

PROSPECT CAPITAL CORP

Form 10-Q

November 09, 2010

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

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

**For the Quarter Ended September 30, 2010**

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

**Commission File Number: 814-00659**

**PROSPECT CAPITAL CORPORATION**

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

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

**43-2048643**  
**(I.R.S. Employer Identification No.)**

**10 East 40th Street**  
**44th Floor**  
**New York, New York**  
**(Address of principal executive offices)**

**10016**  
**(Zip Code)**

**(212) 448-0702**

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

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

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

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

Large accelerated filer <input checked="" type="radio"/>	Accelerated filer <input type="radio"/>	Non-accelerated filer <input type="radio"/>	Smaller reporting company <input type="radio"/>
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☒ (Do not check if a smaller reporting company)

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

The number of shares of the registrant's common stock, \$0.001 par value, outstanding as of November 8, 2010 was 83,423,918.



**PROSPECT CAPITAL CORPORATION**  
**FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2010**  
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[Exhibit 31.1](#)

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[Exhibit 32.1](#)

[Exhibit 32.2](#)

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CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES****September 30, 2010 and June 30, 2010****(in thousands, except share and per share data)**

	<b>September 30, 2010 (Unaudited)</b>	<b>June 30, 2010 (Audited)</b>
<b>Assets (Note 11)</b>		
Investments at fair value:		
Control investments (cost of \$238,633 and \$185,720, respectively)	\$ 258,831	\$ 195,958
Affiliate investments (cost of \$64,429 and \$65,082, respectively)	70,254	73,740
Non-control/Non-affiliate investments (cost of \$503,333 and \$477,957, respectively)	501,092	478,785
Total investments at fair value (cost of \$806,395 and \$728,759, respectively, Note 4)	830,177	748,483
Investments in money market funds	21,040	68,871
Cash	1,062	1,081
Receivables for:		
Interest, net	5,898	5,356
Dividends	1,751	1
Other	679	419
Prepaid expenses	297	371
Deferred financing costs, net	7,359	7,579
Due from broker	1,803	
Other assets	534	534
<b>Total Assets</b>	<b>870,600</b>	<b>832,695</b>
<b>Liabilities</b>		
Credit facility payable (Note 11)	46,600	100,300
Dividends payable	7,889	6,909
Due to broker	1,980	
Due to Prospect Administration (Note 8)	407	294
Due to Prospect Capital Management (Note 8)	6,818	9,006
Accrued expenses	3,044	4,057
Other liabilities	1,038	705
<b>Total Liabilities</b>	<b>67,776</b>	<b>121,271</b>
<b>Net Assets</b>	<b>\$ 802,824</b>	<b>\$ 711,424</b>

**Components of Net Assets**

Common stock, par value \$0.001 per share (200,000,000 and 100,000,000 common shares authorized, respectively; 78,401,363 and 69,086,862 issued and outstanding, respectively) (Note 6)	\$	78	\$	69
Paid-in capital in excess of par (Note 6)		894,568		805,918
Distributions in excess of net investment income		(11,536)		(9,692)
Accumulated realized losses on investments		(104,068)		(104,595)
Unrealized appreciation on investments		23,782		19,724
<b>Net Assets</b>	\$	802,824	\$	711,424
<b>Net Asset Value Per Share</b>	\$	10.24	\$	10.30

See notes to consolidated financial statements.

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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**For The Three Months Ended September 30, 2010 and 2009**  
(in thousands, except share and per share data)  
(Unaudited)

	<b>For Three Months Ended September 30,</b>	
	<b>2010</b>	<b>2009</b>
<b>Investment Income</b>		
Interest income: (Note 4)		
Control investments (Net of foreign withholding tax of \$0 and \$32, respectively)	\$ 5,189	\$ 4,591
Affiliate investments	2,950	849
Non-control/Non-affiliate investments	20,782	9,395
Total interest income	28,921	14,835
Dividend income:		
Control investments	1,750	6,200
Non-control/Non-affiliate investments	440	
Money market funds	4	18
Total dividend income	2,194	6,218
Other income: (Note 5)		
Control/affiliate investments	1,771	
Affiliate investments	147	
Non-control/Non-affiliate investments	2,179	464
Total other income	4,097	464
<b>Total Investment Income</b>	<b>35,212</b>	<b>21,517</b>
<b>Operating Expenses</b>		
Investment advisory fees:		
Base management fee (Note 8)	4,276	3,209
Income incentive fee (Note 8)	5,249	3,080
Total investment advisory fees	9,525	6,289
Interest and credit facility expenses	2,261	1,374
Legal fees	310	
Valuation services	217	120
Audit, compliance and tax related fees	216	262



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Allocation of overhead from Prospect Administration (Note 8)	800	840
Insurance expense	71	63
Directors' fees	64	64
Other general and administrative expenses	753	187
<b>Total Operating Expenses</b>	<b>14,217</b>	<b>9,199</b>
<b>Net Investment Income</b>	<b>20,995</b>	<b>12,318</b>
Net realized gain on investments (Note 4)	527	
Net change in unrealized appreciation (depreciation) on investments (Note 4)	4,058	(18,696)
<b>Net Increase (Decrease) in Net Assets Resulting from Operations</b>	<b>\$ 25,580</b>	<b>\$ (6,378)</b>
Net increase (decrease) in net assets resulting from operations per share (Note 7 and Note 9)	<b>\$ 0.34</b>	<b>\$ (0.13)</b>
Dividends declared per share	<b>\$ 0.30</b>	<b>\$ 0.41</b>

See notes to consolidated financial statements.

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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS**  
**For The Three Months Ended September 30, 2010 and 2009**  
(in thousands, except share data)  
(Unaudited)

	<b>For The Three Months Ended September 30,</b>	
	<b>2010</b>	<b>2009</b>
<b>Increase (Decrease) in Net Assets from Operations:</b>		
Net investment income	\$ 20,995	\$ 12,318
Net realized gain on investments	527	
Net change in unrealized appreciation (depreciation) on investments	4,058	(18,696)
<b>Net Increase (Decrease) in Net Assets Resulting from Operations</b>	<b>25,580</b>	<b>(6,378)</b>
<b>Dividends to Shareholders</b>	<b>(22,838)</b>	<b>(19,548)</b>
<b>Capital Share Transactions:</b>		
Net proceeds from capital shares sold	86,435	98,833
Less: Offering costs of public share offerings	(308)	(1,158)
Reinvestment of dividends	2,531	2,901
<b>Net Increase in Net Assets Resulting from Capital Share Transactions</b>	<b>88,658</b>	<b>100,576</b>
<b>Total Increase in Net Assets</b>	<b>91,400</b>	<b>74,650</b>
Net assets at beginning of period	711,424	532,596
<b>Net Assets at End of Period</b>	<b>\$ 802,824</b>	<b>\$ 607,246</b>
<b>Capital Share Activity:</b>		
Shares sold	9,051,000	11,431,797
Shares issued through reinvestment of dividends	263,501	297,274
Net increase in capital share activity	9,314,501	11,729,071
Shares outstanding at beginning of period	69,086,862	42,943,084
<b>Shares Outstanding at End of Period</b>	<b>78,401,363</b>	<b>54,672,155</b>

See notes to consolidated financial statements.



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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For The Three Months Ended September 30, 2010 and 2009**  
(in thousands, except share data)  
(Unaudited)

	<b>For The Three Months Ended September 30,</b>	
	<b>2010</b>	<b>2009</b>
<b>Cash Flows from Operating Activities:</b>		
Net increase (decrease) in net assets resulting from operations	\$ 25,580	\$ (6,378)
Net realized gain on investments	(527)	
Net change in unrealized (appreciation) depreciation on investments	(4,058)	18,696
Accretion of purchase discount on investments	(4,305)	(501)
Amortization of deferred financing costs	990	823
<b>Change in operating assets and liabilities</b>		
Payments for purchases of investments	(137,797)	(4,599)
Payment-in-kind interest	(3,154)	(1,467)
Proceeds from sale of investments and collection of investment principal	68,148	24,241
Purchases of cash equivalents		(124,998)
Sales of cash equivalents		124,998
Net investments in money market funds	47,831	13,592
Increase in interest receivable	(542)	(1,090)
(Increase) decrease in dividends receivable	(1,750)	21
(Increase) decrease in other receivables	(260)	257
Decrease (increase) in prepaid expenses	74	(712)
Increase in due from broker	(1,803)	
Increase in due to broker	1,980	
Increase (decrease) in due to Prospect Administration	113	(685)
(Decrease) increase in due to Prospect Capital Management	(2,188)	3
Decrease in accrued expenses	(1,013)	(934)
Increase in other liabilities	333	236
<b>Net Cash (Used In) Provided By Operating Activities</b>	<b>(12,348)</b>	<b>41,503</b>
<b>Cash Flows from Financing Activities:</b>		
Borrowings under credit facility	93,200	
Payments under credit facility	(146,900)	(124,800)
Financing costs paid and deferred	(770)	(653)
Net proceeds from issuance of common stock	86,435	98,833
Offering costs from issuance of common stock	(308)	(1,158)
Dividends paid	(19,328)	(16,647)
<b>Net Cash Provided By (Used In) Financing Activities</b>	<b>12,329</b>	<b>(44,425)</b>

<b>Total Decrease in Cash</b>	(19)	(2,922)
Cash balance at beginning of period	1,081	9,942
<b>Cash Balance at End of Period</b>	\$ 1,062	\$ 7,020
<b>Cash Paid For Interest</b>	\$ 982	\$ 348
<b>Non-Cash Financing Activity:</b>		
Amount of shares issued in connection with dividend reinvestment plan	\$ 2,531	\$ 2,901

See notes to consolidated financial statements.

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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY  
CONSOLIDATED SCHEDULE OF INVESTMENTS**

**September 30, 2010 and June 30, 2010**

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

				September 30, 2010		
Portfolio Company	Locale / Industry	Investments <sup>(1)</sup>	Principal Value	Cost	Fair Value <sup>(2)</sup>	% of Net Assets
LEVEL 3 PORTFOLIO INVESTMENTS:						
Control Investments (25.00% or greater of voting control)						
AIRMALL USA, Inc.	Pennsylvania / Property Management	Senior Secured Term Loan (12.00%, due 6/30/2015) <sup>(3), (4)</sup>	\$ 30,000	\$ 30,000	\$ 30,000	3.7%
		Senior Subordinated Term Loan (12.00% plus 6.00% PIK, due 12/31/2015)	12,631	12,631	12,631	1.6%
		Convertible Preferred Stock (9,919.684 shares)		9,920	9,920	1.2%
		Common Stock (100 shares)			3,046	0.4%
				52,551	55,597	6.9%
Ajax Rolled Ring & Machine, Inc.	South Carolina / Manufacturing	Senior Secured Note Tranche A (10.50%, due 4/01/2013) <sup>(3), (4)</sup>	20,937	20,937	20,937	2.6%
		Subordinated Secured Note Tranche B (11.50% plus 6.00% PIK, due 4/01/2013) <sup>(3), (4)</sup>	13,840	13,840	10,046	1.3%
		Convertible Preferred Stock Series A (6,142.6 shares)		6,057		0.0%
		Unrestricted Common Stock (6 shares)				0.0%
				40,834	30,983	3.9%
AWCNC, LLC <sup>(20)</sup>	North Carolina / Machinery	Members Units Class A (1,800,000 units)				0.0%
		Members Units Class B-1 (1 unit)				0.0%
		Members Units Class B-2 (7,999,999 units)				0.0%
						0.0%

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Borga, Inc.	California / Manufacturing	Revolving Line of Credit \$1,000 Commitment (4.75% plus 3.25% default interest, in non-accrual status effective 03/02/2010, past due) <sup>(4), (26)</sup>	1,000	945	850	0.1%
		Senior Secured Term Loan B (8.25% plus 3.25% default interest, in non-accrual status effective 03/02/2010, past due) <sup>(4)</sup>	1,612	1,500	1,370	0.2%
		Senior Secured Term Loan C (12.00% plus 4.00% PIK plus 3.00% default interest, in non-accrual status effective 03/02/2010, past due)	8,713	707	18	0.0%
		Common Stock (100 shares) <sup>(22)</sup>				0.0%
		Warrants (33,750 warrants) <sup>(22)</sup>				0.0%
				<b>3,152</b>	<b>2,238</b>	<b>0.3%</b>
C&J Cladding LLC	Texas / Metal Services and Minerals	Membership Interest (400 units) <sup>(23)</sup>		580	4,958	0.6%
				<b>580</b>	<b>4,958</b>	<b>0.6%</b>
Change Clean Energy Holdings, Inc. ( CCEHI Biomass <sup>(5)</sup> )	Maine / Biomass Power	Common Stock (1,000 shares)		2,383		0.0%
				<b>2,383</b>		<b>0.0%</b>
Fischbein, LLC	North Carolina / Machinery	Senior Subordinated Debt (13.00% plus 5.50% PIK, due 5/01/2013)	2,441	2,273	2,441	0.3%
		Membership Interest <sup>(25)</sup>		1,899	9,715	1.2%
				<b>4,172</b>	<b>12,156</b>	<b>1.5%</b>
Freedom Marine Services LLC	Louisiana / Shipping Vessels	Subordinated Secured Note (16.00% PIK, due 12/31/2011)	10,399	10,359	3,506	0.4%
		Net Profits Interest (22.50% payable on equity distributions) <sup>(7)</sup>				0.0%
				<b>10,359</b>	<b>3,506</b>	<b>0.4%</b>

See notes to consolidated financial statements.



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

**September 30, 2010 and June 30, 2010**

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

			September 30, 2010			
Portfolio Company	Locale / Industry	Investments <sup>(1)</sup>	Principal Value	Cost	Fair Value <sup>(2)</sup>	% of Net Assets
LEVEL 3 PORTFOLIO INVESTMENTS:						
Control Investments (25.00 % or greater of voting control)						
Gas Solutions Holdings, Inc. <sup>(8), (3)</sup>	Texas / Gas Gathering and Processing	Senior Secured Note (18.00%, due 12/11/2016)	\$ 25,000	\$ 25,000	\$ 25,000	3.1%
		Junior Secured Note (18.00%, due 12/12/2016)	12,000	12,000	12,000	1.5%
		Common Stock (100 shares)		5,003	60,596	7.5%
				42,003	97,596	12.1%
Integrated Contract Services, Inc. <sup>(9)</sup>	North Carolina / Contracting	Senior Demand Note (15.00%, past due) <sup>(10)</sup>	1,170	1,170	1,170	0.1%
		Senior Secured Note (7.00% plus 7.00% PIK plus 6.00% default interest, in non-accrual status effective 10/09/2007, past due)	960	660	566	0.1%
		Junior Secured Note (7.00% plus 7.00% PIK plus 6.00% default interest, in non-accrual status effective 10/09/2007, past due)	14,003	14,003	1,642	0.2%
		Preferred Stock Series A (10 shares)				0.0%
		Common Stock (49 shares)		679		0.0%
				16,512	3,378	0.4%
Iron Horse Coiled Tubing, Inc. <sup>(24)</sup>	Alberta, Canada / Production Services	Senior Secured Tranche 1 (Zero Coupon, in non-accrual status effective 1/01/2010, due 12/31/2016)	615	396	615	0.1%
			2,337	2,338	2,338	0.3%

		Senior Secured Tranche 2 (Zero Coupon, in non-accrual status effective 1/01/2010, due 12/31/2016)				
		Senior Secured Tranche 3 (1.00%, in non-accrual status effective 1/01/2010, due 12/31/2016)	18,000	18,000	12,111	1.6%
		Common Stock (3,821 shares)		268		0.0%
				<b>21,002</b>	<b>15,064</b>	<b>2.0%</b>
Manx Energy, Inc. ( Manx <sup>12</sup> )	Kansas / Oil & Gas Production	Appalachian Energy Holdings, LLC ( AEH ) Senior Secured Note (8.00%, in non-accrual status effective 1/19/2010, due 1/19/2013)	2,116	2,000	401	0.0%
		Coalbed, LLC Senior Secured Note (8.00%, in non-accrual status effective 1/19/2010, due 1/19/2013) <sup>(6)</sup>	6,347	5,991	1,202	0.1%
		Manx Senior Secured Note (13.00%, in non-accrual status effective 1/19/2010, due 1/19/2013)	2,800	2,800	2,800	0.3%
		Manx Preferred Stock (6,635 shares)		6,308		0.0%
		Manx Common Stock (3,416,335 shares)		1,171		0.0%
				<b>18,270</b>	<b>4,403</b>	<b>0.4%</b>
NRG Manufacturing, Inc.	Texas / Manufacturing	Senior Secured Note (16.50%, due 8/31/2011) <sup>(3), (4)</sup>	13,080	13,080	13,080	1.6%
		Common Stock (800 shares)		2,317	4,494	0.6%
				<b>15,397</b>	<b>17,574</b>	<b>2.2%</b>
Nupla Corporation	California / Home & Office Furnishings, Housewares & Durable	Revolving Line of Credit \$2,000 Commitment (7.25% plus 2.00% default interest, due 9/04/2012) <sup>(4), (26)</sup>	1,093	971	1,093	0.1%
		Senior Secured Term Loan A (8.00% plus 2.00% default interest, due	4,995	1,359	3,893	0.5%

9/04/2012)<sup>(4)</sup>

Senior Subordinated Debt  
(10.00% plus 5.00% PIK, in  
non-accrual status effective  
4/01/2009, due 3/04/2013)

3,368

0.0%

Preferred Stock Class A  
(2,850 shares)

0.0%

Preferred Stock Class B  
(1,330 shares)

0.0%

Common Stock (2,360,743  
shares)

0.0%

**2,330**

**4,986**

**0.6%**

See notes to consolidated financial statements.

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

**September 30, 2010 and June 30, 2010**

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

		September 30, 2010				% of
Portfolio Company	Locale / Industry	Investments <sup>(1)</sup>	Principal Value	Cost	Fair Value <sup>(2)</sup>	Net Assets
LEVEL 3 PORTFOLIO INVESTMENTS:						
Control Investments (25.00 % or greater of voting control)						
R-V Industries, Inc.	Pennsylvania / Manufacturing	Warrants (200,000 warrants, expiring 6/30/2017)		\$ 1,682	\$ 1,380	0.2%
		Common Stock (545,107 shares)		5,086	3,761	0.5%
				6,768	5,141	0.7%
Sidump r Trailer Company, Inc.	Nebraska / Automobile	Revolving Line of Credit \$2,000 Commitment (7.25%, in non-accrual status effective 11/01/2008, due 1/10/2011) <sup>(4), (26)</sup>	\$ 1,025	479	443	0.1%
		Senior Secured Term Loan A (7.25%, in non-accrual status effective 11/01/2008, due 1/10/2011) <sup>(4)</sup>	2,048	463		0.0%
		Senior Secured Term Loan B (8.75%, in-non-accrual status effective 11/01/2008, due 1/10/2011) <sup>(4)</sup>	2,321			0.0%
		Senior Secured Term Loan C (16.50% PIK, in non-accrual status effective 9/27/2008, due 7/10/2011)	3,085			0.0%
		Senior Secured Term Loan D (7.25%, in non-accrual status effective 11/01/2008, due 7/10/2011) <sup>(4)</sup>	1,700			0.0%
						0.0%
						0.0%

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		Preferred Stock (49,843 shares)				
		Common Stock (64,050 shares)				0.0%
				<b>942</b>	<b>443</b>	<b>0.1%</b>
Yatesville Coal Holdings, Inc. <sup>(11)</sup>	Kentucky / Mining, Steel, Iron and Non-Precious Metals and Coal Production	Senior Secured Note (Non-accrual status effective 1/01/2009, due 12/31/2010) <sup>(4)</sup>	10,000	1,035	808	0.1%
		Junior Secured Note (Non-accrual status effective 1/01/2009, due 12/31/2010) <sup>(4)</sup>	42,180	343		0.0%
		Common Stock (1,000 shares)				0.0%
				<b>1,378</b>	<b>808</b>	<b>0.1%</b>
		<b>Total Control Investments</b>	<b>238,633</b>	<b>258,831</b>	<b>32.2%</b>	

**Affiliate Investments (5.00% to 24.99% voting control)**

Biotronic NeuroNetwork	Michigan / Healthcare	Senior Secured Note (11.50% plus 1.00% PIK, due 2/21/2013) <sup>(3), (4)</sup>	26,227	26,227	26,884	3.3%
		Preferred Stock (9,925,455 shares) <sup>(13)</sup>		2,300	2,824	0.4%
				<b>28,527</b>	<b>29,708</b>	<b>3.7%</b>
Boxercraft Incorporated	Georgia / Textiles & Leather	Senior Secured Term Loan A (9.50%, due 9/16/2013) <sup>(3), (4)</sup>	3,431	2,979	3,257	0.4%
		Senior Secured Term Loan B (10.00%, due 9/16/2013) <sup>(3), (4)</sup>	4,794	3,876	4,478	0.6%
		Subordinated Secured Term Loan (12.00% plus 6.50% PIK, due 3/16/2014) <sup>(3)</sup>	7,356	5,942	6,857	0.9%
		Preferred Stock (1,000,000 shares)			243	0.0%
		Common Stock (10,000 shares)				0.0%
				<b>12,797</b>	<b>14,835</b>	<b>1.9%</b>

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

			September 30, 2010			% of
Portfolio Company	Locale / Industry	Investments <sup>(1)</sup>	Principal Value	Cost	Fair Value <sup>(2)</sup>	Net Assets
LEVEL 3 PORTFOLIO INVESTMENTS:						
Affiliate Investments (5.00% to 24.99% voting control)						
KTPS Holdings, LLC	Colorado / Textiles & Leather	Revolving Line of Credit \$1,500 Commitment (10.50%, due 1/31/2012) <sup>(26), (27)</sup>	\$ 1,250	\$ 1,250	\$ 1,250	0.2%
		Senior Secured Term Loan A (10.50%, due 1/31/2012) <sup>(3), (4)</sup>	2,930	2,699	2,732	0.3%
		Senior Secured Term Loan B (12.00%, due 1/31/2012) <sup>(3)</sup>	430	380	403	0.1%
		Senior Secured Term Loan C (12.00% plus 12.75% PIK, due 3/31/2012) <sup>(3)</sup>	5,093	4,570	3,297	0.4%
		Membership Interest Class A (730 units)				0.0%
		Membership Interest Common (199,795 units)				0.0%
				8,899	7,682	1.0%
Smart, LLC <sup>(15)</sup>	New York / Diversified / Conglomerate Service	Membership Interest Class B (1,218 units)				0.0%
		Membership Interest Class D (1 unit)				0.0%
						0.0%
Sport Helmets Holdings, LLC <sup>(15)</sup>	New York / Personal & Nondurable Consumer Products	Revolving Line of Credit \$3,000 Commitment (4.30%, due 12/14/2013) <sup>(26), (27)</sup>				0.0%
			2,800	1,583	2,758	0.3%

Senior Secured Term Loan A (4.30%, due 12/14/2013) <sup>(3), (4)</sup>				
Senior Secured Term Loan B (4.80%, due 12/14/2013) <sup>(3), (4)</sup>	7,369	5,268	6,106	0.8%
Senior Subordinated Debt Series A (12.00% plus 3.00% PIK, due 6/14/2014) <sup>(3)</sup>	7,381	5,966	6,308	0.8%
Senior Subordinated Debt Series B (10.00% plus 5.00% PIK, due 6/14/2014) <sup>(3)</sup>	1,374	981	1,100	0.1%
Common Stock (20,554 shares)		408	1,757	0.2%
		<b>14,206</b>	<b>18,029</b>	<b>2.2%</b>
<b>Total Affiliate Investments</b>	<b>64,429</b>	<b>70,254</b>	<b>8.8%</b>	

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

ADAPCO, Inc.	Florida / Ecological	Common Stock (5,000 shares)	141	318	0.0%
			<b>141</b>	<b>318</b>	<b>0.0%</b>
Aircraft Fasteners International, LLC	California / Machinery	Revolving Line of Credit \$500 Commitment (9.50%, due 11/01/2012) <sup>(26), (27)</sup>			0.0%
		Senior Secured Term Loan (9.50%, due 11/01/2012) <sup>(3), (4)</sup>	4,451	4,451	0.5%
		Junior Secured Term Loan (12.00% plus 6.00% PIK, due 5/01/2013) <sup>(3)</sup>	5,213	5,213	0.6%
		Convertible Preferred Stock (32,500 units)	396	143	0.0%
			<b>10,060</b>	<b>9,262</b>	<b>1.1%</b>
American Gilsonite Company	Utah / Specialty Minerals	Senior Subordinated Note (12.00% plus 3.00% PIK, due 3/14/2013) <sup>(3)</sup>	14,783	14,783	1.9%
		Membership Interest in AGC/PEP, LLC (99.9999%) <sup>(16)</sup>	1,031	4,737	0.6%



				<b>15,814</b>	<b>19,668</b>	<b>2.5%</b>
Arrowhead General Insurance Agency, Inc. <sup>(17)</sup>	California / Insurance	Senior Secured Term Loan (8.50%, due 8/08/2012)	850	818	822	0.1%
		Junior Secured Term Loan (10.25% plus 2.50% PIK, due 2/08/2013)	6,217	5,123	5,103	0.6%
				<b>5,941</b>	<b>5,925</b>	<b>0.7%</b>

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			September 30, 2010			
Portfolio Company	Locale / Industry	Investments <sup>(1)</sup>	Principal Value	Cost	Fair Value <sup>(2)</sup>	% of Net Assets
LEVEL 3 PORTFOLIO INVESTMENTS:						
Non-control/Non-affiliate Investments (less than 5.00% of voting control)						
Caleel + Hayden, LLC (15)	Colorado / Personal & Nondurable Consumer Products	Membership Units (7,500 shares)		\$ 351	\$ 794	0.1%
		Options in Mineral Fusion Natural Brands, LLC (11,662 options)				0.0%
			351	794	0.1%	
Castro Cheese Company, Inc.	Texas / Food Products	Subordinated Secured Note (11.00% plus 2.00% PIK, due 2/28/2013) <sup>(3)</sup>	\$ 7,732	7,644	7,809	1.0%
			7,644	7,809	1.0%	
Copernicus Group	North Carolina / Healthcare	Revolving Line of Credit \$500 Commitment (10.00%, due 10/08/2013) <sup>(4), (26)</sup>	150	32	141	0.0%
		Senior Secured Term Loan A (10.00%, due 10/08/2013) <sup>(3), (4)</sup>	5,650	4,950	5,307	0.7%
		Senior Subordinated Debt (10.00% plus 10.00% PIK, due 4/08/2014)	13,732	11,829	13,667	1.7%
		Preferred Stock Series A (1,000,000 shares)		67	223	0.0%
		Preferred Stock Series C (212,121 shares)		212	265	0.0%
			17,090	19,603	2.4%	
Deb Shops, Inc. <sup>(17)</sup>			18,190	14,606	1,295	0.2%

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	Pennsylvania / Retail	Second Lien Debt (14.00% PIK, in non-accrual status effective 2/24/2009, due 10/23/2014)				
				14,606	1,295	0.2%
Diamondback Operating, LP	Oklahoma / Oil & Gas Production	Net Profits Interest (15.00% payable on Equity distributions) <sup>(7)</sup>			191	0.0%
					191	0.0%
EXL Acquisition Corporation	South Carolina / Electronics	Revolving Line of Credit \$1,000 Commitment (7.75%, due 06/24/2015) <sup>(26), (27)</sup>				0.0%
		Senior Secured Term Loan A (7.75%, due 6/24/2015) <sup>(3), (4)</sup>	11,744	11,744	11,816	1.5%
		Senior Secured Term Loan B (12.00% plus 2.00% PIK, due 12/24/2015) <sup>(3)</sup>	12,050	12,050	12,094	1.5%
		Common Stock Class A (2,475 shares)		437	415	0.1%
		Common Stock Class B (25 shares)		252	4	0.0%
				24,483	24,329	3.1%
Fairchild Industrial Products, Co.	North Carolina / Electronics	Preferred Stock Class A (285.1 shares)		377	655	0.1%
		Common Stock Class B (28 shares)		211	331	0.0%
				588	986	0.1%
H&M Oil & Gas, LLC	Texas / Oil & Gas Production	Senior Secured Note (13.00% plus 3.00% PIK, due 9/30/2010)	59,561	59,561	44,593	5.6%
		Net Profits Interest (8.00% payable on Equity distributions) <sup>(7)</sup>			605	0.1%
				59,561	45,198	5.7%
Hoffmaster Group, Inc.	Wisconsin / Durable Consumer Products	Second Lien Term Loan (13.50%, due 6/2/2017) <sup>(3)</sup>	20,000	20,000	20,400	2.5%
				20,000	20,400	2.5%

Hudson Products Holdings, Inc. <sup>(17)</sup>	Texas / Manufacturing	Senior Secured Term Loan (8.50%, due 8/24/2015) <sup>(3), (4)</sup>	6,365	5,759	5,243	0.7%
				<b>5,759</b>	<b>5,243</b>	<b>0.7%</b>

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			September 30, 2010			
Portfolio Company	Locale / Industry	Investments <sup>(1)</sup>	Principal Value	Cost	Fair Value <sup>(2)</sup>	% of Net Assets
LEVEL 3 PORTFOLIO INVESTMENTS:						
Non-control/Non-affiliate Investments (less than 5.00% of voting control)						
IEC Systems LP ( IEC ) /Advanced Rig Services LLC ( ARS )	Texas / Oilfield Fabrication	IEC Senior Secured Note (12.00% plus 3.00% PIK, due 11/20/2012) <sup>(3), (4)</sup>	\$ 18,407	\$ 18,407	\$ 18,407	2.3%
		ARS Senior Secured Note (12.00% plus 3.00% PIK, due 11/20/2012) <sup>(3), (4)</sup>	11,067	11,067	11,067	1.4%
				29,474	29,474	3.7%
Label Corp Holdings, Inc.	Nebraska / Printing & Publishing	Senior Secured Term Loan (8.50%, due 8/08/2014) <sup>(3), (4)</sup>	5,779	5,238	5,336	0.7%
				5,238	5,336	0.7%
LHC Holdings Corp. <sup>(17)</sup>	Florida / Healthcare	Revolving Line of Credit \$750 Commitment (9.00%, due 11/30/2012) <sup>(26), (27)</sup>				0.0%
		Senior Secured Term Loan A (8.50%, due 11/30/2012) <sup>(3), (4)</sup>	1,940	1,940	1,793	0.2%
		Senior Subordinated Debt (12.00% plus 2.50% PIK, due 5/31/2013) <sup>(3)</sup>	4,565	4,222	4,173	0.5%
		Membership Interest (125 units)		216	173	0.0%
				6,378	6,139	0.7%
Mac & Massey Holdings, LLC	Georgia / Food Products	Senior Subordinated Debt (10.00% plus 5.75% PIK, due 2/10/2013)	8,799	7,563	8,703	1.1%
		Membership Interest (250 units)		133	387	0.0%

				<b>7,696</b>	<b>9,090</b>	<b>1.1%</b>
Maverick Healthcare, LLC	Arizona / Healthcare	Second Lien Debt (12.50% plus 3.50% PIK, due 4/30/2014) <sup>(3)</sup>	13,239	13,239	13,364	1.7%
		Preferred Units (1,250,000 units)		1,252	1,896	0.2%
		Common Units (1,250,000 units)				0.0%
				<b>14,491</b>	<b>15,260</b>	<b>1.9%</b>
Miller Petroleum, Inc.	Tennessee / Oil & Gas Production	Warrants, Common Stock (2,567,822 warrants, expiring 5/04/2010 to 3/31/2015) <sup>(14)</sup>		150	1,153	0.1%
				<b>150</b>	<b>1,153</b>	<b>0.1%</b>
Northwestern Management Services, LLC	Florida / Healthcare	Revolving Line of Credit \$1,500 Commitment (10.50%, due 7/30/2015) <sup>(26)</sup>				0.0%
		Senior Secured Term Loan A (10.50%, due 7/30/2015) <sup>(3), (4)</sup>	18,750	18,750	18,750	2.3%
		Common Stock (50 shares)		371	631	0.1%
				<b>19,121</b>	<b>19,381</b>	<b>2.4%</b>
Prince Mineral Company, Inc. <sup>(3)</sup>	New York / Metal Services and Minerals	Junior Secured Term Loan (9.00%, due 12/21/2012) <sup>(4)</sup>	11,100	11,100	11,100	1.4%
		Senior Subordinated Debt (13.00% plus 2.00%, due 7/21/2013)	12,322	1,540	12,322	1.5%
				<b>12,640</b>	<b>23,422</b>	<b>2.9%</b>
Progrexion Holdings, LLC <sup>(3), (4)</sup>	Utah / Consumer Services	Senior Secured Term Loan (11.0%, due 12/31/2014)	35,910	35,910	35,910	4.5%
				<b>35,910</b>	<b>35,910</b>	<b>4.5%</b>

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			September 30, 2010			
Portfolio Company	Locale / Industry	Investments <sup>(1)</sup>	Principal Value	Cost	Fair Value <sup>(2)</sup>	% of Net Assets
LEVEL 3 PORTFOLIO INVESTMENTS:						
Non-control/Non-affiliate Investments (less than 5.00 % of voting control)						
Qualitest Pharmaceuticals, Inc. <sup>(17)</sup>	Alabama / Pharmaceuticals	Second Lien Debt (8.03%, due 4/30/2015) <sup>(3), (4)</sup>	\$ 12,000	\$ 11,957	\$ 12,000	1.5%
				11,957	12,000	1.5%
R-O-M Corporation	Missouri / Automobile	Revolving Line of Credit \$1,750 Commitment (4.50%, due 2/08/2013) <sup>(26), (27)</sup>				0.0%
		Senior Secured Term Loan A (4.50%, due 2/08/2013) <sup>(3), (4)</sup>	4,240	3,729	4,173	0.6%
		Senior Secured Term Loan B (8.00%, due 5/08/2013) <sup>(3), (4)</sup>	7,229	7,229	7,175	0.9%
		Senior Subordinated Debt (12.00% plus 3.00% PIK due 8/08/2013) <sup>(3)</sup>	7,118	6,818	6,566	0.8%
				17,776	17,914	2.3%
Seaton Corp	Illinois / Business Services	Subordinated Secured (12.50% plus 2.00% PIK, due 3/14/2014) <sup>(3), (4)</sup>	12,296	12,073	12,664	1.6%
				12,073	12,664	1.6%
Shearer's Foods, Inc.	Ohio / Food Products	Junior Secured Debt (12.00% plus 3.00% PIK, due 3/31/2016) <sup>(3)</sup>	35,536	35,536	37,073	4.6%
		Membership Interest in Mistral Chip Holdings, LLC (2,000 units) <sup>(18)</sup>		2,000	6,460	0.8%
				1,322	1,922	0.2%

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		Membership Interest in Mistral Chip Holdings, LLC 2 (595 units) <sup>(18)</sup>				
				<b>38,858</b>	<b>45,455</b>	<b>5.6%</b>
Skillsoft Public Limited Company	Ireland / Software & Computer Services	Subordinated Unsecured (11.125%, due 06/01/2018)	15,000	14,904	15,000	1.9%
				<b>14,904</b>	<b>15,000</b>	<b>1.9%</b>
SonicWALL, Inc.	California / Software & Computer Services	Subordinated Secured (12.00%, due 1/23/2017) <sup>(4)</sup>	23,000	22,980	23,000	2.9%
				<b>22,980</b>	<b>23,000</b>	<b>2.9%</b>
Stryker Energy, LLC	Ohio / Oil & Gas Production	Subordinated Secured Revolving Credit Facility (12.00% plus 3.00% PIK, due 12/01/2012) <sup>(3), (4)</sup> Overriding Royalty Interests <sup>(19)</sup>	29,953	29,769	29,861	3.7%
					2,744	0.3%
				<b>29,769</b>	<b>32,605</b>	<b>4.0%</b>
TriZetto Group <sup>(17)</sup>	California / Healthcare	Subordinated Unsecured Note (12.00% plus 1.50% PIK, due 10/01/2016) <sup>(3)</sup>	15,492	15,367	15,956	2.0%
				<b>15,367</b>	<b>15,956</b>	<b>2.0%</b>
Unitek <sup>(17)</sup>	Pennsylvania / Technical Services	Second Lien Debt (13.08%, due 12/31/2013) <sup>(3), (4)</sup>	11,500	11,394	11,500	1.4%
				<b>11,394</b>	<b>11,500</b>	<b>1.4%</b>
Wind River Resources Corp. and Wind River II Corp.	Utah / Oil & Gas Production	Senior Secured Note (13.00% plus 3.00% default interest on principal, 16.00% default interest on past due interest, in non-accrual status effective 12/01/2008, past due) <sup>(4)</sup> Net Profits Interest (5.00% payable on Equity distributions) <sup>(7)</sup>	15,000	15,000	8,701	1.1%
						0.0%



	<b>15,000</b>	<b>8,701</b>	<b>1.1%</b>
<b>Total Non-Control/Non-Affiliate Investments (Level 3 Investments)</b>	<b>503,214</b>	<b>500,981</b>	<b>62.4%</b>
<b>Total Level 3 Portfolio Investments</b>	<b>806,276</b>	<b>830,066</b>	<b>103.4%</b>

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			September 30, 2010			
Portfolio Company	Locale / Industry	Investments <sup>(1)</sup>	Principal Value	Cost	Fair Value <sup>(2)</sup>	% of Net Assets
LEVEL 1 PORTFOLIO INVESTMENTS:						
Non-control/Non-affiliate Investments (less than 5.00% of voting control)						
Allied Defense Group, Inc.	Virginia / Aerospace & Defense	Common Stock (10,000 shares)		\$ 56	\$ 24	0.0%
				56	24	0.0%
Dover Saddlery, Inc.	Massachusetts / Retail	Common Stock (30,974 shares)		63	87	0.0%
				63	87	0.0%
Total Non-Control/Non-Affiliate Investments (Level 1 Investments)				119	111	0.0%
Total Portfolio Investments				806,395	830,177	103.4%
SHORT TERM INVESTMENTS: Money Market Funds (Level 2 Investments)						
Fidelity Institutional Money Market Funds (Class I)		Government Portfolio		8,457	8,457	1.6%
Fidelity Institutional Money Market Funds (Class I) <sup>(3)</sup>		Government Portfolio		12,582	12,582	1.1%
Victory Government Money Market Funds				1	1	0.0%
Total Money Market Funds				21,040	21,040	2.6%
Total Investments				827,435	851,217	106.0%

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				June 30, 2010		
Portfolio Company	Locale / Industry	Investments <sup>(1)</sup>	Principal Value	Cost	Fair Value <sup>(2)</sup>	% of Net Assets
LEVEL 3 PORTFOLIO INVESTMENTS:						
Control Investments (25.00% or greater of voting control)						
Ajax Rolled Ring & Machine, Inc.	South Carolina / Manufacturing	Senior Secured Note Tranche A (10.50%, due 4/01/2013) <sup>(3), (4)</sup>	\$ 21,047	\$ 21,047	\$ 21,047	3.0%
		Subordinated Secured Note Tranche B (11.50% plus 6.00% PIK, due 4/01/2013) <sup>(3), (4)</sup>	16,306	16,306	9,857	1.3%
		Subordinated Secured Note Tranche B (15.00%, due 10/30/2010)	500	500		0.0%
		Convertible Preferred Stock Series A (6,142.6 shares)		6,057		0.0%
		Unrestricted Common Stock (6 shares)				0.0%
				43,910	30,904	4.3%
AWCNC, LLC <sup>(20)</sup>	North Carolina / Machinery	Members Units Class A (1,800,000 units)				0.0%
		Members Units Class B-1 (1 unit)				0.0%
		Members Units Class B-2 (7,999,999 units)				0.0%
						0.0%
Borga, Inc.	California / Manufacturing	Revolving Line of Credit \$1,000 Commitment (4.75% plus 3.25% default interest, in non-accrual status effective 03/02/2010, past due) <sup>(4), (26)</sup>	1,000	945	850	0.1%
		Senior Secured Term Loan B (8.25% plus 3.25% default interest, in non-accrual status effective 03/02/2010, past	1,612	1,500	1,282	0.2%

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		due) <sup>(4)</sup> Senior Secured Term Loan C (12.00% plus 4.00% PIK plus 3.00% default interest, in non-accrual status effective 03/02/2010, past due)	8,624	707		0.0%
		Common Stock (100 shares) <sup>(22)</sup>				0.0%
		Warrants (33,750 warrants) <sup>(22)</sup>				0.0%
				<b>3,152</b>	<b>2,132</b>	<b>0.3%</b>
C&J Cladding LLC	Texas / Metal Services and Minerals	Membership Interest (400 units) <sup>(23)</sup>		580	4,128	0.6%
				<b>580</b>	<b>4,128</b>	<b>0.6%</b>
Change Clean Energy Holdings, Inc. ( CCEHI or Biomass <sup>(5)</sup> )	Maine / Biomass Power	Common Stock (1,000 shares)		2,383		0.0%
				<b>2,383</b>		<b>0.0%</b>
Fischbein, LLC	North Carolina / Machinery	Senior Subordinated Debt (13.00% plus 5.50% PIK, due 5/01/2013)	3,811	3,631	3,811	0.5%
		Membership Interest <sup>(25)</sup>		1,899	4,812	0.7%
				<b>5,530</b>	<b>8,623</b>	<b>1.2%</b>
Freedom Marine Services LLC	Louisiana / Shipping Vessels	Subordinated Secured Note (16.00% PIK, due 12/31/2011) <sup>(3)</sup>	10,088	10,040	3,583	0.5%
		Net Profits Interest (22.50% payable on equity distributions) <sup>(3), (7)</sup>				0.0%
				<b>10,040</b>	<b>3,583</b>	<b>0.5%</b>
Gas Solutions Holdings, Inc. <sup>(8), (3)</sup>	Texas / Gas Gathering and Processing	Senior Secured Note (18.00%, due 12/11/2016)	25,000	25,000	25,000	3.5%
		Junior Secured Note (18.00%, due 12/12/2016)	7,500	7,500	7,500	1.1%
		Common Stock (100 shares)		5,003	60,596	8.5%
				<b>37,503</b>	<b>93,096</b>	<b>13.1%</b>

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			June 30, 2010			
Portfolio Company	Locale / Industry	Investments <sup>(1)</sup>	Principal Value	Cost	Fair Value <sup>(2)</sup>	% of Net Assets
LEVEL 3 PORTFOLIO INVESTMENTS:						
Control Investments (25.00 % or greater of voting control)						
Integrated Contract Services, Inc. <sup>(9)</sup>	North Carolina / Contracting	Senior Demand Note (15.00%, past due) <sup>(10)</sup>	\$ 1,170	\$ 1,170	\$ 1,170	0.2%
		Senior Secured Note (7.00% plus 7.00% PIK plus 6.00% default interest, in non-accrual status effective 10/09/2007, past due)	1,100	800	1,100	0.2%
		Junior Secured Note (7.00% plus 7.00% PIK plus 6.00% default interest, in non-accrual status effective 10/09/2007, past due)	14,003	14,003	2,272	0.2%
		Preferred Stock Series A (10 shares)				0.0%
		Common Stock (49 shares)		679		0.0%
				16,652	4,542	0.6%
Iron Horse Coiled Tubing, Inc. <sup>(24)</sup>	Alberta, Canada / Production Services	Senior Secured Tranche 1 (Zero Coupon, in non-accrual status effective 1/01/2010, due 12/31/2016)	615	396	615	0.1%
		Senior Secured Tranche 2 (Zero Coupon, in non-accrual status effective 1/01/2010, due 12/31/2016)	2,337	2,338	2,338	0.3%
		Senior Secured Tranche 3 (1.00%, in non-accrual status effective 1/01/2010, due 12/31/2016)	18,000	18,000	9,101	1.3%
		Common Stock (3,821 shares)		268		0.0%
				21,002	12,054	1.7%
			2,073	2,000	472	0.1%

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Manx Energy, Inc. ( Manx <sup>(12)</sup> )	Kansas / Oil & Gas Production	Appalachian Energy Holdings, LLC ( AEH ) Senior Secured Note (8.00%, in non-accrual status effective 1/19/2010, due 1/19/2013)				
		Coalbed, LLC Senior Secured Note (8.00%, in non-accrual status effective 1/19/2010, due 1/19/2013) <sup>(6)</sup>	6,219	5,991	1,414	0.2%
		Manx Senior Secured Note (13.00%, in non-accrual status effective 1/19/2010, due 1/19/2013)	2,800	2,800	2,800	0.4%
		Manx Preferred Stock (6,635 shares)		6,308		0.0%
		Manx Common Stock (3,416,335 shares)		1,171		0.0%
				<b>18,270</b>	<b>4,686</b>	<b>0.7%</b>
NRG Manufacturing, Inc.	Texas / Manufacturing	Senior Secured Note (16.50%, due 8/31/2011) <sup>(3), (4)</sup>	13,080	13,080	13,080	1.8%
		Common Stock (800 shares)		2,317	7,031	1.0%
				<b>15,397</b>	<b>20,111</b>	<b>2.8%</b>
Nupla Corporation	California / Home & Office Furnishings, Housewares & Durable	Revolving Line of Credit \$2,000 Commitment (7.25% plus 2.00% default interest, due 9/04/2012) <sup>(4), (26)</sup>				
			1,093	958	1,093	0.1%
		Senior Secured Term Loan A (8.00% plus 2.00% default interest, due 9/04/2012) <sup>(4)</sup>	5,139	1,503	3,301	0.5%
		Senior Subordinated Debt (10.00% plus 5.00% PIK, in non-accrual status effective 4/01/2009, due 3/04/2013)	3,368			0.0%
		Preferred Stock Class A (2,850 shares)				0.0%
		Preferred Stock Class B (1,330 shares)				0.0%
		Common Stock (2,360,743 shares)				0.0%
				<b>2,461</b>	<b>4,394</b>	<b>0.6%</b>
R-V Industries, Inc.	Pennsylvania / Manufacturing	Warrants (200,000 warrants, expiring 6/30/2017)		1,682	1,697	0.2%
		Common Stock (545,107 shares)		5,086	4,626	0.7%



**6,768      6,323      0.9%**

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

			June 30, 2010			% of	
Portfolio Company	Locale / Industry	Investments <sup>(1)</sup>	Principal Value	Cost	Fair Value <sup>(2)</sup>	Net Assets	
LEVEL 3 PORTFOLIO INVESTMENTS:							
Control Investments (25.00 % or greater of voting control)							
Sidump r Trailer Company, Inc.	Nebraska / Automobile	Revolving Line of Credit \$2,000 Commitment (7.25%, in non-accrual status effective 11/01/2008, due 1/10/2011) <sup>(4)</sup> , <sup>(26)</sup>	\$ 1,025	\$ 479	\$ 574	0.1%	
		Senior Secured Term Loan A (7.25%, in non-accrual status effective 11/01/2008, due 1/10/2011) <sup>(4)</sup>	2,048	463		0.0%	
		Senior Secured Term Loan B (8.75%, in-non-accrual status effective 11/01/2008, due 1/10/2011) <sup>(4)</sup>	2,321			0.0%	
		Senior Secured Term Loan C (16.50% PIK, in non-accrual status effective 9/27/2008, due 7/10/2011)	3,085			0.0%	
		Senior Secured Term Loan D (7.25%, in non-accrual status effective 11/01/2008, due 7/10/2011) <sup>(4)</sup>	1,700			0.0%	
		Preferred Stock (49,843 shares)				0.0%	
		Common Stock (64,050 shares)				0.0%	
				942	574	0.1%	
Yatesville Coal Holdings, Inc. <sup>(11)</sup>	Kentucky / Mining, Steel, Iron and Non-Precious Metals and Coal Production	Senior Secured Note (Non-accrual status effective 1/01/2009, due 12/31/2010) <sup>(4)</sup>	10,000	1,035	808	0.1%	
			41,931	95		0.0%	

Junior Secured Note  
(Non-accrual status effective  
1/01/2009, due 12/31/2010)<sup>(4)</sup>  
Common Stock (1,000 shares) 0.0%

1,130 808 0.1%

**Total Control Investments 185,720 195,958 27.5%**

# Affiliate Investments (5.00% to 24.99% voting control)

Biotronic NeuroNetwork	Michigan / Healthcare	Senior Secured Note (11.50% plus 1.00% PIK, due 2/21/2013) <sup>(3), (4)</sup>	26,227	26,227	26,744	3.8%
		Preferred Stock (9,925.455 shares) <sup>(13)</sup>		2,300	2,759	0.4%
				<b>28,527</b>	<b>29,503</b>	<b>4.2%</b>

Boxercraft Incorporated	Georgia / Textiles & Leather	Revolving Line of Credit \$1,000 Commitment (9.00%, due 9/16/2013) <sup>(26), (27)</sup>	1,000	1,000	1,000	0.1%
		Senior Secured Term Loan A (9.50%, due 9/16/2013) <sup>(3), (4)</sup>	3,843	3,330	3,577	0.5%
		Senior Secured Term Loan B (10.00%, due 9/16/2013) <sup>(3), (4)</sup>	4,822	3,845	4,386	0.6%
		Subordinated Secured Term Loan (12.00% plus 6.50% PIK, due 3/16/2014) <sup>(3)</sup>	7,235	5,775	6,717	1.0%
		Preferred Stock (1,000,000 shares)			205	0.0%
		Common Stock (10,000 shares)				0.0%
				<b>13,950</b>	<b>15,885</b>	<b>2.2%</b>

KTPS Holdings, LLC	Colorado / Textiles & Leather	Revolving Line of Credit \$1,500 Commitment (10.50%, due 1/31/2012) <sup>(26), (27)</sup>	1,000	1,000	1,000	0.1%
		Senior Secured Term Loan A (10.50%, due 1/31/2012) <sup>(3), (4)</sup>	3,130	2,847	2,916	0.4%
		Senior Secured Term Loan B (12.00%, due 1/31/2012) <sup>(3)</sup>	435	377	409	0.1%
		Senior Secured Term Loan C (12.00% plus 6.00% PIK, due 3/31/2012) <sup>(3)</sup>	4,932	4,345	4,796	0.7%
		Membership Interest Class A (730 units)				0.0%
		Membership Interest Common (199,795 units)				0.0%

**8,569      9,121      1.3%**

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Portfolio Company	Locale / Industry	Investments <sup>(1)</sup>	Principal Value	June 30, 2010		% of Net Assets
				Cost	Fair Value <sup>(2)</sup>	
LEVEL 3 PORTFOLIO INVESTMENTS:						
Affiliate Investments (5.00% to 24.99% voting control)						
Smart, LLC <sup>(15)</sup>	New York / Diversified / Conglomerate Service	Membership Interest Class B (1,218 units)		\$	\$	0.0%
		Membership Interest Class D (1 unit)				0.0%
						0.0%
Sport Helmets Holdings, LLC <sup>(15)</sup>	New York / Personal & Nondurable Consumer Products	Revolving Line of Credit \$3,000 Commitment (4.54%, due 12/14/2013) <sup>(26), (27)</sup>				0.0%
		Senior Secured Term Loan A (4.54%, due 12/14/2013) <sup>(3), (4)</sup>	\$ 3,025	1,658	2,993	0.4%
		Senior Secured Term Loan B (5.04%, due 12/14/2013) <sup>(3), (4)</sup>	7,388	5,161	6,432	0.9%
		Senior Subordinated Debt Series A (12.00% plus 3.00% PIK, due 6/14/2014) <sup>(3)</sup>	7,325	5,857	6,734	0.9%
		Senior Subordinated Debt Series B (10.00% plus 5.00% PIK, due 6/14/2014) <sup>(3)</sup>	1,357	952	1,160	0.2%
		Common Stock (20,554 shares)		408	1,912	0.3%
				14,036	19,231	2.7%
		Total Affiliate Investments		65.082	73,740	10.4%

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

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ADAPCO, Inc.	Florida / Ecological	Common Stock (5,000 shares)		141	340	0.0%
				141	340	0.0%
Aircraft Fasteners International, LLC	California / Machinery	Revolving Line of Credit \$500 Commitment (9.50%, due 11/01/2012) <sup>(26), (27)</sup>				0.0%
		Senior Secured Term Loan (9.50%, due 11/01/2012) <sup>(3), (4)</sup>	4,565	4,565	4,248	0.6%
		Junior Secured Term Loan (12.00% plus 6.00% PIK, due 5/01/2013) <sup>(3)</sup>	5,134	5,134	4,807	0.7%
		Convertible Preferred Stock (32,500 units)		396	98	0.0%
				10,095	9,153	1.3%
American Gilsonite Company	Utah / Specialty Minerals	Senior Subordinated Note (12.00% plus 3.00% PIK, due 3/14/2013) <sup>(3)</sup>	14,783	14,783	14,931	2.1%
		Membership Interest in AGC/PEP, LLC (99.9999%) <sup>(16)</sup>		1,031	3,532	0.5%
				15,814	18,463	2.6%
Arrowhead General Insurance Agency, Inc. <sup>(17)</sup>	California / Insurance	Senior Secured Term Loan (8.50%, due 8/08/2012)	850	809	830	0.1%
		Junior Secured Term Loan (10.25% plus 2.50% PIK, due 2/08/2013)	6,179	5,002	5,122	0.7%
				5,811	5,952	0.8%
Caleel + Hayden, LLC <sup>(15)</sup>	Colorado / Personal & Nondurable Consumer Products	Membership Units (7,500 shares)				
				351	818	0.1%
		Options in Mineral Fusion Natural Brands, LLC (11,662 options)				0.0%
				351	818	0.1%

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			June 30, 2010			
Portfolio Company	Locale / Industry	Investments <sup>(1)</sup>	Principal Value	Cost	Fair Value <sup>(2)</sup>	% of Net Assets
LEVEL 3 PORTFOLIO INVESTMENTS:						
Non-control/Non-affiliate Investments (less than 5.00% of voting control)						
Castro Cheese Company, Inc.	Texas / Food Products	Subordinated Secured Note (11.00% plus 2.00% PIK, due 2/28/2013) <sup>(3)</sup>	\$ 7,692	\$ 7,597	\$ 7,769	1.1%
				7,597	7,769	1.1%
Copernicus Group	North Carolina / Healthcare	Revolving Line of Credit \$500 Commitment (10.00%, due 10/08/2013) <sup>(4), (26)</sup>	150	22	150	0.0%
		Senior Secured Term Loan A (10.00%, due 10/08/2013) <sup>(3), (4)</sup>	5,850	5,058	5,416	0.8%
		Senior Subordinated Debt (10.00% plus 10.00% PIK, due 4/08/2014)	13,390	11,421	12,677	1.8%
		Preferred Stock Series A (1,000,000 shares)		67	104	0.0%
		Preferred Stock Series C (212,121 shares)		212	246	0.0%
				16,780	18,593	2.6%
Deb Shops, Inc. <sup>(17)</sup>	Pennsylvania / Retail	Second Lien Debt (14.00% PIK, in non-accrual status effective 2/24/2009, due 10/23/2014)	17,562	14,606	2,051	0.3%
				14,606	2,051	0.3%
Diamondback Operating, LP	Oklahoma / Oil & Gas Production	Net Profits Interest (15.00% payable on Equity distributions) <sup>(7)</sup>			193	0.0%
					193	0.0%



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EXL Acquisition Corporation	South Carolina / Electronics	Revolving Line of Credit \$1,000 Commitment (7.75%, due 06/24/2015) <sup>(26), (27)</sup>				0.0%
		Senior Secured Term Loan A (7.75%, due 6/24/2015) <sup>(3), (4)</sup>	12,250	12,250	12,250	1.7%
		Senior Secured Term Loan B (12.00% plus 2.00% PIK, due 12/24/2015) <sup>(3)</sup>	12,250	12,250	12,250	1.7%
		Common Stock Class A (2,475 shares)		437	363	0.1%
		Common Stock Class B (25 shares)		252	103	0.0%
				<b>25,189</b>	<b>24,966</b>	<b>3.5%</b>
Fairchild Industrial Products, Co. <sup>(2)</sup>	North Carolina / Electronics	Preferred Stock Class A (285.1 shares)		377	435	0.1%
		Common Stock Class B (28 shares)		211	228	0.0%
				<b>588</b>	<b>663</b>	<b>0.1%</b>
H&M Oil & Gas, LLC	Texas / Oil & Gas Production	Senior Secured Note (13.00% plus 3.00% PIK, due 9/30/2010)	59,107	59,107	48,867	6.9%
		Net Profits Interest (8.00% payable on Equity distributions) <sup>(7)</sup>			827	0.1%
				<b>59,107</b>	<b>49,694</b>	<b>7.0%</b>
Hoffmaster Group, Inc.	Wisconsin / Durable Consumer Products	Second Lien Term Loan (13.50%, due 6/2/2017) <sup>(3)</sup>	20,000	20,000	20,000	2.8%
				<b>20,000</b>	<b>20,000</b>	<b>2.8%</b>
Hudson Products Holdings, Inc. <sup>(17)</sup>	Texas / Manufacturing	Senior Secured Term Loan (8.00%, due 8/24/2015) <sup>(3), (4)</sup>	6,365	5,734	5,314	0.7%
				<b>5,734</b>	<b>5,314</b>	<b>0.7%</b>
IEC Systems LP ( IEC ) /Advanced Rig Services LLC ( ARS )	Texas / Oilfield Fabrication	IEC Senior Secured Note (12.00% plus 3.00% PIK, due 11/20/2012) <sup>(3), (4)</sup>	19,008	19,008	19,008	2.7%
		ARS Senior Secured Note (12.00% plus 3.00% PIK, due 11/20/2012) <sup>(3), (4)</sup>	11,421	11,421	11,421	1.6%

**30,429      30,429      4.3%**

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Portfolio Company	Locale / Industry	Investments <sup>(1)</sup>	Principal Value	June 30, 2010		% of Net Assets
				Cost	Fair Value <sup>(2)</sup>	
LEVEL 3 PORTFOLIO INVESTMENTS:						
Non-control/Non-affiliate Investments (less than 5.00% of voting control)						
Impact Products, LLC	Ohio / Home & Office Furnishings, Housewares & Durable	Junior Secured Term Loan (6.38%, due 9/09/2012) <sup>(4)</sup>				
			\$ 7,300	\$ 6,351	\$ 7,290	1.0%
		Senior Subordinated Debt (10.00% plus 5.00% PIK, due 9/09/2012)	5,548	5,300	5,548	0.8%
				11,651	12,838	1.8%
Label Corp Holdings, Inc.	Nebraska / Printing & Publishing	Senior Secured Term Loan (8.50%, due 8/08/2014) <sup>(3), (4)</sup>	5,794	5,222	5,284	0.7%
				5,222	5,284	0.7%
LHC Holdings Corp. <sup>(17)</sup>	Florida / Healthcare	Revolving Line of Credit Commitment (9.00%, due 11/30/2012) <sup>(26), (27)</sup>	\$750			0.0%
		Senior Secured Term Loan A (9.00%, due 11/30/2012) <sup>(3), (4)</sup>	2,015	2,015	1,839	0.3%
		Senior Subordinated Debt (12.00% plus 2.50% PIK, due 5/31/2013) <sup>(3)</sup>	4,565	4,199	4,220	0.6%
		Membership Interest (125 units)		216	217	0.0%
				6,430	6,276	0.9%
Mac & Massey Holdings, LLC	Georgia / Food Products	Senior Subordinated Debt (10.00% plus 5.75% PIK, due 2/10/2013)	8,671	7,351	8,643	1.2%
		Membership Interest (250 units)		145	390	0.1%

				<b>7,496</b>	<b>9,033</b>	<b>1.3%</b>
Maverick Healthcare, LLC	Arizona / Healthcare	Second Lien Debt (12.50% plus 3.50% PIK, due 4/30/2014) <sup>(3)</sup>	13,122	13,122	13,247	1.9%
		Preferred Units (1,250,000 units)		1,252	2,025	0.2%
		Common Units (1,250,000 units)				0.0%
				<b>14,374</b>	<b>15,272</b>	<b>2.1%</b>
Miller Petroleum, Inc.	Tennessee / Oil & Gas Production	Warrants, Common Stock (2,208,772 warrants, expiring 5/04/2010 to 3/31/2015) <sup>(14)</sup>		150	1,244	0.2%
				<b>150</b>	<b>1,244</b>	<b>0.2%</b>
Northwestern Management Services, LLC	Florida / Healthcare	Revolving Line of Credit \$1,000 Commitment (4.36%, due 12/13/2012) <sup>(26), (27)</sup>	350	350	350	0.0%
		Senior Secured Term Loan A (4.36%, due 12/13/2012) <sup>(3), (4)</sup>	4,309	3,516	3,578	0.5%
		Senior Secured Term Loan B (4.86%, due 12/13/2012) <sup>(3), (4)</sup>	1,219	904	956	0.1%
		Subordinated Secured Term Loan (12.00% plus 3.00%, due 6/13/2013) <sup>(3)</sup>	2,971	2,468	2,606	0.4%
		Common Stock (50 shares)		371	564	0.1%
				<b>7,609</b>	<b>8,054</b>	<b>1.1%</b>
Prince Mineral Company, Inc.	New York / Metal Services and Minerals	Junior Secured Term Loan (9.00%, due 12/21/2012) <sup>(4)</sup>	11,150	11,150	11,150	1.6%
		Senior Subordinated Debt (13.00% plus 2.00%, due 7/21/2013)	12,260	1,420	12,260	1.7%
				<b>12,570</b>	<b>23,410</b>	<b>3.3%</b>
Qualitest Pharmaceuticals, Inc. <sup>(17)</sup>	Alabama / Pharmaceuticals	Second Lien Debt (7.79%, due 4/30/2015) <sup>(3), (4)</sup>	12,000	11,955	12,000	1.7%
				<b>11,955</b>	<b>12,000</b>	<b>1.7%</b>

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Portfolio Company	Locale / Industry	Investments <sup>(1)</sup>	Principal Value	June 30, 2010		% of Net Assets
				Cost	Fair Value <sup>(2)</sup>	
LEVEL 3 PORTFOLIO INVESTMENTS:						
Non-control/Non-affiliate Investments (less than 5.00 % of voting control)						
Regional Management Corporation	South Carolina / Financial Services	Second Lien Debt (12.00% plus 2.00% PIK, due 6/29/2012) <sup>(3)</sup>	\$ 25,814	\$ 25,814	\$ 25,592	3.6%
				<b>25,814</b>	<b>25,592</b>	<b>3.6%</b>
Roll Coater Acquisition Corp.	Indiana / Metal Services and Minerals	Subordinated Secured Debt (10.25%, due 9/30/2010)	6,268	6,102	6,082	0.9%
				<b>6,102</b>	<b>6,082</b>	<b>0.9%</b>
R-O-M Corporation	Missouri / Automobile	Revolving Line of Credit \$1,750 Commitment (4.50%, due 2/08/2013) <sup>(26), (27)</sup>				0.0%
		Senior Secured Term Loan A (4.50%, due 2/08/2013) <sup>(3), (4)</sup>	4,640	4,025	4,571	0.6%
		Senior Secured Term Loan B (8.00%, due 5/08/2013) <sup>(3), (4)</sup>	7,251	7,251	7,078	1.0%
		Senior Subordinated Debt (12.00% plus 3.00% PIK due 8/08/2013) <sup>(3)</sup>	7,118	6,799	6,392	0.9%
				<b>18,075</b>	<b>18,041</b>	<b>2.5%</b>
Seaton Corp	Illinois / Business Services	Subordinated Secured (12.50% plus 2.00% PIK, due 3/14/2011)	12,296	12,060	12,132	1.7%
				<b>12,060</b>	<b>12,132</b>	<b>1.7%</b>
Shearer's Foods, Inc.	Ohio / Food Products	Junior Secured Debt (12.00% plus 3.00% PIK,	35,266	35,266	36,119	5.1%

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		due 3/31/2016) <sup>(3)</sup> Membership Interest in Mistral Chip Holdings, LLC (2,000 units) <sup>(18)</sup>		2,560	6,136	0.9%
		Membership Interest in Mistral Chip Holdings, LLC 2 (595 units) <sup>(18)</sup>		762	1,825	0.2%
				<b>38,588</b>	<b>44,080</b>	<b>6.2%</b>
Skillsoft Public Limited Company	Ireland / Prepackaged Software	Subordinated Unsecured (11.125%, due 06/01/2018)	15,000	14,903	15,000	2.2%
				<b>14,903</b>	<b>15,000</b>	<b>2.2%</b>
Stryker Energy, LLC	Ohio / Oil & Gas Production	Subordinated Secured Revolving Credit Facility (12.00%, due 12/01/2012) <sup>(3), (4)</sup> Overriding Royalty Interests <sup>(19)</sup>	29,724	29,507	29,624	4.2%
					2,768	0.4%
				<b>29,507</b>	<b>32,392</b>	<b>4.6%</b>
TriZetto Group <sup>(17)</sup>	California / Healthcare	Subordinated Unsecured Note (12.00% plus 1.50% PIK, due 10/01/2016) <sup>(3)</sup>	15,434	15,306	15,895	2.2%
				<b>15,306</b>	<b>15,895</b>	<b>2.2%</b>
Unitek <sup>(17)</sup>	Pennsylvania / Technical Services	Second Lien Debt (13.08%, due 12/31/2013) <sup>(3), (4)</sup>	11,500	11,387	11,615	1.7%
				<b>11,387</b>	<b>11,615</b>	<b>1.7%</b>
Wind River Resources Corp. and Wind River II Corp.	Utah / Oil & Gas Production	Senior Secured Note (13.00% plus 3.00% default interest, in non-accrual status effective 12/01/2008, due 7/31/2010) <sup>(4)</sup> Net Profits Interest (5.00% payable on Equity distributions) <sup>(7)</sup>	15,000	15,000	8,779	1.2%
						0.0%
				<b>15,000</b>	<b>8,779</b>	<b>1.2%</b>
		<b>Total Non-Control/Non-Affiliate Investments (Level 3 Investments)</b>		<b>476,441</b>	<b>477,417</b>	<b>67.1%</b>

<b>Total Level 3 Portfolio Investments</b>	<b>727,243</b>	<b>747,115</b>	<b>105.0%</b>
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**September 30, 2010 and June 30, 2010**

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

Portfolio Company	Locale / Industry	Investments <sup>(1)</sup>	Principal Value	June 30, 2010		% of Net Assets
				Cost	Fair Value <sup>(2)</sup>	
LEVEL 1 PORTFOLIO INVESTMENTS:						
Non-control/Non-affiliate Investments (less than 5.00% of voting control)						
Allied Defense Group, Inc.	Virginia / Aerospace & Defense	Common Stock (10,000 shares)		\$ 56	\$ 38	0.0%
				56	38	0.0%
Dover Saddlery, Inc.	Massachusetts / Retail	Common Stock (30,974 shares)		63	97	0.0%
				63	97	0.0%
LyondellBasell Industries N.V. <sup>(22)</sup>	Netherlands / Chemical Company	Class A Common Stock (26,961 shares)		874	435	0.2%
		Class B Common Stock (49,421 shares)		523	798	0.0%
				1,397	1,233	0.2%
		Total Non-Control/Non-Affiliate Investments (Level 1 Investments)		1,516	1,368	0.2%
		Total Portfolio Investments		728,759	748,483	105.2%

**SHORT TERM INVESTMENTS: Money Market Funds (Level 2 Investments)**

Fidelity Institutional Money Market Funds (Class I)	Government Portfolio		62,183	62,183	8.8%
Fidelity Institutional Money Market Funds (Class I) <sup>(3)</sup>	Government Portfolio		6,687	6,687	0.9%
Victory Government Money Market Funds			1	1	0.0%
	<b>Total Money Market Funds</b>		<b>68,871</b>	<b>68,871</b>	<b>9.7%</b>

<b>Total Investments</b>	<b>797,630</b>	<b>817,354</b>	<b>114.9%</b>
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See notes to consolidated financial statements.

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

**September 30, 2010 and June 30, 2010**

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

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

- (1) The securities in which Prospect Capital Corporation ( we , us or our ) has invested were acquired in transactions that were exempt from registration under the Securities Act of 1933, as amended, or the Securities Act. These securities may be resold only in transactions that are exempt from registration under the Securities Act.
- (2) Fair value is determined by or under the direction of our Board of Directors. As of September 30, 2010, two of our portfolio investments, Allied Defense Group, Inc. ( Allied ) and Dover Saddlery, Inc. ( Dover ) were publically traded and

classified as Level 1 within the valuation hierarchy established by Accounting Standards Codification 820, *Fair Value Measurements and Disclosures* ( ASC 820 ). As of June 30, 2010, three of our portfolio investments, Allied, Dover and LyondellBasel Industries N.V., were publically traded and classified as Level 1 within the valuation hierarchy established by ASC 820. As of September 30, 2010 and June 30, 2010, the fair value of our remaining portfolio investments was determined using significant unobservable inputs. ASC 820 classifies such inputs used to measure fair value as Level 3 within the valuation hierarchy. Our investments in money market funds are classified as Level 2. See

Note 3 and Note 4 within the accompanying consolidated financial statements for further discussion.

- (3) Security, or portion thereof, is held as collateral for the revolving credit facility (see Note 11). The market values of these investments at September 30, 2010 and June 30, 2010 were \$604,330 and \$512,244, respectively; they represent 71.0% and 62.7% of total investments at fair value, respectively.
- (4) Security, or portion thereof, has a floating interest rate. Stated interest rate was in effect at September 30, 2010 and June 30, 2010.
- (5) There are several entities involved in the Biomass investment. We own 100 shares of common stock in

Worcester  
Energy  
Holdings, Inc.  
( WEHI ),  
representing  
100% of the  
issued and  
outstanding  
common stock.  
WEHI, in turn,  
owns 51  
membership  
certificates in  
Biochips LLC  
( Biochips ),  
which  
represents a  
51% ownership  
stake.

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

Logging and  
Landclearing,  
Inc. ( Precision ),  
which  
represents 100%  
of the issued  
and outstanding  
common stock.

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

On March 11,  
2009, we  
foreclosed on  
the assets  
formerly held  
by CCEI and  
Biochips with a  
successful credit

bid of \$6,000 to acquire the assets. The assets were subsequently assigned to DEPC, WECO, CCEI and Biochips are joint borrowers on the term note issued to Prospect Capital. Effective July 1, 2008, this loan was placed on non-accrual status.

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



Our Board of Directors set no value for the CCEHI investment as of September 30, 2010 and June 30, 2010.

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

On October 21, 2009, Coalbed LLC foreclosed on the loan formerly made to Conquest. On January 19, 2010, as part of the Manx rollup, the Coalbed LLC assets and loan was assigned to Manx, the holding company. As of September 30, 2010, our Board of Directors assessed a fair value of \$1,202 for the loan position in Coalbed LLC, a decrease of \$212 from the fair value as of June 30, 2010.

- (7) In addition to the stated returns, the net profits interest held will be realized upon sale of the borrower or a sale of the interests.
- (8) Gas Solutions Holdings, Inc. is a wholly-owned investment of us.

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

**September 30, 2010 and June 30, 2010**

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

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

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

(10)

Loan is with  
THS an affiliate  
of ICS.

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

the consolidated group.

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

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

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

There are several entities involved in Yatesville's investment in Whymore at June 30, 2009. As of June 30, 2009, Yatesville owned 10,000 shares of common stock or

100% of the equity and held a \$14,973 senior secured debt receivable from C&A, which owns the equipment.

Yatesville owned 10,000 shares of common stock or 100% of the equity of E&L, which leases the equipment from C&A, employs the workers, is listed as the operator with the Commonwealth of Kentucky, mines the coal, receives revenues and pays all operating expenses.

Yatesville owned 4,900 shares of common stock or 49% of the equity of Whymore, which applies for and holds permits on behalf of E&L.

Yatesville also owned 4,285 Series A convertible preferred shares in each of C&A, E&L and Whymore.

Whymore and E&L are guarantors under the C&A credit agreement with Yatesville.

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

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

2010 and  
June 30, 2010.

(12) On January 19, 2010, we modified the terms of our senior secured debt in AEH and Coalbed in conjunction with the formation of Manx Energy, a new entity consisting in the assets of AEH, Coalbed and Kinley Exploration. The assets of the three companies were brought under new common management. We funded \$2,800 at closing to Manx to provide for working capital. A portion of our loans to AEH and Coalbed was exchanged for Manx preferred equity, while our AEH equity interest was converted into Manx common stock. There was no change to fair value at the time of restructuring, and we continue to fully reserve any income accrued for Manx.

(13) On a fully diluted basis represents,



11.677% of  
voting common  
shares.

- (14) Total common  
shares  
outstanding of  
33,434,838 as of  
September 7,  
2010 from Miller  
Petroleum, Inc. s  
( Miller )  
Quarterly Report  
on Form 10-Q  
filed on  
September 13,  
2010. Total  
common shares  
outstanding of  
33,389,383 as of  
July 22, 2010  
from Miller s  
Annual Report  
on Form 10-K  
filed on July 28,  
2010 as  
applicable to our  
June 30, 2010  
reporting date.

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

**September 30, 2010 and June 30, 2010**

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

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

(15) A portion of the positions listed were issued by an affiliate of the portfolio company.

(16) We own 99.9999% of AGC/PEP, LLC. AGC/PEP, LLC owns 2,037.65 out of a total of 83,818.69 shares (including 4,932 vested and unvested management options) of American Gilsonite Holding Company which owns 100% of American Gilsonite Company.

(17) Syndicated investment which had been originated by another financial institution and broadly distributed.

(18) At September 30,

2010 and  
June 30, 2010,  
Mistral Chip  
Holdings, LLC  
owns 44,800  
shares of Chip  
Holdings, Inc.  
and Mistral  
Chip Holdings  
2, LLC owns  
11,975 shares in  
Chip Holdings,  
Inc. Chip  
Holdings, Inc. is  
the parent  
company of  
Shearer's Foods,  
Inc. and has  
67,936 shares  
outstanding  
before adjusting  
for management  
options.

(19) The overriding  
royalty interests  
held receive  
payments at the  
stated rates  
based upon  
operations of  
the borrower.

(20) On  
December 31,  
2009, we sold  
our investment  
in Aylward  
Enterprises,  
LLC. AWCNC,  
LLC is the  
remaining  
holding  
company with  
zero assets and  
our remaining  
outstanding debt  
has no value of  
September 30,  
2010 and  
June 30, 2010,

respectively.

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

(22) We own warrants to purchase 33,750 shares of common stock in Metal Buildings Holding Corporation

( Metal Buildings ), the former holding company of Borga, Inc. Metal Buildings Holding Corporation owned 100% of Borga, Inc. On March 8, 2010, we foreclosed on the stock in Borga, Inc. that was held by Metal Buildings, obtaining 100% ownership of Borga, Inc.

(23) We own 100% of C&J Cladding Holding Company, Inc., which owns 40% of the membership interests in C&J Cladding, LLC.

(24) On January 1, 2010, we restructured our senior secured and bridge loans investment in Iron Horse Coiled Tubing, Inc. ( Iron Horse ) and we reorganized Iron Horse s management structure. The senior secured loan and bridge loan were replaced with three new

tranches of senior secured debt. From June 30, 2009 to September 30, 2010, our total ownership of Iron Horse decreased from 80.0% to 70.4%, respectively. As of September 30, 2010 and June 30, 2010, our Board of Directors assessed a fair value in Iron Horse of \$15,064 and \$12,054, respectively.

(25) We own 2,800,000 units in Class A Membership Interests and 372,094 units in Class A-1 Membership Interests.

(26) Undrawn committed revolvers incur a 0.50% commitment fee. As of September 30, 2010 and June 30, 2010, we have \$10,982 and \$10,382 of undrawn revolver commitments to our portfolio companies,

respectively.

- (27) Stated interest rates are based on September 30, 2010 and June 30, 2010 one month LIBOR rates plus applicable spreads based on the respective credit agreements. Interest rates are subject to change based on actual elections by the borrower for a LIBOR rate contract or Base Rate contract when drawing on the revolver.

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**PROSPECT CAPITAL CORPORATION AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2010**

**(Unaudited)**

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

**Note 1. Organization**

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

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

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

**Note 2. Patriot Acquisition**

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

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

The merger has been accounted for as an acquisition of Patriot by Prospect Capital Corporation ( Prospect ) in accordance with acquisition method of accounting as detailed in ASC 805, *Business Combinations* ( ASC 805 ). The fair value of the consideration paid was allocated to the assets acquired and liabilities assumed based on their fair values as the date of acquisition. As described in more detail in ASC 805, goodwill, if any, would have been recognized as of the acquisition date, if the consideration transferred exceeded the fair value of identifiable net assets acquired. As of the acquisition date, the fair value of the identifiable net assets acquired exceeded the fair value of the consideration transferred, and we recognized the excess as a gain. A preliminary gain of \$5,714 was recorded by Prospect in the quarter ended December 31, 2009 related to the acquisition of Patriot, which was revised in the fourth quarter of Fiscal 2010 to \$7,708, when we settled severance accruals related to certain members of Patriot's top management and finalized during the first quarter of Fiscal 2011, to \$8,632, when we settled the remaining severance accruals related to the last two members of Patriot's top management. Under ASC 805, the adjustment to our preliminary estimate was reflected in the three months ended December 31, 2009 (See Note 12). The acquisition of Patriot was negotiated in July 2009 with the purchase agreement being signed on August 3, 2009. Between July 2009 and December 2, 2009, our valuation of certain of the investments acquired from Patriot increased due to market improvement, which resulted in the recognition of the gain at closing.



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*Purchase Price Allocation*

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

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

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

(2) The fair value of Patriot's investments were determined by the Board of Directors in conjunction with an

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

- (3) The gain has been determined after the final payments of certain liabilities have been settled.

*Condensed Statement of Net Assets Acquired*

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

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

The following unaudited pro forma condensed combined financial information does not purport to be indicative of actual financial position or results of our operations had the Patriot acquisition actually been consummated at the beginning of each period presented. Certain one-time charges have been eliminated. The pro forma adjustments reflecting the allocation of the purchase price of Patriot and the gain of \$8,632 recognized on the Patriot Acquisition have been eliminated. Management has realized net operating synergies from this transaction. The pro forma condensed combined financial information does not reflect the potential impact of these synergies and does not reflect any impact of additional accretion which would have been recognized on the transaction, except for that which was recorded after the transaction was consummated on December 2, 2009.

		<b>For the Three Months Ended September 30, 2009</b>
Total Investment Income	\$	29,567
Net Investment Income		13,677
Net Increase (Decrease) in Net Assets Resulting from Operations		(10,902)
Net Increase (Decrease) in Net Assets Resulting from Operations per share	\$	(0.19)

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**Note 3. Significant Accounting Policies**

The following are significant accounting policies consistently applied by us:

*Basis of Presentation*

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

*Use of Estimates*

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

*Basis of Consolidation*

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

*Investment Classification*

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

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

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*Investment Risks*

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

*Market Risk*

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

*Credit Risk*

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

*Liquidity Risk*

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

*Interest Rate Risk*

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

*Prepayment Risk*

Most of the Company's debt investments allow for prepayment of principal without penalty. Downward changes in interest rates may cause prepayments to occur at a faster than expected rate, thereby effectively shortening the maturity of the security and making the security less likely to be an income producing instrument.

*Investment Valuation*

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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### *Revenue Recognition*

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

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

Dividend income is recorded on the ex-dividend date.

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

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

### *Federal and State Income Taxes*

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

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

We adopted FASB ASC 740, *Income Taxes* ("ASC 740"). ASC 740 provides guidance for how uncertain tax positions should be recognized, measured, presented, and disclosed in the financial statements. ASC 740 requires the evaluation of tax positions taken or expected to be taken in the course of preparing our tax returns to determine whether the tax positions are more-likely-than-not of being sustained by the applicable tax authority. Tax positions not deemed to meet the more-likely-than-not threshold are recorded as a tax benefit or expense in the current year. Adoption of ASC 740 was applied to all open tax years as of July 1, 2007. The adoption of ASC 740 did not have an effect on our net asset value, financial condition or results of operations as there was no liability for unrecognized tax benefits and no change to our beginning net asset value. As of September 30, 2010 and for the three months then ended, we did not have a liability for any unrecognized tax benefits. Management's determinations regarding ASC 740 may be subject to review and adjustment at a later date based upon factors including, but not limited to, an on-going analysis of tax laws, regulations and interpretations thereof.

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### *Dividends and Distributions*

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

### *Financing Costs*

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

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

### *Guarantees and Indemnification Agreements*

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

### *Per Share Information*

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

### *Recent Accounting Pronouncements*

In June 2009, the FASB issued ASC 860, *Accounting for Transfers of Financial Assets* an amendment to FAS 140 (ASC 860). ASC 860 improves the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets: the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets. ASC 860 is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. The adoption of this standard had no effect on our results of operation or our financial position.

In June 2009, the FASB issued ASC 810, *Consolidation* (ASC 810). ASC 810 is intended to (1) address the effects on certain provisions of FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities, as a result of the elimination of the qualifying special-purpose entity concept in ASC 860, and (2) constituent concerns about the application of certain key provisions of Interpretation 46(R), including those in which the accounting and disclosures under the Interpretation do not always provided timely and useful information about an enterprise's involvement in a variable interest entity. ASC 810 is effective as of the beginning of our first annual reporting period that begins after November 15, 2009. The adoption of this standard had no effect on our results of operation or our financial position.

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





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In February 2010, the FASB issued Accounting Standards Update 2010-10, *Consolidation (Topic 810) - Amendments for Certain Investments Funds* ( ASU 2010-10 ), which defers the application of the consolidation guidance in ASC 810 for certain investments funds. The disclosure requirements continue to apply to all entities. ASU 2010-10 is effective as of the beginning of the first annual period that begins after November 15, 2009 and for interim periods within that first annual period. The adoption of this standard had no effect on our results of operation or our financial position.

In July 2010, the FASB issued Accounting Standards Update 2010-20, *Receivables (Topic 310) - Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses* ( ASC 2010-20 ). The amendments in this update require additional disclosure about the credit quality of financing receivables, such as aging information and credit quality indicators. ASC 2010-20 is effective for interim periods and fiscal years ending after December 15, 2010. Our management does not believe that the adoption of the amended guidance in ASC 2010-20 will have a significant effect on our financial statements.

In August 2010, the FASB issued Accounting Standards Update 2010-21, *Accounting for Technical Amendments to Various SEC Rules and Schedules* ( ASU 2010-21 ). ASU 2010-21 amends various SEC paragraphs pursuant to the issuance of Release No. 33-9026: Technical Amendments to Rules, Forms, Schedules and Codification of Financial Reporting Policies. We are assessing the potential effect this guidance will have on our consolidated financial statements.

In August 2010, the FASB issued Accounting Standards Update 2010-22, *Accounting for Various Topics - Technical Corrections to SEC Paragraphs* ( ASU 2010-22 ). ASU 2010-22 amends various SEC paragraphs based on external comments received and the issuance of Staff Accounting Bulletin ( SAB ) 112, which amends or rescinds portions of certain SAB topics. We are assessing the potential effect this guidance will have on our consolidated financial statements.

**Note 4. Portfolio Investments**

At September 30, 2010, we had invested in 57 long-term portfolio investments, which had an amortized cost of \$806,395 and a fair value of \$830,177 and at June 30, 2010, we had invested in 58 long-term portfolio investments, which had an amortized cost of \$728,759 and a fair value of \$748,483.

As of September 30, 2010, we own controlling interests in Airmall USA, Inc., Ajax Rolled Ring & Machine, Inc., AWCNC, LLC, Borga, Inc. ( Borga ), C&J Cladding, LLC, Change Clean Energy Holdings, Inc., Fischbein, LLC, Freedom Marine Services LLC, Gas Solutions Holdings, Inc. ( GSHI ), Integrated Contract Services, Inc. ( ICS ), Iron Horse Coiled Tubing, Inc. ( Iron Horse ), Manx Energy, Inc. ( Manx ), NRG Manufacturing, Inc., Nupla Corporation ( Nupla ), R-V Industries, Inc., Sidump r Trailer Company, Inc. ( Sidump r ) and Yatesville Coal Holdings, Inc. ( Yatesville ). We also own an affiliated interest in Biotronic NeuroNetwork, Boxercraft Incorporated, KTPS Holdings, LLC, Smart, LLC, and Sport Helmets Holdings, LLC.

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

	Quoted Prices in Active Markets for Identical Securities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Investments at fair value				
Control investments	\$	\$	\$ 258,831	\$ 258,831
Affiliate investments			70,254	70,254
Non-control/non-affiliate investments	111		500,981	501,092
	111		830,066	830,177
Investments in money market funds		21,040		21,040

Total assets reported at fair value	\$	111	\$	21,040	\$	830,066	\$	851,217
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The aggregate values of Level 3 portfolio investments changed during the three months ended September 30, 2010 as follows:

	<b>Fair Value Measurements Using Unobservable Inputs (Level 3)</b>			
	<b>Control Investments</b>	<b>Affiliate Investments</b>	<b>Non-Control/Non-Affiliate Investments</b>	<b>Total</b>
Fair value as of June 30, 2010	\$ 195,958	\$ 73,740	\$ 477,417	\$ 747,115
Total realized gains	123			123
Change in unrealized (depreciation) appreciation	9,960	(2,833)	(2,264)	4,863 <sup>(1)</sup>
Net realized and unrealized (loss) gain	10,083	(2,833)	(2,264)	4,986
Purchases of portfolio investments	57,168	250	71,181	128,599
Payment-in-kind interest	32	629	3,644	4,305
Accretion of original issue discount	982	355	1,817	3,154
Dispositions of portfolio investments	(5,392)	(1,887)	(50,814)	(58,093)
Transfers within Level 3				
Transfers in (out) of Level 3				
Fair value as of September 30, 2010	\$ 258,831	\$ 70,254	\$ 500,981	\$ 830,066

<sup>(1)</sup> Relates to assets held at September 30, 2010

At September 30, 2010 and June 30, 2010, nine loan investments were on non-accrual status: Borga, Deb Shops, Inc., ICS, Iron Horse, Nupla, Manx, Sidump r, Wind River Resources Corp. and Wind River II Corp. ( Wind River ), and Yatesville. The loan principal of these loans amounted to \$164,711 and \$163,653 as of September 30, 2010 and June 30, 2010, respectively. The fair values of these investments represent approximately 5.1% and 5.6% of our net assets as of September 30, 2010 and June 30, 2010, respectively. For the three months ended September 30, 2010 and September 30, 2009, the income foregone as a result of not accruing interest on non-accrual debt investments amounted to \$3,058 and \$4,448, respectively. At September 30, 2010, we held one asset on which payment of interest was 60 days past-due for which we continue to accrue interest, H&M Oil and Gas, LLC. The principal balance of this loan is \$59,561 and the accrued interest receivable is \$1,969 at September 30, 2010. We expect full repayment of principal and interest on this loan.

GSHI has indemnified us against any legal action arising from its investment in Gas Solutions, LP. We have incurred approximately \$2,093 from the inception of the investment in GSHI through September 30, 2010 for fees associated with a legal action, and GSHI has reimbursed us for the entire amount. There were no such legal fees incurred or reimbursed for the three months ended September 30, 2010 and September 30, 2009. Additionally, certain other expenses incurred by us which are attributable to GSHI have been reimbursed by GSHI and are reflected as dividend income: control investments in the Consolidated Statements of Operations. For the three months ended September 30, 2010 and September 30, 2009, such reimbursements totaled as \$540 and \$1,231, respectively.

The original cost basis of debt placements and equity securities acquired, including follow-on investments for existing portfolio companies, totaled \$137,797 and \$4,599 during the three months ended September 30, 2010 and September 30, 2009, respectively. Debt repayments and sales of equity securities with a cost basis of approximately \$68,148 and \$24,241 were received during the three months ended September 30, 2010 and September 30, 2009,

respectively.

During the quarter ended September 30, 2010, we recognized \$4,047 of interest income due to purchase discount accretion from the assets acquired from Patriot. Included in this amount is \$1,116 of accelerated accretion resulting from the repayment of Impact Products, LLC. We also recapitalized our debt investment in Northwestern Management Services, LLC. The \$20,000 loan was issued at market terms comparable to other industry transactions. In accordance with ASC 320-20-35 the cost basis of the new loan was recorded at par value, which precipitated the acceleration of \$1,612 of original purchase discount from the loan repayment which was recognized as interest income.

**Table of Contents****Note 5. Other Investment Income**

Other investment income consists of structuring fees, overriding royalty interests, settlement of net profit interests, deal deposits, administrative agent fee, and other miscellaneous and sundry cash receipts. Income from such sources for the three months ended September 30, 2010 and September 30, 2009 were as follows:

<b>Income Source</b>	<b>For The Three Months Ended September 30,</b>	
	<b>2010</b>	<b>2009</b>
Structuring and amendment fees	\$ 3,957	\$ 405
Overriding royalty interests	48	44
Administrative agent fee	92	15
Other Investment Income	\$ 4,097	\$ 464

**Note 6. Equity Offerings and Related Expenses**

We issued 9,051,000 and 11,431,797 shares of our common stock in public and private offerings during the three months ended September 30, 2010 and September 30, 2009, respectively. The proceeds raised, the related underwriting fees, the offering expenses and the prices at which these shares were issued are as follows:

<b>Issuances of Common Stock</b>	<b>Number of Shares Issued</b>	<b>Gross Proceeds Raised</b>	<b>Underwriting Fees</b>	<b>Offering Expenses</b>	<b>Offering Price</b>
September 29, 2010 - September 30, 2010 <sup>(1)</sup>	302,400	\$ 2,986	\$ 60	\$ 203	\$ 9.873
July 22, 2010 - September 28, 2010 <sup>(2)</sup>	6,000,000	\$ 58,403	\$ 1,156	\$ 103	\$ 9.734
July 1, 2010 - July 21, 2010 <sup>(3)</sup>	2,748,600	\$ 26,799	\$ 536		\$ 9.749
September 24, 2009 <sup>(4)</sup>	2,807,111	\$ 25,264	\$	\$ 840	\$ 9.000
August 20, 2009 <sup>(4)</sup>	3,449,686	\$ 29,322	\$	\$ 117	\$ 8.500
July 7, 2009	5,175,000	\$ 46,575	\$ 2,329	\$ 200	\$ 9.000

(1) On September 24, 2010, we established a new at-the-market program through which we may sell, from time to time and at our sole discretion 6,000,000

shares of our common stock. Through this program we issued 302,400 shares of our common stock at an average price of \$9.87 per share, raising \$2,986 of gross proceeds, from September 29, 2010 through September 30, 2010.

(2) On July 19, 2010, we established a new at-the-market program through which we sold 6,000,000 shares of our common stock at an average price of \$9.73 per share, raising \$58,403 of gross proceeds, from July 22, 2010 through September 28, 2010.

(3) On March 17, 2010, we established an at-the-market program through which we sold 8,000,000 shares of our common stock. Through this

program we  
issued  
2,748,600  
shares of our  
common stock  
at an average  
price of \$9.75  
per share,  
raising \$26,799  
of gross  
proceeds, from  
July 1, 2010  
through July 21,  
2010.

- (4) Concurrent with the sale of these shares, we entered into a registration rights agreement in which we granted the purchasers certain registration rights with respect to the shares. We have filed with the SEC a post-effective amendment to the registration statement on Form N-2 which has been declared effective by the SEC.

Our shareholders' equity accounts at September 30, 2010 and June 30, 2010 reflect cumulative shares issued as of those respective dates. Our common stock has been issued through public offerings, a registered direct offering, private offerings, the exercise of over-allotment options on the part of the underwriters and our dividend reinvestment plan. When our common stock is issued, the related offering expenses have been charged against paid-in capital in excess of par. All underwriting fees and offering expenses were borne by us.



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On October 9, 2008, our Board of Directors approved a share repurchase plan under which we may repurchase up to \$20,000 of our common stock at prices below our net asset value as reported in our financial statements published for the year ended June 30, 2008. We have not made any purchases of our common stock during the period from October 9, 2008 to September 30, 2010 pursuant to this plan.

On August 26, 2010, we announced the declaration of monthly dividends in the following amounts and with the following dates:

\$0.100625 per share for September 2010 to holders of record on September 30, 2010 with a payment date of October 29, 2010;

\$0.100750 per share for October 2010 to holders of record on October 29, 2010 with a payment date of November 30, 2010.

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

**Note 7. Net Increase (Decrease) in Net Assets per Common Share**

The following information sets forth the computation of net (decrease) increase in net assets resulting from operations per common share for the three months ended September 30, 2010 and September 30, 2009, respectively.

	<b>For The Three Months Ended September 30,</b>	
	<b>2010</b>	<b>2009</b>
Net increase (decrease) in net assets resulting from operations	\$ 25,580	\$ (6,378)
Weighted average common shares outstanding	74,177,194	49,804,906
Net increase (decrease) in net assets resulting from operations per common share	\$ 0.34	\$ (0.13)

**Note 8. Related Party Agreements and Transactions***Investment Advisory Agreement*

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

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

The total base management fees incurred to the favor of the Investment Adviser for the three months ended September 30, 2010 and September 30, 2009 were \$4,276, and \$3,209, respectively.

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

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

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

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

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

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

The second part of the incentive fee, the capital gains incentive fee, is determined and payable in arrears as of the end of each calendar year (or upon termination of the Investment Advisory Agreement, as of the termination date), and equals 20.00% of our realized capital gains for the calendar year, if any, computed net of all realized capital losses and unrealized capital depreciation at the end of such year. In determining the capital gains incentive fee payable to the Investment Adviser, we calculate the aggregate realized capital gains, aggregate realized capital losses and aggregate unrealized capital depreciation, as applicable, with respect to each investment that has been in its portfolio. For the purpose of this calculation, an investment is defined as the total of all rights and claims which maybe asserted against a portfolio company arising from our participation in the debt, equity, and other financial instruments issued by that company. Aggregate realized capital gains, if any, equals the sum of the differences between the aggregate net sales price of each investment and the aggregate cost basis of such investment when sold or otherwise disposed. Aggregate realized capital losses equal the sum of the amounts by which the aggregate net sales price of each investment is less than the aggregate cost basis of such investment when sold or otherwise disposed. Aggregate unrealized capital depreciation equals the sum of the differences, if negative, between the aggregate valuation of each investment and the aggregate cost basis of such investment as of the applicable calendar year-end. At the end of the applicable calendar year, the amount of capital gains that serves as the basis for our calculation of the capital gains incentive fee involves netting aggregate realized capital gains against aggregate realized capital losses on a since-inception basis and then reducing this amount by the aggregate unrealized capital depreciation. If this number is positive, then the capital gains incentive fee payable is equal to 20.00% of such amount, less the aggregate amount of any capital gains incentive fees paid since inception.

For the three months ended September 30, 2010 and September 30, 2009, \$5,249 and \$3,080, respectively, of income incentive fees were incurred. No capital gains incentive fees were incurred for the three months ended September 30,

2010 and September 30, 2009.

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### *Administration Agreement*

We have also entered into an Administration Agreement with Prospect Administration, LLC ( Prospect Administration ) under which Prospect Administration, among other things, provides (or arranges for the provision of) administrative services and facilities for us. For providing these services, we reimburse Prospect Administration for our allocable portion of overhead incurred by Prospect Administration in performing its obligations under the Administration Agreement, including rent and our allocable portion of the costs of our chief compliance officer and chief financial officer and their respective staffs. For the three months ended September 30, 2010 and 2009, the reimbursement was approximately \$800 and \$840, respectively. Under this agreement, Prospect Administration furnishes us with office facilities, equipment and clerical, bookkeeping and record keeping services at such facilities. Prospect Administration also performs, or oversees the performance of, our required administrative services, which include, among other things, being responsible for the financial records that we are required to maintain and preparing reports to our stockholders and reports filed with the SEC. In addition, Prospect Administration assists us in determining and publishing our net asset value, overseeing the preparation and filing of our tax returns and the printing and dissemination of reports to our stockholders, and generally oversees the payment of our expenses and the performance of administrative and professional services rendered to us by others. Under the Administration Agreement, Prospect Administration also provides on our behalf managerial assistance to those portfolio companies to which we are required to provide such assistance. The Administration Agreement may be terminated by either party without penalty upon 60 days written notice to the other party. Prospect Administration is a wholly owned subsidiary of our Investment Adviser.

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

Prospect Administration, pursuant to the approval of our Board of Directors, engaged Vastardis Fund Services LLC ( Vastardis ) to serve as our sub-administrator to perform certain services required of Prospect Administration. Under the sub-administration agreement, Vastardis provided us with office facilities, equipment, clerical, bookkeeping and record keeping services at such facilities. Vastardis also conducted relations with custodians, depositories, transfer agents, dividend disbursing agents, other stockholder servicing agents, accountants, attorneys, underwriters, brokers and dealers, corporate fiduciaries, insurers, banks and such other persons in any such other capacity deemed to be necessary or desirable. Vastardis provided reports to the Administrator and the Directors of its performance of obligations and furnished advice and recommendations with respect to such other aspects of our business and affairs as it shall determine to be desirable. Under the sub-administration agreement, Vastardis also provided the service of William E. Vastardis as our Chief Financial Officer ( CFO ). We compensated Vastardis for providing us these services by the payment of an asset-based fee with a \$400 annual minimum, payable monthly. Our service agreement was amended on September 28, 2008 so that Mr. Vastardis no longer served as our CFO effective as of November 11, 2008. At that time, Brian H. Oswald, a managing director at Prospect Administration, assumed the role of CFO.

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

### *Managerial Assistance*

As a business development company, we offer, and must provide upon request, managerial assistance to certain of our portfolio companies. This assistance could involve, among other things, monitoring the operations of our portfolio companies, participating in board and management meetings, consulting with and advising officers of portfolio companies and providing other organizational and financial guidance. We billed \$254 and \$215 of managerial assistance fees for the three months ended September 30, 2010 and June 30, 2010, respectively, of which \$360 and

\$247 remains on the consolidated statement of assets and liabilities as of September 30, 2010, and June 30, 2010, respectively. These fees are paid to the Administrator when received. We simultaneously accrue a payable to the Administrator for the same amounts, which remain on the consolidated statements of assets and liabilities.

**Table of Contents****Note 9. Financial Highlights**

	<b>For The Three Months Ended September 30,</b>	
	<b>2010</b>	<b>2009</b>
<b>Per Share Data<sup>(1)</sup>:</b>		
Net asset value at beginning of period	\$ 10.30	\$ 12.40
Net investment income	0.28	0.25
Net realized gain	0.01	
Net unrealized appreciation (depreciation )	0.05	(0.38)
Net decrease in net assets as a result of public offerings	(0.09)	(0.77)
Dividends declared and paid	(0.31)	(0.39)
Net asset value at end of period	\$ 10.24	\$ 11.11
Per share market value at end of period	\$ 9.71	\$ 10.71
Total return based on market value <sup>(2)</sup>	3.74%	20.84%
Total return based on net asset value <sup>(2)</sup>	2.50%	(7.00%)
Shares outstanding at end of period	78,401,363	54,672,155
Average weighted shares outstanding for period	74,177,194	49,804,906
<b>Ratio / Supplemental Data:</b>		
Net assets at end of period	\$ 802,824	\$ 607,246
Annualized ratio of operating expenses to average net assets	7.51%	7.59%
Annualized ratio of net operating income to average net assets	11.09%	10.02%

**Table of Contents****Note 9. Financial Highlights (continued)**

	Year Ended June 30, 2010	Year Ended June 30, 2009	Year Ended June 30, 2008	Year Ended June 30, 2007	Year Ended June 30, 2006
<b>Per Share Data<sup>(1)</sup>:</b>					
Net asset value at beginning of period	\$ 12.40	\$ 14.55	\$ 15.04	\$ 15.31	\$ 14.59
Costs related to the initial public offering					0.01
Costs related to the secondary public offering			(0.07)	(0.06)	
Net investment income	1.13	1.87	1.91	1.47	1.21
Realized (loss) gain	(0.87)	(1.24)	(0.69)	0.12	0.04
Net unrealized appreciation (depreciation)	0.07	0.48	(0.05)	(0.52)	0.58
Net (decrease) increase in net assets as a result of public offering	(0.85)	(2.11)		0.26	
Net increase in net assets as a result of shares issued for Patriot acquisition	0.12				
Dividends declared and paid	(1.70)	(1.15)	(1.59)	(1.54)	(1.12)
Net asset value at end of period	\$ 10.30	\$ 12.40	\$ 14.55	\$ 15.04	\$ 15.31
Per share market value at end of period	\$ 9.65	\$ 9.20	\$ 13.18	\$ 17.47	\$ 16.99
Total return based on market value <sup>(2)</sup>	17.66%	(18.60%)	(15.90%)	12.65%	44.90%
Total return based on net asset value <sup>(2)</sup>	(6.82%)	(0.61%)	7.84%	7.62%	12.76%
Shares outstanding at end of period	69,086,862	42,943,084	29,520,379	19,949,065	7,069,873
Average weighted shares outstanding for period	59,429,222	31,559,905	23,626,642	15,724,095	7,056,846
<b>Ratio / Supplemental Data:</b>					
Net assets at end of period (in thousands)	\$ 711,424	\$ 532,596	\$ 429,623	\$ 300,048	\$ 108,270
Annualized ratio of operating expenses to	7.54%	9.03%	9.62%	7.36%	8.19%

average net assets					
Annualized ratio of net investment income to average net assets	10.69%	13.14%	12.66%	9.71%	7.90%

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

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

#### **Note 10. Litigation**

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



We are not aware of any such litigation as of September 30, 2010.

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**Note 11. Revolving Credit Agreements**

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

On June 25, 2009, we completed a first closing on an expanded \$250,000 revolving credit facility (the Syndicated Facility ). The new Syndicated Facility, which had \$175,000 total commitments as of June 30, 2009, included an accordion feature which allows the Syndicated Facility to accept up to an aggregate total of \$250,000 of commitments for which we solicited additional commitments from other lenders for an additional \$35,000 raising the commitments to \$210,000. The revolving period ended on June 11, 2010, when we closed on our expanded revolving credit facility.

On June 11, 2010, we closed an extension and expansion of our revolving credit facility with a syndicate of lenders. The lenders have extended commitments of \$240,000 under the new credit facility as of September 30, 2010. The new credit facility includes an accordion feature which allows the facility to be increased to up to \$300,000 of commitments in the aggregate to the extent additional or existing lenders commit to increase the commitments. We will seek to add additional lenders in order to reach the maximum size; although no assurance can be given we will be able to do so. As we make additional investments which are eligible to be pledged under the credit facility, we will generate additional availability to the extent such investments are eligible to be placed into the borrowing base. The revolving period of the credit facility extends through June 2012, with an additional one year amortization period (with distributions allowed) after the completion of the revolving period. During such one year amortization period, all principal payments on the pledged assets will be applied to reduce the balance. At the end of the one year amortization period, the remaining balance will become due if required by the lenders.

The Syndicated Facility contains restrictions pertaining to the geographic and industry concentrations of funded loans, maximum size of funded loans, interest rate payment frequency of funded loans, maturity dates of funded loans and minimum equity requirements. The Syndicated Facility also contains certain requirements relating to portfolio performance, including required minimum portfolio yield and limitations on delinquencies and charge-offs, violation of which could result in the early termination of the Syndicated Facility. The Syndicated Facility also requires the maintenance of a minimum liquidity requirement. At September 30, 2010, we were in compliance with the applicable covenants.

Interest on borrowings under the credit facility is one-month LIBOR plus 325 basis points, subject to a minimum Libor floor of 100 basis points. Additionally, the lenders charge a fee on the unused portion of the credit facility equal to either 75 basis points if at least half of the credit facility is used or 100 basis points otherwise. As of September 30, 2010 and June 30, 2010, we had \$235,101 and \$180,678 available to us for borrowing under our credit facility, of which \$46,600 and \$100,300 was outstanding, respectively. As we make additional investments which are eligible to be pledged under the credit facility, we will generate additional availability to the extent such investments are eligible to be placed into the borrowing base. At September 30, 2010, the investments used as collateral for the Syndicated Facility had an aggregate market value of \$604,330, which represents 75.3% of net assets.

In connection with the origination and amendments of the Syndicated Facility, we incurred \$8,547 of fees, including \$3,224 of fees carried over from the previous facility, which are being amortized over the term of the facility in accordance with ASC 470-50, *Debt Modifications and Extinguishments*.

**Table of Contents****Note 12. Selected Quarterly Financial Data (Unaudited)**

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

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

(2) Additional income for this quarter was driven by other investment income from the settlement of net profits interests on IEC Systems LP and Advanced Rig Services LLC for \$12,576.

(3) As adjusted for increase in gain

from Patriot  
acquisition. See  
Note 2.

**Note 13. Subsequent Events**

On October 29, 2010, we issued 92,999 shares of our common stock in connection with the dividend reinvestment plan.

During the period from October 1, 2010 to November 3, 2010, we issued 4,929,556 shares of our common stock at an average price of \$9.86 per share, and raised \$48,611 of gross proceeds, under our at-the-market program. Net proceeds were \$47,639 after 2% commission to the broker-dealer on shares sold.

On October 12, 2010, we made a senior secured debt investment of \$32,500 in ICON Health & Fitness, Inc., a leading manufacturer and marketer of branded health and fitness equipment.

On October 29, 2010, Castro Cheese Company, Inc. repaid the \$7,732 loan receivable to us.

On November 1, 2010, we announced an increase in commitments to our credit facility of \$20,000. The commitments to the credit facility now stand at \$260,000.

On November 3, 2010, TriZetto Group repaid the \$15,492 loan receivable to us.

On November 8, 2010, we announced the declaration of monthly dividends in the following amounts and with the following dates:

\$0.100875 per share for November 2010 to holders of record on November 30, 2010 with a payment date of December 31, 2010;

\$0.101000 per share for December 2010 to holders of record on December 31, 2010 with a payment date of January 31, 2011;

\$0.101125 per share for January 2011 to holders of record on January 31, 2011 with a payment date of February 28, 2011.

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

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

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

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

**Note on Forward Looking Statements**

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

our future operating results;

our business prospects and the prospects of our portfolio companies;

the impact of investments that we expect to make;

our contractual arrangements and relationships with third parties;

the dependence of our future success on the general economy and its impact on the industries in which we invest;

the ability of our portfolio companies to achieve their objectives;

our expected financings and investments;

the adequacy of our cash resources and working capital; and

the timing of cash flows, if any, from the operations of our portfolio companies.

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

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

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### **General**

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

We seek to be a long-term investor with our portfolio companies. From our July 27, 2004 inception to the fiscal year ended June 30, 2007, we invested primarily in industries related to the industrial/energy economy. Since then, we have widened our strategy to focus in other sectors of the economy and continue to diversify our portfolio holdings.

The aggregate value of our portfolio investments was \$830,177 and \$748,483 as of September 30, 2010 and June 30, 2010, respectively. During the quarter ended September 30, 2010, our net cost of investments increased by \$77,636, or 10.7%, primarily as a result of our investment in four new and two follow-on investments while we received full repayment on four investments, sold one investment and received several partial prepayments and revolver paydowns. Compared to the end of last fiscal year (ended June 30, 2010), net assets increased by \$91,400 or 12.8% during the quarter ended September 30, 2010, from \$711,424 to \$802,824. This increase resulted from the issuance of new shares of our common stock (less offering costs) in the amount of \$86,127, dividend reinvestments of \$2,531, and another \$25,580 from operations. These increases, in turn, were offset by \$22,838 in dividend distributions to our stockholders. The \$25,580 increase in net assets resulting from operations is net of the following: net investment income of \$20,995, net realized gain on investments of \$527, and an increase in net assets due to changes in net unrealized appreciation of investments of \$4,058.

### **Patriot Acquisition**

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

On December 2, 2009, Patriot made a final dividend equal to its undistributed net ordinary income and capital gains of \$0.38 per share. In accordance with a recent IRS revenue procedure, the dividend was paid 10% in cash and 90% in newly issued shares of Patriot's common stock. The exchange ratio was adjusted to give effect to the tax distribution. The merger has been accounted for as an acquisition of Patriot by Prospect Capital Corporation ( "Prospect" ) in accordance with acquisition method of accounting as detailed in Accounting Standards Codification ( "ASC" or "Codification" ) 805, *Business Combinations* ( "ASC 805" ). The fair value of the consideration paid was allocated to the assets acquired and liabilities assumed based on their fair values as the date of acquisition. As described in more detail in ASC 805, goodwill, if any, would have been recognized as of the acquisition date, if the consideration transferred exceeded the fair value of identifiable net assets acquired. As of the acquisition date, the fair value of the identifiable net assets acquired exceeded the fair value of the consideration transferred, and we recognized the excess as a gain. A preliminary gain of \$5,714 was recorded by Prospect in the quarter ended December 31, 2009 related to the acquisition of Patriot, which was revised in the fourth quarter of Fiscal 2010, to \$7,708, when we settled severance accruals related to certain members of Patriot's top management, and finalized during the first quarter of Fiscal 2011, to \$8,632, when we settled the remaining severance accruals related to the last two members of Patriot's top management. Under ASC 805, the adjustment to our preliminary estimates is reflected in the three months ended December 31, 2009 (See Note 12 to our consolidated financial statements.). The acquisition of Patriot was negotiated in July 2009 with the purchase agreement being signed on August 3, 2009. Between July 2009 and December 2, 2009, our valuation of certain of the investments acquired from Patriot increased due to market improvement, which resulted in the recognition of the gain at closing.



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

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

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

(2) The fair value of Patriot's investments were determined by the Board of Directors in conjunction with an independent



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

- (3) The gain has  
been determined  
after the final  
payments of  
certain liabilities  
have been  
settled.

During the three months ended September 30, 2010, we recognized \$4,047 of interest income due to purchase discount accretion from the assets acquired from Patriot. Included in this amount is \$1,116 of accelerated accretion resulting from the repayment of Impact Products, LLC ( Impact ) and \$1,612 resulting from the acceleration of purchase discounts from the recapitalizing of our loan to Northwestern Management Services, LLC ( Northwestern ). As of September 30, 2010, \$27,083 of purchase discount from the Patriot acquisition remains to be accreted.

#### **Market Conditions**

While the economy continues to show signs of recovery from the deteriorating credit markets of 2008 and 2009, there is still a level of uncertainty and volatility in the capital markets. The growth and improvement in the capital markets that began during the second half of 2009 carried over into the first quarter of 2010. While encouraged by the signs of improvement, we operate in a challenging environment that is still recovering from a recession and financial services industry negatively affected by the deterioration of credit quality in subprime residential mortgages that spread rapidly to other credit markets. Market liquidity and credit quality conditions continue to remain weaker today than three years ago.

We believe that Prospect is well positioned to navigate through these adverse market conditions. As a business development company, we are limited to a maximum 1 to 1 debt to equity ratio, and as of September 30, 2010, we had \$235,101 available under our credit facility, of which \$46,600 was outstanding. Further, as we make additional investments that are eligible to be pledged under the credit facility, we will generate additional credit facility availability. The revolving period for our credit facility continues until June 13, 2012, with an amortization running to June 13, 2013, with interest distributions to us allowed.

We also continue to generate liquidity through public and private stock offerings. On July 7, 2009, we completed a public stock offering for 5,175,000 shares of our common stock at \$9.00 per share, raising \$46,575 of gross proceeds. On August 20, 2009 and September 24, 2009, we issued 3,449,686 shares and 2,807,111 shares, respectively, of our common stock at \$8.50 and \$9.00 per share, respectively, in private stock offerings, raising \$29,322, and \$25,264 of

gross proceeds, respectively. Concurrent with the sale of these shares, we entered into a registration rights agreement in which we granted the purchasers certain registration rights with respect to the shares. Under the terms and conditions of the registration rights agreement, we filed with the SEC a post-effective amendment to the registration statement on Form N-2 on November 6, 2009. Such amendment was declared effective by the SEC on November 9, 2009.

On March 4, 2010, our Registration Statement on Form N-2 was declared effective by the SEC. Under this Shelf Registration Statement, we can issue up to \$351,434 of additional equity securities as of September 30, 2010.

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On March 17, 2010, we established an at-the-market program through which we sold shares of our common stock. An at-the-market offering is a registered offering by a publicly traded issuer of its listed equity securities selling shares directly into the market at market prices. We engaged two broker-dealers to act as agents and sell our common stock directly into the market over a period of time. We paid a 2% commission to the broker-dealer on shares sold. Through this program we issued 8,000,000 shares of our common stock at an average price of \$10.90 per share, raising \$87,177 of gross proceeds, from March 23, 2010 through July 21, 2010.

On July 19, 2010, we established a second at-the-market program, as we had sold all the shares authorized in the original at-the-market program. We engaged three broker-dealers to act as potential agents and sell our common stock directly into the market over a period of time. We paid a 2% commission to the broker-dealer on shares sold. Through this program we issued 6,000,000 shares of our common stock at an average price of \$9.73 per share, raising \$58,403 of gross proceeds, from July 22, 2010 through September 28, 2010.

On September 24, 2010, we established a third at-the-market program, as we had sold all the shares authorized in the preceding at-the-market programs, through which we may sell, from time to time and at our discretion, 6,000,000 shares of our common stock. We engaged three broker-dealers to act as potential agents and sell our common stock directly into the market over a period of time. We currently pay a 2% commission to the broker-dealer on shares sold. Through this program we issued 302,400 shares of our common stock at an average price of \$9.87 per share, raising \$2,986 of gross proceeds, from September 29, 2010 through September 30, 2010.

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

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

## **First Quarter Highlights**

### *Investment Transactions*

On July 14, 2010, we closed a \$37,400 first lien senior secured credit facility to Progrexion Holdings, LLC ( Progrexion ), a leading consumer credit enhancement services company. The first lien note bears interest in cash at the greater of 11.0% or Libor plus 9.0% and has a final maturity on December 31, 2014.

On July 23, 2010, we made a secured debt investment of \$21,000 in SonicWALL, Inc. ( SonicWALL ), a global leader in network security and data protection for small, mid-sized, and large enterprise organizations. The second lien note bears interest in cash at the greater of 12.0% or Libor plus 10.0% and has a final maturity on January 23, 2017. On September 30, 2010, we made a follow-on secured debt investment of \$2,000 in SonicWALL.

On July 30, 2010, we invested \$52,420 of combined debt and equity in AIRMALL USA Inc. ( AIRMALL ), a leading developer and manager of airport retail operations. The \$30,000 first lien note bears interest in cash at the greater of 12.0% or Libor plus 9.0% and has a final maturity on June 30, 2015. The \$12,500 subordinated secured note bears interest in cash at 12.0% plus PIK interest of 6.0% and has a final maturity on December 31, 2015.

On July 30, 2010, we recapitalized our debt investment in Northwestern, a leading dental practice management company in the Southeast Florida market, providing \$11,500 of additional funding to fund the acquisition of six dental practices. The \$20,000 senior secured term loan bears interest in cash at the greater of 10.5% or Libor plus 7.5% and has a final maturity on July 30, 2015.

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*Equity Issuance*

From July 1, 2010 to September 28, 2010, we completed the sale of the remaining 8,748,600 shares of our common stock pursuant to the March 17, 2010 and July 19, 2010 equity distribution agreements, resulting in net proceeds of approximately \$83,407 after deducting related expenses including commissions.

On September 24, 2010, we established a new at-the-market program through which we may sell 6,000,000 shares of our common stock. Through this program we issued 302,400 shares of our common stock at an average price of \$9.87 per share, raising \$2,986 of gross proceeds, from September 29, 2010 through September 30, 2010.

On July 30, 2010, August 31, 2010 and September 30, 2010, we issued 83,875, 89,620 and 90,006, shares of our common stock in connection with the dividend reinvestment plan, respectively.

*Dividend*

On August 26, 2010, we announced the declaration of monthly dividends in the following amounts and with the following dates:

\$0.100625 per share for September 2010 to holders of record on September 30, 2010 with a payment date of October 29, 2010;

\$0.100750 per share for October 2010 to holders of record on October 29, 2010 with a payment date of November 30, 2010.

*Credit Facility*

On September 9, 2010, we announced an increase in commitments to our credit facility of \$30,000. As of September 30, 2010, the lenders have extended commitments of \$240,000 under the credit facility. Our credit facility includes an accordion feature which allows the facility to be increased to up to \$300,000 of commitments in the aggregate to the extent additional or existing lenders commit to increase the commitments. We will seek to add additional lenders in order to reach the maximum size; although no assurance can be given we will be able to do so.

**Recent Developments**

On October 29, 2010, we issued 92,999 shares of our common stock in connection with the dividend reinvestment plan.

During the period from October 1, 2010 to November 3, 2010, we issued 4,929,556 shares of our common stock at an average price of \$9.86 per share, and raised \$48,611 of gross proceeds, under our at-the-market program. Net proceeds were \$47,639 after 2% commission to the broker-dealer on shares sold.

On October 12, 2010, we made a senior secured debt investment of \$32,500 in ICON Health & Fitness, Inc., a leading manufacturer and marketer of branded health and fitness equipment.

On October 29, 2010, Castro Cheese Company, Inc. repaid the \$7,732 loan receivable to us.

On November 1, 2010, we announced an increase in commitments to our credit facility of \$20,000. The commitments to the credit facility now stand at \$260,000.

On November 3, 2010, TriZetto Group repaid the \$15,492 loan receivable to us.

On November 8, 2010, we announced the declaration of monthly dividends in the following amounts and with the following dates:

\$0.100875 per share for November 2010 to holders of record on November 30, 2010 with a payment date of December 31, 2010;

\$0.101000 per share for December 2010 to holders of record on December 31, 2010 with a payment date of January 31, 2011;

\$0.101125 per share for January 2011 to holders of record on January 31, 2011 with a payment date of February 28, 2011.

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

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

#### *Basis of Consolidation*

Under the 1940 Act rules, the regulations pursuant to Article 6 of Regulation S-X, and the American Institute of Certified Public Accountants Audit and Accounting Guide for Investment Companies, we are precluded from consolidating any entity other than another investment company or an operating company which provides substantially all of its services and benefits to us. Our September 30, 2010 and June 30, 2010 financial statements include our accounts and the accounts of Prospect Capital Funding, LLC, our only wholly-owned, closely-managed subsidiary that is also an investment company. All intercompany balances and transactions have been eliminated in consolidation.

#### *Investment Classification*

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

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

#### *Investment Valuation*

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

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

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

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

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



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

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

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

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

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

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

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

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

In January 2010, the FASB issued Accounting Standards Update 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements* (ASC 2010-06). ASU 2010-06 amends ASC 820-10 and clarifies and provides additional disclosure requirements related to recurring and non-recurring fair value measurements and employers' disclosures about postretirement benefit plan assets. ASU 2010-06 is effective for interim and annual reporting periods beginning after December 15, 2009. Our management does not believe that the adoption of the amended guidance in ASC 820-10 will have a significant effect on our financial statements.

### *Federal and State Income Taxes*

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

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





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We adopted FASB ASC 740, *Income Taxes* ( ASC 740 ). ASC 740 provides guidance for how uncertain tax positions should be recognized, measured, presented, and disclosed in the financial statements. ASC 740 requires the evaluation of tax positions taken or expected to be taken in the course of preparing our tax returns to determine whether the tax positions are more-likely-than-not of being sustained by the applicable tax authority. Tax positions not deemed to meet the more-likely-than-not threshold are recorded as a tax benefit or expense in the current year. Adoption of ASC 740 was applied to all open tax years as of July 1, 2007. The adoption of ASC 740 did not have an effect on our net asset value, financial condition or results of operations as there was no liability for unrecognized tax benefits and no change to our beginning net asset value. As of September 30, 2010 and for the three months then ended, we did not have a liability for any unrecognized tax benefits. Management's determinations regarding ASC 740 may be subject to review and adjustment at a later date based upon factors including, but not limited to, an on-going analysis of tax laws, regulations and interpretations thereof.

### *Revenue Recognition*

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

Interest income, adjusted for amortization of premium and accretion of discount, is recorded on an accrual basis. Origination, closing and/or commitment fees associated with investments in portfolio companies are accreted into interest income over the respective terms of the applicable loans. Upon the prepayment of a loan or debt security, any prepayment penalties and unamortized loan origination, closing and commitment fees are recorded as interest income. Loans are placed on non-accrual status when principal or interest payments are past due 90 days or more or when there is reasonable doubt that principal or interest will be collected. Unpaid accrued interest is generally reversed when a loan is placed on non-accrual status. Interest payments received on non-accrual loans may be recognized as income or applied to principal depending upon management's judgment. Non-accrual loans are restored to accrual status when past due principal and interest is paid and in management's judgment, are likely to remain current. As of September 30, 2010, approximately 5.1% of our net assets are in non-accrual status.

Dividend income is recorded on the ex-dividend date.

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

### *Dividends and Distributions*

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

### *Financing Costs*

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

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

### *Guarantees and Indemnification Agreements*

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

### *Per Share Information*

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



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### *Recent Accounting Pronouncements*

In June 2009, the FASB issued ASC 860, *Accounting for Transfers of Financial Assets* an amendment to FAS 140 ( ASC 860 ). ASC 860 improves the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets: the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets. ASC 860 is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. The adoption of this standard had no effect on our results of operation or our financial position.

In June 2009, the FASB issued ASC 810, *Consolidation* ( ASC 810 ). ASC 810 is intended to (1) address the effects on certain provisions of FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities, as a result of the elimination of the qualifying special-purpose entity concept in ASC 860, and (2) constituent concerns about the application of certain key provisions of Interpretation 46(R), including those in which the accounting and disclosures under the Interpretation do not always provided timely and useful information about an enterprise's involvement in a variable interest entity. ASC 810 is effective as of the beginning of our first annual reporting period that begins after November 15, 2009. The adoption of this standard had no effect on our results of operation or our financial position.

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

In February 2010, the FASB issued Accounting Standards Update 2010-10, *Consolidation (Topic 810) - Amendments for Certain Investments Funds* ( ASU 2010-10 ), which defers the application of the consolidation guidance in ASC 810 for certain investments funds. The disclosure requirements continue to apply to all entities. ASU 2010-10 is effective as of the beginning of the first annual period that begins after November 15, 2009 and for interim periods within that first annual period. The adoption of this standard had no effect on our results of operation or our financial position.

In July 2010, the FASB issued Accounting Standards Update 2010-20, *Receivables (Topic 310) - Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses* ( ASC 2010-20 ). The amendments in this update require additional disclosure about the credit quality of financing receivables, such as aging information and credit quality indicators. ASC 2010-20 is effective for interim periods and fiscal years ending after December 15, 2010. Our management does not believe that the adoption of the amended guidance in ASC 2010-20 will have a significant effect on our financial statements.

In August 2010, the FASB issued Accounting Standards Update 2010-21, *Accounting for Technical Amendments to Various SEC Rules and Schedules* ( ASU 2010-21 ). This Accounting Standards Update various SEC paragraphs pursuant to the issuance of Release No. 33-9026: Technical Amendments to Rules, Forms, Schedules and Codification of Financial Reporting Policies. We are assessing the potential effect this guidance will have on our consolidated financial statements.

In August 2010, the FASB issued Accounting Standards Update 2010-22, *Accounting for Various Topics - Technical Corrections to SEC Paragraphs* ( ASU 2010-22 ). ASU 2010-22 amends various SEC paragraphs based on external comments received and the issuance of Staff Accounting Bulletin ( SAB ) 112, which amends or rescinds portions of certain SAB topics. We are assessing the potential effect this guidance will have on our consolidated financial statements.



**Table of Contents****Investment Holdings**

As of September 30, 2010, we continue to pursue our investment strategy. Despite our name change to Prospect Capital Corporation and the termination of our policy to invest at least 80% of our net assets in energy companies in May 2007, we currently have a concentration of investments in companies in the energy and energy related industries. Some of the companies in which we invest have relatively short or no operating histories. These companies are and will be subject to all of the business risk and uncertainties associated with any new business enterprise, including the risk that these companies may not reach their investment objective or the value of our investment in them may decline substantially or fall to zero.

Our portfolio had an annualized current yield of 13.4% and 15.7% across all our long-term debt and certain equity investments as of September 30, 2010 and September 30, 2009, respectively. At September 30, 2010, this yield includes interest from all of our long-term investments as well as dividends from Gas Solutions Holdings, Inc. ( GSHI ), Northwestern and American Gilsonite Company ( American Gilsonite ). The 2.3% decrease is primarily due to a reduction in dividends received from GSHI and an increase in non-accrual loans. This decrease is partially offset by accretion of purchase discounts on the loans acquired from Patriot. We expect the current yield to decline over time as we increase the size of the portfolio. Monetization of other equity positions that we hold is not included in this yield calculation. In each of our portfolio companies, we hold equity positions, ranging from minority interests to majority stakes, which we expect over time to contribute to our investment returns. Some of these equity positions include features such as contractual minimum internal rates of returns, preferred distributions, flip structures and other features expected to generate additional investment returns, as well as contractual protections and preferences over junior equity, in addition to the yield and security offered by our cash flow and collateral debt protections.

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

As of September 30, 2010, we own controlling interests in AIRMALL, Ajax Rolled Ring & Machine, Inc. ( Ajax ), AWCNC, LLC, Borga, Inc., C&J Cladding, LLC ( C&J ), Change Clean Energy Holdings, Inc. ( CCEHI ), Fischbein, LLC ( Fischbein ), Freedom Marine Services LLC, GSHI, Integrated Contract Services, Inc. ( ICS ), Iron Horse Coiled Tubing, Inc. ( Iron Horse ), Manx Energy, Inc. ( Manx ), NRG Manufacturing, Inc. ( NRG ), Nupla Corporation, R-V Industries ( R-V ), Inc., Sidump r Trailer Company, Inc. and Yatesville Coal Holdings, Inc. ( Yatesville ). We also own an affiliated interest in Biotronic NeuroNetwork, Boxercraft Incorporated, KTPS Holdings, LLC ( KTPS ), Smart, LLC, and Sport Helmets Holdings, LLC ( Sport Helmets ).

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

Level of Control	Cost	September 30, 2010			Cost	June 30, 2010		
		Percent of Portfolio	Fair Value	Percent of Portfolio		Percent of Portfolio	Fair Value	Percent of Portfolio
Control	\$ 238,633	28.8%	\$ 258,831	30.4%	\$ 185,720	23.3%	\$ 195,958	24.0%
Affiliate	64,429	7.8%	70,254	8.3%	65,082	8.2%	73,740	9.0%
Non-control/Non-affiliate	503,333	60.9%	501,092	58.9%	477,957	59.9%	478,785	58.6%
Money Market Funds	21,040	2.5%	21,040	2.5%	68,871	8.6%	68,871	8.4%
Total Portfolio	\$ 827,435	100.0%	\$ 851,217	100.0%	\$ 797,630	100.0%	\$ 817,354	100.0%



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The following is our investment portfolio presented by type of investment at September 30, 2010 and June 30, 2010, respectively:

Level of Control	September 30, 2010				June 30, 2010			
	Cost	Percent of Portfolio	Fair Value	Percent of Portfolio	Cost	Percent of Portfolio	Fair Value	Percent of Portfolio
Money Market Funds	\$ 21,040	2.5%	\$ 21,040	2.5%	\$ 68,871	8.6%	\$ 68,871	8.4%
Revolving Line of Credit	3,677	0.4%	3,777	0.4%	4,754	0.6%	5,017	0.6%
Senior Secured Debt	391,621	47.3%	361,599	42.5%	313,755	39.4%	287,470	35.2%
Subordinated Secured Debt	325,727	39.5%	306,993	36.1%	333,453	41.8%	313,511	38.4%
Subordinated Unsecured Debt	30,271	3.7%	30,956	3.6%	30,209	3.8%	30,895	3.8%
Preferred Stock	26,889	3.2%	16,169	1.9%	16,969	2.1%	5,872	0.7%
Common Stock	18,846	2.3%	75,464	8.9%	20,243	2.5%	77,131	9.4%
Membership Interests	6,952	0.8%	24,188	2.8%	6,964	0.9%	17,730	2.2%
Overriding Royalty Interests		%	2,744	0.3%		%	2,768	0.3%
Net Profit Interests		%	796	0.1%		%	1,020	0.1%
Warrants	2,412	0.3%	7,491	0.9%	2,412	0.3%	7,069	0.9%
Total Portfolio	\$ 827,435	100.0%	\$ 851,217	100.0%	\$ 797,630	100.0%	\$ 817,354	100.0%

The following is our investment portfolio presented by geographic location of the investment at September 30, 2010 and June 30, 2010, respectively:

Level of Control	September 30, 2010				June 30, 2010			
	Cost	Percent of Portfolio	Fair Value	Percent of Portfolio	Cost	Percent of Portfolio	Fair Value	Percent of Portfolio
Canada	\$ 21,002	2.5%	\$ 15,064	1.8%	\$ 21,002	2.6%	\$ 12,054	1.5%
Ireland	14,904	1.8%	15,000	1.8%	14,903	1.9%	15,000	1.8%
Netherlands		%		%	1,397	0.2%	1,233	0.2%
Midwest US	153,677	18.6%	151,014	17.7%	170,869	21.5%	167,571	20.5%
Northeast US	114,611	13.9%	115,071	13.5%	61,813	7.7%	62,727	7.7%
Southeast US	173,712	21.0%	158,689	18.6%	193,420	24.2%	171,144	20.9%
Southwest US	184,159	22.3%	231,779	27.2%	179,641	22.6%	235,945	28.9%
Western US	144,330	17.4%	143,560	16.9%	85,714	10.7%	82,809	10.1%
Money Market Funds	21,040	2.5%	21,040	2.5%	68,871	8.6%	68,871	8.4%
Total Portfolio	\$ 827,435	100.0%	\$ 851,217	100.0%	\$ 797,630	100.0%	\$ 817,354	100.0%

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The following is our investment portfolio presented by industry sector of the investment at September 30, 2010 and June 30, 2010, respectively:

Industry	Cost	September 30, 2010		Percent of Portfolio	Cost	June 30, 2010		Percent of Portfolio
		Percent of Portfolio	Fair Value			Percent of Portfolio	Fair Value	
Aerospace and Defense	\$ 56	%	\$ 24	%	\$ 56	%	\$ 38	%
Automobile	18,718	2.3%	18,357	2.2%	19,017	2.4%	18,615	2.3%
Biomass Power	2,383	0.3%		%	2,383	0.3%		%
Business Services	12,073	1.5%	12,664	1.5%	12,060	1.5%	12,132	1.5%
Chemical		%		%	1,397	0.2%	1,233	0.2%
Consumer Services	35,910	4.3%	35,910	4.2%		%		%
Contracting	16,512	2.0%	3,378	0.4%	16,652	2.1%	4,542	0.6%
Durable Consumer Products	20,000	2.4%	20,400	2.4%	20,000	2.5%	20,000	2.4%
Ecological	141	%	318	%	141	%	340	%
Electronics	25,071	3.0%	25,315	3.0%	25,777	3.2%	25,629	3.1%
Financial Services		%		%	25,814	3.2%	25,592	3.1%
Food Products	54,198	6.6%	62,354	7.3%	53,681	6.7%	60,882	7.4%
Gas Gathering and Processing	42,003	5.1%	97,596	11.5%	37,503	4.7%	93,096	11.4%
Healthcare	100,974	12.2%	106,047	12.5%	89,026	11.2%	93,593	11.5%
Home and Office Furnishings, Housewares and Durable	2,330	0.3%	4,986	0.6%	14,112	1.8%	17,232	2.1%
Insurance	5,941	0.7%	5,925	0.7%	5,811	0.7%	5,952	0.7%
Machinery	14,232	1.7%	21,418	2.5%	15,625	2.0%	17,776	2.2%
Manufacturing	71,910	8.7%	61,179	7.2%	74,961	9.4%	64,784	7.9%
Metal Services and Minerals	13,220	1.6%	28,380	3.3%	19,252	2.4%	33,620	4.1%
Mining, Steel, Iron and Non-Precious Metals and Coal Production	1,378	0.2%	808	0.1%	1,130	0.1%	808	0.1%
Oil and Gas Production	122,750	14.8%	92,251	10.7%	122,034	15.3%	96,988	11.9%
Oilfield Fabrication	29,474	3.6%	29,474	3.5%	30,429	3.8%	30,429	3.7%
Personal and Nondurable Consumer Products	14,557	1.8%	18,823	2.2%	14,387	1.8%	20,049	2.5%
Pharmaceuticals	11,957	1.4%	12,000	1.4%	11,955	1.5%	12,000	1.5%



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Property Management	52,551	6.3%	55,597	6.5%		%		%
Printing and Publishing	5,238	0.6%	5,336	0.6%	5,222	0.7%	5,284	0.6%
Production Services	21,002	2.5%	15,064	1.8%	21,002	2.6%	12,054	1.5%
Retail	14,669	1.8%	1,382	0.2%	14,669	1.8%	2,148	0.3%
Shipping Vessels	10,359	1.3%	3,506	0.4%	10,040	1.3%	3,583	0.4%
Software & Computer Services	37,884	4.6%	38,000	4.5%	14,903	1.9%	15,000	1.8%
Specialty Minerals	15,814	1.9%	19,668	2.3%	15,814	2.1%	18,463	2.3%
Technical Services	11,394	1.4%	11,500	1.4%	11,387	1.4%	11,615	1.4%
Textiles and Leather	21,696	2.6%	22,517	2.6%	22,519	2.8%	25,006	3.1%
Money Market Funds	21,040	2.5%	21,040	2.5%	68,871	8.6%	68,871	8.4%
Total Portfolio	\$ 827,435	100.0%	\$ 851,217	100.0%	\$ 797,630	100.0%	\$ 817,354	100.0%

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### **Investment Activity**

At September 30, 2010, approximately 103.4% of our net assets or about \$830,177 was invested in 57 long-term portfolio investments and 2.6% of our net assets invested in money market funds. Liabilities in excess of other assets offset the excess of these amounts over 100%.

### **Long-Term Portfolio Investment Activity**

During the three months ended September 30, 2010, we acquired \$132,800 of new investments, completed follow-on investments in existing portfolio companies, totaling approximately \$4,747, funded \$250 of revolver advances, and recorded PIK interest of \$3,154, resulting in gross investment originations of \$140,951. The more significant of these investments are described briefly in the following:

On July 14, 2010, we closed a \$37,400 first lien senior secured credit facility to Progrexion, a leading consumer credit enhancement services company.

On July 23, 2010, we made a secured debt investment of \$21,000 in SonicWALL, a global leader in network security and data protection for small, mid-sized, and large enterprise organizations. On September 30, 2010, we made a follow-on secured debt investment of \$2,000 in SonicWALL.

On July 30, 2010, we invested \$52,420 of combined debt and equity in AIRMALL, a leading developer and manager of airport retail operations.

On July 30, 2010, we invested \$20,000 in Northwestern, a leading dental practice management company in the Southeast Florida market.

On September 30, 2010, we made a follow-on secured debt investment of \$4,500 in GSHI to support the acquisition of a gathering pipeline system in Texas.

During the three months ended September 30, 2010, we closed-out five positions which are briefly described below.

On July 30, 2010, Northwestern repaid the \$8,500 loan receivable to us.

On August 26, 2010, Regional Management Corporation repaid the \$25,814 loan receivable to us.

On September 1, 2010, Impact repaid the \$12,848 loan receivable to us.

On September 23, 2010, Roll Coater Acquisition Corp. repaid the \$6,268 loan receivable to us.

On September 29, 2010 we sold our common stock in LyondellBasell Industries N.V. for \$1,803, realizing a gain of \$527.

During the three months ended September 30, 2010, we also received principal amortization payments of \$3,258 on several loans, and \$5,865 of partial prepayments related to Ajax, EXL Acquisition Corporation, Fischbein and Progrexion.

During the quarter ended September 30, 2010, we recognized \$4,047 of interest income due to purchase discount accretion from the assets acquired from Patriot. Included in this amount is \$1,116 of accelerated accretion resulting from the repayment of Impact. We also recapitalized our debt investment in Northwestern. The \$20,000 loan was issued at market terms comparable to other industry transactions. In accordance with ASC 320-20-35 the cost basis of the new loan was recorded at par value, which precipitated the acceleration of \$1,612 of original purchase discount from the loan repayment which recognized as interest income.

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

<b>Quarter-End</b>	<b>Acquisitions<sup>(1)</sup></b>	<b>Dispositions<sup>(2)</sup></b>
September 30, 2010	\$ 140,951	\$ 68,148
June 30, 2010	88,973	39,883
March 31, 2010	59,311	26,603
December 31, 2009 <sup>(3)</sup>	210,438	45,494
September 30, 2009	6,066	24,241
June 30, 2009	7,929	3,148
March 31, 2009	6,356	10,782
December 31, 2008	13,564	2,128
September 30, 2008	70,456	10,949
June 30, 2008	118,913	61,148
March 31, 2008	31,794	28,891
December 31, 2007	120,846	19,223
September 30, 2007	40,394	17,949
June 30, 2007	130,345	9,857
March 31, 2007	19,701	7,731
December 31, 2006	62,679	17,796
September 30, 2006	24,677	2,781
June 30, 2006	42,783	5,752
March 31, 2006	15,732	901
December 31, 2005		3,523
September 30, 2005	25,342	
June 30, 2005	17,544	
March 31, 2005	7,332	
December 31, 2004	23,771	32,083
September 30, 2004	30,371	
Since inception	\$ 1,316,268	\$ 439,011

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

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

(3) The \$210,438 of acquisitions for

the quarter  
ended  
December 31,  
2009 includes  
\$207,126 of  
portfolio  
investments  
acquired from  
Patriot.

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### **Investment Valuation**

In determining the fair value of our portfolio investments at September 30, 2010, the Audit Committee considered valuations from the independent valuation firm and from management having an aggregate range of \$805,005 to \$882,044, excluding money market investments.

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

The Board of Directors looked at several factors in determining where within the range to value the asset including: recent operating and financial trends for the asset, independent ratings obtained from third parties and comparable multiples for recent sales of companies within the industry. The composite of all these analysis, applied to each investment, was a total valuation of \$830,177, excluding money market investments.

Our portfolio companies are generally lower middle market companies, outside of the financial sector, with less than \$50,000 of annual EBITDA. We believe our market has experienced less volatility than others because we believe there are more buy and hold investors who own these less liquid investments.

During the three months ended September 30, 2010, there has been a general improvement in the markets in which we operate, and market rates of interest negotiated for middle market loans have decreased.

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

#### *Ajax Rolled Ring & Machine, Inc.*

We acquired a controlling equity interest in Ajax in a recapitalization of the company that was closed on April 4, 2008. We funded \$22,000 of senior secured term debt, \$11,500 of subordinated term debt and \$6,300 of equity as of that closing. During the fiscal year ended June 30, 2010, we funded an additional \$3,530 of secured subordinated debt to refinance a third-party revolver provider and provide working capital. Ajax repaid \$3,461 of this secured subordinated debt during the quarter ended September 30, 2010. As of September 30, 2010, we control 78.1% of the fully-diluted common and preferred equity.

Ajax forges seamless steel rings sold to various customers. The rings are used in a range of industrial applications, including in construction equipment and wind power turbines. Ajax's business is cyclical, and the business experienced a significant decline in the first half of 2009 in light of the global macroeconomic crisis. The second half of 2009 and to-date 2010 show steady improvement versus the first half of 2009. At September 30, 2010, Ajax had a backlog of new business that would indicate continued improvement for the remainder of 2010 and beyond.

The Board of Directors increased the fair value of our investment in Ajax to \$30,983 as of September 30, 2010, a reduction of \$9,851 from its amortized cost, compared to the \$13,006 unrealized depreciation recorded at June 30, 2010.

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

Change Clean Energy, Inc. ( CCEI ) is an investment, that we originated in September 2005, which owns and operated a biomass energy plant. In March 2009, CCEI ceased operations, as the business became uneconomic based on the cost of materials and the price being received for the electricity generated. During that quarter, we instituted foreclosure proceedings against the co-borrowers of our debt. In anticipation of such proceedings, CCEHI was established. On March 11, 2009, the foreclosure was completed and the assets were assigned to a wholly owned subsidiary of CCEHI. During the year ended June 30, 2010, we provided additional funding of \$296 to CCEHI to fund ongoing operations. CCEI currently has no material operations. At June 30, 2009 we determined that the impairment at both CCEI and CCEHI was other than temporary and recognized a realized loss of \$41,134, which was the amount by which the amortized cost exceeded the fair value. At September 30, 2010, our Board of Directors, under recommendation from senior management, has set the value of the CCEHI investment with no value, a reduction of

\$2,383 from its amortized cost after the recognized depreciation.

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### *Gas Solutions Holdings, Inc.*

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

In February 2010, we hired Robert Bourne as President and CEO of Gas Solutions. Mr. Bourne has over 30 years of experience in the midstream sector, including gathering and processing, gas purchasing, storing and trading; producer services; and business development mergers and acquisitions. He served most recently at Energy Transfer, where he managed Houston Pipeline, among other activities. Mr. Bourne is focusing on our upside plant projects and seeking new opportunities to help Gas Solutions grow beyond its existing footprint. On September 30, 2010, we made a follow-on secured debt investment of \$4,500 in Gas Solutions to support the acquisition of a gathering pipeline system in Texas.

In April 2010, Gas Solutions purchased a series of propane puts with strike prices of \$1.00 per gallon and \$0.95 per gallon covering the periods May 1, 2010, through April 30, 2011, and May 1, 2011, through April 30, 2012, respectively. Gas Solutions hedged approximately 85% of its current exposure to natural gas liquids based on current plant volumes. These hedges will reduce the volatility on earnings associated with lower prices of natural gas liquids without limiting the upside from higher prices, helping GSHI to continue to generate sufficient cash flow to make interest and dividend payments.

In determining the value of GSHI, we have utilized two valuation techniques to determine the value of the investment. Our Board of Directors has determined the value to be \$97,596 for our debt and equity positions at September 30, 2010 based upon a combination of a discounted cash flow analysis and a public comparables analysis. At September 30, 2010 and June 30, 2010, GSHI was valued \$55,593 above its amortized cost.

### *Integrated Contract Services, Inc.*

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

In January 2009, we foreclosed on the real and personal property of ICS. Through this foreclosure process, we gained 100% ownership of THS and certain ESA assets. Based upon an analysis of the liquidation value of the ESA assets and the enterprise value of THS, our Board of Directors determined the fair value of our investment in ICS to be \$3,378 at September 30, 2010, a reduction of \$13,134 from its amortized cost, compared to the \$12,110 unrealized loss recorded at June 30, 2010.

### *Iron Horse Coiled Tubing, Inc.*

Iron Horse is an investment that we completed in April 2006. Iron Horse had been a provider of coiled tubing subcontractor services prior to making a strategic decision in late 2007 to directly service natural gas and oil producers in the Western Canadian Sedimentary Basin ( WCSB ) as a fracturing services provider. As a result of the business transition, the Company's 2008 financial performance declined significantly from 2007 levels. Iron Horse completed its transition from a subcontractor to a direct service provider in 2009, but natural gas prices declined to trough levels due to the recession and heightened natural gas inventory levels. Since November 2009, Iron Horse has experienced increased activity in the WCSB and is now completing wells for a diversified base of large and small producers in the WCSB.





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Prior to December 31, 2007, we owned 8.5% of the common stock in Iron Horse. On December 31, 2007, we received an additional 50.3% of the common stock in Iron Horse, which increased our total ownership to 58.8%. Through a series of subsequent loans that were used to construct equipment and facilitate the transition from a subcontractor to a direct service provider, we secured an additional 21.0% of the common stock in Iron Horse in September 2008, which increased our total ownership to 79.8% of the common stock in Iron Horse.

Effective January 1, 2010, we restructured our senior secured and bridge loans to Iron Horse and we reorganized Iron Horse's management structure. Our loans were replaced with three new tranches of senior secured debt and our total ownership of Iron Horse decreased to 70.4% on a fully-diluted basis. Our equity ownership will incrementally decrease as debt tranches are repaid. There was no change to fair value at the time of restructuring, and we continue to fully reserve any income accrued for Iron Horse.

The Board of Directors increased the fair value of our investment in Iron Horse to \$15,064 as of September 30, 2010, a reduction of \$5,938 from its amortized cost, compared to the \$8,948 unrealized depreciation recorded at June 30, 2010.

### *Manx Energy, Inc.*

On January 19, 2010, we modified the terms of our senior secured debt in AEH and Coalbed in conjunction with the formation of Manx, a new entity consisting of the assets of AEH, Coalbed and Kinley Exploration. The assets of the three companies were combined under new common management. We funded \$2,800 at closing to Manx to provide for working capital. A portion of our loans to AEH and Coalbed was exchanged for Manx preferred equity, while our AEH equity interest was converted into Manx common stock. There was no change to fair value at the time of restructuring, and we continue to fully reserve any income accrued for Manx.

The Board of Directors wrote-down the fair value of our investment in Manx to \$4,403 as of September 30, 2010, a reduction of \$13,867 from its amortized cost, compared to the \$13,584 unrealized loss recorded at June 30, 2010.

### *Yatesville Coal Holdings, Inc.*

All of our coal holdings have been consolidated under the Yatesville entity. Yatesville delivered improved operating results after the consolidation of the coal holdings, but the company mined its permitted reserves in December 2008 and has not produced meaningful revenues since then. We continue to evaluate strategies for Yatesville, such as soliciting indications of interest regarding a transaction involving part or all of recoverable reserves. During the quarter ended December 31, 2009, we discontinued operations at Yatesville. At December 31, 2009, our Board of Directors determined that, consistent with the decision to discontinue operations, the impairment of Yatesville was other than temporary, and we recorded a realized loss of \$51,228, which was the amount that the amortized cost exceeded the fair value at December 31, 2009. As of September 30, 2010 and June 30, 2010, our Board of Directors set the value of the remaining Yatesville investment at \$808, which represents the residual value of recoverable reserves.

Equity positions in the portfolio are susceptible to potentially significant changes in value, both increases as well as decreases, due to changes in operating results. Four control investments have experienced such volatility—C&J and Fischbein with improved operating results, and NRG and R-V with declining operating results. Nine of the other controlled investments have continuing challenges and have been valued at discounts to the original investment. Three of the control investments are valued at premiums to the original investment amounts. Overall, at September 30, 2010, the control investments are valued at \$20,198 above their amortized cost.

We hold five affiliate investments at September 30, 2010. Two of these investments reported declining operating results, resulting in valuations decreasing for these investments—KTPS and Sport Helmets. Sport Helmets, despite the declining operating results, is still valued at a premium to its amortized cost. The remaining affiliate investments are valued at amortized cost or higher. Overall, at September 30, 2010, affiliate investments are valued \$5,825 above their amortized cost.

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With the non-control/non-affiliate investments, generally, there is less volatility related to our total investments because our equity positions tend to be smaller than with our control/affiliate investments, and debt investments are generally not as susceptible to large swings in value as equity investments. For debt investments, the fair value is limited on the high side to each loan's par value, plus any prepayment premia that could be imposed. Many of the debt investments in this category have not experienced a significant change in value, as they were previously valued at or near par value. The exception to this categorization relates to investments which were acquired in the Patriot Acquisition, many of which were acquired at significant discounts to par value, and any changes in operating results or interest rates can have a significant effect on the value of such investments. Ajax, American Gilsonite and Copernicus Group experienced meaningful increases in valuations. Deb Shops, Inc. ( Deb Shops ) and H&M Oil & Gas, LLC ( H&M ) experienced decreases in valuations due to declines in their operating results. Shearer's Foods, Inc. completed a significant acquisition, which is driving the operating results and the increase in the value of the investment. The remaining investments did not experience significant changes in operations or valuation.

During the quarter ended September 30, 2010, we recognized \$4,047 of interest income due to purchase discount accretion from the assets acquired from Patriot. Included in this amount is \$1,116 of accelerated accretion resulting from the repayment of Impact. We also recapitalized our debt investment in Northwestern. The \$20,000 loan was issued at market terms comparable to other industry transactions. In accordance with ASC 320-20-35 the cost basis of the new loan was recorded at par value, which precipitated the acceleration of \$1,612 of original purchase discount from the loan repayment which recognized as interest income.

**Capitalization**

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

On June 25, 2009, we completed a first closing on an expanded \$250,000 syndicated revolving credit facility (the Facility ). The Facility included an accordion feature which allowed the Facility to accept up to an aggregate total of \$250,000 of commitments for which we had \$210,000 of commitments from six lenders when the Facility was renegotiated. The revolving period of the Facility extended through June 2010, with an additional one year amortization period after the completion of the revolving period.

On June 11, 2010, we closed an extension and expansion of our revolving credit facility with a syndicate of lenders. The lenders have extended commitments of \$240,000 under the new credit facility as of September 30, 2010. On November 1, 2010, lender commitments increased to \$260,000. The new credit facility includes an accordion feature which allows the facility to be increased to up to \$300,000 of commitments in the aggregate to the extent additional or existing lenders commit to increase the commitments. We will seek to add additional lenders in order to reach the maximum size; although no assurance can be given we will be able to do so. As we make additional investments which are eligible to be pledged under the credit facility, we will generate additional availability to the extent such investments are eligible to be placed into the borrowing base. The revolving period of the credit facility extends through June 2012, with an additional one year amortization period (with distributions allowed) after the completion of the revolving period. During such one year amortization period, all principal payments on the pledged assets will be applied to reduce the balance. At the end of the one year amortization period, the remaining balance will become due if required by the lenders.

As of September 30, 2010 and June 30, 2010, we had \$235,101 and \$180,678 available to us for borrowing under our credit facility, of which \$46,600 and \$100,300 was outstanding, respectively. Interest on borrowings under the credit facility was one-month Libor plus 250 basis points prior to June 25, 2009, increasing to one-month Libor plus 400 basis points, subject to a minimum Libor floor of 200 basis points for the period from June 26, 2009 to June 10, 2010 and thereafter. The maintenance of this facility requires us to pay a fee for the amount not drawn upon. Prior to June 25, 2009, this fee was assessed at the rate of 37.5 basis points per annum of the amount of that unused portion. For the period from June 26, 2010 to June 10, 2010, this rate increased to 100 basis points per annum. After June 11, 2010, the lenders charge a fee on the unused portion of the credit facility equal to either 75 basis points if at least half of the credit facility is used or 100 basis points otherwise. The following table shows the facility amounts and outstanding

borrowings at September 30, 2010 and June 30, 2010:

	As of September 30, 2010		As of June 30, 2010	
	Facility Amount	Amount Outstanding	Facility Amount	Amount Outstanding
Revolving Credit Facility	\$ 240,000	\$ 46,600	\$ 210,000	\$ 100,300

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The following table shows the contractual maturity of our revolving credit facility at September 30, 2010:

	<b>Payments Due By Period</b>		
	<b>Less Than 1 Year</b>	<b>1 - 3 Years</b>	<b>More Than 3 Years</b>
Credit Facility Payable	\$	\$ 46,600	\$

Concurrent with the extension of our revolving credit facility, we wrote off \$759 of the unamortized debt issue costs associated with the original credit facility, in accordance with ASC 470-50, *Debt Modifications and Extinguishments*. During the three months ended September 30, 2010, we raised \$86,130 of additional equity by issuing 9,051,000 shares of our common stock below net asset value diluting shareholder value by \$0.09 per share. The following table shows the calculation of net asset value per share as of September 30, 2010 and June 30, 2010:

	<b>As of September 30, 2010</b>	<b>As of June 30, 2010</b>
Net Assets	\$ 802,824	\$ 711,424
Shares of common stock outstanding	78,401,363	69,086,862
Net asset value per share	\$ 10.24(1)	\$ 10.30

- (1) Our most recently estimated NAV per share is \$10.11 on an as adjusted basis solely to give effect to our issuance of common shares on October 29, 2010 in connection with our dividend reinvestment plan, dividend of \$0.10075 per share with October 29, 2010 record date, and issuances during the period from October 1, 2010 to November 3, 2010 under the ATM Program, versus \$10.24 determined by

us as of  
 September 30,  
 2010. NAV as  
 of November 3,  
 2010 may be  
 higher or lower  
 than \$10.11  
 based on  
 potential  
 changes in  
 valuations. Our  
 Board of  
 Directors has  
 not yet  
 determined the  
 fair value of  
 portfolio  
 investments  
 subsequent to  
 September 30,  
 2010. Our  
 Board of  
 Directors  
 determines the  
 fair value of our  
 portfolio  
 investments on  
 a quarterly basis  
 in connection  
 with the  
 preparation of  
 quarterly  
 financial  
 statements and  
 based on input  
 from an  
 independent  
 valuation firm,  
 our Investment  
 Advisor and the  
 audit committee  
 of our Board of  
 Directors.

At September 30, 2010, we had 78,401,363 of our common stock issued and outstanding.

#### **Results of Operations**

Net increase (decrease) in net assets resulting from operations for the three months ended September 30, 2010 and 2009 was \$25,580 and (\$6,378), respectively, representing \$0.34 and (\$0.13) per weighted average share, respectively. During the three months ended September 30, 2010, we experienced net unrealized and realized gains of \$4,585 or approximately \$0.06 per weighted average share primarily from significant write-ups of our investments in AIRMALL, Ajax, American Gilsonite, Fischbein and Iron Horse. These instances of unrealized appreciation were partially offset by unrealized depreciation in H&M, KTPS, NRG, R-V and Sport Helmets. During the three months

ended September 30, 2009, we experienced net unrealized and realized losses of \$18,696 or approximately \$0.38 per weighted average share primarily from write-downs of our investments in Ajax, Appalachian Energy Holdings, LLC ( AEH ), C&J, Conquest Cherokee, LLC ( Conquest ), Deb Shops, and Yatesville.

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

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

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

Investment income, which consists of interest income, including accretion of loan origination fees and prepayment penalty fees, dividend income and other income, including settlement of net profits interests, overriding royalty interests and structuring fees, was \$35,212 and \$21,517 for the quarters ended September 30, 2010 and September 30, 2009, respectively. The primary driver of the increase is the acquisition of additional assets from Patriot and other new investments which increased interest income. This increase is partially offset by a decline in dividend income from GSHI. The following table describes the various components of investment income and the related levels of debt investments:

	<b>For The Three Months Ended September 30</b>	
	<b>2010</b>	<b>2009</b>
Interest income	\$ 28,921	\$ 14,835
Dividend income	2,194	6,218
Other income	4,097	464
Total investment income	\$ 35,212	\$ 21,517
Average debt principal of investments	\$ 874,382	\$ 497,161
Weighted-average annualized interest rate earned	13.23%	11.84%

Total investment income has increased for the three months ended September 30, 2010 from the amount reported for the three months ended September 30, 2009 as we have deployed additional capital in revenue-producing assets including assets acquired in the Patriot acquisition.

Average interest income producing assets have increased from \$497,161 for the three months ended September 30, 2009 to \$874,382 for the three months ended September 30, 2010. The average yield on interest bearing assets increased from 11.8% for the three months ended September 30, 2009 to 12.9% for the three months ended September 30, 2010. This increase is primarily the result of higher interest rates earned on the assets acquired in the Patriot acquisition (including discount accretion).

Investment income is also generated from dividends and other income. Dividend income has declined from \$6,218 to \$2,194 for the three months ended September 30, 2009 and September 30, 2010, respectively. The decrease in dividend income is primarily attributable to the level of dividends received from our investment in GSHI. We received dividends from GSHI of \$6,000 and \$1,750 during the three months ended September 30, 2009 and September 30, 2010, respectively.

Other income has come primarily from structuring fees, overriding royalty interests, and settlement of net profits interests. Income from other sources grew from \$464 for the three months ended September 30, 2009 to \$4,097 for the three months ended September 30, 2010. The increase in other income is largely due to \$3,438 of structuring fees related to AIRMALL, Progrexion, SonicWALL and various other portfolio investments.





**Table of Contents****Operating Expenses**

Our primary operating expenses consist of investment advisory fees (base management and income incentive fees), credit facility costs, legal and professional fees and other operating and overhead-related expenses. These expenses include our allocable portion of overhead under the Administration Agreement with Prospect Administration under which Prospect Administration provides administrative services and facilities for us. Our investment advisory fees compensate our Investment Adviser for its work in identifying, evaluating, negotiating, closing and monitoring our investments. We bear all other costs and expenses of our operations and transactions in accordance with our Administration Agreement with Prospect Administration. Operating expenses were \$14,217 and \$9,199 for the three months ended September 30, 2010 and September 30, 2009, respectively.

The base investment advisory expenses were \$4,276 and \$3,209 for the three months ended September 30, 2010 and September 30, 2009, respectively. This increase is directly related to our growth in total assets. For the three months ended September 30, 2010 and September 30, 2009, we incurred \$5,249 and \$3,080, respectively, of income incentive fees. The \$2,169 increase in the income incentive fee for the respective three-month period is driven by an increase in pre-incentive fee net investment income from \$15,398 for the three months ended September 30, 2009 to \$26,244 for the three months ended September 30, 2010, primarily due to an increase in interest income from a larger asset base. No capital gains incentive fee has yet been incurred pursuant to the Investment Advisory Agreement.

During the three months ended September 30, 2010, we incurred \$2,261 of expenses related to our credit facility. This compares with expenses of \$1,374 incurred during the three months ended September 30, 2009. These expenses are related directly to the leveraging capacity put into place for each of those periods and the levels of indebtedness actually undertaken during those quarters. The table below describes the various credit facility expenses and the related indicators of leveraging capacity and indebtedness during these periods.

	<b>For The Three Months Ended September 30,</b>	
	<b>2010</b>	<b>2009</b>
Interest expense	\$ 949	\$ 127
Amortization of deferred financing costs	990	824
Commitment and other fees	322	423
<b>Total</b>	<b>\$ 2,261</b>	<b>\$ 1,374</b>
 Weighted-average debt outstanding	 \$ 87,359	 \$ 8,398
Weighted-average interest rate incurred	4.25%	6.00%
Facility amount at beginning of period	\$ 210,000	\$ 195,000

The decrease in our interest rate occurred on June 11, 2010 with the closing of our current facility. The borrowing rate and Libor floor decreased by 75 basis points and 100 basis points, respectively.

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

Prospect Administration have, as expected, increased alongside with the increase in staffing and asset base.

Total operating expenses, net of investment advisory fees and interest costs ( Other Operating Expenses ), were \$2,431 and \$1,536 for the three months ended September 30, 2010 and 2009, respectively. The \$895 increase in Other Operating Expenses is primarily due to the increased size of our portfolio, for which we have incurred higher costs for litigation, valuation services and administrative support.

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

Our net investment income was \$20,995 and \$12,318 for the three months ended September 30, 2010 and September 30, 2009, respectively. Net investment income represents the difference between investment income and operating expenses and is directly impacted by the items described above.

Net realized gains were \$527 and zero for the three months ended September 30, 2010 and September 30, 2009, respectively. The net realized gain of \$527 for the three months ended September 30, 2010 was due primarily to the sale of our common stock in LyondellBasel Industries N.V.

Net increase (decrease) in net assets from changes in unrealized appreciation (depreciation) was \$4,058 and (\$18,696) for the three months ended September 30, 2010 and September 30, 2009, respectively. For the three months ended September 30, 2010, the \$4,058 increase in net assets from the net change in unrealized appreciation (depreciation) was driven by significant write-ups of our investments in AIRMALL, Ajax, American Gilsonite, Fischbein and Iron Horse. These instances of unrealized appreciation were partially offset by unrealized depreciation in H&M, KTPS, NRG, R-V and Sport Helmets. For the three months ended September 30, 2009, the \$18,696 decrease in net assets from the net change in unrealized appreciation/depreciation was driven primarily by write-downs of our investments in Ajax, AEH, C&J, Conquest, Deb Shops, and Yatesville.

**Financial Condition, Liquidity and Capital Resources**

For the three months ended September 30, 2010 and September 30, 2009, our operating activities (used) provided (\$12,348) and \$41,503 of cash, respectively. Financing activities provided (used) \$12,329 and (\$44,425) of cash during the three months ended September 30, 2010 and September 30, 2009, respectively, which included the payments of dividends of \$19,328 and \$16,647, during the three months ended September 30, 2010 and September 30, 2009, respectively.

Our primary uses of funds have been to continue to invest in our investments in portfolio companies, to add new companies to our investment portfolio, acquire Patriot, repay outstanding borrowings and to make cash distributions to holders of our common stock.

We have and may continue to fund a portion of our cash needs through borrowings from banks, issuances of senior securities or secondary offerings. We may also securitize a portion of our investments in mezzanine or senior secured loans or other assets. Our objective is to put in place such borrowings in order to enable us to expand our portfolio. At September 30, 2010, we had \$46,600 outstanding borrowings on our revolving credit facility.

On March 4, 2010, our Registration Statement on Form N-2 was declared effective by the SEC. Under this Shelf Registration Statement, we can issue up to \$351,434 of additional equity securities as of September 30, 2010.

We also continue to generate liquidity through public and private stock offerings. On July 7, 2009 we completed a public stock offering for 5,175,000 shares of our common stock at \$9.00 per share, raising \$46,575 of gross proceeds. On August 20, 2009 and September 24, 2009, we issued 3,449,686 shares and 2,807,111 shares, respectively, of our common stock at \$8.50 and \$9.00 per share, respectively, in private stock offerings, raising \$29,322, and \$25,264 of gross proceeds, respectively. Concurrent with the sale of these shares, we entered into a registration rights agreement in which we granted the purchasers certain registration rights with respect to the shares. Under the terms and conditions of the registration rights agreement, we filed with the SEC a post-effective amendment to the registration statement on Form N-2 on November 6, 2009. Such amendment was declared effective by the SEC on November 9, 2009.

On March 17, 2010, we established an at-the-market program through which we sold shares of our common stock. An at-the-market offering is a registered offering by a publicly traded issuer of its listed equity securities selling shares directly into the market at market prices. We engaged two broker-dealers to act as agents and sell our common stock directly into the market over a period of time. We paid a 2% commission to the broker-dealer on shares sold. Through this program we issued 8,000,000 shares of our common stock at an average price of \$10.90 per share, raising \$87,177 of gross proceeds, from March 23, 2010 through July 21, 2010.

On July 19, 2010, we established a second at-the-market program, as we had sold all the shares authorized in the original at-the-market program. We engaged three broker-dealers to act as potential agents and sell our common stock directly into the market over a period of time. We paid a 2% commission to the broker-dealer on shares sold. Through

this program we issued 6,000,000 shares of our common stock at an average price of \$9.73 per share, raising \$58,403 of gross proceeds, from July 22, 2010 through September 28, 2010.

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On September 24, 2010, we established a third at-the-market program, as we had sold all the shares authorized in the preceding programs, through which we may sell, from time to time and at our discretion, 6,000,000 shares of our common stock. We engaged three broker-dealers to act as potential agents and sell our common stock directly into the market over a period of time. We currently pay a 2% commission to the broker-dealer on shares sold. Through this program we issued 302,400 shares of our common stock at an average price of \$9.87 per share, raising \$2,986 of gross proceeds, from September 29, 2010 through September 30, 2010.

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

### **Off-Balance Sheet Arrangements**

At September 30, 2010, we did not have any off-balance sheet liabilities or other contractual obligations that are reasonably likely to have a current or future material effect on our financial condition, other than those which originate from 1) the investment advisory and management agreement and the administration agreement and 2) the portfolio companies.

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

We are subject to financial market risks, including changes in interest rates and equity price risk. At September 30, 2010, most of the loans in our portfolio bore interest at fixed interest rates. Several of our floating rate loans have floors which have effectively converted the loans to fixed rate loans in the current interest rate environment. At September 30, 2010, the principal value of loans totaling \$27,948 bear interest at floating rates.

If we continue to invest in fixed rate loans, we may hedge against interest rate fluctuations by using standard hedging instruments such as futures, options and forward contracts subject to the requirements of the 1940 Act. While hedging activities may insulate us against adverse changes in interest rates, they may also limit our ability to participate in the benefits of lower interest rates with respect to our portfolio of investments. During the three months ended September 30, 2010, we did not engage in interest rate hedging activities.

### **Item 4. Controls and Procedures**

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

There have been no changes in the Company's internal controls over financial reporting that occurred during the quarter ended September 30, 2010 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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

From time to time, we may become involved in various investigations, claims and legal proceedings that arise in the ordinary course of our business. These matters may relate to intellectual property, employment, tax, regulation, contract or other matters. The resolution of such of these matters as may arise will be subject to various uncertainties and, even if such claims are without merit, could result in the expenditure of significant financial and managerial resources. We are not aware of any such litigation as of September 30, 2010.

**Item 1A. Risk Factors**

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

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

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

<b>Record Date/Issuance Date</b>	<b>Shares Issued</b>	<b>Aggregate Offering Price (in 000s)</b>	<b>% of Dividend</b>
March 23, 2006 / March 30, 2006	6,841	\$ 111	5.2%
June 23, 2006 / June 30, 2006	7,932	130	5.4%
September 22, 2006 / September 29, 2006	80,818	1,273	26.2%
December 29, 2006 / January 5, 2007	108,047	1,850	25.5%
March 23, 2007 / March 30, 2007	93,843	1,595	20.8%
June 22, 2007 / June 29, 2007	69,834	1,190	15.3%
September 19, 2007 / September 28, 2007	72,073	1,243	15.9%
March 31, 2008 / April 16, 2008	99,241	1,510	14.4%
September 30, 2008 / October 16, 2008	117,549	1,506	12.7%
December 31, 2008 / January 20, 2009	148,200	1,774	14.8%
March 31, 2009 / April 20, 2009	214,456	1,827	14.4%
July 8, 2009 / July 20, 2009	297,274	2,901	14.8%
October 8, 2010 / October 19, 2009	233,523	2,457	11.0%
December 31, 2009 / January 25, 2010	236,985	2,896	11.2%
March 31, 2010 / April 23, 2010	248,731	2,962	11.2%
June 30, 2010 / July 30, 2010	83,875	822	11.9%
July 30, 2010 / August 31, 2010	89,620	833	11.4%
August 31, 2010 / September 30, 2010	90,006	876	11.5%
September 30, 2010 / October 29, 2010	92,999	913	11.6%

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The following table reflects recent sales of unregistered common stock:

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

(1) Concurrent with the sale of these shares, we entered into a registration rights agreement in which we granted the purchasers certain registration rights with respect to the shares. We filed with the SEC a post-effective amendment to the registration statement on Form N-2 on October 9, 2009, and will also use our reasonable best efforts to cause such post-effective amendment to be declared effective by the SEC no later than December 15, 2009. Under the registration rights agreement, we may be

obligated to  
make liquidated  
damages  
payments to  
holders upon the  
occurrence of  
certain events.

- (2) We claimed  
exemption to  
registration  
under Rule 506  
of Regulation D  
of the Securities  
Act of 1933, as  
amended, and  
the rules and  
regulations  
promulgated  
thereunder (the  
Securities Act ).

- (3) Shares were  
purchased by  
qualified  
institutional  
buyers and  
institutional  
accredited  
investors as  
defined in  
Rule 144A  
under the  
Securities Act.

**Item 3. Defaults upon Senior Securities**

Not applicable.

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

No matters were submitted to a vote of security holders during the first quarter of the fiscal year ended June 30, 2011.

**Item 5. Other Information**

None.



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**Item 6. Exhibits**

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

- 2.1 Agreement and Plan of Merger by and between Patriot Capital Funding, Inc. and Prospect Capital Corporation, dated as of August 3, 2009 (12).
- 3.1 Articles of Amendment and Restatement (15).
- 3.2 Amended and Restated Bylaws (9).
- 4.1 Form of Share Certificate (1).
- 10.1 Investment Advisory Agreement between Registrant and Prospect Capital Management LLC (1).
- 10.2 Custodian Agreement (2).
- 10.3 Administration Agreement between Registrant and Prospect Administration LLC (1).
- 10.4 Transfer Agency and Service Agreement (2).
- 10.5 Dividend Reinvestment Plan (1).
- 10.6 License Agreement between Registrant and Prospect Capital Management LLC (1).
- 10.7 Loan and Servicing Agreement dated June 6, 2007 among Prospect Capital Funding LLC, Prospect Capital Corporation, the lenders from time to time party thereto and Coöperative Centrale Raisseisen-Boerenleenbank B.A., Rabobank Nederland, New York Branch (6).
- 10.8 First Amendment to Loan and Servicing Agreement dated December 31, 2007 among Prospect Capital Funding LLC, Prospect Capital Corporation, and Coöperative Centrale Raisseisen-Boerenleenbank B.A., Rabobank Nederland, New York Branch (7).
- 10.9 Amended and Restated Loan and Servicing Agreement dated June 25, 2009 among Prospect Capital Funding LLC, Prospect Capital Corporation and Coöperative Centrale Raiffeisen-Boerenleenbank B.A., Rabobank Nederland, New York Branch (11).
- 10.10 Amended and Restated Loan and Servicing Agreement dated June 11, 2010 among Prospect Capital Funding LLC, Prospect Capital Corporation, the lenders from time to time party thereto, the managing agents from time to time party thereto, Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A., Rabobank Nederland, New York Branch and Key Equipment Finance Inc. as Syndication Agents, U.S. Bank National Association as Calculation Agent, Paying Agent and Documentation Agent, and Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A., Rabobank Nederland, New York Branch as Facility Agent (14).
- 10.11 Equity Distribution Agreement by and between Prospect Capital Corporation and RBC Capital Markets Corporation, dated September 24, 2010 (13)
- 10.12

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Equity Distribution Agreement by and between Prospect Capital Corporation and BMO Capital Markets Corp., dated September 24, 2010 (13)

- 10.13 Equity Distribution Agreement by and between Prospect Capital Corporation and KeyBanc Capital Markets Inc., dated September 24, 2010 (13)
- 11 Computation of Per Share Earnings (included in the notes to the financial statements contained in this report).
- 12 Computation of Ratios (included in the notes to the financial statements contained in this report).
- 14 Code of Conduct (10)
- 16 Letter regarding change in certifying accountant (4).

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21	Subsidiaries of the Registrant: (included in the notes to the consolidated financial statements contained in this annual report). (8)
22.1	Proxy Statement (5).
31.1*	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
31.2*	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
32.1*	Certification of Chief Executive Officer pursuant to Section 906 of The Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
32.2*	Certification of Chief Financial Officer pursuant to Section 906 of The Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).

\* Filed herewith.

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

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

(3) Incorporated by reference from the Registrant's Form 10-K filed on

September 28,  
2006.

- (4) Incorporated by reference to the form 8-K/A (File No. 814-00659), filed on January 21, 2005.
- (5) Incorporated by reference from the Registrant's Proxy Statement filed on October 20, 2008.
- (6) Incorporated by reference from the Registrant's Registration Statement on Form N-2 (File No. 333-143819) filed on September 5, 2007.
- (7) Incorporated by reference from the Registrant's Quarterly Report on Form 10-Q filed on February 11, 2008.
- (8) Incorporated by reference from the Registrant's Form 10-K filed on September 28, 2007.
- (9) Incorporated by reference from the Registrant's Form 8-K filed on September 10, 2008.

(10)

Incorporated by  
reference from the  
Registrant's  
Quarterly Report  
on Form 10-Q  
filed on  
November 10,  
2008.

(11) Incorporated by  
reference to  
Exhibit 99.1 of  
the Registrant's  
Form 8-K filed on  
June 26, 2009.

(12) Incorporated by  
reference to  
Exhibit 2.1 of the  
Registrant's Form  
8-K filed on  
August 5, 2009

(13) Incorporated by  
reference to  
Post-Effective  
Amendment No. 4  
to the Registrant's  
Registration  
Statement on  
Form N-2 (File  
No. 333-164270),  
filed on  
September 24,  
2010.

(14) Incorporated by  
reference  
Exhibit 99.1 of  
the Registrant's  
Form 8-K filed on  
June 15, 2010.

(15) Incorporated by  
reference from the  
Registrant's Form  
8-K filed on  
September 7,  
2010.



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**SIGNATURE**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on November 9, 2010.

**PROSPECT CAPITAL CORPORATION**

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