

PROSPECT CAPITAL CORP  
Form 10-Q  
May 12, 2008

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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 quarterly period ended March 31, 2008**

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

**PROSPECT CAPITAL CORPORATION**

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

**Maryland**

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

**43-2048643**

**(I.R.S. Employer Identification No.)**

**10 East 40th Street**

**44th Floor**

**New York, New York**

**(Address of principal executive offices)**

**10016**

**(Zip Code)**

**(212) 448-0702**

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

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

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

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

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

The number of shares of the registrant's common stock, \$0.001 par value, outstanding as of May 6, 2008 was 26,270,379.

**PROSPECT CAPITAL CORPORATION  
FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 2008  
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**PART I: FINANCIAL INFORMATION**

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

**Item 1. Financial Statements**

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

|   |                                    |
|---|------------------------------------|
| <b>March 31,<br/>2008<br/>(Unaudited)</b> | <b>June 30, 2007<br/>(Audited)</b> |
|---|------------------------------------|

| <b>Assets</b>  |                   |                   |
|--|-------------------|-------------------|
| Investments at fair value (cost of \$436,557 and \$326,197, respectively)<br>(Note 3):   |                   |                   |
| Control investments (cost of \$147,142 and \$124,664, respectively)  | \$ 141,631        | \$ 139,292        |
| Affiliate investments (cost of \$5,582 and \$14,821, respectively)   | 5,582             | 14,625            |
| Non-control/Non-affiliate investments (cost of \$283,833 and \$186,712, respectively)  | 281,943           | 174,305           |
| Total investments at fair value  | 429,156           | 328,222           |
| Investments in money market funds  | 27,249            | 41,760            |
| Cash   | 16,570            | □                 |
| Receivables for:   |                   |                   |
| Interest   | 4,039             | 2,139             |
| Dividends  | 45                | 263               |
| Loan principal   | 107               | □                 |
| Structuring fees   | □                 | 1,625             |
| Investments sold   | 506               | □                 |
| Other  | 419               | 271               |
| Prepaid expenses   | 298               | 471               |
| Deferred financing costs   | 1,618             | 1,751             |
| <b>Total Assets</b>  | <b>480,007</b>    | <b>376,502</b>    |
| <b>Liabilities</b>   |                   |                   |
| Credit facility payable (Note 9)   | 90,667            | □                 |
| Payable for investments purchased  | □                 | 70,000            |
| Dividends payable  | 8,958             | □                 |
| Due to Prospect Administration (Note 5)  | 931               | 330               |
| Due to Prospect Capital Management (Note 5)  | 5,562             | 4,508             |
| Accrued expenses   | 1,227             | 1,312             |
| Other liabilities  | 944               | 304               |
| <b>Total Liabilities</b>   | <b>108,289</b>    | <b>76,454</b>     |
| <b>Net Assets</b>  | <b>\$ 371,718</b> | <b>\$ 300,048</b> |
| <b>Components of Net Assets (Note 4)</b>   |                   |                   |
| Common stock, par value \$0.001 per share (100,000,000 and 100,000,000 common shares authorized, respectively; 26,270,379 and 19,949,065 issued and outstanding, respectively) | \$ 26             | \$ 20             |
| Paid-in capital in excess of par   | 395,571           | 299,845           |
| Distributions in excess of net investment income   | (315)             | (4,092)           |
| Accumulated realized gains (losses) on investments   | (16,163)          | 2,250             |
| Unrealized appreciation (depreciation) on investments  | (7,401)           | 2,025             |
| <b>Net Assets</b>  | <b>\$ 371,718</b> | <b>\$ 300,048</b> |
| <b>Net Asset Value Per Share</b>   | <b>\$ 14.15</b>   | <b>\$ 15.04</b>   |

See notes to consolidated financial statements.

|  | Three Months Ended<br>March 31,<br>2008 | March 31,<br>2007 |
|--|---|-------------------|
| <b>Investment Income</b>   |   |                   |
| Interest income:   |   |                   |
| Control investments (Net of foreign withholding tax of \$35 and \$67, respectively)                      | \$ 4,556                                | \$ 3,845          |
| Affiliate investments (Net of foreign withholding tax of \$0 and \$35, respectively)                     | 290                                     | 800               |
| Non-control/Non-affiliate investments  | 10,044                                  | 4,025             |
| Total interest income  | 14,890                                  | 8,670             |
| Dividend income:   |   |                   |
| Control investments  | 3,300                                   | 850               |
| Money market funds   | 123                                     | 1,245             |
| Total dividend income  | 3,423                                   | 2,095             |
| Other income (2):  |   |                   |
| Control investments  | 200                                     | 8                 |
| Non-control/Non-affiliate investments  | 3,487                                   | 1,296             |
| Total other income   | 3,687                                   | 1,304             |
| <b>Total Investment Income</b>   | <b>22,000</b>                           | <b>12,069</b>     |
| <b>Operating Expenses</b>  |   |                   |
| Investment advisory fees:  |   |                   |
| Base management fee (Note 5)   | 2,388                                   | 1,531             |
| Income incentive fee (Note 5)  | 3,230                                   | 1,754             |
| Total investment advisory fees   | 5,618                                   | 3,285             |
| Interest expense and credit facility costs   | 1,863                                   | 353               |
| Chief Compliance Officer and Sub-administration fees   | 228                                     | 164               |
| Legal fees   | 449                                     | 593               |
| Valuation services   | 198                                     | 92                |
| Audit and tax related fees   | 45                                      | 43                |
| Recruitment and other professional fees  | 18                                      | 4                 |
| Insurance expense  | 64                                      | 72                |
| Directors' fees  | 55                                      | 55                |
| Other general and administrative expenses  | 543                                     | 393               |
| <b>Total Operating Expenses</b>  | <b>9,081</b>                            | <b>5,054</b>      |
| <b>Net Investment Income</b>   | <b>12,919</b>                           | <b>7,015</b>      |
| Net realized gain (loss) on investments  | 208                                     | (1)               |
| Increase (decrease) in net assets from net change in unrealized appreciation/depreciation on investments | (14,386)                                | (2,038)           |
| <b>Increase (Decrease) in Net Assets Resulting from Operations</b>                                       | <b>\$ (1,259)</b>                       | <b>\$ 4,976</b>   |
| Earnings(loss) per common share (Note 6)   | \$ (0.05)                               | \$ 0.26           |

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

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

See notes to consolidated financial statements.

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

|  | Nine Months Ended<br>March 31,<br>2008 | March 31,<br>2007 |
|--|--|-------------------|
| <b>Investment Income</b>   |  |                   |
| Interest income:   |  |                   |
| Control investments (Net of foreign withholding tax of \$193 and \$112, respectively)  | \$ 14,689                              | \$ 9,455          |
| Affiliate investments (Net of foreign withholding tax of \$70 and \$202, respectively) | 1,612                                  | 2,837             |
| Non-control/Non-affiliate investments  | 26,237                                 | 8,656             |
| Total interest income  | 42,538                                 | 20,948            |
| Dividend income:   |  |                   |
| Control investments  | 6,950                                  | 2,550             |
| Money market funds   | 557                                    | 1,839             |
| Total dividend income  | 7,507                                  | 4,389             |
| Other income (2):  |  |                   |
| Control investments  |  | 8                 |
| Affiliate investments  | 210                                    | 3                 |
| Non-control/Non-affiliate investments  | 5,699                                  | 1,324             |
| Total Other income   | 5,909                                  | 1,335             |
| <b>Total Investment Income</b>   | 55,954                                 | 26,672            |
| <b>Operating Expenses</b>  |  |                   |
| Investment advisory fees:  |  |                   |
| Base management fee (Note 5)   | 6,366                                  | 3,715             |
| Income incentive fee (Note 5)  | 7,861                                  | 3,695             |
| Total investment advisory fees   | 14,227                                 | 7,410             |
| Interest expense and credit facility costs   | 4,719                                  | 1,385             |
| Chief Compliance Officer and Sub-administration fees                                   | 620                                    | 402               |
| Legal fees   | 2,224                                  | 970               |
| Valuation services   | 431                                    | 285               |
| Sarbanes-Oxley compliance expenses   | 10                                     | 46                |
| Audit and tax related fees   | 338                                    | 382               |
| Recruitment and other professional fees  | 53                                     | 4                 |
| Insurance expense  | 192                                    | 219               |
| Directors' fees  | 165                                    | 175               |
| Other general and administrative expenses  | 1,531                                  | 612               |

|  |          |           |
|--|----------|-----------|
| <b>Total Operating Expenses</b>  | 24,510   | 11,890    |
| <b>Net Investment Income</b>   | 31,444   | 14,782    |
| Net realized (loss) gain on investments  | (18,413) | 1,949     |
| Increase (decrease) in net assets from net change in unrealized appreciation/<br>depreciation on investments | (9,426)  | (4,851)   |
| <b>Increase (Decrease) in Net Assets Resulting from Operations</b>   | \$ 3,605 | \$ 11,880 |
| Earnings (loss) per common share (Note 6)  | \$ 0.16  | \$ 0.82   |

- (1) Certain amounts have been reclassified to conform to the current period's presentation.
- (2) Includes Structuring Fees of \$2,431, Deal Deposit Income of \$72, Overriding Royalty Interests of \$3,364, Forbearance Fees of \$10 and Administrative Agent Fees of \$32 for the nine months ended March 31, 2008 and Prepayment Penalty on Net Profits Interest of \$960, Net Profits Interests of \$26, Deal Deposit Income of \$292 and Overriding Royalty Interests of \$57 for the nine months ended March 31, 2007.
- See notes to consolidated financial statements.

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

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

|  |                   |                   |
|--|-------------------|-------------------|
| Net increase in capital shares             | 6,321,314         | 12,809,358        |
| Shares outstanding at beginning of period  | 19,949,065        | 7,069,873         |
| <b>Shares Outstanding at End of Period</b> | <b>26,270,379</b> | <b>19,879,231</b> |

See notes to consolidated financial statements.

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

|  | <b>Nine Months Ended</b> |                  |
|--|--------------------------|------------------|
|  | <b>March 31,</b>         | <b>March 31,</b> |
|  | <b>2008</b>              | <b>2007 (1)</b>  |
| <b>Cash Flows from Operating Activities:</b>   |                          |                  |
| Increase (decrease) in net assets resulting from operations  | \$ 3,605                 | \$ 11,880        |
| Adjustments to reconcile net increase (decrease) in net assets resulting from operations to net cash provided by (used in) operating activities: |                          |                  |
| Net (increase) decrease in net assets from net change in unrealized appreciation/depreciation on investments                                     | 9,426                    | 4,851            |
| Net realized (gain) loss on investments  | 18,413                   | (1,949)          |
| Accretion of original issue discount on investments  | (1,785)                  | (1,436)          |
| Amortization of deferred financing costs   | 547                      | 836              |
| <b>Change in operating assets and liabilities:</b>   |                          |                  |
| Payments for purchases of investments  | (193,033)                | (106,846)        |
| Proceeds from sale of investments  | 66,063                   | 28,096           |
| Purchases of cash equivalents  | (229,955)                | (249,895)        |
| Sales of cash equivalents  | 229,938                  | 249,893          |
| Net investments in money market funds  | 14,511                   | (97,976)         |
| (Increase) decrease in interest receivable   | (1,900)                  | (329)            |
| (Increase) decrease in dividends receivable  | 218                      | (435)            |
| (Increase) decrease in loan principal receivable   | (107)                    | (119)            |
| (Increase) decrease in receivable for structuring fees   | 1,625                    | □                |
| (Increase) decrease in receivables for securities sold   | (506)                    | 369              |
| (Increase) decrease in other receivables   | (148)                    | (254)            |
| (Increase) decrease in due from Prospect Administration  | □                        | 28               |
| (Increase) decrease in due from Prospect Capital Management  | □                        | 5                |
| (Increase) decrease in prepaid expenses  | 173                      | (86)             |
| Increase (decrease) in payables for securities purchased   | (70,000)                 | 1,666            |
| Increase (decrease) in due to Prospect Administration  | 601                      | 286              |
| Increase (decrease) in due to Prospect Capital Management  | 1,054                    | 2,723            |
| Increase (decrease) in accrued expenses  | (85)                     | 3                |
| Increase (decrease) in other liabilities   | 640                      | 442              |
| <b>Net Cash Used In Operating Activities</b>   | <b>(150,705)</b>         | <b>(158,247)</b> |
| <b>Cash Flows from Financing Activities:</b>   |                          |                  |
| Borrowings under credit facility   | 184,992                  | □                |
| Payments under credit facility   | (94,325)                 | (28,500)         |
| (Increase) decrease in deferred financing costs  | (415)                    | (868)            |
| (Increase) decrease in deferred offering costs   | □                        | 32               |
| Net proceeds from issuance of common stock   | 94,230                   | 197,557          |
| Offering costs from issuance of common stock   | (1,251)                  | (869)            |
| Dividends paid   | (15,956)                 | (15,071)         |

|   |           |            |
|---|-----------|------------|
| <b>Net Cash Provided By Financing Activities</b>                      | 167,275   | 152,281    |
| <b>Net Increase (decrease) in Cash</b>                                | 16,570    | (5,964)    |
| Cash, beginning of period   | □         | □          |
| <b>Cash (bank overdraft), End of Period</b>                           | \$ 16,570 | \$ (5,964) |
| <b>Cash Paid For Interest</b>   | \$ 1,825  | \$ 526     |
| <b>Non-Cash Financing Activity:</b>                                   |           |            |
| Amount of shares issued in connection with dividend reinvestment plan | \$ 2,753  | \$ 4,719   |

(1) Certain amounts have been reclassified to conform to the current period's presentation. See notes to consolidated financial statements.

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

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



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|   |   |           |               |              |             |
|---|---|-----------|---------------|--------------|-------------|
| due 9/30/2010                             |   | \$ 14,003 | 14,003        | □            | 0.0%        |
| Senior secured note, 14.00%               |   |           |               |              |             |
| due 9/30/2010                             |   | \$ 800    | 800           | 5,000        | 1.3%        |
| Senior demand note, 15.00% (7)            |   |           |               |              |             |
| due 4/11/2011                             |   | \$ 1,170  | 1,170         | □            | 0.0%        |
| <b>Total</b>                              |   |           | <b>16,100</b> | <b>5,000</b> | <b>1.3%</b> |
| <b>Iron Horse Coiled Tubing, Inc. (4)</b> | <b>Alberta, Canada/<br/>Production<br/>services</b> |           |               |              |             |
| Common shares                             |   | 643       | 268           | □            | 0.0%        |
| Senior secured note, 15.00%               |   |           |               |              |             |
| due 4/19/2009                             |   | \$ 9,250  | 9,051         | 9,051        | 2.4%        |
| <b>Total</b>                              |   |           | <b>9,319</b>  | <b>9,051</b> | <b>2.4%</b> |

See notes to consolidated financial statements.

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

| <b>Portfolio Investments (1)</b>               | <b>Locale/<br/>Industry</b>                | <b>Par Value/<br/>Shares/<br/>Ownership %</b> | <b>Cost</b>   | <b>Fair Value<br/>(2)</b> | <b>% of<br/>Net<br/>Assets</b> |
|--|--|---|---------------|---------------------------|--------------------------------|
| NRG Manufacturing, Inc.                        | Texas/<br>Manufacturing                    |   |               |                           |                                |
| Common shares                                  |  | 800   | \$ 2,317      | \$ 8,656                  | 2.3%                           |
| Senior secured note, 16.50% (8)                |  |   |               |                           |                                |
| due 8/31/2013 (4)                              |  | \$ 13,080                                     | 13,080        | 13,080                    | 3.5%                           |
| <b>Total</b>                                   |  |   | <b>15,397</b> | <b>21,736</b>             | <b>5.8%</b>                    |
| North Fork Collieries LLC                      | Kentucky/<br>Mining and Coal<br>Production |   |               |                           |                                |
| Membership Interests                           |  | 100%  | □             | □                         | 0.0%                           |
| Senior secured note, 18.00%                    |  |   |               |                           |                                |
| due 3/31/2009                                  |  | \$ 5,121                                      | 5,121         | 5,121                     | 1.4%                           |
| <b>Total</b>                                   |  |   | <b>5,121</b>  | <b>5,121</b>              | <b>1.4%</b>                    |
| R-V Industries, Inc.                           | Pennsylvania/<br>Manufacturing             |   |               |                           |                                |
| Common shares                                  |  | 545,107                                       | 5,025         | 5,025                     | 1.4%                           |
| Warrants, common shares,<br>expiring 6/30/2017 |  | 200,000                                       | 1,681         | 1,829                     | 0.5%                           |
| Senior secured note, 15.00%                    |  |   |               |                           |                                |

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|  |   |           |                  |                  |              |
|--|---|-----------|------------------|------------------|--------------|
| due 6/30/2017 (4)                                  |   | \$ 7,526  | 5,894            | 5,747            | 1.5%         |
| <b>Total</b>                                       |   |           | <b>12,600</b>    | <b>12,601</b>    | <b>3.4%</b>  |
| <b>Whymore Coal Company, Inc. (9)</b>              | <b>Kentucky/<br/>Mining and Coal<br/>Production</b> |           |                  |                  |              |
| Equity ownership                                   |   | Various   | 209              | 1                | 0.0%         |
| Senior secured note, 15.00% (10)<br>due 12/31/2010 |   | \$ 12,510 | 12,510           | 6,063            | 1.6%         |
| <b>Total</b>                                       |   |           | <b>12,719</b>    | <b>6,064</b>     | <b>1.6%</b>  |
| <b>Worcester Energy Company, Inc. (11)</b>         | <b>Maine/Biomass<br/>Power</b>                      |           |                  |                  |              |
| Equity ownership                                   |   | Various   | 303              | 1                | 0.0%         |
| Senior secured note, 12.50%<br>due 12/31/2012      |   | \$ 34,383 | 34,247           | 19,579           | 5.3%         |
| <b>Total</b>                                       |   |           | <b>\$ 34,550</b> | <b>\$ 19,580</b> | <b>5.3%</b>  |
| <b>Total Control Investments</b>                   |   |           | <b>147,142</b>   | <b>141,631</b>   | <b>38.1%</b> |

See notes to consolidated financial statements.

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

| Portfolio Investments (1)  | Locale/<br>Industry                                 | Par Value/<br>Shares/<br>Ownership<br>% | Cost         | Fair Value<br>(2) | % of<br>Net<br>Assets |
|--|---|---|--------------|-------------------|-----------------------|
| <b>Affiliate Investments (5.00% to 24.99% of voting control)</b>                 |   |   |              |                   |                       |
| <b>Appalachian Energy Holdings LLC (12) (4)</b>                                  | <b>West Virginia/<br/>Construction<br/>Services</b> |   |              |                   |                       |
| Common shares  |   | 100                                     | □            | □                 | 0.0%                  |
| Series A preferred shares  |   | 200                                     | 149          | 149               | 0.0%                  |
| Warrants, expiring 2/14/2016   |   | 6,065                                   | 348          | 348               | 0.1%                  |
| Senior secured note, 14.00%,<br>plus 3.00% PIK due 1/31/2011                     |   | \$ 5,224                                | 5,085        | 5,085             | 1.4%                  |
| <b>Total Affiliate Investments</b>   |   |   | <b>5,582</b> | <b>5,582</b>      | <b>1.5%</b>           |
| <b>Non-Control/Non-Affiliate Investments (less than 5.00% of voting control)</b> |   |   |              |                   |                       |
| American Gilsonite Company   | Utah/Specialty                                      |   |              |                   |                       |

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|  | Minerals                  |           |                 |                 |             |
|--|---------------------------|-----------|-----------------|-----------------|-------------|
| Membership Interests in AGC\PEP, LLC                               |                           | 99.999%   | 1,000           | 1,000           | 0.3%        |
| Senior secured note, 12.00% plus 3.00% due 3/14/2013 (4)           |                           | \$ 14,500 | 14,500          | 14,500          | 3.9%        |
| <b>Total</b>   |                           |           | <b>15,500</b>   | <b>15,500</b>   | <b>4.2%</b> |
| Arctic Acquisition Corp. (13) (4)                                  | Texas/Production services |           |                 |                 |             |
| Warrants, common shares, expiring 7/19/2012                        |                           | 596,251   | 507             | 970             | 0.3%        |
| Warrants, Series A redeemable preferred shares, expiring 7/19/2012 |                           | 1,054     | 507             | 970             | 0.3%        |
| <b>Total</b>   |                           |           | <b>1,014</b>    | <b>1,940</b>    | <b>0.6%</b> |
| C&J Cladding LLC (4)   | Texas/Metal Services      |           |                 |                 |             |
| Warrants, common shares, expiring 3/30/2014                        |                           | 510       | 580             | 1,795           | 0.5%        |
| Senior secured note, 14.00% (14) due 3/31/2012                     |                           | \$ 5,100  | 4,375           | 4,375           | 1.2%        |
| <b>Total</b>   |                           |           | <b>\$ 4,955</b> | <b>\$ 6,170</b> | <b>1.7%</b> |

See notes to consolidated financial statements.

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

| Portfolio Investments (1)                     | Locale/<br>Industry                     | Par Value/<br>Shares/<br>Ownership<br>% | Cost   | Fair Value<br>(2) | % of<br>Net<br>Assets |
|---|---|---|--------|-------------------|-----------------------|
| Conquest Cherokee, LLC (15) (4)               | Tennessee/<br>Oil and Gas<br>Production |   |        |                   |                       |
| Senior secured note, 13.00% (16) due 5/5/2009 |   | \$ 10,200                               | 10,104 | 10,104            | 2.7%                  |
| Deb Shops, Inc. (4)                           | Pennsylvania/<br>Retail Apparel         |   |        |                   |                       |
| Senior secured note, 10.69% due 1/31/2015     |   | \$ 15,000                               | 14,566 | 14,566            | 3.9%                  |
| Deep Down, Inc. (4)                           | Texas/Production<br>Services            |   |        |                   |                       |
| Warrants, common shares, expiring 8/6/2012    |   | 4,960,585                               | □      | □                 | 0.0%                  |
| Senior secured note, 12.50%,                  |   |   |        |                   |                       |

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|  |   |    |        |               |               |             |
|--|---|----|--------|---------------|---------------|-------------|
| plus 3.00% PIK due 8/1/2011  |   | \$ | 12,000 | 12,000        | 12,000        | 3.2%        |
| <b>Total</b>   |   |    |        | <b>12,000</b> | <b>12,000</b> | <b>3.2%</b> |
| <b>Diamondback Operating, LP (17) (4)</b>                                | <b>Oklahoma/<br/>Oil and Gas<br/>Production</b> |    |        |               |               |             |
| Senior secured note, 12.00%,<br>plus 2.00% PIK due 8/28/2011             |   | \$ | 9,200  | 9,200         | 9,200         | 2.5%        |
| <b>H&amp;M Oil &amp; Gas, LLC (17) (4)</b>                               | <b>Texas/Oil and<br/>Gas Production</b>         |    |        |               |               |             |
| Senior secured note, 13.00% (18)<br>due 6/30/2010                        |   | \$ | 45,000 | 45,000        | 45,000        | 12.1%       |
| <b>IEC Systems LP/Advance Rig Services<br/>LLC (ARS) (4)</b>             | <b>Texas/Oilfield<br/>Fabrication</b>           |    |        |               |               |             |
| IEC senior secured note, 12.00%,<br>plus 3.00% PIK due 11/20/2012        |   | \$ | 19,192 | 19,192        | 19,192        | 5.2%        |
| ARS senior secured note, 12.00%,<br>plus 3.00% PIK due 11/20/2012        |   | \$ | 5,875  | 5,875         | 5,875         | 1.6%        |
| <b>Total</b>   |   |    |        | <b>25,067</b> | <b>25,067</b> | <b>6.8%</b> |
| <b>Jettco Marine Services LLC (17) (4)</b>                               | <b>Louisiana/<br/>Shipping</b>                  |    |        |               |               |             |
| Subordinated secured note, 12.00% (19),<br>plus 4.00% PIK due 12/31/2011 |   | \$ | 6,878  | 6,775         | 6,775         | 1.8%        |

See notes to consolidated financial statements.

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

| <b>Portfolio Investments (1)</b>                              | <b>Locale/<br/>Industry</b>                      | <b>Par Value/<br/>Shares/<br/>Ownership %</b> | <b>Cost</b>   | <b>Fair Value<br/>(2)</b> | <b>% of<br/>Net<br/>Assets</b> |
|---|--|---|---------------|---------------------------|--------------------------------|
| <b>Maverick Healthcare, Inc. (4)</b>                          | <b>Arizona/Medical<br/>Services</b>              |   |               |                           |                                |
| Common shares   |  | 1,250,000                                     | 1,250         | 1,250                     | 0.3%                           |
| Preferred shares  |  | 1,250,000                                     | □             | □                         | 0.0%                           |
| Senior secured note, 12.00%,<br>plus 1.50% PIK due 10/31/2014 |  | \$  | 12,500        | 12,500                    | 3.4%                           |
| <b>Total</b>  |  |   | <b>13,750</b> | <b>13,750</b>             | <b>3.7%</b>                    |
| <b>Miller Petroleum, Inc.</b>                                 | <b>Tennessee/<br/>Oil and Gas<br/>Production</b> |   |               |                           |                                |
| Warrants, common shares,                                      |  |   |               |                           |                                |

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|  |  |   |           |               |               |             |
|--|--|---|-----------|---------------|---------------|-------------|
| Qualitest Pharmaceuticals, Inc. (4)            | Alabama/<br>Pharmaceuticals              | expiring 5/4/2010 to 3/31/2013  | 1,480,108 | \$ 150        | 2             | 0.0%        |
| Regional Management Corp. (4)                  | South Carolina/<br>Financial<br>Services | Second lien debt, 12.45% (20)<br>due 4/30/2015                        | \$ 12,000 | 11,942        | 11,942        | 3.2%        |
| Resco Products, Inc. (4)                       | Pennsylvania/<br>Manufacturing           | Subordinated secured note, 12.00%,<br>plus 2.00% PIK due 6/29/2012    | \$ 25,000 | 25,000        | 25,000        | 6.7%        |
| Shearer's Foods, Inc. (4)                      | Ohio/Food<br>Products                    | Second lien debt, 11.06% (21)<br>due 6/24/2014                        | \$ 9,750  | 9,570         | 9,570         | 2.6%        |
| Mistral Chip Holdings, LLC<br>membership units |  |   | 4.415%    | 2,000         | 2,000         | 0.5%        |
| Second lien debt, 14.00%<br>due 10/31/2013     |  |   | \$ 18,000 | 18,000        | 18,000        | 4.9%        |
| <b>Total</b>                                   |  |   |           | <b>20,000</b> | <b>20,000</b> | <b>5.4%</b> |
| Stryker Energy, LLC (22) (4)                   | Ohio/Oil and<br>Gas Production           | Subordinated revolving credit facility,<br>12.00% (23) due 11/30/2011 | \$ 29,500 | 29,015        | 29,015        | 7.8%        |

See notes to consolidated financial statements.

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

| Portfolio Investments (1)   | Locale/<br>Industry                        | Par Value/<br>Shares/<br>Ownership % | Cost   | Fair<br>Value<br>(2) | % of<br>Net<br>Assets |
|---|--|--------------------------------------|--------|----------------------|-----------------------|
| Unitek (4)  | Pennsylvania/<br>Technical<br>Services     |                                      |        |                      |                       |
| Second lien debt, 12.75% (24)<br>due 9/27/2013                      |  | \$ 11,500                            | 11,332 | 11,332               | 3.0%                  |
| Unity Virginia Holdings, LLC  | Virginia/<br>Mining and Coal<br>Production |                                      |        |                      |                       |
| Subordinated secured note, 15.00%,<br>plus 15.00% PIK due 1/31/2009 |  | \$ 3,580                             | 3,893  | 10                   | 0.0%                  |
| Wind River Resources Corp. and Wind                                 | Utah/Oil and                               |                                      |        |                      |                       |

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|   |                |            |            |            |        |
|---|----------------|------------|------------|------------|--------|
| River II Corp. (17) (4)   | Gas Production |            |            |            |        |
| Senior secured note, 13.00%,<br>Due 7/31/2009                                 |                | \$ 15,000  | 15,000     | 15,000     | 4.0%   |
| <b>Total Non-Control/Non-Affiliate Investments</b>                            |                |            | \$ 283,833 | 281,943    | 75.9%  |
| <b>Total Portfolio Investments</b>  |                |            | \$ 436,557 | 429,156    | 115.5% |
| <b>Money Market Funds</b>   |                |            |            |            |        |
| Fidelity Institutional Money Market Funds -<br>Government Portfolio (Class I) |                |            |            |            |        |
|   |                | 23,142,184 | \$ 23,142  | \$ 23,142  | 6.2%   |
| First American Funds, Inc. -<br>Prime Obligations Fund<br>(Class A) (4)       |                |            |            |            |        |
|   |                | 4,106,793  | 4,107      | \$ 4,107   | 1.1%   |
| <b>Total Money Market Funds</b>   |                |            | \$ 27,249  | \$ 27,249  | 7.3%   |
| <b>Total Investments</b>  |                |            | \$ 463,806 | \$ 456,405 | 122.8% |

- (1) The securities in which Prospect Capital has invested were acquired in transactions that were exempt from registration under the Securities Act of 1933, as amended, or the [Securities Act.] These securities may be resold only in transactions that are exempt from registration under the Securities Act.
- (2) Fair value is determined by or under the direction of the Board of Directors of Prospect Capital (Note 2).
- (3) Gas Solutions Holdings, Inc. is a wholly-owned investment of Prospect Capital.
- (4) Security, or portion thereof, is held as collateral for the credit facility with Rabobank Nederland (See Note 9). At March 31, 2008, the value of these investments was \$338,498 which represents 91.1% of net assets.

See notes to consolidated financial statements.

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

- (5) Interest rate is the greater of 15.0% or 6-Month LIBOR plus 11.0%; rate reflected is as of March 31, 2008.
- (6) Entity was formed as a result of the debt restructuring of ESA Environmental Specialist, Inc.
- (7) Loan is with Lisamarie Fallon, Inc., (d/b/a The Healing Staff) an affiliate of the Integrated Contract Services, Inc.

- (8) Interest rate is the greater of 16.5% or 12-Month LIBOR plus 11.0%; rate reflected is as of March 31, 2008.
- (9) There are several entities involved in the Whymore investment. Prospect Capital has provided senior secured debt financing to C&A Construction, Inc. (["C&A"]), which owns the equipment. E&L Construction, Inc. (["E&L"]) leases the equipment from C&A, employs the workers, is listed as the operator with the Commonwealth of Kentucky, mines the coal, receives revenues and pays all operating expenses. Whymore Coal Company, Inc. (["Whymore"]) applies for and holds permits, pays royalties to landowners, and holds escrow funds for reclamation expenses following mining operations. Whymore and E&L are guarantors under the C&A credit agreement with Prospect Capital. Prospect Capital owns 10,000 shares of common stock of C&A (100% ownership), 10,000 shares of common stock of E&L (100% ownership), and 4,900 shares of common stock of Whymore (49% ownership). Prospect Capital owns 4,285 Series A convertible preferred shares in each of C&A, E&L and Whymore. Additionally, Prospect Capital retains an option to purchase the remaining 51% of Whymore. As of March 31, 2008, the Board of Directors of Prospect Capital assessed a fair value of \$1 for the preferred equity.
- (10) Interest rate is the greater of 15.0% or 5-Year US Treasury Note plus 11.5%; rate reflected is as of March 31, 2008.
- (11) There are several entities involved in the Worcester Energy Company, Inc. investment. Prospect Capital owns 100 shares of common stock in Worcester Energy Holdings, Inc. (["WEHI"]) representing 100%. WEHI, in turn, owns 51 membership certificates in Biochips LLC, which represents 51% ownership. Prospect Capital also owns 282 shares of common stock in Worcester Energy Co., Inc. (["WECO"]), which represents 51% ownership. Prospect Capital also owns 1,665 shares of common stock in Worcester Energy Partners, Inc. (["WEPI"]), which represents 51% ownership. Prospect Capital also owns 1,000 of series A convertible preferred shares in WEPI. WECO, WEPI and Biochips LLC are joint borrowers on the term note issued to Prospect Capital. WEPI owns the equipment and operates the biomass generation facility. Biochips LLC currently has no material operations. WEPI owns 100 shares of common stock in Precision Logging and Landclearing, Inc. (["Precision"]), which represents 100% ownership. Precision conducts all logging, processing and delivery operations to supply fuel to the biomass generation facility. As of March 31, 2008, the Board of Directors of Prospect Capital assessed a fair value of \$1 for all of these equity positions.
- (12) There are several entities involved in the Appalachian Energy Holdings (["Appalachian Energy"]) investment. Prospect Capital owns 100 shares of Class A common stock of AEH Investment Corp. (["AEH"]), 200 shares of Series A preferred stock of AEH and 6,065 warrants, expiring 2/14/2016 to purchase Class A common stock. The senior secured note is with C & S Operating LLC and East Cumberland L.L.C., both operating companies owned by Appalachian Energy Holdings LLC. AEH owns Appalachian Energy.
- (13) The Portfolio Investment does business as Cougar Pressure Control.
- (14) Interest rate is the greater of 14.0% or 12-Month LIBOR plus 7.5%; rate reflected is as of March 31, 2008.

- (15) Prospect Capital has an overriding royalty interest and net profits interest in the Portfolio Investment.
- (16) Interest rate is the greater of 13.0% or 12-Month LIBOR plus 7.5%; rate reflected is as of March 31, 2008.
- (17) Prospect Capital has a net profits interest in the Portfolio Investment.
- (18) Interest rate is the greater of 13.0% or 12-Month LIBOR plus 7.5%; rate reflected is as of March 31, 2008.
- See notes to consolidated financial statements.

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

- (19) Interest rate is the greater of 13.0% or 3-Month LIBOR plus 6.11%; rate reflected is as of March 31, 2008.
- (20) Interest rate is the greater of 12.5% or 3-Month LIBOR plus 7.5%; rate reflected is as of March 31, 2008.
- (21) Interest rate is 3-Month LIBOR plus 8.0%; rate reflected is as of March 31, 2008.
- (22) Prospect Capital has an overriding royalty interest in the Portfolio Investment.
- (23) Interest rate is the greater of 12.0% or 12-Month LIBOR plus 7.0%; rate reflected is as of March 31, 2008.
- (24) Interest rate is the greater of 12.75% or 3-Month LIBOR plus 7.25%; rate reflected is as of March 31, 2008.
- See notes to consolidated financial statements.

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

| Portfolio Investments (1)<br>Control Investments (25.00% or greater of voting control) | Locale/<br>Industry                          | Par<br>Value/<br>Shares | Cost   | Fair Value<br>(2) | % of<br>Net<br>Assets |
|--|--|-------------------------|--------|-------------------|-----------------------|
| Advantage Oilfield Group Ltd. (23)   | Alberta, Canada/<br>Construction<br>Services | 33                      | \$ 220 | \$ □              | 0.0%                  |
| Common shares, Class A (3)   |  |                         |        |                   |                       |



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|  |  |           |        |        |       |
|--|--|-----------|--------|--------|-------|
| Senior secured note, 15.00%<br>due 5/30/2009             |  | \$ 17,321 | 16,930 | 9,880  | 3.3%  |
| <b>Total</b>   |  |           | 17,150 | 9,880  | 3.3%  |
| Gas Solutions Holdings, Inc. (4)                         | Texas/Gas<br>Gathering and<br>Processing   |           |        |        |       |
| Common shares  |  | 100       | 4,878  | 26,100 | 8.7%  |
| Subordinated secured note, 18.00%<br>due 12/22/2011 (23) |  | \$ 18,400 | 18,400 | 18,400 | 6.1%  |
| <b>Total</b>   |  |           | 23,278 | 44,500 | 14.8% |
| Genesis Coal Corp.                                       | Kentucky/<br>Mining and Coal<br>Production |           |        |        |       |
| Common shares  |  | 63        | 23     | 1      | 0.0%  |
| Warrants, preferred shares,<br>expiring 2/9/2016         |  | 1,000     | 33     | 1      | 0.0%  |
| Senior secured note, 16.40% (5)<br>due 12/31/2010        |  | \$ 14,533 | 14,408 | 11,423 | 3.8%  |
| <b>Total</b>   |  |           | 14,464 | 11,425 | 3.8%  |
| NRG Manufacturing, Inc.                                  | Texas/<br>Manufacturing                    |           |        |        |       |
| Common shares  |  | 800       | 2,315  | 11,785 | 3.9%  |
| Senior secured note, 16.50% (6)<br>due 8/31/2013 (23)    |  | \$ 10,080 | 10,080 | 10,080 | 3.4%  |
| <b>Total</b>   |  |           | 12,395 | 21,865 | 7.3%  |

See notes to consolidated financial statements.

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

| Portfolio Investments (1)                      | Locale/<br>Industry            | Par Value/<br>Shares | Cost     | Fair Value<br>(2) | % of<br>Net<br>Assets |
|--|--------------------------------|----------------------|----------|-------------------|-----------------------|
| R-V Industries, Inc.                           | Pennsylvania/<br>Manufacturing |                      |          |                   |                       |
| Common shares                                  |                                | 545,107              | 4,985    | 4,985             | 1.6%                  |
| Warrants, common shares, expiring<br>6/30/2017 |                                | 200,000              | \$ 1,682 | \$ 1,682          | 0.6%                  |
| Senior secured note, 15.00%                    |                                |                      |          |                   |                       |

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|  |   |           |                |                |              |
|--|---|-----------|----------------|----------------|--------------|
| due 6/30/2017 (23)   |   | \$ 14,526 | 12,844         | 12,844         | 4.3%         |
| <b>Total</b>   |   |           | <b>19,511</b>  | <b>19,511</b>  | <b>6.5%</b>  |
| <b>Whymore Coal Company, Inc. (7)</b>                            | <b>Kentucky/<br/>Mining and Coal<br/>Production</b> |           |                |                |              |
| Equity ownership   |   | Various   | 111            | 1              | 0.0%         |
| Senior secured note, 16.42% (8)<br>due 12/31/2010                |   | \$ 11,022 | 11,022         | 7,063          | 2.4%         |
| <b>Total</b>   |   |           | <b>11,133</b>  | <b>7,064</b>   | <b>2.4%</b>  |
| <b>Worcester Energy Company, Inc. (9)</b>                        | <b>Maine/Biomass<br/>Power</b>                      |           |                |                |              |
| Equity ownership   |   | Various   | 137            | 1              | 0.0%         |
| Senior secured note, 12.50%<br>due 12/31/2012                    |   | \$ 26,774 | 26,596         | 25,046         | 8.3%         |
| <b>Total</b>   |   |           | <b>26,733</b>  | <b>25,047</b>  | <b>8.3%</b>  |
| <b>Total Control Investments</b>                                 |   |           | <b>124,664</b> | <b>139,292</b> | <b>46.4%</b> |
| <b>Affiliate Investments (5.00% to 24.99% of voting control)</b> |   |           |                |                |              |
| <b>Appalachian Energy Holdings LLC (10) (23)</b>                 | <b>West Virginia/<br/>Construction<br/>Services</b> |           |                |                |              |
| Series A preferred shares  |   | 200       | 104            | 104            | 0.0%         |
| Warrants, expiring 2/14/2016                                     |   | 6,065     | 348            | 152            | 0.1%         |
| Senior secured note, 14.00%,<br>plus 3.00% PIK due 1/31/2011     |   | \$ 5,358  | 5,169          | 5,169          | 1.7%         |
| <b>Total</b>   |   |           | <b>5,621</b>   | <b>5,425</b>   | <b>1.8%</b>  |

See notes to consolidated financial statements.

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

| <b>Portfolio Investments (1)</b>           | <b>Locale/<br/>Industry</b>                         | <b>Par<br/>Value/<br/>Shares</b> | <b>Cost</b> | <b>Fair<br/>Value<br/>(2)</b> | <b>% of<br/>Net<br/>Assets</b> |
|--|---|----------------------------------|-------------|-------------------------------|--------------------------------|
| <b>Iron Horse Coiled Tubing, Inc. (23)</b> | <b>Alberta, Canada/<br/>Production<br/>services</b> |                                  |             |                               |                                |
| Common shares                              |   | 93                               | 268         | 268                           | 0.1%                           |
| Senior secured note, 15.00%                |   |                                  |             |                               |                                |

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|  |                           |           |                  |                  |             |
|--|---------------------------|-----------|------------------|------------------|-------------|
| due 4/19/2009  |                           | \$ 9,250  | 8,932            | 8,932            | 3.0%        |
| <b>Total</b>   |                           |           | <b>9,200</b>     | <b>9,200</b>     | <b>3.1%</b> |
| <b>Total Affiliate Investments</b>   |                           |           | <b>\$ 14,821</b> | <b>\$ 14,625</b> | <b>4.9%</b> |
| <b>Non-Control/Non-Affiliate Investments (less than 5.00% of voting control)</b> |                           |           |                  |                  |             |
| Arctic Acquisition Corp. (11) (23)   | Texas/Production services |           |                  |                  |             |
| Warrants, common shares, expiring 7/19/2012                                      |                           | 596,251   | 507              | 507              | 0.2%        |
| Warrants, Series A redeemable preferred shares, expiring 7/19/2012               |                           | 1,054     | 507              | 507              | 0.2%        |
| Senior secured note, 13.00% due 7/19/2009  |                           | \$ 13,301 | 12,656           | 12,656           | 4.2%        |
| <b>Total</b>   |                           |           | <b>13,670</b>    | <b>13,670</b>    | <b>4.6%</b> |
| C&J Cladding LLC (23)  | Texas/Metal Services      |           |                  |                  |             |
| Warrants, common shares, expiring 3/30/2014                                      |                           | 510       | 580              | 580              | 0.2%        |
| Senior secured note, 14.00% (12) due 3/31/2012                                   |                           | \$ 6,000  | 5,249            | 5,249            | 1.7%        |
| <b>Total</b>   |                           |           | <b>5,829</b>     | <b>5,829</b>     | <b>1.9%</b> |
| Central Illinois Energy, LLC (23)  | Illinois/Biofuels/Ethanol |           |                  |                  |             |
| Senior secured note, 15.35% (13) due 3/31/2014                                   |                           | \$ 8,000  | 8,000            | 8,000            | 2.7%        |

See notes to consolidated financial statements.

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

| Portfolio Investments (1)                     | Locale/<br>Industry                     | Par Value/<br>Shares | Cost   | Fair<br>Value<br>(2) | % of<br>Net<br>Assets |
|---|---|----------------------|--------|----------------------|-----------------------|
| Conquest Cherokee, LLC (14) (23)              | Tennessee/<br>Oil and Gas<br>Production |                      |        |                      |                       |
| Senior secured note, 13.00% (15) due 5/5/2009 |   | \$ 10,200            | 10,046 | 10,046               | 3.3%                  |

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|   |   |           |               |              |  |             |
|---|---|-----------|---------------|--------------|--|-------------|
| ESA Environmental Specialist, Inc. (23)                                 | North Carolina/<br>Contracting          |           |               |              |  |             |
| Warrants, common shares,<br>expiring 4/11/2017                          |   | 1,059     | 1             |              |  | 0.0%        |
| Senior secured note, 14.00% (16)<br>due 4/11/2011                       |   | \$ 12,200 | 12,200        | 4,428        |  | 1.5%        |
| Senior secured note, 14.00% (16)<br>due 6/7/2008                        |   | \$ 1,575  | \$ 1,575      | \$ 572       |  | 0.2%        |
| <b>Total</b>  |   |           | <b>13,776</b> | <b>5,000</b> |  | <b>1.7%</b> |
| Evolution Petroleum Corp. (17)  | Texas/Oil and<br>Gas Production         |           |               |              |  |             |
| Common shares, unregistered   |   | 139,926   | 20            | 378          |  | 0.1%        |
| H&M Oil & Gas, LLC (18) (23)  | Texas/Oil and<br>Gas Production         |           |               |              |  |             |
| Senior secured note, 13.00% (19)<br>due 6/30/2010                       |   | \$ 45,000 | 45,000        | 45,000       |  | 15.0%       |
| Jettco Marine Services LLC (18) (23)                                    | Louisiana/<br>Shipping                  |           |               |              |  |             |
| Subordinated secured note, 12.00% (20),<br>plus 4.0% PIK due 12/31/2011 |   | \$ 6,671  | 6,553         | 6,553        |  | 2.2%        |
| Ken-Tex Energy Corp. (14) (23)  | Texas/Oil and<br>Gas Production         |           |               |              |  |             |
| Senior secured note, 13.00%<br>due 6/4/2010                             |   | \$ 10,750 | 10,750        | 10,750       |  | 3.6%        |
| Miller Petroleum, Inc.  | Tennessee/<br>Oil and Gas<br>Production |           |               |              |  |             |
| Warrants, common shares, expiring<br>5/4/2010 to 6/30/2012              |   | 1,206,859 | 150           | 22           |  | 0.0%        |

See notes to consolidated financial statements.

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

| <b>Portfolio Investments (1)</b>   | <b>Locale/<br/>Industry</b>              | <b>Par Value/<br/>Shares</b> | <b>Cost</b> | <b>Fair<br/>Value<br/>(2)</b> | <b>% of<br/>Net<br/>Assets</b> |
|------------------------------------|--|------------------------------|-------------|-------------------------------|--------------------------------|
| Regional Management Corp. (23)     | South Carolina/<br>Financial<br>Services |                              |             |                               |                                |
| Subordinated secured note, 12.00%, |  |                              |             |                               |                                |

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|  |                                     |    |            |            |            |        |
|--|-------------------------------------|----|------------|------------|------------|--------|
| plus 2.0% PIK due 6/29/2012  |                                     | \$ | 25,000     | 25,000     | 25,000     | 8.3%   |
| Stryker Energy, LLC (21)   | Ohio/Oil and Gas Production         |    |            |            |            |        |
| Subordinated revolving credit facility, 12.43% (22) due 11/30/2011         |                                     | \$ | 29,500     | 28,942     | 28,942     | 9.7%   |
| TLOGH, L.P. (21)   | Texas/Oil and Gas Production        |    |            |            |            |        |
| Senior secured note, 13.00%, due 10/23/2009                                |                                     | \$ | 15,291     | 15,105     | 15,105     | 5.0%   |
| Unity Virginia Holdings, LLC   | Virginia/Mining and Coal Production |    |            |            |            |        |
| Subordinated secured note, 15.00%, plus 15.00% PIK due 1/31/2009           |                                     | \$ | 3,580      | \$ 3,871   | \$ 10      | 0.0%   |
| <b>Total Non-Control/Non-Affiliate Investments</b>                         |                                     |    |            | 186,712    | 174,305    | 58.1%  |
| <b>Total Portfolio Investments</b>   |                                     |    |            | 326,197    | 328,222    | 109.4% |
| <b>Money Market Funds</b>  |                                     |    |            |            |            |        |
| Fidelity Institutional Money Market Funds - Government Portfolio (Class I) |                                     |    | 38,227,118 | 38,227     | 38,227     | 12.7%  |
| First American Funds, Inc. - Prime Obligations Fund (Class A) (23)         |                                     |    | 289,000    | 289        | 289        | 0.1%   |
| First American Funds, Inc. - Prime Obligations Fund (Class Y)              |                                     |    | 3,243,731  | 3,244      | 3,244      | 1.1%   |
| <b>Total Money Market Funds</b>  |                                     |    |            | 41,760     | 41,760     | 13.9%  |
| <b>Total Investments</b>   |                                     |    |            | \$ 367,957 | \$ 369,982 | 123.3% |

(1) The securities in which Prospect Capital has invested were acquired in transactions that were exempt from registration under the Securities Act of 1933, as amended, or the Securities Act. These securities may be resold only in transactions that are exempt from registration under the Securities Act.

(2) Fair value is determined by or under the direction of the Board of Directors of Prospect Capital (Note 2).

See notes to consolidated financial statements.

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- (3) Prospect Capital has the right to purchase 184 shares of Class A common shares at a purchase price of \$1.00 per share in the event of a default under the credit agreement.
- (4) Gas Solutions Holdings, Inc. is a wholly-owned investment of Prospect Capital.
- (5) Interest rate is the greater of 15.0% or 6-Month LIBOR plus 11.0%; rate reflected is as of June 30, 2007.
- (6) Interest rate is the greater of 16.5% or 12-Month LIBOR plus 11.0%; rate reflected is as of June 30, 2007.
- (7) There are several entities involved in the Whymore investment. Prospect Capital has provided senior secured debt financing to C&A Construction, Inc. (□C&A□), which owns the equipment. E&L Construction, Inc. (□E&L□) leases the equipment from C&A, employs the workers, is listed as the operator with the Commonwealth of Kentucky, mines the coal, receives revenues and pays all operating expenses. Whymore Coal Company, Inc. (□Whymore□) applies for and holds permits on behalf of E&L. Whymore and E&L are guarantors under the C&A credit agreement with Prospect Capital. Prospect Capital owns 10,000 shares of common stock of C&A (100% ownership), 10,000 shares of common stock of E&L (100% ownership), and 4,900 shares of common stock of Whymore (49% ownership). Prospect Capital owns 4,285 Series A convertible preferred shares in each of C&A, E&L and Whymore. Additionally, Prospect Capital retains an option to purchase the remaining 51% of Whymore. As of June 30, 2007, the Board of Directors of Prospect Capital assessed a fair value of \$1 for all of these equity positions.
- (8) Interest rate is the greater of 15.0% or 5-Year US Treasury Note plus 11.5%; rate reflected is as of June 30, 2007.
- (9) There are several entities involved in the Worcester Energy Company, Inc. investment. Prospect Capital owns 100 shares of common stock in Worcester Energy Holdings, Inc. (□WEHI□) representing 100%. WEHI, in turn, owns 51 membership certificates in Biochips LLC, which represents 51% ownership. Prospect Capital also owns 282 shares of common stock in Worcester Energy Co., Inc. (□WECO□), which represents 51% ownership. Prospect Capital also owns 1,665 shares of common stock in Worcester Energy Partners, Inc. (□WEPI□), which represents 51% ownership. Prospect Capital also owns 1,000 of series A convertible preferred shares in WEPI. WECO, WEPI and Biochips LLC are joint borrowers on the term note issued to Prospect Capital. WEPI owns the equipment and operates the biomass generation facility. Biochips LLC currently has no material operations. As of June 30, 2007, the Board of Directors of Prospect Capital assessed a fair value of \$1 for all of these equity positions.
- (10) There are several entities involved in the Appalachian Energy Holdings (□Appalachian Energy□) investment. Prospect Capital owns 100 shares of Class A common stock of AEH Investment Corp. (□AEH□), 200 shares of Series A preferred stock of AEH and 6,065 warrants, expiring 2/14/2016 to purchase Class A common stock. The senior secured note is with C & S Operating LLC and East Cumberland L.L.C., both operating companies owned by Appalachian Energy Holdings LLC. AEH owns Appalachian Energy.
- (11) The Portfolio Investment does business as Cougar Pressure Control.

- (12) Interest rate is the greater of 14.0% or 12-Month LIBOR plus 7.5%; rate reflected is as of June 30, 2007.
- (13) Interest rate is LIBOR plus 10.0%; rate reflected is as of June 30, 2007.
- (14) Prospect Capital has an overriding royalty interest and net profits interest in the Portfolio Investment.
- (15) Interest rate is the greater of 13.0% or 12-Month LIBOR plus 7.5%; rate reflected is as of June 30, 2007.
- (16) Interest rate is the greater of 14.0% or 1-Month LIBOR plus 8.5%; rate reflected is as of June 30, 2007.
- (17) Formerly known as Natural Gas Systems, Inc.
- (18) Prospect Capital has a net profits interest in the Portfolio Investment.
- See notes to consolidated financial statements.

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

- (19) Interest rate is the greater of 13.0% or 12-Month LIBOR plus 7.5%; rate reflected is as of June 30, 2007.
- (20) Interest rate is the greater of 13.0% or 3-Month LIBOR plus 6.11%; rate reflected is as of June 30, 2007.
- (21) Prospect Capital has an overriding royalty interest in the Portfolio Investment.
- (22) Interest rate is the greater of 12.0% or 12-Month LIBOR plus 7.0%; rate reflected is as of June 30, 2007.
- (23) Security, or portion thereof, is held as collateral for the credit facility with Rabobank Nederland (See Note 9). At June 30, 2007, the value of these investments was \$195,966, which represents 65.3% of net assets.

See notes to consolidated financial statements.

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

**Note 1. Organization**

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

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

## **Note 2. Significant Accounting Policies**

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

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

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

### *Consolidation:*

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

### *Investments:*

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

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

b) Valuation:

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

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2) Short-term investments that mature in 60 days or less, such as United States Treasury Bills, are valued at amortized cost, which approximates fair value. The amortized cost method involves recording a security at its cost (i.e., principal amount plus any premium and less any discount) on the date of purchase and thereafter amortizing/accreting that difference between the principal amount due at maturity and cost assuming a constant yield to maturity as determined at the time of purchase. Short-term securities that mature in more than 60 days are valued at current market quotations by an independent pricing service or at the mean between the bid and



ask prices obtained from at least two brokers or dealers (if available, or otherwise by a principal market maker or a primary market dealer). Investments in money market mutual funds are valued at their net asset value as of the close of business on the day of valuation.

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

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

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

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

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

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

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

g) Loans are placed on non-accrual status when principal or interest payments are past due 90 days or more or when there is reasonable doubt that principal or interest will be collected. Accrued interest is generally reversed when a loan is placed on non-accrual status. Interest payments received on non-accrual loans may be recognized as income or applied to principal depending upon management's judgment. Non-accrual loans are restored to accrual status when past due principal and interest is paid and in management's judgment, are likely to remain current. As of March 31, 2008, approximately 1.0% of the Company's net assets are in non-accrual status.

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

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

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

#### *Dividends and Distributions:*

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

#### *Financing Costs:*

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

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

#### *Guarantees and Indemnification Agreements:*

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

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*Per Share Information:*

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

**Note 3. Portfolio Investments**

At March 31, 2008, 115.5% of our net assets or about \$429,156 was invested in 31 long-term portfolio investments (including a net profits interest in Charlevoix Energy Trading LLC) and 7.3% of our net assets was invested in money market funds. The remainder (22.8%) of our net assets represented liabilities in excess of other assets. At June 30, 2007, 109.4% of our net assets or about \$328,222 was invested in 24 long-term portfolio investments (including a net profits interest in Charlevoix Energy Trading LLC) and 13.9% of our net assets was invested in money market funds. The remainder (23.3%) of our net assets represented liabilities in excess of other assets. Prospect Capital is a non-diversified company within the meaning of the 1940 Act. We classify our investments by level of control. As defined in the 1940 Act, control investments are those where there is the ability or power to exercise a controlling influence over the management or policies of a company. Control is generally deemed to exist when a company or individual owns 25% or more of the voting securities of an investee company. Affiliated investments and affiliated companies are defined by a lesser degree of influence. This lesser degree of influence is deemed to exist through ownership of 5% or more but less than 25% of the outstanding voting securities of another person. As of March 31, 2008, the Company owns a controlling interest in Gas Solutions Holdings, Inc. (□GSHI□), Genesis Coal Corp. (□Genesis□), Integrated Contract Services, Inc. (□Integrated□), Iron Horse Coiled Tubing, Inc. (□Iron Horse□), NRG Manufacturing, Inc. (□NRG□), North Fork Collieries LLC (□North Fork□), R-V Industries, Inc. (R-V), Whymore Coal Company, Inc. (□Whymore□), and Worcester Energy Company, Inc. (□WECO□). The Company also owns an affiliated interest in Appalachian Energy Holdings, LLC (□AEH□). The Company has no other controlled or affiliated investments.

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

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

From time to time, the Company provides guarantees for portfolio companies for payments to counterparties, usually as an alternative to investing additional capital. Currently, agreements for two guarantees and one indemnification are outstanding which are related to two portfolio companies categorized as Control Investments □ Whymore Coal Company, Inc. (□Whymore□) and North Fork Collieries LLC (□North Fork□). The two guarantees are related to Whymore with one in the amount of \$3,478 for equipment leases and another of \$416 for a □payment-over-time□ contract for coal purchases. The contingent indemnification obligation arose from the Company's acquisition of the assets of Traveler Coal, LLC (□Traveler□) through the Company's subsidiary North Fork. Specifically, as part of that acquisition, the Company has agreed to indemnify the seller of those assets for personal guarantees that that seller had extended on behalf of Traveler. The amount of this contingency may reach \$5,000.

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**Note 4. Equity Offerings and Related Expenses**

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

| Issuances of Common Stock        | Number of Shares Issued | Gross Proceeds Raised | Underwriting Fees | Offering Expenses | Offering Price |
|----------------------------------|-------------------------|-----------------------|-------------------|-------------------|----------------|
| March 31, 2008                   | 1,150,000               | \$ 17,768             | \$ 759            | \$ 350            | \$ 15.450      |
| March 28, 2008                   | 1,300,000               | 19,786                | □                 | 350               | 15.220         |
| November 13, 2007 over-allotment | 200,000                 | \$ 3,268              | \$ 163            | \$ □              | \$ 16.340      |
| October 17, 2007                 | 3,500,000               | 57,190                | 2,860             | 551               | 16.340         |
| January 11, 2007 over-allotment  | 810,000                 | \$ 14,025             | \$ 688            | \$ □              | \$ 17.315*     |
| December 13, 2006                | 6,000,000               | 106,200               | 5,100             | 279               | 17.700         |
| August 28, 2006 over-allotment   | 745,650                 | \$ 11,408             | \$ 567            | \$ □              | \$ 15.300      |
| August 10, 2006                  | 4,971,000               | 76,056                | 3,778             | 595               | 15.300         |
| August 27, 2004 over-allotment   | 55,000                  | \$ 825                | \$ 58             | \$ 2              | \$ 15.000      |
| July 27, 2004                    | 7,000,000               | 105,000               | 7,350             | 1,385             | 15.000         |

\* The Company declared a dividend of \$0.385 per share between offering and over □allotment dates.

Offering expenses were charged against paid-in capital in excess of par. All underwriting fees and offering expenses were borne by Prospect Capital.

### Note 5. Related Party Agreements and Transactions

#### *Investment Advisory Agreement*

Prospect Capital has entered into an investment advisory and management agreement with Prospect Management (the □Investment Advisory Agreement□) under which the Investment Adviser, subject to the overall supervision of Prospect Capital□s Board of Directors, manages the day-to-day operations of, and provides investment advisory services to, Prospect Capital. 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 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 Prospect Capital, 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 Prospect Capital□s 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 Prospect Capital□s gross assets at the end of the two most recently completed calendar quarters (the closing of Prospect Capital□s initial public offering was treated as a quarter-end for this purpose) and appropriately adjusted for any share issuances or repurchases during the current calendar quarter. The total base management fees earned by Prospect Management during the three months ended March 31, 2008 and March 31, 2007 were \$2,388 and \$1,531, respectively and during the nine months ended March 31, 2008 and March 31, 2007 were \$6,366 and \$3,715, respectively.

The incentive fee has two parts. The first part, the income incentive fee, is calculated and payable quarterly in arrears based on Prospect Capital's pre-incentive fee net investment income for the immediately preceding calendar quarter. For this purpose, pre-incentive fee net investment income means interest income, dividend income and any other income (including any other fees (other than fees for providing managerial assistance), such as commitment, origination, structuring, diligence and consulting fees and other fees that Prospect Capital receives from portfolio companies) accrued during the calendar quarter, minus Prospect Capital's 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 Prospect Capital's 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. Prospect Capital pays the Investment Adviser an income incentive fee with respect to Prospect Capital's pre-incentive fee net investment income in each calendar quarter as follows:

- no incentive fee in any calendar quarter in which Prospect Capital's pre-incentive fee net investment income does not exceed the hurdle rate;
- 100.00% of Prospect Capital's pre-incentive fee net investment income with respect to that portion of such pre-incentive fee net investment income, if any, that exceeds the hurdle rate but is less than 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 Prospect Capital's 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 pro rated 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 Prospect Capital's 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, Prospect Capital calculates the aggregate realized capital gains, aggregate realized capital losses and aggregate unrealized capital depreciation, as applicable, with respect to each of the investments in its portfolio. For this purpose, aggregate realized capital gains, if any, equals the sum of the differences between the net sales price of each investment, when sold, and the original cost of such investment since inception. Aggregate realized capital losses equal the sum of the amounts by which the net sales price of each investment, when sold, is less than the original cost of such investment since inception. Aggregate unrealized capital depreciation equals the sum of the difference, if negative, between the valuation of each investment as of the applicable date and the original cost of such investment. At the end of the applicable period, the amount of capital gains that serves as the basis for Prospect Capital's calculation of the capital gains incentive fee equals the aggregate realized capital gains less aggregate realized capital losses and less aggregate unrealized capital depreciation with respect to its portfolio of investments. If this number is positive at the end of such period, then the capital gains incentive fee for such period is equal to 20.00% of such amount, less the aggregate amount of any capital gains incentive fees paid in respect of its portfolio in all prior periods.

The total income incentive fees earned by Prospect Management were \$3,230 and \$1,754 for the three months ended March 31, 2008 and March 31, 2007, respectively and \$7,861 and \$3,695 for the nine months ended March 31, 2008 and March 31, 2007, respectively. No capital gains incentive fees were earned during the three and nine-month periods ended March 31, 2008 and March 31, 2007.

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*Administration Agreement*

Prospect Capital has 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 Prospect Capital. For providing these services, Prospect Capital reimburses Prospect Administration for Prospect Capital's allocable portion of overhead incurred by Prospect Administration in performing its obligations under the Administration Agreement, including rent and our allocable portion of the costs of our chief compliance officer and chief financial officer and their respective staffs. Under this agreement, Prospect Administration furnishes us with office facilities, equipment and clerical, bookkeeping and record keeping services at such facilities. Prospect Administration also performs, or oversees the performance of, our required administrative services, which include, among other things, being responsible for the financial records that we are required to maintain and preparing reports to our stockholders and reports filed with the Securities and Exchange Commission (["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 Prospect Capital 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 Prospect Capital.

Prospect Administration, pursuant to the approval of our Board of Directors, has engaged Vastardis Fund Services LLC (["Vastardis"]) to serve as the sub-administrator of Prospect Capital to perform certain services required of Prospect Administration. This engagement began in May 2005 and ran on a month-to-month basis at the rate of \$25 annually, payable monthly. Under the sub-administration agreement, Vastardis provides Prospect Capital with office facilities, equipment, clerical, bookkeeping and record keeping services at such facilities. Vastardis also conducts relations with custodians, depositories, transfer agents, dividend disbursing agents, other stockholder servicing agents, accountants, attorneys, underwriters, brokers and dealers, corporate fiduciaries, insurers, banks and such other persons in any such other capacity deemed to be necessary or desirable. Vastardis provides reports to the Administrator and the Directors of its performance of obligations and furnishes advice and recommendations with respect to such other aspects of the business and affairs of Prospect Capital as it shall determine to be desirable. Under the revised and renewed sub-administration agreement, Vastardis also provides the service of William E. Vastardis as the Chief Financial Officer (["CFO"]) of the Company. This service was formerly provided at the rate of \$225 annually, payable monthly. In May 2006, the engagement was revised and renewed as an asset-based fee on a sliding scale starting at 0.20% on the first \$250,000 in gross assets and ending at 0.05% on gross assets over \$1,000,000 with a \$400 annual minimum, payable monthly. Vastardis does not provide any advice or recommendation relating to the securities and other assets that Prospect Capital should purchase, retain or sell or any other investment advisory services to Prospect Capital. Vastardis is responsible for the financial and other records that either Prospect Capital (or the Administrator on behalf of Prospect Capital) is required to maintain and prepares reports to stockholders, and reports and other materials filed with the SEC. In addition, Vastardis assists Prospect Capital in determining and publishing Prospect Capital's net asset value, overseeing the preparation and filing of Prospect Capital's tax returns, and the printing and dissemination of reports to stockholders of Prospect Capital, and generally overseeing the payment of Prospect Capital's expenses and the performance of administrative and professional services rendered to Prospect Capital by others.

Under the sub-administration agreement, Vastardis and its officers, partners, agents, employees, controlling persons, members, and any other person or entity affiliated with Vastardis, are not liable to the Administrator or Prospect Capital for any action taken or omitted to be taken by Vastardis in connection with the performance

of any of its duties or obligations or otherwise as sub-administrator for the Administrator on behalf of Prospect Capital. The agreement also provides that, absent willful misfeasance, bad faith or negligence in the performance of Vastardis' duties or by reason of the reckless disregard of Vastardis' duties and obligations, Vastardis and its officers, partners, agents, employees, controlling persons, members, and any other person or entity affiliated with Vastardis are entitled to indemnification from the Administrator and Prospect Capital. All damages, liabilities, costs and expenses (including reasonable attorneys' fees and amounts reasonably paid in settlement) incurred in or by reason of any pending, threatened or completed action, suit, investigation or other proceeding (including an action or suit by or in the right of the Administrator or Prospect Capital or the security holders of Prospect Capital) arising out of or otherwise based upon the performance of any of Vastardis' duties or obligations under the agreement or otherwise as sub-administrator for the Administrator on behalf of Prospect Capital are subject to such indemnification.

#### Managerial Assistance

As a BDC, 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 have received \$245 and \$693 in fees for managerial assistance for the three months and nine months ended March 31, 2008, respectively, as compared to \$193 and \$392 for the three months and nine months ended March 31, 2007, respectively. These fees are paid to the Administrator.

#### Note 6. Earnings Per Share

The following information sets forth the computation of basic and diluted per share net increase (decrease) in net assets resulting from operations for the three months ended March 31, 2008 and March 31, 2007, respectively:

|  | Three Months Ended           |                                 | Nine Months Ended               |                                 |
|--|------------------------------|---------------------------------|---------------------------------|---------------------------------|
|  | Mar. 31, 2008<br>(unaudited) | Mar. 31,<br>2007<br>(unaudited) | Mar. 31,<br>2008<br>(unaudited) | Mar. 31,<br>2007<br>(unaudited) |
| Numerator for increase (decrease) in net assets per share:                                   | \$ (1,259)                   | \$ 4,976                        | \$ 3,605                        | \$ 11,880                       |
| Denominator for basic and diluted weighted average shares:                                   | 23,858,492                   | 19,697,473                      | 22,349,987                      | 14,341,811                      |
| Basic and diluted net increase (decrease) in net assets per share resulting from operations: | \$ (0.05)                    | \$ 0.26                         | \$ 0.16                         | \$ 0.82                         |

#### Note 7. Financial Highlights

|   | Three Months Ended           | Three Months Ended           | Nine Months Ended            | Nine Months Ended            |
|---|------------------------------|------------------------------|------------------------------|------------------------------|
|   | Mar. 31, 2008<br>(unaudited) | Mar. 31, 2007<br>(unaudited) | Mar. 31, 2008<br>(unaudited) | Mar. 31, 2007<br>(unaudited) |
| <b>Per Share Data (1):</b>  |                              |                              |                              |                              |
| Net asset value at beginning of period                              | \$ 14.58                     | \$ 15.24                     | \$ 15.04                     | \$ 15.31                     |
| Costs related to the secondary public offering                      | (0.03)                       | .01                          | (0.06)                       | (0.06)                       |
| Net investment income   | 0.54                         | 0.36                         | 1.41                         | 1.02                         |
| Realized gain/(loss)  | 0.01                         | □                            | (0.82)                       | 0.14                         |
| Net unrealized appreciation (depreciation)                          | (0.60)                       | (0.10)                       | (0.42)                       | (0.34)                       |
| Net increase in net assets as a result of secondary public offering | 0.05                         | 0.06                         | 0.18                         | 0.27                         |
| Dividends declared and paid   | (0.40)                       | (0.39)                       | (1.18)                       | (1.16)                       |

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|  |            |            |            |            |
|--|------------|------------|------------|------------|
| Net asset value at end of period               | \$ 14.15   | \$ 15.18   | \$ 14.15   | \$ 15.18   |
| Per share market value at end of period        | \$ 15.22   | \$ 17.14   | \$ 15.22   | \$ 17.14   |
| Total return based on market value (2)         | 19.69%     | 2.34%      | (5.76%)    | 8.05%      |
| Total return based on net asset value (2)      | (0.40%)    | 1.88%      | 1.78%      | 6.19%      |
| Shares outstanding at end of period            | 26,270,379 | 19,879,231 | 26,270,379 | 19,879,231 |
| Average weighted shares outstanding for period | 23,858,492 | 19,697,473 | 22,349,987 | 14,341,811 |

**Ratio / Supplemental Data:**

|  |            |            |            |            |
|--|------------|------------|------------|------------|
| Net assets at end of period (in thousands)                     | \$ 371,718 | \$ 301,767 | \$ 371,718 | \$ 301,767 |
| Annualized ratio of operating expenses to average net assets   | 10.25%     | 6.79%      | 9.90%      | 7.01%      |
| Annualized ratio of net operating income to average net assets | 15.01%     | 9.23%      | 12.45%     | 9.36%      |

- (1) Financial highlights are based on weighted average share except dividends declared and paid.
- (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 Prospect Capital's 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 Prospect Capital's dividend reinvestment plan. The total returns are not annualized.

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**Note 8. Litigation**

On December 6, 2004, Dallas Gas Partners, L.P. ("DGP") served Prospect Capital with a complaint filed November 30, 2004 in the U.S. District for the Southern District of Texas, Galveston Division. DGP alleges that DGP was defrauded and that Prospect Capital breached its fiduciary duty to DGP and tortiously interfered with DGP's contract to purchase Gas Solutions, Ltd. (a subsidiary of our portfolio company, GSHI) in connection with Prospect Capital's alleged agreement in September 2004 to loan DGP funds with which DGP intended to buy Gas Solutions, Ltd. for approximately \$26,000. The complaint seeks relief not limited to \$100,000. The Company believes that the DGP complaint is frivolous and without merit, and intend to defend the matter vigorously. On November 30, 2005, U.S. Magistrate Judge John R. Froeschner of the U.S. District Court for the Southern District of Texas, Galveston Division, issued a recommendation that the court grant Prospect Capital's Motion for Summary Judgment dismissing all claims by DGP. On February 21, 2006, U.S. District Judge Samuel Kent of the U.S. District Court for the Southern District of Texas, Galveston Division issued an order granting Prospect Capital's Motion for Summary Judgment dismissing all claims by DGP, against Prospect Capital Corporation. On May 16, 2007, the Court also granted Prospect Capital summary judgment on DGP's liability to Prospect Capital on Prospect Capital's counterclaim for DGP's breach of a release and covenant not to sue. On January 4, 2008, the Court, Judge Melinda Harmon presiding, granted Prospect Capital's motion to dismiss all DGP's claims asserted against certain officers and affiliates of Prospect Capital. Prospect Capital's damage claims against DGP remain pending.

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



The Company is 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.

### Note 9. Revolving Credit Agreements

On July 26, 2006, we closed a \$50,000 revolving credit facility (the "Facility") with HSH Nordbank AG as administrative agent and sole lead arranger, replacing a pre-existing \$30,000 Credit Facility. This Facility was used, together with our equity capital, to make additional long-term investments. Interest on borrowings under the Facility was charged, at our option, at either (i) LIBOR plus the applicable spread, ranging from 200 to 250 basis points (the refinanced facility being at 250 basis points over LIBOR), or (ii) the greater of the lender prime rate or the federal funds effective rate plus 50 to 100 basis points. The applicable spread decreases as our equity base increases.

On June 6, 2007, Prospect Capital closed on a \$200,000 three-year revolving credit facility (as amended on December 31, 2007) with Rabobank Nederland as administrative agent and sole lead arranger (the "Rabobank Facility"). The Rabobank Facility refinanced the \$50,000 Facility with HSH Nordbank AG. Interest on the Rabobank Facility is charged at LIBOR plus 175 basis points. Additionally, Rabobank charges 37.5 basis points on the unused portion of the facility. At March 31, 2008, the investments used as collateral had an aggregate market value of \$338,498, which represents 91.1% of net assets.

As of March 31, 2008, we had drawn down \$90,667 on the Rabobank Facility.

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### Note 10. Subsequent Events

On April 3, 2008, the Company provided \$39,800 of first and second lien debt and equity for the recapitalization of Ajax Rolled Ring & Machine ("Ajax"), a custom forger of seamless rolled steel rings located in York, South Carolina. Prospect's debt is secured by a first lien on inventory, machinery, and certain other assets of Ajax. The equity interest purchased in Ajax is controlling in nature and was made alongside equity co-investments by Ajax's senior managers.

On April 30, 2008, we provided debt financing of \$20,000 to support the acquisition by Peerless Mfg Co. ("Peerless"), headquartered in Dallas, Texas, of Nitram Energy Inc. ("Nitram"). Peerless is a leading designer, manufacturer, and marketer of industrial environmental separation and filtration systems while Nitram focuses on separation, heat transfer, pulsation dampening, and industrial silencing products. Peerless and Nitram serve a diversified, global list of customers in industries such as oil and gas production, gas pipelines, chemical and petrochemical processing, and power generation.

On April 30, 2008 we fully exited out of our investment in Arctic Acquisition Corp., dba Cougar Pressure Control ("Cougar") through the sale of our equity interest in Cougar for approximately \$3,400.

### Note 11. Selected Quarterly Financial Data (unaudited) (in thousands except per share amounts)

| Quarter Ended      | Investment Income |            | Net Investment Income (Loss) |            | Net Realized and Unrealized Gains (Losses) |            | Net Increase (Decrease) in Net Assets from Operations |            |
|--------------------|-------------------|------------|------------------------------|------------|--|------------|---|------------|
|                    | Total             | Per Share* | Total                        | Per Share* | Total                                      | Per Share* | Total   | Per Share* |
| December 31, 2005  | \$ 3,935          | \$ 0.56    | \$ 2,040                     | \$ 0.29    | \$ 488                                     | \$ 0.07    | \$ 2,528  | \$ 0.36    |
| March 31, 2006     | 4,026             | 0.57       | 2,126                        | 0.30       | 829  | 0.12       | 2,955   | 0.42       |
| June 30, 2006      | 5,799             | 0.82       | 2,977                        | 0.42       | 2,963                                      | 0.42       | 5,940   | 0.84       |
| September 30, 2006 | 6,432             | 0.65       | 3,274                        | 0.33       | 690  | 0.07       | 3,964   | 0.40       |
| December 31, 2006  | 8,171             | 0.60       | 4,493                        | 0.33       | (1,553)                                    | (0.11)     | 2,940   | 0.22       |
| March 31, 2007     | 12,069            | 0.61       | 7,015                        | 0.36       | (2,039)                                    | (0.10)     | 4,976   | 0.25       |

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|                    |        |      |        |      |          |        |         |        |
|--------------------|--------|------|--------|------|----------|--------|---------|--------|
| June 30, 2007      | 14,009 | 0.70 | 8,349  | 0.42 | (3,501)  | (0.18) | 4,848   | 0.24   |
| 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) |

\* Per share amounts are calculated using weighted average shares during the period referenced.

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

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

This quarterly report on Form 10-Q contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause the results of Prospect Capital to differ materially from those expressed or implied by such forward-looking statements. All statements other than statements of historical fact are statements that could be deemed forward-looking statements, including any projections of revenue, expenses, earnings or losses from operations or investments, or other financial items; any statements of the plans, strategies and objectives of management for future operations; any statements of expectation or belief; and any statements of assumptions underlying any of the foregoing. The risks, uncertainties and assumptions referred to above include risks that are set forth in our Form 10-K for the fiscal year ended June 30, 2007 and that are otherwise described from time to time in our reports filed with the SEC.

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The forward-looking statements included in this report represent our estimates as of the date of this report. We specifically disclaim any obligation to update these forward-looking statements in the future.

We use words such as "anticipates," "believes," "expects," "future," "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" in this report. We caution you that forward-looking statements of this type are subject to uncertainties and risks, many of which cannot be predicted or quantified.

*The following analysis of our financial condition and results of operations should be read in conjunction with our financial statements and the related notes thereto contained elsewhere in this Form 10-Q.*

**Overview**

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

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

Compared to the end of last fiscal year (ended June 30, 2007), net assets increased by \$70,694 during the nine-month period ended March 31, 2008, from \$300,048 to \$370,742. This increase resulted from the issuance of new shares of our common stock (less offering costs) in the amount of \$92,979, dividend re-investments of \$2,753, and another \$3,605 from operations. These increases, in turn, were offset by \$27,667 in dividend distributions to our shareholders. The \$3,605 increase in net assets resulting from operations is net of the following: Net investment income of \$31,444, realized loss on investments of \$18,413, and a net decrease in net assets due to changes in unrealized appreciation/depreciation of investments of \$9,426. The realized losses were mainly due to the sale of Central Illinois Energy, LLC ("CIE") and Advantage Oilfield Group Ltd. ("AOG"). The net unrealized depreciation was driven by significant write-downs in our investments in Integrated Contract Services, WECO, and Genesis which, in turn, were partially offset by write-ups for our investments in GSHI and by the

disposition of previously written-down investments in AOG and in ESA Environmental Specialists.

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

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

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

Since June 2007, there has been a significant reduction in liquidity in the corporate debt capital markets and transactions in the high-yield and leveraged loan markets have recently been cancelled, postponed, or restructured, enhancing opportunities for us going forward. The extra supply and meaningfully less demand has shifted the

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

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

### **Recent Developments**

On April 3, 2008, the Company provided \$39,800 of first and second lien debt and equity for the recapitalization of Ajax Rolled Ring & Machine (Ajax), a custom forger of seamless rolled steel rings located in York, South Carolina. Prospect's debt is secured by a first lien on inventory, machinery, and certain other assets of Ajax. The equity interest purchased in Ajax is controlling in nature and was made alongside equity co-investments by Ajax's senior managers.

On April 30, 2008, we provided debt financing of \$20,000 to support the acquisition by Peerless Mfg Co. (Peerless), headquartered in Dallas, Texas, of Nitram Energy Inc. (Nitram). Peerless is a leading designer, manufacturer, and marketer of industrial environmental separation and filtration systems while Nitram focuses on separation, heat transfer, pulsation dampening, and industrial silencing products. Peerless and Nitram serve a diversified, global list of customers in industries such as oil and gas production, gas pipelines, chemical and

petrochemical processing, and power generation.

On April 30, 2008 we fully exited out of our investment in Arctic Acquisition Corp., dba Cougar Pressure Control (□Cougar□) through the sale of our equity interest in Cougar for approximately \$3,400.

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

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

*Investments:*

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

b) Valuation:

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

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

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

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

5) In February 2007, the FASB issued SFAS 159, □The Fair Value Option for Financial Assets and Financial Liabilities - including an amendment of FASB Statement No. 115□. SFAS 159 permits an entity to elect fair value as the initial and subsequent measurement attribute for many of assets and liabilities for which the fair value option has been elected and similar assets and liabilities measured using another measurement attribute. SFAS 159 becomes effective for fiscal years beginning after November 15, 2007 and, therefore, is

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applicable for the Company's upcoming fiscal year beginning July 1, 2008. The Company's management does not believe that the adoption of SFAS No. 159 will have a material impact on its financial statements.

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

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

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

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

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

Our portfolio across all our long-term debt and certain equity investments had an annualized current yield of 16.8% and 17.0% as of March 31, 2008 and March 31, 2007, respectively. This yield includes interest from all of our long-term investments as well as dividends from GSHI and NRG as of March 31, 2008 and from GSHI as of March 31, 2007. We expect the current yield to decline over time as we increase the size of the portfolio. Monetization of other equity positions that we hold is not included in this yield calculation. In each of our portfolio companies, we hold equity positions, ranging from minority interests to majority stakes, which we expect over time to contribute to our investment returns. Many of these equity positions include features such as contractual minimum internal rates of returns, preferred distributions, flip structures and other features expected to generate additional investment returns, as well as contractual protections and preferences over junior equity, in addition to

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the yield and security offered by our cash flow and collateral debt protections. Set forth below are several views of our investment portfolio, classified by type of investment, geographic diversification and sector diversification at March 31, 2008, and March 31, 2007, respectively:

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

| Geographic Exposure | 3/31/08              |                | 3/31/07              |                |
|---------------------|----------------------|----------------|----------------------|----------------|
|                     | Fair Value<br>(000s) | % of Portfolio | Fair Value<br>(000s) | % of Portfolio |
| Midwest U.S.        | \$ 49,015            | 10.7%          | \$ 36,476            | 11.7%          |
| Northeast U.S.      | 67,649               | 14.8%          | 24,898               | 8.0%           |
| Southeast U.S.      | 83,628               | 18.3%          | 37,835               | 12.2%          |
| Southwest U.S.      | 189,313              | 41.5%          | 85,793               | 27.6%          |
| Western U.S.        | 30,500               | 6.7%           | □                    | □              |

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|                        |                   |               |                   |               |
|------------------------|-------------------|---------------|-------------------|---------------|
| Canada                 | 9,051             | 2.0%          | 26,251            | 8.5%          |
| Money Market Funds     | 27,249            | 6.0%          | 99,584            | 32.0%         |
| <b>Total Portfolio</b> | <b>\$ 456,405</b> | <b>100.0%</b> | <b>\$ 310,837</b> | <b>100.0%</b> |

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| Sector                       | 3/31/08              |                   | 3/31/07              |                   |
|------------------------------|----------------------|-------------------|----------------------|-------------------|
|                              | Fair Value<br>(000s) | % of<br>Portfolio | Fair Value<br>(000s) | % of<br>Portfolio |
| Biofuels/Ethanol             | \$ □                 | □%                | \$ 8,000             | 2.6%              |
| Biomass Power                | 19,580               | 4.3%              | 24,898               | 8.0%              |
| Construction Services        | 5,582                | 1.2%              | 22,672               | 7.3%              |
| Contracting                  | 5,000                | 1.1%              | □                    | □%                |
| Financial Services           | 25,000               | 5.5%              | □                    | □%                |
| Food Products                | 20,000               | 4.4%              | □                    | □%                |
| Gas Gathering and Processing | 54,450               | 11.9%             | 37,900               | 12.2%             |
| Healthcare                   | 13,750               | 3.0%              | □                    | □%                |
| Manufacturing                | 43,907               | 9.6%              | 14,676               | 4.7%              |
| Metal Services               | 6,170                | 1.4%              | 5,820                | 1.9%              |
| Mining and Coal Production   | 19,223               | 4.2%              | 15,718               | 5.1%              |
| Natural Gas Marketing        | □                    | □%                | 4,782                | 1.5%              |
| Oilfield Fabrication         | 108,321              | 23.7%             | □                    | □%                |
| Oil and Gas Production       | 25,067               | 5.5%              | 49,358               | 15.9%             |
| Pharmaceuticals              | 11,942               | 2.6%              | □                    | □%                |
| Production Services          | 22,991               | 5.0%              | 20,947               | 6.7%              |
| Retail                       | 14,566               | 3.2%              | □                    | □%                |
| Seismic Services             | □                    | □%                | □                    | □%                |
| Shipping Vessels             | 6,775                | 1.5%              | 6,482                | 2.1%              |
| Specialty Minerals           | 15,500               | 3.4%              | □                    | □%                |
| Technical Services           | 11,332               | 2.5%              | □                    | □%                |
| Money Market Funds           | 27,249               | 6.0%              | 99,584               | 32.0%             |
| <b>Total Portfolio</b>       | <b>\$ 456,405</b>    | <b>100.0%</b>     | <b>\$ 310,837</b>    | <b>100.0%</b>     |

## Results of Operations

### Investment Activity

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

### Long-Term Portfolio Investments

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

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On February 11, 2008, the Company made a \$5,121 senior secured loan to North Fork Collieries LLC (□North Fork□), a Kentucky-based mining and coal production company. The Company also has a controlling equity interest

in North Fork.

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

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

For the three months ended March 31, 2008, the Company closed-out three positions which are briefly described below.

On February 20, 2008, one of the Company's investees, Ken-Tex Energy Corp. (Ken-Tex), repaid the \$10,800 debt that it owed Prospect Capital. As part of the transaction, the Company also sold back its net profit interest (NPI) and overriding royalty interest (ORRI) in Ken-Tex. In addition to the debt repayment, this transaction generated \$3,300 in the form of a prepayment penalty and the sale of the NPI and ORRI.

On March 5, 2008, the Company closed out its position of common shares of Evolution Petroleum Corp. at a gain of \$486.

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

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

| Quarter-End        | Acquisitions<br>(1) | Dispositions<br>(2) |
|--------------------|---------------------|---------------------|
| 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              | □                   |

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

(2) Includes scheduled principal payments, prepayments and refinancings

We classify our investments by level of control. As defined in the 1940 Act, control investments are those where there is the ability or power to exercise a controlling influence over the management or policies of a company. Control is generally deemed to exist when a company or individual owns 25% or more of the voting securities of an investee company. Affiliated investments and affiliated companies are defined by a lesser degree of influence. This lesser degree of influence is deemed to exist through ownership of 5% or more but less than 25% of the outstanding voting securities of another person. As of March 31, 2008, we held a controlling interest in GSHI, Genesis, Integrated, Iron Horse, NRG, North Fork, R-V Industries, Inc., Whymore, and WECO. As of March 31,

2008, we held an affiliated interest in AEH.

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

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

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

ESA defaulted under our contract governing our investment in ESA, prompting us to commence foreclosure actions with respect to certain ESA assets in respect of which we have a priority lien. In response to our actions, ESA filed voluntarily for reorganization under the bankruptcy code. We have a senior-secured, first-lien debt position with collateral in the form of receivables, real estate, other assets, personal guaranties and the stock of ESA's subsidiary company, Lisamarie Fallon, Inc. (dba The Healing Staff). On September 20, 2007 the U.S. Bankruptcy Court approved a Section 363 Asset Sale for ESA to Prospect Capital. To complete this transaction, we contributed our ESA debt to a newly-formed entity, Integrated Contract Services, Inc. (["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 Prospect Capital.

In late December 2007, the Company's largest 100% controlled investment, Gas Solutions Holdings Inc (["Gas Solutions"]), a midstream gathering and processing business in East Texas, engaged RBC Capital Markets Corporation as a financial advisor to explore strategic alternatives, including a potential sale. This monetization process is ongoing, and extensive discussions are occurring with multiple interested parties. Management seeks entering into a definitive purchase agreement before the conclusion of the Company's fourth fiscal quarter, but can make no assurances as to the likelihood or timing of any agreement. In late March 2008, Royal Bank of Canada provided a \$38 million term loan to Gas Solutions II Ltd, a wholly owned subsidiary of Gas Solutions, the proceeds

of which were used to refinance all of Citibank's approximately \$8 million of outstanding senior secured debt as well as to make a \$30 million cash distribution to Gas Solutions. The Company has non-recourse access to this cash at Gas Solutions, in addition to the Company's other assets and undrawn revolving credit facility. In early May 2008, Gas Solutions II Ltd purchased a series of propane puts at \$0.10 out of the money and at prices of \$1.53 per gallon and \$1.394 per gallon covering the periods May 1, 2008, through April 30, 2009, and May 1, 2009, through April 30, 2010, respectively. These hedges have been executed at close to the highest market propane prices ever achieved on an historical basis; such hedges preserve the upside of Gas Solutions II Ltd to benefit from potential future increases in commodity prices. Gas Solutions has generated approximately \$24.3



million of unadjusted plant operating income based on annualizing the performance of the six months ending March 31, 2008, which is an increase of 74% from the previous year. For calendar year 2008, Gas Solutions estimates based on current commodity prices that it would achieve more than \$30 million of unadjusted plant operating income.

### *Investment Income*

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

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

### *Operating Expenses*

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

The base investment advisory fees were \$2,388 and \$1,531 for the three months ended March 31, 2008 and March 31, 2007, respectively and \$6,366 and \$3,715 for the nine months ended March 31, 2008 and March 31, 2007, respectively. The income incentive fees were \$3,230 and \$1,754 for the three months ended March 31, 2008 and March 31, 2007, respectively and \$7,861 and \$3,695 for the nine months ended March 31, 2008 and March 31, 2007, respectively. The increases are directly related to the growth of our investment portfolio as compared with the previous period. Our investment advisory fees compensate our Investment Adviser for its work in identifying, evaluating, negotiating, closing and monitoring our investments. No capital gains incentive fee has yet been incurred pursuant to the Investment Advisory Agreement.

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

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| Item                                     | Three Months Ended March 31, 2008 | Three Months Ended March 31, 2007 | Nine Months Ended March 31, 2008 | Nine Months Ended March 31, 2007 |
|--|-----------------------------------|-----------------------------------|----------------------------------|----------------------------------|
| Interest expense                         | \$ 1,584                          | \$ 0                              | \$ 3,781                         | \$ 357                           |
| Amortization of deferred financing costs | 180                               | 290                               | 547                              | 836                              |
| Commitment fees                          | 85                                | 63                                | 348                              | 192                              |
| Administrative Agent fees                | 14                                | 0                                 | 43                               | 0                                |

|       |    |       |    |     |    |       |    |       |
|-------|----|-------|----|-----|----|-------|----|-------|
| Total | \$ | 1,863 | \$ | 353 | \$ | 4,719 | \$ | 1,385 |
|-------|----|-------|----|-----|----|-------|----|-------|

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

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

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

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

*Financial Condition, Liquidity and Capital Resources*

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

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

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

|  | March 31, 2008  |                    | June 30, 2007   |                    |
|--|-----------------|--------------------|-----------------|--------------------|
|  | Facility Amount | Amount Outstanding | Facility Amount | Amount Outstanding |
| Senior Secured Revolving Credit Facility | \$ 200,000      | \$ 90,667          | \$ 200,000      | \$ 0               |

*Off-Balance Sheet Arrangements*

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

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

There has been no material change in quantitative or qualitative disclosures about market risk as previously disclosed in our most recent 10-K filing.

**Item 4. Controls and Procedures**

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

There have been no changes in the Company's internal controls over financial reporting that occurred during the quarter ended March 31, 2008 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II: OTHER INFORMATION**

**Item 1. Legal Proceedings**

On December 6, 2004, Dallas Gas Partners, L.P. ("DGP") served Prospect Capital with a complaint filed November 30, 2004 in the U.S. District for the Southern District of Texas, Galveston Division. DGP alleges that DGP was defrauded and that Prospect Capital breached its fiduciary duty to DGP and tortiously interfered with DGP's contract to purchase Gas Solutions, Ltd. (a subsidiary of our portfolio company, GSHI) in connection with Prospect Capital's alleged agreement in September 2004 to loan DGP funds with which DGP intended to buy Gas Solutions, Ltd. for approximately \$26,000. The complaint seeks relief not limited to \$100,000. The Company believes that the DGP complaint is frivolous and without merit, and intend to defend the matter vigorously. On November 30, 2005, U.S. Magistrate Judge John R. Froeschner of the U.S. District Court for the Southern District of Texas, Galveston Division, issued a recommendation that the court grant Prospect Capital's Motion for Summary Judgment dismissing all claims by DGP. On February 21, 2006, U.S. District Judge Samuel Kent of the U.S. District Court for the Southern District of Texas, Galveston Division issued an order granting Prospect Capital's Motion for Summary Judgment dismissing all claims by DGP, against Prospect Capital Corporation. On May 16, 2007, the Court also granted Prospect Capital summary judgment on DGP's liability to Prospect Capital on Prospect Capital's counterclaim for DGP's breach of a release and covenant not to sue. On January 4, 2008, the Court, Judge Melinda Harmon presiding, granted Prospect Capital's motion to dismiss all DGP's claims asserted against certain officers and affiliates of Prospect Capital. Prospect Capital's damage claims against DGP remain pending.

In May 2006, based in part on unfavorable due diligence and the absence of investment committee approval, the Company declined to extend a loan for \$10 million to a potential borrower ("plaintiff"). Plaintiff was subsequently sued by its own attorney in a local Texas court for plaintiff's failure to pay fees owed to its attorney. In December

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2006, plaintiff filed a cross-action against the Company and certain affiliates (the "defendants") in the same local Texas court, alleging, among other things, tortious interference with contract and fraud. The Company petitioned the United States District Court for the Southern District of New York (the "District Court") to compel arbitration and to enjoin the Texas action. In February 2007, the Company's motions were granted. Plaintiff appealed that decision. The arbitration commenced in July 2007 and concluded in late November 2007. Post-hearing briefings

were completed in February 2008. On April 14, 2008, the arbitrator rendered an award in favor of the Company, rejecting all of plaintiff's claims. On April 18, 2008, the Company filed a petition before the District Court to confirm the award, which is now pending.

We are 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.

**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:

| Date               | Shares Issued | Aggregate Offering Price (in 000s) | % of Dividend |
|--------------------|---------------|------------------------------------|---------------|
| March 31, 2006     | 6,841         | \$ 110                             | 5.2%          |
| June 30, 2006      | 7,932         | 130                                | 5.4%          |
| September 29, 2006 | 80,818        | 1,273                              | 26.2%         |
| December 29, 2006  | 108,047       | 1,851                              | 25.5%         |
| March 30, 2007     | 93,843        | 1,595                              | 20.8%         |
| June 30, 2007      | 69,834        | 1,190                              | 15.3%         |
| September 30, 2007 | 72,073        | 1,243                              | 15.9%         |
| March 31, 2008     | 99,241        | 1,510                              | 14.4%         |

**Item 3. Defaults upon Senior Securities**

Not applicable

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

The 2007 Annual Meeting of Stockholders of the Company ("Meeting") was convened at the offices of the Company on Thursday, November 29, 2007, at 10:30 a.m. No business was conducted. The Meeting was adjourned at the time and reconvened on Thursday, January 17, 2008 at 10:00 a.m. at the offices of the Company, and it was determined that a quorum was established and that both proposals before the Company's stockholders were approved as follows:

To elect one Class III director of the Company, John F. Barry, to serve for a term of three years, or until a successor is duly elected and qualified; and

| Votes   | Votes Cast    | % of Total |
|---------|---------------|------------|
| For     | 14,566,360.89 | 90.83%     |
| Against | 1,470,726.43  | 9.17%      |
| Abstain | □             | □          |
| Total   | 16,037,087.32 | 100.00%    |

To ratify the selection of BDO Seidman, LLP to serve as the Company's independent registered public accounting firm for the fiscal year ending June 30, 2008; and

|         | <b>Votes</b>  | <b>Votes Cast</b> | <b>% of Total</b> |
|---------|---------------|-------------------|-------------------|
| For     | 15,966,376.71 |                   | 99.56%            |
| Against | 46,837.06     |                   | 0.29%             |
| Abstain | 23,873.55     |                   | 0.15%             |
| Total   | 16,037,087.32 |                   | 100.00%           |

The company received 16,037,087.32 votes (or 80.1%) of the 20,021,138 shares outstanding on the record date of October 9, 2007.

#### **Item 5. Other Information**

None

#### **Item 6. Exhibits**

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

- 3.1 Amended and Restated Articles of Incorporation (1).
- 3.2 Amended and Restated Bylaws (2).
- 4.1 Form of Share Certificate (2).
- 10.1 Investment Advisory Agreement between Registrant and Prospect Capital Management, LLC (2).
- 10.2 Custodian Agreement (3).
- 10.3 Administration Agreement between Registrant and Prospect Administration, LLC (2).
- 10.4 Transfer Agency and Service Agreement (3).
- 10.5 Dividend Reinvestment Plan (2).
- 10.6.1.1 License Agreement between Registrant and Prospect Capital Management, LLC (2).
- 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 Cooperative Centrale Raiffeisen-Boerenleenbank B.A., [Rabobank Nederland,] New York Branch. (7)
- 10.8 First Amendment to Loan and Servicing Agreement dated December 31, 2007 among Prospect Capital Funding LLC, Prospect Capital Corporation, and Cooperative Centrale Raiffeisen-Boerenleenbank B.A., [Rabobank Nederland,] New York Branch. (8)
- 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 (4)
- 16 Letter regarding change in certifying accountant (5).

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- 21 Subsidiaries of the Registrant: (included in Note 1 of the Notes to Consolidated Financial Statements) (6)
- 31.1\* Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.

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- 31.2\* Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
- 32.1\* Certification of Chief Executive Officer pursuant to Section 906 of The Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
- 32.2\* Certification of Chief Financial Officer pursuant to Section 906 of The Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).

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- \* Filed herewith.
- (1) Incorporated by reference to Pre-Effective Amendment No. 2 to the Registrant's Registration Statement on Form N-2 (File No. 333-114522), filed on July 6, 2004.
- (2) Incorporated by reference to Pre-Effective Amendment No. 2 to the Registrant's Registration Statement on Form N-2 (File No. 333-114522), filed on July 6, 2004.
- (3) 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.
- (4) Incorporated by reference from the Registrant's Form 10-K filed on September 28, 2006.
- (5) Incorporated by reference to the form 8-K/A (File No. 814-00659), filed on January 21, 2005.
- (6) Incorporated by reference from the Registrant's Form 10-K filed on September 28, 2007.
- (7) Incorporated by reference from the Registrant's Registration Statement on Form N-2/A filed on September 5, 2007.
- (8) Incorporated by reference from the Registrant's Quarterly Report on Form 10-Q filed on February 11, 2008.

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**SIGNATURE**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on May 12, 2008.

**PROSPECT CAPITAL CORPORATION**

**By:**

John F. Barry III

Chief Executive Officer and Chairman of the Board