8.43%(7)		1,912	$ 2,009	$ 1,949
SOCAY Corp.(10)(13)	Aerospace & Defense	8.59%(7)		12,357	13,059	12,668
Wyle Laboratories	Aerospace & Defense	8.00%	7/17/2015	387	39	47
Total Preferred Equity					**$ 15,107**	**$ 14,664**
Common Equity / Partnership Interests / Warrants 6.81%						
Ark Real Estate Partners LP(9)(11)(12)	Buildings & Real Estate			41,818,834	$ 41,819	$ 35,820
Grakon, LLC	Machinery			1,714,286	1,714	
Grakon, LLC Warrants	Machinery			3,518,001		
Great American Group Inc.(14)	Personal, Food & Misc. Services			572,800	2,681	69
Great American Group Inc.(15)	Personal, Food & Misc. Services			187,500	3	23
National Specialty Alloys, LLC(10)	Mining, Steel, Iron & Nonprecious Metals			1,000,000	10,000	16,000
Nuveen Investments, Inc.	Finance			3,486,444	30,875	7,844
NXP Semiconductors Netherlands B.V.(3)	Electronics			645,292	17,592	9,918
Seven West Media Limited	Broadcasting & Entertainment			437,687	2,424	1,450
Total Common Equity/Partnerships Interests / Warrants					**$ 107,108**	**$ 71,124**
Total Investments					**$ 1,152,573**	**$ 1,045,043**

(1) We generally acquire our investments in private transactions exempt from registration under the Securities Act of 1933, as amended (the Securities Act). Our investments are therefore generally subject to certain limitations on resale, and may be deemed to be restricted securities under the Securities Act.

(2) For each debt investment we have provided the current interest rate in effect as of December 31, 2011. Variable rate debt investments generally bear interest at a rate that may be determined by reference to LIBOR or EURIBOR, and which may reset daily, quarterly or semi-annually.

(3) The following entities are domiciled outside the United States and the investments are denominated in British Pounds, Euro, Canadian Dollars or Australian Dollars: Weetabix Group in the United Kingdom; ProSieben Sat.1 Media AG in Germany; Granite Global Solutions Corp. in Canada; and Seven West Media Group Pty Limited in Australia. NXP Semiconductors Netherlands B.V. is domiciled in the Netherlands and $14,750 of MYI Aquiror Corporation is domiciled in the United Kingdom, but these assets are denominated in US Dollars. All other investments are domiciled in the United States.

(4) Solar Capital Ltd. s foreign domiciled portion of MYI Aquiror Corporation is held through its wholly-owned subsidiary Solar Capital Luxembourg I S.a.r.l.

(5) Solar Capital Ltd. s investments in Weetabix Group are held through its wholly-owned subsidiary Solar Capital Luxembourg I S.a.r.l.

(6) Solar Capital Ltd. s investments in ProSieben Sat. 1 Media AG are held through its wholly-owned subsidiary Solar Capital Luxembourg I S.a.r.l.

(7) Coupon is payable in cash and/or in kind (PIK).

(8) Includes an unfunded commitment of $6,000.

(9) Solar Capital Ltd. has an unfunded commitment of $2,879.

(10) Denotes a Control Investment. Control Investments are defined in the 1940 Act as investments in those companies that the Company is deemed to Control. Generally, under the Investment Company Act of 1940, as amended (the 1940 Act), the Company is deemed to Control a company in which it has invested if it owns 25% or more of the voting securities of such company or has greater than 50% representation on its board.

(11) Denotes an Affiliate Investment. Affiliate Investments are investments in those companies that are Affiliated Companies of the Company, as defined in the 1940 Act, which are not Control Investments. The Company is deemed to be an Affiliate of a company in which it has invested if it owns 5%

or more but less than 25% of the voting securities of such company.

(12) Solar Capital Ltd. s investment in Ark Real Estate Partners LP is held through its taxable subsidiary SLRC ADI Corp.

(13) SODO Corp. and SOCAY Corp. own equity interests that represent a majority of the equity ownership in Aviator Cap SII, LLC and USAW 767. Solar Capital Ltd. s investments in SODO Corp. and SOCAY Corp. each include a one dollar investment in common shares.

(14) Founders Shares.

(15) Contingent Founders Shares.

(16) Includes an unfunded commitment of $15,600 Canadian Dollars or $15,313 U.S Dollars as of December 31, 2011.

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SOLAR CAPITAL LTD.

CONSOLIDATED SCHEDULE OF INVESTMENTS (continued)

December 31, 2011

(in thousands, except shares)

(17) Indicates an investment held by Solar Capital Ltd. through its wholly-owned subsidiary Solar Capital Funding II LLC. Such investments are pledged as collateral under the Senior Secured Loan Facility (see Note 6 to the consolidated financial statements) and are not generally available to the creditors of Solar Capital Ltd. Unless otherwise noted, as of December 31, 2011, all other investments were pledged as collateral for the Senior Secured Revolving Credit Facility and the Term Loan (see Note 6 to the consolidated financial statements).

(18) Indicates an investment partially held by Solar Capital Ltd. through its wholly-owned subsidiary Solar Capital Funding II LLC. (See note 17 above for further explanation.) Par amounts held through Solar Capital Funding II LLC include: Asurion $14,224; Fulton Holding Corp. $18,000; Interactive Health Solutions, Inc. $10,236; Roundy s Supermarkets Inc. $10,000; Transplace Texas, LP $18,800; ViaWest Inc. $15,239; Vision Holding Corp $13,883; Earthbound $23,500; Midcap Financial Intermediate Holdings, LLC $23,500; and Rug Doctor L.P. $9,515. Remaining par balances are held directly by Solar Capital Ltd.

(19) Includes an unfunded commitment of $1,250.

(20) Investment is on non-accrual status.

See notes to consolidated financial statements.

SOLAR CAPITAL LTD.

CONSOLIDATED SCHEDULE OF INVESTMENTS (continued)

December 31, 2011

Industry Classification	Percentage of Total Investments (at fair value) as of December 31, 2011
Beverage, Food & Tobacco	16%
Insurance	10%
Banking	10%
Personal, Food & Misc. Services	8%
Leisure, Amusement, Entertainment	7%
Healthcare, Education & Childcare	5%
Farming & Agriculture	5%
Grocery	5%
Retail Stores	4%
Diversified/Conglomerate Service	4%
Personal & Nondurable Consumer Products	4%
Aerospace & Defense	4%
Buildings & Real Estate	3%
Cargo Transport	2%
Hotels, Motels, Inns and Gaming	2%
Machinery	2%
Personal Transportation	2%
Mining, Steel, Iron & Nonprecious Metals	1%
Textiles & Leather	1%
Broadcasting & Entertainment	1%
Electronics	1%
Telecommunications	1%
Finance	1%
Home, Office Furnishing & Durable Consumer Prds	1%
	100.00%

See notes to consolidated financial statements.

SOLAR CAPITAL LTD.

CONSOLIDATED SCHEDULE OF INVESTMENTS

December 31, 2010

(in thousands, except shares)

Description(1)	Industry	Interest(2)	Maturity	Par Amount/ Shares	Cost	Fair Value
Bank Debt/Senior Secured Loans 25.3%						
Asurion Corporation(18)	Insurance	6.76%	7/3/2015	$ 49,310	$ 49,266	$ 46,609
Classic Cruises Holdings(5)	Leisure, Amusement, Entertainment	10.11%	1/31/2015	26,000	25,478	23,920
Emdeon Business Services LLC	Healthcare, Education & Childcare	5.26%	5/16/2014	15,000	15,087	14,850
Fulton Holding Corp(18)	Retail Stores	13.82%	5/28/2016	35,000	33,964	35,000
Ram Energy Resources, Inc.	Oil & Gas	12.75%	11/29/2012	9,270	9,247	8,899
Roundy s Supermarkets, Inc.(18)	Grocery	10.00%	4/16/2016	22,000	21,612	22,371
USAW 767(10)	Aerospace & Defense	14.50%	12/31/2012	6,753	6,621	6,618
ViaWest Inc(18)	Personal, Food & Misc. Services	13.50%(21)	5/20/2016	32,757	31,863	31,774
Vision Holding Corp.	Healthcare, Education & Childcare	12.00%	11/23/2016	40,000	39,238	39,225
VPSI, Inc.	Personal Transportation	12.00%	12/23/2015	18,333	17,877	17,875
Total Bank Debt/Senior Secured Loans				**$ 254,423**	**$ 250,253**	**$ 247,141**
Subordinated Debt/Corporate Notes 66.6%						
Ares Capital Corporation(17)	Finance	6.00%	4/1/2012	$ 15,393	$ 12,046	$ 15,947
Ares Capital Corporation(18)	Finance	6.63%	7/15/2011	14,500	12,552	14,784
Adams Outdoor Advertising	Diversified/Conglomerate Service	18.00%	12/8/2015	42,500	41,784	41,775
AMC Entertainment Holdings, Inc.	Leisure, Amusement, Entertainment	5.30%(21)	6/13/2012	25,729	25,564	23,414
Booz Allen	Aerospace & Defense	13.00%	7/31/2016	17,362	17,103	17,927
Direct Buy Inc.(18)	Home, Office Furnishing & Durable Consumer Prds	16.00%	5/30/2013	38,100	37,724	34,614
DS Waters	Beverage, Food & Tobacco	15.00%(21)	4/24/2012	107,759	107,158	100,216
Earthbound(18)	Farming & Agriculture	14.25%	6/21/2017	58,947	57,475	58,358
Fleetpride Corporation(18)	Cargo Transport	11.50%	10/1/2014	43,000	43,119	41,065
Grakon, LLC(12)	Machinery	14.00%(21)	6/19/2013	22,084	18,620	6,625
Iglo Birds Eye Group Limited(3)(4)	Beverage, Food & Tobacco	11.79%(21)	11/3/2016	5,100	5,131	5,144
Iglo Birds Eye Group Limited(3)(4)	Beverage, Food & Tobacco	11.33%(21)	11/3/2016	12,378	15,257	12,427
Magnolia River, LLC	Hotels, Motels, Inns and Gaming	14.00%	4/28/2014	19,064	18,492	18,111
Midcap Financial Intermediate Holdings, LLC(16) (18)	Banking	14.25%	7/9/2015	75,000	73,205	73,125
ProSieben Sat.1 Media AG(3)(8)	Broadcasting & Entertainment	8.14%(21)	3/6/2017	21,059	19,813	17,247
Richelieu Foods, Inc.(17)	Beverage, Food & Tobacco	13.75%	5/18/2016	22,500	21,901	21,881
Rug Doctor L.P.(18)	Personal, Food & Misc. Services	13.50% to 16.00%(21) (avg. 14.95%)	10/31/2014	49,715	47,828	47,229
Seven Media Group Pty Limited(3)	Broadcasting & Entertainment	11.18%	12/29/2013	20,712	16,328	20,297
Seven Media Group Pty Limited(3)	Broadcasting & Entertainment	12.00%(21)	12/29/2013	8,794	6,212	8,003
Shoes For Crews, LLC(17)	Textiles & Leather	13.75%	7/23/2016	15,650	15,249	15,650
Tri-Star Electronics International, Inc.	Aerospace & Defense	15.25%	8/2/2013	22,834	22,743	21,236
Weetabix Group(3)(7)	Beverage, Food & Tobacco	10.53%(21)	9/14/2016	14,586	17,092	11,304
Weetabix Group(3)(7)	Beverage, Food & Tobacco	10.03%(21)	5/7/2017	31,206	38,421	23,405
Total Subordinated Debt/Corporate Notes				**$ 703,972**	**$ 690,817**	**$ 649,784**

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SOLAR CAPITAL LTD.

CONSOLIDATED SCHEDULE OF INVESTMENTS (continued)

December 31, 2010

(in thousands, except shares)

Description(1)	**Industry**	**Interest(2)**	**Maturity**	**Par Amount/ Shares**	**Cost**	**Fair Value**
Preferred Equity 0.4%						
SODO Corp.(10)(20)	Aerospace & Defense	10.00% (21)		388	$ 390	$ 390
SOCAY Corp.(10)(20)	Aerospace & Defense	10.00% (21)		3,484	3,500	3,500
Wyle Laboratories	Aerospace & Defense	8.00%	7/17/2015	387	39	44
Total Preferred Equity					$ 3,929	$ 3,934
Common Equity / Partnership Interests / Warrants 7.7%						
Ark Real Estate Partners LP(9)(11)(19)	Buildings & Real Estate			34,806,121	$ 34,806	$ 29,235
Direct Buy Inc.	Home, Office Furnishing & Durable Consumer Prds			5,000,000	5,000	2,500
Global Garden Products(3)(6)	Farming & Agriculture			88,483		
Grakon, LLC	Machinery			1,714,286	1,714	
Great American Group Inc.(13)	Personal, Food & Misc. Services			572,800	2,681	281
Great American Group Inc.(14)	Personal, Food & Misc. Services			187,500	3	92
National Specialty Alloys, LLC(10)	Mining, Steel, Iron & Nonprecious Metals			1,000,000	10,000	10,000
Nuveen Investments, Inc.	Finance			3,000,000	30,000	7,500
NXP Semiconductors Netherlands B.V.(3)(15)	Electronics			1,139,081	31,057	21,897
Seven Media Group Pty Limited(3)	Broadcasting & Entertainment			4,285,714	3,301	3,857
Total Common Equity/Partnerships Interests / Warrants					$ 118,562	$ 75,362
Total Investments					$ 1,063,561	$ 976,221

(1) We generally acquire our investments in private transactions exempt from registration under the Securities Act. Our investments are therefore generally subject to certain limitations on resale, and may be deemed to be restricted securities under the Securities Act.

(2) A majority of the variable rate debt investments bear interest at a rate that may be determined by reference to LIBOR or EURIBOR, and which reset daily, quarterly or semi-annually. For each debt investment we have provided the current interest rate in effect as of December 31, 2010.

(3) The following entities are domiciled outside the United States and the investments are denominated in either Euro, British Pounds or Australian Dollars: Iglo Birds Eye Group Limited, Global Garden Products and Weetabix Group in the United Kingdom; ProSieben Sat.1 Media AG in Germany; and Seven Media Group Pty Limited in Australia. NXP Semiconductors Netherlands B.V. is domiciled in the Netherlands and is denominated in U.S. dollars. All other investments are domiciled in the United States.

(4) Solar Capital Ltd. s investments in Iglo Birds Eye Group Limited are held through its wholly-owned subsidiary Solar Capital Luxembourg I S.a.r.l.

(5) Solar Capital Ltd. s investments in Classic Cruises Holdings are held through its wholly-owned subsidiary Solar Capital Luxembourg I S.a.r.l.

(6) Solar Capital Ltd. s investments in Global Garden Products are held through its wholly-owned subsidiary Solar Capital Luxembourg I S.a.r.l.

(7) Solar Capital Ltd. s investments in Weetabix Group are held through its wholly-owned subsidiary Solar Capital Luxembourg I S.a.r.l.

(8) Solar Capital Ltd. s investments in ProSieben Sat. 1 Media AG are held through its wholly-owned subsidiary Solar Capital Luxembourg I S.a.r.l.

(9) Solar Capital Ltd. has an unfunded commitment of $9,946.

(10) Denotes a Control Investment. Control Investments are defined in the 1940 Act as investments in those companies that the Company is deemed to Control. Generally, under the 1940 Act, the Company is deemed to Control a company in which it has invested if it owns 25% or more of the voting securities of

such company or has greater than 50% representation on its board.

(11) Denotes an Affiliate Investment. Affiliate Investments are investments in those companies that are Affiliated Companies of the Company, as defined in the 1940 Act, which are not Control Investments. The Company is deemed to be an Affiliate of a company in which it has invested if it owns 5% or more but less than 25% of the voting securities of such company.

(12) Investment is on non-accrual status

(13) Founders Shares

(14) Contingent Founders Shares

(15) Administrative agent to NXP management equity plan

(16) Includes an unfunded par commitment of $15,000

SOLAR CAPITAL LTD.

CONSOLIDATED SCHEDULE OF INVESTMENTS (continued)

December 31, 2010

(in thousands, except shares)

(17) Indicates an investment held by Solar Capital Ltd. through its wholly-owned subsidiary Solar Capital Funding II LLC. Such investments are pledged as collateral under the Senior Secured Loan Facility (see Note 6 to the consolidated financial statements) and are not generally available to the creditors of Solar Capital Ltd. Unless otherwise noted, as of December 31, 2010, all other investments were pledged as collateral for the Senior Secured Revolving Credit Facility and the Term Loan (see Note 6 to the consolidated financial statements).

(18) Indicates an investment partially held by Solar Capital Ltd. through its wholly-owned subsidiary Solar Capital Funding II LLC. (See note 17 above for further explanation.) Par amounts held through Solar Capital Funding II LLC include: Asurion $14,224; Fulton Holding Corp. $18,000; Roundy s Supermarkets Inc. $10,000; ViaWest Inc. $15,054; Ares Capital Corporation $12,000; Direct Buy Inc. $15,000; Earthbound $23,500; Fleetpride Corporation $23,500; Midcap Financial Intermediate Holdings, LLC $23,500; and Rug Doctor L.P. $9,371. Remaining par balances are held directly by Solar Capital Ltd.

(19) Solar Capital Ltd. s investments in Ark Real Estate Partners LP are held though it wholly-owned subsidiary SLRC ADI Corp.

(20) Solar Capital Ltd. s investments in SODO Corp. and SOCAY Corp. each include a one dollar investment in common shares

(21) Coupon is payable in cash and/or in kind (PIK).

See notes to consolidated financial statements.

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SOLAR CAPITAL LTD.

CONSOLIDATED SCHEDULE OF INVESTMENTS (continued)

December 31, 2010

Industry Classification	Pecentage of Total Investments (at fair value) as of December 31, 2010
Beverage, Food & Tobacco	18%
Personal, Food & Misc. Services	8%
Banking	7%
Farming & Agriculture	6%
Healthcare, Education & Childcare	5%
Aerospace & Defense	5%
Broadcasting & Entertainment	5%
Leisure, Amusement, Entertainment	5%
Insurance	5%
Diversified/Conglomerate Service	4%
Cargo Transport	4%
Finance	4%
Home, Office Furnishing & Durable Consumer Prds	4%
Retail Stores	4%
Buildings & Real Estate	3%
Grocery	2%
Electronics	2%
Hotels, Motels, Inns and Gaming	2%
Personal Transportation	2%
Textiles & Leather	2%
Mining, Steel, Iron & Nonprecious Metals	1%
Oil & Gas	1%
Machinery	1%
	100%

See notes to consolidated financial statements.

SOLAR CAPITAL LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011

(in thousands, except shares)

Note 1. Organization

Solar Capital Ltd. (Solar Capital , the Company or we), a Maryland corporation formed in November 2007, is a closed-end, externally managed, non-diversified management investment company that has elected to be treated as a business development company (BDC) under the Investment Company Act of 1940, as amended (the 1940 Act). In addition, for tax purposes the Company has elected to be treated as a regulated investment company (RIC) under Subchapter M of the Internal Revenue Code of 1986, as amended (the Code).

On February 9, 2010, Solar Capital Ltd. priced its initial public offering, selling 5.68 million shares, including the underwriters over-allotment, at a price of $18.50 per share. Concurrent with this offering, management purchased an additional 600,000 shares through a private placement, also at $18.50 per share.

Immediately prior to the initial public offering, through a series of transactions Solar Capital Ltd. merged with Solar Capital LLC, leaving Solar Capital Ltd. as the surviving entity (the Merger). Solar Capital Ltd. issued an aggregate of approximately 26.65 million shares of common stock and $125 million in Senior Unsecured Notes to the existing Solar Capital LLC unit holders in connection with the Merger. Solar Capital Ltd. had no assets or operations prior to completion of the Merger and as a result, the historical books and records of Solar Capital LLC have become the books and records of the surviving entity.

Solar Capital LLC, a Maryland limited liability company, was formed in February 2007 and commenced operations on March 13, 2007 with initial capital of $1.2 billion of which 47.04% was funded by affiliated parties.

The Company s investment objective is to generate both current income and capital appreciation through debt and equity investments. The Company invests primarily in middle-market companies in the form of mezzanine and senior secured loans, each of which may include an equity component, and, to a lesser extent, by making direct equity investments in such companies.

Note 2. Significant Accounting Policies

Basis of Presentation The accompanying consolidated financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America (GAAP), and include the accounts of the Company and its wholly-owned subsidiaries, Solar Capital Luxembourg I S.a.r.l., which was incorporated under the laws of the Grand Duchy of Luxembourg on April 26, 2007, and Solar Capital Funding II LLC (SC Funding), a Delaware limited liability company formed on December 8, 2010. The consolidated financial statements reflect all adjustments and reclassifications which, in the opinion of management, are necessary for the fair presentation of the results of the operations and financial condition for the years presented. All significant intercompany balances and transactions have been eliminated.

As required by ASC 260-10, *Earnings Per Share*, the number of shares used to calculate weighted average shares for use in computations on a per share basis have been decreased retroactively by a factor of approximately 0.4022 for all periods prior to February 9, 2010. This factor represents the effective impact of the reduction in shares resulting from the Merger.

Investments The Company applies fair value accounting in accordance with GAAP. Securities transactions are accounted for on trade date. Securities for which market quotations are readily available on an exchange are valued at such price as of the closing price on the valuation date. The Company may also obtain quotes with respect to certain of its investments from pricing services or brokers or dealers in order to value

SOLAR CAPITAL LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2011

(in thousands, except shares)

assets. When doing so, the Company determines whether the quote obtained is sufficient according to GAAP to determine the fair value of the security. If determined adequate, the Company uses the quote obtained.

Securities for which reliable market quotations are not readily available or for which the pricing source does not provide a valuation or methodology or provides a valuation or methodology that, in the judgment of the Company s investment adviser or Board of Directors (the Board), does not represent fair value, shall each be valued as follows:

1) The quarterly valuation process begins with each portfolio company or investment being initially valued by the investment professionals responsible for the portfolio investment;

2) Preliminary valuation conclusions are then documented and discussed with senior management;

3) Third-party valuation firms are engaged by, or on behalf of, the Board to conduct independent appraisals and review management s preliminary valuations and make their own independent assessment, for all material assets; and

4) The Board discusses valuations and determines the fair value of each investment in the portfolio in good faith based on the input of our investment adviser (note 4) and, where appropriate, the respective independent valuation firms.

Valuation methods, among other measures and as applicable, may include comparisons of financial ratios of the portfolio companies that issued such private equity securities to peer companies that are public, the nature and realizable value of any collateral, the portfolio company s ability to make payments and its earnings and discounted cash flows, the markets in which the portfolio company does business, and other relevant factors.

When an external event such as a purchase transaction, public offering or subsequent equity sale occurs, the Company will consider the pricing indicated by the external event to corroborate the private equity valuation. 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 the investments may differ significantly from the values that would have been used had a readily available market value existed for such investments, and the differences could be material.

Investments of sufficient credit quality purchased within 60 days of maturity are valued at cost plus accreted discount, or minus amortized premium, which approximates fair value.

Cash and Cash Equivalents Cash and cash equivalents include investments in money market accounts or investments with original maturities of three months or less.

Revenue Recognition The Company s revenue recognition policies are as follows:

Sales: Gains or losses on the sale of investments are calculated by using the specific identification method.

Interest Income: 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 part of interest income. The Company has loans in its portfolio that contain a payment-in-kind (PIK) provision. PIK interest is accrued at the contractual rates and added to the loan principal on the reset dates.

Dividend Income: Dividend income on preferred equity securities is recorded as dividend income on an accrual basis to the extent that such amounts are payable by the portfolio company and are expected to be collected. Dividend income on common equity securities is recorded on the record date for private portfolio companies or on the ex-dividend date for publicly traded portfolio companies.

SOLAR CAPITAL LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2011

(in thousands, except shares)

Non-accrual: Loans are placed on non-accrual status when principal or interest payments are past due 30 days or more or when there is reasonable doubt that principal or interest will be collected. Accrued interest is generally reversed when a loan is placed on non-accrual status. Interest payments received on non-accrual loans may be recognized as income or applied to principal depending upon management s judgment. Non-accrual loans are restored to accrual status when past due principal and interest is paid and, in management s judgment, are likely to remain current.

Fee Revenue Receivable Fee revenue receivable consists of premium payments owed to the Company at the maturity of certain loans. The premium payments are recorded as a receivable at the inception of the loan and are accreted into interest income over the respective terms of the applicable loans.

Deferred Fee Revenue Deferred fee revenue represents the unearned portion of premium payments owed to the Company at the maturity of certain loans.

U.S. Federal Income Taxes The Company has elected to be treated as a RIC under subchapter M of the Code and operates in a manner so as to qualify for the tax treatment applicable to RICs. In order to qualify as a RIC, among other things, the Company is required to timely distribute to its stockholders at least 90% of investment company taxable income, as defined by the Code, for each year. Depending on the level of taxable income earned in a given tax year, we may choose to carry forward taxable income in excess of current year dividend distributions into the next tax year and pay a 4% excise tax on such income, as required. 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, the Company accrues excise tax, if any, on estimated excess taxable income as taxable income is earned. For the years ended December 31, 2011 and 2010, $697 and $120 was recorded for U.S. Federal excise tax, respectively.

Although we file federal and state tax returns, our major tax jurisdiction is federal. Our inception-to-date federal tax years remain subject to examination by the Internal Revenue Service. The Company is also subject to taxes in Luxembourg, through Solar Capital Luxembourg I S.a.r.l., a wholly-owned subsidiary. Under the laws of Luxembourg, the Company pays a corporate income tax and a municipal business tax on its subsidiary s taxable income.

We have formed and used certain taxable subsidiaries to be taxed as a corporation for federal income tax purposes. These taxable subsidiaries allow us to hold portfolio companies organized as pass-through entities and still satisfy certain RIC income requirements. We do not consolidate the taxable subsidiaries for income tax purposes but we do recognize the results of these subsidiaries for financial reporting purposes.

The Company evaluates tax positions taken or expected to be taken in the course of preparing its financial statements 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 reversed and recorded as a tax benefit or expense in the current year. All penalties and interest associated with income taxes are included in income tax expense. Conclusions regarding tax positions are subject to review and may be adjusted at a later date based on factors including, but not limited to, on-going analyses of tax laws, regulations and interpretations thereof. We did not have any uncertain tax positions that met the recognition or measurement criteria of ASC 740-10-25 nor did we have any unrecognized tax benefits as of the periods presented herein.

Capital Accounts Certain capital accounts including under (over) distributed net investment income, accumulated net realized gain or loss, net unrealized depreciation, and paid-in capital in excess of par, are adjusted, at least annually, for permanent differences between book and tax. In addition, the character of income and gains to be distributed is determined in accordance with income tax regulations that may differ from GAAP.

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SOLAR CAPITAL LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2011

(in thousands, except shares)

Dividends Dividends and distributions to common stockholders are recorded on the ex-dividend date. Quarterly dividend payments are determined by the Board and are generally based upon taxable earnings estimated by management. Net realized capital gains, if any, are distributed at least annually, although we may decide to retain such capital gains for investment. We have adopted a dividend reinvestment plan that provides for reinvestment of any distributions we declare in cash on behalf of our stockholders, unless a stockholder elects to receive cash. As a result, if our Board authorizes, and we declare, a cash dividend, then our stockholders who have not opted out of our dividend reinvestment plan will have their cash dividends automatically reinvested in additional shares of our common stock, rather than receiving the cash dividend. While we generally use newly issued shares to implement the plan (especially if our shares are trading at a premium to net asset value), we may purchase shares in the open market in connection with our obligations under the plan. In particular, if our shares are trading at a significant enough discount to net asset value and we are otherwise permitted under applicable law to purchase such shares, we intend to purchase shares in the open market in connection with our obligations under our dividend reinvestment plan.

Foreign Currency Translation The accounting records of the Company are maintained in U.S. dollars. Foreign currency amounts are translated into U.S. dollars on the following basis:

(i) Market value of investment securities, other assets and liabilities at the current rates of exchange.

(ii) Purchase and sales of investment securities, income and expenses at the rates of exchange prevailing on the respective date of such transactions.

The Company does not isolate that portion of realized and unrealized gains or losses on investments that result from changes in market prices of investments from those that result from fluctuations in foreign exchange rates. Net realized foreign currency gains or losses arise from sales or repayments of foreign denominated investments (recorded in realized gain/loss on investments), maturities or terminations of foreign currency derivatives (recorded in realized gain/loss on derivatives), repayments of foreign denominated liabilities and other transactional gain or loss resulting from fluctuations in foreign exchange rates on amounts received or paid (recorded in realized gain/loss on foreign exchange). Net unrealized foreign exchange gains and losses arise from valuation changes in foreign denominated assets and liabilities, resulting from changes in exchange rates, including unrealized foreign exchange gains and losses on investments (recorded in unrealized gain/loss on investments), foreign currency derivatives (recorded in unrealized gain/loss on derivatives), and all other assets and liabilities (recorded in unrealized gain/loss on foreign exchange).

The Company s investments in foreign securities may involve certain risks such as foreign exchange restrictions, expropriation, taxation or other political, social or economic risks, all of which could affect the market and/or credit risk of the investment. In addition, changes in the relationship of foreign currencies to the U.S. dollar can significantly affect the value of these investments and therefore the earnings of the Company.

Derivative Instruments and Hedging Activity The Company recognizes derivatives as either assets or liabilities at fair value on its Consolidated Statements of Assets and Liabilities with valuation changes recorded as realized or unrealized gains and losses. The Company currently does not have any formally documented hedges that qualify for hedge accounting treatment.

The Company uses foreign exchange forward contracts and/or borrowings on its multicurrency revolving credit facility to economically hedge its foreign currency risks. Changes in the values of the Company s foreign denominated assets are recorded in current earnings as realized and unrealized gains and losses (see above); likewise, realized and unrealized gains and losses from derivatives and foreign denominated debt are also recorded in current earnings. The fair value of foreign exchange forward contracts is determined by recognizing

SOLAR CAPITAL LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2011

(in thousands, except shares)

the difference between the contract exchange rate and the current market exchange rate. Fluctuations in market values of assets and liabilities denominated in the same foreign currency offset in earnings providing a natural foreign currency hedge.

The Company uses interest rate caps to create a synthetic ceiling on its borrowing rates. An interest rate cap is a derivative in which the buyer receives payments at the end of each period in which the interest rate exceeds an agreed strike price. Interest payments on the Company s credit facilities are primarily LIBOR based. By purchasing caps on LIBOR, if LIBOR exceeds the strike price, the Company will pay a higher interest rate on its credit facilities but receive an offsetting payment from the cap counterparty on the notional amount above the strike price. Caps have an initial cost. The fair value of interest rate caps is determined using option pricing models that use readily available market inputs.

Deferred Offering Costs Offering costs consist of fees paid in relation to legal, accounting, regulatory and printing work completed in connection with offerings of our common stock or debt.

Receivable for Investments Sold Receivable for investments sold represents a receivable for investments that have sold but the proceeds have not been received.

Payable for Investments Purchased Payable for investments purchased represents a liability for investments that have been purchased but the proceeds have not been paid and any unfunded loan commitments.

Deferred Credit Facility Costs Deferred credit facility costs are being amortized over the life of the related credit facility.

Use of Estimates in the Preparation of Financial Statements The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amount 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 materially.

Subsequent Events Evaluation The Company has evaluated the need for disclosures and/or adjustments resulting from subsequent events through the date the financial statements were issued and determined that none are required, except for the following.

Subsequent to December 31, 2011, DSW Group, Inc., the Company s largest investment, announced it is seeking to refinance its capital structure. Until the terms of the recapitalization have been finalized, the Company cannot fully assess the impact on its portfolio; however, at this time the Company does not believe the impact will be material.

Note 3. Investments

Investments consisted of the following as of December 31, 2011 and 2010:

	December 31, 2011		December 31, 2010	
	Cost	Fair Value	Cost	Fair Value
Bank Debt/Senior Secured Loans	$ 426,201	$ 412,396	$ 250,253	$ 247,141
Subordinated Debt/Corporate Notes	604,157	546,859	690,817	649,784
Preferred Equity	15,107	14,664	3,929	3,934
Common Equity/Partnership Interests/Warrants	107,108	71,124	118,562	75,362

Total	$ 1,152,573	$ 1,045,043	$ 1,063,561	$ 976,221

SOLAR CAPITAL LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2011

(in thousands, except shares)

There was one asset on non-accrual status as of December 31, 2011 with a total fair value of $5,875. As of December 31, 2010, the Company had one investment on non-accrual status with a total fair value of $6,625.

Note 4. Agreements

Solar Capital has an Investment Advisory and Management Agreement with Solar Capital Partners LLC (the Investment Adviser), under which the Investment Adviser will manage the day-to-day operations of, and provide investment advisory services to, Solar Capital. For providing these services, the Investment Adviser receives a fee from Solar Capital, consisting of two components a base management fee and an incentive fee. The base management fee is determined by taking the average value of Solar Capital s gross assets at the end of the two most recently completed calendar quarters calculated at an annual rate of 2.00%. The incentive fee has two parts, as follows: one part is calculated and payable quarterly in arrears based on Solar Capital s pre-incentive fee net investment income for the immediately preceding calendar quarter. For this purpose, pre-incentive fee net investment income means interest income, dividend income and any other income (including any other fees (other than fees for providing managerial assistance), such as commitment, origination, structuring, diligence and consulting fees or other fees that we receive from portfolio companies) accrued during the calendar quarter, minus Solar Capital s operating expenses for the quarter (including the base management fee, any expenses payable under the Administration Agreement, and any interest expense and dividends paid on any issued and outstanding preferred stock, but excluding the incentive fee). Pre-incentive fee net investment income does not include any realized capital gains computed net of all realized capital losses and unrealized capital depreciation. Pre-incentive fee net investment income, expressed as a rate of return on the value of Solar Capital s net assets at the end of the immediately preceding calendar quarter, is compared to the hurdle rate of 1.75% per quarter (7% annualized). Our net investment income used to calculate this part of the incentive fee is also included in the amount of our gross assets used to calculate the 2% base management fee. Solar Capital pays the Investment Adviser an incentive fee with respect to Solar Capital s pre-incentive fee net investment income in each calendar quarter as follows: (1) no incentive fee in any calendar quarter in which Solar Capital s pre-incentive fee net investment income does not exceed the hurdle rate; (2) 100% of Solar Capital s pre-incentive fee net investment income with respect to that portion of such pre-incentive fee net investment income, if any, that exceeds the hurdle rate but is less than 2.1875% in any calendar quarter; and (3) 20% of the amount of Solar Capital s pre-incentive fee net investment income, if any, that exceeds 2.1875% in any calendar quarter. These calculations are appropriately pro-rated for any period of less than three months and adjusted for any share issuances or repurchases during the relevant quarter. The second part of the incentive fee is determined and payable in arrears as of the end of each calendar year (or upon termination of the Investment Advisory and Management Agreement, as of the termination date), commencing on February 12, 2007, and will equal 20% of Solar Capital s cumulative realized capital gains less cumulative realized capital losses, unrealized capital depreciation (unrealized depreciation on a gross investment-by-investment basis at the end of each calendar year) and all capital gains upon which prior performance-based capital gains incentive fee payments were previously made to the adviser. For financial statement purposes, the second part of the incentive fee is accrued based upon 20% of cumulative net realized and unrealized capital appreciation. No accrual was required for the years ended December 31, 2011, 2010 or 2009.

Solar Capital has also entered into an Administration Agreement with Solar Capital Management, LLC (the Administrator) under which the Administrator provides administrative services for Solar Capital. For providing these services, facilities and personnel, Solar Capital reimburses the Administrator for Solar Capital s allocable portion of overhead and other expenses incurred by the Administrator in performing its obligations under the Administration Agreement, including rent. The Administrator will also provide, on Solar Capital s behalf, managerial assistance to those portfolio companies to which Solar Capital is required to provide such assistance.

SOLAR CAPITAL LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2011

(in thousands, except shares)

Note 5. Derivatives

The Company is exposed to interest rate risk both as a lender and a borrower. The Company s borrowing facilities and term loan bear interest at a floating rate, which means that rising interest rates would increase our cost of borrowing. To partially mitigate this risk, in 2011, the Company purchased two interest rate cap contracts, which effectively limit the interest rate payable on $150 million of LIBOR based borrowings. The Company had no interest rate derivatives prior to 2011.

The following table highlights the outstanding interest rate caps:

	December 31, 2011						
Index Rate	Cap Rate	Notional Amount	Expiration	Cost	Fair Value	Unrealized Depreciation	Counterparty
3 Month Libor	1.0%	$ 100,000	1/13/2014	$ 1,950	$ 279	$ (1,671)	Wells Fargo
3 Month Libor	1.0%	50,000	5/4/2014	988	190	(798)	Wells Fargo
		$ 150,000		$ 2,938	$ 469	$ (2,469)	

The Company is also exposed to foreign exchange risk through its investments denominated in foreign currencies. The Company mitigates this risk through the use of foreign currency forward contracts. As an investment company, all changes in the fair value of assets, including changes caused by foreign currency fluctuation, flow through current earnings. The forward contracts serve as an economic hedge with their realized and unrealized gains and losses also recorded in current earnings. The Company has no derivatives designated as hedging instruments. During the year ended December 31, 2011, we entered into 80 foreign currency forward contracts with durations of 1 month with average U.S. dollar notional amounts of $30,697. During the year ended December 31, 2010, we entered into 77 foreign currency forward contracts with durations of 1 month with average U.S. dollar notional amounts of $28,181.

As of December 31, 2011, there were two open forward foreign currency contracts denominated in Euro and British Pounds, both of which terminate on January 10, 2012. As of December 31, 2010, there were three open forward foreign currency contracts denominated in Euro, Australian Dollar and British Pounds, all of which terminated on January 7, 2011. At December 31, 2011 and 2010, there was no fixed collateral held by counterparties for the open contracts and no credit-related contingent features associated with any of the open forward contracts. The contract details are as follows:

	December 31, 2011				December 31, 2010			
SOLD	Foreign Currency	USD Value	Unrealized appreciation (depreciation)	Counterparty	Foreign Currency	USD Value	Unrealized appreciation (depreciation)	Counterparty
EUR	966	$ 1,295	$ 44	SunTrust Bank	18,307	$ 24,464	$ (191)	SunTrust Bank
GBP	12,989	20,308	136	SunTrust Bank	37,942	59,155	604	SunTrust Bank
AUD					30,639	31,337	(1,348)	SunTrust Bank
Total Sold		$ 21,602	$ 180			$ 114,956	$ (935)	

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SOLAR CAPITAL LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2011

(in thousands, except shares)

The following tables show the fair value and effect of the derivative instruments on the Consolidated Statements of Assets and Liabilities and the Consolidated Statements of Operations:

Fair Value of Derivative Instruments

	Derivative Assets					
	December 31, 2011			December 31, 2010		
	Balance Sheet Location	Fair Value		Balance Sheet Location	Fair Value	
Derivatives not designated as hedging instruments(a)						
Foreign exchange contracts	Derivative assets	$	180	Derivative assets	$	604
Interest rate caps	Derivative assets		469	Derivative assets		
Total derivatives not designated as hedging instruments(a)		$	649		$	604
Total derivative assets		$	649		$	604

	Derivative Liabilities					
	December 31, 2011			December 31, 2010		
	Balance Sheet Location	Fair Value		Balance Sheet Location	Fair Value	
Derivatives not designated as hedging instruments(a)						
Foreign exchange contracts	Derivative liabilities	$		Derivative liabilities	$	1,539
Total derivatives not designated as hedging instruments(a)		$			$	1,539
Total derivative liabilities		$			$	1,539

(a) See Note 2 for additional information on the Company s purpose for entering into derivatives not designated as hedging instruments and its overall risk management strategy.

Effect of Derivative Instruments on the Consolidated Statements of Operations

Derivatives not designated as hedging instruments(a)	Location of Gain or (Loss) Recognized in Income on Derivatives	Amount of Gain or (Loss) Recognized in Income on Derivatives		
		Year ended December 31, 2011	Year ended December 31, 2010	Year ended December 31, 2009
Foreign exchange contracts	Realized gain (loss):			

	Derivatives	$ (5,620)	$ (3,124)	$ (12,608)
Foreign exchange contracts	Unrealized gain (loss):			
	Derivatives	1,115	(1,204)	(2,583)
Interest rate caps	Unrealized gain (loss):			
	Derivatives	(2,469)		
Total		$ (6,974)	$ (4,328)	$ (15,191)

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SOLAR CAPITAL LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2011

(in thousands, except shares)

Note 6. Borrowing Facilities, Senior Unsecured Notes, and Term Loan

Senior Secured Revolving Credit Facility On January 11, 2008, Solar Capital LLC entered into a $200 million Senior Secured Revolving Credit Facility (the $405 Million Facility) with Citigroup Global Markets, Inc. (CGMI), various lenders, and Citibank, N.A., as administrative agent for the lenders. CGMI acted as the sole lead bookrunner and the sole lead arranger for the $405 Million Facility.

On February 12, 2010, Solar Capital Ltd. amended and restated the $405 Million Facility, extending the maturity to February 2013 and increasing the total commitments under the facility to $270 million. Per the amended agreement, borrowings bear interest at a rate per annum equal to the base rate plus 3.25% or the alternate base rate plus 2.25%. The commitment fee on unused balances is 0.375%. Total commitments under the $405 Million Facility have been increased to $405 million as a result of the addition of three new lenders on May 12, 2010, June 23, 2010 and December 19, 2011. The facility size may be increased up to $600 million with additional new lenders or the increase in commitments of current lenders. The Credit Facility contains certain customary affirmative and negative covenants and events of default, including the occurrence of a change of control. In addition, the Credit Facility contains certain financial covenants that among other things, requires the Company to maintain a minimum shareholder s equity and a minimum asset coverage ratio.

Term Loan On September 2, 2010, Solar Capital Ltd. entered into a fully funded $35 million senior secured term loan (the Term Loan), which matures in September 2013, bears interest at a rate per annum equal to the base rate plus 3.25%, and has terms substantially similar to our existing revolving credit facility. The Term Loan contains certain customary affirmative and negative covenants and events of default, including the occurrence of a change of control. In addition, the Term Loan contains certain financial covenants that among other things, requires the Company to maintain a minimum shareholders equity and a minimum asset coverage ratio.

Senior Secured Loan Facility On December 17, 2010, Solar Capital Ltd. entered into a $100 million senior secured credit facility (the $100 Million Facility) with Wells Fargo Securities LLC, as administrative agent. Solar Capital entered into (i) a Purchase and Sale Agreement (the Purchase and Sale Agreement) with SC Funding, pursuant to which Solar Capital will sell to SC Funding certain loans that it has originated or acquired, or will originate or acquire (the Loans) from time to time; (ii) a Loan and Servicing Agreement (the Loan and Servicing Agreement and, together with the Purchase and Sale Agreement, the Agreements) with SC Funding as borrower; and (iii) various supporting documentation. The $100 Million Facility is secured by all of the assets held by SC Funding. The $100 Million Facility, among other things, matures on December 17, 2015 and bears interest based on LIBOR plus 3.00%. Under the Agreements, Solar Capital and SC Funding, as applicable, are required to comply with various covenants, reporting requirements and other customary requirements for similar credit facilities. The Purchase and Sale Agreement includes usual and customary events of default for credit facilities of this nature.

Senior Unsecured Notes On February 9, 2010, in connection with the Merger, senior unsecured notes (the Senior Unsecured Notes) of Solar Capital Ltd. were issued to certain equity holders. The Senior Unsecured Notes were scheduled to mature in February 2014 and had a coupon of 8.75%, payable quarterly in cash beginning May 1, 2010. The Senior Unsecured Notes were redeemable at any time, in whole or in part, at a price of 100% of their principal amount, plus accrued and unpaid interest to the date of redemption. Further, net cash proceeds from the issuance of any other senior notes had to be used either to redeem or make an offer to purchase the outstanding Senior Unsecured Notes at a price of 100% of their principal amount, plus accrued and unpaid interest to the date of redemption. The Senior Unsecured Notes subjected Solar Capital Ltd. to customary covenants, including, among other things, (i) a requirement to maintain an asset coverage ratio of at least 2.00

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SOLAR CAPITAL LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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to 1.00; (ii) a requirement that in the event of a change of control (as defined in the agreement governing the Senior Unsecured Notes) Solar Capital Ltd. will be required to offer to repurchase the Senior Unsecured Notes at a price of 101% of their principal amount, plus accrued and unpaid interest to the date of repurchase; and (iii) a restriction on incurring any debt on a junior lien basis, or any debt that is contractually subordinated in right of payment to any other debt unless it is also subordinated to the Senior Unsecured Notes on substantially identical terms. The agreement under which the Senior Unsecured Notes have been issued contained customary events of default. The Senior Unsecured Notes were repaid in full in December 2010 at par plus accrued interest.

The weighted average annualized interest cost for all borrowings for the year ended December 31, 2011 and 2010 was 3.66% and 7.71%, respectively. These costs are exclusive of commitment fees and for other prepaid expenses related to establishing the $405 Million Facility, the $100 Million Facility, the Senior Unsecured Notes, and the Term Loan (collectively the Credit Facilities). This weighted average annualized interest cost reflects the average interest cost for all outstanding borrowings. The average debt outstanding for the year ended December 31, 2011 and 2010 was $152,047 and $140,301, respectively. The maximum amounts borrowed on the Credit Facilities during the year ended December 31, 2011 and 2010 were $435,356 and $460,000, respectively. There was $236,355 drawn on the Credit Facilities as of December 31, 2011 and $435,000 as of December 31, 2010. At December 31, 2011 and 2010, the Company was in compliance with all financial and operational covenants required by the Credit Facilities.

Note 7. Fair Value

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. GAAP establishes a framework for measuring fair value that includes a hierarchy used to classify the inputs used in measuring fair value. The hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three levels. The level in the fair value hierarchy within which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement.

GAAP fair value measurement guidance classifies the inputs used to measure these fair values into the following hierarchy:

Level 1. Financial assets and liabilities whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market that the Company has the ability to access (examples include active exchange-traded equity securities, exchange-traded derivatives, and most U.S. Government and agency securities).

Level 2. Financial assets and liabilities whose values are based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability. Level 2 inputs include the following:

a) Quoted prices for similar assets or liabilities in active markets;

b) Quoted prices for identical or similar assets or liabilities in non-active markets (examples include corporate and municipal bonds, which trade infrequently);

c) Pricing models whose inputs are observable for substantially the full term of the asset or liability (examples include most over-the-counter derivatives, including foreign exchange forward contracts); and

d) Pricing models whose inputs are derived principally from or corroborated by observable market data through correlation or other means for substantially the full term of the asset or liability.

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Level 3. Financial assets and liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect management s own assumptions about the assumptions a market participant would use in pricing the asset or liability (examples include certain of our private debt and equity investments) and long-dated or complex derivatives (including certain equity and currency derivatives).

When the inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level input that is significant to the fair value measurement in its entirety. For example, a Level 3 fair value measurement may include inputs that are observable (Levels 1 and 2) and unobservable (Level 3). Therefore gains and losses for such assets and liabilities categorized within the Level 3 table below may include changes in fair value that are attributable to both observable inputs (Levels 1 and 2) and unobservable inputs (Level 3). Further, it should be noted that the following tables do not take into consideration the effect of offsetting Levels 1 and 2 financial instruments entered into by the Company that economically hedge certain exposures to the Level 3 positions.

A review of fair value hierarchy classifications is conducted on a quarterly basis. Changes in the observability of valuation inputs may result in a reclassification for certain financial assets or liabilities. Reclassifications impacting Level 3 of the fair value hierarchy are reported as transfers in/out of the Level 3 category as of the beginning of the quarter in which the reclassifications occur.

The following table presents the balances of assets and liabilities measured at fair value on a recurring basis, as of December 31, 2011 and 2010:

Fair Value Measurements

As of December 31, 2011

	Level 1	Level 2	Level 3	Total
Assets:				
Bank Debt/Senior Secured Loans	$	$ 46,377	$ 366,019	$ 412,396
Subordinated Debt / Corporate Notes		10,508	536,351	546,859
Preferred Equity			14,664	14,664
Common Equity / Partnership Interests / Warrants	11,460		59,664	71,124
Derivative assets - interest rate cap		469		469
Derivative assets - forward contracts		180		180

Fair Value Measurements

As of December 31, 2010

	Level 1	Level 2	Level 3	Total
Assets:				
Bank Debt/Senior Secured Loans	$	$ 46,609	$ 200,532	$ 247,141
Subordinated Debt / Corporate Notes		83,476	566,308	649,784
Preferred Equity			3,934	3,934
Common Equity / Partnership Interests	373	21,897	53,092	75,362

Derivative assets forward contracts	604	604
Liabilities:		
Derivative liabilities forward contracts	1,539	1,539

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SOLAR CAPITAL LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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(in thousands, except shares)

The following table provides a summary of the changes in fair value of Level 3 assets and liabilities for the years ended December 31, 2011 and 2010, as well as the portion of gains or losses included in income attributable to unrealized gains or losses related to those assets and liabilities still held at December 31, 2011 and 2010:

The Company had no assets or liabilities measured at fair value on a nonrecurring basis during the year.

Fair Value Measurements Using Level 3 Inputs

As of December 31, 2011

	Bank Debt/ Senior Secured Loans	Subordinated Debt/ Corporate Notes	Preferred Equity	Common Equity/ Partnership Interests/ Warrants
Fair value, January 1, 2011	$ 200,532	$ 566,308	$ 3,934	$ 53,092
Total gains or losses included in earnings:				
Net realized gain (loss)	(87)	6,218		(4,500)
Net change in unrealized gain (loss)	(13,392)	(6,991)	(448)	6,931
Purchase of investment securities	247,421	115,852	11,178	7,942
Proceeds from dispositions of investment securities	(68,455)	(103,971)		(3,801)
Transfers in/out of Level 3		(41,065)		
Fair value, December 31, 2011	$ 366,019	$ 536,351	$ 14,664	$ 59,664
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held by the Company at the end of the period:				
Net change in unrealized gain (loss):	$ (15,535)	$ (17,844)	$ (448)	$ 4,988

During 2011, one investment with a fair value of $41,065 was transferred from Level 3 to Level 2 as a result of an increase in the availability and reliability of third party market quotes for this investment. During 2011, one asset with a fair value of $9,900 was transferred from Level 2 to Level 1 when trading restrictions expired on a publicly traded equity investment.

Fair Value Measurements Using Level 3 Inputs

As of December 31, 2010

	Bank Debt/Senior Secured Loans	Subordinated Debt/ Corporate Notes	Preferred Equity	Common Equity/ Partnership Interests/Warrants
Fair value, January 1, 2010	$ 163,499	$ 576,031	$ 40	$ 55,121

Total gains or losses included in earnings:				
Net realized gain (loss)	463	(54,012)		15,316
Net change in unrealized gain (loss)	3,704	86,974	4	(4,006)
Purchases, sales, issuances, and settlements (net)	84,566	315	3,890	(11,642)
Transfers out of Level 3	(51,700)	(43,000)		(1,697)
Fair value, December 31, 2010	$ 200,532	$ 566,308	$ 3,934	$ 53,092
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held by the Company at the end of the period:				
Net change in unrealized gain:	$ 5,522	$ 18,999	$ 4	$ 9,161

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SOLAR CAPITAL LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2011

(in thousands, except shares)

During 2010, two debt investments with fair values of $51,700 and $43,000 were transferred from Level 3 to Level 2 as a result of increases in the availability and reliability of third party market quotes for these investments. In addition, one equity investment with a fair value of $1,697 was transferred from Level 3 to Level 2 as a result of the company s initial public offering. During 2010, one asset with a fair value of $400 was transferred from Level 2 to Level 1 when trading restrictions expired on a publicly traded equity investment.

Note 9. Stockholders Equity

The table below illustrates the effect of certain transactions on our capital accounts for the years ended December 31, 2011 and 2010:

	Common Stock				Under (Over) Distributed			
	Shares	Par Amount	Partners Capital	Paid in Capital in Excess of Par	Net Investment Income	Accumulated Net Realized Gain/(Loss)	Net Unrealized Depreciation	Total Stockholders Equity
Balance at December 31, 2009		$	$ 697,903	$	$	$	$	$ 697,903
Solar Capital Merger(1)	26,647,312	266	(697,903)	772,553			(199,916)	(125,000)
Issuances of common stock in IPO(2)	6,280,945	63		106,088				106,151
Issuances of common stock in private placement(3)	2,965,000	30		67,836				67,866
Reinvestment of dividends	489,901	5		10,841				10,846
Net increase in stockholders equity resulting from operations					69,212	(38,968)	111,641	141,885
Dividends declared ($2.14 per share)					(65,457)	(7,200)		(72,657)
Permanent tax differences				(30,327)	(5,300)	35,627		
Balance at December 31, 2010	36,383,158	$ 364	$	$ 926,991	$ (1,545)	$ (10,541)	$ (88,275)	$ 826,994
Reinvestment of dividends	224,880	2		5,162				5,164
Net increase in stockholders equity resulting from operations					81,904	(2,393)	(18,196)	61,315
Dividends declared ($2.40 per share)					(73,532)	(14,000)		(87,532)
Permanent tax differences				(3,973)	(4,582)	8,555		
Balance at December 31, 2011	36,608,038	$ 366	$	$ 928,180	$ 2,245	$ (18,379)	$ (106,471)	$ 805,941

(1) Immediately prior to the initial public offering, through a series of transactions Solar Capital Ltd. merged with Solar Capital LLC, leaving Solar Capital Ltd. as the surviving entity. Solar Capital Ltd. issued an aggregate of approximately 26.65 million shares of common stock and $125 million in Senior Unsecured Notes to the existing Solar Capital LLC unit holders in connection with the Merger.
(2) On February 9, 2010 Solar Capital Ltd. priced its initial public offering, selling 5.68 million shares, including the underwriters over-allotment, at a price of $18.50 per share. Concurrent with this offering, management purchased an additional 600,000 shares through a private placement, also at $18.50 per share.
(3) On November 30, 2010 Solar Capital Ltd. priced a private offering, selling 2.85 million shares, at a price of $22.94 per share. Concurrent with this offering, management purchased an additional 115,000 shares, also at $22.94 per share.

SOLAR CAPITAL LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2011

(in thousands, except shares)

Note 10. Earnings Per Share

The following information sets forth the computation of basic and diluted net increase (decrease) in shareholders equity per share resulting from operations for the years ended December 31, 2011, 2010 and 2009:

	Year ended December 31, 2011	Year ended December 31, 2010	Year ended December 31, 2009
Numerator for basic and diluted earnings per share:	$ 61,315	$ 141,885	$ 86,936
Denominator for basic and diluted weighted average share:	36,470,384	33,258,402	32,860,454
Basic and diluted net increase in share holders equity resulting from operations per share:	$ 1.68	$ 4.27	$ 2.65

As required by ASC 260-10, *Earnings Per Share*, the number of shares used to calculate weighted average shares for use in computations on a per share basis have been decreased retroactively by a factor of approximately 0.4022 for all periods prior to February 9, 2010. This factor represents the effective impact of the reduction in shares resulting from the Merger.

Note 11. Income Tax Information and Distributions to Stockholders

The tax character of dividends for the fiscal years ended December 31, 2011 and 2010 were as follows:

	2011		2010	
Ordinary income	$ 73,532	84.0%	$ 65,457	90.1%
Capital gains	14,000	16.0%	7,200	9.9%
Total dividends	$ 87,532	100.0%	$ 72,657	100.0%

For the years ended December 31, 2011 and 2010, the reconciliation of net increase in net assets resulting from operations to taxable income is as follows:

	2011	2010
Net increase in net assets resulting from operations	$ 61,315	$ 141,885
Net unrealized (gain)/loss on investments	17,654	(113,508)
Pre IPO earnings adjustment		15,164
Consolidated subsidiaries adjustment	(2,021)	9,994
Post-October capital (gains)/losses	(3,232)	3,006
Market discount and OID adjustments	23,844	
Other book-to-tax differences	7,840	20,821
Taxable income before deductions for dividends	$ 105,400	$ 77,362

During 2011, as a result of permanent book-to-tax differences, the Company decreased under (over) distributed net investment income by $4,582, decreased accumulated net realized loss by $8,555, and decreased paid-in capital in excess of par value by $3,973. Aggregate stockholders equity was not affected by this reclassification.

SOLAR CAPITAL LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2011

(in thousands, except shares)

As of December 31, 2011 and 2010, the components of accumulated gain and losses on a tax basis were as follows:

	2011	2010
Undistributed ordinary income	$ 21,586	$ 1,917
Undistributed long-term net capital gains		2,788
Total undistributed net earnings	21,586	4,705
Post-October capital gains/(losses)		(3,006)
Net unrealized appreciation on investments	(133,468)	32,795
Total undistributed (undistributable) taxable income	$ (111,882)	$ 34,494

Tax information for the fiscal year ended December 31, 2011 is an estimate and will not be finally determined until the Company files its 2011 tax return in September 2012.

We did not have any uncertain tax positions that met the recognition or measurement criteria of ASC 740-10-25, *Income Taxes*, nor did we have any unrecognized tax benefits as of the periods presented herein. Although we file federal and state tax returns, our major tax jurisdiction is federal. Our inception-to-date federal tax years remain subject to examination by the Internal Revenue Service.

There were no deferred tax assets or liabilities as of December 31, 2011 or 2010.

Pre-Merger Taxation

Prior to the February 9, 2010, the Company was classified as a partnership for U.S. tax purposes, and therefore was generally not subject to federal and state income taxes. Each partner took into account separately on their tax return their share of the taxable income, gains, losses, deductions or credits for the partnership s taxable year. Accordingly, no provisions were made in the accompanying financial statements for federal and state income tax. The Company was also subject to New York City unincorporated business tax (UBT), which is imposed on the business income of every unincorporated business that is carried on in New York City. The UBT is imposed for each taxable year at a rate of approximately 4 percent of taxable income that is allocable to New York City.

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SOLAR CAPITAL LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2011

(in thousands, except shares)

Note 12. Financial Highlights

The following is a schedule of financial highlights for the respective periods:

	Year ended December 31, 2011	Year ended December 31, 2010	Year ended December 31, 2009	Year ended December 31, 2008	March 13, 2007 (inception) through December 31, 2007
Per Share Data: (a)					
Net asset value, beginning of year	$ 22.73	$ 21.24	$ 25.95	$ 38.30	$ 37.30
Net investment income	2.25	2.08	2.05	2.66	1.62
Net realized and unrealized gain (loss)	(0.57)	2.19	0.60	(15.01)	(0.12)
Net increase in net assets resulting from operations	1.68	4.27	2.65	(12.35)	1.50
Dividends to shareholders declared	(2.40)	(2.14)			
Distributions to unit holders declared			(7.36)		
Effect of dilution	0.01	(0.33)			
Offering costs		(0.31)			(0.50)
Net asset value, end of period	$ 22.02	$ 22.73	$ 21.24	$ 25.95	$ 38.30
Total return(b)	(1.07)%	45.51%	10.16%	(32.25)%	4.00%
Net assets, end of period	$ 805,941	$ 826,994	$ 697,903	$ 852,673	$ 1,258,501
Per share market value at end of period	$ 22.09	$ 24.78	N/A	N/A	N/A
Shares outstanding end of period	36,608,038	36,383,158	32,860,454	32,860,454	32,860,454
Ratio to average net assets:					
Expenses without incentive fees	4.45%	5.13%	3.35%	3.27%	2.55%
Incentive fees	2.49%	2.33%	2.20%	0.78%	%
Total expenses	6.94%	7.46%	5.55%	4.05%	2.55%
Net investment income	9.97%	9.31%	8.85%	7.59%	5.36%
Portfolio turnover ratio	34.54%	38.90%	19.36%	11.55%	20.67%

(a) Calculated using the average shares outstanding method. The number of shares used to calculate weighted average shares have been decreased retroactively by a factor of approximately 0.4022 for all periods prior to February 9, 2010. This factor represents the effective impact of the reduction in shares resulting from the Merger.

(b)

Total return for 2011 is based on the change in market price per share during the period and takes into account dividends reinvested with the dividend reinvestment plan. For 2010, the public offering price is used as the beginning market price and does not assume dividend reinvestment. Total return for 2009, 2008 and 2007 is equal to the net increase in net assets resulting from operations divided by the net asset value at beginning of year.

SOLAR CAPITAL LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2011

(in thousands, except shares)

Note 13. New Accounting Pronouncements and Accounting Standards Updates

In May 2011, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (ASU 2011-04). ASU 2011-04 was issued concurrently with International Financial Reporting Standards No. 13 (IFRS 13), Fair Value Measurements, to provide largely identical guidance about fair value measurement and disclosure requirements as is currently required under ASU 2010-06, Fair Value Measurements and Disclosures (Topic 820). The new standards do not extend the use of fair value but, rather, provide guidance about how fair value should be applied where it already is required or permitted under IFRS or GAAP. For GAAP, most of the changes are clarifications of existing guidance or wording changes to align with IFRS 13. ASU 2011-04 eliminates the concepts of in-use and in-exchange when measuring fair value of all financial instruments. For Level 3 fair value measurements, the ASU requires that our disclosure include quantitative information about significant unobservable inputs, a qualitative discussion about the sensitivity of the fair value measurement to changes in the unobservable inputs and the interrelationship between inputs, and a description of our valuation process. Public companies are required to apply ASU 2011-04 prospectively for interim and annual periods beginning after December 15, 2011. Upon adoption of ASU 2011-04, it is not expected that it will have a significant impact on the Company s financial statements and the Company is currently evaluating the impact on its disclosures.

Note 14. Selected Quarterly Financial Data (unaudited)

For the Quarter Ended	Investment Income		Net Investment Income		Net Realized And Unrealized Gain (Loss) on Assets		Increase (Decrease) In Net Assets From Operations	
	Total	Per Share	Total	Per Share	Total	Per Share	Total	Per Share
December 31, 2011	$ 35,994	0.98	$ 20,675	0.57	$ 31,182	0.85	$ 51,857	1.42
September 30, 2011	35,329	0.97	20,711	0.57	(72,655)	(1.99)	(51,944)	(1.42)
June 30, 2011	35,283	0.97	21,368	0.59	(8,984)	(0.25)	12,384	0.34
March 31, 2011	32,294	0.89	19,150	0.53	29,868	0.82	49,018	1.35
December 31, 2010	31,644	0.92	17,384	0.51	24,974	0.73	42,358	1.24
September 30, 2010	29,403	0.89	15,551	0.47	5,458	0.16	21,009	0.63
June 30, 2010	28,284	0.86	15,166	0.46	1,348	0.04	16,514	0.50
March 31, 2010	35,310	1.08	21,111	0.65	40,893	1.26	62,004	1.90
December 31, 2009	28,456	0.87	17,685	0.54	22,271	0.68	39,956	1.23
September 30, 2009	27,785	0.85	16,383	0.50	22,181	0.68	38,564	1.17
June 30, 2009	25,252	0.77	16,099	0.49	17,899	0.54	33,998	1.03
March 31, 2009	28,177	0.86	17,095	0.52	(42,677)	(1.30)	(25,582)	(0.78)

See notes to consolidated financial statements.

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SOLAR CAPITAL LTD.

SCHEDULE OF INVESTMENTS IN AND ADVANCES TO AFFILIATES

(unaudited)

(in thousands, except shares)

Schedule 12-14

			Year ended December 31, 2011		
Portfolio Company	Investment	As of December 31, 2011 Number of Shares/Principal Amount	Amount of dividends and interest included in income	Amount of equity in net profit and loss	As of December 31, 2011 Fair Value
Investments Owned Greater than 25%					
AviatorCap SII, LLC I	Senior Debt	3,728	$ 288	$	$ 3,671
AviatorCap SII, LLC II	Senior Debt	5,697	243		5,611
AviatorCap SII, LLC III	Senior Debt	8,856	628		8,724
USAW 767	Senior Debt	4,904	920		4,831
SODO Corp.	Preferred Equity/Common	1,912	96		1,949
SOCAY Corp.	Preferred Equity/Common	12,357	686		12,668
National Specialty Alloys, LLC	Equity	1,000,000	4,102		16,000
Total Investments Owned Greater than 25%			$ 6,963	$	$ 53,454
Investments Owned Greater than 5% and Less than 25%					
Ark Real Estate Partners LP	Equity	41,818,834			35,820
Total Investments Owned Greater than 5% and Less than 25%			$	$	$ 35,820

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The table below represents the balance at the beginning of the year, December 31, 2010 and any gross additions and reductions and net unrealized gain (loss) made to such investments as well as the ending fair value as of December 31, 2011.

Gross additions represent increases in the investment from additional investments, amortization and payments in kind of interest or dividends.

Gross reductions represent decreases in the investment from sales of investments or repayments.

	Beginning Fair Value December 31, 2010	Gross additions	Gross reductions	Change in Unrealized Gain (Loss)	Fair Value as of December 31, 2011
AviatorCap SII, LLC I	$	$ 4,047	$ 369	(7)	$ 3,671
AviatorCap SII, LLC II		6,094	476	(7)	5,611
AviatorCap SII, LLC III		10,062	1,366	28	8,724
USAW 767	6,618	76	1,848	(15)	4,831
SODO Corp.	390	1,619		(60)	1,949
SOCAY Corp.	3,500	9,559		(391)	12,668
National Specialty Alloys, LLC	10,000			6,000	16,000
Ark Real Estate Partners LP	29,235	7,066	53	(428)	35,820

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SOLAR CAPITAL LTD.

SCHEDULE OF INVESTMENTS IN AND ADVANCES TO AFFILIATES

(unaudited)

(in thousands, except units)

Schedule 12-14

			Year ended December 31, 2010		
Portfolio Company	**Investment**	**As of December 31, 2010 Number of Shares/Principal Amount**	**Amount of dividends and interest included in income**	**Amount of equity in net profit and loss**	**As of December 31, 2010 Fair Value**
Investments Owned Greater than 25%					
USAW 767	Senior Debt	6,753	$ 52	$	$ 6,618
SODO Corp.	Preferred Equity/Common	388	2		390
SOCAY Corp.	Preferred Equity/Common	3,484	16		3,500
National Specialty Alloys, LLC	Equity	1,000,000	600		10,000
Total Investments Owned Greater than 25%			$ 670	$	$ 20,508
Investments Owned Greater than 5% and Less than 25%					
National Interest Security Corp.	Senior Debt		$ 3,544	$	$
National Interest Security Corp.	Subordinated		4,075		
Ark Real Estate Partners LP	Equity	34,806,121			29,235
Total Investments Owned Greater than 5% and Less than 25%			$ 7,619	$	$ 29,235

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The table below represents the balance at the beginning of the year, December 31, 2009 and any gross additions and reductions and net unrealized gain (loss) made to such investments as well as the ending fair value as of December 31, 2010.

Gross additions represent increases in the investment from additional investments, payments in kind of interest or dividends.

Gross reductions represent decreases in the investment from sales of investments or repayments.

	Beginning Fair Value December 31, 2009	Gross additions	Gross reductions	Change in Unrealized Gain (Loss)	Fair Value as of December 31, 2010
USAW 767	$	$ 7,297	$ 676	$ (3)	$ 6,618
SODO Corp.		390			390
SOCAY Corp.		3,500			3,500
National Specialty Alloys, LLC	9,000			1,000	10,000
National Interest Security Corp.	26,152		24,740	(1,412)	
National Interest Security Corp.	31,303		30,230	(1,073)	
National Interest Security Corp.	16,293		2,126	(14,167)	
Ark Real Estate Partners LP	19,675	6,800		2,760	29,235

Federal Income Tax Information (unaudited)

The Company designates the maximum amount available but not less than $600 of the Company s ordinary income dividends paid from 2011 earnings as qualified dividend income in accordance with section 854 of the Internal Revenue Code. The Company designates the maximum amount available but not less than $7,200 of the Company s dividends paid from 2011 net realized securities gains as capital gain dividends in accordance with section 852(b)(3)(C) of the Internal Revenue Code.

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders

Solar Capital Ltd.:

We have reviewed the accompanying consolidated statement of assets and liabilities, including the consolidated schedule of investments, of Solar Capital Ltd. (the Company) as of March 31, 2012, and the related consolidated statements of operations for the three-month periods ended March 31, 2012 and 2011, the consolidated statement of changes in net assets for the three-month period ended March 31, 2012 and consolidated statements of cash flows for the three-month periods ended March 31, 2012 and 2011. These consolidated financial statements and financial highlights are the responsibility of the Company s management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial accounting and reporting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying consolidated financial statements in order for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the accompanying consolidated statement of assets and liabilities, including the consolidated schedule of investments, of Solar Capital Ltd. as of December 31, 2011, and the related consolidated statement of net assets for the year ended December 31, 2011 and we expressed an unqualified opinion on them in our report dated February 22, 2012.

/s/ KPMG LLP

New York, New York

May 1, 2012

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SOLAR CAPITAL LTD.

CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES

(in thousands, except shares)

	March 31, 2012 (unaudited)	December 31, 2011
Assets		
Investments at value:		
Companies more than 25% owned (cost: $36,058 and $47,910, respectively)	$ 36,031	$ 53,454
Companies 5% to 25% owned (cost: $44,698 and $41,819, respectively)	36,540	35,820
Companies less than 5% owned (cost: $1,016,455 and $1,062,844 respectively)	935,944	955,769
Total investments (cost: $1,097,211 and $1,152,573, respectively)	1,008,515	1,045,043
Cash and cash equivalents	10,363	11,787
Interest and dividends receivable	11,542	9,763
Receivable for investments sold	21,099	3,225
Fee revenue receivable	3,948	4,379
Deferred credit facility costs	3,060	3,635
Derivative assets	294	649
Deferred offering costs	575	469
Prepaid expenses and other receivables	411	481
Total Assets	1,059,807	1,079,431
Liabilities		
Credit facilities payable	128,643	201,355
Term Loan	35,000	35,000
Payable for investments purchased	29,273	22,443
Dividend payable	21,965	
Due to Solar Capital Partners LLC:		
Investment advisory and management fee payable	5,278	5,277
Performance-based incentive fee payable	5,275	5,203
Interest payable	961	1,063
Derivative liabilities	1,080	
Due to Solar Capital Management LLC	638	1,069
Income taxes payable	1,035	720
Deferred fee revenue	83	318
Other accrued expenses and payables	442	1,042
Total Liabilities	229,673	273,490
Net Assets		
Common stock, par value $0.01 per share 36,608,038 shares issued and outstanding, 200,000,000 authorized	366	366
Paid-in capital in excess of par	928,180	928,180
Underdistributed net investment income	1,379	2,245
Accumulated net realized losses	(9,213)	(18,379)
Net unrealized depreciation	(90,578)	(106,471)
Total Net Assets	$ 830,134	$ 805,941

Number of shares outstanding	36,608,038	36,608,038
Net Asset Value Per Share	$ 22.68	$ 22.02

See notes to consolidated financial statements.

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SOLAR CAPITAL LTD.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except shares)

	Three months ended March 31, 2012 (unaudited)	Three months ended March 31, 2011 (unaudited)
INVESTMENT INCOME:		
Interest and dividends:		
Companies more than 25% owned	$ 1,082	$ 695
Other interest and dividend income	35,227	31,599
Total interest and dividends	36,309	32,294
Total investment income	36,309	32,294
EXPENSES:		
Investment advisory and management fees	5,278	4,987
Performance-based incentive fee	5,275	4,788
Interest and other credit facility expenses	2,695	2,037
Administrative service fee	696	438
Other general and administrative expenses	1,009	894
Total operating expenses	14,953	13,144
Net investment income before income tax expense	21,356	19,150
Income tax expense	257	
Net investment income	21,099	19,150
REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS, DERIVATIVES AND FOREIGN CURRENCIES:		
Net realized gain (loss):		
Investments:		
Companies more than 25% owned	11,002	
Companies less than 5% owned	(725)	2,802
Net realized gain on investments	10,277	2,802
Derivatives	(944)	(4,363)
Foreign currency exchange	618	(72)
Net realized gain (loss) before income taxes	9,951	(1,633)
Income tax expense	785	
Net realized gain (loss)	9,166	(1,633)

Net change in unrealized gain:

Investments:				
Companies more than 25% owned		(5,571)		1,625
Companies 5% to 25% owned		(2,159)		(260)
Companies less than 5% owned		26,564		30,867
Net change in unrealized gain on investments		18,834		32,232
Derivatives		(1,435)		(259)
Foreign currency exchange		(1,506)		(472)
Net change in unrealized gain		15,893		31,501
Net realized and unrealized gain on investments, derivatives and foreign currencies		25,059		29,868
Net increase in net assets resulting from operations	$	46,158	$	49,018
Earnings per share	$	1.26	$	1.35

See notes to consolidated financial statements.

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SOLAR CAPITAL LTD.

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS

(in thousands, except shares)

	Three months ended March 31, 2012 (unaudited)	Year ended December 31, 2011
Increase (decrease) in net assets resulting from operations:		
Net investment income	$ 21,099	$ 81,904
Net realized gain (loss)	9,166	(2,393)
Net change in unrealized gain (loss)	15,893	(18,196)
Net increase in net assets resulting from operations	46,158	61,315
Dividends and distributions declared	(21,965)	(87,532)
Capital share transactions:		
Reinvestment of dividends		5,164
Net increase in net assets resulting from capital share transactions		5,164
Net increase in net assets	24,193	(21,053)
Net assets at beginning of period	805,941	826,994
Net assets at end of period	$ 830,134	$ 805,941

See notes to consolidated financial statements.

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SOLAR CAPITAL LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands except shares)

	Three months ended March 31, 2012 (unaudited)	Three months ended March 31, 2011 (unaudited)
Cash Flows from Operating Activities:		
Net increase in net assets from operations	$ 46,158	$ 49,018
Adjustments to reconcile net increase in net assets from operations to net cash provided by operating activities:		
Net realized gain from investments	(10,277)	(2,802)
Net realized (gain) loss from foreign currency exchange	(618)	72
Net change in unrealized gain on investments	(18,834)	(32,232)
Net change in unrealized loss on derivatives	1,435	259
(Increase) decrease in operating assets:		
Purchase of investment securities	(69,197)	(80,985)
Proceeds from disposition of investment securities	135,469	109,568
Increase in accrued payment-in-kind interest	(7,724)	(6,005)
Collections of payment-in-kind interest	7,094	
Interest and dividends receivable	(1,779)	(4,543)
Purchase of interest rate cap		(1,950)
Fee revenue receivable	431	22
Receivable for investments sold	(17,874)	4,467
Prepaid expenses and other receivables	70	(54)
Increase (decrease) in operating liabilities:		
Payable for investments purchased	6,830	16,094
Investment advisory and management fee payable	1	95
Performance-based incentive fee payable	72	441
Interest payable	(102)	299
Due to Solar Capital Management LLC	(431)	(391)
Income taxes payable	315	(260)
Deferred fee revenue	(235)	(317)
Other accrued expenses and payables	(599)	(722)
Net Cash Provided by Operating Activities	70,205	50,074
Cash Flows from Financing Activities:		
Deferred offering costs	(106)	(193)
Deferred credit facility costs	575	565
Proceeds from borrowings on credit facilities	160,212	357,253
Repayments of borrowings on credit facilities	(232,310)	(357,253)
Net Cash Used in Financing Activities	(71,629)	372
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(1,424)	50,446
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	11,787	288,732
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 10,363	$ 339,178

Supplemental disclosure of cash flow information:				
Cash paid for interest	$	2,175	$	818
Cash paid for income taxes	$	727	$	257
Non-cash financing activity:				
Dividends payable	$	21,965	$	21,830

See notes to consolidated financial statements.

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SOLAR CAPITAL LTD.

CONSOLIDATED SCHEDULE OF INVESTMENTS

March 31, 2012

(in thousands, except shares)

(unaudited)

Description[1]	Industry	Interest[2]	Maturity	Par Amount/ Shares	Cost	Fair Value
Bank Debt/Senior Secured Loans - 40.45%						
Asurion Corporation (17)	Insurance	9.00%	5/24/2019	$40,000	$39,816	$40,600
Airvana Network Solutions Inc.	Telecommunications	10.00%	3/25/2015	7,464	7,344	7,133
AviatorCap SII, LLC I (9)	Aerospace & Defense	12.00%	12/31/2014	3,571	3,529	3,569
AviatorCap SII, LLC II (9)	Aerospace & Defense	11.00%	12/31/2014	5,394	5,324	5,394
AviatorCap SII, LLC III(9)	Aerospace & Defense	13.00%	12/31/2014	7,601	7,465	7,601
Direct Buy Inc. (19)	Home, Office Furnishing & Durable Consumer Prds	12.00%	2/1/2017	25,000	24,347	4,375
DSW Group, Inc. (24)	Beverage, Food & Tobacco	15% (11% Cash & 4% PIK)(7)	2/28/2018	29,991	28,941	29,691
Fulton Holding Corp (18)	Retail Stores	13.57%	5/28/2016	35,000	34,203	35,000
Grakon, LLC	Machinery	12.00%	12/31/2015	9,524	7,613	9,429
Good Sam Enterprise, LLC	Insurance	11.50%	12/1/2016	7,000	6,534	7,210
Grocery Outlet Inc. (17)	Grocery	10.50%	12/15/2017	33,432	32,463	33,432
Isotoner Corporation	Personal & Nondurable Consumer Products	10.75%	1/8/2018	39,000	37,927	38,610
Interactive Health Solutions, Inc. (17)(18)	Healthcare, Education & Childcare	11.50%	10/4/2016	20,013	19,588	20,013
MYI Acquiror Corporation (3)(4)(8)(20)	Insurance	13% (12% Cash & 1% PIK)(7)	3/13/2017	31,578	30,993	31,578
Southern Auto Finance Company (20)	Banking	13.50%	10/19/2017	25,000	24,469	24,625
Spencer Spirit Holdings, Inc.	Retail Stores	11.00%	5/1/2017	10,000	10,000	10,300
Transplace Texas, LP (17)	Cargo Transport	11.00%	4/12/2017	20,000	19,554	19,700
USAW 767 (10)	Aerospace & Defense	14.50%	12/31/2012	4,381	4,346	4,381
ViaWest Inc (17)	Personal, Food & Misc. Services	13.5% (12% Cash & 1.5% PIK)(7)	5/20/2016	40,385	39,288	39,981
Vision Holding Corp. (17)	Healthcare, Education & Childcare	12.00%	11/23/2016	35,300	34,792	35,300
Total Bank Debt/Senior Secured Loans				**$429,634**	**$418,536**	**$407,922**

Subordinated Debt/Corporate Notes - 52.39%						
Adams Outdoor Advertising	Diversified/Conglomerate Service	18.00%	12/8/2015	$42,500	$41,798	$42,500
Asurion Holdco (22)	Insurance	11.00%(7)	3/2/2019	12,000	11,644	12,189
CIBT Solutions	Leisure, Amusement, Entertainment	13.50%	6/15/2018	36,200	35,409	35,838
Crosman Corporation	Leisure, Amusement, Entertainment	13% (11% Cash & 2% PIK)(7)	10/15/2016	15,219	14,822	14,913
DSW Group, Inc.	Beverage, Food & Tobacco	15% PIK	4/24/2012	129,849	129,821	110,372
Earthbound Farm (17)	Farming & Agriculture	14.25%	6/21/2017	58,947	57,806	57,474
Grakon Holdings LLC Sr	Machinery	14% PIK	12/31/2015	1,644	1,644	1,627
Grakon Holdings LLC Jr	Machinery	12% PIK	12/31/2015	15,572	12,802	9,343
Granite Global Solutions Corp. (3)(15)(20)	Insurance	13.50%	5/31/2016	30,624	30,249	29,092
Midcap Financial Intermediate Holdings, LLC (23)	Banking	13.00% to 14.25%	7/9/2015	85,000	83,583	85,000
ProSieben Sat.1 Media AG (3)(6)(20)	Broadcasting & Entertainment	8.43% (4.93% Cash & 3.5% PIK)(7)	3/6/2017	22,162	20,652	15,543
Richelieu Foods, Inc. (16)	Beverage, Food & Tobacco	14.25% (12% Cash & 2.25% PIK)(7)	5/18/2016	22,693	22,186	21,786
Rug Doctor L.P. (17)(21)	Personal, Food & Misc. Services	15.50% to 20.00% (wtd. avg. 17.54%)(7)	10/31/2014	51,831	48,885	49,240
Weetabix Group (3)(5)(20)	Beverage, Food & Tobacco	9.13% PIK	9/14/2016	17,221	19,348	14,638
Weetabix Group (3)(5)(20)	Beverage, Food & Tobacco	10.29% PIK	5/3/2017	35,321	41,739	28,786
Total Subordinated Debt/Corporate				**$576,783**	**$572,388**	**$528,341**

See notes to consolidated financial statements.

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SOLAR CAPITAL LTD.

CONSOLIDATED SCHEDULE OF INVESTMENTS (continued)

March 31, 2012

(in thousands, except shares)

(unaudited)

Description[(1)]	Industry	Interest[(2)]	Maturity	Par Amount/ Shares	Cost	Fair Value
Preferred Equity - 1.50%						
SODO Corp. (9)(12)	Aerospace & Defense	8.43% PIK		2,052	$ 2,052	$ 2,011
SOCAY Limited (9)(12)(20)	Aerospace & Defense	8.59% PIK		13,342	13,342	13,075
Wyle Laboratories	Aerospace & Defense	8.00%	7/17/2015	387	39	47
Total Preferred Equity					**$ 15,433**	**$ 15,133**
Common Equity / Partnership Interests / Warrants - 5.66%						
Ark Real Estate Partners LP (9)(10)(11)	Buildings & Real Estate			44,697,684	$ 44,698	$ 36,540
Grakon, LLC	Machinery			1,714,286	1,714	
Grakon, LLC Warrants	Machinery			3,518,001		
Great American Group Inc. (13)(20)	Personal, Food & Misc. Services			572,800	2,681	69
Great American Group Inc. (14)(20)	Personal, Food & Misc. Services			187,500	3	23
Nuveen Investments, Inc.	Finance			3,486,444	30,876	10,459
NXP Semiconductors Netherlands B.V.(3)(20)	Electronics			310,271	8,458	8,256
Seven West Media Limited (20)	Broadcasting & Entertainment			437,687	2,424	1,772
Total Common Equity/Partnerships Interests / Warrants					**$ 90,854**	**$ 57,119**
Total Investments					**$ 1,097,211**	**$ 1,008,515**

(1) We generally acquire our investments in private transactions exempt from registration under the Securities Act of 1933, as amended (the Securities Act). Our investments are therefore generally subject to certain limitations on resale, and may be deemed to be restricted securities under the Securities Act.
(2) A majority of the variable rate debt investments bear interest at a rate that may be determined by reference to LIBOR or EURIBOR, and which reset daily, quarterly or semi-annually. For each debt investment we have provided the current interest rate in effect as of March 31, 2012.
(3) The following entities are domiciled outside the United States and the investments are denominated in either Euro, British Pounds, Canadian Dollars or Australian Dollars: Weetabix Group in the United Kingdom; ProSieben Sat.1 Media AG in Germany; Granite Global Solutions Corp. in Canada; and Seven Media Group Pty Limited in Australia. NXP Semiconductors Netherlands B.V. is domiciled in the Netherlands and is denominated in U.S. dollars. All other investments are domiciled in the United States.
(4) Solar Capital Ltd. s foreign domiciled portion of MYI Aquiror Corporation is held through its wholly-owned subsidiary Solar Capital Luxembourg I S.ar.l.
(5) Solar Capital Ltd. s investments in Weetabix Group are held through its wholly-owned subsidiary Solar Capital Luxembourg I S.a.r.l.
(6) Solar Capital Ltd. s investment in ProSieben Sat. 1 Media AG is held through its wholly-owned subsidiary Solar Capital Luxembourg I S.a.r.l.
(7) Coupon is payable in cash and/or in kind (PIK).
(8) Includes an unfunded commitment of $6,000.
(9) Denotes a Control Investment. Control Investments are defined in the 1940 Act as investments in those companies that the Company is deemed to Control. Generally, under the Investment Company Act of 1940, as amended (the 1940 Act), the Company is deemed to Control a company in which it has invested if it owns 25% or more of the voting securities of such company or has greater than 50% representation on its board.
(10) Denotes an Affiliate Investment. Affiliate Investments are investments in those companies that are Affiliated Companies of the Company, as defined in the 1940 Act, which are not Control Investments. The Company is deemed to be an Affiliate of a company in which it has invested if it owns 5% or more but less than 25% of the voting securities of such company.

(11) Investments are held in taxable subsidiaries through Solar Capital Ltd Investment in Ark Real Estate Partners LP is held through SLRC ADI Corp and equity investment in Grakon LLC are held through Grakon TL Holding, Inc.
(12) Solar Capital Ltd. s investments in SODO Corp. and SOCAY Corp. each include a one dollar investment in common shares.
(13) Founders Shares.
(14) Contingent Founders Shares.
(15) Includes an unfunded commitment of $12,054 Canadian Dollars or $12,225 U.S. Dollars as of March 31, 2012.
(16) Indicates an investment held by Solar Capital Ltd. through its wholly-owned subsidiary Solar Capital Funding II LLC. Such investments are pledged as collateral under the Senior Secured Loan Facility (see Note 6 to the consolidated financial statements) and are not generally available to the creditors of Solar Capital Ltd. Unless otherwise noted, as of March 31, 2012, all other investments were pledged as collateral for the Senior Secured Revolving Credit Facility and the Term Loan (see Note 6 to the consolidated financial statements).
(17) Indicates an investment partially held by Solar Capital Ltd. through its wholly-owned subsidiary Solar Capital Funding II LLC. (See note 18 above for further explanation.) Par amounts held through Solar Capital Funding II LLC include: Asurion Corp $14,438; Earthbound Farm $22,913; Fulton Holding Corp. $18,000; Grocery Outlet Inc. $19,900; Interactive Health Solutions, Inc. $11,662; Midcap Financial Intermediate Holdings, LLC $23,500; Rug Doctor L.P. $9,104; Transplace Texas, LP $18,518; ViaWest Inc. $15,143; and Vision Holding Corp $17,569. Remaining par balances are held directly by Solar Capital Ltd.
(18) Includes an unfunded commitment of $1,250.
(19) Investment is on non-accrual status.
(20) Indicates assets that the Company believes do not represent qualifying assets under Section 55(a) of the Investment Company Act of 1940, as amended. Qualifying assets must represent at least 70% of the Company s total assets at the time of acquisition of any additional non-qualifying assets.
(21) Includes PIK payable on $12,586 of par at 4.50% PIK, $14,572 of par at 5.25% PIK, $15,090 of par at 8.00% PIK, and $9,583 of par at 3.50% PIK.
(22) Asurion Holdco has the option to pay interest in kind at L+10.25 if certain specified conditions are met.
(23) Includes an unfunded commitment of $10,000.
(24) In March 2012, Solar Capital Ltd. purchased $36,991 and participated $7,000 to a third party with no recourse to the Company.

See notes to consolidated financial statements.

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SOLAR CAPITAL LTD.

CONSOLIDATED SCHEDULE OF INVESTMENTS (continued)

March 31, 2012

(unaudited)

Industry Classification	Pecentage of Total Investments (at fair value) as of March 31, 2012
Beverage, Food & Tobacco	20%
Insurance	12%
Banking	11%
Personal, Food & Misc. Services	9%
Farming & Agriculture	6%
Healthcare, Education & Childcare	6%
Leisure, Amusement, Entertainment	5%
Retail Stores	4%
Diversified/Conglomerate Service	4%
Buildings & Real Estate	4%
Personal & Nondurable Consumer Products	4%
Aerospace & Defense	3%
Grocery	3%
Machinery	2%
Cargo Transport	2%
Broadcasting & Entertainment	1%
Finance	1%
Electronics	1%
Telecommunications	1%
Home, Office Furnishing & Durable Consumer Prds	1%
	100%

See notes to consolidated financial statements.

SOLAR CAPITAL LTD.

CONSOLIDATED SCHEDULE OF INVESTMENTS

December 31, 2011

(in thousands, except shares)

Description(1)	Industry	Interest(2)	Maturity	Par Amount/ Shares	Cost	Fair Value
Bank Debt/Senior Secured Loans 39.46%						
Asurion Corporation (18)	Insurance	9.00%	5/24/2019	$40,000	$39,811	$39,517
Airvana Network Solutions Inc.	Telecommunications	10.00%	3/25/2015	8,324	8,186	8,324
AviatorCap SII, LLC I (10)	Aerospace & Defense	12.00%	12/31/2014	3,728	3,678	3,671
AviatorCap SII, LLC II (10)	Aerospace & Defense	11.00%	12/31/2014	5,697	5,618	5,611
AviatorCap SII, LLC III(10)	Aerospace & Defense	13.00%	12/31/2014	8,856	8,696	8,724
Direct Buy Inc. (20)	Home, Office Furnishing & Durable Consumer Prds	12.00%	2/1/2017	25,000	24,332	5,875
Fulton Holding Corp (18)	Retail Stores	13.74%	5/28/2016	35,000	34,155	35,000
Grakon, LLC	Machinery	12.00%	12/31/2015	9,524	7,610	9,286
Good Sam Enterprise, LLC	Insurance	11.50%	12/1/2016	7,000	6,523	6,860
Grocery Outlet Inc.	Grocery	10.50%	12/15/2017	33,600	32,599	32,592
Isotoner Corporation	Personal & Nondurable Consumer Products	10.75%	1/8/2018	39,000	37,895	37,830
Interactive Health Solutions, Inc. (18)(19)	Healthcare, Education & Childcare	11.50%	10/4/2016	20,131	19,691	19,930
MYI Acquiror Corporation (3)(4)(8)(21)	Insurance	13% (12% Cash & 1% PIK)(7)	3/13/2017	31,500	30,899	31,500
Roundy s Supermarkets, Inc. 2nd Lien (18)	Grocery	10.00%	4/16/2016	22,000	21,685	22,069
Southern Auto Finance Company (21)	Banking	13.50%	10/19/2017	25,000	24,453	24,437
Spencer Spirit Holdings, Inc.	Retail Stores	11.00%	5/1/2017	10,000	10,000	10,000
Transplace Texas, LP (18)	Cargo Transport	11.00%	4/12/2017	20,000	19,533	19,500
USAW 767 (10)	Aerospace & Defense	14.50%	12/31/2012	4,904	4,850	4,831
ViaWest Inc (18)	Personal, Food & Misc. Services	13.5% (12% Cash & 1.5% PIK)(7)	5/20/2016	33,255	32,520	32,756
Vision Holding Corp. (18)	Healthcare, Education & Childcare	12.00%	11/23/2016	37,500	36,869	37,125
VPSI, Inc. (17)	Personal Transportation	12.00%	12/23/2015	16,958	16,598	16,958
Total Bank Debt/Senior Secured Loans				**$436,977**	**$426,201**	**$412,396**
Subordinated Debt/Corporate Notes 52.33%						
Adams Outdoor Advertising	Diversified/Conglomerate Service	18.00%	12/8/2015	$42,500	$41,878	$42,075
AMC Entertainment Holdings, Inc.	Leisure, Amusement, Entertainment	5.55%PIK	6/13/2012	27,141	27,086	26,462
CIBT Solutions	Leisure, Amusement, Entertainment	13.50%	6/15/2018	36,200	35,389	35,386
Crosman Corporation	Leisure, Amusement, Entertainment	13% (11% Cash & 2% PIK)(7)	10/15/2016	15,219	14,808	14,762
DSW Group, Inc.	Beverage, Food & Tobacco	15% PIK	4/24/2012	125,106	124,972	106,340
Earthbound Farm (18)	Farming & Agriculture	14.25%	6/21/2017	58,947	57,739	56,590
Grakon Holdings LLC Sr	Machinery	14% PIK	12/31/2015	1,588	1,588	1,469
Grakon Holdings LLC Jr	Machinery	12% PIK	12/31/2015	15,118	12,344	7,710
Granite Global Solutions Corp. (3)(16)(21)	Insurance	13.50%	5/31/2016	29,983	30,234	29,121
Magnolia River, LLC	Hotels, Motels, Inns and Gaming	14.00%	4/28/2014	19,064	18,664	19,064

Midcap Financial Intermediate Holdings, LLC (18)	Banking	14.25%	7/9/2015	75,000	73,542	75,000
ProSieben Sat.1 Media AG (3)(6)(21)	Broadcasting & Entertainment	8.83%(5.3% Cash & 3.5% PIK)(7)	3/6/2017	21,125	20,261	10,508
Richelieu Foods, Inc. (17)	Beverage, Food & Tobacco	13.75%	5/18/2016	22,500	21,972	21,150
Rug Doctor L.P. (18)(22)	Personal, Food & Misc. Services	15.50% to 20.00%(7) (wtd. avg. 17.54%)	10/31/2014	51,225	48,034	47,383
Shoes For Crews, LLC (17)	Textiles & Leather	13.75%(7)	7/23/2016	15,650	15,318	15,650
Weetabix Group (3)(5)(21)	Beverage, Food & Tobacco	9.22% PIK	9/14/2016	15,986	18,589	12,469
Weetabix Group (3)(5)(21)	Beverage, Food & Tobacco	10.03%PIK	5/3/2017	34,294	41,739	25,720
Total Subordinated Debt/Corporate Notes				**$606,646**	**$604,157**	**$546,859**

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SOLAR CAPITAL LTD.

CONSOLIDATED SCHEDULE OF INVESTMENTS (continued)

December 31, 2011

(in thousands, except shares)

Description(1)	Industry	Interest(2)	Maturity	Par Amount/ Shares	Cost	Fair Value
Preferred Equity - 1.40%						
SODO Corp. (10)(13)	Aerospace & Defense	8.43% PIK		1,912	$ 2,009	$ 1,949
SOCAY Limited (10)(13)	Aerospace & Defense	8.59% PIK		12,357	13,059	12,668
Wyle Laboratories	Aerospace & Defense	8.00%	7/17/2015	387	39	47
Total Preferred Equity					**$ 15,107**	**$ 14,664**
Common Equity / Partnership Interests / Warrants - 6.81%						
Ark Real Estate Partners LP (9)(11)(12)	Buildings & Real Estate			41,818,834	$ 41,819	$ 35,820
Grakon, LLC	Machinery			1,714,286	1,714	
Grakon, LLC Warrants	Machinery			3,518,001		
Great American Group Inc. (14)	Personal, Food & Misc. Services			572,800	2,681	69
Great American Group Inc. (15)	Personal, Food & Misc. Services			187,500	3	23
National Specialty Alloys, LLC(10)	Mining, Steel, Iron & Nonprecious Metals			1,000,000	10,000	16,000
Nuveen Investments, Inc.	Finance			3,486,444	30,875	7,844
NXP Semiconductors Netherlands B.V.(3)	Electronics			645,292	17,592	9,918
Seven West Media Limited	Broadcasting & Entertainment			437,687	2,424	1,450
Total Common Equity/Partnerships Interests / Warrants					$ 107,108	$ 71,124
Total Investments					**$ 1,152,573**	**$ 1,045,043**

(1) We generally acquire our investments in private transactions exempt from registration under the Securities Act of 1933, as amended (the Securities Act). Our investments are therefore generally subject to certain limitations on resale, and may be deemed to be restricted securities under the Securities Act.
(2) For each debt investment we have provided the current interest rate in effect as of December 31, 2011. Variable rate debt investments generally bear interest at a rate that may be determined by reference to LIBOR or EURIBOR, and which may reset daily, quarterly or semi-annually.
(3) The following entities are domiciled outside the United States and the investments are denominated in British Pounds, Euro, Canadian Dollars or Australian Dollars: Weetabix Group in the United Kingdom; ProSieben Sat.1 Media AG in Germany; Granite Global Solutions Corp. in Canada; and Seven West Media Group Pty Limited in Australia. NXP Semiconductors Netherlands B.V. is domiciled in the Netherlands and $14,750 of MYI Aquiror Corporation is domiciled in the United Kingdom, but these assets are denominated in US Dollars. All other investments are domiciled in the United States.
(4) Solar Capital Ltd. s foreign domiciled portion of MYI Aquiror Corporation is held through its wholly-owned subsidiary Solar Capital Luxembourg I S.a.r.l.
(5) Solar Capital Ltd. s investments in Weetabix Group are held through its wholly-owned subsidiary Solar Capital Luxembourg I S.a.r.l.
(6) Solar Capital Ltd. s investments in ProSieben Sat. 1 Media AG are held through its wholly-owned subsidiary Solar Capital Luxembourg I S.a.r.l.
(7) Coupon is payable in cash and/or in kind (PIK).
(8) Includes an unfunded commitment of $6,000.
(9) Solar Capital Ltd. has an unfunded commitment of $2,879.
(10) Denotes a Control Investment. Control Investments are defined in the 1940 Act as investments in those companies that the Company is deemed to Control. Generally, under the Investment Company Act of 1940, as amended (the 1940 Act), the Company is deemed to Control a company in which it has invested if it owns 25% or more of the voting securities of such company or has greater than 50% representation on its board.
(11) Denotes an Affiliate Investment. Affiliate Investments are investments in those companies that are Affiliated Companies of the Company, as defined in the 1940 Act, which are not Control Investments. The Company is deemed to be an Affiliate of a company in which it has invested if it owns 5% or more but less than 25% of the voting securities of such company.

(12) Solar Capital Ltd. s investment in Ark Real Estate Partners LP is held through its taxable subsidiary SLRC ADI Corp.
(13) SODO Corp. and SOCAY Corp. own equity interests that represent a majority of the equity ownership in Aviator Cap SII, LLC and USAW 767. Solar Capital Ltd. s investments in SODO Corp. and SOCAY Corp. each include a one dollar investment in common shares.
(14) Founders Shares.
(15) Contingent Founders Shares.
(16) Includes an unfunded commitment of $15,600 Canadian Dollars or $15,313 U.S Dollars as of December 31, 2011.
(17) Indicates an investment held by Solar Capital Ltd. through its wholly-owned subsidiary Solar Capital Funding II LLC. Such investments are pledged as collateral under the Senior Secured Loan Facility (see Note 6 to the consolidated financial statements) and are not generally available to the creditors of Solar Capital Ltd. Unless otherwise noted, as of December 31, 2011, all other investments were pledged as collateral for the Senior Secured Revolving Credit Facility and the Term Loan (see Note 6 to the consolidated financial statements).
(18) Indicates an investment partially held by Solar Capital Ltd. through its wholly-owned subsidiary Solar Capital Funding II LLC. (See note 17 above for further explanation.) Par amounts held through Solar Capital Funding II LLC include: Asurion $14,224; Fulton Holding Corp. $18,000; Interactive Health Solutions, Inc. $10,236; Roundy s Supermarkets Inc. $10,000; Transplace Texas, LP $18,800; ViaWest Inc. $15,239; Vision Holding Corp $13,883; Earthbound $23,500; Midcap Financial Intermediate Holdings, LLC $23,500; and Rug Doctor L.P. $9,515. Remaining par balances are held directly by Solar Capital Ltd.
(19) Includes an unfunded commitment of $1,250.
(20) Investment is on non-accrual status.
(21) Indicates assets that the Company believes do not represent qualifying assets under Section 55(a) of the Investment Company Act of 1940, as amended. Qualifying assets must represent at least 70% of the Company s total assets at the time of acquisition of any additional non-qualifying assets.
(22) Includes PIK payable on $12,466 of par at 4.50% PIK, $14,405 of par at 5.25% PIK, $14,839 of par at 8.00% PIK, and $9,515 of par at 3.50% PIK.

See notes to consolidated financial statements.

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SOLAR CAPITAL LTD.

CONSOLIDATED SCHEDULE OF INVESTMENTS (continued)

December 31, 2011

Industry Classification	Percentage of Total Investments (at fair value) as of December 31, 2011
Beverage, Food & Tobacco	16%
Insurance	10%
Banking	10%
Personal, Food & Misc. Services	8%
Leisure, Amusement, Entertainment	7%
Healthcare, Education & Childcare	5%
Farming & Agriculture	5%
Grocery	5%
Retail Stores	4%
Diversified/Conglomerate Service	4%
Personal & Nondurable Consumer Products	4%
Aerospace & Defense	4%
Buildings & Real Estate	3%
Cargo Transport	2%
Hotels, Motels, Inns and Gaming	2%
Machinery	2%
Personal Transportation	2%
Mining, Steel, Iron & Nonprecious Metals	1%
Textiles & Leather	1%
Broadcasting & Entertainment	1%
Electronics	1%
Telecommunications	1%
Finance	1%
Home, Office Furnishing & Durable Consumer Prds	1%
	100%

See notes to consolidated financial statements.

SOLAR CAPITAL LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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(in thousands, except shares)

(unaudited)

Note 1. Organization

Solar Capital Ltd. (Solar Capital or the Company), a Maryland corporation formed in November 2007, is a closed-end, externally managed, non-diversified management investment company that has elected to be treated as a business development company (BDC) under the Investment Company Act of 1940, as amended (the 1940 Act). In addition, for tax purposes the Company has elected to be treated as a regulated investment company (RIC) under Subchapter M of the Internal Revenue Code of 1986, as amended (the Code). In February 2010, Solar Capital Ltd. completed its initial public offering.

The Company s investment objective is to generate both current income and capital appreciation through debt and equity investments. The Company invests primarily in middle-market companies in the form of mezzanine and senior secured loans, each of which may include an equity component, and, to a lesser extent, by making direct equity investments in such companies.

Note 2. Significant Accounting Policies

Basis of Presentation The accompanying consolidated financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America (GAAP), and include the accounts of the Company and its wholly-owned subsidiaries, Solar Capital Luxembourg I S.a.r.l., which was incorporated under the laws of the Grand Duchy of Luxembourg on April 26, 2007, and Solar Capital Funding II LLC (SC Funding), a Delaware limited liability company formed on December 8, 2010. The consolidated financial statements reflect all adjustments and reclassifications which, in the opinion of management, are necessary for the fair presentation of the results of the operations and financial condition for the years presented. All significant intercompany balances and transactions have been eliminated.

Interim financial statements are prepared in accordance with GAAP for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Articles 6 or 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for annual financial statements. In the opinion of management, all adjustments, consisting solely of normal recurring accruals considered necessary for the fair presentation of financial statements for the interim period, have been included. The current period s results of operations will not necessarily be indicative of results that ultimately may be achieved for the fiscal year ending December 31, 2012.

Investments The Company applies fair value accounting in accordance with GAAP. Securities transactions are accounted for on trade date. Securities for which market quotations are readily available on an exchange are valued at such price as of the closing price on the valuation date. The Company may also obtain quotes with respect to certain of its investments from pricing services or brokers or dealers in order to value assets. When doing so, the Company determines whether the quote obtained is sufficient according to GAAP to determine the fair value of the security. If determined adequate, the Company uses the quote obtained.

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Securities for which reliable market quotations are not readily available or for which the pricing source does not provide a valuation or methodology or provides a valuation or methodology that, in the judgment of the Company s investment adviser or Board of Directors (the Board), does not represent fair value, shall each be valued as follows:

1) The quarterly valuation process begins with each portfolio company or investment being initially valued by the investment professionals responsible for the portfolio investment;

2) Preliminary valuation conclusions are then documented and discussed with senior management;

3) Third-party valuation firms are engaged by, or on behalf of, the Board to conduct independent appraisals and review management s preliminary valuations and make their own independent assessment, for all material assets; and

4) The Board discusses valuations and determines the fair value of each investment in the portfolio in good faith based on the input of our investment adviser (note 4) and, where appropriate, the respective independent valuation firms.

Valuation methods, among other measures and as applicable, may include comparisons of financial ratios of the portfolio companies that issued such private equity securities to peer companies that are public, the nature and realizable value of any collateral, the portfolio company s ability to make payments and its earnings and discounted cash flows, the markets in which the portfolio company does business, and other relevant factors.

When an external event such as a purchase transaction, public offering or subsequent equity sale occurs, the Company will consider the pricing indicated by the external event to corroborate the private equity valuation. 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 the investments may differ significantly from the values that would have been used had a readily available market value existed for such investments, and the differences could be material.

Investments of sufficient credit quality purchased within 60 days of maturity are valued at cost plus accreted discount, or minus amortized premium, which approximates fair value.

Cash and Cash Equivalents Cash and cash equivalents include investments in money market accounts or investments with original maturities of three months or less.

Revenue Recognition The Company s revenue recognition policies are as follows:

Sales: Gains or losses on the sale of investments are calculated by using the specific identification method.

Interest Income: 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 part of interest income. The Company has loans in its portfolio that contain a payment-in-kind (PIK) provision. PIK interest is accrued at the contractual rates and added to the loan principal on the reset dates.

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Dividend Income: Dividend income on preferred equity securities is recorded as dividend income on an accrual basis to the extent that such amounts are payable by the portfolio company and are expected to be collected. Dividend income on common equity securities is recorded on the record date for private portfolio companies or on the ex-dividend date for publicly traded portfolio companies.

Non-accrual: Loans are placed on non-accrual status when principal or interest payments are past due 30 days or more or when there is reasonable doubt that principal or interest will be collected. Accrued interest is generally reversed when a loan is placed on non-accrual status. Interest payments received on non-accrual loans may be recognized as income or applied to principal depending upon management s judgment. Non-accrual loans are restored to accrual status when past due principal and interest is paid and, in management s judgment, are likely to remain current.

Fee Revenue Receivable Fee revenue receivable consists of premium payments owed to the Company at the maturity of certain loans. The premium payments are recorded as a receivable at the inception of the loan and are accreted into interest income over the respective terms of the applicable loans.

Deferred Fee Revenue Deferred fee revenue represents the unearned portion of premium payments owed to the Company at the maturity of certain loans.

U.S. Federal Income Taxes The Company has elected to be treated as a RIC under subchapter M of the Code and operates in a manner so as to qualify for the tax treatment applicable to RICs. In order to qualify as a RIC, among other things, the Company is required to timely distribute to its stockholders at least 90% of investment company taxable income, as defined by the Code, for each year. Depending on the level of taxable income earned in a given tax year, we may choose to carry forward taxable income in excess of current year dividend distributions into the next tax year and pay a 4% excise tax on such income, as required. 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, the Company accrues excise tax, if any, on estimated excess taxable income as taxable income is earned. For the three months ended March 31, 2012, $985 was recorded for U.S. Federal excise tax. No Federal excise tax was recorded for the three months ended March 31, 2011.

Although the Company files federal and state tax returns, its major tax jurisdiction is federal. The Company s inception-to-date federal tax years remain subject to examination by the Internal Revenue Service. The Company is also subject to taxes in Luxembourg, through Solar Capital Luxembourg I S.a.r.l., a wholly-owned subsidiary. Under the laws of Luxembourg, the Company pays a corporate income tax and a municipal business tax on its subsidiary s taxable income.

The Company has formed and used certain taxable subsidiaries to be taxed as a corporation for federal income tax purposes. These taxable subsidiaries allow the Company to hold portfolio companies organized as pass-through entities and still satisfy certain RIC income requirements. The Company does not consolidate the taxable subsidiaries for income tax purposes but recognizes the results of these subsidiaries for financial reporting purposes.

The Company evaluates tax positions taken or expected to be taken in the course of preparing its financial statements 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 reversed and recorded

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as a tax benefit or expense in the current year. All penalties and interest associated with income taxes are included in income tax expense. Conclusions regarding tax positions are subject to review and may be adjusted at a later date based on factors including, but not limited to, on-going analyses of tax laws, regulations and interpretations thereof. The Company did not have any uncertain tax positions that met the recognition or measurement criteria of ASC 740-10-25 nor did it have any unrecognized tax benefits as of the periods presented herein.

Capital Accounts Certain capital accounts including under (over) distributed net investment income, accumulated net realized gain or loss, net unrealized depreciation, and paid-in capital in excess of par, are adjusted, at least annually, for permanent differences between book and tax. In addition, the character of income and gains to be distributed is determined in accordance with income tax regulations that may differ from GAAP.

Dividends Dividends and distributions to common stockholders are recorded on the ex-dividend date. Quarterly dividend payments are determined by the Board and are generally based upon taxable earnings estimated by management. Net realized capital gains, if any, are distributed at least annually, although we may decide to retain such capital gains for investment. We have adopted a dividend reinvestment plan that provides for reinvestment of any distributions we declare in cash on behalf of our stockholders, unless a stockholder elects to receive cash. As a result, if our Board authorizes, and we declare, a cash dividend, then our stockholders who have not opted out of our dividend reinvestment plan will have their cash dividends automatically reinvested in additional shares of our common stock, rather than receiving the cash dividend. While we generally use newly issued shares to implement the plan (especially if our shares are trading at a premium to net asset value), we may purchase shares in the open market in connection with our obligations under the plan. In particular, if our shares are trading at a significant enough discount to net asset value and we are otherwise permitted under applicable law to purchase such shares, we intend to purchase shares in the open market in connection with our obligations under our dividend reinvestment plan.

Foreign Currency Translation The accounting records of the Company are maintained in U.S. dollars. Foreign currency amounts are translated into U.S. dollars on the following basis:

(i) Market value of investment securities, other assets and liabilities at the current rates of exchange.

(ii) Purchase and sales of investment securities, income and expenses at the rates of exchange prevailing on the respective date of such transactions.

The Company does not isolate that portion of realized and unrealized gains or losses on investments that result from changes in market prices of investments from those that result from fluctuations in foreign exchange rates. Net realized foreign currency gains or losses arise from sales or repayments of foreign denominated investments (recorded in realized gain/loss on investments), maturities or terminations of foreign currency derivatives (recorded in realized gain/loss on derivatives), repayments of foreign denominated liabilities and other transactional gain or loss resulting from fluctuations in foreign exchange rates on amounts received or paid (recorded in realized gain/loss on foreign exchange). Net unrealized foreign exchange gains and losses arise from valuation changes in foreign denominated assets and liabilities, resulting from changes in exchange rates, including unrealized foreign exchange gains and losses on investments (recorded in unrealized gain/loss on investments), foreign currency derivatives (recorded in unrealized gain/loss on derivatives), and all other assets and liabilities (recorded in unrealized gain/loss on foreign exchange).

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The Company s investments in foreign securities may involve certain risks such as foreign exchange restrictions, expropriation, taxation or other political, social or economic risks, all of which could affect the market and/or credit risk of the investment. In addition, changes in the relationship of foreign currencies to the U.S. dollar can significantly affect the value of these investments and therefore the earnings of the Company.

Derivative Instruments and Hedging Activity The Company recognizes derivatives as either assets or liabilities at fair value on its Consolidated Statements of Assets and Liabilities with valuation changes recorded as realized or unrealized gains and losses. The Company currently does not have any formally documented hedges that qualify for hedge accounting treatment.

The Company uses foreign exchange forward contracts and/or borrowings on its multicurrency revolving credit facility to economically hedge its foreign currency risks. Changes in the values of the Company s foreign denominated assets are recorded in current earnings as realized and unrealized gains and losses (see above); likewise, realized and unrealized gains and losses from derivatives and foreign denominated debt are also recorded in current earnings. The fair value of foreign exchange forward contracts is determined by recognizing the difference between the contract exchange rate and the current market exchange rate. Fluctuations in market values of assets and liabilities denominated in the same foreign currency offset in earnings, providing a natural foreign currency hedge.

The Company uses interest rate caps to create a synthetic ceiling on its borrowing rates. An interest rate cap is a derivative in which the buyer receives payments at the end of each period in which the interest rate exceeds an agreed strike price. Interest payments on the Company s credit facilities are primarily LIBOR based. By purchasing caps on LIBOR, if LIBOR exceeds the strike price, the Company will pay a higher interest rate on its credit facilities but receive an offsetting payment from the cap counterparty on the notional amount above the strike price. Caps have an initial cost. The fair value of interest rate caps is determined using option pricing models that use readily available market inputs.

Deferred Offering Costs Offering costs consist of fees paid in relation to legal, accounting, regulatory and printing work completed in connection with offerings of the Company s common stock or debt.

Receivable for Investments Sold Receivable for investments sold represents a receivable for investments that have been sold but the proceeds have not been received.

Payable for Investments Purchased Payable for investments purchased represents a liability for investments that have been purchased but the proceeds have not been paid and any unfunded loan commitments.

Deferred Credit Facility Costs Deferred credit facility costs are amortized over the life of the related credit facility.

Use of Estimates in the Preparation of Financial Statements The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amount 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 materially.

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Subsequent Events Evaluation The Company has evaluated the need for disclosures and/or adjustments resulting from subsequent events through the date the financial statements were issued and determined that none are required, except for the following.

Subsequent to March 31, 2012, DSW Group Inc. (DSW), the Company s largest investment, completed its recapitalization. In April 2012, Solar Capital and other Holdco note holders exchanged their PIK notes for preferred and common equity of DSW. The preferred equity has a dividend rate and liquidation preference consistent with the notes. In addition, Holdco note holders received a majority of DSW s common equity, control of the board, and will have control over significant corporate actions including refinancing and exit alternatives. The Company does not believe that the valuation of the new assets would have differed materially from the valuation of the asset held at March 31, 2012, had this event occurred prior to the end of the quarter.

Note 3. Investments

Investments consisted of the following as of March 31, 2012 and December 31, 2011:

	March 31, 2012		December 31, 2011	
	Cost	Fair Value	Cost	Fair Value
Bank Debt/Senior Secured Loans	$ 418,536	$ 407,922	$ 426,201	$ 412,396
Subordinated Debt/Corporate Notes	572,388	528,341	604,157	546,859
Preferred Equity	15,433	15,133	15,107	14,664
Common Equity/Partnership Interests/Warrants	90,854	57,119	107,108	71,124
Total	$ 1,097,211	$ 1,008,515	$ 1,152,573	$ 1,045,043

As of March 31, 2012 and December 31, 2011, the Company had one non-accrual asset with a total market value of $4,375 and $5,875, respectively.

Note 4. Agreements

Solar Capital has an Investment Advisory and Management Agreement with Solar Capital Partners, LLC (the Investment Adviser), under which the Investment Adviser will manage the day-to-day operations of, and provide investment advisory services to, Solar Capital. For providing these services, the Investment Adviser receives a fee from Solar Capital, consisting of two components a base management fee and an incentive fee. The base management fee is determined by taking the average value of Solar Capital s gross assets at the end of the two most recently completed calendar quarters calculated at an annual rate of 2.00%. The incentive fee has two parts, as follows: one part is calculated and payable quarterly in arrears based on Solar Capital s pre-incentive fee net investment income for the immediately preceding calendar quarter. For this purpose, pre-incentive fee net investment income means interest income, dividend income and any other income (including any other fees (other than fees for providing managerial assistance), such as commitment, origination, structuring, diligence and consulting fees or other fees that we receive from portfolio companies) accrued during the calendar quarter, minus Solar Capital s operating expenses for the quarter (including the base management fee, any expenses payable under the Administration Agreement, and any interest expense and dividends paid on

SOLAR CAPITAL LTD.

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any issued and outstanding preferred stock, but excluding the incentive fee). Pre-incentive fee net investment income does not include any realized capital gains computed net of all realized capital losses and unrealized capital depreciation. Pre-incentive fee net investment income, expressed as a rate of return on the value of Solar Capital s net assets at the end of the immediately preceding calendar quarter, is compared to the hurdle rate of 1.75% per quarter (7% annualized). Our net investment income used to calculate this part of the incentive fee is also included in the amount of our gross assets used to calculate the 2% base management fee. Solar Capital pays the Investment Adviser an incentive fee with respect to Solar Capital s pre-incentive fee net investment income in each calendar quarter as follows: (1) no incentive fee in any calendar quarter in which Solar Capital s pre-incentive fee net investment income does not exceed the hurdle rate; (2) 100% of Solar Capital s pre-incentive fee net investment income with respect to that portion of such pre-incentive fee net investment income, if any, that exceeds the hurdle rate but is less than 2.1875% in any calendar quarter; and (3) 20% of the amount of Solar Capital s pre-incentive fee net investment income, if any, that exceeds 2.1875% in any calendar quarter. These calculations are appropriately pro-rated for any period of less than three months and adjusted for any share issuances or repurchases during the relevant quarter. The second part of the incentive fee is determined and payable in arrears as of the end of each calendar year (or upon termination of the Investment Advisory and Management Agreement, as of the termination date), commencing on February 12, 2007, and will equal 20% of Solar Capital s cumulative realized capital gains less cumulative realized capital losses, unrealized capital depreciation (unrealized depreciation on a gross investment-by-investment basis at the end of each calendar year) and all capital gains upon which prior performance-based capital gains incentive fee payments were previously made to the adviser. For financial statement purposes, the second part of the incentive fee is accrued based upon 20% of cumulative net realized and unrealized capital appreciation. No accrual was required for the three months ended March 31, 2012 or for the year ended December 31, 2011.

Solar Capital has also entered into an Administration Agreement with Solar Capital Management, LLC (the Administrator) under which the Administrator provides administrative services for Solar Capital. For providing these services, facilities and personnel, Solar Capital reimburses the Administrator for Solar Capital s allocable portion of overhead and other expenses incurred by the Administrator in performing its obligations under the Administration Agreement, including rent. The Administrator will also provide, on Solar Capital s behalf, managerial assistance to those portfolio companies to which Solar Capital is required to provide such assistance.

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Note 5. Derivatives

The Company is exposed to interest rate risk both as a lender and a borrower. The Company s borrowing facilities and term loan bear interest at a floating rate, which means that rising interest rates would increase our cost of borrowing. To partially mitigate this risk, in 2011, the Company purchased two interest rate cap contracts, which effectively limit the interest rate payable on $150 million of LIBOR based borrowings. The following table highlights the outstanding interest rate caps:

					March 31, 2012		December 31, 2011		
Index Rate	**Cap Rate**	**Notional Amount**	**Expiration**	**Cost**	**Fair Value**	**Unrealized Depreciation**	**Fair Value**	**Unrealized Depreciation**	**Counterparty**
3 Month Libor	1.0%	$ 100,000	1/13/2014	$ 1,950	$ 117	$ (1,833)	$ 279	$ (1,671)	Wells Fargo
3 Month Libor	1.0%	50,000	5/4/2014	988	95	(893)	190	(798)	Wells Fargo
		$ 150,000		$ 2,938	$ 212	$ (2,726)	$ 469	$ (2,469)	

The Company is also exposed to foreign exchange risk through its investments denominated in foreign currencies. The Company mitigates this risk through the use of foreign currency forward contracts. As an investment company, all changes in the fair value of assets, including changes caused by foreign currency fluctuation, flow through current earnings. The forward contracts serve as an economic hedge with their realized and unrealized gains and losses also recorded in current earnings. During the quarter ended March 31, 2012, we entered into 28 foreign currency forward contracts with durations of 1 month with average U.S. dollar notional amounts of $15,774. During the year ended December 31, 2011, we entered into 80 foreign currency forward contracts with durations of 1 month with average U.S. dollar notional amounts of $30,697.

As of March 31, 2012, there were three open forward foreign currency contracts denominated in Euro, British Pounds and Canadian Dollar, all of which terminated on April 11, 2012. As of December 31, 2011, there were two open forward foreign currency contracts denominated in Euro and British Pounds, both of which terminated on January 10, 2012. At March 31, 2012 and December 31, 2011, there was no fixed collateral held by counterparties for the open contracts and no credit-related contingent features associated with any of the open forward contracts. The contract details are as follows:

	March 31, 2012				December 31, 2011			
SOLD	**Foreign Currency**	**USD Value**	**Unrealized appreciation (depreciation)**	**Counterparty**	**Foreign Currency**	**USD Value**	**Unrealized appreciation (depreciation)**	**Counterparty**
EUR	16,893	$ 22,531	$ (455)	Wells Fargo	966	$ 1,295	$ 44	SunTrust Bank
GBP	20,837	33,329	(625)	SunTrust Bank	12,989	20,307	136	SunTrust Bank
CAD	18,826	18,874	82	SunTrust Bank				
Total Sold		$ 74,734	$ (998)			$ 21,602	$ 180	

The Company had no derivatives designated as hedging instruments at March 31, 2012 or December 31, 2011.

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The following tables show the fair value and effect of the derivative instruments on the Consolidated Statements of Assets and Liabilities and the Consolidated Statements of Operations:

Fair Value of Derivative Instruments

	Derivative Assets			
	March 31, 2012		December 31, 2011	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives not designated as hedging instruments [(a)]				
Foreign exchange contracts	Derivative assets	$ 82	Derivative assets	$ 180
Interest rate caps	Derivative assets	212	Derivative assets	469
Total derivatives not designated as hedging instruments (a)		$ 294		$ 649
Total derivative assets		$ 294		$ 649

	Derivative Liabilities			
	March 31, 2012		December 31, 2011	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives not designated as hedging instruments (a)				
Foreign exchange contracts	Derivative liabilities	$ 1,080	Derivative liabilities	$
Total derivatives not designated as hedging instruments (a)		$ 1,080		$
Total derivative liabilities		$ 1,080		$

(a) See Note 2 for additional information on the Company s purpose for entering into derivatives not designated as hedging instruments and its overall risk management strategy.

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Effect of Derivative Instruments on the Consolidated Statements of Operations

Derivatives not designated as hedging instruments(a)	Location of Gain or (Loss) Recognized in Income on Derivative	Amount of Gain or (Loss) Recognized in Income on Derivative	
		Three months ended March 31, 2012 (unaudited)	Three months ended March 31, 2011 (unaudited)
Foreign exchange contracts	Realized gain (loss): Derivatives	$ (944)	$ (4,363)
Foreign exchange contracts	Unrealized gain (loss): Derivatives	(1,178)	(289)
Interest rate caps	Unrealized gain (loss): Derivatives	(257)	30
Total		$ (2,379)	$ (4,622)

Note 6. Borrowing Facilities, Senior Unsecured Notes, and Term Loan

Senior Secured Revolving Credit Facility On January 11, 2008, Solar Capital LLC entered into a $200 million Senior Secured Revolving Credit Facility (the $405 Million Facility) with Citigroup Global Markets, Inc. (CGMI), various lenders, and Citibank, N.A., as administrative agent for the lenders. CGMI acted as the sole lead bookrunner and the sole lead arranger for the $405 Million Facility.

On February 12, 2010, Solar Capital Ltd. amended and restated the $405 Million Facility, extending the maturity to February 2013 and increasing the total commitments under the facility to $270 million. Per the amended agreement, borrowings bear interest at a rate per annum equal to the base rate plus 3.25% or the alternate base rate plus 2.25%. The commitment fee on unused balances is 0.375%. Total commitments under the $405 Million Facility have been increased to $405 million as a result of the addition of three new lenders on May 12, 2010, June 23, 2010 and December 19, 2011. The $405 Million Facility may be increased up to $600 million with additional new lenders or the increase in commitments of current lenders. The $405 Million Facility contains certain customary affirmative and negative covenants and events of default, including the occurrence of a change of control. In addition, the $405 Million Facility contains certain financial covenants that among other things, requires the Company to maintain a minimum shareholder s equity and a minimum asset coverage ratio.

Term Loan On September 2, 2010, Solar Capital Ltd. entered into a fully funded $35 million senior secured term loan (the Term Loan), which matures in September 2013, bears interest at a rate per annum equal to the base rate plus 3.25%, and has terms substantially similar to our existing revolving credit facility. The Term Loan contains certain customary affirmative and negative covenants and events of default, including the occurrence of a change of control. In addition, the Term Loan contains certain financial covenants that among other things, requires the Company to maintain a minimum shareholders equity and a minimum asset coverage ratio.

Senior Secured Loan Facility On December 17, 2010, Solar Capital Ltd. entered into a $100 million senior secured credit facility (the $100 Million Facility) with Wells Fargo Securities LLC, as administrative agent. Solar Capital entered into (i) a Purchase and Sale Agreement (the Purchase and Sale Agreement) with SC

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Funding, pursuant to which Solar Capital will sell to SC Funding certain loans that it has originated or acquired, or will originate or acquire (the Loans) from time to time; (ii) a Loan and Servicing Agreement (the Loan and Servicing Agreement and, together with the Purchase and Sale Agreement, the Agreements) with SC Funding as borrower; and (iii) various supporting documentation. The $100 Million Facility is secured by all of the assets held by SC Funding. The $100 Million Facility, among other things, matures on December 17, 2015 and bears interest based on LIBOR plus 2.75%. Under the Agreements, Solar Capital and SC Funding, as applicable, are required to comply with various covenants, reporting requirements and other customary requirements for similar credit facilities. The Purchase and Sale Agreement includes usual and customary events of default for credit facilities of this nature.

The weighted average annualized interest cost for all borrowings for the three months ended March 31, 2012 and 2011 was 3.85% and 3.58%, respectively. These costs are exclusive of commitment fees and for other prepaid expenses related to establishing the $405 million Credit Facility, the $100 million Credit Facility and the Term Loan (collectively the Credit Facilities.) This weighted average annualized interest cost reflects the average interest cost for all outstanding borrowings. For the three months ended March 31, 2012 and 2011, average debt outstanding was $183,958 and $126,318, respectively. The maximum amounts borrowed on the Credit Facilities during the three months ended March 31, 2012 and 2011 was $236,879 and $435,000, respectively. There was $163,643 drawn on the Credit Facilities as of March 31, 2012 and $236,355 as of December 31, 2011. At March 31, 2012 and December 31, 2011, the Company was in compliance with all financial and operational covenants required by the Credit Facilities.

Note 7. Fair Value

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. GAAP establishes a framework for measuring fair value that includes a hierarchy used to classify the inputs used in measuring fair value. The hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three levels. The level in the fair value hierarchy within which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement. The levels of the fair value hierarchy are as follows:

GAAP fair value measurement guidance classifies the inputs used to measure these fair values into the following hierarchy:

Level 1. Financial assets and liabilities whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market that the Company has the ability to access (examples include active exchange-traded equity securities, exchange-traded derivatives, and most U.S. Government and agency securities).

Level 2. Financial assets and liabilities whose values are based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability. Level 2 inputs include the following:

a) Quoted prices for similar assets or liabilities in active markets;

b) Quoted prices for identical or similar assets or liabilities in non-active markets (examples include corporate and municipal bonds, which trade infrequently);

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c) Pricing models whose inputs are observable for substantially the full term of the asset or liability (examples include most over-the-counter derivatives, including foreign exchange forward contracts); and

d) Pricing models whose inputs are derived principally from or corroborated by observable market data through correlation or other means for substantially the full term of the asset or liability.

Level 3. Financial assets and liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect management s own assumptions about the assumptions a market participant would use in pricing the asset or liability (examples include certain of our private debt and equity investments) and long-dated or complex derivatives (including certain equity and currency derivatives).

When the inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level input that is significant to the fair value measurement in its entirety. For example, a Level 3 fair value measurement may include inputs that are observable (Levels 1 and 2) and unobservable (Level 3). Therefore gains and losses for such assets and liabilities categorized within the Level 3 table below may include changes in fair value that are attributable to both observable inputs (Levels 1 and 2) and unobservable inputs (Level 3). Further, it should be noted that the following tables do not take into consideration the effect of offsetting Levels 1 and 2 financial instruments entered into by the Company that economically hedge certain exposures to the Level 3 positions.

A review of fair value hierarchy classifications is conducted on a quarterly basis. Changes in the observability of valuation inputs may result in a reclassification for certain financial assets or liabilities. Reclassifications impacting Level 3 of the fair value hierarchy are reported as transfers in/out of the Level 3 category as of the beginning of the quarter in which the reclassifications occur.

The following table presents the balances of assets and liabilities measured at fair value on a recurring basis, as of March 31, 2012 and December 31, 2011:

Fair Value Measurements

As of March 31, 2012

	Level 1	Level 2	Level 3	Total
Assets:				
Bank Debt/Senior Secured Loans		47,810	360,112	407,922
Subordinated Debt / Corporate Notes		27,731	500,610	528,341
Preferred Equity			15,133	15,133
Common Equity / Partnership Interests / Warrants	10,120		46,999	57,119
Derivative assets - interest rate cap		212		212
Derivative assets - forward contracts		82		82
Liabilities:				
Derivative liabilities - forward contracts		1,080		1,080

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Fair Value Measurements

As of December 31, 2011

	Level 1	Level 2	Level 3	Total
Assets:				
Bank Debt/Senior Secured Loans	$	$ 46,377	$ 366,019	$ 412,396
Subordinated Debt / Corporate Notes		10,508	536,351	546,859
Preferred Equity			14,664	14,664
Common Equity / Partnership Interests / Warrants	11,460		59,664	71,124
Derivative assets - interest rate cap		469		469
Derivative assets - forward contracts		180		180

The following table provides a summary of the changes in fair value of Level 3 assets and liabilities for the three months ended March 31, 2012 and the year ended December 31, 2011, as well as the portion of gains or losses included in income attributable to unrealized gains or losses related to those assets and liabilities still held at March 31, 2012 and December 31, 2011:

Fair Value Measurements Using Level 3 Inputs

As of March 31, 2012

	Bank Debt/ Senior Secured Loans	Subordinated Debt/ Corporate Notes	Preferred Equity	Common Equity/ Partnership Interests/ Warrants
Fair value, January 1, 2012	$ 366,019	$ 536,351	$ 14,664	$ 59,664
Total gains or losses included in earnings:				
Net realized gain (loss)				10,277
Net change in unrealized gain (loss)	1,773	8,062	148	(5,544)
Purchase of investment securities	43,618	18,052	321	2,879
Proceeds from dispositions of investment securities	(51,298)	(61,855)		(20,277)
Transfers in/out of Level 3				
Fair value, March 31, 2012	$ 360,112	$ 500,610	$ 15,133	$ 46,999

Unrealized gains (losses) for the period relating to those Level 3 assets that were still held by the Company at the end of the period:								
Net change in unrealized gain (loss):	$	2,517	$	8,170	$	148	$	(5,544)

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The Company had no assets or liabilities measured at fair value on a nonrecurring basis during the period. During the three months ended March 31, 2012, there were no transfers in and out of Levels 1 and 2.

Fair Value Measurements Using Level 3 Inputs

As of December 31, 2011

	Bank Debt/ Senior Secured Loans	Subordinated Debt/ Corporate Notes	Preferred Equity	Common Equity/ Partnership Interests/ Warrants
Fair value, January 1, 2011	$ 200,532	$ 566,308	$ 3,934	$ 53,092
Total gains or losses included in earnings:				
Net realized gain (loss)	(87)	6,218		(4,500)
Net change in unrealized gain (loss)	(13,392)	(6,991)	(448)	6,931
Purchase of investment securities	247,421	115,852	11,178	7,942
Proceeds from dispositions of investment securities	(68,455)	(103,971)		(3,801)
Transfers in/out of Level 3		(41,065)		
Fair value, December 31, 2011	$ 366,019	$ 536,351	$ 14,664	$ 59,664
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held by the Company at the end of the period:				
Net change in unrealized gain (loss):	$ (15,535)	$ (17,844)	$ (448)	$ 4,988

During 2011, one investment with a fair value of $41,065 was transferred from Level 3 to Level 2 as a result of an increase in the availability and reliability of third party market quotes for this investment. During 2011, one asset with a fair value of $9,900 was transferred from Level 2 to Level 1 when trading restrictions expired on a publicly traded equity investment.

The significant unobservable quantitative inputs typically used in the fair value measurement of the Company s Level 3 investments include current market yields as indicated by comparable publicly traded investments and loan indices and EBITDA multiples as indicated by current, comparable market transactions (see table below). However, due to the nature of certain investments, fair value measurements may be based on other criteria, such as third-party appraisals of collateral, and not presented in the table below.

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The ranges of unobservable inputs used in the fair value measurement of the Company s Level 3 investments as of March 31, 2012 were as follows:

EBITDA Multiples (Enterprise Value)	3.6x to 12.0x
Market Yields	10.2% to 20.5%

Significant increases or decreases in any of the above inputs in isolation would result in a significantly lower or higher fair value measurement.

Note 9. Stockholders Equity

The table below illustrates the effect of certain transactions on our capital accounts for the year ended December 31, 2011 and the three months ended March 31, 2012:

	Common Stock						
	Shares	Par Amount	Paid in Capital in Excess of Par	Under (Over) Distributed Net Investment Income	Accumulated Net Realized Gain/(Loss)	Net Unrealized Depreciation	Total Stockholders Equity
Balance at December 31, 2010	36,383,158	$ 364	$ 926,991	$ (1,545)	$ (10,541)	$ (88,275)	$ 826,994
Reinvestment of dividends	224,880	2	5,162				5,164
Net increase in stockholders equity resulting from operations				81,904	(2,393)	(18,196)	61,315
Dividends declared ($2.40 per share)				(73,532)	(14,000)		(87,532)
Permanent tax differences			(3,973)	(4,582)	8,555		
Balance at December 31, 2011	36,608,038	$ 366	$ 928,180	$ 2,245	$ (18,379)	$ (106,471)	$ 805,941
Net increase in stockholders equity resulting from operations				21,099	9,166	15,893	46,158
Dividends declared ($0.60 per share)				(21,965)			(21,965)
Balance at March 31, 2012	36,608,038	$ 366	$ 928,180	$ 1,379	$ (9,213)	$ (90,578)	$ 830,134

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Note 10. Earnings Per Share

The following information sets forth the computation of basic and diluted net increase in shareholders equity per share resulting from operations for the three months ended March 31, 2012 and 2011:

	Three months ended March 31, 2012 (unaudited)	Three months ended March 31, 2011 (unaudited)
Numerator for basic and diluted earnings per share:	$ 46,158	$ 49,018
Denominator for basic and diluted weighted average share:	36,608,038	36,383,158
Basic and diluted net increase in shareholders equity resulting from operations per share:	$ 1.26	$ 1.35

Note 11. Taxation

We did not have any uncertain tax positions that met the recognition or measurement criteria of ASC 740-10-25, *Income Taxes*, nor did we have any unrecognized tax benefits as of the periods presented herein. Although we file federal and state tax returns, our major tax jurisdiction is federal. Our inception-to-date federal tax years remain subject to examination by the Internal Revenue Service.

There were no deferred tax assets or liabilities as of March 31, 2012 or December 31, 2011.

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Note 12. Financial Highlights

The following is a schedule of financial highlights for the three months ended March 31, 2012 and 2011:

	Three months ended March 31, 2012	Three months ended March 31, 2011
Per Share Data [(a)]:		
Net asset value, beginning of year	$ 22.02	$ 22.73
Net investment income	0.58	0.53
Net realized and unrealized gain	0.68	0.82
Net increase in net assets resulting from operations	1.26	1.35
Dividends to shareholders declared	(0.60)	(0.60)
Net asset value, end of period	$ 22.68	$ 23.48
Total return [(b)]	2.63%	(1.21)%
Net assets, end of period	$ 830,134	$ 854,182
Per share market value at end of period	$ 22.07	$ 23.88
Shares outstanding end of period	36,608,038	36,383,158
Ratio to average net assets:		
Expenses without incentive fees [(c)]	4.75%	4.03%
Incentive fees	0.64%	0.57%
Total expenses	5.39%	4.60%
Net investment income [(c)]	10.35%	9.24%
Portfolio turnover ratio	7.38%	9.36%

(a) Calculated using the average shares outstanding method

(b) Total return is based on the change in market price per share during the period and takes into account dividends reinvested with the dividend reinvestment plan. Not annualized for periods less than one year.

(c) Annualized.

Note 13. New Accounting Pronouncements and Accounting Standards Updates

In May 2011, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (ASU 2011-04). ASU 2011-04 was issued concurrently with International Financial Reporting Standards No. 13 (IFRS 13), Fair Value Measurements, to provide largely identical guidance about fair value measurement and disclosure requirements as is currently required under ASU 2010-06, Fair Value Measurements and Disclosures (Topic 820). The new standards do not extend the use of fair value but, rather, provide guidance about how fair value should be applied where it already is

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required or permitted under IFRS or GAAP. For GAAP, most of the changes are clarifications of existing guidance or wording changes to align with IFRS 13. ASU 2011-04 eliminates the concepts of in-use and in-exchange when measuring fair value of all financial instruments. For Level 3 fair value measurements, the ASU requires that our disclosure include quantitative information about significant unobservable inputs, a qualitative discussion about the sensitivity of the fair value measurement to changes in the unobservable inputs and the interrelationship between inputs, and a description of our valuation process. Public companies are required to apply ASU 2011-04 prospectively for interim and annual periods beginning after December 15, 2011. The adoption of ASU 2011-04 did not have a significant impact on the Company s financial statements or its disclosures.

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SOLAR CAPITAL LTD.

SCHEDULE OF INVESTMENTS IN AND ADVANCES TO AFFILIATES

(unaudited)

(in thousands, except shares)

Schedule 12-14

Portfolio Company	Investment	As of March 31, 2012 Number of Shares/Principal Amount	Three months ended March 31, 2012 Amount of dividends and interest included in income	Amount of equity in net profit and loss	As of March 31, 2012 Fair Value
Investments Owned Greater than 25%					
AviatorCap SII, LLC I	Senior Debt	3,571	$ 117	$	$ 3,569
AviatorCap SII, LLC II	Senior Debt	5,394	160		5,394
AviatorCap SII, LLC III	Senior Debt	7,601	294		7,601
USAW 767	Senior Debt	4,381	189		4,381
SODO Corp.	Preferred Equity/Common	2,052	42		2,011
SOCAY Corp.	Preferred Equity/Common	13,342	280		13,075
Total Investments Owned Greater than 25%			$ 1,082	$	$ 36,031
Investments Owned Greater than 5% and Less than 25%					
Ark Real Estate Partners LP	Equity	44,697,684			36,540
Total Investments Owned Greater than 5% and Less than 25%			$	$	$ 36,540

The table below represents the balance at the beginning of the year, December 31, 2011 and any gross additions and reductions and net unrealized gain (loss) made to such investments as well as the ending fair value as of March 31, 2012.

Gross additions represent increases in the investment from additional investments, payments in kind of interest or dividends.

Gross reductions represent decreases in the investment from sales of investments or repayments.

	Beginning Fair Value December 31, 2011	Gross additions	Gross reductions	Change in Unrealized Gain (Loss)	Fair Value as of March 31, 2012
AviatorCap SII, LLC I	$ 3,671	$ 8	$ 157	$ 47	$ 3,569
AviatorCap SII, LLC II	5,611	8	302	77	5,394

AviatorCap SII, LLC III	8,724	25	1,256	108	7,601
USAW 767	4,831	20	523	53	4,381
SODO Corp.	1,949	42		20	2,011
SOCAY Corp.	12,668	280		127	13,075
Ark Real Estate Partners LP	35,820	2,879		(2,159)	36,540

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SCHEDULE OF INVESTMENTS IN AND ADVANCES TO AFFILIATES

(unaudited)

(in thousands, except shares)

Schedule 12-14

Portfolio Company	Investment	As of December 31, 2011 Number of Shares/Principal Amount	Year ended December 31, 2011 Amount of dividends and interest included in income	Amount of equity in net profit and loss	As of December 31, 2011 Fair Value
Investments Owned Greater than 25%					
AviatorCap SII, LLC I	Senior Debt	3,678	$ 288	$	$ 3,671
AviatorCap SII, LLC II	Senior Debt	5,618	243		5,611
AviatorCap SII, LLC III	Senior Debt	8,696	628		8,724
USAW 767	Senior Debt	4,850	920		4,831
SODO Corp.	Preferred Equity/Common	2,009	96		1,949
SOCAY Corp.	Preferred Equity/Common	13,059	686		12,668
National Specialty Alloys, LLC	Equity	10,000	4,102		16,000
Total Investments Owned Greater than 25%			$ 6,963	$	$ 53,454
Investments Owned Greater than 5% and Less than 25%					
Ark Real Estate Partners LP	Equity	41,818,834			35,820
Total Investments Owned Greater than 5% and Less than 25%			$	$	$ 35,820

The table below represents the balance at the beginning of the year, December 31, 2010 and any gross additions and reductions and net unrealized gain (loss) made to such investments as well as the ending fair value as of December 31, 2011.

Gross additions represent increases in the investment from additional investments, amortization and payments in kind of interest or dividends.

Gross reductions represent decreases in the investment from sales of investments or repayments.

	Beginning Fair Value December 31, 2010	Gross additions	Gross reductions	Change in Unrealized Gain	Fair Value as of December 31, 2011

				(Loss)	
AviatorCap SII, LLC I	$	$ 4,047	$ 369	(7)	$ 3,671
AviatorCap SII, LLC II		6,094	476	(7)	5,611
AviatorCap SII, LLC III		10,062	1,366	28	8,724
USAW 767	6,618	76	1,848	(15)	4,831
SODO Corp.	390	1,619		(60)	1,949
SOCAY Corp.	3,500	9,559		(391)	12,668
National Specialty Alloys, LLC	10,000			6,000	16,000
Ark Real Estate Partners LP	29,235	7,066	53	(428)	35,820

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2,000,000 shares

Solar Capital Ltd.

Common Stock

PROSPECTUS SUPPLEMENT

August 23, 2012