MAXLINEAR INC
Form 10-K
February 17, 2016

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

FORM 10-K

þ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 2015
OR

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

For the Transition Period From to
Commission file number: 001-34666
MaxLinear, Inc.
(Exact name of Registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	14-1896129 (I.R.S. Employer Identification No.)
5966 La Place Court, Suite 100 Carlsbad, California (Address of principal executive offices)	92008 (Zip Code)

(760) 692-0711
(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of the exchange on which registered
Class A Common Stock, $0.0001 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No þ
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No þ
Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

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

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

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

The aggregate market value of the registrant's common stock, $0.0001 par value per share, held by non-affiliates of the registrant on June 30, 2015, the last business day of the registrant's most recently completed second fiscal quarter, was $649.5 million (based on the closing sales price of the registrant's Class A common stock on that date). Shares of the registrant's Class A or Class B common stock held by each officer and director and each person known to the registrant to own 10% or more of the outstanding voting power of the registrant have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not a determination for other purposes.
As of February 10, 2015, the registrant has 55,750,809 shares of Class A common stock, par value $0.0001, and 6,666,777 shares of Class B common stock, par value $0.0001, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Information required by Part III of this Form 10-K is incorporated by reference to the registrant's proxy statement (the "Proxy Statement") for the 2016 annual meeting of stockholders, which proxy statement will be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year covered by this Form 10-K.

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MAXLINEAR, INC.
PART I
Forward-Looking Statements
The information in this Annual Report on Form 10-K for the fiscal year ended December 31, 2015, or this Form 10-K, contains forward-looking statements and information within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which are subject to the “safe harbor” created by those sections. These forward-looking statements include, but are not limited to, statements concerning our strategy, future operations, future financial position, future revenues, projected costs, prospects and plans and objectives of management. The words “anticipates”, “believes”, “estimates”, “expects”, “intends”, “may”, “plans”, “projects”, “will”, “woul
similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. We may not actually achieve the plans, intentions or expectations disclosed in our forward-looking statements and you should not place undue reliance on our forward-looking statements. Actual results or events could differ materially from the plans, intentions and expectations disclosed in the forward-looking statements that we make. These forward-looking statements involve risks and uncertainties that could cause our actual results to differ materially from those in the forward-looking statements, including, without limitation, the risks set forth in Part I, Item 1A, “Risk Factors” in this Form 10-K. We do not assume any obligation to update any forward-looking statements except as required by law.

ITEM 1. BUSINESS
Corporate Information
We incorporated in the State of Delaware in September 2003. Our executive offices are located at 5966 La Place Court, Suite 100, Carlsbad, California 92008, and our telephone number is (760) 692-0711. In this Form 10-K, unless the context otherwise requires, the “Company,” “we,” “us” and “our” refer to MaxLinear, Inc. and its wholly owned subsidiaries. Our website address is www.maxlinear.com. The contents of our website are not incorporated by reference into this Form 10-K. We provide free of charge through a link on our website access to our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, as well as amendments to those reports, as soon as reasonably practical after the reports are electronically filed with, or furnished to, the Securities and Exchange Commission, or SEC. Refer to Intellectual Property Rights section below for a list of our trademarks and trade names. All other trademarks and trade names appearing in this Form 10-K are the property of their respective owners.
Overview

We are a provider of radio frequency, or RF, and mixed-signal integrated circuits for cable and satellite broadband communications, the connected home, and for data center, metro, and long-haul fiber networks. Our high performance RF receiver products capture and process digital and analog broadband signals to be decoded for various applications. These products include both RF receivers and RF receiver systems-on-chip (SoCs), which incorporate our highly integrated radio system architecture and the functionality necessary to receive and demodulate broadband signals, and physical medium devices that provide a constant current source, current-to-voltage regulation, and data alignment and retiming functionality in optical interconnect applications. Through our acquisition of Entropic Communications, Inc., or Entropic, in April of 2015, we provide semiconductor solutions for the connected home, ranging from MoCA® (Multimedia over Coax Alliance) solutions that transform how traditional HDTV broadcast and Internet Protocol- (IP) based streaming video content is seamlessly, reliably, and securely delivered, processed, and distributed into and throughout the home, to digital set-top box (STB) components and system solutions for the global satellite, terrestrial, cable and IP television (IPTV) markets. Our products enable the distribution and display of broadband video and data content in a wide range of electronic devices, including Pay-TV operator set-top boxes and voice and data gateways, hybrid analog and digital televisions, Direct Broadcast Satellite outdoor units, and optical modules for data center, metro, and long-haul transport network applications.
We combine our high performance RF and mixed-signal semiconductor design skills with our expertise in digital communications systems, software and embedded systems to provide highly integrated semiconductor devices that are

manufactured using a range of semiconductor manufacturing processes, including low-cost complementary metal oxide semiconductor, or CMOS, process technology, Silicon Germanium, Gallium Arsenide, BiCMOS and Indium Phosphide process technologies due to our acquisitions of Physpeed and Entropic. Our ability to design analog and mixed-signal circuits in CMOS allows us to efficiently combine analog and digital signal processing functionality in the same integrated circuit. As a result, our

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RF receivers and RF receiver SoCs have high levels of functional integration and performance, small silicon die size and low power consumption. Moreover, our proprietary CMOS-based radio system architecture provides to our customers the benefits of superior RF system performance, shorter design cycles, significant design flexibility and low system cost across a wide range of broadband communications applications. It is our intention to drive future optical interconnect products to CMOS versus existing Silicon Germanium BiCMOS and Indium Phosphide process technology designs.

We sell our products to original equipment manufacturers, or OEMs, module makers and original design manufacturers, or ODMs. During 2015, we sold our products to more than 179 end customers. For the year ended December 31, 2015, our net revenue was $300.4 million as compared to $133.1 million in the year ended December 31, 2014.

Recent Developments

On April 30, 2015, we completed its acquisition of Entropic Communications, Inc., or Entropic. Pursuant to the terms of the merger agreement dated as of February 3, 2015, by and among the Company, Entropic, and two wholly-owned subsidiaries of the Company, all of the Entropic outstanding shares were converted into the right to receive consideration consisting of cash and shares of our Class A common stock. We paid an aggregate of $111.1 million and issued an aggregate of 20.4 million shares of our Class A common stock to the stockholders of Entropic. In addition, we assumed all outstanding Entropic stock options and unvested restricted stock units that were held by continuing service providers (as defined in the merger agreement). We used Entropic's cash and cash equivalents to fund a significant portion of the cash portion of the merger consideration and, to a lesser extent, our own cash and cash equivalents.

As a result of the acquisition, we believe we have benefited from the economies of scale across engineering and supply chain operations, as well as from elimination of redundancy across engineering, sales, and general and administrative functions. Entropic had been recognized for pioneering the MoCA® (Multimedia over Coax Alliance) home networking standard and inventing Direct Broadcast Satellite outdoor unit, or DBS ODU, solutions which consist of band translation switch, or BTS, and channel stacking switch, or CSS, products which simplify the installation required to support simultaneous reception of multiple channels from multiple satellites over a single cable. We believe the acquisition of Entropic added significant scale to our analog/mixed-signal business and expanded our addressable market and enhanced the strategic value of the Company's offerings to broadband and access partners, OEM customers, and service providers. For a discussion of specific risks and uncertainties that could affect our ability to achieve these and other strategic objectives of the acquisition, please refer to Part I, Item 1A, "Risk Factors" under the subsection captioned "Risks Relating to the Proposed Acquisition of Entropic."

Industry Background

Technological advances in the broadband data, broadcast TV, voice, and wired and wireless data markets are driving dramatic changes in the way consumers access the internet and experience multimedia content. These advances include the ongoing worldwide conversion from analog to digital television broadcasting; the increasing availability of high-speed broadband and wireless data connectivity; the resolution transitions from standard-definition, to high-definition to ultra-high-definition/4K video television; the proliferation of multi-channel digital video recording, or DVR; the proliferation of multimedia content being both accessible and stored in the cloud through cable, satellite and telecommunications carrier services. As a result, system designers are adding enhanced multimedia functionality to set-top boxes and digital televisions, and expanding voice, video and data access functions and capabilities to home broadband gateways and mobile devices, which in turn is creating demand for higher speed optical interconnects in data center, metro, and long-haul transport network applications. We believe that several trends, across multiple target markets, are creating revenue opportunities for providers of RF and analog/mixed-signal solutions. These trends include the following:

- Service Provider/Operator: Competing cable, satellite, and other broadband service providers differentiate their services by providing consumers with bundled video, voice, and broadband data access, referred to as triple-play services. These services include advanced features such as; channel guide information, video-on-demand, multi-channel digital video recording, or DVR, and picture-in-picture viewing. Many set-top boxes, including those used for triple-play services, now enable consumers to simultaneously access, and manage multimedia content from multiple locations in the same house. These advanced features require either a home gateway or a set-top box to simultaneously receive, demodulate, and decode multiple signals spread across several channels of frequency bandwidth. Traditional architectures would require that each simultaneously accessed signal require a dedicated RF receiver. In these emerging home gateway or media servers, where content may be delivered using internet protocol or IP, there may be “thin or remote clients” that may not have traditional TV tuners, but necessarily include a broadband RF receiver such as MoCA or WiFi. This greatly increases the number of RF receivers required to be deployed in each set-top box. In addition, in order to deliver increasing data bandwidth to

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the home, cable MSOs have deployed DOCSIS 3.0 equipment and services, which enable channel bonding, or the concurrent reception of multiple channels, resulting in higher aggregate "sum of the channels" bandwidth available to DOCSIS 3.0 cable subscribers.

- Infrastructure and Non-Operator Terrestrial: Growth in data traffic generated from smartphones and tablets, over-the-top, or OTT, streaming video, cloud computing and data analytics in hyper-scale data centers is creating demand for higher speed interconnect products addressing enterprise and telecommunications infrastructure market applications. These solutions provide the interconnect function between the top-of-rack to the core-router within a datacenter, and the metro and long haul connections within a service provider network. Datacenter links are consistently increasing in performance/speed and are currently changing from 1Gbps to 10Gbps on the servers and from 10/40Gbps to 100Gbps on the routers and switches, and we believe that over the next several years they will likely migrate to 400Gbps. In the markets for non-operator terrestrial solutions, consumers are utilizing a broad array of consumer electronic devices beyond the television, such as personal computers, netbooks, tablets, and mobile phones to access broadcast television and other multimedia content. Specifically, with the increased popularity of accessing multimedia content over-the-top, or OTT, via broadband-enabled streaming services, consumers are increasingly augmenting these OTT multimedia content services with local free-to-air broadcast programming. Consumers can access these terrestrial broadcasts through set-top boxes containing terrestrial RF receiver solutions.

As a result of these trends, RF and analog/mixed signal receiver technology is being deployed in a variety of devices for the terrestrial, cable, satellite, datacenter, and metro and long-haul telecom transport network markets. The proliferation of applications with advanced features has led to an increase in the number of devices with multiple RF receivers and RF receiver SoCs. RF receivers incorporate RF, digital and analog signal processing functions.

Challenges Faced by Providers of Systems and RF Receivers and Optical Interconnects

The stringent performance requirements of broadband communications and optical interconnect applications and the distinct technological challenges associated with the terrestrial, cable, satellite, datacenter, and metro and long-haul telecom transport markets present significant obstacles to service providers and system designers. In particular, designing and implementing RF receivers to capture broadcast digital television signals is extremely challenging due in part to the wide frequency band across which broadcast digital television signals are transmitted. As compared to other digital radio technologies, such as those found in cellular, WiFi and Bluetooth applications, television signals that are broadcast over air, on cable, and by satellite are acquired over a much wider frequency band and encounter many more sources of interference. As a result, traditionally, design and implementation of these RF receivers have been accomplished using conventional radio system architectures that employ multiple discrete components and are fabricated using expensive special purpose semiconductor manufacturing processes, such as silicon germanium, gallium arsenide, and special purpose CMOS-based RF process technologies.

The core challenges of capturing and processing high quality broadband communications signals are common to the terrestrial, cable, and satellite markets. These challenges include:

- Design Challenges of Receiving Multiple RF Signals. System designers and service providers across various markets seek to enhance consumer appeal through the addition of new features in their products. Incorporating more than one channel of RF reception in an electronic device enables many of these features and advanced applications that are rapidly becoming a part of the standard offering from device makers and service providers. For example, in the cable set-top box market, it is necessary to support the simultaneous reception of multiple channels for voice, video and data applications in many system designs. In order to meet such requirements, OEMs must employ either multiple narrow or wideband RF receivers or Full Spectrum Capture (FSC™) receiver SoCs in their system design. Each additional RF receiver poses new challenges to the system designer, such as increased design complexity, overall cost, circuit board space, power consumption and heat dissipation. In addition, a high level of integration in multiple-receiver designs is necessary to combat the reliability and signal interference issues arising from the close proximity of sensitive RF elements.
- Signal Clarity Performance Requirements. Television reception requires a robust and clear signal to provide an adequate user experience. One of the core attributes of system performance is signal clarity, often measured by the signal-to-noise ratio parameter, which measures the strength of the desired signal relative to the combined noise and undesired signal strength in the same channel. Television reception requires an RF receiver that has a wide dynamic

range and the ability to isolate the desired signal from the undesired signals, which include the noise

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generated by extraneous radio waves and interferers produced by home networking systems such as wireless local area network, or WLAN, and Bluetooth. Traditional RF receiver implementations utilized expensive discrete components, such as band-pass filters, resonance elements and varactor diodes to meet the stringent requirements imposed by broadband television reception. In high speed mobile environments, a method known as diversity combining of radio signals, in which the desired signal is captured using multiple RF receivers and reconstructed into a single signal, has been employed to improve the signal-to-noise ratio. Diversity combining of radio signals requires substantial RF, digital signal processing and software expertise. Both the traditional broadband reception and diversity combining of RF signals in mobile environments are difficult to implement and pose challenges to RF receiver providers.

- Multiple Standards. Worldwide, there are several regional standards for the transmission and reception of broadband analog and digital TV signals. Technical performance, feature requirements and the predominance of a particular means of TV transmission vary regionally. Further, each major geographic region has adopted its own TV standard for cable, terrestrial, and satellite transmissions, such as DVB-T/T2/C/C2/S/S2, ATSC, NTSC, ISDB-T, PAL, SECAM, DTMB, CMMB, etc. As a result of these multiple standards, there are region-specific RF receiver requirements and implementations, which make global standards compliance extremely challenging. Many system designers prefer a multiple standards and protocol compliant solution that was previously not possible. Providers of RF receivers face the design challenge of providing this flexibility to the system designer without any increase in power consumption, or any loss of performance quality or competitiveness.
- Power Consumption. Power consumption is an important consideration for consumers and a critical design specification for system designers. For example, in battery-operated devices such as netbooks and notebooks, and voice-enabled cable modems, long battery life is a differentiating device attribute. In addition, government sponsored programs, such as Energy Star in the U.S., induce consumers to purchase more energy efficient products. For example, in September 2009, the U.S. Environmental Protection Agency announced that Energy Star compliant televisions would be required to be 40% more energy efficient than their noncompliant counterparts. The addition of one or more RF receivers to a system in order to enable digital TV functionality significantly increases the overall power consumption imposing severe platform level design constraints on multiple channel receiver systems. In fact, in some multiple receiver system designs, a majority of the system’s overall power consumption is attributable to the RF receiver and related components. Providers of RF receivers and RF receiver SoCs are confronted with the design challenge of lowering power consumption while maintaining or improving device performance.
- Size. The size of electronic components, such as RF receivers, is a key consideration for system designers and service providers. Given the proliferation of the number of RF receivers in broadband service provider video and data gateways market, size can be a determining factor for whether or not a particular component, such as an RF receiver is designed into the product. In the television market, as system designers create thinner flat-screen displays, the size of RF receivers is becoming a significant consideration, especially when multiple RF receivers are incorporated in a single system.

The challenges of processing high-speed optical interconnect signals for datacenter, metro and long-haul telecommunications transport markets include:

- Optical Fiber Channel Impairments. The optical properties of the fiber material results in impairments to the optical signal that is being propagated across the fiber. These impairments include loss of light intensity, modal, chromatic and polarization dispersion as the light propagates through the fiber. These impairments result in degradation of signal integrity which contributes to effective reduction in data throughput.
- Optical Device Technology. The state-of-art in optical device technology today lags the speeds contemplated for data traffic within cloud data centers and transport links between telecom data centers. So, there are severe physical limits to the conversion of electrical signals to optical signals and vice versa at extremely high speeds. These limitations arise from bandwidth, nonlinearities, and noise properties in lasers, modulators, and photo detectors.
- Form Factor. The form factor of the face plates in server, storage, switch, and networking racks in data centers limits the capacity to dissipate heat generated by electrical and optical devices inside the transceivers to which optical fibers are connected. As data rates increase dramatically, the physical form of the face plates and connectors does not scale to cope with accompanying increase in power density.

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Our RF Receiver Solution

We are a provider of integrated, radio-frequency and mixed-signal integrated circuits for broadband communications and data center, metro, and long-haul transport network applications. Our products enable the display of broadband video and data content in a wide range of electronic devices, including cable and terrestrial and satellite set-top boxes, DOCSIS data and voice gateways, hybrid analog and digital televisions, satellite low-noise blocker transponders or outdoor units and optical modules for data center, metro, and long-haul transport network applications.

We combine our high performance analog and mixed-signal semiconductor design skills with our expertise in digital communications systems, software and embedded systems to develop RF receivers and RF receiver SoCs. We integrate our RF receivers with digital demodulation and other communications functions in standard CMOS process technology. Our solutions have the following key features:

- Proprietary Radio Architecture. Digital signal processing is at the core of our RF receivers and RF receiver SoCs. Using our proprietary CMOS-based radio architecture, we leverage both analog and digital signal processing to improve system performance across multiple products. The partitioning of the signal processing in the chip between analog and digital domains is designed to deliver high performance, small die size and low power for a given application. Moreover, our architecture is implemented in standard CMOS process technology, which enables us to realize the integration benefits of analog and digital circuits on the same integrated circuit. This allows us to predictably scale the on-chip digital circuits in successive advanced CMOS process technology nodes. Our solutions have been designed into products in markets with extremely stringent specifications for quality, performance and reliability, such as the television and automotive markets. We believe that our success in these markets demonstrates that our solution can be implemented successfully across multiple markets and applications.
- High Signal Clarity Performance. We design our RF receivers and RF receiver SoCs to provide high signal clarity performance regardless of the application in which they are employed. For example, in the set-top box market, we deploy our core RF and mixed-signal CMOS process technology platform and radio system architecture to overcome the interference from in-home networks that can degrade cable broadband signals. We believe that signal clarity is more critical in television compared to other communications applications such as voice and data, because signal loss and interference have a more adverse impact on the end user experience.
- Highly Integrated. Our products integrate on a single chip the functionality associated with traditional analog and digital integrated circuits and other expensive discrete components. This high level of integration has the cost benefits associated with smaller silicon die area, fewer external components and lower power. Our CMOS-based RF receiver SoC eliminates analog interface circuit blocks and external components situated at the interface between discrete analog and digital demodulator chips and reduces the cost associated with multiple integrated circuit packages and related test costs. We are also able to integrate multiple RF receivers along with a demodulator onto a single die to create application-specific configurations for our customers. Thus, our highly integrated solution reduces the technical difficulties associated with overcoming the undesired interactions between multiple discrete analog and digital integrated circuits comprising a single system. Our solutions reduce the technical burden on system designers in deploying enhanced television functionality in their products.
- Low Power. Our products enable our customers to reduce power consumption in consumer electronic devices without compromising the stringent performance requirements of applications such as broadcast television. In addition, our products enable our customers to decrease overall system costs by reducing the power consumption and heat dissipation requirements in their systems. For example, in cable boxes supporting voice applications, low power consumption may enable a reduction in the number of batteries or battery capacity required to support standby and lifeline telephony. In certain set-top boxes, reduced overall power consumption may allow system designers to eliminate one or more cooling fans required to dissipate the heat generated by high power consumption. The benefits of low power consumption increase with the number of RF receivers included in a system.
- Scalable Platform. Our product families share a highly modular, core radio system architecture, which enables us to offer RF receiver and RF receiver SoC solutions that meet the requirements of a wide variety of geographies, broadcast standards and applications. This is in contrast to legacy solutions that require significant customization to conform to regional standards, technical performance and feature requirements. Moreover, by leveraging our flexible core architecture platform, our integrated circuit solutions can be deployed across multiple device

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categories. As a result, our customers can minimize the design resources required to develop applications for multiple target markets. In addition, our engineering resources can be deployed more efficiently to design products for larger addressable markets. We believe that our core technology platform also can be applied to other communications markets with similar performance requirements.

- Space Efficient Solution. Our highly integrated CMOS-based RF receivers and RF receiver SoCs have an extremely small silicon die size, require minimal external components and consume very little power. Our unique radio architecture, more specifically our Full-Spectrum Capture™ technology, not only enables us to integrate multiple RF receivers in a chip, but also results in a reduction in the incremental power and die area required per each additional channel of reception. This enables our customers to design multi-receiver applications, such as cable modems and set-top boxes, in an extremely small form factor. In addition, our products are easily adapted to space-constrained devices such as flat screen televisions, netbooks, and laptops.

Our Strategy

Our objective is to be the leading provider of mixed-signal RF receivers and RF receiver SoCs for broadband video and data communications, datacenter, and metro and long-haul telecom transport market applications and, in the future, to leverage this core competency to expand into other communications markets with similar performance requirements. The key elements of our strategy are:

- Extend Technology Leadership in RF Receivers and RF Receiver + Demodulator SoCs. We believe that our success has been, and will continue to be, largely attributable to our RF and mixed-signal design capability, as well as advanced digital design, which we leverage to develop high-performance, low-cost semiconductor solutions for broadband communications applications. The broadband RF receiver market presents significant opportunities for innovation through the further integration of RF and mixed-signal functionality with digital signal processing capability in CMOS process technology. By doing so, we will be able to deliver products with lower power consumption, superior performance and increased cost benefits to system designers and service providers. We believe that our core competencies and design expertise in this market will enable us to acquire more customers and design wins over time. We will continue to invest in this capability and strive to be an innovation leader in this market.
- Leverage and Expand our Existing Customer Base. We target customers who are leaders in their respective markets. We intend to continue to focus on sales to customers who are leaders in our current target markets, and to build on our relationships with these leading customers to define and enhance our product roadmap. By solving the specific problems faced by our customers, we can minimize the risks associated with our customers' adoption of our new integrated circuit products, and reduce the length of time from the start of product design to customer revenue. Further, our engagements with market leaders will enable us to participate in emerging technology trends and new industry standards.
- Target Additional High-Growth Markets. Our core competency is in RF analog and mixed-signal integrated circuit design in CMOS process technology for broadband communications applications. Several of the technological challenges involved in developing RF solutions for video broadcasting and broadband reception are common to a majority of broadband communication markets. We intend to leverage our core competency in developing highly integrated RF receiver and RF receiver SoCs in standard CMOS process technology to address additional markets within broadband communications, communications infrastructure, and connectivity markets that we believe offer profitable high growth potential.
- Expand Global Presence. Due to the global nature of our supply chain and customer locations, we intend to continue to expand our sales, design and technical support organization both in the United States and overseas. In particular, we expect to increase the number of employees in Asia, Europe and the United States to provide regional support to our increasing base of customers. We believe that our customers will increasingly expect this kind of local capability and support.
- Attract and Retain Top Talent. We are committed to recruiting and retaining highly talented personnel with proven expertise in the design, development, marketing and sales of communications integrated circuits. We believe that we have assembled a high-quality team in all the areas of expertise required at a semiconductor communications company. We provide an attractive work environment for all of our employees. We believe that our ability to attract the best engineers is a critical component of our future growth and success in our chosen markets.

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Products

Our products are integrated into a wide range of electronic devices, including cable and terrestrial and satellite set-top boxes, DOCSIS data and voice gateways, hybrid analog and digital televisions, satellite low-noise blocker transponders or outdoor units and physical medium devices that go into optical modules for data center, metro, and long-haul transport network applications.

We provide our customers with guidelines, known as reference designs, so that they can efficiently use our products in their product designs. We currently provide the following types of semiconductors:

- RF Receivers. These semiconductor products combine RF receiver technology that traditionally required multiple external discrete components, such as very high frequency, or VHF, and ultra-high frequency, or UHF, tracking filters, surface acoustic wave, or SAW, filters, intermediate-frequency, or IF, amplifiers, low noise amplifiers and transformers. All of these external components have been either eliminated or integrated into a single semiconductor produced entirely in standard CMOS process technology.
- RF Receiver SoCs. These semiconductor products combine the functionality of RF receivers, and demodulators in a single chip. In some configurations, these products may incorporate multiple RF receivers and single or multiple demodulators in a single chip to provide application or market specific solutions to customers.
- Laser Modulator Drivers. These semiconductor products reside in optical modules and provide a constant current source that delivers exactly the current to the laser diode that it needs to operate for a particular application
- Transimpedance Amplifiers. These semiconductor products reside in optical modules and provide current-to-voltage conversion, converting the low-level current of a sensor to a voltage.
- Clock and Data Recovery Circuits. These semiconductor products generate a clock from an approximate frequency reference, and then phase-aligns to the transitions in the data stream with a phase-locked loop, or PLL.

Customers

We sell our products, directly and indirectly, to original equipment manufacturers, or OEMs, module makers and original design manufacturers, or ODMs, and refer to these as our end customers. By providing a highly integrated reference design solution that our customers can incorporate in their products with minimal modifications, we enable our customers to design cost-effective high performance digital RF receiver and RF receiver SoC solutions rapidly. In the year ended December 31, 2015, we sold our products to more than 179 end customers. A significant but declining portion of our sales to these and other customers are through distributors based in Asia, and we do not consider distributors as our end customers, despite selling the products to and being paid by the distributors.

A significant portion of our net revenue has historically been generated by a limited number of customers. In the years ended December 31, 2015, 2014 and 2013, ten customers accounted for approximately 76%, 67% and 72% of our net revenue, respectively. In the years ended December 31, 2015, 2014 and 2013, Arris Group, Inc., or Arris, represented 28%, 31% and 28% of revenue. Sales to Arris as a percentage of revenue include sales to Motorola Home, which was acquired by Arris in April 2013, for the years ended December 31, 2015, 2014 and 2013. In the year ended December 31, 2015, Cisco Systems, Inc., or Cisco, represented 13% of revenue. In November 2015, Technicolor completed its purchase of Cisco’s connected devices business. The revenue percentage did not include the 1% revenue percentage for Technicolor.

Products shipped to Asia accounted for 91%, 94% and 93% of our net revenue in the years ended December 31, 2015, 2014 and 2013, respectively. Products shipped to Japan accounted for 1%, 7% and 9% of our net revenue in the years ended December 31, 2015, 2014 and 2013, respectively. Products shipped to China and Taiwan accounted for 77% and 8%, respectively, of our net revenue in the year ended December 31, 2015. Products shipped to China and Taiwan accounted for 71% and 6%, respectively, of our net revenue in the year ended December 31, 2014. Products shipped to China and Taiwan accounted for 68% and 8%, respectively, of our net revenue in the year ended December 31, 2013. Although a large percentage of our products are shipped to Asia, we believe that a significant number of the systems designed by these customers and incorporating our semiconductor products are then sold outside Asia. For example, we believe revenue generated from sales of our digital terrestrial set-top box products during the years ended December 31, 2015, 2014 and 2013 related principally to sales to Asian set-top box manufacturers delivering products into Europe, Middle East, and Africa, or EMEA, markets. Similarly, revenue generated from sales of our cable modem products during the years ended December 31, 2015, 2014 and 2013 related principally to sales to Asian

ODM's and contract manufacturers delivering products into European and North American

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markets. To date, all of our sales have been denominated in United States dollars. See Note 11 to our consolidated financial statements, included in Part IV, Item 15 of this Report for a discussion of total revenue by geographical region for 2015, 2014 and 2013.

Sales and Marketing

We sell our products worldwide through multiple channels, using our direct sales force, third party sales representatives, and a network of domestic and international distributors. We have direct sales personnel covering the United States, Europe and Asia, and operate customer engineering support offices in Carlsbad, Irvine, and San Jose in California; Atlanta in Georgia; Tokyo in Japan; Shanghai and Shenzhen in China; Hsinchu in Taiwan; Seoul in South Korea; and Bangalore, India. We also employ a staff of field applications engineers to provide direct engineering support locally to some of our customers.

Our distributors are independent entities that assist us in identifying and servicing customers in a particular territory, usually on a non-exclusive basis. Sales through distributors accounted for approximately 13%, 28% and 29% of our net revenue in the years ended December 31, 2015, 2014 and 2013, respectively.

Our sales cycles typically require a significant amount of time and a substantial expenditure of resources before we can realize revenue from the sale of products, if any. Our typical sales cycle consists of a multi-month sales and development process involving our customers' system designers and management. The typical time from early engagement by our sales force to actual product introduction runs from nine to twelve months for the consumer market, to as much as 18 to 24 months for the cable and satellite markets. If successful, this process culminates in a customer's decision to use our products in its system, which we refer to as a design-win. Volume production may begin within three to nine months after a design-win, depending on the complexity of our customer's product and other factors upon which we may have little or no influence. Once our products have been incorporated into a customer's design, they are likely to be used for the life cycle of the customer's product. Thus, a design-win may result in an extended period of revenue generation. Conversely, a design-loss to our competitors, may adversely impact our financial results for an extended period of time.

We generally receive purchase orders from our customers approximately six to twenty-four weeks prior to the scheduled product delivery date. These purchase orders may be cancelled without charge upon notification, so long as notification is received within an agreed period of time in advance of the delivery date. Because of the scheduling requirements of our foundries and assembly and test contractors, we generally provide our contractors production forecasts and place firm orders for products with our suppliers, up to twenty-four weeks prior to the anticipated delivery date, often without a purchase order from our own customers. Our standard warranty provides that products containing defects in materials, workmanship or product performance may be returned for a refund of the purchase price or for replacement, at our discretion.

Manufacturing

We use third-party foundries and assembly and test contractors to manufacture, assemble and test our semiconductor products. This outsourced manufacturing approach allows us to focus our resources on the design, sale and marketing of our products. Our engineers work closely with our foundries and other contractors to increase yield, lower manufacturing costs and improve product quality.

Wafer Fabrication. We utilize an increasing range of process technologies to manufacture our products, from standard CMOS to more exotic processes including SiGe and GaAs. Within this range of processes, we use a variety of process technology nodes ranging from 0.18µ down to 28 nanometer. We depend on independent silicon foundry manufacturers to support our wafer fabrication requirements. Our key foundry partners include United Microelectronics Corporation or UMC in Taiwan and Singapore, Taiwan Semiconductor Manufacturing Corporation or TSMC in Taiwan, Semiconductor Manufacturing International Corporation or SMIC in China, Global Foundries Inc. in Singapore, Silterra Malaysia Sdn. Bhd. in Malaysia, Tower-Jazz in Newport Beach California, and WIN Semiconductor in Taiwan.

Assembly/packaging and Test. Upon completion of the silicon processing at the foundry, we forward the finished silicon wafers to independent assembly/packaging and test service subcontractors. The majority of our assembly/packaging and test requirements are supported by the following independent subcontractors: Advanced Semiconductor Engineering or ASE in Taiwan (assembly/packaging and test), Giga Solution Technology Co. Ltd. in

Taiwan (test only), Amkor Technology in Korea, Philippines, and China (assembly/packaging and test), United Test and Assembly Center or UTAC Holdings Ltd. in Singapore and China (assembly/packaging and test), King Yuan Electronics Co. Ltd. or KYEC in Taiwan (test only), SIGURD Microelectronics Corp. in Taiwan (test only), Siliconware Precision Industries Co. Ltd. or SPIL in Taiwan (assembly/packaging only) and Unisem (M) Berhad in China (assembly/packaging only).

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Quality Assurance. We have implemented significant quality assurance procedures to assure high levels of product quality for our customers. We closely monitor the work-in-progress information and production records maintained by our suppliers, and communicate with our third-party contractors to assure high levels of product quality and an efficient manufacturing time cycle. Upon successful completion of the quality assurance procedures, all of our products are stored and shipped to our customers or distributors directly from our third-party contractors in accordance with our shipping instructions.

Research and Development

We believe that our future success depends on our ability to both improve our existing products and to develop new products for both existing and new markets. We direct our research and development efforts largely to the development of new high performance, mixed-signal semiconductor solutions for broadband communications, datacenter, and metro and long-haul telecommunications transport market applications. We target applications that require stringent overall system performance and low power consumption. As new and challenging communication applications proliferate, we believe that many of these applications may benefit from our SoC solutions combining analog and mixed-signal processing with digital signal processing functions. We have assembled a team of highly skilled semiconductor and embedded software design engineers with expertise in broadband RF and mixed-signal integrated circuit design, digital signal processing, communications systems and SoC design. As of December 31, 2015, we had approximately 345 employees in our research and development group. Our engineering design teams are located in Carlsbad, Irvine, Camarillo and San Jose in California; Atlanta in Georgia; Shenzhen in China; and Bangalore in India. Our research and development expense was $85.4 million, $56.6 million and $53.1 million in 2015, 2014 and 2013, respectively.

Competition

We compete with both established and development-stage semiconductor companies that design, manufacture and market analog and mixed-signal broadband RF receiver and optical interconnect products. Our competitors include companies with much longer operating histories, greater name recognition, access to larger customer bases and substantially greater financial, technical and operational resources. In addition, our industry is experiencing substantial consolidation. As a result, our competitors are increasingly large multi-national semi-conductor companies with substantial market influence. Our competitors may develop products that are similar or superior to ours. We consider our primary competitors to be companies with a proven track record of supporting market leaders and the technical capability to develop and bring to market competing broadband RF receiver and RF receiver SoC and optical interconnect products. Our primary competitors include NXP B.V. in cable and terrestrial TV markets, Silicon Laboratories in terrestrial TV markets, RDA Microelectronics and Rafael Microelectronics, Inc. in TV and terrestrial set-top-box markets, Broadcom Corporation in terrestrial, cable, and satellite markets. Competitors we face in our development initiatives targeting datacenter, and metro and long-haul telecommunications transport applications include Inphi, M/A-COM, Semtech, Qorvo, Broadcom, and Microsemi amongst others. In addition, it is quite likely that a number of other public and private companies, including some of our customers and semiconductor platform partners, could be developing competing products for broadband communications, datacenter, and metro and long-haul telecommunications transport applications.

The market for analog and mixed-signal semiconductor products is highly competitive, and we believe that it will grow more competitive as a result of continued technological advances. We believe that the principal competitive factors in our markets include the following:

- product performance;
- features and functionality;
- energy efficiency;
- size;
- ease of system design;
- customer support;
- product roadmap;
- reputation;
- reliability; and

- price.

We believe that we compete favorably as measured against each of these criteria. However, our ability to compete in the future will depend upon the successful design, development and marketing of compelling RF and mixed-signal semiconductor integrated solutions for high growth communications markets. In addition, our competitive position will depend on our ability to continue to attract and retain talent while protecting our intellectual property.

Intellectual Property Rights

Our success and ability to compete depend, in part, upon our ability to establish and adequately protect our proprietary technology and confidential information. To protect our technology and confidential information, we rely on a combination of intellectual property rights, including patents, trade secrets, copyrights and trademarks. We also protect our proprietary technology and confidential information through the use of internal and external controls, including contractual protections with employees, contractors, business partners, consultants and advisors. Protecting mask works, or the “topography” or semiconductor material designs, of our integrated circuit products is of particular importance to our business and we seek to prevent or limit the ability of others to copy, reproduce or distribute our mask works.

We have 662 issued patents and 327 patent applications pending in the United States. We also have 262 issued foreign patents and 147 other pending foreign patent applications, based on our issued patents and pending patent applications in the United States. Of the total 924 domestic and foreign issued patents, 753 are related to Entropic and 171 are related to Maxlinear. Of the total 474 domestic and foreign pending patents, 204 are related to Entropic and 270 are related to Maxlinear.

We are the owner of twelve trademarks (“MxL,” “MxLWare,” “Full-Spectrum Capture, “FSC,” “Full Spectrum Transceiver,” “Full-Spectrum Transceiver,” “FST,” “C.LINK,” “ENTROPIC,” “ENTROPIC and Design,” ENTROPIC BUILT-IN and Desig and “ENTROPIC COMMUNICATIONS and Design”) that have been registered and/or published for opposition in the United States. We also own foreign counterparts (including eight foreign registrations) of certain of these registered trademarks in Argentina, Brazil, Chile, China, the EU, Israel, India, Japan, Korea and Taiwan. We also claim common law rights in certain other trademarks that are not registered.

We may not gain any competitive advantages from our patents and other intellectual property rights. Our existing and future patents may be circumvented, designed around, blocked or challenged as to inventorship, ownership, scope, validity or enforceability. It is possible that we may be provided with information in the future that could negatively affect the scope or enforceability of either our present or future patents. Furthermore, our pending and future patent applications may or may not be granted under the scope of the claims originally submitted in our patent applications. The scope of the claims submitted or granted may or may not be sufficiently broad to protect our proprietary technologies. Moreover, we have adopted a strategy of seeking limited patent protection with respect to the technologies used in or relating to our products.

We are a party to a number of license agreements for various technologies, such as a license agreement with Intel Corporation relating to demodulator technologies that are licensed specifically for use in our products for cable set-top boxes. The agreement was originally entered into with Texas Instruments but was subsequently assigned to Intel Corporation as part of Intel Corporation’s acquisition of Texas Instruments’ cable modem product line in 2010. The license agreement with Intel Corporation has a perpetual term, but Intel Corporation may terminate the agreement for any uncured material breach or in the event of bankruptcy. If the agreement is terminated, we would not be able to manufacture or sell products that contain the demodulator technology licensed from Intel Corporation, and there would be a delay in the shipment of our products containing the technology until we found a replacement for the demodulator technology in the marketplace on commercially reasonable terms or we developed the demodulator technology itself. We believe we could find a substitute for the currently licensed demodulator technology in the marketplace on commercially reasonable terms or develop the demodulator technology ourselves. In either case, obtaining new licenses or replacing existing technology could have a material adverse effect on our business, as described in “Risk Factors—Risks Related to Our Business—We utilize a significant amount of intellectual property in our business. If we are unable to protect our intellectual property, our business could be adversely affected.”

The semiconductor industry is characterized by frequent litigation and other vigorous offensive and protective enforcement actions over rights to intellectual property. Moreover, there are numerous patents in the semiconductor industry, and new patents are being granted rapidly worldwide. Our competitors may obtain patents that block or limit our ability to develop new technology and/or improve our existing products. If our products were found to infringe any patents or other intellectual property rights held by third parties, we could be prevented from selling our products or be subject to litigation fees, statutory fines and/or other significant expenses. We may be required to initiate litigation in order to enforce any patents issued to us, or to determine the scope or validity of a third-party’s patent or other proprietary rights. We may in the future be

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contacted by third parties suggesting that we seek a license to intellectual property rights that they may believe we are infringing. In addition, in the future, we may be subject to lawsuits by third parties seeking to enforce their own intellectual property rights, as described in “Risk Factors—Risks Related to Our Business—We recently settled and are currently a party to intellectual property litigation and may face additional claims of intellectual property infringement. Current litigation and any future litigation could be time-consuming, costly to defend or settle and result in the loss of significant rights” and in “Item 3—Legal Proceedings.”

Employees

As of December 31, 2015, we had approximately 500 employees, including 345 in research and development, 69 in sales and marketing, 19 in operations and semiconductor technology and 67 in administration. None of our employees is represented by a labor organization or under any collective bargaining arrangement, and we have never had a work stoppage. We consider our employee relations to be good.

Backlog

Our sales are made primarily pursuant to standard purchase orders. Because industry practice allows customers to reschedule, or in some cases, cancel orders on relatively short notice, we do not believe that backlog is a good indicator of our future sales.

Geographic Information

During our last three years, substantially all of our revenue was generated from products shipped to China, Japan and Taiwan, and substantially all of our long-lived assets are located within the United States.

Seasonality

The semiconductor industry is highly cyclical and is characterized by constant and rapid technological change, rapid product obsolescence and price erosion, evolving technical standards, short product life cycles and wide fluctuations in product supply and demand. From time to time, these and other factors, together with changes in general economic conditions, cause significant upturns and downturns in the industry, and in our business in particular.

In addition, our operating results are subject to substantial quarterly and annual fluctuations due to a number of factors, such as the demand for semiconductor solutions for broadband communications applications, the timing of receipt, reduction or cancellation of significant orders, the gain or loss of significant customers, market acceptance of our products and our customers’ products, our ability to timely develop, introduce and market new products and technologies, the availability and cost of products from our suppliers, new product and technology introductions by competitors, intellectual property disputes and the timing and extent of product development costs.

ITEM 1A. RISK FACTORS

This Annual Report on Form 10-K, or Form 10-K, including any information incorporated by reference herein, contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, referred to as the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, referred to as the Exchange Act. In some cases, you can identify forward-looking statements by terms such as “may,” “will,” “should,” “expect,” “plan,” “intend,” “forecast,” “anticipate,” “believe,” “estimate,” “predict,” “potential,” “continue” or the negative of t other comparable terminology. The forward-looking statements contained in this 10-K involve known and unknown risks, uncertainties and situations that may cause our or our industry’s actual results, level of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these statements. These factors include those listed below in this Item 1A and those discussed elsewhere in this Form 10-K. We encourage investors to review these factors carefully. We may from time to time make additional written and oral forward-looking statements, including statements contained in our filings with the SEC. We do not undertake to update any forward-looking statement that may be made from time to time by or on behalf of us, whether as a result of new information, future events or otherwise, except as required by law.

Before you invest in our securities, you should be aware that our business faces numerous financial and market risks, including those described below, as well as general economic and business risks. The following discussion provides information concerning the material risks and uncertainties that we have identified and believe may adversely affect our business, our

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financial condition and our results of operations. Before you decide whether to invest in our securities, you should carefully consider these risks and uncertainties, together with all of the other information included in this Form 10-K and in our other public filings.

On April 30, 2015, we completed our acquisition of Entropic Communications, Inc., or Entropic, and promptly following such acquisition, Entropic merged with and into Excalibur Subsidiary, LLC, with Excalibur Subsidiary, LLC continuing as the surviving entity and changing its name to Entropic Communications, LLC. For the risks relating to our acquisition of Entropic, please refer to the section of these risk factors captioned “Risks Relating to Our Recent Acquisition of Entropic.”

Risks Related to Our Business

We face intense competition and expect competition to increase in the future, which could have an adverse effect on our revenue, revenue growth rate, if any, and market share.

The global semiconductor market in general, and the RF receiver market in particular, are highly competitive. We compete in different target markets to various degrees on the basis of a number of principal competitive factors, including our products’ performance, features and functionality, energy efficiency, size, ease of system design, customer support, product roadmap, reputation, reliability and price, as well as on the basis of our customer support, the quality of our product roadmap and our reputation. We expect competition to increase and intensify as a result of industry consolidation and the resulting creation of larger semiconductor companies. In addition, we expect the internal resources of large, integrated original equipment manufacturers, or OEMs, may continue to enter our markets. Increased competition could result in price pressure, reduced profitability and loss of market share, any of which could materially and adversely affect our business, revenue, revenue growth rates and operating results.

As our products are integrated into a variety of electronic devices, we compete with suppliers of both can tuners and traditional silicon RF receivers, and with providers of physical medium devices for optical interconnect markets. Our competitors range from large, international companies offering a wide range of semiconductor products to smaller companies specializing in narrow markets and internal engineering groups within television, set-top box, data modems and gateway, satellite low-noise blocker, and optical module manufacturers, some of which may be our customers. Our primary competitors include Silicon Labs, NXP B.V., RDA Microelectronics, Inc., Broadcom Ltd (recently created through the merger of Broadcom Corporation and Avago Technologies Limited), and Rafael Microelectronics, Inc. Inphi Corporation, M/A-COM Technology Solutions Holdings, Inc., Semtech Corporation, Qorvo Inc., and Microsemi Corporation (which recently acquired PMC-Sierra) are competitors. It is quite likely that competition in the markets in which we participate will increase in the future as existing competitors improve or expand their product offerings. In addition, it is quite likely that a number of other public and private companies are in the process of developing competing products for digital television and other broadband communication applications. Because our products often are building block semiconductors which provide functions that in some cases can be integrated into more complex integrated circuits, we also face competition from manufacturers of integrated circuits, some of which may be existing customers or platform partners that develop their own integrated circuit products. If we cannot offer an attractive solution for applications where our competitors offer more fully integrated tuner/demodulator/video processing products, we may lose significant market share to our competitors. Certain of our competitors have fully integrated tuner/demodulator/video processing solutions targeting high performance cable, satellite, or DTV applications, and thereby potentially provide customers with smaller and cheaper solutions. Some of our targeted customers for our optical interconnect solutions are module makers who are vertically integrated, where we compete with internally supplied components.

Our ability to compete successfully depends on factors both within and outside of our control, including industry and general economic trends. During past periods of downturns in our industry, competition in the markets in which we operate intensified as manufacturers of semiconductors reduced prices in order to combat production overcapacity and high inventory levels. Many of our competitors have substantially greater financial and other resources with which to withstand similar adverse economic or market conditions in the future. Moreover, the competitive landscape is changing as a result of consolidation within our industry as some of our competitors have merged with or been acquired by other competitors, and other competitors have begun to collaborate with each other. These developments may materially and adversely affect our current and future target markets and our ability to compete successfully in those markets.

We depend on a limited number of customers, that have undergone or are subject to pending consolidation and who themselves are dependent on a consolidating set of service provider customers, for a substantial portion of our revenue, and the loss of, or a significant reduction in orders from one or more of our major customers could have a material adverse effect on our revenue and operating results.

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For fiscal 2015, two customers accounted for 41% of our net revenue, and our ten largest customers accounted for 76% of our net revenue. For fiscal 2014, one customer accounted for approximately 31% of our net revenue, and our ten largest customers collectively accounted for approximately 67% of our net revenue. For fiscal 2013, one customer accounted for approximately 28% of our net revenue, and our ten largest customers collectively accounted for approximately 72% of our net revenue. We expect that our operating results for the foreseeable future will continue to depend on sales to a relatively small number of customers and on the ability of these customers to sell products that incorporate our RF receivers or RF receiver SoCs, digital STB video SoCs, DBS ODU, and MoCA® connectivity solutions. In the future, these customers may decide not to purchase our products at all, may purchase fewer products than they did in the past, or may defer or cancel purchases or otherwise alter their purchasing patterns. Factors that could affect our revenue from these large customers include the following:

- substantially all of our sales to date have been made on a purchase order basis, which permits our customers to cancel, change or delay product purchase commitments with little or no notice to us and without penalty;
- some of our customers have sought or are seeking relationships with current or potential competitors which may affect their purchasing decisions; and
- service provider and OEM consolidation across cable, satellite, and fiber markets could result in significant changes to our customers' technology development and deployment priorities and roadmaps, which could affect our ability to forecast demand accurately and could lead to increased volatility in our business.

In addition, delays in development could impair our relationships with our strategic customers and negatively impact sales of the products under development. Moreover, it is possible that our customers may develop their own product or adopt a competitor's solution for products that they currently buy from us. If that happens, our sales would decline and our business, financial condition and results of operations could be materially and adversely affected.

Our relationships with some customers may deter other potential customers who compete with these customers from buying our products. To attract new customers or retain existing customers, we may offer these customers favorable prices on our products. In that event, our average selling prices and gross margins would decline. The loss of a key customer, a reduction in sales to any key customer or our inability to attract new significant customers could seriously impact our revenue and materially and adversely affect our results of operations.

A significant portion of our revenue is attributable to demand for our products in markets for broadband and pay-TV operator applications, and consolidation among cable and satellite television operators could adversely affect our future revenues and operating results.

For fiscal 2015, revenue directly attributable to operator applications accounted for approximately 75% of our net revenue. For fiscal 2014, revenue directly attributable to these applications accounted for approximately 76% of our net revenue. For fiscal 2013, revenue directly attributable to cable and satellite operator applications accounted for approximately 77% of our net revenue. Delays in the development of, or unexpected developments in the operator applications markets could have an adverse effect on order activity by manufacturers in these markets and, as a result, on our business, revenue, operating results and financial condition. In addition, consolidation trends among television operators may continue, which could have a material adverse effect on our future operating results and financial condition.

If we fail to penetrate new markets, specifically the market for satellite set-top and gateway boxes and outdoor units, our revenue, revenue growth rate, if any, and financial condition could be materially and adversely affected.

Currently, we sell most of our products to manufacturers of applications for television, to Chinese manufacturers of terrestrial set-top boxes for sale in various markets worldwide, broadband voice and data modems and gateways, and pay-TV set-top boxes and gateways, to manufacturers of satellite outdoor units or LNB's, and to manufacturers of optical modules for long-haul and metro telecommunications markets. Our future revenue growth, if any, will depend in part on our ability to expand beyond these markets with analog and mixed-signal solutions targeting the markets for high-speed optical interconnects for datacenter, metro, and long-haul optical modules, telecommunications wireless infrastructure, and cable infrastructure products supporting future Cable operator deployments of DOCSIS 3.1. Each of these markets presents distinct and substantial risks. If any of these markets do not develop as we currently anticipate, or if we are unable to penetrate them successfully, it could materially and adversely affect our revenue and revenue growth rate, if any.

We expect broadband data modems/gateways and pay-TV and satellite set-top boxes and video gateways to represent our largest North American and European target market. The North American and European pay-TV set-top box market is

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dominated by only a few OEMs, including Cisco Systems, Inc. (whose connected devices business was acquired by Technicolor in November 2015), Arris Group, Inc., Pace plc, Humax Co., Ltd., Samsung Electronics Co., Ltd., and Technicolor S.A. These OEMs are large multinational corporations with substantial negotiating power relative to us and are undergoing significant consolidation. Securing design wins with any of these companies requires a substantial investment of our time and resources. Even if we succeed, additional testing and operational certifications will be required by the OEMs' customers, which include large pay-TV television companies such as Comcast Corporation, Time Warner Cable Inc., DIRECTV, and EchoStar Corporation. In addition, our products will need to be compatible with other components in our customers' designs, including components produced by our competitors or potential competitors. There can be no assurance that these other companies will support or continue to support our products. If we fail to penetrate these or other new markets upon which we target our resources, our revenue and revenue growth rate, if any, likely will decrease over time and our financial condition could suffer.

We may be unable to make the substantial and productive research and development investments which are required to remain competitive in our business.

The semiconductor industry requires substantial investment in research and development in order to develop and bring to market new and enhanced technologies and products. Many of our products originated with our research and development efforts and we believe have provided us with a significant competitive advantage. For fiscal 2015, our research and development expense was $85.4 million. For fiscal 2014, our research and development expense was $56.6 million. For fiscal 2013, our research and development expense was $53.1 million. For fiscal 2014 and 2015, we continued to increase our research and development expenditures as part of our strategy of devoting focused research and development efforts on the development of innovative and sustainable product platforms. We are committed to investing in new product development internally in order to stay competitive in our markets and plan to maintain research and development and design capabilities for new solutions in advanced semiconductor process nodes such as 40nm and 28nm and beyond. We do not know whether we will have sufficient resources to maintain the level of investment in research and development required to remain competitive as semiconductor process nodes continue to shrink and become increasingly complex. In addition, we cannot assure you that the technologies which are the focus of our research and development expenditures will become commercially successful.

The complexity of our products could result in unforeseen delays or expenses caused by undetected defects or bugs, which could reduce the market acceptance of our new products, damage our reputation with current or prospective customers and adversely affect our operating costs.

Highly complex products like our RF receivers and RF receiver SoCs and physical medium devices for optical modules may contain defects and bugs when they are first introduced or as new versions are released. We have previously experienced, and may in the future experience, defects and bugs and, in particular, have identified liabilities of several million dollars arising from warranty claims related to legacy Entropic products. Where any of our products, including legacy Entropic products, contain defects or bugs, or have reliability, quality or compatibility problems, we may not be able to successfully correct these problems. Consequently, our reputation may be damaged and customers may be reluctant to buy our products, which could materially and adversely affect our ability to retain existing customers and attract new customers, and our financial results. In addition, these defects or bugs could interrupt or delay sales to our customers. If any of these problems are not found until after we have commenced commercial production of a new product (as in the case of the legacy Entropic products experiencing warranty claims), we may be required to incur additional development costs and product recall, repair or replacement costs, and our operating costs could be adversely affected. These problems may also result in warranty or product liability claims against us by our customers or others that may require us to make significant expenditures to defend these claims or pay damage awards. In the event of a warranty claim, we may also incur costs if we compensate the affected customer. We maintain product liability insurance, but this insurance is limited in amount and subject to significant deductibles. There is no guarantee that our insurance will be available or adequate to protect against all claims. We also may incur costs and expenses relating to a recall of one of our customers' products containing one of our devices. The process of identifying a recalled product in devices that have been widely distributed may be lengthy and require significant resources, and we may incur significant replacement costs, contract damage claims from our customers and reputational harm. Costs or payments made in connection with warranty and product liability claims and product recalls could materially affect our financial condition and results of operations.

Average selling prices of our products could decrease rapidly, which could have a material adverse effect on our revenue and gross margins.

We may experience substantial period-to-period fluctuations in future operating results due to the erosion of our average selling prices. From time to time, we have reduced the average unit price of our products due to competitive pricing pressures,

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new product introductions by us or our competitors, and for other reasons, and we expect that we will have to do so again in the future. If we are unable to offset any reductions in our average selling prices by increasing our sales volumes or introducing new products with higher margins, our revenue and gross margins will suffer. To support our gross margins, we must develop and introduce new products and product enhancements on a timely basis and continually reduce our and our customers' costs. Our inability to do so would cause our revenue and gross margins to decline.

If we fail to develop and introduce new or enhanced products on a timely basis, our ability to attract and retain customers could be impaired and our competitive position could be harmed.

We operate in a dynamic environment characterized by rapidly changing technologies and industry standards and technological obsolescence. To compete successfully, we must design, develop, market and sell new or enhanced products that provide increasingly higher levels of performance and reliability and meet the cost expectations of our customers. The introduction of new products by our competitors, the market acceptance of products based on new or alternative technologies, or the emergence of new industry standards could render our existing or future products obsolete. Our failure to anticipate or timely develop new or enhanced products or technologies in response to technological shifts could result in decreased revenue and our competitors winning more competitive bid processes, known as "design wins." In particular, we may experience difficulties with product design, manufacturing, marketing or certification that could delay or prevent our development, introduction or marketing of new or enhanced products. If we fail to introduce new or enhanced products that meet the needs of our customers or penetrate new markets in a timely fashion, we will lose market share and our operating results will be adversely affected.

In particular, we believe that we will need to develop new products in part to respond to changing dynamics and trends in our end user markets, including (among other trends) consolidation among cable and satellite operators, potential industry shifts away from the hardware devices and other technologies that incorporate our products, and changes in consumer television viewing habits and how consumers access and receive broadcast content and digital broadband services. We cannot predict how these trends will continue to develop or how or to what extent they may affect our future revenues and operating results. We believe that we will need to continue to make substantial investments in research and development in an attempt to ensure a product roadmap that anticipates these types of changes; however, we cannot provide any assurances that we will accurately predict the direction in which our markets will evolve or that we will be able to develop, market, or sell new products that respond to such changes successfully or in a timely manner, if at all.

We recently settled and are currently a party to intellectual property litigation and may face additional claims of intellectual property infringement. Current litigation and any future litigation could be time-consuming, costly to defend or settle and result in the loss of significant rights.

The semiconductor industry is characterized by companies that hold large numbers of patents and other intellectual property rights and that vigorously pursue, protect and enforce intellectual property rights. Third parties have in the past and may in the future assert against us and our customers and distributors their patent and other intellectual property rights to technologies that are important to our business. In particular, from time to time, we receive correspondence from competitors seeking to engage us in discussions concerning potential claims against us, and we receive correspondence from customers seeking indemnification for potential claims related to infringement claims asserted against down-stream users of our products. We investigate these requests as received and could be required to enter license agreements with respect to third party intellectual property rights or indemnify third parties, either of which could have an adverse effect on our future operating results.

On January 21, 2014, CrestaTech Technology Corporation, or CrestaTech, filed a complaint for patent infringement against us in the United States District Court of Delaware (the "District Court Litigation"). In its complaint, CrestaTech alleges that we infringe U.S. Patent Nos. 7,075,585 (the "'585 Patent") and 7,265,792. In addition to asking for compensatory damages, CrestaTech alleges willful infringement and seeks a permanent injunction. CrestaTech also names Sharp Corporation, Sharp Electronics Corp. and VIZIO, Inc. as defendants based upon their alleged use of our television tuners. On January 28, 2014, CrestaTech filed a complaint with the U.S. International Trade Commission, or ITC, again naming, among others, us, Sharp, Sharp Electronics, and VIZIO (the "ITC Investigation").

On December 1-5, 2014, the ITC held a trial in the ITC Investigation. On February 27, 2015, the Administrative Law Judge issued a written Initial Determination ("ID"), ruling that the Company Respondents do not violate Section 1337 in connection with CrestaTech's asserted patents because CrestaTech failed to satisfy the economic prong of the domestic industry requirement pursuant to Section 1337(a)(2). In addition, the ID stated that certain of our television tuners and televisions incorporating those tuners manufactured and sold by certain customers infringe three claims of the '585 Patent, and these three

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claims were not determined to be invalid. On April 30, 2015, the ITC issued a notice indicating that it intended to review portions of the ID finding no violation of Section 1337, including the ID's findings of infringement with respect to, and validity of, the '585 Patent, and the ID's finding that CrestaTech failed to establish the existence of a domestic industry within the meaning of Section 1337.

The ITC requested additional briefing from the parties on certain issues under review by the Commission. The ITC subsequently issued its opinion, which terminated its investigation. The opinion affirmed the findings of the administrative law judge that no violation of Section 1337 had occurred because CrestaTech had failed to establish the economic prong of the domestic industry requirement. The ITC also affirmed the administrative law judge's finding of infringement with respect to the three claims of the '585 Patent that were not held to be invalid. On November 30, 2015, CrestaTech filed an appeal of the ITC decision with the United States Court of Appeals for the Federal Circuit (the "Federal Circuit").

In addition, we have filed four petitions for inter partes review ("IPR") by the US Patent Office of the two CrestaTech patents asserted against us. The Patent Trial and Appeal Board ("PTAB") did not institute two of these IPRs as being redundant to IPRs filed by another party that are already underway for the same CrestaTech patent. The remaining two petitions were instituted or instituted-in-part and, together with the IPRs filed by third parties, there are currently six IPR proceedings filed involving the two CrestaTech patents asserted against us. In October 2015, the PTAB issued final decisions in two of the six IPR proceedings, holding that all of the reviewed claims are unpatentable. Included in these decisions was one of the three claims mentioned above. CrestaTech is appealing the PTAB's decisions at the Federal Circuit.

We cannot predict the outcome of the District Court Litigation or the IPRs. Any adverse determination in the District Court Litigation could have a material adverse effect on our business and operating results.

Claims that our products, processes or technology infringe third-party intellectual property rights, regardless of their merit or resolution and including the CrestaTech claims, are costly to defend or settle and could divert the efforts and attention of our management and technical personnel. In addition, many of our customer and distributor agreements require us to indemnify and defend our customers or distributors from third-party infringement claims and pay damages in the case of adverse rulings. Claims of this sort also could harm our relationships with our customers or distributors and might deter future customers from doing business with us. In order to maintain our relationships with existing customers and secure business from new customers, we have been required from time to time to provide additional assurances beyond our standard terms. If any future proceedings result in an adverse outcome, we could be required to:

- cease the manufacture, use or sale of the infringing products, processes or technology;
- pay substantial damages for infringement;
- expend significant resources to develop non-infringing products, processes or technology;
- license technology from the third-party claiming infringement, which license may not be available on commercially reasonable terms, or at all;
- cross-license our technology to a competitor to resolve an infringement claim, which could weaken our ability to compete with that competitor; or
- pay substantial damages to our customers or end users to discontinue their use of or to replace infringing technology sold to them with non-infringing technology.

Any of the foregoing results could have a material adverse effect on our business, financial condition and results of operations.

We utilize a significant amount of intellectual property in our business. If we are unable to protect our intellectual property, our business could be adversely affected.

Our success depends in part upon our ability to protect our intellectual property. To accomplish this, we rely on a combination of intellectual property rights, including patents, copyrights, trademarks and trade secrets in the United States and in selected foreign countries where we believe filing for such protection is appropriate. Effective patent, copyright, trademark and trade secret protection may be unavailable, limited or not applied for in some countries. Some of our products and technologies are not covered by any patent or patent application. We cannot guarantee that:

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- any of our present or future patents or patent claims will not lapse or be invalidated, circumvented, challenged or abandoned;
- our intellectual property rights will provide competitive advantages to us;
- our ability to assert our intellectual property rights against potential competitors or to settle current or future disputes will not be limited by our agreements with third parties;
- any of our pending or future patent applications will be issued or have the coverage originally sought;
- our intellectual property rights will be enforced in jurisdictions where competition may be intense or where legal protection may be weak;
- any of the trademarks, copyrights, trade secrets or other intellectual property rights that we presently employ in our business will not lapse or be invalidated, circumvented, challenged or abandoned; or
- we will not lose the ability to assert our intellectual property rights against or to license our technology to others and collect royalties or other payments.

In addition, our competitors or others may design around our protected patents or technologies. Effective intellectual property protection may be unavailable or more limited in one or more relevant jurisdictions relative to those protections available in the United States, or may not be applied for in one or more relevant jurisdictions. If we pursue litigation to assert our intellectual property rights, an adverse decision in any of these legal actions could limit our ability to assert our intellectual property rights, limit the value of our technology or otherwise negatively impact our business, financial condition and results of operations.

Monitoring unauthorized use of our intellectual property is difficult and costly. Unauthorized use of our intellectual property may have occurred or may occur in the future. Although we have taken steps to minimize the risk of this occurring, any such failure to identify unauthorized use and otherwise adequately protect our intellectual property would adversely affect our business. Moreover, if we are required to commence litigation, whether as a plaintiff or defendant as has occurred with CrestaTech, not only will this be time-consuming, but we will also be forced to incur significant costs and divert our attention and efforts of our employees, which could, in turn, result in lower revenue and higher expenses.

We also rely on customary contractual protections with our customers, suppliers, distributors, employees and consultants, and we implement security measures to protect our trade secrets. We cannot assure you that these contractual protections and security measures will not be breached, that we will have adequate remedies for any such breach or that our suppliers, employees or consultants will not assert rights to intellectual property arising out of such contracts.

In addition, we have a number of third-party patent and intellectual property license agreements. Some of these license agreements require us to make one-time payments or ongoing royalty payments. Also, a few of our license agreements contain most-favored nation clauses or other price restriction clauses which may affect the amount we may charge for our products, processes or technology. We cannot guarantee that the third-party patents and technology we license will not be licensed to our competitors or others in the semiconductor industry. In the future, we may need to obtain additional licenses, renew existing license agreements or otherwise replace existing technology. We are unable to predict whether these license agreements can be obtained or renewed or the technology can be replaced on acceptable terms, or at all.

When we settled a trademark dispute with Linear Technology Corporation, we agreed not to register the “MAXLINEAR” mark or any other marks containing the term “LINEAR”. We may continue to use “MAXLINEAR” as a corporate identifier, including to advertise our products and services, but may not use that mark on our products. The agreement does not affect our ability to use our registered trademark “MxL”, which we use on our products. Due to our agreement not to register the “MAXLINEAR” mark, our ability to effectively prevent third parties from using the “MAXLINEAR” mark in connection with similar products or technology may be affected. If we are unable to protect our trademarks, we may experience difficulties in achieving and maintaining brand recognition and customer loyalty.

Our business, revenue and revenue growth, if any, will depend in part on the timing and development of the global transition from analog to digital television, which is subject to numerous regulatory and business risks outside our control.

In the year ended December 31, 2015, sales of our RF receiver products used in digital terrestrial television applications, or DTT, including digital televisions, terrestrial set-top boxes, and terrestrial receivers in satellite video gateways represented a declining, but not insignificant, portion of our revenues. We expect a declining but not insignificant portion of our revenue in

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future periods to continue to depend on the demand for DTT applications. In contrast to the United States, where the transition from analog to digital television occurred on a national basis in June 2009, in Europe and other parts of the world, the digital transition is being phased in on a local and regional basis and is expected to occur over many years. Many countries in Eastern Europe and Latin America are expected to convert to digital television by the end of 2018, with other countries targeting dates as late as 2024. As a result, our future revenue will depend in part on government mandates requiring conversion from analog to digital television and on the timing and implementation of those mandates. If the ongoing global transition to digital TV standards does not continue to progress or experiences significant delays, our business, revenue, operating results and financial condition would be materially and adversely affected. If during the transition to digital TV standards, consumers disproportionately purchase TV's with digital or hybrid tuning capabilities, this could diminish the size of the market for our digital-to-analog converter set-top box solutions, and as result our business, revenue, operating results and financial condition would be materially and adversely affected.

Global economic conditions, including factors that adversely affect consumer spending for the products that incorporate our integrated circuits, could adversely affect our revenues, margins, and operating results.

Our products are incorporated in numerous consumer devices, and demand for our products will ultimately be driven by consumer demand for products such as televisions, automobiles, cable modems, and set-top boxes. Many of these purchases are discretionary. Global economic volatility and economic volatility in the specific markets in which the devices that incorporate our products are ultimately sold can cause extreme difficulties for our customers and third-party vendors in accurately forecasting and planning future business activities. This unpredictability could cause our customers to reduce spending on our products, which would delay and lengthen sales cycles. Furthermore, during challenging economic times our customers may face challenges in gaining timely access to sufficient credit, which could impact their ability to make timely payments to us. These events, together with economic volatility that may face the broader economy and, in particular, the semiconductor and communications industries, may adversely affect, our business, particularly to the extent that consumers decrease their discretionary spending for devices deploying our products.

We rely on a limited number of third parties to manufacture, assemble and test our products, and the failure to manage our relationships with our third-party contractors successfully could adversely affect our ability to market and sell our products.

We do not have our own manufacturing facilities. We operate an outsourced manufacturing business model that utilizes third-party foundry and assembly and test capabilities. As a result, we rely on third-party foundry wafer fabrication and assembly and test capacity, including sole sourcing for many components or products. Currently, all of our products are manufactured by United Microelectronics Corporation, or UMC, Silterra Malaysia Sdn Bhd, Global Foundries, Semiconductor Manufacturing International Corporation, or SMIC, Taiwan Semiconductor Manufacturing Corp, or TSMC, Jazz Semiconductor, and WIN Semiconductor at foundries in Taiwan, Singapore, Malaysia, China, and the United States. We also use third-party contractors for all of our assembly and test operations.

Relying on third party manufacturing, assembly and testing presents significant risks to us, including the following:

- failure by us, our customers, or their end customers to qualify a selected supplier;
- capacity shortages during periods of high demand;
- reduced control over delivery schedules and quality;
- shortages of materials;
- misappropriation of our intellectual property;
- limited warranties on wafers or products supplied to us; and
- potential increases in prices.

The ability and willingness of our third-party contractors to perform is largely outside our control. If one or more of our contract manufacturers or other outsourcers fails to perform its obligations in a timely manner or at satisfactory quality levels, our ability to bring products to market and our reputation could suffer. For example, in the event that manufacturing capacity is reduced or eliminated at one or more facilities, including as a response to the recent worldwide decline in the semiconductor industry, manufacturing could be disrupted, we could have difficulties fulfilling our customer orders and our net revenue could decline. In addition, if these third parties fail to deliver quality products and components on time and at reasonable prices, we

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could have difficulties fulfilling our customer orders, our net revenue could decline and our business, financial condition and results of operations would be adversely affected.

Additionally, our manufacturing capacity may be similarly reduced or eliminated at one or more facilities due to the fact that our fabrication and assembly and test contractors are all located in the Pacific Rim region, principally in China, Taiwan, Singapore and Malaysia. The risk of earthquakes in these geographies is significant due to the proximity of major earthquake fault lines, and Taiwan in particular is also subject to typhoons and other Pacific storms. Earthquakes, fire, flooding, or other natural disasters in Taiwan or the Pacific Rim region, or political unrest, war, labor strikes, work stoppages or public health crises, such as outbreaks of H1N1 flu, in countries where our contractors' facilities are located could result in the disruption of our foundry, assembly or test capacity. Any disruption resulting from these events could cause significant delays in shipments of our products until we are able to shift our manufacturing, assembly or test from the affected contractor to another third-party vendor. There can be no assurance that alternative capacity could be obtained on favorable terms, if at all.

We do not have any long-term supply contracts with our contract manufacturers or suppliers, and any disruption in our supply of products or materials could have a material adverse effect on our business, revenue and operating results.

We currently do not have long-term supply contracts with any of our third-party vendors, including UMC, Silterra Malaysia Sdn Bhd, Global Foundries, SMIC, TSMC, Jazz Semiconductor, and WIN Semiconductor. We make substantially all of our purchases on a purchase order basis, and neither UMC nor our other contract manufacturers are required to supply us products for any specific period or in any specific quantity. Foundry capacity may not be available when we need it or at reasonable prices. Availability of foundry capacity has in the past been reduced from time to time due to strong demand. Foundries can allocate capacity to the production of other companies' products and reduce deliveries to us on short notice. It is possible that foundry customers that are larger and better financed than we are, or that have long-term agreements with our foundry, may induce our foundry to reallocate capacity to them. This reallocation could impair our ability to secure the supply of components that we need. We expect that it would take approximately nine to twelve months to transition performance of our foundry or assembly services to new providers. Such a transition would likely require a qualification process by our customers or their end customers. We generally place orders for products with some of our suppliers approximately four to five months prior to the anticipated delivery date, with order volumes based on our forecasts of demand from our customers. Accordingly, if we inaccurately forecast demand for our products, we may be unable to obtain adequate and cost-effective foundry or assembly capacity from our third-party contractors to meet our customers' delivery requirements, or we may accumulate excess inventories. On occasion, we have been unable to adequately respond to unexpected increases in customer purchase orders and therefore were unable to benefit from this incremental demand. None of our third-party contractors has provided any assurance to us that adequate capacity will be available to us within the time required to meet additional demand for our products.

To address capacity considerations, we are in the process of qualifying additional semiconductor fabricators. Qualification will not occur if we identify a defect in a fabricator's manufacturing process or if our customers choose not to invest the time and expense required to qualify the proposed fabricator. If full qualification of a fabricator does not occur, we may not be able to sell all of the materials produced by this fabricator or to fulfill demand for our products, which would adversely affect our business, revenue and operating results. In addition, the resulting write-off of unusable inventories would have an adverse effect on our operating results.

We may have difficulty accurately predicting our future revenue and appropriately budgeting our expenses particularly as we seek to enter new markets where we may not have prior experience.

Our recent operating history has focused on developing integrated circuits for specific terrestrial, cable and satellite television, and broadband voice and data applications, and as part of our strategy, we seek to expand our addressable market into new product categories. For example, we have recently expanded into the market for and physical medium devices for the optical interconnect markets, and are attempting to enter the markets for telecommunications wireless infrastructure and cable infrastructure. Our limited operating experience in new markets or potential markets we may enter, combined with the rapidly evolving nature of our markets in general, substantial uncertainty concerning how these markets may develop and other factors beyond our control, reduces our ability to accurately forecast quarterly or annual revenue. We are currently expanding our staffing and increasing our expense levels in anticipation of future revenue growth. If our revenue does not increase as anticipated, we could incur significant losses due to our higher expense levels if we are not able to decrease our expenses in a timely manner to offset any shortfall in future revenue.

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We may not sustain our growth rate, and we may not be able to manage future growth effectively.

We have been experiencing significant growth in a short period of time. Our net revenue increased from approximately $97.7 million in 2012, to $119.6 million in 2013, to $133.1 million in 2014 and $300.4 million in 2015. We may not achieve similar growth rates in future periods. You should not rely on our operating results for any prior quarterly or annual periods as an indication of our future operating performance. If we are unable to maintain adequate revenue growth, our financial results could suffer and our stock price could decline.

To manage our growth successfully and handle the responsibilities of being a public company, we believe we must effectively, among other things:

- recruit, hire, train and manage additional qualified engineers for our research and development activities, especially in the positions of design engineering, product and test engineering and applications engineering;
- add sales personnel and expand customer engineering support offices;
- implement and improve our administrative, financial and operational systems, procedures and controls; and
- enhance our information technology support for enterprise resource planning and design engineering by adapting and expanding our systems and tool capabilities, and properly training new hires as to their use.

If we are unable to manage our growth effectively, we may not be able to take advantage of market opportunities or develop new products and we may fail to satisfy customer requirements, maintain product quality, execute our business plan or respond to competitive pressures.

If we are unable to attract, train and retain qualified personnel, especially our design and technical personnel, we may not be able to execute our business strategy effectively.

Our future success depends on our ability to retain, attract and motivate qualified personnel, including our management, sales and marketing and finance, and especially our design and technical personnel. We do not know whether we will be able to retain all of these personnel as we continue to pursue our business strategy. Historically, we have encountered difficulties in hiring and retaining qualified engineers because there is a limited pool of engineers with the expertise required in our field. Competition for these personnel is intense in the semiconductor industry. As the source of our technological and product innovations, our design and technical personnel represent a significant asset. The loss of the services of one or more of our key employees, especially our key design and technical personnel, or our inability to retain, attract and motivate qualified design and technical personnel, could have a material adverse effect on our business, financial condition and results of operations.

Our business would be adversely affected by the departure of existing members of our senior management team.

Our success depends, in large part, on the continued contributions of our senior management team. None of our senior management team is bound by written employment contracts to remain with us for a specified period. In addition, we have not entered into non-compete agreements with members of our senior management team. The loss of any member of our senior management team could harm our ability to implement our business strategy and respond to the rapidly changing market conditions in which we operate.

Our customers require our products and our third-party contractors to undergo a lengthy and expensive qualification process which does not assure product sales.

Prior to purchasing our products, our customers require that both our products and our third-party contractors undergo extensive qualification processes, which involve testing of the products in the customer's system and rigorous reliability testing. This qualification process may continue for six months or more. However, qualification of a product by a customer does not assure any sales of the product to that customer. Even after successful qualification and sales of a product to a customer, a subsequent revision to the RF receiver or RF receiver SoC and physical medium devices for optical modules, changes in our customer's manufacturing process or our selection of a new supplier may require a new qualification process, which may result in delays and in us holding excess or obsolete inventory. After our products are qualified, it can take six months or more before the customer commences volume production of components or devices that incorporate our products. Despite these uncertainties, we devote substantial resources, including design, engineering, sales, marketing and management efforts, to qualifying our products with customers in anticipation of sales. If we are unsuccessful or delayed in qualifying any of our products with a customer, sales of this product to the customer may be precluded or delayed, which may impede our growth and cause our business to suffer.

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We are subject to risks associated with our distributors' product inventories and product sell-through. Should any of our distributors cease or be forced to stop distributing our products, our business would suffer.

We currently sell a significant but declining portion of our products to customers through our distributors, who maintain their own inventories of our products.

For fiscal 2015, sales through distributors accounted for 13% of our net revenue. For fiscal 2014, sales through distributors accounted for 28% of our net revenue. For fiscal 2013, sales through distributors accounted for 29% of our net revenue. For these distributor transactions, revenue is not recognized until product is shipped to the end customer and the amount that will ultimately be collected is fixed or determinable. Upon shipment of product to these distributors, title to the inventory transfers to the distributor and the distributor is invoiced, generally with 30 day terms. On shipments to our distributors where revenue is not recognized, we record a trade receivable for the selling price as there is a legally enforceable right to payment, relieving the inventory for the carrying value of goods shipped since legal title has passed to the distributor, and record the corresponding gross profit in the consolidated balance sheet as a component of deferred revenue and deferred profit, representing the difference between the receivable recorded and the cost of inventory shipped. Future pricing credits and/or stock rotation rights from our distributors may result in the realization of a different amount of profit included our future consolidated statements of operations than the amount recorded as deferred profit in our consolidated balance sheets.

If our distributors are unable to sell an adequate amount of their inventories of our products in a given quarter to manufacturers and end users or if they decide to decrease their inventories of our products for any reason, our sales through these distributors and our revenue may decline. In addition, if some distributors decide to purchase more of our products than are required to satisfy end customer demand in any particular quarter, inventories at these distributors would grow in that quarter. These distributors likely would reduce future orders until inventory levels realign with end customer demand, which could adversely affect our product revenue in a subsequent quarter.

Our reserve estimates with respect to the products stocked by our distributors are based principally on reports provided to us by our distributors, typically on a weekly basis. To the extent that this resale and channel inventory data is inaccurate or not received in a timely manner, we may not be able to make reserve estimates for future periods accurately or at all.

We are subject to order and shipment uncertainties, and differences between our estimates of customer demand and product mix and our actual results could negatively affect our inventory levels, sales and operating results.

Our revenue is generated on the basis of purchase orders with our customers rather than long-term purchase commitments. In addition, our customers can cancel purchase orders or defer the shipments of our products under certain circumstances. Our products are manufactured using a silicon foundry according to our estimates of customer demand, which requires us to make separate demand forecast assumptions for every customer, each of which may introduce significant variability into our aggregate estimate. We have limited visibility into future customer demand and the product mix that our customers will require, which could adversely affect our revenue forecasts and operating margins. Moreover, because our target markets are relatively new, many of our customers have difficulty accurately forecasting their product requirements and estimating the timing of their new product introductions, which ultimately affects their demand for our products. Historically, because of this limited visibility, actual results have been different from our forecasts of customer demand. Some of these differences have been material, leading to excess inventory or product shortages and revenue and margin forecasts above those we were actually able to achieve. These differences may occur in the future, and the adverse impact of these differences between forecasts and actual results could grow if we are successful in selling more products to some customers. In addition, the rapid pace of innovation in our industry could render significant portions of our inventory obsolete. Excess or obsolete inventory levels could result in unexpected expenses or increases in our reserves that could adversely affect our business, operating results and financial condition. Conversely, if we were to underestimate customer demand or if sufficient manufacturing capacity were unavailable, we could forego revenue opportunities, potentially lose market share and damage our customer relationships. In addition, any significant future cancellations or deferrals of product orders or the return of previously sold products due to manufacturing defects could materially and adversely impact our profit margins, increase our write-offs due to product obsolescence and restrict our ability to fund our operations.

Winning business is subject to lengthy competitive selection processes that require us to incur significant expenditures. Even if we begin a product design, customers may decide to cancel or change their product plans, which could cause us to generate no revenue from a product and adversely affect our results of operations.
We are focused on securing design wins to develop RF receivers and RF receiver SoCs, MoCA SoCs, DBS-ODU SoCs, physical medium devices for optical modules, and SoC solutions targeting infrastructure opportunities within the

telecommunications, wireless, and cable operator markets for use in our customers' products. These selection processes typically are lengthy and can require us to incur significant design and development expenditures and dedicate scarce engineering resources in pursuit of a single customer opportunity. We may not win the competitive selection process and may never generate any revenue despite incurring significant design and development expenditures. These risks are exacerbated by the fact that some of our customers' products likely will have short life cycles. Failure to obtain a design win could prevent us from offering an entire generation of a product, even though this has not occurred to date. This could cause us to lose revenue and require us to write off obsolete inventory, and could weaken our position in future competitive selection processes. After securing a design win, we may experience delays in generating revenue from our products as a result of the lengthy development cycle typically required. Our customers generally take a considerable amount of time to evaluate our products. The typical time from early engagement by our sales force to actual product introduction runs from nine to twelve months for the consumer market, to as much as 36 months for the cable operator market. The delays inherent in these lengthy sales cycles increase the risk that a customer will decide to cancel, curtail, reduce or delay its product plans, causing us to lose anticipated sales. In addition, any delay or cancellation of a customer's plans could materially and adversely affect our financial results, as we may have incurred significant expense and generated no revenue. Finally, our customers' failure to successfully market and sell their products could reduce demand for our products and materially and adversely affect our business, financial condition and results of operations. If we were unable to generate revenue after incurring substantial expenses to develop any of our products, our business would suffer.

Our operating results are subject to substantial quarterly and annual fluctuations and may fluctuate significantly due to a number of factors that could adversely affect our business and our stock price.

Our revenue and operating results have fluctuated in the past and are likely to fluctuate in the future. These fluctuations may occur on a quarterly and on an annual basis and are due to a number of factors, many of which are beyond our control. These factors include, among others:

- changes in end-user demand for the products manufactured and sold by our customers;
- the receipt, reduction or cancellation of significant orders by customers;
- fluctuations in the levels of component inventories held by our customers;
- the gain or loss of significant customers;
- market acceptance of our products and our customers' products;
- our ability to develop, introduce and market new products and technologies on a timely basis;
- the timing and extent of product development costs;
- new product announcements and introductions by us or our competitors;
- incurrence of research and development and related new product expenditures;
- seasonality or cyclical fluctuations in our markets;
- currency fluctuations;
- fluctuations in IC manufacturing yields;
- significant warranty claims, including those not covered by our suppliers;
- changes in our product mix or customer mix;
- intellectual property disputes;
- loss of key personnel or the shortage of available skilled workers;
- impairment of long-lived assets, including masks and production equipment; and
- the effects of competitive pricing pressures, including decreases in average selling prices of our products.

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These factors are difficult to forecast, and these, as well as other factors, could materially adversely affect our quarterly or annual operating results. We typically are required to incur substantial development costs in advance of a prospective sale with no certainty that we will ever recover these costs. A substantial amount of time may pass between a design win and the generation of revenue related to the expenses previously incurred, which can potentially cause our operating results to fluctuate significantly from period to period. In addition, a significant amount of our operating expenses are relatively fixed in nature due to our significant sales, research and development costs. Any failure to adjust spending quickly enough to compensate for a revenue shortfall could magnify its adverse impact on our results of operations.

We are subject to the cyclical nature of the semiconductor industry.

The semiconductor industry is highly cyclical and is characterized by constant and rapid technological change, rapid product obsolescence and price erosion, evolving standards, short product life cycles and wide fluctuations in product supply and demand. Any future downturns may result in diminished product demand, production overcapacity, high inventory levels and accelerated erosion of average selling prices. Furthermore, any upturn in the semiconductor industry could result in increased competition for access to third-party foundry and assembly capacity. We are dependent on the availability of this capacity to manufacture and assemble our all of our products. None of our third-party foundry or assembly contractors has provided assurances that adequate capacity will be available to us in the future. A significant downturn or upturn could have a material adverse effect on our business and operating results.

The use of open source software in our products, processes and technology may expose us to additional risks and harm our intellectual property.

Our products, processes and technology sometimes utilize and incorporate software that is subject to an open source license. Open source software is typically freely accessible, usable and modifiable. Certain open source software licenses require a user who intends to distribute the open source software as a component of the user's software to disclose publicly part or all of the source code to the user's software. In addition, certain open source software licenses require the user of such software to make any derivative works of the open source code available to others on unfavorable terms or at no cost. This can subject previously proprietary software to open source license terms.

While we monitor the use of all open source software in our products, processes and technology and try to ensure that no open source software is used in such a way as to require us to disclose the source code to the related product, processes or technology when we do not wish to do so, such use could inadvertently occur. Additionally, if a third party software provider has incorporated certain types of open source software into software we license from such third party for our products, processes or technology, we could, under certain circumstances, be required to disclose the source code to our products, processes or technology. This could harm our intellectual property position and have a material adverse effect on our business, results of operations and financial condition.

We rely on third parties to provide services and technology necessary for the operation of our business. Any failure of one or more of our partners, vendors, suppliers or licensors to provide these services or technology could have a material adverse effect on our business.

We rely on third-party vendors to provide critical services, including, among other things, services related to accounting, billing, human resources, information technology, network development, network monitoring, in-licensing and intellectual property that we cannot or do not create or provide ourselves. We depend on these vendors to ensure that our corporate infrastructure will consistently meet our business requirements. The ability of these third-party vendors to successfully provide reliable and high quality services is subject to technical and operational uncertainties that are beyond our control. While we may be entitled to damages if our vendors fail to perform under their agreements with us, our agreements with these vendors limit the amount of damages we may receive. In addition, we do not know whether we will be able to collect on any award of damages or that these damages would be sufficient to cover the actual costs we would incur as a result of any vendor's failure to perform under its agreement with us. Any failure of our corporate infrastructure could have a material adverse effect on our business, financial condition and results of operations. Upon expiration or termination of any of our agreements with third-party vendors, we may not be able to replace the services provided to us in a timely manner or on terms and conditions, including service levels and cost, that are favorable to us and a transition from one vendor to another vendor could subject us to operational delays and inefficiencies until the transition is complete.

Additionally, we incorporate third-party technology into and with some of our products, and we may do so in future products. The operation of our products could be impaired if errors occur in the third-party technology we use. It may be more difficult for us to correct any errors in a timely manner if at all because the development and maintenance of the technology is

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not within our control. There can be no assurance that these third parties will continue to make their technology, or improvements to the technology, available to us, or that they will continue to support and maintain their technology. Further, due to the limited number of vendors of some types of technology, it may be difficult to obtain new licenses or replace existing technology. Any impairment of the technology or our relationship with these third parties could have a material adverse effect on our business.

Unanticipated changes in our tax rates or unanticipated tax obligations could affect our future results.

Since we operate in different countries and are subject to taxation in different jurisdictions, our future effective tax rates could be impacted by changes in such countries' tax laws or their interpretations. Both domestic and international tax laws are subject to change as a result of changes in fiscal policy, changes in legislation, evolution of regulation and court rulings. The application of these tax laws and related regulations is subject to legal and factual interpretation, judgment and uncertainty. We cannot determine whether any legislative proposals may be enacted into law or what, if any, changes may be made to such proposals prior to their being enacted into law. If U.S. or international tax laws change in a manner that increases our tax obligation, it could result in a material adverse impact on our net income and our financial position.

The Federal examination by the Internal Revenue Service for the years 2010 and 2011 was completed during the three months ended March 31, 2014. The Company is still subject to examination for 2012 through 2015. In the event we are determined to have any unaccrued tax obligation arising from future audits, our operating results would be adversely affected.

Our future effective tax rate could be unfavorably affected by unanticipated changes in the valuation of our deferred tax assets and liabilities. Changes in our effective tax rate could have a material adverse impact on our results of operations. We record a valuation allowance to reduce our net deferred tax assets to the amount that we believe is more likely than not to be realized. In assessing the need for a valuation allowance, we consider historical levels of income, expectations and risks associated with estimates of future taxable income and ongoing prudent and practical tax planning strategies. On a periodic basis we evaluate our deferred tax asset balance for realizability. To the extent we believe it is more likely than not that some portion of our deferred tax assets will not be realized, we will recognize a valuation allowance against the deferred tax asset. Realization of our deferred tax assets is dependent primarily upon future U.S. taxable income. During the year ended December 31, 2015, we maintained a full valuation allowance on our net federal and state deferred tax assets net of deferred tax liabilities related to indefinite-lived intangibles for which no future realization can be expected.

Our business, financial condition and results of operations could be adversely affected by the political and economic conditions of the countries in which we conduct business and other factors related to our international operations.

We sell our products throughout the world. Products shipped to Asia accounted for 91% of our net revenue in the year ended December 31, 2015. In addition, approximately 33% of our employees are located outside of the United States. All of our products are manufactured, assembled and tested in Asia, and all of our major distributors are located in Asia. Multiple factors relating to our international operations and to particular countries in which we operate could have a material adverse effect on our business, financial condition and results of operations. These factors include:

- changes in political, regulatory, legal or economic conditions;
- restrictive governmental actions, such as restrictions on the transfer or repatriation of funds and foreign investments and trade protection measures, including export duties and quotas and customs duties and tariffs;
- disruptions of capital and trading markets;
- changes in import or export licensing requirements;
- transportation delays;
- civil disturbances or political instability;
- geopolitical turmoil, including terrorism, war or political or military coups;
- public health emergencies;

- differing employment practices and labor standards;
- limitations on our ability under local laws to protect our intellectual property;

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- local business and cultural factors that differ from our customary standards and practices;
- nationalization and expropriation;
- changes in tax laws;
- currency fluctuations relating to our international operating activities; and
- difficulty in obtaining distribution and support.

In addition to a significant portion of our wafer supply coming from Singapore, China and Malaysia, substantially all of our products undergo packaging and final testing in Taiwan. Any conflict or uncertainty in this country, including due to natural disaster or public health or safety concerns, could have a material adverse effect on our business, financial condition and results of operations. In addition, if the government of any country in which our products are manufactured or sold sets technical standards for products manufactured in or imported into their country that are not widely shared, it may lead some of our customers to suspend imports of their products into that country, require manufacturers in that country to manufacture products with different technical standards and disrupt cross-border manufacturing relationships which, in each case, could have a material adverse effect on our business, financial condition and results of operations. We also are subject to risks associated with international political conflicts involving the U.S. government. For example, in 2008 we were instructed by the U.S. Department of Homeland Security to cease using Polar Star International Company Limited, a distributor based in Hong Kong, that delivered third-party products, to a political group that the U.S. government did not believe should have been provided with the products in question. As a result, we immediately ceased all business operations with that distributor. The loss of Polar Star as a distributor did not materially delay shipment of our products because Polar Star was a non-exclusive distributor and we had in place alternative distribution arrangements. However, we cannot provide assurances that similar disruptions of distribution arrangements in the future will not result in delayed shipments until we are able to identify alternative distribution channels, which could include a requirement to increase our direct sales efforts. Loss of a key distributor under similar circumstances could have an adverse effect on our business, revenues and operating results.

If we suffer losses to our facilities or distribution system due to catastrophe, our operations could be seriously harmed.

Our facilities and distribution system, and those of our third-party contractors, are subject to risk of catastrophic loss due to fire, flood or other natural or man-made disasters. A number of our facilities and those of our contract manufacturers are located in areas with above average seismic activity. The foundries that manufacture all of our wafers are located in Taiwan, Singapore, Malaysia, Southern California and China, and all of the third-party contractors who assemble and test our products also are located in Asia. In addition, our headquarters are located in Southern California. The risk of an earthquake in the Pacific Rim region or Southern California is significant due to the proximity of major earthquake fault lines. For example, in 2002 and 2003, major earthquakes occurred in Taiwan. Any catastrophic loss to any of these facilities would likely disrupt our operations, delay production, shipments and revenue and result in significant expenses to repair or replace the facility.

Our business is subject to various governmental regulations, and compliance with these regulations may cause us to incur significant expenses. If we fail to maintain compliance with applicable regulations, we may be forced to recall products and cease their manufacture and distribution, and we could be subject to civil or criminal penalties.

Our business is subject to various international and U.S. laws and other legal requirements, including packaging, product content, labor, import/export control regulations, and the Foreign Corrupt Practices Act. These regulations are complex, change frequently and have generally become more stringent over time. We may be required to incur significant costs to comply with these regulations or to remedy violations. Any failure by us to comply with applicable government regulations could result in cessation of our operations or portions of our operations, product recalls or impositions of fines and restrictions on our ability to conduct our operations. In addition, because many of our products are regulated or sold into regulated industries, we must comply with additional regulations in marketing our products.

Our products and operations are also subject to the rules of industrial standards bodies, like the International Standards Organization, as well as regulation by other agencies, such as the U.S. Federal Communications Commission. If we fail to adequately address any of these rules or regulations, our business could be harmed.

For example, the SEC adopted a final rule to implement Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which requires new disclosures concerning the use of conflict minerals, generally tantalum, tin, gold, or tungsten that originated in the Democratic Republic of the Congo or an adjoining country. These disclosures are required whether or not these products containing conflict minerals are manufactured by us or third parties. Verifying the source of any conflict minerals in our products has created and will continue to create additional costs in order to comply with the new disclosure requirements and we may not be able to certify that the metals in our products are conflict free, which may create issues with our customers. In addition, the new rule may affect the pricing, sourcing and availability of minerals used in the manufacture of our products.

We must conform the manufacture and distribution of our semiconductors to various laws and adapt to regulatory requirements in all countries as these requirements change. If we fail to comply with these requirements in the manufacture or distribution of our products, we could be required to pay civil penalties, face criminal prosecution and, in some cases, be prohibited from distributing our products in commerce until the products or component substances are brought into compliance.

In addition to our acquisitions of Entropic and Physpeed, we may, from time to time, make additional business acquisitions or investments, which involve significant risks.

In addition to the acquisitions of Entropic, which we completed in the second quarter of fiscal 2015, and Physpeed, which we completed in the fourth quarter of fiscal 2014, we may, from time to time, make acquisitions, enter into alliances or make investments in other businesses to complement our existing product offerings, augment our market coverage or enhance our technological capabilities. However, any such transactions could result in:

- issuances of equity securities dilutive to our existing stockholders;
- substantial cash payments;
- the incurrence of substantial debt and assumption of unknown liabilities;
- large one-time write-offs;
- amortization expenses related to intangible assets;
- a limitation on our ability to use our net operating loss carryforwards;
- the diversion of management’s time and attention from operating our business to acquisition integration challenges;
- stockholder or other litigation relating to the transaction;
- adverse tax consequences; and
- the potential loss of key employees, customers and suppliers of the acquired business.

Additionally, in periods subsequent to an acquisition, we must evaluate goodwill and acquisition-related intangible assets for impairment. If such assets are found to be impaired, they will be written down to estimated fair value, with a charge against earnings.

Integrating acquired organizations and their products and services, including the integration of Entropic and Physpeed following completion of the acquisitions, may be expensive, time-consuming and a strain on our resources and our relationships with employees, customers and suppliers, and ultimately may not be successful. The benefits or synergies we may expect from the acquisition of complementary or supplementary businesses may not be realized to the extent or in the time frame we initially anticipate. Some of the risks that may affect our ability to successfully integrate acquired companies, including Entropic and Physpeed, include those associated with:

- failure to successfully further develop the acquired products or technology;
- conforming the acquired company’s standards, policies, processes, procedures and controls with our operations;
- coordinating new product and process development, especially with respect to highly complex technologies;
- loss of key employees or customers of the acquired company;
- hiring additional management and other critical personnel;
- in the case of foreign acquisitions, the need to integrate operations across different cultures and languages and to address the particular economic, currency, political and regulatory risks associated with specific countries;

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- increasing the scope, geographic diversity and complexity of our operations;
- consolidation of facilities, integration of the acquired company's accounting, human resource and other administrative functions and coordination of product, engineering and sales and marketing functions;
- the geographic distance between the companies;
- liability for activities of the acquired company before the acquisition, including patent and trademark infringement claims, violations of laws, commercial disputes, tax liabilities and other known and unknown liabilities; and
- litigation or other claims in connection with the acquired company, including claims for terminated employees, customers, former stockholders or other third parties.

We may be subject to information technology failures, including data protection breaches and cyber-attacks, that could disrupt our operations, damage our reputation and adversely affect our business, operations, and financial results.

We rely on our information technology systems for the effective operation of our business and for the secure maintenance and storage of confidential data relating to our business and third party businesses. Although we have implemented security controls to protect our information technology systems, experienced programmers or hackers may be able to penetrate our security controls, and develop and deploy viruses, worms and other malicious software programs that compromise our confidential information or that of third parties and cause a disruption or failure of our information technology systems. Any such compromise of our information technology systems could result in the unauthorized publication of our confidential business or proprietary information, result in the unauthorized release of customer, supplier or employee data, result in a violation of privacy or other laws, expose us to a risk of litigation, or damage our reputation. The cost and operational consequences of implementing further data protection measures either as a response to specific breaches or as a result of evolving risks, could be significant. In addition, our inability to use or access our information systems at critical points in time could adversely affect the timely and efficient operation of our business. Any delayed sales, significant costs or lost customers resulting from these technology failures could adversely affect our business, operations and financial results.

Third parties with which we conduct business, such as foundries, assembly and test contractors, and distributors, have access to certain portions of our sensitive data. In the event that these third parties do not properly safeguard our data that they hold, security breaches could result and negatively impact our business, operations and financial results.

Investor confidence may be adversely impacted if we are unable to comply with Section 404 of the Sarbanes-Oxley Act of 2002, and as a result, our stock price could decline.

We are subject to rules adopted by the Securities Exchange Commission, or SEC, pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, or Sarbanes-Oxley Act, which require us to include in our Annual Report on Form 10-K our management's report on, and assessment of the effectiveness of, our internal controls over financial reporting.

If we fail to maintain the adequacy of our internal controls, there is a risk that we will not comply with all of the requirements imposed by Section 404. Moreover, effective internal controls, particularly those related to revenue recognition, are necessary for us to produce reliable financial reports and are important to helping prevent financial fraud. Any of these possible outcomes could result in an adverse reaction in the financial marketplace due to a loss of investor confidence in the reliability of our consolidated financial statements and could result in investigations or sanctions by the SEC, the New York Stock Exchange, or NYSE, or other regulatory authorities or in stockholder litigation. Any of these factors ultimately could harm our business and could negatively impact the market price of our securities. Ineffective control over financial reporting could also cause investors to lose confidence in our reported financial information, which could adversely affect the trading price of our common stock.

Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives. However, our management, including our principal executive officer and principal financial officer, does not expect that our disclosure controls and procedures will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected.

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Our products must conform to industry standards in order to be accepted by end users in our markets.
Generally, our products comprise only a part of a communications device. All components of these devices must uniformly comply with industry standards in order to operate efficiently together. We depend on companies that provide other components of the devices to support prevailing industry standards. Many of these companies are significantly larger and more influential in driving industry standards than we are. Some industry standards may not be widely adopted or implemented uniformly, and competing standards may emerge that may be preferred by our customers or end users. If larger companies do not support the same industry standards that we do, or if competing standards emerge, market acceptance of our products could be adversely affected, which would harm our business.
Products for communications applications are based on industry standards that are continually evolving. Our ability to compete in the future will depend on our ability to identify and ensure compliance with these evolving industry standards. The emergence of new industry standards could render our products incompatible with products developed by other suppliers. As a result, we could be required to invest significant time and effort and to incur significant expense to redesign our products to ensure compliance with relevant standards. If our products are not in compliance with prevailing industry standards for a significant period of time, we could miss opportunities to achieve crucial design wins. We may not be successful in developing or using new technologies or in developing new products or product enhancements that achieve market acceptance. Our pursuit of necessary technological advances may require substantial time and expense.

Risks Relating to Our Class A Common Stock

The dual class structure of our common stock as contained in our charter documents will have the effect of allowing our founders, executive officers, employees and directors and their affiliates to limit your ability to influence corporate matters that you may consider unfavorable.
We sold Class A common stock in our initial public offering. Our founders, executive officers, directors and their affiliates and employees hold shares of our Class B common stock, which is not publicly traded. Until March 29, 2017, the dual class structure of our common stock will have the following effects with respect to the holders of our Class A common stock:

- allows the holders of our Class B common stock to have the sole right to elect two management directors to the Board of Directors;
- with respect to change of control matters, allows the holders of our Class B common stock to have ten votes per share compared to the holders of our Class A common stock who will have one vote per share on these matters; and
- with respect to the adoption of or amendments to our equity incentive plans, allows the holders of our Class B common stock to have ten votes per share compared to the holders of our Class A common stock who will have one vote per share on these matters, subject to certain limitations.

Thus, our dual class structure will limit your ability to influence corporate matters, including with respect to transactions involving a change of control, and, as a result, we may take actions that our stockholders do not view as beneficial, which may adversely affect the market price of our Class A common stock. In addition to the additional voting rights granted to holders of our Class B common stock, which is held principally by certain of our executive officers and founders, we have entered change of control agreements with our executive officers, which could have an adverse effect on a third party’s willingness to consider acquiring us, either because it may be more difficult to retain key employees with change of control benefits or because of the incremental cost associated with these benefits.
The concentration of our capital stock ownership with our founders will limit your ability to influence corporate matters and their interests may differ from other stockholders.
As of December 31, 2015, our founders who are existing employees of the Company, including our Chairman, President and Chief Executive Officer, Dr. Seendripu, together control approximately 10% of our outstanding capital stock, representing approximately 49% of the voting power of our outstanding capital stock with respect to change of control matters and the adoption of or amendment to our equity incentive plans. Dr. Seendripu and the other founders therefore have significant influence over our management and affairs and over all matters requiring stockholder approval, including the election of two Class B directors and significant corporate transactions, such as a merger or other sale of MaxLinear or its assets, for the foreseeable future.

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Our management team may use our available cash, cash equivalents, and liquid investment assets in ways with which you may not agree or in ways which may not yield a return.

We use our cash, cash equivalents, and liquid investment assets for general corporate purposes, including working capital. We may also use a portion of these assets to acquire complementary businesses, products, services or technologies. Our management has considerable discretion in the application of our cash, cash equivalents, and investment resources, and you will not have the opportunity to assess whether these liquid assets are being used in a manner that you deem best to maximize your return. We may use our available resources for corporate purposes that do not increase our operating results or market value. In addition, our cash, cash equivalents, and liquid investment resources may be placed in investments that do not produce significant income or that may lose value

Anti-takeover provisions in our charter documents and under Delaware law could make an acquisition of us more difficult, limit attempts by our stockholders to replace or remove our current management and limit the market price of our Class A common stock.

Provisions in our certificate of incorporation and bylaws, as amended and restated, may have the effect of delaying or preventing a change of control or changes in our management. These provisions provide for the following:

- authorize our Board of Directors to issue, without further action by the stockholders, up to 25,000,000 shares of undesignated preferred stock;
- require that any action to be taken by our stockholders be effected at a duly called annual or special meeting and not by written consent;
- specify that special meetings of our stockholders can be called only by our Board of Directors, our Chairman of the Board of Directors, our President or by unanimous written consent of our directors appointed by the holders of Class B common stock;
- establish an advance notice procedure for stockholder approvals to be brought before an annual meeting of our stockholders, including proposed nominations of persons for election to our Board of Directors;
- establish that our Board of Directors is divided into three classes, Class I, Class II and Class III, with each class serving staggered terms and with one Class B director being elected to each of Classes II and III;
- provide for a dual class common stock structure, which provides our founders, current investors, executives and employees with significant influence over all matters requiring stockholder approval, including the election of directors and significant corporate transactions, such as a merger or other sale of our Company or its assets;
- provide that our directors may be removed only for cause;
- provide that vacancies on our Board of Directors may be filled only by a majority of directors then in office, even though less than a quorum, other than any vacancy in the two directorships reserved for the designees of the holders of Class B common stock, which may be filled only by the affirmative vote of the holders of a majority of the outstanding Class B common stock or by the remaining director elected by the Class B common stock (with the consent of founders holding a majority in interest of the Class B common stock over which the founders then exercise voting control);
- specify that no stockholder is permitted to cumulate votes at any election of directors; and
- require supermajority votes of the holders of our common stock to amend specified provisions of our charter documents.

These provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our Board of Directors, which is responsible for appointing the members of our management. In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which generally prohibits a Delaware corporation from engaging in any of a broad range of business combinations with any “interested” stockholder for a period of three years following the date on which the stockholder became an “interested” stockholder.

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Our share price may be volatile as a result of limited trading volume and other factors.

Our shares of Class A common stock began trading on the New York Stock Exchange in March 2010. An active public market for our shares on the New York Stock Exchange may not be sustained. In particular, limited trading volumes and liquidity may limit the ability of stockholders to purchase or sell our common stock in the amounts and at the times they wish. Trading volume in our Class A common stock tends to be modest relative to our total outstanding shares, and the price of our Class A common stock may fluctuate substantially (particularly in percentage terms) without regard to news about us or general trends in the stock market. An inactive market may also impair our ability to raise capital to continue to fund operations by selling shares and may impair our ability to acquire other companies or technologies by using our shares as consideration.

In addition, the trading price of our Class A common stock could become highly volatile and could be subject to wide fluctuations in response to various factors, some of which are beyond our control. These factors include those discussed in this “Risk Factors” section of this Annual Report on Form 10-K and others such as:

- actual or anticipated fluctuations in our financial condition and operating results;
- overall conditions in the semiconductor market;
- addition or loss of significant customers;
- changes in laws or regulations applicable to our products;
- actual or anticipated changes in our growth rate relative to our competitors;
- announcements of technological innovations by us or our competitors;
- announcements by us or our competitors of significant acquisitions, strategic partnerships, joint ventures or capital commitments;
- additions or departures of key personnel;
- competition from existing products or new products that may emerge;
- issuance of new or updated research or reports by securities analysts;
- fluctuations in the valuation of companies perceived by investors to be comparable to us;
- disputes or other developments related to proprietary rights, including patents, litigation matters and our ability to obtain intellectual property protection for our technologies;
- the recently completed acquisition of Entropic may not be accretive and may cause dilution to our earnings per shares;
- announcement or expectation of additional financing efforts;
- sales of our Class A or Class B common stock by us or our stockholders;
- share price and volume fluctuations attributable to inconsistent trading volume levels of our shares; and
- general economic and market conditions.

Furthermore, the stock markets recently have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many companies. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. These broad market and industry fluctuations, as well as general economic, political and market conditions such as recessions, interest rate changes or international currency fluctuations, may negatively impact the market price of our Class A common stock. In the past, companies that have experienced volatility in the market price of their stock have been subject to securities class action litigation. We may be the target of this type of litigation in the future. Securities litigation against us could result in substantial costs and divert our management’s attention from other business concerns, which could seriously harm our business.

If securities or industry analysts do not publish research or reports about our business, or publish negative reports about our business, especially due to our dual-class voting structure, our share price and trading volume could decline.

The trading market for our Class A common stock depends in part on the research and reports that securities or industry analysts publish about us or our business, especially with respect to our unique dual-class voting structure as to the election of directors, change of control matters and matters related to our equity incentive plans. We do not have any control over these analysts. If one or more of the analysts who cover us downgrade our shares or change their opinion of our shares, our share price would likely decline. If one or more of these analysts cease coverage of our Company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which could cause our share price or trading volume to decline.

Future sales of our Class A common stock in the public market could cause our share price to decline.

Sales of a substantial number of shares of our Class A common stock in the public market, or the perception that these sales might occur, could depress the market price of our Class A common stock and could impair our ability to raise capital through the sale of additional equity securities. As of December 31, 2015, we had 55.7 million shares of Class A common stock and 6.7 million shares of Class B common stock outstanding.

All shares of Class A common stock are freely tradable without restrictions or further registration under the Securities Act of 1933, as amended, or the Securities Act, except for any shares held by our affiliates as defined in Rule 144 under the Securities Act.

We have filed registration statements on Form S-8 under the Securities Act to register 18.9 million shares of our Class A common stock for issuance under our 2010 Equity Incentive Plan and 2010 Employee Stock Purchase Plan in addition to 3.2 million awards that were assumed and remain outstanding in connection with the Entropic acquisition. These shares may be freely sold in the public market upon issuance and once vested, subject to other restrictions provided under the terms of the applicable plan and/or the option agreements entered into with option holder.

Our Executive Incentive Bonus Plan permits the settlement of awards under the plan in the form of shares of its Class A common stock. For the 2013 performance period, actual awards under the Executive Incentive Bonus Plan were settled in Class A common stock issued under our 2010 Equity Incentive Plan, as amended, with the number of shares issuable to plan participants determined based on the closing sales price of our Class A common stock as determined in trading on the New York Stock Exchange on May 9, 2014. Additionally, we settled all bonus awards for all other employees for the 2013 performance period in shares of its Class A common stock. We issued 0.6 million shares of our Class A common stock for the 2013 performance period upon settlement of the bonus awards on May 9, 2014. We issued 0.2 million shares of our Class A common stock for the 2014 performance period upon settlement of the bonus awards on May 14, 2015. We issued 0.3 million shares of our Class A common stock for the January 1, 2015 to June 30, 2015 performance period upon settlement of the bonus awards on August 20, 2015. We expect to issue shares of our Class A common stock for the July 1, 2015 to December 31, 2015 performance period upon settlement of the bonus awards in May 2016.These shares may be freely sold in the public market immediately following the issuance of such shares and the issuance of such shares may have an adverse effect on our share price once they are issued.

We do not intend to pay dividends for the foreseeable future.

We have never declared or paid any cash dividends on our common stock and do not intend to pay any cash dividends in the foreseeable future. We anticipate that we will retain all of our future earnings for use in the development of our business and for general corporate purposes. Any determination to pay dividends in the future will be at the discretion of our Board of Directors. Accordingly, investors must rely on sales of their Class A common stock after price appreciation, which may never occur, as the only way to realize any future gains on their investments.

Risks Relating to Our Acquisition of Entropic

Actual financial and operating results could differ materially from any expectations or guidance provided by us concerning future results, including (without limitation) expectations or guidance with respect to the financial impact of any cost savings and other potential synergies resulting from our acquisition of Entropic.

We currently expect to continue realizing material cost savings and other synergies as a result of our acquisition of Entropic, and as a result, we currently believe that the acquisition will continue to be accretive to our earnings per share, excluding upfront non-recurring charges, transaction related expenses, and the amortization of purchased intangible assets. The expectations and guidance we have provided with respect to the potential financial impact of the acquisition are subject to numerous assumptions, however, including assumptions derived from our diligence efforts concerning the status of and prospects for Entropic’s business, and assumptions relating to the near-term prospects for the semiconductor industry generally

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and the markets for the legacy Entropic products in particular. Additional assumptions we have made relate to numerous matters, including (without limitation) the following:

- projections of future revenues in the legacy Entropic businesses;
- the anticipated financial performance of legacy Entropic products and products currently in development;
- anticipated cost savings and other synergies associated with the acquisition, including potential revenue synergies;
- the amount of goodwill and intangibles that will result from the acquisition;
- certain other purchase accounting adjustments that we have recorded in our financial statements in connection with the acquisition;
- acquisition costs, including restructuring charges and transactions costs payable to our financial, legal, and accounting advisors; and
- our ability to maintain, develop, and deepen relationships with customers of the legacy Entropic business.

We cannot provide any assurances with respect to the accuracy of our assumptions, including our assumptions with respect to future revenues or revenue growth rates, if any, of the legacy Entropic business, and we cannot provide assurances with respect to our ability to realize further cost savings. Risks and uncertainties that could cause our actual results to differ materially from currently anticipated results include, but are not limited to, risks relating to our ability to integrate the legacy Entropic business successfully; currently unanticipated additional incremental costs that we may incur in connection with integrating the two companies; risks relating to our ability to continue to realize incremental revenues from the acquisition in the amounts that we currently anticipate; risks relating to the willingness of legacy Entropic customers and other partners to continue to conduct business with MaxLinear; and numerous risks and uncertainties that affect the semiconductor industry generally and the markets for our products and those of the legacy Entropic business specifically. Any failure to integrate the legacy Entropic business successfully and to continue to realize the financial benefits we currently anticipate from the acquisition would have a material adverse impact on our future operating results and financial condition and could materially and adversely affect the trading price or trading volume of our Class A common stock.

Failure to integrate our business and operations successfully with those of Entropic in the expected time-frame or otherwise may adversely affect our operating results and financial condition.

We do not have a substantial history of acquiring other companies and had never pursued an acquisition of the size and complexity of Entropic. The success of the acquisition of Entropic depends, in substantial part, on our ability to integrate Entropic’s business and operations successfully with those of MaxLinear and to realize fully the anticipated benefits and potential synergies from combining our companies, including, among others, cost savings from eliminating duplicative functions; operational efficiencies in our respective supply chains and in research and development investments; and revenue growth resulting from the addition of Entropic’s product portfolio. If we are unable to achieve these objectives, the anticipated benefits and potential synergies from the acquisition may not be realized fully, or may take longer to realize than expected. Any failure to timely realize these anticipated benefits would have a material adverse effect on our business, operating results, and financial condition.

We completed our acquisition of Entropic in April 2015. While we believe the integration process is substantially complete, we cannot ensure that remaining integration objectives will not adversely affect our operating results. In connection with the integration process, we could experience the loss of key customers, decreases in revenues relative to current expectations and increases in operating costs, as well as the disruption of our ongoing businesses, any or all of which could limit our ability to achieve the anticipated benefits and potential synergies from the acquisition and have a material adverse effect on our business, operating results, and financial condition.

Our business relationships, including customer relationships, and those of Entropic may be subject to disruption due to uncertainty associated with the acquisition.

In response to the completion of the acquisition, customers, vendors, licensors, and other third parties with whom we do business or Entropic did business or otherwise have relationships may experience uncertainty associated with the acquisition, and this uncertainty could materially affect their decisions with respect to existing or future business relationships with us. Moreover, with respect to Entropic’s prior acquisition of certain television and set-top box assets from Trident Microsystems, Inc., or Trident, we were unable to conduct substantial diligence with respect to certain licenses and intellectual property rights

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because Entropic acquired these assets through Trident's bankruptcy proceedings. As a result, we are in many instances unable to evaluate the impact of the acquisition on certain assumed contract rights and obligations, including intellectual property rights.

These business relationships may be subject to disruption as customers and others may elect to delay or defer purchase or design-win decisions or switch to other suppliers due to the uncertainty about the direction of our offerings, any perceived unwillingness on our part to support existing legacy Entropic products, or any general perceptions by customers or other third parties that impute operational or business challenges to us arising from the acquisition. In addition, customers or other third parties may attempt to negotiate changes in existing business relationships, which may result in additional obligations imposed on us. These disruptions could have a material adverse effect on our business, operating results, and financial condition. Any loss of customers, customer products, design win opportunities, or other important strategic relationships could have a material adverse effect on our business, operating results, and financial condition and could have a material and adverse effect on the trading price or trading volume of our Class A common stock.

We have incurred and expect to continue to incur substantial expenses related to the integration of MaxLinear and Entropic.

We have incurred and expect to continue to incur substantial expenses in connection with integrating the operations, technologies, and business systems of MaxLinear and Entropic. Business systems integration between the two companies requires, and we expect it to continue to require into the foreseeable future, substantial management attention, including integration of information management, purchasing, accounting and finance, sales, and regulatory compliance functions. Numerous factors, many of which, are beyond our control, could affect the total cost or the timing of expected integration expenses. Moreover, many of the expenses that will be incurred are by their nature difficult to estimate accurately at the present time. These expenses could reduce the savings that we expect to achieve from the elimination of duplicative expenses and the realization of economies of scale and cost savings related to the integration of the businesses. These integration expenses have resulted in MaxLinear's taking significant charges against earnings following the completion of the acquisition.

We have recorded goodwill that could become impaired and adversely affect our future operating results.

The acquisition is accounted for as an acquisition by MaxLinear in accordance with accounting principles generally accepted in the United States. Under the acquisition method of accounting, the assets and liabilities of Entropic have been recorded, as of completion, at their respective fair values and added to our assets and liabilities. Our reported financial condition and results of operations after completion of the acquisition reflect Entropic's balances and results but are not restated retroactively to reflect the historical financial position or results of operations of Entropic for periods prior to the acquisition. As a result, comparisons of future results against prior period results will be more difficult for investors.

Under the acquisition method of accounting, the total purchase price is allocated to Entropic's tangible assets and liabilities and identifiable intangible assets based on their fair values as of the date of completion of the acquisition. The excess of the purchase price over those fair values is recorded as goodwill. The acquisition has resulted in the creation of goodwill based upon the application of the acquisition method of accounting. To the extent the value of goodwill or intangibles becomes impaired, we may be required to incur material charges relating to such impairment. Any such impairment charge could have a material impact on our operating results in future periods, and the announcement of a material impairment could have an adverse effect on the trading price and trading volume of our Class A common stock. For example, in the quarter ended December 31, 2015, we recognized IPR&D impairment losses of $21.6 million related principally to acquired Entropic assets. As of December 31, 2015, our balance sheet reflected goodwill of $49.8 million, and we could recognize impairment charges in the future.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our corporate headquarters occupy approximately 68,000 square feet in Carlsbad, California under a lease that expires in June 2022. A full range of business and engineering functions are represented at our corporate headquarters, including a laboratory for research and development and manufacturing operations. On November 11, 2015, we entered into a real property

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lease with The Northwestern Mutual Life Insurance Company, a Wisconsin corporation, with respect to the lease of approximately 50,235 square feet of office and laboratory space located at 50 Parker in Irvine, California. We expect to relocate our current operations in Irvine, California to the new facility in 2016. In addition to our principal office spaces in Carlsbad, we have leased facilities in Irvine, California; Bangalore in India; Singapore; Taiwan; and Shenzhen in China.

ITEM 3. LEGAL PROCEEDINGS

Entropic Communications Merger Litigation

The Delaware Actions

Beginning on February 9, 2015, eleven stockholder class action complaints (captioned Langholz v. Entropic Communications, Inc., et al., C.A. No. 10631-VCP (filed Feb. 9, 2015); Tomblin v. Entropic Communications, Inc., C.A. No. 10632-VCP (filed Feb. 9, 2015); Crill v. Entropic Communications, Inc., et al., C.A. No. 10640-VCP (filed Feb. 11, 2015); Wohl v. Entropic Communications, Inc., et al., C.A. No. 10644-VCP (filed Feb. 11, 2015); Parshall v. Entropic Communications, Inc., et al., C.A. No. 10652-VCP (filed Feb. 12, 2015); Saggar v. Padval, et al., C.A. No. 10661-VCP (filed Feb. 13, 2015); Iyer v. Tewksbury, et al., C.A. No. 10665-VCP (filed Feb. 13, 2015); Respler v. Entropic Communications, Inc., et al., C.A. No. 10669-VCP (filed Feb. 17, 2015); Gal v. Entropic Communications, Inc., et al., C.A. No. 10671-VCP (filed Feb. 17, 2015); Werbowsky v. Padval, et al., C.A. No. 10673-VCP (filed Feb. 18, 2015); and Agosti v. Entropic Communications, Inc., C.A. No. 10676-VCP (filed Feb. 18, 2015)) were filed in the Court of Chancery of the State of Delaware on behalf of a putative class of Entropic Communications, Inc. stockholders. The complaints name Entropic, the board of directors of Entropic, MaxLinear, Excalibur Acquisition Corporation, and Excalibur Subsidiary, LLC as defendants. The complaints generally allege that, in connection with the proposed acquisition of Entropic by MaxLinear, the individual defendants breached their fiduciary duties to Entropic stockholders by, among other things, purportedly failing to take steps to maximize the value of Entropic to its stockholders and agreeing to allegedly preclusive deal protection devices in the merger agreement. The complaints further allege that Entropic, MaxLinear, and/or the merger subsidiaries aided and abetted the individual defendants in the alleged breaches of their fiduciary duties. The complaints seek, among other things, an order enjoining the defendants from consummating the proposed transaction, an order declaring the merger agreement unlawful and unenforceable, in the event that the proposed transaction is consummated, an order rescinding it and setting it aside or awarding rescissory damages to the class, imposition of a constructive trust, damages, and/or attorneys' fees and costs.
On March 27, 2015, plaintiffs Ankur Saggar, Jon Werbowsky, and Angelo Agosti filed an amended class action complaint. Also on March 27, 2015, plaintiffs Martin Wohl and Jeffrey Park filed an amended class action complaint. On April 1, 2015, plaintiff Mark Respler filed an amended class action complaint.

On April 16, 2015, the Court entered an order consolidating the Delaware actions, captioned In re Entropic Communications, Inc. Consolidated Stockholders Litigation, C.A. No. 10631-VCP (the "Consolidated Action"). The April 16, 2015 order appointed plaintiffs Rama Iyer and Jon Werbowsky as Co-Lead Plaintiffs and designated the amended complaint filed by plaintiffs Ankur Saggar, Jon Werbowsky, and Angelo Agosti as the operative complaint (the "Amended Complaint").

The Amended Complaint names as defendants Entropic, the board of directors of Entropic, the Company, Excalibur Acquisition Corporation, and Excalibur Subsidiary, LLC. The Amended Complaint generally alleges that, in connection with the proposed acquisition of Entropic by the Company, the individual defendants breached their fiduciary duties to Entropic stockholders by, among other things, purportedly failing to maximize the value of Entropic to its stockholders, engaging in a purportedly unfair and conflicted sale process, agreeing to allegedly preclusive deal protection devices in the merger agreement, and allegedly misrepresenting and/or failing to disclose all material information in connection with the proposed transaction. The Amended Complaint further alleges that the Company and the merger subsidiaries aided and abetted the individual defendants in the alleged breaches of their fiduciary duties. The Amended Complaint seeks, among other things: an order declaring the merger agreement unlawful and unenforceable, an order rescinding, to the extent already implemented, the merger agreement, an order enjoining defendants from consummating the proposed transaction, imposition of a constructive trust, and attorneys' and experts' fees and costs.

On April 24, 2015, the parties to the Consolidated Action entered into a memorandum of understanding regarding a proposed settlement of the Delaware actions. The proposed settlement is subject to negotiation of the settlement papers by the parties and is subject to court approval after notice and an opportunity to object is provided to the proposed settlement class. There can be no assurance that the parties will reach agreement regarding the final terms of the settlement agreement or that the Court of Chancery will approve the settlement.

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Based on the above, we have determined that an unfavorable outcome is probable or reasonably possible; or determined that the amount or range of any possible loss is reasonably estimable. The reasonably estimable loss is not material.

CrestaTech Litigation

On January 21, 2014, CrestaTech Technology Corporation, or CrestaTech, filed a complaint for patent infringement against us in the United States District Court of Delaware (the “District Court Litigation”). In its complaint, CrestaTech alleges that we infringe U.S. Patent Nos. 7,075,585 (the “’585 Patent”) and 7,265,792. In addition to asking for compensatory damages, CrestaTech alleges willful infringement and seeks a permanent injunction. CrestaTech also names Sharp Corporation, Sharp Electronics Corp. and VIZIO, Inc. as defendants based upon their alleged use of our television tuners. On January 28, 2014, CrestaTech filed a complaint with the U.S. International Trade Commission, or ITC, again naming, among others, us, Sharp, Sharp Electronics, and VIZIO (“the “ITC Investigation”). On May 16, 2014 the ITC granted CrestaTech’s motion to file an amended complaint adding six OEM Respondents, namely, SIO International, Inc., Hon Hai Precision Industry Co., Ltd., Wistron Corp., Wistron Infocomm Technology (America) Corp., Top Victory Investments Ltd. and TPV International (USA), Inc. (collectively, with us, Sharp and VIZIO, the “Company Respondents”). CrestaTech’s ITC complaint alleged a violation of 19 U.S.C. § 1337 through the importation into the United States, the sale for importation, or the sale within the United States after importation of the Company’s accused products that CrestaTech alleges infringe the same two patents asserted in the Delaware action. Through its ITC complaint, CrestaTech sought an exclusion order preventing entry into the United States of certain of our television tuners and televisions containing such tuners from Sharp, Sharp Electronics, and VIZIO. CrestaTech also sought a cease and desist order prohibiting the Company Respondents from engaging in the importation into, sale for importation into, the sale after importation of, or otherwise transferring within the United States certain of our television tuners or televisions containing such tuners.

On December 1-5, 2014, the ITC held a trial in the ITC Investigation. On February 27, 2015, the Administrative Law Judge issued a written Initial Determination (“ID”), ruling that the Company Respondents do not violate Section 1337 in connection with CrestaTech’s asserted patents because CrestaTech failed to satisfy the economic prong of the domestic industry requirement pursuant to Section 1337(a)(2). In addition, the ID stated that certain of our television tuners and televisions incorporating those tuners manufactured and sold by certain customers infringe three claims of the ‘585 Patent, and these three claims were not determined to be invalid. On April 30, 2015, the ITC issued a notice indicating that it intended to review portions of the ID finding no violation of Section 1337, including the ID’s findings of infringement with respect to, and validity of, the ‘585 Patent, and the ID’s finding that CrestaTech failed to establish the existence of a domestic industry within the meaning of Section 1337.

The ITC has subsequently issued its opinion, which terminated its investigation. The opinion affirmed the findings of the administrative law judge that no violation of Section 1337 had occurred because CrestaTech had failed to establish the economic prong of the domestic industry requirement. The ITC also affirmed the administrative law judge's finding of infringement with respect to the three claims of the '585 Patent that were not held to be invalid. On November 30, 2015, CrestaTech filed an appeal of the ITC decision with the United States Court of Appeals for the Federal Circuit (the "Federal Circuit").

The District Court Litigation remains stayed pending resolution of the appeal to the ITC. In addition, we have filed four petitions for inter partes review ("IPR") by the US Patent Office of the two CrestaTech patents asserted against us. The Patent Trial and Appeal Board (“PTAB”) did not institute two of these IPRs as being redundant to IPRs filed by another party that are already underway for the same CrestaTech patent. The remaining two petitions were instituted or instituted-in-part and, together with the IPRs filed by third parties, there are currently six IPR proceedings filed involving the two CrestaTech patents asserted against us. In October 2015, the PTAB issued final decisions in two of the six IPR proceedings, holding that all of the reviewed claims are unpatentable. Included in these decisions was one of the three claims mentioned above. CrestaTech is appealing the PTAB’s decisions at the Federal Circuit.

We cannot predict the outcome of any appeal by CrestaTech, the District Court Litigation, or the IPRs. Any adverse determination in the District Court Litigation could have a material adverse effect on our business and operating results.

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Other Matters

In addition, from time to time, we are subject to threats of litigation or actual litigation in the ordinary course of business, some of which may be material. Other than the Entropic and CrestaTech litigation described above, we believe that there are no other currently pending matters that, if determined adversely to us, would have a material effect on our business or that would not be covered by our existing liability insurance maintained by us.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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PART II — FINANCIAL INFORMATION

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information and Holders

In March 2010, we completed the initial public offering of our Class A common stock. Our Class A common stock is traded on the New York Stock Exchange, or the NYSE, under the symbol MXL. The following table sets forth, for the periods indicated, the high and low sale prices for our Class A common stock as reported by the NYSE:

	Year Ended December 31, 2015	
	High	Low
First Quarter (January 1, 2015 to March 31, 2015)	$9.21	$7.15
Second Quarter (April 1, 2015 to June 30, 2015)	$13.33	$8.06
Third Quarter (July 1, 2015 to September 30, 2015)	$12.96	$9.00
Fourth Quarter (October 1, 2015 to December 31, 2015)	$17.75	$11.76
	Year Ended December 31, 2014	
	High	Low
First Quarter (January 1, 2014 to March 31, 2014)	$11.32	$8.94
Second Quarter (April 1, 2014 to June 30, 2014)	$10.33	$7.74
Third Quarter (July 1, 2014 to September 30, 2014)	$10.80	$6.63
Fourth Quarter (October 1, 2014 to December 31, 2014)	$8.09	$6.25

On December 31, 2015, the last reported sales price of our common stock was $14.73 and, according to our transfer agent, as of February 10, 2016, there were 83 record holders of our Class A common stock and 49 record holders of our Class B common stock.

Our Class B common stock is not publicly traded. Each share of Class B common stock is convertible at any time at the option of the holder into one share of Class A common stock and in most instances automatically converts upon sale or other transfer.

Dividend Policy

We have never declared or paid cash dividends on our common stock. We currently intend to retain all available funds and any future earnings for use in the operation of our business and do not anticipate paying any dividends on our common stock in the foreseeable future. Any future determination to declare dividends will be made at the discretion of our Board of Directors and will depend on our financial condition, operating results, capital requirements, general business conditions and other factors that our Board of Directors may deem relevant.

Stock Performance Graph

Notwithstanding any statement to the contrary in any of our previous or future filings with the SEC, the following information relating to the price performance of our common stock shall not be deemed "filed" with the SEC or "Soliciting Material" under the Exchange Act, or subject to Regulation 14A or 14C, or to liabilities of Section 18 of the Exchange Act except to the extent we specifically request that such information be treated as soliciting material or to the extent we specifically incorporate this information by reference.

The graph below compares the cumulative total stockholder return on our Class A common stock with the cumulative total return on The NYSE Composite Index and The Philadelphia Semiconductor Index. The period shown commences on March 23, 2010 and ends on December 31, 2015, the end of our last fiscal year. The graph assumes an investment of $100 on March 23, 2010, and the reinvestment of any dividends. In addition, the graph assumes the value of our common stock on March 23, 2010 was the initial public offering price of $14.00 per share.

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The comparisons in the graph below are required by the Securities and Exchange Commission and are not intended to forecast or be indicative of possible future performance of our common stock.

Recent Sales of Unregistered Securities

In the year ended December 31, 2015, we issued an aggregate of 0.2 million shares of our Class B common stock to certain employees upon the exercise of options awarded under our 2004 Stock Plan. We received aggregate proceeds of approximately $0.4 million in the year ended December 31, 2015 as a result of the exercise of these options. We believe these transactions were exempt from the registration requirements of the Securities Act in reliance on Rule 701 thereunder as transactions pursuant to compensatory benefit plans and contracts relating to compensation as provided under Rule 701. As of December 31, 2015, options to purchase an aggregate of 1.5 million shares of our Class B common stock remain outstanding. All issuances of shares of our Class B common stock pursuant to the exercise of these options will be made in reliance on Rule 701. All option grants made under the 2004 Stock Plan were made prior to the effectiveness of our initial public offering. No further option grants will be made under our 2004 Stock Plan.

None of the foregoing transactions involved any underwriters, underwriting discounts or commissions, or any public offering.

Each share of our Class B common stock is convertible at any time at the option of the holder into one share of our Class A common stock. In addition, each share of our Class B common stock will convert automatically into one share of Class A common stock upon any transfer, whether or not for value, except for certain transfers described in our certificate of incorporation.

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ITEM 6. SELECTED FINANCIAL DATA

We have derived the selected consolidated statement of operations data for the years ended December 31, 2015, 2014 and 2013 and selected consolidated balance sheet data as of December 31, 2015 and 2014 from our consolidated financial statements and related Notes included elsewhere in this report. We have derived the statement of operations data for the years ended December 31, 2012 and 2011 and the balance sheet data as of December 31, 2013, 2012 and 2011 from our consolidated financial statements not included in this report. Our historical results are not necessarily indicative of the results to be expected for any future period. The following selected consolidated financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes included elsewhere in this report.

	Years Ended December 31,				
	2015	2014	2013	2012	2011
	(in thousands, except per share amounts)				
Consolidated Statement of Operations Data:					
Net revenue	$300,360	$133,112	$119,646	$97,728	$71,937
Cost of net revenue	144,937	51,154	46,683	37,082	26,690
Gross profit	155,423	81,958	72,963	60,646	45,247
Operating expenses:					
Research and development	85,405	56,625	53,132	46,458	40,157
Selling, general and administrative	77,981	34,191	32,181	27,254	20,216
Impairment loss	21,600	—	—	—	—
Restructuring expense	14,086	—	—	—	—
Total operating expenses	199,072	90,816	85,313	73,712	60,373
Loss from operations	(43,649)	(8,858)	(12,350)	(13,066)	(15,126)
Interest income	275	236	222	282	292
Other income (expense), net	468	(123)	(203)	(127)	(197)
Loss before income taxes	(42,906)	(8,745)	(12,331)	(12,911)	(15,031)
Provision (benefit) for income taxes	(575)	(1,704)	402	341	6,993
Net loss	(42,331)	(7,041)	(12,733)	(13,252)	(22,024)
Net loss attributable to common stockholders:	$(42,331)	$(7,041)	$(12,733)	$(13,252)	$(22,024)
Net loss per share attributable to common stockholders:					
Basic	$(0.79)	$(0.19)	$(0.37)	$(0.40)	$(0.68)
Diluted	$(0.79)	$(0.19)	$(0.37)	$(0.40)	$(0.68)
Shares used to compute net loss per share:					
Basic	53,378	36,472	34,012	33,198	32,573
Diluted	53,378	36,472	34,012	33,198	32,573

	As of December 31,				
	2015	2014	2013	2012	2011
	(in thousands)				
Consolidated Balance Sheet Data:					
Cash, cash equivalents and short- and long-term investments, available-for-sale	$130,498	$79,351	$86,354	$77,256	$85,736
Working capital	134,170	67,668	56,558	68,450	76,585
Total assets	334,505	135,711	124,929	110,597	112,376
Capital lease obligations, net of current portion	—	—	—	—	2
Total stockholders' equity	262,924	99,102	86,674	80,233	93,025

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

The following discussion and analysis of the financial condition and results of our operations should be read in conjunction with the consolidated financial statements and related notes included elsewhere in this report. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those discussed below. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section titled “Risk Factors” included elsewhere in this report.

Overview

We are a provider of radio frequency, or RF, and mixed-signal integrated circuits for cable and satellite broadband communications, the connected home, and for data center, metro, and long-haul fiber networks. Our high performance RF receiver products capture and process digital and analog broadband signals to be decoded for various applications. These products include both RF receivers and RF receiver systems-on-chip (SoCs), which incorporate our highly integrated radio system architecture and the functionality necessary to receive and demodulate broadband signals, and physical medium devices that provide a constant current source, current-to-voltage regulation, and data alignment and retiming functionality in optical interconnect applications. Through our acquisition of Entropic Communications, Inc., or Entropic, in April of 2015, we provide semiconductor solutions for the connected home, ranging from MoCA® (Multimedia over Coax Alliance) solutions that transform how traditional HDTV broadcast and Internet Protocol- (IP) based streaming video content is seamlessly, reliably, and securely delivered, processed, and distributed into and throughout the home. Our products enable the reception, distribution and display of broadband video and data content in a wide range of electronic devices, including Pay-TV operator set-top boxes and voice and data gateways, hybrid analog and digital televisions and consumer terrestrial set-top boxes, Direct Broadcast Satellite outdoor units, and optical modules for data center, metro, and long-haul transport network applications.

Our net revenue has grown from approximately $0.6 million in fiscal 2006 to $300.4 million in fiscal 2015. In fiscal 2015, our net revenue was derived primarily from sales of RF receivers and RF receiver systems-on-chip and MoCA connectivity solutions into operator voice and data modems and gateways and global analog and digital RF receiver products for analog and digital television applications. These analog and digital serif size=1>substantially all assets Preferred stock, stock and common convertible, Series A; equity Senior secured note, 12.50% due 12/31/2012

Name of Portfolio Company	Nature of its Principal Business (Location)	Title and Class of Securities Held	Collateral Held	Investment Structure
Companies 5% to 25% owned				
Appalachian Energy Holdings, LLC	Construction services (West Virginia)	Senior secured debt, preferred equity with penny warrants	First priority lien on substantially all assets	Preferred shares; Warrants, preferr shares, expiring 2/14/2016; Warrants, commo shares, expiring 2/14/2016; Senior secured no 14.00%, 3.00% PI

				2/14/2011
Iron Horse Coiled Tubing, Inc.	Production services (Alberta, Canada)	Senior secured debt and common stock	First priority lien on substantially all assets	Common shares; Senior secured no 15.00% due 4/19/
Companies less than 5% owned				
Arctic Acquisition Corp.	Production services (Texas)	Senior secured debt with warrants for common and preferred	First priority lien on substantially all assets	Warrants, commo shares, expiring 7/19/2012; Warrants, preferr shares, expiring 7/19/2012; Senior secured no 13.00% due 6/15/
Miller Petroleum, Inc.	Oil and gas production (Tennessee)	Senior secured debt and warrants	N/A loan repaid	Warrants, expirin 5/4/2010, through 9/30/2011
Stryker Energy II, LLC	Oil and gas production (Ohio)	Senior secured debt	First priority lien on substantially all assets	Senior secured te note, 12.33% due 11/30/2011
Unity Virginia Holdings LLC	Coal mining (Virginia)	Secured subordinated debt	Second priority lien on substantially all assets, subject to first priority lien of senior lender, PlainsCapital Bank	Subordinated sec note, due 1/31/20
Charlevoix Energy Trading, LLC	Natural gas marketing (Michigan)	Senior secured debt	First priority lien on substantially all assets	Net profits royalty interest, 10%; Senior secured no 12.5% due 3/31/1
Central Illinois Energy, LLC	Biofuels/Ethanol (Illinois)	Senior secured debt	First priority lien on substantially all assets	Senior secured no 15.36% due 3/31/
Conquest Cherokee LLC	Oil and gas production (Tennessee)	Senior secured debt	First priority lien on substantially all assets	Overriding royalty interest, 5-10%; Senior secured no 13.00% due 5/5/0
Evolution Petroleum Corp.	Oil and Gas Production (Texas)	Common shares	None	Common shares
TLOGH, L.P.	Oil and Gas Production (Texas)	Senior secured debt	First priority lien on substantially all assets	Senior secured no 13.00% due 10/23
Jettco Marine Services LLC	Shipping (Louisiana)	Subordinated secured debt	Second priority lien on substantially all assets	Subordinated sec note 12.00% plus PIK due 12/31/20
C&J Cladding LLC	Metal services (Texas)	Senior secured debt	First priority lien on substantially all assets	Senior secured no 14.00% due 03/31

DETERMINATION OF NET ASSET VALUE

The net asset value per share of our outstanding shares of common stock will be determined quarterly by dividing the value of total assets minus liabilities by the total number of shares outstanding.

In calculating the value of our total assets, we will value investments for which market quotations are readily available at such market quotations. Short-term investments which mature in 60 days or less, such as U.S. Treasury bills, are valued at amortized cost, which approximates market value. The amortized cost method involves valuing a security at its cost on the date of purchase and thereafter assuming a constant amortization to maturity of the difference between the principal amount due at maturity and cost. Short-term securities which 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.

It is expected that most of the investments in the Company's portfolio will not have readily available market values. Debt and equity securities whose market price is not readily available are valued at fair value, with the assistance of an independent valuation service, using a valuation policy and a consistently applied valuation process which is under the direction of our Board of Directors. Due to the inherent uncertainty of determining the fair value of investments that do not have a readily available market value, the fair value of our investments may differ significantly from the values that would have been used had a ready market existed for such investments, and the differences could be material. For a discussion of the risks inherent in determining the value of securities for which readily available market values do not exist, see "Risk Factors—Most of our portfolio investments are recorded at fair value as determined in good faith by our Board of Directors and, as a result, there is uncertainty as to the value of our portfolio investments."

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 financial environment in which the portfolio company operates, comparisons to securities of similar publicly traded companies and other relevant factors. Due to the inherent uncertainty of determining the fair value of investments that do not have a readily available market value, the fair value of these investments may differ significantly from the values that would have been used had a ready market existed for such investments, and any such differences could be material.

As part of the fair valuation process, the Audit Committee reviews the preliminary evaluations prepared by the independent valuation firm engaged by the Board of Directors, as well as management's valuation recommendations. Management and the independent valuation firm respond to the preliminary evaluation to reflect comments provided by the Audit Committee. The Audit Committee reviews the final valuation report and management's valuation recommendations and makes a recommendation to the Board of Directors based on its analysis of the methodologies employed and the various weights that should be accorded to each portion of the valuation as well as factors that the independent valuation firm and management may not have included in their evaluation processes. The Board of Directors then evaluates the Audit Committee recommendations and undertakes a similar analysis to determine the fair value of each investment in the portfolio in good faith.

Determination of fair values involves subjective judgments and estimates not susceptible to substantiation by auditing procedures. Accordingly, under current auditing standards, the notes to our financial statements will refer to the uncertainty with respect to the possible effect of such valuations, and any change in such valuations, on our financial statements.

DIVIDEND REINVESTMENT PLAN

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

No action is required on the part of a registered stockholder to have their cash dividend reinvested in shares of our common stock. A registered stockholder may elect to receive an entire dividend in cash by notifying the plan administrator and our transfer agent and registrar, in writing so that such notice is received by the plan administrator no later than the record date for dividends to stockholders. The plan administrator sets up an account for shares acquired through the plan for each stockholder who has not elected to receive dividends in cash and hold such shares in noncertificated form. Upon request by a stockholder participating in the plan, the plan administrator will, instead of crediting shares to the participant's account, issue a certificate registered in the participant's name for the number of whole shares of our common stock and a check for any fractional share. Such request by a stockholder must be received three days prior to the dividend payable date in order for that dividend to be paid in cash. If such request is received less than three days prior to the dividend payable date, then the dividends are reinvested and shares are repurchased for the stockholder's account; however, future dividends are paid out in cash on all balances. Those stockholders whose shares are held by a broker or other financial intermediary may receive dividends in cash by notifying their broker or other financial intermediary of their election.

We may use primarily newly issued shares to implement the plan, whether our shares are trading at a premium or at a discount to net asset value. However, we reserve the right to purchase shares in the open market in connection with our implementation of the plan. The number of shares to be issued to a stockholder is determined by dividing the total dollar amount of the dividend payable to such stockholder by the market price per share of our common stock at the close of regular trading on The NASDAQ National Market on the valuation date for such dividend. If we use newly-issued shares to implement the plan, the valuation date will not be earlier than the last day that stockholders have the right to elect to receive cash in lieu of shares. Market price per share on that date will be the closing price for such shares on The NASDAQ National Market or, if no sale is reported for such day, at the average of their reported bid and asked prices. The number of shares of our common stock to be outstanding after giving effect to payment of the dividend cannot be established until the value per share at which additional shares will be issued has been determined and elections of our stockholders have been tabulated.

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There are no brokerage charges or other charges to stockholders who participate in the plan. The plan administrator's fees under the plan is paid by us. If a participant elects by written notice to the plan administrator to have the plan administrator sell part or all of the shares held by the plan administrator in the participant's account and remit the proceeds to the participant, the plan administrator is authorized to deduct a $15 transaction fee plus a $0.10 per share brokerage commissions from the proceeds.

Stockholders who receive dividends in the form of stock are subject to the same federal, state and local tax consequences as are stockholders who elect to receive their dividends in cash. A stockholder's basis for determining gain or loss upon the sale of stock received in a dividend from us will be equal to the total dollar amount of the dividend payable to the stockholder. Any stock received in a dividend will have a new holding period for tax purposes commencing on the day following the day on which the shares are credited to the U.S. stockholder's account.

Participants may terminate their accounts under the plan by notifying the plan administrator via its website at www.amstock.com or by filling out the transaction request form located at the bottom of their statement and sending it to the plan administrator at American Stock Transfer & Trust Company, P.O. Box 922, Wall Street Station, New York, NY 10269-0560 or by calling the plan administrator's Interactive Voice Response System at (888) 888-0313.

The plan may be terminated by us upon notice in writing mailed to each participant at least 30 days prior to any payable date for the payment of any dividend by us. All correspondence concerning the plan should be directed to the plan administrator by mail at American Stock Transfer & Trust Company, 59 Maiden Lane, New York, NY 10007 or by telephone at (718) 921-8200.

Stockholders who purchased their shares through or hold their shares in the name of a broker or financial institution should consult with a representative of their broker or financial institution with respect to their participation in our dividend reinvestment plan. Such holders of our stock may not be identified as our registered stockholders with the plan administrator and may not automatically have their cash dividend reinvested in shares of our common stock.

MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS

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

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

- a citizen or individual resident of the United States;
- a corporation, or other entity treated as a corporation for U.S. federal income tax purposes, created or organized in or under the laws of the United States or any state thereof or the District of Columbia;
- an estate, the income of which is subject to U.S. federal income taxation regardless of its source; or

- a trust if (1) a U.S. court is able to exercise primary supervision over the administration of such trust and one or more U.S. persons have the authority to control all substantial decisions of the trust or (2) it has a valid election in place to be treated as a U.S. person.

A “Non-U.S. stockholder” is a beneficial owner of shares of our common stock that is not a U.S. stockholder.

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

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

Election To Be Taxed As A RIC

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

Taxation As A RIC

Provided that we qualify as a RIC and satisfy the Annual Distribution Requirement, we will not be subject to federal income tax on the portion of our investment company taxable income and net capital gain (i.e., net long-term capital gains in excess of net short-term capital losses) we timely distribute to stockholders. We will be subject to U.S. federal income tax at the regular corporate rates on any income or capital gain not distributed (or deemed distributed) to our stockholders.

We will be subject to a 4% non-deductible federal excise tax on certain undistributed income of RICs unless we distribute in a timely manner an amount at least equal to the sum of (1) 98% of our ordinary income for each calendar year, (2) 98% of our capital gain net income for the one-year period ending October 31 in that calendar year and (3) any income realized, but not distributed, in preceding years. We currently intend to make sufficient distributions each taxable year such that we will not be subject to federal income or excise taxes on our net income.

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

- qualify to be treated as a business development company under the 1940 Act at all times during each taxable year;
- derive in each taxable year at least 90% of our gross income from dividends, interest, payments with respect to certain securities loans, gains from the sale of stock or other securities, or other income derived with respect to our business of investing in such stock or securities and net income derived from an interest in a qualified publicly traded partnership (as defined in the Code) (the 90% Income Test); and
- diversify our holdings so that at the end of each quarter of the taxable year:
    - at least 50% of the value of our assets consists of cash, cash equivalents, U.S. Government securities, securities of other RICs, and other securities if such other securities of any one issuer do not represent more than 5% of the value of our assets or more than 10% of the outstanding voting securities of the issuer (which for these purposes includes the equity securities of a qualified publicly traded partnership); and
- no more than 25% of the value of our assets is invested in the securities, other than U.S. Government securities or securities of other RICs, (i) of one issuer (ii) of two or more issuers that are controlled, as determined under applicable tax rules, by us and that are engaged in the same or similar or related trades or businesses or (iii) of one or more qualified publicly traded partnerships (the Diversification Tests).

To the extent that we invest in entities treated as partnerships for federal income tax purposes (other than a qualified publicly traded partnership), we generally must include the items of gross income derived by the partnerships for purposes of the 90% Income Test, and the income that is derived from a partnership (other than a qualified publicly traded partnership) will be treated as qualifying income for purposes of the 90% Income Test only to the extent that such income is attributable to items of income of the partnership which would be qualifying income if realized by us directly. In addition, we generally must take into account our proportionate share of the assets held by partnerships (other than a qualified publicly traded partnership) in which we are a partner for purposes of the Diversification Tests.

In order to meet the 90% Income Test, we may establish one or more special purpose corporations to hold assets from which we do not anticipate earning dividend, interest or other qualifying income under the 90% Income Test. Any such special purpose corporation would generally be subject to U.S. federal income tax, and could result in a reduced after-tax yield on the portion of our assets held there.

We may be required to recognize taxable income in circumstances in which we do not receive cash. For example, if we hold debt obligations that are treated under applicable tax rules as having original issue discount (such as debt instruments with payment-in-kind interest or, in certain cases, increasing interest rates or issued with warrants), we must include in income each year a portion of the original issue discount that accrues over the life of the obligation, regardless of whether cash representing such income is received by us in the same taxable year. Because any original issue discount accrued will be included in our investment company taxable income for the year of accrual, we may be required to make a distribution to our stockholders in order to satisfy the Annual Distribution Requirement, even though we will not have received any corresponding cash amount.

Gain or loss realized by us from warrants acquired by us as well as any loss attributable to the lapse of such warrants generally will be treated as capital gain or loss. Such gain or loss generally will be long-term or short-term, depending on how long we held a particular warrant.

Although we do not presently expect to do so, we are authorized to borrow funds and to sell assets in order to satisfy distribution requirements. However, under the 1940 Act, we are not permitted to make distributions to our stockholders while our debt obligations and other senior securities are outstanding unless certain "asset coverage" tests are met. See "Regulation—Senior securities." Moreover, our ability to dispose of assets to meet our distribution requirements may be limited by (1) the illiquid nature of our portfolio and/or (2) other requirements relating to our status as a RIC, including the Diversification Tests. If we dispose of assets in order to meet the Annual Distribution Requirement or the Excise Tax Avoidance Requirement, we may make such dispositions at times that, from an investment standpoint, are not advantageous.

If we fail to satisfy the Annual Distribution Requirement or otherwise fail to qualify as a RIC in any taxable year, we will be subject to tax in that year on all of our taxable income, regardless of whether we make any distributions to our stockholders. In that case, all of such income will be subject to corporate-level federal income tax, reducing the amount available to be distributed to our stockholders. See "Failure to Obtain RIC Tax Treatment" below. In contrast, assuming we qualify as a RIC, our corporate-level federal income tax should be substantially reduced or eliminated. See "Election to be taxed as a RIC" above.

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

To the extent that we invest in equity securities of entities that are treated as partnerships for federal income tax purposes, the effect of such investments for purposes of the 90% Income Test and the Diversification Tests will depend on whether the partnership is a "qualified publicly traded partnership" or not. If the partnership is a "qualified publicly traded partnership," the net income derived from such investments will be qualifying income for purposes of the 90% Income Test and will be "securities" for purposes of the Diversification Tests, as described above. If the partnership, however, is not treated as a "qualified publicly traded partnership," then the consequences of an investment in the partnership will depend upon the amount and type of income and assets of the partnership allocable to us. The income derived from such investments may not be qualifying income for purposes of the 90% Income Test and, therefore, could adversely affect our qualification as a RIC. We intend to monitor our investments in equity securities of entities that are treated as partnerships for federal income tax purposes to prevent our disqualification as a RIC.

We may invest in preferred securities or other securities the federal income tax treatment of which may not be clear or may be subject to recharacterization by the IRS. To the extent the tax treatment of such securities or the income from such securities differs from the expected tax treatment, it could affect the timing or character of income recognized, requiring us to purchase or sell securities, or otherwise change our portfolio, in order to comply with the tax rules applicable to RICs under the Code.

Taxation Of U.S. Stockholders

Distributions by us generally are taxable to U.S. stockholders as ordinary income or capital gains. Distributions of our "investment company taxable income" (which is, generally, our ordinary income plus realized net short-term capital gains in excess of realized net long-term capital losses) will be taxable as ordinary income to U.S. stockholders to the extent of our current or accumulated earnings and profits, whether paid in cash or reinvested in additional common stock. For taxable years beginning on or before December 31, 2008, to the extent such distributions paid by us to noncorporate stockholders (including individuals) are attributable to dividends from U.S. corporations and certain qualified foreign corporations, such distributions generally will be eligible for taxation at rates applicable to long term capital gains (currently a maximum tax rate of 15%) *provided* that we properly designate such distribution as derived from "qualified dividend income." In this regard, it is not anticipated that a significant portion of distributions paid by us will be attributable to dividends and, therefore, generally will not qualify for the 15% maximum rate. Distributions of our net capital gains (which is generally our realized net long-term capital gains in excess of realized net short-term capital losses) properly designated by us as capital gain dividends will be taxable to a U.S. stockholder as long-term capital gains at a maximum rate of 15% in the case of individuals, trusts or estates, regardless of the U.S. stockholders holding period for his, her or its common stock and regardless of whether paid in cash or reinvested in additional common stock. Distributions in excess of our current and accumulated earnings and profits first will reduce a U.S. stockholders adjusted tax basis in such stockholders common stock and, after the adjusted basis is reduced to zero, will constitute capital gains to such U.S. stockholder.

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

For purposes of determining (1) whether the Annual Distribution Requirement is satisfied for any year and (2) the amount of capital gain dividends paid for that year, we may, under certain circumstances, elect to treat a dividend that is paid during the following taxable year as if it had been paid during the taxable year in question. If we make such an election, the U.S. stockholder will still be treated as receiving the dividend in the taxable year in which the distribution is made. However, any dividend declared by us in October, November or December of any calendar year, payable to stockholders of record on a specified date in any such month and actually paid during January of the following year, will be treated as if it had been received by our U.S. stockholders on December 31 of the year in which the dividend was declared.

If an investor purchases shares of our common stock shortly before the record date of a distribution, the price of the shares will include the value of the distribution and the investor will be subject to tax on the distribution even though it represents a return of his, her or its investment.

A U.S. stockholder generally will recognize taxable gain or loss if the stockholder sells or otherwise disposes of his, her or its shares of our common stock. Any gain arising from such sale or disposition generally will be treated as long-term capital gain or loss if the stockholder has held his, her or its shares for more than one year. Otherwise, it would be classified as short-term capital gain or loss. However, any capital loss arising from the sale or disposition of shares of our common stock held for six months or less will be treated as long-term capital loss to the extent of the amount of capital gain dividends received, or undistributed capital gain deemed received, with respect to such shares. In addition, all or a portion of any loss recognized upon a disposition of shares of our common stock may be disallowed if other substantially identical shares are purchased (whether through reinvestment of distributions or otherwise) within 30 days before or after the disposition. The ability to otherwise deduct capital losses may be subject to other limitations under the code.

In general, individual U.S. stockholders currently are subject to a maximum federal income tax rate of 15% on their net capital gain, i.e., the excess of realized net long-term capital gain over realized net short-term capital loss for a taxable year, including a long-term capital gain derived from an investment in our shares. Such rate is lower than the maximum rate on ordinary income currently payable by individuals. Corporate U.S. stockholders currently are subject to federal income tax on net capital gain at the maximum 35% rate also applied to ordinary income. Noncorporate stockholders with net capital losses for a year (i.e., capital losses in excess of capital gains) generally may deduct up to $3,000 of such losses against their ordinary income each year; any net capital losses of a noncorporate stockholder in excess of $3,000 generally may be carried forward and used in subsequent years as provided in the Code. Corporate stockholders generally may not deduct any net capital losses for a year, but may carry back such losses for three years or carry forward such losses for five years.

We will send to each of our U.S. stockholders, as promptly as possible after the end of each calendar year, a notice detailing, on a per share and per distribution basis, the amounts includible in such U.S. stockholders taxable income for such year as ordinary income and as long-term capital gain. In addition, the federal tax status of each years distributions generally will be reported to the Internal Revenue Service (including the amount of dividends, if any, eligible for the 15% maximum rate). Distributions may also be subject to additional state, local and foreign taxes depending on a U.S. stockholders particular situation. Dividends distributed by us generally will not be eligible for the dividends-received deduction or the preferential rate applicable to qualifying dividends.

We may be required to withhold federal income tax (backup withholding) currently at a rate of 28% from all taxable distributions to any noncorporate U.S. stockholder (1) who fails to furnish us with a correct taxpayer identification number or a certificate that such stockholder is exempt from backup withholding, or (2) with respect to whom the IRS notifies us that such stockholder has failed to properly report certain interest and dividend income to the IRS and to respond to notices to that effect. An individuals taxpayer identification number is his or her social security number. Any amount withheld under backup withholding is allowed as a credit against the U.S. stockholders federal income tax liability and may entitle such shareholder to a refund*provided* that proper information is timely provided to the IRS.

Taxation Of Non-U.S. Stockholders

Whether an investment in the shares is appropriate for a Non-U.S. stockholder will depend upon that persons particular circumstances. An investment in the shares by a Non-U.S. stockholder may have adverse tax consequences. Non-U.S. stockholders should consult their tax advisers before investing in our common stock.

Distributions of our investment company taxable income to Non-U.S. stockholders that are not effectively connected with a U.S. trade or business carried on by the Non-U.S. stockholder, will generally be subject to withholding of federal income tax at a rate of 30% (or lower rate provided by an applicable treaty) to the extent of our current and accumulated earnings and profits. However, effective for taxable years beginning before January 1, 2008, we generally will not be required to withhold any amounts with respect to distributions of (i) U.S.-source interest income that would not have been subject to withholding of federal income tax if they had been earned directly by a Non-U.S. stockholder, and (ii) net short-term capital gains in excess of net long-term capital losses that would not have been subject to withholding of federal income tax if they had been earned directly by a Non-U.S. stockholder, in each case only to the extent that such distributions are properly designated by us as interest-related dividends or short-term capital gain dividends, as the case may be, and certain other requirements are met.

Actual or deemed distributions of our net capital gains to a Non-U.S. stockholder, and gains realized by a Non-U.S. stockholder upon the sale of our common stock, that are not effectively connected with a U.S. trade or business carried on by the Non-U.S. stockholder, will generally not be subject to federal withholding tax and generally will not be subject to federal income tax unless the Non-U.S. stockholder is a nonresident alien individual and is physically present in the United States for more than 182 days during the taxable year and meets certain other requirements. However, withholding of federal income tax at a rate of 30% on capital gains of nonresident alien individuals who are physically present in the United States for more than the 182 day period only applies in exceptional cases because any individual present in the United States for more than 182 days during the taxable year is generally treated as a resident for U.S. income tax purposes; in that case, he or she would be subject to U.S. income tax on his or her worldwide income at the graduated rates applicable to U.S. citizens, rather than the 30% federal withholding tax. In addition, with respect of dividends paid or deemed paid to Non-U.S. stockholders on or before December 31, 2007, that are attributable to gain from U.S. real property interests (USRPIs), which the Code defines to include direct holdings of U.S. real property and interests (other than solely as a creditor) in U.S. real property holding corporations such as real estate investment trusts (REITs) and also may include certain REIT capital gain dividends, will generally be subject to federal income tax and will give rise to an obligation for those Non-U.S. stockholders to file a federal income tax return, and may be subject to withholding tax as well under future regulations.

If we distribute our net capital gains in the form of deemed rather than actual distributions (which we may do in the future), a Non-U.S. stockholder will be entitled to a federal income tax credit or tax refund equal to the stockholder's allocable share of the tax we pay on the capital gains deemed to have been distributed. In order to obtain the refund, the Non-U.S. stockholder must obtain a U.S. taxpayer identification number and file a federal income tax return even if the Non-U.S. stockholder would not otherwise be required to obtain a U.S. taxpayer identification number or file a federal income tax return. Accordingly, investment in the shares may not be appropriate for a Non-U.S. stockholder.

Distributions of our "investment company taxable income" and net capital gains (including deemed distributions) to Non-U.S. stockholders, and gains realized by Non-U.S. stockholders upon the sale of our common stock that is "effectively connected" with a U.S. trade or business carried on by the Non-U.S. stockholder (or if an income tax treaty applies, attributable to a "permanent establishment" in the United States), will be subject to federal income tax at the graduated rates applicable to U.S. citizens, residents and domestic corporations. Corporate Non-U.S. stockholders may also be subject to an additional branch profits tax at a rate of 30% imposed by the Code (or lower rate provided by an applicable treaty). In the case of a non-corporate Non-U.S. stockholder, we may be required to withhold federal income tax from distributions that are otherwise exempt from withholding tax (or taxable at a reduced rate) unless the Non-U.S. stockholder certifies his or her foreign status under penalties of perjury or otherwise establishes an exemption.

The tax consequences to a Non-U.S. stockholder entitled to claim the benefits of an applicable tax treaty may differ from those described herein. Non-U.S. stockholders are advised to consult their own tax advisers with respect to the particular tax consequences to them of an investment in our shares.

A Non-U.S. stockholder who is a nonresident alien individual may be subject to information reporting and backup withholding of federal income tax on dividends unless the Non-U.S. stockholder provides us or the dividend paying agent with an IRS Form W8BEN (or an acceptable substitute form) or otherwise meets documentary evidence requirements for establishing that it is a Non-U.S. stockholder or otherwise establishes an exemption from backup withholding.

Non-U.S. persons should consult their own tax advisors with respect to the U.S. federal income tax and withholding tax, and state, local and foreign tax consequences of an investment in the shares.

Failure To Obtain RIC Tax Treatment

If we were unable to obtain tax treatment as a RIC, we would be subject to tax on all of our taxable income at regular corporate rates. We would not be able to deduct distributions to stockholders, nor would they be required to be made. Distributions would generally be taxable to our stockholders as ordinary dividend income eligible for the 15% maximum rate to the extent of our current and accumulated earnings and profits. Subject to certain limitations under the Code, corporate distributees would be eligible for the dividends-received deduction. Distributions in excess of our current and accumulated earnings and profits would be treated first as a return of capital to the extent of the stockholder's tax basis, and any remaining distributions would be treated as a capital gain.

DESCRIPTION OF OUR CAPITAL STOCK

The following description is based on relevant portions of the Maryland General Corporation Law and on our charter and bylaws. This summary is not necessarily complete, and we refer you to the Maryland General Corporation Law and our charter and bylaws for a more detailed description of the provisions summarized below.

Capital Stock

Our authorized capital stock consists of 100,000,000 shares of stock, par value $.001 per share, all of which is initially classified as common stock. Our common stock is traded on The NASDAQ National Market under the symbol "PSEC." There are no outstanding options or warrants to purchase our stock. No stock has been authorized for issuance under any equity compensation plans. Under Maryland law, our stockholders generally are not personally liable for our debts or obligations.

Under our charter, our Board of Directors is authorized to classify and reclassify any unissued shares of stock into other classes or series of stock, and to authorize the issuance of such shares, without obtaining stockholder approval. As permitted by the Maryland General Corporation Law, our charter provides that the Board of Directors, without any action by our stockholders, may amend the charter from time to time to increase or decrease the aggregate number of shares of stock or the number of shares of stock of any class or series that we have authority to issue.

Common stock

All shares of our common stock have equal rights as to earnings, assets, dividends and voting and, when they are issued, will be duly authorized, validly issued, fully paid and nonassessable. Distributions may be paid to the holders of our common stock if, as and when authorized by our Board of Directors and declared by us out of funds legally available therefor. Shares of our common stock have no preemptive, conversion or redemption rights and are freely transferable, except where their transfer is restricted by federal and state securities laws or by contract. In the event of a liquidation, dissolution or winding up of us, each share of our common stock would be entitled to share ratably in all of our assets that are legally available for distribution after we pay all debts and other liabilities and subject to any preferential rights of holders of our preferred stock, if any preferred stock is outstanding at such time. Each share of our common stock is entitled to one vote on all matters submitted to a vote of stockholders, including the election of directors. Except as provided with respect to any other class or series of stock, the holders of our common stock will possess exclusive voting power. There is no cumulative voting in the election of directors, which means that holders of a majority of the outstanding shares of common stock will elect all of our directors, and holders of less than a majority of such shares will be unable to elect any director.

Preferred stock

Our charter authorizes our Board of Directors to classify and reclassify any unissued shares of stock into other classes or series of stock, including preferred stock. Prior to issuance of shares of each class or series, the Board of Directors is required by Maryland law and by our charter to set the terms, preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms or conditions of redemption for each class or series. Thus, the Board of Directors could authorize the issuance of shares of preferred stock with terms and conditions which could have the effect of delaying, deferring or preventing a transaction or a change in control that might involve a premium price for holders of our common stock or otherwise be in their best interest. You should note, however, that any issuance of preferred stock must comply with the requirements of the 1940 Act. The 1940 Act requires, among other things, that (1) immediately after issuance and before any dividend or other distribution is made with respect to our common stock and before any purchase of common stock is made, such preferred stock together with all other senior securities must not exceed an amount equal to 50% of our total assets after deducting the amount of such dividend, distribution or purchase price, as the case may be, and (2) the holders of shares of preferred stock, if any are issued, must be entitled as a class to elect two directors at all times and to elect a majority of the directors if dividends on such preferred stock are in arrears by two years or more. Certain matters under the 1940 Act require the separate vote of the holders of any issued and outstanding preferred stock. For example, holders of preferred stock would vote separately from the holders of common stock on a proposal to cease operations as a business development company. We believe that the availability for issuance of preferred stock will provide us with increased flexibility in structuring future financings and acquisitions.

Limitation On Liability Of Directors And Officers; Indemnification And Advance Of Expenses

Maryland law permits a Maryland corporation to include in its charter a provision limiting the liability of its directors and officers to the corporation and its stockholders for money damages except for liability resulting from (a) actual receipt of an improper benefit or profit in money, property or services or (b) active and deliberate dishonesty established by a final judgment as being material to the cause of action. Our charter contains such a provision which eliminates directors and officers liability to the maximum extent permitted by Maryland law, subject to the requirements of the 1940 Act.

Our charter authorizes us, to the maximum extent permitted by Maryland law and subject to the requirements of the 1940 Act, to obligate ourselves to indemnify any present or former director or officer or any individual who, while serving as a director or officer and at our request, serves or has served another corporation, real estate investment trust, partnership, joint venture, trust, employee benefit plan or other enterprise as a director, officer, partner or trustee, from and against any claim or liability to which that person may become subject or which that person may incur by reason of his or her service in any such capacity and to pay or reimburse their reasonable expenses in advance of final disposition of a proceeding. Our bylaws obligate us, to the maximum extent permitted by Maryland law and subject to the requirements of the 1940 Act, to indemnify any present or former director or officer or any individual who, while serving as a director or officer and at our request, serves or has served another corporation, real estate investment trust, partnership, joint venture, trust, employee benefit plan or other enterprise as a director, officer, partner or trustee and who is made, or threatened to be made, a party to the proceeding by reason of his or her service in any such capacity from and against any claim or liability to which that person may become subject or which that person may incur by reason of his or her service in any such capacity and to pay or reimburse their reasonable expenses in advance of final disposition of a proceeding. The charter and bylaws also permit us to indemnify and advance expenses to any person who served a predecessor of us in any of the capacities described above and any of our employees or agents or any employees or agents of our predecessor. In accordance with the 1940 Act, we will not indemnify any person for any liability to which such person would be subject by reason of such person's willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his or her office.

Maryland law requires a corporation (unless its charter provides otherwise, which our charter does not) to indemnify a director or officer who has been successful, on the merits or otherwise, in the defense of any proceeding to which he or she is made, or threatened to be made, a party by reason of his or her service in that capacity. Maryland law permits a corporation to indemnify its present and former directors and officers, among others, against judgments, penalties, fines, settlements and reasonable expenses actually incurred by them in connection with any proceeding to which they may be made, or threatened to be made, a party by reason of their service in those or other capacities unless it is established that (a) the act or omission of the director or officer was material to the matter giving rise to the proceeding and (1) was committed in bad faith or (2) was the result of active and deliberate dishonesty, (b) the director or officer actually received an improper personal benefit in money, property or services or (c) in the case of any criminal proceeding, the director or officer had reasonable cause to believe that the act or omission was unlawful. However, under Maryland law, a Maryland corporation may not indemnify for an adverse judgment in a suit by or in the right of the corporation or for a judgment of liability on the basis that a personal benefit was improperly received, unless in either case a court orders indemnification, and then only for expenses. In addition, Maryland law permits a corporation to advance reasonable expenses to a director or officer upon the corporation's receipt of (a) a written affirmation by the director or officer of his or her good faith belief that he or she has met the standard of conduct necessary for indemnification by the corporation and (b) a written undertaking by him or her or on his or her behalf to repay the amount paid or reimbursed by the corporation if it is ultimately determined that the standard of conduct was not met.

Our insurance policy does not currently provide coverage for claims, liabilities and expenses that may arise out of activities that a present or former director or officer of us has performed for another entity at our request. There is no assurance that such entities will in fact carry such insurance. However, we note that we do not expect to request our present or former directors or officers to serve another entity as a director, officer, partner or trustee unless we can obtain insurance providing coverage for such persons for any claims, liabilities or expenses that may arise out of their activities while serving in such capacities.

Provisions Of The Maryland General Corporation Law And Our Charter And Bylaws

Anti-takeover Effect

The Maryland General Corporation Law and our charter and bylaws contain provisions that could make it more difficult for a potential acquiror to acquire us by means of a tender offer, proxy contest or otherwise. These provisions are expected to discourage certain coercive takeover practices and inadequate takeover bids and to encourage persons seeking to acquire control of us to negotiate first with our Board of Directors. These provisions could have the effect of depriving shareholders of an opportunity to sell their shares at a premium over prevailing market prices by discouraging a third party from seeking to obtain control of us. We believe that the benefits of these provisions outweigh the potential disadvantages of discouraging any such acquisition proposals because, among other things, the negotiation of such proposals may improve their terms.

Control share acquisitions

The Maryland General Corporation Law provides that control shares of a Maryland corporation acquired in a control share acquisition have no voting rights except to the extent approved by a vote of two-thirds of the votes entitled to be cast on the matter (the Control Share Act). Shares owned by the acquiror, by officers or by directors who are employees of the corporation are excluded from shares entitled to vote on the matter. Control shares are voting shares of stock which, if aggregated with all other shares of stock owned by the acquiror or in respect of which the acquiror is able to exercise or direct the exercise of voting power (except solely by virtue of a revocable proxy), would entitle the acquiror to exercise voting power in electing directors within one of the following ranges of voting power:

- one-tenth or more but less than one-third,
- one-third or more but less than a majority, or
- a majority or more of all voting power.

The requisite stockholder approval must be obtained each time an acquiror crosses one of the thresholds of voting power set forth above. Control shares do not include shares the acquiring person is then entitled to vote as a result of having previously obtained stockholder approval. A control share acquisition means the acquisition of control shares, subject to certain exceptions.

A person who has made or proposes to make a control share acquisition may compel the Board of Directors of the corporation to call a special meeting of stockholders to be held within 50 days of demand to consider the voting rights of the shares. The right to compel the calling of a special meeting is subject to the satisfaction of certain conditions, including an undertaking to pay the expenses of the meeting. If no request for a meeting is made, the corporation may itself present the question at any stockholders meeting.

If voting rights are not approved at the meeting or if the acquiring person does not deliver an acquiring person statement as required by the statute, then the corporation may repurchase for fair value any or all of the control shares, except those for which voting rights have previously been approved. The right of the corporation to repurchase control shares is subject to certain conditions and limitations, including, as provided in our bylaws, compliance with the 1940 Act. Fair value is determined, without regard to the absence of voting rights for the control shares, as of the date of the last control share acquisition by the acquiror or of any meeting of stockholders at which the voting rights of the shares are considered and not approved. If voting rights for control shares are approved at a stockholders meeting and the acquiror becomes entitled to vote a majority of the shares entitled to vote, all other stockholders may exercise appraisal rights. The fair value of the shares as determined for purposes of appraisal rights may not be less than the highest price per share paid by the acquiror in the control share acquisition.

The Control Share Act does not apply (a) to shares acquired in a merger, consolidation or share exchange if the corporation is a party to the transaction or (b) to acquisitions approved or exempted by the charter or bylaws of the corporation.

Our bylaws contain a provision exempting from the Control Share Act any and all acquisitions by any person of our shares of stock. There can be no assurance that such provision will not be amended or eliminated at any time in the future. However, we will amend our bylaws to be subject to the Control Share Act only if the Board of Directors determines that it would be in our best interests and if the SEC does not object to our determination that our being subject to the Control Share Act does not conflict with the 1940 Act.

Business combinations

Under Maryland law, business combinations between a Maryland corporation and an interested stockholder or an affiliate of an interested stockholder are prohibited for five years after the most recent date on which the interested stockholder becomes an interested stockholder. These business combinations include a merger, consolidation, share exchange or, in circumstances specified in the statute, an asset transfer or issuance or reclassification of equity securities. An interested stockholder is defined as:

- any person who beneficially owns 10% or more of the voting power of the corporations shares; or
- an affiliate or associate of the corporation who, at any time within the two-year period prior to the date in question, was the beneficial owner of 10% or more of the voting power of the then outstanding voting stock of the corporation.

A person is not an interested stockholder under this statute if the Board of Directors approved in advance the transaction by which he otherwise would have become an interested stockholder. However, in approving a transaction, the Board of Directors may provide that its approval is subject to compliance, at or after the time of approval, with any terms and conditions determined by the Board.

After the five-year prohibition, any business combination between the Maryland corporation and an interested stockholder generally must be recommended by the Board of Directors of the corporation and approved by the affirmative vote of at least:

- 80% of the votes entitled to be cast by holders of outstanding shares of voting stock of the corporation; and
- two-thirds of the votes entitled to be cast by holders of voting stock of the corporation other than shares held by the interested stockholder with whom or with whose affiliate the business combination is to be effected or held by an affiliate or associate of the interested stockholder.

These super-majority vote requirements do not apply if the corporations common stockholders receive a minimum price, as defined under Maryland law, for their shares in the form of cash or other consideration in the same form as previously paid by the interested stockholder for its shares.

The statute permits various exemptions from its provisions, including business combinations that are exempted by the Board of Directors before the time that the interested stockholder becomes an interested stockholder. Our Board of Directors has adopted a resolution that any business combination between us and any other person is exempted from the provisions of the Maryland Business Combination Act (the Business Combination Act)*provided* that the business combination is first approved by the Board of Directors, including a majority of the directors who are not interested persons as defined in the 1940 Act. This resolution, however, may be altered or repealed in whole or in part at any time. If this resolution is repealed, or the Board of Directors does not otherwise approve a business combination, the statute may discourage others from trying to acquire control of us and increase the difficulty of consummating any offer.

Conflict with 1940 Act

Our bylaws provide that, if and to the extent that any provision of the Maryland General Corporation Law, including the Control Share Act (if we amend our bylaws to be subject to such Act) and the Business Combination Act, or any provision of our charter or bylaws conflicts with any provision of the 1940 Act, the applicable provision of the 1940 Act will control.

Classified Board of Directors

Our Board of Directors is divided into three classes of directors serving staggered three-year terms. The current terms of the first, second and third classes will expire in 2008, 2009 and 2007 respectively, and in each case, until their successors are duly elected and qualify. Each year one class of Directors will be elected by the stockholders. A classified board may render a change in control of us or removal of our incumbent management more difficult. We believe, however, that the longer time required to elect a majority of a classified Board of Directors will help to ensure the continuity and stability of our management and policies.

Election of directors

Our charter and bylaws provide that the affirmative vote of the holders of a majority of the outstanding shares of stock entitled to vote in the election of directors will be required to elect a director. Under the charter, our Board of Directors may amend the bylaws to alter the vote required to elect directors.

Number of directors; vacancies; removal

Our charter provides that the number of directors will be set only by the Board of Directors in accordance with our bylaws. Our bylaws provide that a majority of our entire Board of Directors may at any time increase or decrease the number of directors. However, unless our bylaws are amended, the number of directors may never be less than three nor more than eight. Our charter provides that, at such time as we have three independent directors and our common stock is registered under the Exchange Act, we elect to be subject to the provision of Subtitle 8 of Title 3 of the Maryland General Corporation Law regarding the filling of vacancies on the Board of Directors. Accordingly, at such time, except as may be provided by the Board of Directors in setting the terms of any class or series of preferred stock, any and all vacancies on the Board of Directors may be filled only by the affirmative vote of a majority of the remaining directors in office, even if the remaining directors do not constitute a quorum, and any director elected to fill a vacancy will serve for the remainder of the full term of the directorship in which the vacancy occurred and until a successor is elected and qualifies, subject to any applicable requirements of the 1940 Act.

Our charter provides that a director may be removed only for cause, as defined in our charter, and then only by the affirmative vote of at least two-thirds of the votes entitled to be cast in the election of directors.

Action by stockholders

The Maryland General Corporation Law provides that stockholder action can be taken only at an annual or special meeting of stockholders or (unless the charter provides for stockholder action by less than unanimous written consent, which our charter does not) by unanimous written consent in lieu of a meeting. These provisions, combined with the requirements of our bylaws regarding the calling of a stockholder-requested special meeting of stockholders discussed below, may have the effect of delaying consideration of a stockholder proposal until the next annual meeting.

Advance notice provisions for stockholder nominations and stockholder proposals

Our bylaws provide that with respect to an annual meeting of stockholders, nominations of persons for election to the Board of Directors and the proposal of business to be considered by stockholders may be made only (1) pursuant to our notice of the meeting, (2) by the Board of Directors or (3) by a stockholder who is entitled to vote at the meeting and who has complied with the advance notice procedures of the bylaws. With respect to special meetings of stockholders, only the business specified in our notice of the meeting may be brought before the meeting. Nominations of persons for election to the Board of Directors at a special meeting may be made only (1) pursuant to our notice of the meeting, (2) by the Board of Directors or (3) *provided* that the Board of Directors has determined that directors will be elected at the meeting, by a stockholder who is entitled to vote at the meeting and who has complied with the advance notice provisions of the bylaws.

The purpose of requiring stockholders to give us advance notice of nominations and other business is to afford our Board of Directors a meaningful opportunity to consider the qualifications of the proposed nominees and the advisability of any other proposed business and, to the extent deemed necessary or desirable by our Board of Directors, to inform stockholders and make recommendations about such qualifications or business, as well as to provide a more orderly procedure for conducting meetings of stockholders. Although our bylaws do not give our Board of Directors any power to disapprove stockholder nominations for the election of directors or proposals recommending certain action, they may have the effect of precluding a contest for the election of directors or the consideration of stockholder proposals if proper procedures are not followed and of discouraging or deterring a third party from conducting a solicitation of proxies to elect its own slate of directors or to approve its own proposal without regard to whether consideration of such nominees or proposals might be harmful or beneficial to us and our stockholders.

Calling of special meetings of stockholders

Our bylaws provide that special meetings of stockholders may be called by our Board of Directors and certain of our officers. Additionally, our bylaws provide that, subject to the satisfaction of certain procedural and informational requirements by the stockholders requesting the meeting, a special meeting of stockholders will be called by the secretary of the corporation upon the written request of stockholders entitled to cast not less than a majority of all the votes entitled to be cast at such meeting.

Approval of extraordinary corporate action; amendment of charter and bylaws

Under Maryland law, a Maryland corporation generally cannot dissolve, amend its charter, merge, sell all or substantially all of its assets, engage in a share exchange or engage in similar transactions outside the ordinary course of business, unless approved by the affirmative vote of stockholders entitled to cast at least two-thirds of the votes entitled to be cast on the matter. However, a Maryland corporation may provide in its charter for approval of these matters by a lesser percentage, but not less than a majority of all of the votes entitled to be cast on the matter. Our charter generally provides for approval of charter amendments and extraordinary transactions by the stockholders entitled to cast at least a majority of the votes entitled to be cast on the matter.

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Our charter also provides that certain charter amendments and any proposal for our conversion, whether by merger or otherwise, from a closed-end company to an open-end company or any proposal for our liquidation or dissolution requires the approval of the stockholders entitled to cast at least 80 percent of the votes entitled to be cast on such matter. However, if such amendment or proposal is approved by at least two-thirds of our continuing directors (in addition to approval by our Board of Directors), such amendment or proposal may be approved by a majority of the votes entitled to be cast on such a matter. The continuing directors are defined in our charter as our current directors as well as those directors whose nomination for election by the stockholders or whose election by the directors to fill vacancies is approved by a majority of the continuing directors then on the Board of Directors.

Our charter and bylaws provide that the Board of Directors will have the exclusive power to make, alter, amend or repeal any provision of our bylaws.

No appraisal rights

Except with respect to appraisal rights arising in connection with the Control Share Act discussed below, as permitted by the Maryland General Corporation Law, our charter provides that stockholders will not be entitled to exercise appraisal rights.

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DESCRIPTION OF OUR PREFERRED STOCK

In addition to shares of common stock, our charter authorizes the issuance of preferred stock. If we offer preferred stock under this prospectus, we will issue an appropriate prospectus supplement. We may issue preferred stock from time to time in one or more series, without stockholder approval. Our Board of Directors is authorized to fix for any series of preferred stock the number of shares of such series and the designation, relative powers, preferences and rights, and the qualifications, limitations or restrictions of such series; except that, such an issuance must adhere to the requirements of the 1940 Act, Maryland law and any other limitations imposed by law.

The 1940 Act requires, among other things, that (1) immediately after issuance and before any distribution is made with respect to common stock, the liquidation preference of the preferred stock, together with all other senior securities, must not exceed an amount equal to 50% of our total assets (taking into account such distribution) and (2) the holders of shares of preferred stock, if any are issued, must be entitled as a class to elect two directors at all times and to elect a majority of the directors if dividends on the preferred stock are in arrears by two years or more.

For any series of preferred stock that we may issue, our Board of Directors will determine and the prospectus supplement relating to such series will describe:

- the designation and number of shares of such series;
- the rate and time at which, and the preferences and conditions under which, any dividends will be paid on shares of such series, as well as whether such dividends are cumulative or non-cumulative and participating or non-participating;
- any provisions relating to convertibility or exchangeability of the shares of such series;
- the rights and preferences, if any, of holders of shares of such series upon our liquidation, dissolution or winding up of our affairs;
- the voting powers, if any, of the holders of shares of such series;
- any provisions relating to the redemption of the shares of such series;
- any limitations on our ability to pay dividends or make distributions on, or acquire or redeem, other securities while shares of such series are outstanding;
- any conditions or restrictions on our ability to issue additional shares of such series or other securities;
- if applicable, a discussion of certain U.S. federal income tax considerations; and
- any other relative power, preferences and participating, optional or special rights of shares of such series, and the qualifications, limitations or restrictions thereof.

All shares of preferred stock that we may issue will be identical and of equal rank except as to the particular terms thereof that may be fixed by our Board of Directors, and all shares of each series of preferred stock will be identical and of equal rank except as to the dates from which cumulative dividends, if any, thereon will be cumulative.

DESCRIPTION OF OUR WARRANTS

The following is a general description of the terms of the warrants we may issue from time to time. Particular terms of any warrants we offer will be described in the prospectus supplement relating to such warrants.

We may issue warrants to purchase shares of our common stock. Such warrants may be issued independently or together with shares of common stock and may be attached or separate from such shares of common stock. We will issue each series of warrants under a separate warrant agreement to be entered into between us and a warrant agent. The warrant agent will act solely as our agent and will not assume any obligation or relationship of agency for or with holders or beneficial owners of warrants.

A prospectus supplement will describe the particular terms of any series of warrants we may issue, including the following:

- the title of such warrants;

- the aggregate number of such warrants;
- the price or prices at which such warrants will be issued;
- the currency or currencies, including composite currencies, in which the price of such warrants may be payable;
- the number of shares of common stock issuable upon exercise of such warrants;
- the price at which and the currency or currencies, including composite currencies, in which the shares of common stock purchasable upon exercise of such warrants may be purchased;
- the date on which the right to exercise such warrants will commence and the date on which such right will expire;
- whether such warrants will be issued in registered form or bearer form;
- if applicable, the minimum or maximum amount of such warrants which may be exercised at any one time;
- if applicable, the number of such warrants issued with each share of common stock;
- if applicable, the date on and after which such warrants and the related shares of common stock will be separately transferable;
- information with respect to book-entry procedures, if any;
- if applicable, a discussion of certain U.S. federal income tax considerations; and
- any other terms of such warrants, including terms, procedures and limitations relating to the exchange and exercise of such warrants.

We and the warrant agent may amend or supplement the warrant agreement for a series of warrants without the consent of the holders of the warrants issued thereunder to effect changes that are not inconsistent with the provisions of the warrants and that do not materially and adversely affect the interests of the holders of the warrants.

Under the 1940 Act, we may generally only offer warrants *provided* that (1) the warrants expire by their terms within ten years; (2) the exercise or conversion price is not less than the current market value at the date of issuance; (3) our stockholders authorize the proposal to issue such warrants, and our Board of Directors approves such issuance on the basis that the issuance is in the best interests of Prospect Capital and its stockholders; and (4) if the warrants are accompanied by other securities, the warrants are not separately transferable unless no class of such warrants and the securities accompanying them has been publicly distributed. The 1940 Act also provides that the amount of our voting securities that would result from the exercise of all outstanding warrants at the time of issuance may not exceed 25% of our outstanding voting securities.

DESCRIPTION OF OUR DEBT SECURITIES

We may issue debt securities in one or more series under an indenture to be entered into between us and a trustee. The specific terms of each series of debt securities will be described in the particular prospectus supplement relating to that series. For a complete description of the terms of a particular series of debt securities, you should read both this prospectus and the prospectus supplement relating to that particular series.

The prospectus supplement, which will accompany this prospectus, will describe the particular series of debt securities being offered by including:

- the designation or title of the series of debt securities;
- the total principal amount of the series of debt securities;
- the percentage of the principal amount at which the series of debt securities will be offered;
- the date or dates on which principal will be payable;

- the rate or rates (which may be either fixed or variable) and/or the method of determining such rate or rates of interest, if any;
- the date or dates from which any interest will accrue, or the method of determining such date or dates, and the date or dates on which any interest will be payable;
- the terms for redemption, extension or early repayment, if any;
- the currencies in which the series of debt securities are issued and payable;
- the provision for any sinking fund;
- any restrictive covenants;
- any Events of Default;
- whether the series of debt securities are issuable in certificated form;
- any provisions for defeasance or covenant defeasance;
- any special federal income tax implications, including, if applicable, federal income tax considerations relating to original issue discount;
- any provisions for convertibility or exchangeability of the debt securities into or for any other securities;
- whether the debt securities are subject to subordination and the terms of such subordination;
- the listing, if any, on a securities exchange;
- the name and address of the trustee; and
- any other terms.

The debt securities may be secured or unsecured obligations. Under the provisions of the 1940 Act, we are permitted, as a business development company, to issue debt only in amounts such that our asset coverage, as defined in the 1940 Act, equals at least 200% after each issuance of debt. Unless the prospectus supplement states otherwise, principal (and premium, if any) and interest, if any, will be paid by us in immediately available funds.

REGULATION

We are a closed-end, non-diversified investment company that has filed an election to be treated as a business development company under the 1940 Act and has elected to be treated as a RIC under Subchapter M of the Code. The 1940 Act contains prohibitions and restrictions relating to transactions between business development companies and their affiliates (including any Investment Advisers or sub-advisers), principal underwriters and affiliates of those affiliates or underwriters and requires that a majority of the directors be persons other than interested persons, as that term is defined in the 1940 Act. In addition, the 1940 Act provides that we may not change the nature of our business so as to cease to be, or to withdraw our election as, a business development company unless approved by a majority of our outstanding voting securities.

We may invest up to 100% of our assets in securities acquired directly from issuers in privately negotiated transactions. With respect to such securities, we may, for the purpose of public resale, be deemed an underwriter as that term is defined in the Securities Act. Our intention is to not write (sell) or buy put or call options to manage risks associated with the publicly traded securities of our portfolio companies, except that we may enter into hedging transactions to manage the risks associated with interest rate and other market fluctuations. However, we may purchase or otherwise receive warrants to purchase the common stock of our portfolio companies in connection with acquisition financing or other investment. Similarly, in connection with an acquisition, we may acquire rights to require the issuers of acquired securities or their affiliates to repurchase them under certain circumstances. We also do not intend to acquire securities issued by any investment company that exceed the limits imposed by the 1940 Act. Under these limits, we generally cannot acquire more than 3% of the voting stock of any registered investment company, invest more than 5% of the value of our total assets in the securities of one investment company or invest more than 10% of the value of our total assets in the securities of more than one investment company. With regard to that portion of our portfolio invested in securities issued by investment companies, it should be noted that such investments might subject our stockholders to additional expenses. None of these policies are fundamental and may be changed without stockholder approval.

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Qualifying Assets

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

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

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

(b) is not an investment company (other than a small business investment company wholly owned by the business development company) or a company that would be an investment company but for certain exclusions under the 1940 Act; and

(c) satisfies any of the following:

1. does not have any class of securities with respect to which a broker or dealer may extend margin credit;

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

3. is a small and solvent company having total assets of not more than $4 million and capital and surplus of not less than $2 million.

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

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

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

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

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

In addition, a business development company must have been organized and have its principal place of business in the United States and must be operated for the purpose of making investments in the types of securities described in (1), (2) or (3) above.

Managerial Assistance to Portfolio Companies

In order to count portfolio securities as qualifying assets for the purpose of the 70% test, the business development company must either control the issuer of the securities or must offer to make available to the issuer of the securities (other than small and solvent companies described above) significant managerial assistance; except that, where the business development company purchases such securities in conjunction with one or more other persons acting together, one of the other persons in the group may make available such managerial assistance. Making available significant managerial assistance means, among other things, any arrangement whereby the business development company, through its directors, officers or employees, offers to provide, and, if accepted, does so provide, significant guidance and counsel concerning the management, operations or business objectives and policies of a portfolio company.

Temporary Investments

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

Senior Securities

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

Code of Ethics

We and Prospect Capital Management have each adopted a code of ethics pursuant to Rule 17j-1 under the 1940 Act that establishes procedures for personal investments and restricts certain personal securities transactions. Personnel subject to each code may invest in securities for their personal investment accounts, including securities that may be purchased or held by us, so long as such investments are made in accordance with the codes requirements. For information on how to obtain a copy of each code of ethics, see Available Information.

Investment Concentration

Our investment objective is to maximize our portfolios total return, principally by investing in the debt and/or equity securities of private and microcap public companies. Many of our investments are in the energy sector.

Compliance Policies and Procedures

We and our Investment Adviser have adopted and implemented written policies and procedures reasonably designed to prevent violation of the federal securities laws, and are required to review these compliance policies and procedures annually for their adequacy and the effectiveness of their implementation, and to designate a Chief Compliance Officer to be responsible for administering the policies and procedures. William E. Vastardis serves as Chief Compliance Officer for both Prospect Capital and our Investment Adviser.

Proxy Voting Policies and Procedures

We have delegated our proxy voting responsibility to Prospect Capital Management. The Proxy Voting Policies and Procedures of Prospect Capital Management are set forth below. The guidelines are reviewed periodically by Prospect Capital Management and our independent directors, and, accordingly, are subject to change.

Introduction. As an investment adviser registered under the Investment Advisers Act of 1940, Prospect Capital Management has a fiduciary duty to act solely in the best interests of its clients. As part of this duty, Prospect Capital Management recognizes that it must vote client securities in a timely manner free of conflicts of interest and in the best interests of its clients.

These policies and procedures for voting proxies for Prospect Capital Managements Investment Advisory clients are intended to comply with Section 206 of, and Rule 206(4)-6 under, the Investment Advisers Act of 1940.

Proxy policies. These policies are designed to be responsive to the wide range of subjects that may be the subject of a proxy vote. These policies are not exhaustive due to the variety of proxy voting issues that Prospect Capital Management may be required to consider. In general, Prospect Capital Management will vote proxies in accordance with these guidelines unless: (1) Prospect Capital Management has determined to consider the matter on a case-by-case basis (as is stated in these guidelines), (2) the subject matter of the vote is not covered by these guidelines, (3) a material conflict of interest is present, or (4) Prospect Capital Management might find it necessary to vote contrary to its general guidelines to maximize shareholder value and vote in its clients best interests. In such cases, a decision on how to vote will be made by the Proxy Voting Committee (as described below). In reviewing proxy issues, Prospect Capital Management will apply the following general policies:

Elections of directors. In general, Prospect Capital Management will vote in favor of the management-proposed slate of directors. If there is a proxy fight for seats on the Board or Prospect Capital Management determines that there are other compelling reasons for withholding votes for directors, the Proxy Voting Committee will determine the appropriate vote on the matter. Prospect Capital Management believes that directors have a duty to respond to shareholder actions that have received significant shareholder support. Prospect Capital Management may withhold votes for directors that fail to act on key issues such as failure to implement proposals to declassify boards, failure to implement a majority vote requirement, failure to submit a rights plan to a shareholder vote and failure to act on tender offers where a majority of shareholders have tendered their shares. Finally, Prospect Capital Management may withhold votes for directors of non-U.S. issuers where there is insufficient information about the nominees disclosed in the proxy statement.

Appointment of auditors. Prospect Capital Management believes that the company remains in the best position to choose the auditors and will generally support managements recommendation.

Changes in capital structure. Changes in a companys charter, articles of incorporation or by-laws may be required by state or federal regulation. In general, Prospect Capital Management will cast its votes in accordance with the companys management on such proposal. However, the Proxy Voting Committee will review and analyze on a case-by-case basis any proposals regarding changes in corporate structure that are not required by state or federal regulation.

Corporate restructurings, mergers and acquisitions. Prospect Capital Management believes proxy votes dealing with corporate reorganizations are an extension of the investment decision. Accordingly, the Proxy Voting Committee will analyze such proposals on a case-by-case basis.

Proposals affecting shareholder rights. Prospect Capital Management will generally vote in favor of proposals that give shareholders a greater voice in the affairs of the company and oppose any measure that seeks to limit those rights. However, when analyzing such proposals, Prospect Capital Management will weigh the financial impact of the proposal against the impairment of shareholder rights.

Corporate governance. Prospect Capital Management recognizes the importance of good corporate governance in ensuring that management and the Board of Directors fulfill their obligations to the shareholders. Prospect Capital Management favors proposals promoting transparency and accountability within a company.

Anti-takeover measures. The Proxy Voting Committee will evaluate, on a case-by-case basis, proposals regarding anti-takeover measures to determine the measures likely effect on shareholder value dilution.

Stock splits. Prospect Capital Management will generally vote with management on stock split matters.

Limited liability of directors. Prospect Capital Management will generally vote with management on matters that would affect the limited liability of directors.

Social and corporate responsibility. The Proxy Voting Committee may review and analyze on a case-by-case basis proposals relating to social, political and environmental issues to determine whether they will have a financial impact on shareholder value. Prospect Capital Management may abstain from voting on social proposals that do not have a readily determinable financial impact on shareholder value.

Proxy voting procedures. Prospect Capital Management will generally vote proxies in accordance with these guidelines. In circumstances in which (1) Prospect Capital Management has determined to consider the matter on a case-by-case basis (as is stated in these guidelines), (2) the subject matter of the vote is not covered by these guidelines, (3) a material conflict of interest is present, or (4) Prospect Capital Management might find it necessary to vote contrary to its general guidelines to maximize shareholder value and vote in its clients best interests, the Proxy Voting Committee will vote the proxy.

Proxy voting committee. Prospect Capital Management has formed a proxy voting committee to establish general proxy policies and consider specific proxy voting matters as necessary. In addition, members of the committee may contact management and interested shareholder groups as necessary to discuss proxy issues. Members of the committee will include relevant senior personnel. The committee may also evaluate proxies where we face a potential conflict of interest (as discussed below). Finally, the committee monitors adherence to guidelines, and reviews the policies contained in this statement from time to time.

Conflicts of interest. Prospect Capital Management recognizes that there may be a potential conflict of interest when it votes a proxy solicited by an issuer that is its advisory client or a client or customer of one of our affiliates or with whom it has another business or personal relationship that may affect how it votes on the issuers proxy. Prospect Capital Management believes that adherence to these policies and procedures ensures that proxies are voted with only its clients best interests in mind. To ensure that its votes are not the product of a conflict of interests, Prospect Capital Management requires that: (i) anyone involved in the decision making process (including members of the Proxy Voting Committee) disclose to the chairman of the Proxy Voting Committee any potential conflict that he or she is aware of and any contact that he or she has had with any interested party regarding a proxy vote; and (ii) employees involved in the decision making process or vote administration are prohibited from revealing how Prospect Capital Management intends to vote on a proposal in order to reduce any attempted influence from interested parties.

Proxy voting. Each accounts custodian will forward all relevant proxy materials to Prospect Capital Management, either electronically or in physical form to the address of record that Prospect Capital Management has provided to the custodian.

Proxy recordkeeping. Prospect Capital Management must retain the following documents pertaining to proxy voting:

- copies of its proxy voting polices and procedures;
- copies of all proxy statements;
- records of all votes cast by Prospect Capital Management;
- copies of all documents created by Prospect Capital Management that were material to making a decision how to vote proxies or that memorializes the basis for that decision; and
- copies of all written client requests for information with regard to how Prospect Capital Management voted proxies on behalf of the client as well as any written responses provided.

All of the above-referenced records will be maintained and preserved for a period of not less than five years from the end of the fiscal year during which the last entry was made. The first two years of records must be maintained at our office.

Proxy voting records. Clients may obtain information about how Prospect Capital Management voted proxies on their behalf by making a written request for proxy voting information to: Compliance Officer, Prospect Capital Management, LLC, 10 East 40th Street, 44th Floor, New York, NY 10016.

CUSTODIAN, TRANSFER AND DIVIDEND PAYING AGENT AND REGISTRAR

Our Securities are held under a custody agreement by U.S. Bank National Association. The address of the custodian is: 1555 North Rivercenter Drive, MK-WI-5302, Milwaukee, WI 53212, Attention: Mutual Fund Custody Account Administrator, facsimile: (866) 350-1430. American Stock Transfer & Trust Company will act as our transfer agent, dividend paying agent and registrar. The principal business address of American Stock Transfer & Trust Company is 59 Maiden Lane, New York, NY 10007, telephone number: (718) 921-8200.

BROKERAGE ALLOCATION AND OTHER PRACTICES

Since we generally acquire and dispose of our investments in privately negotiated transactions, we infrequently use brokers in the normal course of our business. From the commencement of all operations through March 31, 2007, we have not paid any brokerage commissions. Subject to policies established by our Board of Directors, the Investment Adviser is primarily responsible for the execution of the publicly traded securities portion of our portfolio transactions and the allocation of brokerage commissions.

The Investment Adviser does not expect to execute transactions through any particular broker or dealer, but seeks to obtain the best net results for Prospect Capital, taking into account such factors as price (including the applicable brokerage commission or dealer spread), size of order, difficulty of execution, and operational facilities of the firm and the firm□s risk and skill in positioning blocks of securities. While the Investment Adviser generally seeks reasonably competitive trade execution costs, Prospect Capital will not necessarily pay the lowest spread or commission available. Subject to applicable legal requirements, the Investment Adviser may select a broker based partly upon brokerage or research services provided to the Investment Adviser and Prospect Capital and any other clients. In return for such services, we may pay a higher commission than other brokers would charge if the Investment Adviser determines in good faith that such commission is reasonable in relation to the services provided.

PLAN OF DISTRIBUTION

We may sell the Securities in any of three ways (or in any combination): (a) through underwriters or dealers; (b) directly to a limited number of purchasers or to a single purchaser, including existing stockholders in a rights offering; or (c) through agents. In the case of a rights offering, the applicable prospectus supplement will set forth the number of shares of our common stock issuable upon the exercise of each right and the other terms of such rights offering. Any underwriter or agent involved in the offer and sale of the Securities will also be named in the applicable prospectus supplement. The Securities may be sold □at-the-market□ to or through a market maker or into an existing trading market for the securities, on an exchange or otherwise. The prospectus supplement will set forth the terms of the offering of such securities, including:

- the name or names of any underwriters, dealers or agents and the amounts of Securities underwritten or purchased by each of them;
- the offering price of the Securities and the proceeds to us and any discounts, commissions or concessions allowed or reallowed or paid to dealers; and
- any securities exchanges on which the Securities may be listed.

If so indicated in the applicable prospectus supplement, we will authorize underwriters or other persons acting as our agents to solicit offers by certain institutions to purchase the Securities from us pursuant to contracts providing for payment and delivery on a future date. Institutions with which such contracts may be made include commercial and savings banks, insurance companies, pension funds, investment companies, educational and charitable institutions and others, but in all cases such institutions must be approved by us. The obligations of any purchaser under any such contract will be subject to the condition that the purchase of the securities not at the time of delivery be prohibited under the laws of the jurisdiction to which such purchaser is subject. The underwriters and such other agents will not have any responsibility in respect of the validity or performance of such contracts. Such contracts will be subject only to those conditions set forth in the prospectus supplement, and the prospectus supplement will set forth the commission payable for solicitation of such contracts.

We may use Stock to acquire investments in companies, the terms of which will be further disclosed in a prospectus supplement.

Any offering price and any discounts or concessions allowed or reallowed or paid to dealers may be changed from time to time.

We may sell shares of our common stock at a price below net asset value per share if the following conditions are met: (1) a majority of the our directors who have no financial interest in the sale and a majority of such directors who are not interested persons of us have determined that any such sale would be in our best interests and in the best interests of our stockholders; and (2) a majority of our directors who have no financial interest in the sale and a majority of such directors who are not interested persons of us, in consultation with the underwriter or underwriters of the offering if it is to be underwritten, have determined in good faith, and as of a time immediately prior to the first solicitation by or on behalf of us of firm commitments to purchase such securities or immediately prior to the issuance of such securities, that the price at which such securities are to be sold is not less than a price which closely approximates the market value of those securities, less any distributing commission or discount. On January 17, 2007, our stockholders approved, for a one year period, the sale of shares of our common stock at a price below net asset value per share if the above conditions are met.

If underwriters are used in the sale of any Securities, the Securities will be acquired by the underwriters for their own account and may be resold from time to time in one or more transactions, including negotiated transactions, at a fixed public offering price or at varying prices determined at the time of sale. The Securities may be either offered to the public through underwriting syndicates represented by managing underwriters, or directly by underwriters. Generally, the underwriters’ obligations to purchase the Securities will be subject to certain conditions precedent.

The maximum commission or discount to be received by any NASD member or independent broker-dealer will not exceed 5%. In connection with any rights offering to our stockholders, we may also enter into a standby underwriting arrangement with one or more underwriters pursuant to which the underwriter(s) will purchase our common stock remaining unsubscribed for after the rights offering.

We may sell the Securities through agents from time to time. The prospectus supplement will name any agent involved in the offer or sale of the Securities and any commissions we pay to them. Generally, any agent will be acting on a best efforts basis for the period of its appointment.

We may authorize underwriters, dealers or agents to solicit offers by certain purchasers to purchase the Securities from us at the public offering price set forth in the prospectus supplement pursuant to delayed delivery contracts providing for payment and delivery on a specified date in the future. The contracts will be subject only to those conditions set forth in the prospectus supplement, and the prospectus supplement will set forth any commissions we pay for soliciting these contracts.

Agents, dealers and underwriters may be entitled to indemnification by us against certain civil liabilities, including liabilities under the Securities Act or to contribution with respect to payments which the agents or underwriters may be required to make in respect thereof. Agents, dealers and underwriters may be customers of, engage in transactions with, or perform services for us in the ordinary course of business.

We may enter into derivative transactions with third parties, or sell securities not covered by this prospectus to third parties in privately negotiated transactions. If the applicable prospectus supplement indicates, in connection with those derivatives, the third parties may sell securities covered by this prospectus and the applicable prospectus supplement, including in short sale transactions. If so, the third party may use securities pledged by us or borrowed from us or others to settle those sales or to close out any related open borrowings of stock, and may use securities received from us in settlement of those derivatives to close out any related open borrowings of stock. The third party in such sale transactions will be an underwriter and, if not identified in this prospectus, will be identified in the applicable prospectus supplement (or a post-effective amendment). We or one of our affiliates may loan or pledge securities to a financial institution or other third party that in turn may sell the securities using this prospectus. Such financial institution or third party may transfer its short position to investors in our Securities or in connection with a simultaneous offering of other securities offered by this prospectus or otherwise.

Any of our common stock sold pursuant to a prospectus supplement will be listed on The NASDAQ National Market, or another exchange on which our common stock is traded.

In order to comply with the securities laws of certain states, if applicable, the Securities offered hereby will be sold in such jurisdictions only through registered or licensed brokers or dealers. In addition, in certain states, the Securities may not be sold unless they have been registered or qualified for sale in the applicable state or an exemption from the registration or qualification requirements is available and is complied with.

LEGAL MATTERS

Certain legal matters regarding the securities offered by this prospectus will be passed upon for Prospect Capital by Clifford Chance US LLP, New York, NY, and Venable LLP as special Maryland counsel.

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

BDO Seidman, LLP is the independent registered public accounting firm of Prospect Capital.

AVAILABLE INFORMATION

We have filed with the SEC a registration statement on Form N-2, together with all amendments and related exhibits, under the Securities Act, with respect to our Securities offered by this prospectus. The registration statement contains additional information about us and the Securities being registered by this prospectus. We file with or submit to the SEC annual, quarterly and current periodic reports, proxy statements and other information meeting the informational requirements of the Exchange Act. This information and the information specifically regarding how we voted proxies relating to portfolio securities for the period ended June 30, 2006, are available free of charge by contacting us at 10 East 40th Street, 44th floor, New York, NY 10016 or by telephone at toll-free (888) 748-0702. You may inspect and copy these reports, proxy statements and other information, as well as the registration statement and related exhibits and schedules, at the Public Reference Room of the SEC at 100 F Street NE, Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at (202) 551-8090. The SEC maintains an Internet site that contains reports, proxy and information statements and other information filed electronically by us with the SEC which are available on the SEC's Internet site at http://www.sec.gov. Copies of these reports, proxy and information statements and other information may be obtained, after paying a duplicating fee, by electronic request at the following E-mail address: publicinfo@sec.gov, or by writing the SEC's Public Reference Section, Washington, D.C. 20549-0102.

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* Commencement of operations

PROSPECT CAPITAL CORPORATION
STATEMENT OF ASSETS AND LIABILITIES
(unaudited)
(in thousands, except share and per share amounts)

	March 31, 2007 (Unaudited)	June 30, 2006[(1)]
Assets		
Investments at fair value (cost of $205,728 and $123,593, respectively, Note 3):		
Control investments (cost of $101,094 and $39,759, respectively)	$ 110,268	$ 49,58
Affiliate investments (cost of $14,751 and $25,329, respectively)	14,751	25,32
Non-control/Non-affiliate investments (cost of $89,883 and $58,505, respectively)	86,234	59,05
Total investments at fair value	211,253	133,96
Investments in money market funds	99,584	1,60
Receivables for:		
Interest	1,968	1,63
Dividends	448	1
Loan principal	504	38
Securities sold	—	36
Other	254	
Due from Prospect Administration (Note 5)	—	
Due from Prospect Energy Management (Note 5)	—	2

Prepaid expenses	163	7
Deferred financing costs	387	35
Deferred offering costs		3
Total Assets	314,561	138,48
Liabilities		
Credit facility payable		28,50
Payable for investments	1,666	
Bank overdraft	5,964	
Due to Prospect Administration (Note 5)	286	
Due to Prospect Capital Management (Note 5)	3,468	74
Accrued expenses	846	84
Other current liabilities	564	12
Total Liabilities	12,794	30,21
Net Assets	$ 301,767	$ 108,27
Components of Net Assets		
Common stock, par value $0.001 per share (100,000,000 and 100,000,000 common shares authorized, respectively; 19,879,231 and 7,069,873 issued and outstanding, respectively)	$ 20	$
Paid-in capital in excess of par	298,659	97,26
Undistributed (distributions in excess of) net investment income	(4,688)	31
Accumulated realized gains on investments	2,251	30
Unrealized appreciation on investments	5,525	10,37
Net Assets	$ 301,767	$ 108,27
Net Asset Value Per Share	$ 15.18	$ 15.3

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

See notes to financial statements.

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

	Three Months Ended	
	March 31, 2007	**March 31, 2006[(1)]**
Investment Income		
Interest income:		
Control investments (Net of foreign withholding tax of $67 and $ -, respectively)	$ 3,845	$ 1,319
Affiliate investments (Net of foreign withholding tax of $35 and $ -, respectively)	800	70
Non-control/Non-affiliate investments	4,025	1,586
Cash equivalents		111

Total interest income	8,670	3,086
Dividend income:		
Control investments	850	850
Non-control/Non-affiliate investments		10
Money market funds	1,245	80
Total dividend income	2,095	940
Other income[2]:		
Affiliate investments	8	
Non-control/Non-affiliate investments	1,296	
Total Other income	1,304	
Total Investment Income	12,069	4,026
Operating Expenses		
Investment advisory fees:		
Base management fee (Note 5)	1,531	521
Income incentive fee (Note 5)	1,754	533
Total investment advisory fees	3,285	1,054
Interest expense and credit facility costs	353	12
Chief Compliance Officer and Sub-administration fees	164	81
Legal fees	593	390
Valuation services	92	45
Other professional fees	47	85
Insurance expense	72	85
Directors fees	55	55
Other general and administrative expenses	393	93
Total Operating Expenses	5,054	1,900
Net Investment Income	7,015	2,126
Net realized gain (loss) on investments	(1)	1
Net change in unrealized appreciation (depreciation) on investments	(2,038)	828
Net Increase in Net Assets Resulting from Operations	$ 4,976	$ 2,955
Net increase in net assets resulting from operations per share:	$ 0.25	$ 0.42
Weighted average shares of common stock outstanding:	19,697,473	7,055,176

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

(2) Includes Net Profits Interests, Prepayment Penalties not related to loans, Deal Deposit and Overriding Royalty Interests.

See notes to financial statements.

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

	Nine Months Ended	
	March 31, 2007	**March 31, 2006(1)**
Investment Income		
Interest income:		
Control investments (Net of foreign withholding tax of $112 and $-, respectively)	$ 9,455	$ 3,334
Affiliate investments (Net of foreign withholding tax of $202 and $-, respectively)	2,837	70
Non-control/Non-affiliate investments	8,656	4,451
Cash equivalents	—	427
Total interest income	20,948	8,372
Dividend income:		
Control investments	2,550	2,249
Non-control/Non-affiliate investments	—	300
Money market funds	1,839	150
Total dividend income	4,389	2,699
Other income(2):		
Control investments	8	—
Affiliate investments	3	—
Non-control/Non-affiliate investments	1,324	—
Total Other income	1,335	—
Total Investment Income	26,672	—
Operating Expenses		
Investment advisory fees:		
Base management fee (Note 5)	3,715	1,554
Income incentive fee (Note 5)	3,695	1,041
Total investment advisory fees	7,410	2,595
Interest expense and credit facility costs	1,385	12
Chief Compliance Officer and Sub-administration fees	402	244
Legal fees	970	1,501
Valuation services	285	132
Sarbanes-Oxley compliance expenses	46	—
Other professional fees	386	313
Insurance expense	219	269
Directors’ fees	175	165
Other general and administrative expenses	612	258
Total Operating Expenses	11,890	5,489
Net Investment Income	14,782	5,582
Net realized gain (loss) on investments	1,949	(18)
Net change in unrealized appreciation (depreciation) on investments	(4,851)	1,392
Net Increase in Net Assets Resulting from Operations	$ 11,880	$ 6,956
Net increase in net assets resulting from operations per share:	$ 0.83	$ 0.99
Weighted average shares of common stock outstanding:	14,341,811	7,055,125

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

(2) Includes Net Profits Interests, Prepayment Penalties not related to loans, Deal Deposit and Overriding Royalty Interests.

See notes to financial statements.

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

	Nine Months Ended	
	March 31, 2007	**March 31, 2006[1]**
Increase in Net Assets from Operations:		
Net investment income	$ 14,782	$ 5,582
Net realized gain (loss) on investments	1,949	(18)
Net change in unrealized appreciation (depreciation) on investments	(4,851)	1,392
Net Increase in Net Assets Resulting from Operations	11,880	6,956
Dividends to Shareholders:	(19,790)	(5,502)
Capital Share Transactions:		
Net proceeds from shares sold	197,557	—
Less offering costs of public share offerings	(869)	71
Reinvestment of dividends	4,719	110
Net Increase in Net Assets Resulting from Capital Share Transactions	201,407	181
Total Increase in Net Assets:	193,497	1,635
Net assets at beginning of period	108,270	102,967
Net Assets at End of Period	$ 301,767	$ 104,602
Capital Share Activity:		
Shares sold	12,526,650	—
Shares issued through reinvestment of dividends	282,708	6,840
Net increase in capital share activity	12,809,358	6,840
Shares outstanding at beginning of period	7,069,873	7,055,100
Shares Outstanding at End of Period	19,879,231	7,061,940

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

See notes to financial statements.

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PROSPECT CAPITAL CORPORATION
STATEMENTS OF CASH FLOWS
(in 000s, except share data)
(Unaudited)

	Nine Months En	
	March 31 2007	Ma 2
Cash Flows from Operating Activities:		
Net increase in net assets resulting from operations	$ 11,880	$
Adjustments to reconcile net increase in net assets resulting from operations to net cash provided by (used in) operating activities:		
Net change in unrealized appreciation (depreciation) on investments	4,851	
Net realized gain (loss) on investments	(1,949)	
Accretion of original issue discount on investments	(1,436)	
Amortization of deferred financing costs	836	
Change in operating assets and liabilities:		
Purchases of investments	(106,846)	(1
Sales of investments	28,096	1
Net investments in money market funds	(97,976)	
Increase in interest receivable	(329)	
Increase in dividends receivable	(435)	
Increase in loan principal receivable	(119)	
Decrease in receivable for securities sold	369	
Increase in other receivable	(254)	
Decrease in due from Gas Solutions Holdings, Inc.	—	
Decrease (increase) in due from Prospect Administration	28	
Decrease (increase) in due from Prospect Capital Management	5	
Increase in prepaid expenses	(86)	
Decrease in deferred offering costs	32	
Increase in payable for securities purchased	1,666	
Increase in due to Prospect Administration	286	
Increase in due to Prospect Capital Management	2,723	
Increase (decrease) in accrued expenses	3	
Increase in other current liabilities	442	
	(158,213)	
Net Cash Used In Operating Activities		
Cash Flows from Financing Activities:		
Borrowings under credit facility	(28,500)	
Net proceeds from issuance of common stock	197,557	
Increase in deferred financing costs	(868)	
Offering costs from issuance of common stock	(869)	
Dividends declared and paid	(15,071)	
Net Cash Provided By (Used In) Financing Activities	152,249	
Net Increase (Decrease) in Cash	(5,964)	
Cash, beginning of period	—	
Cash (Bank Overdraft), End of Period	$ (5,964)	$

Cash Paid For Interest	$	526	$	
Non-Cash Financing Activity:				
Shares issued in connection with dividend reinvestment plan	$	4,719	$	

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

See notes to financial statements.

PROSPECT CAPITAL CORPORATION
SCHEDULE OF INVESTMENTS
March 31, 2007
(in 000s except share amounts)
(Unaudited)

Portfolio Investments[1]	**Locale/Industry**	**Par Value/ Shares**	**Cost**	**Fair Value**[2]	**% of Net Asets**
	Control Investments (25.00% or greater of voting control)				
Advantage Oilfield Group Ltd.	Alberta, Canada/ Construction Services				
Common shares, Class A		33	$ 219	$ 219	0.1%
Senior secured note, 15.00% due 5/30/2009[3]		$ 17,321	16,867	16,867	5.6%
Total			17,086	17,086	5.7%
Gas Solutions Holdings, Inc.[4]	Texas/Gas Gathering and Processing				
Common shares		100	4,882	19,500	6.5%
Subordinated secured note, 18.00% due 12/22/2011		$ 18,400	18,400	18,400	6.1%
Total			23,282	37,900	12.6%
Genesis Coal Corp.	Kentucky/ Mining and Coal Production				
Common Stock		60	10	1	0.0%
Warrants, preferred shares, expiring 2/9/2016		1,000	33	1	0.0%
Senior secured note, 16.40%[10] due 12/31/2010		$ 12,786	12,646	9,805	3.2%
Total			12,689	9,807	3.2%
NRG Manufacturing, Inc.	Texas/				

	Manufacturing				
Common shares		800	2,316	4,596	1.5%
Senior secured note, 16.50%[5] due 8/31/2013		$ 10,080	10,080	10,080	3.3%
Total			12,396	14,676	4.8%
Whymore Coal Company, Inc.[6]	Kentucky/ Mining and Coal Production				
Equity ownership		Various	98	1	0.0%
Senior secured note, 16.03%[7] due 12/31/2010		$ 10,644	$ 10,644	$ 5,900	2.0%
Total			10,742	5,901	2.0%

See notes to financial statements.

PROSPECT CAPITAL CORPORATION
SCHEDULE OF INVESTMENTS
March 31, 2007
(in 000s except share amounts)
(Unaudited)

Portfolio Investments[1]	Locale/Industry	Par Value/ Shares	Cost	Fair Value[2]	% of Net Asets
Worcester Energy Company, Inc.[8]	Maine/Biomass Power				
Equity ownership		Various	2	1	0.0%
Senior secured note, 12.50% due 12/31/2012		$ 25,089	24,897	24,897	8.2%
Total			24,899	24,898	8.2%
Total Control Investments			101,094	110,268	36.5%
Affiliate Investments (5.00% to 24.99% of voting control)					
Appalachian Energy Holdings LLC[9]	West Virginia/ Construction Services				
Series A preferred shares		200	63	63	0.0%
Warrants, expiring 2/14/2016		6,065	348	348	0.1%
Senior secured note, 14.00%, 3.00% PIK due 1/31/2011		$ 5,380	5,175	5,175	1.7%
Total			5,586	5,586	1.8%

Iron Horse Coiled Tubing, Inc.	Alberta, Canada/ Production services				
Common shares		93	268	268	0.1%
Senior secured note, 15.00% due 4/19/2009		$ 9,250	8,897	8,897	3.0%
Total			9,165	9,165	3.1%
Total Affiliate Investments			14,751	14,751	4.9%
Non-Control/Non-Affiliate Investments (less than 5.00% of voting control)					
Arctic Acquisition Corp.[11]	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 6/15/2009		$ 11,507	10,768	10,768	3.5%
Total			11,782	11,782	3.9%

See notes to financial statements.

PROSPECT CAPITAL CORPORATION
SCHEDULE OF INVESTMENTS
March 31, 2007
(in 000s except share amounts)
(Unaudited)

Portfolio Investments[1]	**Locale/Industry**	**Par Value/ Shares**	**Cost**	**Fair Value**
C&J Cladding LLC	Texas/Metal Services			
Warrants, common shares, expiring 3/30/2014		510	580	5
Senior secured note, 14.00%[12] due 3/31/2012		$ 6,000	5,240	5,2
Total			5,820	5,8
Central Illinois Energy, LLC	Illinois/ Biofuels/ Ethanol			
Senior secured note, 15.35%[13] due 3/31/2014		$ 8,000	8,000	8,0

Charlevoix Energy Trading, LLC[14]	Michigan/ Natural Gas Marketing				
Senior secured note, 12.50% due 3/31/2011		$	4,840	4,782	4,7
Conquest Cherokee, LLC[14]	Tennessee/Oil and Gas Production				
Senior secured note, 13.00%[16] due 5/5/2009		$	10,200	10,028	10,0
Evolution Petroleum Corp.[17]	Texas/Oil and Gas Production				
Common shares, unregistered			139,926	20	3
Jettco Marine Services LLC[14]	Louisiana/ Shipping				
Subordinated secured note, 12.00%[18], plus 4.0% PIK due 12/31/2011		$	6,604	6,482	6,4
Miller Petroleum, Inc.	Tennessee/Oil and Gas Production				
Warrants, expiring 5/4/2010 to 3/31/2012			1,115,776	$ 151	$
Stryker Energy, LLC[19]	Ohio/Oil and Gas Production				
Subordinated revolving credit facility, 12.22%[20] due 11/30/2011		$	24,000	23,694	23,6
TLOGH, L.P.[19]	Texas/Oil and Gas Production				
Senior secured note, 13.00%, Due 10/23/2009		$	15,500	15,297	15,2

See notes to financial statements.

PROSPECT CAPITAL CORPORATION
SCHEDULE OF INVESTMENTS
March 31, 2007
(in 000s except share amounts)
(Unaudited)

Portfolio Investments[1]	**Locale/Industry**	**Par Value/ Shares**	**Cost**	**Fair Value[2]**	**% of Net Asets**
Unity Virginia Holdings, LLC	Virginia/ Mining				

and Coal Production				
Subordinated secured note, 15.00%, 15.00% PIK due 1/31/2009	$ 3,580	3,827	10	0.0%
Total Non-Control/Non-Affiliate Investments		89,883	86,234	28.6%
Total Portfolio Investments		205,728	211,253	70.0%
Money Market Funds				
Fidelity Institutional Money Market Funds - Government Portfolio (Class I)	91,847,284	91,847	91,847	30.4%
First American Funds, Inc. - Prime Obligations Fund (Class Y)	7,736,865	7,737	7,737	2.6%
Total Money Market Funds		99,584	99,584	33.0%
Total Investments		$ 305,312	$ 310,837	103.0%

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(1) The securities in which Prospect Energy 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 Energy (Note 2).

(3) Prospect Energy 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. and NRG Manufacturing, Inc. are wholly-owned investments of Prospect Energy.

(5) Interest rate is the greater of 16.5% or 12-Month LIBOR plus 11.0%; rate reflected is as of December 31, 2006.

(6) There are several entities involved in the Whymore investment. The senior secured debt is with 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 Energy. Prospect Energy 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 Energy owns 4,285 Series A convertible preferred shares in each of C&A, E&L and Whymore. Additionally, Prospect Energy retains an option to purchase the remaining 51% of Whymore. As of December 31, 2006, the Board of Directors of Prospect Energy assessed a fair value of $0 for all of these equity positions.

(7) Interest rate is the greater of 15.0% or 5-Year US Treasury Note plus 11.5%; rate reflected is as of December 31, 2006.

(8) There are several entities involved in the Worcester investment. Prospect Energy 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 Energy also owns 282 shares of common stock in Worcester Energy Co., Inc. (WECO), which represents 51% ownership. Prospect

Energy also owns 1,665 shares of common stock in Worcester Energy Partners, Inc. (WEPI), which represents 51% ownership. Prospect Energy 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 by Prospect Energy. WEPI owns the equipment and operates the biomass generation facility. Biochips LLC currently has no material operations.

(9) There are several entities involved in the Appalachian Energy Holdings (Appalachian Energy) investment. Prospect Energy 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.

See notes to financial statements.

(10) Interest rate is the greater of 15.0% or 6-Month LIBOR plus 11.0%; rate reflected is as of December 31, 2006.

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

(12) Interest rate is LIBOR plus 10.0%; rate reflected is as of December 31, 2006.

(13) Prospect Energy has a net profits interest in the Portfolio Investment.

(14) Prospect Energy 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 December 31, 2006.

(16) Interest rate is the greater of 13.0% or 12-Month LIBOR plus 7.0%; rate reflected is as of December 31, 2006.

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

(18) Interest rate is the greater of 12.0% or 3-Month LIBOR plus 6.11%; rate reflected is as of December 31, 2006.

(19) Prospect Energy has an overriding royalty interest in Portfolio Investment.

(20) Interest rate is the greater of 12.0% or 12-Month LIBOR plus 7.0%; rate reflected is as of December 31, 2006.

See notes to financial statements.

PROSPECT ENERGY CORPORATION
SCHEDULE OF INVESTMENTS
June 30, 2006
(in 000s except share amounts)

Portfolio Investments[1]	Locale/Industry	Par Value/ Shares	Cost	Fair Value[2]	% of Net Assets
Control Investments (25.00% or greater of voting control)					

Gas Solutions Holdings, Inc.[3]	Texas/Gas Gathering and Processing				
Common shares		100	$ 4,875	$ 14,700	13.6%
Subordinated secured note, 18.00% due 12/22/2011		$ 18,400	18,400	18,400	17.0%
Total			23,275	33,100	30.6%
Worcester Energy Company, Inc.[4]	Maine/Biomass Power				
Equity ownership		Various	—	1	0.0%
Senior secured note, 12.50% due 12/31/2012		$ 20,338	16,484	16,484	15.2%
Total			16,484	16,485	15.2%
Total Control Investments			**39,759**	**49,585**	**45.8%**
Affiliate Investments (5.00% to 24.99% of voting control)					
Advantage Oilfield Group Ltd.	Alberta, Canada/ Construction Services				
Common shares, Class A		30	173	173	0.2%
Senior secured note, 15.00% due 5/30/2009[5]		$ 16,500	15,926	15,926	14.7%
Total			16,099	16,099	14.9%
Appalachian Energy Holdings LLC[6]	West Virginia/ Construction Services				
Series A preferred shares		200	35	35	0.0%
Warrants, expiring 2/14/2016		6,065	348	348	0.3%
Senior secured note, 14.00%, 3.00% PIK due 1/31/2011		$ 3,000	2,760	2,760	2.5%
Total			3,143	3,143	2.8%
Iron Horse Coiled Tubing, Inc.	Alberta, Canada/ Production Services				
Common shares		93	$ 268	$ 268	0.2%
Senior secured note, 15.00% due 4/19/2009		$ 6,250	5,819	5,819	5.4%
Total			6,087	6,087	5.6%
Total Affiliate Investments			25,329	25,329	23.3%

See notes to financial statements.

PROSPECT ENERGY CORPORATION
SCHEDULE OF INVESTMENTS
June 30, 2006
(in 000s except share amounts)

Portfolio Investments[1]	Locale/Industry	Par Value/ Shares	Cost	Fair Value[2]	% of Net Assets
Non-Control/Non-Affiliate Investments (less than 5.00% of voting control)					
Arctic Acquisition Corp.	Texas/ Production Services				
Warrants, common shares, expiring 7/19/2012		596,251	507	507	0.5%
Warrants, Series A redeemable preferred shares, expiring 7/19/2012		1,054	507	507	0.5%
Senior secured note, 13.00% due 6/15/2009		$ 9,099	8,082	8,082	7.5%
Total			9,096	9,096	8.5%
Central Illinois Energy, LLC	Illinois/ Biofuels/ Ethanol				
Senior secured note, 15.50%[7] due 3/31/2014		$ 8,000	8,000	8,000	7.4%
Charlevoix Energy Trading, LLC	Michigan/ Natural Gas Marketing				
Senior secured note, 12.50% due 3/31/2011		$ 5,500	5,422	5,422	5.0%
Conquest Cherokee, LLC	Tennessee/Oil and Gas Production				
Senior secured note, 13.24%[8] due 5/5/2009		$ 3,500	3,434	3,434	3.2%
Genesis Coal Corp.	Kentucky/ Mining and Coal Production				
Warrants, preferred shares, expiring 2/9/2016		1,000	$ 33	$ 33	0.0%
Senior secured note, 15.89%[9] due 12/31/2010		$ 6,925	6,734	6,734	6.2%
Total			6,767	6,767	6.2%
Miller Petroleum, Inc.	Tennessee/Oil				

	and Gas Production				
Warrants, expiring 5/4/2010 through 6/30/2011		842,527	150	150	0.1%
Natural Gas Systems, Inc.	Texas/Oil and Gas Production				
Common shares, registered		732,528	164	2,124	2.0%
Common shares, unregistered		139,926	20	345	0.3%
Total			184	2,469	2.3%

See notes to financial statements.

PROSPECT ENERGY CORPORATION
SCHEDULE OF INVESTMENTS
June 30, 2006
(in 000s except share amounts)

Portfolio Investments[1]	Locale/Industry	Par Value/ Shares	Cost	Fair Value[2]	% of Net Assets
Stryker Energy II, LLC[10]	Ohio/Oil and Gas Production				
Preferred stock		350	1,470	1,470	1.4%
Senior secured note, 13.32% due 4/8/2010		$ 13,330	13,139	13,138	12.1%
Total			14,609	14,608	13.5%
Unity Virginia Holdings, LLC	Virginia/ Mining and Coal Production				
Subordinated secured note, 15.00%, 15.00% PIK due 1/31/2009		$ 3,580	3,529	2,754	2.5%
Whymore Coal Company, Inc.[11]	Kentucky/ Mining and Coal Production				
Preferred shares, convertible, Series A		4,285	$ —	$ 1	0.0%
Senior secured note, 16.59%[12] due 12/31/2010		$ 7,425	7,314	6,354	5.9%
Total			7,314	6,355	5.9%
Total Non-Control/Non-Affiliate Investments			58,505	59,055	54.6%
Total Portfolio Investments			123,593	133,969	123.7%
Money Market Fund					
First American Funds, Inc. — Prime Obligations Fund (Class Y)		1,607,893	$ 1,608	$ 1,608	1.5%

Total Investments	$ 125,201	$ 135,577	125.2%

(1) The securities in which Prospect Energy 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 Energy (Note 2).

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

(4) There are several entities involved in the Worcester investment. Prospect Energy 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 Energy also owns 282 shares of common stock in Worcester Energy Co., Inc. (WECO), which represents 51% ownership. Prospect Energy also owns 1,665 shares of common stock in Worcester Energy Partners, Inc. (WEPI), which represents 51% ownership. Prospect Energy 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 by Prospect Energy. WEPI owns the equipment and operates the biomass generation facility. Biochips LLC currently has no material operations.

(5) Prospect Energy 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.

(6) There are several entities involved in the Appalachian Energy Holdings (Appalachian Energy) investment. Prospect Energy 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.

See notes to financial statements.

(7) Interest rate is LIBOR plus 10.0%; rate reflected is as of June 30, 2006.

(8) Interest rate is the greater of 13.0% or 12-Month LIBOR plus 7.5%; rate reflected is as of June 30, 2006.

(9) Interest rate is the greater of 15.0% or 6-Month LIBOR plus 11.0%; rate reflected is as of June 30, 2006.

(10) Prospect Energy owns 100 shares of common stock in PEH Stryker, Inc. (PEH Stryker), which represents 100%. PEH Stryker holds 350 non-voting Class A preferred units in Stryker Energy II, LLC (Stryker II), which represents a 35% interest. Stryker II is the borrower on the term note issued by Prospect Energy. Prospect Energy also holds one warrant expiring 4/18/2025 for anti-dilution purposes.

(11) There are several entities involved in the Whymore investment. The senior secured debt is with 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 Energy. Prospect Energy owns 4,285 Series A convertible preferred shares in each of C&A, E&L and Whymore.

(12) Interest rate is the greater of 15.0% or 5-Year US Treasury Note plus 11.5%; rate reflected is as of June 30, 2006.

See notes to financial statements.

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 is a closed-end investment company that has filed an election to be treated as a business development company under the Investment Company Act of 1940 (the 1940 Act). On July 27, 2004, the Company completed its initial public offering (IPO) and sold 7,000,000 shares of common stock at a price of $15.00 per share, less underwriting discounts and commissions totaling $1.05 per share. Since the IPO, the Company has had an exercise of an over-allotment option with respect to the IPO on August 27, 2004, a public offering on August 10, 2006, and subsequent exercise of an over-allotment option on August 28, 2006. On December 13, 2006, the Company priced a public offering of 6,000,000 shares of common stock at $17.70 per share, raising $106,200 in gross proceeds as well as an additional 810,000 shares of common stock at $17.70 per share raising $14,337 in gross proceeds in the exercise of an over-allotment option on January 11, 2007. The Company expects to use the net proceeds of its recent equity offering to fund investments in portfolio companies and for general corporate purposes.

Prospect Capital focuses primarily on investments in energy companies and will invest, under normal circumstances, at least 80% of its net assets (including the amount of any borrowings for investment purposes) in these companies. Prospect Capital concentrates on making investments in energy companies having annual revenues of less than $250,000 and in transaction sizes of less than $30,000. In most cases, these companies are privately held or have thinly traded public equity securities. From time to time, the Company will not hold at least 80% of its net assets in energy companies, especially immediately following a public offering of shares of its common stock.

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.

The statements include portfolio investments at fair value of $211,253 and $133,969 at March 31, 2007 and June 30, 2006, respectively. At March 31, 2007 and June 30, 2006, 70.0% and 123.7%, respectively, of the Companys net assets represented portfolio investments whose fair values have been determined by the board of directors in good faith in the absence of readily available market values. 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 a ready market existed for the investments, and the differences could be material.

Interim financial statements are prepared in accordance with GAAP for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 6 or 10 of Regulation S-X, as appropriate.

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

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 market value. The amortized cost method involves valuing a security at its cost on the date of purchase and thereafter assuming a constant amortization to maturity of the difference between the principal amount due at maturity and cost. 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 readily available market values. Debt and equity securities whose market prices are not readily available are valued at fair value, with the assistance of an independent valuation service, using a documented valuation policy and a consistently applied valuation process, which is under the direction of our Board of Directors.

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

As part of the fair valuation process, the Audit Committee reviews the preliminary evaluations prepared by the independent valuation firm engaged by the Board of Directors. Management and the independent valuation firm respond to the preliminary evaluation to reflect comments provided by the Audit Committee. The Audit Committee reviews the final valuation report and makes a recommendation to the Board of Directors based on its analysis of the methodologies employed and the various weights that should be accorded to each portion of the valuation as well as factors that the independent valuation firm and management may not have included in their evaluation process. The Board of Directors then evaluates the Audit Committee recommendations and undertakes a similar analysis to determine the fair value of each investment in the portfolio in good faith.

4) The Financial Accounting Standards Board (FASB) has recently issued a new pronouncement addressing fair value measurements, Statement of Financial Accounting Standards Number 157, Fair Value Measurements (FAS 157). This statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. FAS 157 does not become effective until November 2007 and is not expected to have a material effect on the 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) 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, 2007 and March 31, 2006, less than 0.01% and none, respectively of the Company s net assets are in non-accrual status.

g) The Company includes Net Profits Interest, Prepayment Penalties not related to loans, Deal Deposit Income and Overriding Royalty Interests as Other Income on the Statement of Operations.

Federal and State Income Taxes:

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

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

In July 2006, the FASB issued FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes, which establishes that a tax position taken or expected to be taken in a tax return is to be recognized in the financial statements when it is more likely than not, based on the technical merits, that the position will be sustained upon examination. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company does not believe that the adoption of FIN 48 will have a material impact on our results of operations or our financial position.

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 managements estimate of our earnings for the quarter. Net realized capital gains, if any, are distributed at least annually.

Consolidation:

As an investment company, Prospect Capital only consolidates subsidiaries that are also investment companies. At March 31, 2007 and at March 31, 2006, Prospect Capital did not have any consolidated subsidiaries.

In September 2006, the FASB cleared the AICPA Statement of Position No. 07-1, Clarification of the Scope of the Audit and Accounting Guide Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies (SOP 07-1) for issuance. SOP 07-1 addresses whether the accounting principles of the AICPA Audit and Accounting Guide Investment Companies may be applied to an entity by clarifying the definition of an investment company and whether those accounting principles may be retained by a parent company in consolidation or by and investor in the application method of accounting. SOP 07-1 applies to the later of (1) reporting periods beginning on or after December 15, 2007 or (2) the first permitted early adoption date of the FASBs fair value option statement. The adoption of SOP 07-1 is not expected to have a material impact on our combined financial statements.

Financing Costs:

The Company records origination expenses related to its credit facility as prepaid assets. 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 are charged as a reduction of capital upon utilization, in accordance with Section 8.24 of the AICPA Audit and Accounting Guide for Investment Companies.

Guarantees and Indemnification Agreements:

The Company follows FASB Interpretation Number 45, Guarantors 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, for ability for the fair value of the obligation undertaken in issuing certain guarantees. FIN 45 did not have a material effect on the financial statements. Refer to Note 3 for further discussion of guarantees and indemnification agreements.

Per Share Information:

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

Note 3. Portfolio Investments

At March 31, 2007, approximately 70.0% of our net assets or about $211,253 was invested in nineteen long-term portfolio investments and 33.0% of our net assets was invested in money market funds. The remainder (3.0%) of our net assets represented liabilities in excess of other assets. At March 31, 2006, approximately 89.5% of our net assets or about $93,560 was invested in nine long-term portfolio investments and 10.2% of our net assets was invested in money market funds and other short-term investments with the remaining 0.3% representing other assets in excess of liabilities. 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 more than 25% or more of the voting securities of an investee company. Affiliated investments and affiliated companies are defined by a lesser degree of influence and are deemed to exist through ownership of 5% or more of the outstanding voting securities of another person. The Company owns a controlling interest in Advantage Oilfield Group, Ltd. (AOG), Gas Solutions Holdings, Inc. (GSHI), Genesis Coal Corp. (Genesis), NRG Manufacturing, Inc. (NRG), Worcester Energy Company, Inc. (WECO) and Whymore Coal Company (Whymore). The Company also owns an affiliated interest in Appalachian Energy Holdings, LLC (AEH) and Iron Horse Coiled Tubing, Inc. (Iron Horse). The Company has no other controlled or affiliated investments. At March 31, 2006 the Company held a controlling interest in GSHI and WECO and had 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 $1,753 in fees associated with a legal action through March 31, 2007, and GSHI has reimbursed Prospect Capital the entire amount. Of the $1,753 reimbursement, $15 and $129 is reflected as Dividend income, Controlled entities on the accompanying statement of operations for the three months ended March 31, 2007 and March 31, 2006, respectively, and $136 and $772 for the nine months ended March 31, 2007 and March 31, 2006, respectively,

Debt placements and interests in non-voting equity securities with an original cost basis of approximately $19,699 and $106,846 were acquired during the three and nine months ended March 31, 2007, respectively. Debt repayments and sales of equity securities with an original cost basis of approximately $7,731 and $26,148 were disposed during the three and nine months ended March 31, 2007, respectively. Debt placements and interests in non-voting equity securities with an original cost basis of approximately $14,832 and $40,121 were acquired during the three and nine months ended March 31, 2006, respectively. Debt repayments and sales of equity securities with an original cost basis of approximately $0 and $3,470 were disposed of during the three and nine months ended March 31, 2006, respectively.

During the last six months, coal prices for Central Appalachian coal softened and have recovered only slightly due to mild winter weather and utility inventory surpluses. Marginal spot prices for coal have fallen to below operating costs for many of the smaller coal producers in that region. Genesis has a firm coal sales contract valid through all of 2007 with fixed pricing above both current spot market levels and operating costs. Genesis continues to sell coal under that contract. Whymore currently is selling coal on a spot basis to industrial users, which pay above the average utility spot price. These industrial customers are paying above Whymores operating costs, as well. Unity is currently not operating. While both Genesis and Whymore are not free of market risk and the risk of loss of capital due to these market conditions, cost cutting and revenue enhancing efforts at the companies, recent upward movements in demand and pricing due to colder weather in late winter, and production cuts at other producers may help to improve Genesis and Whymores operating margins. We are looking at opportunities to take advantage of the current depressed pricing environment through acquisitions at favorable prices.

With respect to Unity, discussions are underway between Unity, Prospect Capital, the second lien holder, and Texas Capital, the senior lender whose exposure has been reduced to $1.35 million, and Unity regarding liquifying the last remaining saleable property in the collateral package which consists of land, coal inventory, and the refuse area. According to Unity, the sale could yield up to $195,000. Prospect Capital believes that Unity principals would then have to pay off the remaining debt to Texas Capital, making Prospect Capital the senior most secured lender. Prospect Capital has declined a buyout offer from Unity principals for a nominal amount.

From time to time, the Company provides guarantees for portfolio companies for payments to counterparties, usually as an alternative to investing additional capital. Currently, guarantees are outstanding only for two portfolio companies categorized as Control Investments, which are not deemed by management to be material individually or in the aggregate.

Note 4. Organizational and Offering Expenses

A portion of the net proceeds of our initial public offering and the subsequent exercise of the over-allotment option was used for organizational and offering expenses of approximately $125 and $1,386, respectively. Organizational expenses were expensed as incurred. Offering expenses were charged against paid-in capital in excess of par. All organizational and offering expenses were borne by Prospect Capital.

A portion of the net proceeds of our August secondary offering and the subsequent exercise of the over-allotment option was used for offering expenses of approximately $594. A portion of the net proceeds of our December secondary offering and the subsequent exercise of the over-allotment option in January 2007 was used for offering expenses of approximately $275. Offering expenses were charged against paid-in capital in excess of par. All 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 Capitals 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 Managements 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 Capitals gross assets (including amounts borrowed). For services rendered under the Investment Advisory Agreement during the period commencing from the closing of Prospect Capitals initial public offering through and including the first six months of operations, the base management fee was payable monthly in arrears. 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 Capitals gross assets at the end of the two most recently completed calendar quarters (the closing of Prospect Capitals initial public offering was treated as a quarter end for these purposes) and appropriately adjusted for any share issuances or repurchases during the current calendar quarter. Base management fees for any partial month or quarter are appropriately pro rated. The total base management fees earned by and paid to Prospect Management during the three months ended March 31, 2007 and March 31, 2006 were $1,531 and $521, respectively, and during the nine months ended March 31, 2007 and March 31, 2006 were $3,715 and $1,554, respectively.

The incentive fee has two parts. The first part, the income incentive fee, is calculated and payable quarterly in arrears based on Prospect Capitals 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 Capitals 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 Capitals 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). Previously, our Investment Adviser had voluntarily agreed that for each fiscal quarter from January 1, 2005 to March 31, 2007, the quarterly hurdle rate will be equal to the greater of (a) 1.75% and (b) a percentage equal to the sum of 25.0% of the daily average of the quoted treasury rate for each month in the immediately preceding two quarters plus 0.50%. Quoted treasury rate means the yield to maturity (calculated on a semi-annual bond equivalent basis) at the time of computation for Five Year U.S. Treasury notes with a constant maturity (as compiled and published in the most recent Federal Reserve Statistical Release H). These calculations will be appropriately pro rated for any period of less than three months and adjusted for any share issuances or repurchases during the current quarter. The voluntary agreement by the Investment Adviser that the hurdle rate be fluctuating for each fiscal quarter after January 1, 2005 (as discussed above) has been terminated by the Investment Adviser for the June 30, 2007, quarter and beyond.

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 Capitals pre-incentive fee net investment income in each calendar quarter as follows:

- no incentive fee in any calendar quarter in which Prospect Capitals pre-incentive fee net investment income does not exceed the hurdle rate;
- 100.00% of Prospect Capitals 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 Capitals 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 Capitals 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 Capitals 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.

$1,754 and $533 income incentive fees were earned for the three months ended March 31, 2007 and March 31, 2006, respectively, and $3,695 and $1,041 income incentive fees were earned for the nine months ended March 31, 2007 and March 31, 2006, respectively. No capital gains incentive fees were earned were earned for the three or nine months ended March 31, 2007 and March 31, 2006.

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 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 Fund. 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 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 Securities and Exchange Commission. 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.

Managerial Assistance

As a business development company, we offer, and must provide upon request, managerial assistance to certain of our portfolio companies. This assistance could involve, among other things, monitoring the operations of our portfolio companies, participating in board and management meetings, consulting with and advising officers of portfolio companies and providing other organizational and financial guidance. We have received $193 and $392 in managerial assistance for the three and nine month periods ended March 31, 2007, respectively, and $71 and $148 for the three and nine month periods ended March 31, 2006, respectively. These fees are paid to the Administrator.

Note 6. Financial Highlights

	Three Months Ended Mar. 31, 2007 (Unaudited)	Three Months Ended Mar. 31, 2006 (Unaudited)	Nine Months Ended Mar. 31, 2007 (Unaudited)	Nine Months Ended Mar. 31, 2006 (Unaudited)
Per Share Data[1]:				
Net asset value at beginning of period	$ 15.24	$ 14.69	$ 15.31	$ 14.59
Costs related to the initial public offering	—	—	—	0.01
Costs related to the secondary public offering	0.01	—	(0.06)	—
Share issuances related to dividend reinvestment	—	0.02	—	0.02
Net investment income	0.36	0.30	1.02	0.79
Realized gain	—	—	0.14	—
Net unrealized appreciation (depreciation)	(0.10)	0.10	(0.34)	0.18
Net increase in net assets as a result of secondary public offering	0.06	—	0.27	—
Dividends declared and paid	(0.39)	(0.30)	(1.16)	(0.78)
Net asset value at end of period	$ 15.18	$ 14.81	$ 15.18	$ 14.81
Per share market value at end of period	$ 17.14	$ 16.44	$ 17.14	$ 16.44
Total return based on market value[2]	2.34%	11.08%	8.05%	37.35%
Total return based on net asset value[2]	1.88%	3.00%	6.19%	7.13%
Shares outstanding at end of period	19,879,231	7,061,940	19,879,231	7,061,940
Average weighted shares outstanding for period	19,697,473	7,055,176	14,341,811	7,055,125
Ratio / Supplemental Data:				
Net assets at end of period (in thousands)	$ 301,767	$ 104,602	$ 301,767	$ 104,602
Annualized ratio of operating expenses to average net assets	6.79%	7.27%	7.01%	6.96%
Annualized ratio of net operating income to average net assets	9.23%	8.13%	9.36%	7.12%

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

(2) Total return based on market value is based on the change in market price per share between the opening and ending market prices per share in each period and assumes that dividends are reinvested in accordance with Prospect Capitals 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 Capitals dividend reinvestment plan. The total returns are not annualized.

Note 7. Litigation

The Company is a defendant in two legal actions arising out of its activities. While predicting the outcome of litigation is inherently very difficult, and the ultimate resolution, range of possible loss and possible impact on operating results cannot be reliably estimated, management believes, based upon its understanding of the facts and the advice of legal counsel, that it has meritorious defenses for both actions. We continue to defend both of these actions vigorously, and believe that resolution of these actions will not have a materially adverse effect on the Companys financial position.

On December 6, 2004, 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 DGPs contract to purchase Gas Solutions, Ltd. (a subsidiary of our portfolio company, GSHI) in connection with Prospect Capitals 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. We believe 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 Capitals 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 Capitals Motion for Summary Judgment dismissing all claims by Dallas Gas Partners, L.P., against Prospect Capital Corporation. DGP has appealed this decision.

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On April 7, 2005 a former officer of the Company filed a complaint with the Occupational Safety and Health Administration of the Department of Labor (OSHA) alleging discrimination, retaliation, infliction of emotional distress and other claims. This officer seeks economic reinstatement and other relief. On September 15, 2005, OSHA issued findings, including an order dismissing this complaint. The complainant has filed written objections to the order and had a hearing before an Administrative Law Judge on March 16, 2006. On May 5, 2006, the Administrative Law Judge issued a Decision and Order granting Summary Decision and dismissing the complaint, which the former officer has appealed. The Company does not believe that these claims, even if ultimately resolved against the Company, would be material. The Company believes the complaint is frivolous and without merit and intends to defend itself vigorously.

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

Note 8. Revolving Credit Agreement

On February 21, 2006, Prospect Capital entered into a $20,000 senior secured revolving credit facility (the Previous Credit Facility) with Bank of Montreal as administrative agent and Harris Nesbitt Corp. as sole lead arranger and sole book runner. The Previous Credit Facility supplemented the Companys equity capital and provided funding for additional portfolio investments. All amounts borrowed under the Previous Credit Facility would have matured, and all accrued and unpaid interest thereunder would have been due and payable within six months of the date of the borrowing. The Previous Credit Facility had a termination date of August 21, 2006. On May 11, 2006, the Previous Credit Facility was increased to $30,000.

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 the $30,000 Previous Credit Facility. This Facility was used, together with our equity capital, to make additional long-term investments. Interest on borrowings under the Facility is 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.

As of March 31, 2007 and March 31, 2006, we had no amounts drawn down on the Facility.

Note 9. Subsequent Event

On April 12, 2007, Prospect Capital provided acquisition and growth financing of approximately $12.2 million to ESA Environmental Specialists, Inc. ("ESA"), located in Charlotte, North Carolina. Prospect Capital’s investment is in the form of a senior secured debt instrument with a first lien on all assets of ESA, including receivables and real estate. Prospect Capital has received a significant equity ownership in ESA as part of its investment.

Note 10. Selected Quarterly Financial Data (unaudited) (in thousands except per share amounts)

	Investment Income		Net Investment Income (Loss)		Net Realized and Unrealized Gains (Losses)		Net Increase (Decrease) in Net Assets from Operations	
Quarter Ended	**Total**	**Per Share***	**Total**	**Per Share***	**Total**	**Per Share***	**Total**	**Per Share***
September 30, 2004	$ 266	$ 0.05	$ (434)	$ (0.09)	$ —	$ —	$ (434)	$ (0.06)
December 31, 2004	2,946	0.42	1,228	0.17	(2)	—	1,226	0.17
March 31, 2005	2,202	0.31	444	0.06	414	0.06	858	0.12
June 30, 2005	2,679	0.38	1,173	0.17	5,928	0.84	7,101	1.01
September 30, 2005	3,109	0.44	1,415	0.20	58	0.01	1,473	0.21
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

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

Report of Independent Registered Public Accounting Firm

BDO SEIDMAN, LLP

Board of Directors and Stockholders
Prospect Energy Corporation
New York, NY

We have audited the accompanying balance sheets of Prospect Energy Corporation as of June 30, 2006 and 2005, including the schedule of investments, and the related statements of operations, stockholders' equity, and cash flows for the two years ended June 30, 2006 and 2005 and for the period from April 13, 2004 (inception) through June 30, 2004. These financial statements and financial highlights are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial highlights based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits, which included confirmation of securities at June 30, 2006 by correspondence with the custodian and issuers, provide a reasonable basis for our opinion.

In our opinion, the financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of Prospect Energy Corporation at June 30, 2006 and 2005, and the results of its operations and its cash flows for the two years ended June 30, 2006 and 2005 and for the period from April 13, 2004 (inception) through June 30, 2004, in conformity with accounting principles generally accepted in the United States of America.

Also, in our opinion, the schedules present fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Prospect Energy Corporation's internal control over financial reporting as of June 30, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Comission (COSO) and our report dated September 25, 2006 expressed an unqualified opinion thereon.

/s/ BDO Seidman LLP
New York, NY
September 25, 2006

As of the end of the period covered by this report, Prospect Energy carried out an evaluation, under the supervision and with the participation of Prospect Energy's management, including Prospect Energy's chief executive officer and chief financial officer, of the effectiveness of the design and operation of Prospect Energy's disclosure controls and procedures (as defined in Rule 13a-15 of the Securities Exchange Act of 1934 (the "1934 Act")). Based on that evaluation, as of September 27, 2006, the chief executive officer and the chief financial officer have concluded that Prospect Energy's current disclosure controls and procedures are effective in timely alerting them of material information relating to Prospect Energy that is required to be disclosed by Prospect Energy in the reports it files or submits under the 1934 Act.

Report of Management on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, and for performing an assessment of the effectiveness of internal control over financial reporting as of June 30, 2006. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company's internal control over financial reporting includes those policies and procedures that (i) pertain to assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company□s assets that could have a material effect on the financial statements.

Management performed an assessment of the effectiveness of the Company□s internal control over financial reporting as of June 30, 2006 based upon criteria in Internal Control□Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (□COSO□). Based on our assessment, management determined that the Company□s internal control over financial reporting was effective as of June 30, 2006 based on the criteria on Internal Control□Integrated Framework issued by COSO.

Our management□s assessment of the effectiveness of the Company□s internal control over financial reporting as of June 30, 2006 has been audited by BDO Seidman LLP, an independent registered public accounting firm, as stated in their report which appears herein.

There have been no changes in Prospect Energy's internal control over financial reporting that occurred during the three months ended June 30, 2006 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting

Board of Directors and Stockholders
Prospect Energy Corporation
New York, New York

We have audited management□s assessment, included in the accompanying Management□s Report on Internal Control Over Financial Reporting, that Prospect Energy Corporation (the □Company□) maintained effective internal control over financial reporting as of June 30, 2006, based on the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company□s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management□s assessment and an opinion on the effectiveness of the Company□s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management□s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company□s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company□s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company□s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management’s assessment that Prospect Energy Corporation maintained effective internal control over financial reporting as of June 30, 2006, is fairly stated, in all material respects, based on the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also in our opinion, Prospect Energy Corporation maintained, in all material respects, effective internal control over financial reporting as of June 30, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the balance sheets of Prospect Energy Corporation as of June 30, 2006 and 2005, including the schedule of investments and the related statements of operations, stockholders’ equity, and cash flows for the two years ended June 30, 2006 and 2005 and for the period from April 13, 2004 (inception) through June 30, 2004, and our report dated September 25, 2006 expressed an unqualified opinion.

/s/ BDO Seidman, LLP
New York, New York
September 25, 2006

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PROSPECT ENERGY CORPORATION
BALANCE SHEETS
(in thousands, except share and per share amounts)

	Ju 2
Assets	
Investments at fair value (cost - $125,201 and $87,524, respectively, Note 3)	
Investment in controlled entity at fair value (cost - $39,759 and $23,327, respectively)	$ 4
Investments in affiliated entities, at fair value (cost - $25,329 and $-, respectively)	2
Investments in uncontrolled and unaffiliated entities at fair value (cost - $60,113 and $64,197, respectively)	6
Total investments at fair value	13
Cash held in segregated account (Note 3)	
Accrued interest and dividend receivable	
Loan principal receivable	
Due from Gas Solutions Holdings, Inc. (Note 3)	
Due from Prospect Capital Management, LLC (Note 5)	
Due from Prospect Administration, LLC (Note 5)	
Due from broker	
Prepaid expenses	
Deferred financing fees	
Deferred offering costs	
Total assets	$ 13
Liabilities	
Credit facility payable	$ 2
Accrued liabilities	
Due to Prospect Capital Management, LLC (Note 5)	
Other current liabilities	
Total liabilities	3

Commitments and contingencies (Notes 3 and 7)	
Stockholders equity (Notes 1, 4 and 6)	
Common stock, par value $.001 per share (100,000,000 and 100,000,000 common shares authorized, respectively, 7,069,873 and 7,055,100 issued and outstanding, respectively)	
Paid-in capital in excess of par	9
Undistributed (distributions in excess of) net investment income	
Realized gain (loss)	
Net unrealized appreciation	1
Total stockholders equity	10
Total liabilities and stockholders equity	$ 13
Net asset value per share	$

(1) Certain amounts have been reclassified to conform to the current periods presentation

See notes to financial statements.

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PROSPECT ENERGY CORPORATION

SCHEDULE OF INVESTMENTS

(in thousands, except share amounts)

June 30, 2006

Portfolio Investments(1)	**Locale/Industry**	**Pricipal Amount/ Shares**	**Cost**	**Fair Value**
Controlled Entities				
Gas Solutions Holdings, Inc.(3)	Texas/Gas gathering and processing			
Common shares		100	$ 4,875	$ 14,7
Subordinated secured note, 18.00% due 12/23/2011		$ 18,400	18,400	18,4
Total			23,275	33,1
Worcester Energy Company, Inc.	Maine/Wood processing and biomass power generation			
Common shares		282		
Preferred stock, Convertible, Series A		1,000		
Senior secured note, 12.50% due 1/31/2012		$ 16,721	16,484	16,4
Total			16,484	16,4
Total Controlled Entities			39,759	49,5
Affiliated Entities				

Advantage Oilfield Group, Ltd.	Alberta, Canada/ Pipeline and Facility construction			
Common shares		30	173	1
Senior secured note, 15.00% due 5/30/2009		$ 16,500	15,926	15,9
Total			16,099	16,0
Appalachian Energy Holdings, LLC	West Virginia/Energy Construction services			
Preferred equity interest		200	35	
Warrants, Preferred equity interest, Expiring 2/14/16		6,065	348	3
Senior secured note, 14.00%, 3.00% PIK, due 1/31/2011		$ 3,000	2,760	2,7
Total			3,143	3,1
Iron Horse Coiled Tubing, Inc.	Alberta, Canada/ Coiled tubing Services			
Common shares		93	268	2
Senior secured note, 15.00% due 4/19/2009		$ 6,250	5,819	5,8
Total			6,087	6,0
Total Affiliated Entities			25,329	25,3
Uncontrolled and Unaffiliated Entities				
Arctic Acquisition Corporation	Texas/Oilfield services			
Warrants, Common Shares, Expiring 7/19/2012		596,251	$ 507	$ 5
Warrants, Preferred Shares, Expiring 7/19/2012		1,054	507	5
Senior secured note, 13.00% due 6/15/2009		$ 9,009	8,082	8,0
Total			9,096	9,0

PROSPECT ENERGY CORPORATION

SCHEDULE OF INVESTMENTS

(in thousands, except share amounts)

June 30, 2006 (continued)

Portfolio Investments[(1)]	**Locale/Industry**	**Principal Amount/ Shares**	**Cost**	**F Val**
Central Illinois Energy, LLC	Illinois/Ethanol			
Senior secured note, 10.00% plus LIBOR, due 3/31/2014		$ 8,000	8,000	
Charlevoix Energy Trading, LLC	Michigan/Natural gas marketing			
Senior secured note, 12.50% due 3/31/2011		$ 5,500	5,422	
Conquest Cherokee, LLC	Tennessee/Oil and gas production	$ 3,500	3,434	

— Senior secured note, 13.00% due 5/5/2009

Genesis Coal Corporation	Kentucky/Coal Production			
— Warrants, Preferred Shares, Expiring 1/31/2006		1,000	33	
— Senior secured note, 15.86% due 12/31/2010		$ 6,925	6,734	
Total			6,767	
Miller Petroleum, Inc.	Tennessee/Oil and gas production			
— Warrants Expiring 5/4/2010		630,000	150	
— Warrants Expiring 12/31/2010		30,361	—	
— Warrants Expiring 1/31/2011		30,361	—	
— Warrants Expiring 2/28/2011		30,361	—	
— Warrants Expiring 3/31/2011		30,361	—	
— Warrants Expiring 4/30/2011		30,361	—	
— Warrants Expiring 5/31/2011		30,361	—	
— Warrants Expiring 6/30/2011		30,361	—	
Total			150	
— Common shares, Registered		732,528	164	
— Common shares, Unregistered		139,926	20	
Total			184	
Stryker Energy II, LLC	Ohio/Oil and gas production			
— Preferred units		350	$ 1,470	$
— Senior secured note, 13.32% due 4/8/2010		$ 13,330	13,139	1
Total			14,609	1
Unity Virginia Holdings, LLC	Virginia/Coal production			
— Subordinated secured note, 15.00%, 15.00% PIK due 1/31/2009		$ 3,580	3,529	
Whymore Coal Company	Kentucky/Coal production			
— Preferred shares, Convertible, Series A		1,000	—	
— Senior secured note, 15.00% due 3/31/2009		$ 7,008	7,314	
Total			7,314	
Total Portfolio Investments			123,593	13

PROSPECT ENERGY CORPORATION
SCHEDULE OF INVESTMENTS
(in thousands, except share amounts)
June 30, 2006 (continued)

Portfolio Investments[1]	Locale/ Industry	Principal Amount/ Shares	Cost	Fair Value[2]	% of Net Assets
Money Market Fund		**Shares**			
First American Prime Obligation Fund (Class Y)		1,607,893	1,608	1,608	1.5%
Total Uncontrolled and Unaffiliated Entities			60,113	60.663	56.1%
Total Investments at Fair Value			$ 125,201	$ 135,577	125.2%

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(1) The securities in which Prospect Energy 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 Energy (Note 2).

(3) Gas Solutions Holdings Inc. is a wholly owned investment of Prospect Energy.

PROSPECT ENERGY CORPORATION
SCHEDULE OF INVESTMENTS
(in thousands, except share amounts)
June 30, 2005

Portfolio Investments[1]	Locale/ Industry	Principal Amount/ Shares	Cost	Fair Value[2]	% of Net Assets
Controlled Entity					
Gas Solutions Holdings, Inc.[3]	Texas/Gas gathering and processing				
Common shares		100	$ 4,927	$ 11,100	10.8%
Subordinated secured note, 18.00% due 12/22/2011		$ 18,400	18,400	18,400	17.9%
Total			23,327	29,500	28.7%
Total Controlled Entity			23,327	29,500	28.7%
Uncontrolled and Unaffiliated Entities					
Miller Petroleum, Inc.	Tennessee/Oil and gas production				
Warrants, Expiring 5/4/2010		630,000	$ 365	$ 365	0.4%
Senior secured note, 12.50% due 8/21/2006		$ 3,150	2,730	2,778	2.7%
Total			3,095	3,143	3.1%
Natural Gas Systems, Inc.	Texas/Gas gathering and processing				
Warrants, Expiring 2/2/2010		1,000,000	210	175	0.2%

Senior secured note, 14.00% due 2/3/2010		$ 4,000	3,729	3,746	3.6%
Total			3,939	3,921	3.8%
Stryker Energy II, LLC	Ohio/Oil and gas production				
Preferred units		350	1,470	1,470	1.4%
Senior secured note, 14.12% due 4/8/2010		$ 8,330	8,177	8,177	8.0%
Total			9,647	9,663	9.4%
Unity Virginia Holdings, LLC	Virginia/Coal production				
Preferred shares, 100%, non-voting		1,00	585	585	0.6%
Subordinated secured note, 17.65% due 1/31/2009		$ 3,315	3,210	3,210	3.1%
Total			3,795	3,795	3.7%
Whymore Coal	Kentucky/Coal production				
Preferred stock, Convertible, Series A		1,000		1	
Senior secured note, 15.00% due 3/31/2009		$ 4,885	4,885	4,885	4.7%
Total			4,885	5,008	4.8%
Total Portfolio Investments			48,688	55,030	53.5%
U.S. Government Securities	**Yield to Maturity[4]**				
U.S. Treasury Bill due 7/7/2005	2.52%	$ 5,518	5,516	5,516	5.4%
U.S. Treasury Bill due 7/14/2005	2.49%	$ 9,514	9,505	9,505	9.2%
U.S. Treasury Bill due 7/21/2005	2.55%	$ 22,261	22,226	22,226	21.6%
Total U.S. Government Securities			37,247	37,247	36.2%

PROSPECT ENERGY CORPORATION
SCHEDULE OF INVESTMENTS
(in thousands, except share amounts)
June 30, 2005 (continued)

Portfolio Investments[1]	**Locale/ Industry**	**Principal Amount/ Shares**	**Cost**	**Fair Value[2]**	**% of Net Assets**
Money Market Fund		**Shares**			
First American Prime Obligation Fund (Class Y)		1,587,854	1,589	1,589	1.5%
Total Uncontrolled and Unaffiliated Entities			**64,197**	**64,366**	**62.5%**
Total Investments at Fair Value			**$ 87,524**	**$ 93,866**	**91.2%**

See notes to financial statements.

(1) The securities in which Prospect Energy 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 Energy (Note 2).

(3) Gas Solutions Holdings Inc. is wholly owned and controlled investments of Prospect Energy.

(4) Yield to maturity at time of purchase.

PROSPECT ENERGY CORPORATION
STATEMENTS OF OPERATIONS
(in thousands, except share and per share amounts)

	For the twelve months ended June 30, 2006	For the twelve months ended June 30, 2005	For the Period from April 13, 2004 (inception) through June 30, 2004
Investment income			
Interest income			
Interest income, uncontrolled and unaffiliated entities	$ 6,997	$ 1,882	$ —
Interest income, controlled entities	4,810	2,704	—
Interest income, affiliated entities	560	—	—
Total interest income	12,367	4,586	—
Dividend income			
Dividend income, controlled entities (Note 3)	3,099	3,151	—
Dividend income, uncontrolled and unaffiliated entities	502	284	—
Total dividend income	3,601	3,435	—
Other income	901	72	—
Total investment income	16,869	8,093	—
Operating expenses			
Investment advisory fees:			
Base management fee (Note 5)	2,082	1,808	—
Income incentive fee (Note 5)	1,786	—	—
Total Investment advisory fees	3,868	1,808	—
Interest expense and credit facility costs	642	—	—
Administration costs (Note 5)	310	266	—
Legal fees (Note 3)	1,835	2,575	—
Valuation services	193	42	—
Other professional fees	485	230	—
Insurance expense	365	325	—

Directors’ fees	220	220	—
Organizational costs (Note 4)	—	25	100
General and administrative expenses	393	191	—
Total operating costs	8,311	5,682	100
Net investment income (loss)	8,558	2,411	(100)
Net realized gain (loss)	303	(2)	—
Net unrealized appreciation	4,035	6,342	—
Net increase in stockholders’ equity resulting from operations	$ 12,896	8,751	$ (100)
Basic and diluted net increase in stockholders equity per common share resulting from operations (Note 6)	$ 1.83	1.24	$ N/A

See notes to financial statements.

PROSPECT ENERGY CORPORATION
STATEMENT OF STOCKHOLDERS’ EQUITY
(in thousands, except share and per share amounts)

	Common Stock		Paid in Capital in Excess of Par	Undistributed (Distributions in Excess of) Net Investment Income	Realized Gain (Loss)	Net Investment Application	Total Stockholders’ Equity
	Shares	Amount					
Balance, April 13, 2004 (inception)	—	—	—	—	—	—	—
Issuance of common stock	100	—	$ —	$ 1	—	—	$ 1
Net decrease in stockholders’ equity from operations for the period from April 13, 2004 (inception) to June 30, 2004	—	—	—	(100)	—	—	(100)
Balance, June 30, 2004	100	$ —	$ 1	(100)	—	—	(99)
Issuance of common stock from public offering (net of underwriting costs)	7,055,000	7	98,417	—	—	—	98,424
Offering Costs	—	—	(1,463)	—	—	—	(1,463)
Net increase in stockholders’ equity resulting from operations for the year ended June 30, 2005	—	—	—	2,411	(2)	6,342	8,751
Dividends declared ($0.38 per share) and paid to stockholders	—	—	—	(2,646)	—	—	(2,646)
Balance, June 30, 2005	7,055,100	7	96,955	(335)	(2)	6,342	102,967

Offering Costs	—	—	70	—	—	—	70
Net increase in stockholders’ equity resulting from operations for the twelve months ended June 30, 2006	—	—	—	8,558	303	4,035	12,896
Dividends declared ($1.12 per share) and paid to stockholders	—	—	—	(7,904)	—	—	(7,904)
Shares issued in connection with dividend reinvestment	14,773		241	—	—	—	241
Balance, June 30, 2006	7,069,873	$ 7	$ 97,266	$ 319	$ 301	$ 10,377	$ 108,270

See notes to financial statements.

PROSPECT ENERGY CORPORATION
STATEMENTS OF CASH FLOWS
(in thousands)

	For the twelve months ended June 30, 2006	For the twelve months ended June 30, 2005	For the period from April 13, 2004 (inception) through June 30, 2004
Cash flows from operating activities:			
Net increase in stockholders’ equity resulting from operations	$ 12,896	$ 8,751	$ (100)
Adjustments to reconcile net increase in stockholders’ equity resulting from operations to net cash used in operating activities:			
Net unrealized appreciation on investments	(4,035)	(6,342)	—
Amortization of loan origination fees	(910)	(72)	—
Change in operating assets and liabilities:			—
Purchases of investments	(1,757,247)	(701,558)	—
Sale / refinancing of investments	1,720,481	614,106	—
Increase in prepaid expenses	28	(49)	—
Increase in accrued interest receivable	(1,446)	(206)	—
Increase in loan principal receivable	(385)	—	—
Decrease (increase) in due from Gas Solutions Holdings, Inc.	201	(201)	—
Increase in due from Prospect Capital Management, LLC	(5)	—	—
Increase in due from Prospect Administration, LLC	(28)	—	—
Increase in due from broker	(369)	—	—
Increase in deferred financing fees	(355)	—	—
Increase in deferred offering costs	(32)	—	—
Increase in accrued liabilities	25	818	—
Increase in other current liabilities	75	47	—
Increase (decrease) in due to Prospect Capital Management, LLC	668	(23)	100
Net cash used in operating activities	(30,494)	(84,729)	—
Cash flows from financing activities:			
Borrowings under credit facility	28,500	—	—

Net proceeds from the issuance of common stock		98,424	1
Offering costs from the issuance of common stock	70	(1,463)	
Dividends declared and paid	(7,663)	(2,646)	
Net cash (used in) provided by financing activities	20,907	94,315	1
Net (decrease) increase in cash	(9,587)	9,586	1
Cash, beginning of period	9,587	1	
Cash, end of period	$	$ 9,587	$ 1
Cash paid for interest	$ 422	$	$
Non-cash financing activity:			
Shares issued in connection with dividend reinvestment plan	$ 241	$	$

See notes to financial statements.

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Note 1. Organization

Prospect Energy Corporation (Prospect Energy or the Company), a Maryland corporation, was organized on April 13, 2004 and is a closed-end investment company that has filed an election to be treated as a business development company under the Investment Act of 1940. On July 27, 2004, the Company completed its initial public offering and sold 7,000,000 shares of common stock at a price of $15.00 per share, less underwriting discounts and commissions totaling $1.05 per share. On August 27, 2004, an additional 55,000 shares were issued for a price of $15.00 per share, less underwriting discounts and commissions of $1.05 per share in connection with the exercise of an over-allotment option with respect to the offering.

Prospect Energy Corporation focuses primarily on investments in private and microcap public companies. At June 30, 2006, approximately 123.7% of our net assets or about $134.0 million was invested in fifteen long-term portfolio investments and 1.5% of our net assets in a money market fund. The remaining (25.2%) of our net assets represented liabilities in excess of other assets. Prospect Energy is a non-diversified company within the meaning of the 1940 Act. Prospect Energy concentrates on making investments in companies having annual revenues of less than $250.0 million and in transaction sizes of less than $30.0 million. In most cases, these companies are privately held or have thinly traded public equity securities.

In the opinion of management, all adjustments (consisting primarily of normal recurring adjustments) have been made that are necessary to present fairly the financial position of the Company.

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.

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

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

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

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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.

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

f) Loan origination, facility, commitments, consent and other advance fees received by us on loan agreements or other investments are accreted into income over the term of the loan.

The Financial Accounting Standards Board ("FASB") has recently issued a new pronouncement addressing fair value measurements, Statement of Financial Accounting Standards Number 157, "Fair Value Measurements" ("FAS

157). This statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. FAS 157 is not expected to have a material effect on the financial statements.

Federal and State Income Taxes:

Prospect Energy 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.

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 managements estimate of our earnings for the quarter. Net realized capital gains, if any, are distributed at least annually.

Consolidation:

As an investment company, Prospect Energy only consolidates subsidiaries which are also investment companies. At June 30, 2006 Prospect Energy did not have any consolidated subsidiaries.

Guarantees and Indemnification Agreements:

The Company follows FASB Interpretation Number 45, Guarantors 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, a liability for the fair value of the obligation undertaken in issuing certain guarantees. FIN 45 did not have a material effect on the financial statements. Refer to Note 3 for further discussion of guarantees and indemnification agreements.

Note 3. Portfolio Investments

We classify our investments by level of control. As defined in the 1940 Act, control investments are those where there is the ability or power to exercise a controlling influence over the management or policies of a company. Control is generally deemed to exist when a company or individual owns more than 25% or more of the voting securities of an investee company. Affiliated investments and affiliated companies are defined by a lesser degree of influence and are deemed to exist through ownership of 5% or more of the outstanding voting securities of another person. The Company owns a controlling interest in GSHI and Worcester Energy Company, Inc.. The company also owns an affiliated interest in Advantage Oilfield Group, Ltd., Appalachian Energy Holdings, LLC and Iron Horse Coiled Tubing, Inc. The Company has no other controlled or affiliated investments.

GSHI has indemnified Prospect Energy against any legal action arising from its investment in Gas Solutions, LP. Prospect Energy has incurred approximately $1.617 million in fees associated with this legal action through June 30, 2006. GSHI has reimbursed Prospect Energy $1.617 million as of June 30, 2006. The $1.617 million reimbursement is reflected as Dividend income, controlled entities on the accompanying statement of operations for the year ended June 30, 2006 and June 30, 2005 and for the period from April 13, 2004 (inception) through June 30, 2004.

Debt placements and interests in non-voting equity securities with an original cost basis of approximately $74.0 million were acquired during the twelve months ended June 30, 2006. Debt repayments and sales of equity securities with an original cost basis of approximately $9.6 million were disposed during the twelve months ended June 30, 2006.

Note 4. Organizational and Offering Expenses

A portion of the net proceeds of our initial public offering and the subsequent exercise of the over-allotment option was used for organizational and offering expenses of approximately $0.125 million and $1.386 million, respectively. Organizational expenses were expensed as incurred. Offering expenses were charged against paid-in capital in excess of par. All organizational and offering expenses were borne by Prospect Energy.

Note 5. Related Party Agreements And Transactions

Investment Advisory Agreement

Prospect Energy 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 Energys board of directors, manages the day-to-day operations of, and provides investment advisory services to, Prospect Energy. 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 Managements 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 Energy, 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 Energys gross assets (including amounts borrowed). For services rendered under the Investment Advisory Agreement during the period commencing from the closing of Prospect Energys initial public offering through and including the first six months of operations, the base management fee was payable monthly in arrears. 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 Energys gross assets at the end of the two most recently completed calendar quarters (the closing of Prospect Energys initial public offering was treated as a quarter end for these purposes) and appropriately adjusted for any share issuances or repurchases during the current calendar quarter. Base management fees for any partial month or quarter are appropriately pro rated. The total base management fees earned by and paid to Prospect Management during the twelve months ended June 30, 2006 and June 30, 2005 were $2.1 million and $1.8 million, respectively.

The incentive fee has two parts. The first part, the income incentive fee, is calculated and payable quarterly in arrears based on Prospect Energys 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 Energy receives from portfolio companies) accrued during the calendar quarter, minus Prospect Energys 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 Energys 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). However, our Investment Adviser has voluntarily agreed that for each fiscal quarter after January 1, 2005, the quarterly hurdle rate will be equal to the greater of (a) 1.75% and (b) a percentage equal to the sum of 25.0% of the daily average of the quoted treasury rate for each month in the immediately preceding two quarters plus 0.50%. Quoted treasury rate means the yield to maturity (calculated on a semi-annual bond equivalent basis) at the time of computation for Five Year U.S. Treasury notes with a constant maturity (as compiled and published in the most recent Federal Reserve Statistical Release H). These calculations will be appropriately pro rated for any period of less than three months and adjusted for any share issuances or repurchases during the current quarter. The voluntary agreement by the Investment Adviser that the hurdle rate be fluctuating for each fiscal quarter after January 1, 2005 (as discussed above) may be terminated by the Investment Adviser at any time upon 90 days prior notice.

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 Energy pays the Investment Adviser an income incentive fee with respect to Prospect Energys pre-incentive fee net investment income in each calendar quarter as follows:

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

- 100.00% of Prospect Energys 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 Energys 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 Energys 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 Energy 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 Energys 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.

$1.8 million and no income incentive fees were earned for the twelve months ended June 30, 2006 and June 30, 2005, respectively. No capital gains incentive fees were earned for the twelve months ended June 30, 2006 and June 30, 2005.

Administration Agreement

Prospect Energy 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 Energy. For providing these services, Prospect

Energy reimburses Prospect Administration for Prospect Energys 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 which we are required to maintain and preparing reports to our stockholders and reports filed with the SEC. In addition, Prospect Administration assists us in determining and publishing our net asset value, overseeing the preparation and filing of our tax returns and the printing and dissemination of reports to our stockholders, and generally oversees the payment of our expenses and the performance of administrative and professional services rendered to us by others. Under the Administration Agreement, Prospect Administration also provides on our behalf managerial assistance to those portfolio companies to which we are required to provide such assistance. The Administration Agreement may be terminated by either party without penalty upon 60 days written notice to the other party. Prospect Administration is a wholly owned subsidiary of our Investment Adviser.

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

Prospect Administration, pursuant to the approval of our board of directors, has engaged Vastardis Fund Services LLC (VFS) to serve as the sub-administrator of Prospect Energy 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 $25,000 annually, payable monthly. Under the sub-administration agreement, VFS provides Prospect Energy with office facilities, equipment, clerical, bookkeeping and record keeping services at such facilities. VFS 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. VFS 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 Energy as it shall determine to be desirable. Under the revised and renewed sub-administration agreement, VFS also provides the service of William E. Vastardis as the Chief Financial Officer (CFO) of the Fund. This service was formerly provided at the rate of $225,000 annually, payable monthly. In May 2006, the engagement was revised and renewed as an asset-based fee with a $400,000 annual minimum, payable monthly. VFS does not provide any advice or recommendation relating to the securities and other assets that Prospect Energy should purchase, retain or sell or any other investment advisory services to Prospect Energy. VFS is responsible for the financial and other records that either Prospect Energy (or the Administrator on behalf of Prospect Energy) is required to maintain and prepares reports to stockholders, and reports and other materials filed with the Securities and Exchange Commission and provides on Prospect Energys behalf significant managerial assistance to those portfolio companies to which Prospect Energy is required to provide such assistance under the Investment Company Act or other applicable law. In addition, VFS assists Prospect Energy in determining and publishing Prospect Energys net asset value, overseeing the preparation and filing of Prospect Energys tax returns, and the printing and dissemination of reports to stockholders of Prospect Energy, and generally overseeing the payment of Prospect Energys expenses and the performance of administrative and professional services rendered to Prospect Energy by others.

Under the sub-administration agreement, VFS and its officers, partners, agents, employees, controlling persons, members, and any other person or entity affiliated with VFS, is not liable to the Administrator or Prospect Energy for any action taken or omitted to be taken by VFS in connection with the performance of any of its duties or obligations or otherwise as sub-administrator for the Administrator on behalf of Prospect Energy. The agreement also provides that, absent willful misfeasance, bad faith or negligence in the performance of VFSs duties or by reason of the reckless disregard of VFSs duties and obligations, VFS and its officers, partners, agents, employees, controlling persons, members, and any other person or entity affiliated with VFS is entitled to indemnification from the Administrator and Prospect Energy. 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 Energy or the security holders of Prospect Energy) arising out of or otherwise based upon the performance of any of VFSs duties or obligations under the agreement or otherwise as sub-administrator for the Administrator on behalf of Prospect Energy.

Managerial Assistance

As a business development company, we offer, and must provide upon request, managerial assistance to certain of our portfolio companies. This assistance could involve, among other things, monitoring the operations of our portfolio companies, participating in board and management meetings, consulting with and advising officers of portfolio companies and providing other organizational and financial guidance. We have received $0.193 million in managerial assistance for the twelve months ended June 30, 2006. These fees are paid to the Administrator.

Note 6. Financial Highlights

The following is a schedule of financial highlights for the twelve months ended June 30, 2006 and June 30, 2005:

	For the Year Ended June 30, 2006	For the Year Ended June 30, 2005
Per Share Data[1]:		
Net asset value at beginning of period	$ 14.59	$ (0.01)
Proceeds from initial public offering		13.95
Costs related to the initial public offering	0.01	(0.21)
Net investment income	1.21	0.34
Realized gain	0.04	
Net unrealized appreciation	0.58	0.90
Dividends declared and paid	(1.12)	(0.38)
Net asset value at end of period	$ 15.31	$ 14.59
Per share market value at end of period	$ 16.99	$ 12.60
Total return based on market value[2]	44.79%	(13.46%)
Total return based on net asset value[2]	13.27%	7.40%
Shares outstanding at end of period	7,069,873	7,055,100
Ratio / Supplemental Data:		
Net assets at end of period (in thousands)	$ 108,270	$ 102,967
Annualized ratio of operating expenses to average net assets	8.19%	5.52%
Annualized ratio of net operating income to average net assets	7.90%	8.50%

(1) Financial highlights as of June 30, 2006 are based on 7,069,873 shares and financial highlights from June 30, 2005 are based on 7,055,100 shares outstanding.

(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 Energys 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 Energys dividend reinvestment plan. The total return is not annualized.

Note 7. Litigation

The Company is a defendant in two legal actions arising out of its activities. While predicting the outcome of litigation is inherently very difficult, and the ultimate resolution, range of possible loss and possible impact on operating results cannot be reliably estimated, management believes, based upon its understanding of the facts and the advice of legal counsel, that it has meritorious defenses for both actions. We continue to defend both of these actions vigorously, and believe that resolution of these actions will not have a materially adverse effect on the Company's financial position.

On December 6, 2004, DGP served Prospect Energy 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 Energy 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 Energy's alleged agreement in September 2004 to loan DGP funds with which DGP intended to buy Gas Solutions, Ltd. for approximately $26 million. The complaint seeks relief not limited to $100 million. We believe 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 Energy'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 Energy's Motion for Summary Judgment dismissing all claims by Dallas Gas Partners, L.P., against Prospect Energy Corporation. DGP has appealed this decision.

On April 7, 2005 a former officer of the Company filed a complaint with the Occupational Safety and Health Administration of the Department of Labor ("OSHA") alleging discrimination, retaliation, infliction of emotional distress and other claims. This officer seeks economic reinstatement and other relief. On September 15, 2005, OSHA issued findings, including an order dismissing this complaint. The complainant has filed written objections to the order and had a hearing before an Administrative Law Judge on March 16, 2006. On May 5, 2006, the Administrative Law Judge issued a Decision and Order granting Summary Decision and dismissing the Complaint, which the former officer has appealed. The Company does not believe that these claims, even if ultimately resolved against the Company, would be material. The Company believes the complaint is frivolous and without merit and intends to defend itself vigorously.

We are not aware of any other material pending legal proceeding, and no such material proceedings are known to be contemplated, to which we are a party or of which any of our property is subject.

Note 8. Revolving Credit Agreement

On February 21, 2006, Prospect Energy entered into a $20.0 million senior secured revolving credit facility (the "Credit Facility") with Bank of Montreal as administrative agent and Harris Nesbitt Corp. as sole lead arranger and sole book runner. The Credit Facility supplements the Company's equity capital and provides funding for additional portfolio investments. All amounts borrowed under the Credit Facility will mature, and all accrued and unpaid interest thereunder will be due and payable within six months of the date of the borrowing; the Credit Facility has a termination date of August 21, 2006. On May 11, 2006, the Credit Facility was increased to $30.0 million. As of June 30, 2006, we had drawn down $28.5 million on the Credit Facility.

Note 9. Subsequent Events

On July 20, 2006, William J. Gremp joined Prospect's board of directors.

On July 26, 2006, we closed a $50.0 million revolving credit facility (the "Facility") with HSH Nordbank AG as administrative agent and sole lead arranger, replacing Prospect's prior smaller $30 million facility. This Facility is being used to refinance Prospect's prior $30.0 million credit facility and, together with our equity capital, to make additional long-term investments. Interest on borrowings under the Facility is 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. The term of the facility is one year.

On August 1, 2006, we declared a first fiscal quarter (for the fiscal year ending June 30, 2007) dividend of $0.38 per share, payable on September 29, 2006, to shareholders of record as of September 22, 2006. The ex-dividend date is September 20, 2006.

On August 1, 2006, we obtained a controlling interest in the common equity of Whymore Coal. As of September 28, 2006, we have provided an additional $0.6 million of senior secured debt financing to Whymore Coal.

On August 2, 2006, we completed the sale of all Natural Gas Systems, Inc. (NGS) registered common shares. The capital gain from these sales was approximately $2.3 million.

On August 10, 2006, we priced a public offering of 4,971,000 shares of common stock at $15.30 per share, raising $76,056,300 in gross proceeds. On August 28, 2006, the underwriters exercised their over-allotment option related to the public offering on August 10, 2006 to purchase 745,650 shares at $15.30 per share, raising an additional $11,408,445 in gross proceeds. We expect to use the net proceeds of our recent equity offering to fund investments in portfolio companies and for general corporate purposes.

On September 5, 2006 we provided $11.0 million in senior secured debt financing and a controlling equity interest in NRG Manufacturing, Inc. (NRG), a leading fabricator of structures and vessels for oil and gas drilling applications based in Tomball, Texas.

On September 7, 2006 we provided $4.3 million in senior secured debt financing to Cypress Consulting Services, Inc. (Cypress), a seismic surveying company based in Houston, Texas. We received a net profit interest in Cypress as part of the investment.

On September 7, 2006 we provided the remaining $3.0 million of the $9.25 million senior secured debt investment in Iron Horse Coiled Tubing Inc. (Iron Horse), an oilfield services company based in Medicine Hat, Alberta. This disbursement is being utilized for Iron Horses purchase of additional coiled tubing equipment.

On September 15, 2006, Michael E. Basham resigned from Prospects board of directors.

On September 15, 2006, Robert A. Davidson resigned from Prospects board of directors.

On September 21, 2006, F. Lee Liebolt, Jr. joined Prospects board of directors.

On September 27, 2006, William E. Vastardis indicated in a letter to Prospect Energy his intention to remain on as chief compliance officer of Prospect Energy and Prospect Capital Management for the foreseeable future.

Note 10. Selected Quarterly Financial Data (unaudited) (in thousands except per share amounts)

	Investment Income		Net Investment Income		Net Realized and Unrealized Gains (Losses)		Net Increase (Decrease) in Net Assets from Operations	
Quarter Ended	**Total**	**Per Share**	**Total**	**Per Share**	**Total**	**Per Share**	**Total**	**Per Share**
September 30, 2005	$ 3,110	$ 0.44	$ 1,415	$ 0.20	$ 58	$ 0.01	$ 1,473	$ 0.21
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	2,122	0.30	829	0.12	2,951	0.42
June 30, 2006	5,798	0.82	2,981	0.42	2,963	0.42	5,944	0.84

Quarter Ended	Investment Income		Net Investment Income		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
September 30, 2004	$ 266	$ 0.05	$ (434)	$ (0.09)	$ —	$ —	$ (434)	$ (0.06)
December 31, 2004	2,946	0.42	1,228	0.17	(2)	—	1,226	0.17
March 31, 2005	2,202	0.31	444	0.06	414	0.06	858	0.12
June 30, 2005	2,679	0.38	1,173	0.17	5,928	0.84	7,101	1.01

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$500,000,000

Common Stock
Preferred Stock
Warrants
Debt Securities

PROSPECTUS

August , 2007

PART C OTHER INFORMATION

ITEM 25. FINANCIAL STATEMENTS AND EXHIBITS

(1) Financial Statements

The following statements of Prospect Capital Corporation (the Company or the Registrant) are included in Part A of this Registration Statement:

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Financial Statements

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* Commencement of operations

(2) Exhibits

Exhibit No.	Description
(a)(1)	Articles of Incorporation**
(a)(2)	Articles of Amendment and Restatement***
(a)(3)	Amended and Restated Articles of Incorporation
(b)(1)	Bylaws***
(b)(2)	Amended and Restated Bylaws***
(c)	Not Applicable
(d)(1)	Form of Stock Certificate***
(d)(2)	Form of Indenture
(e)	Form of Dividend Reinvestment Plan***

(f)	Not Applicable
(g)	Form of Investment Advisory Agreement between Registrant and Prospect Capital Management, LLC***
(h)	Form of Underwriting Agreement
(i)	Not Applicable
(j)	Form of Custodian Agreement****
(k)(1)	Form of Administration Agreement between Registrant and Prospect Administration, LLC***

Exhibit No.	Description
(k)(2)	Form of Transfer Agency and Registrar Services Agreement****
(k)(3)	Form of Trademark License Agreement between the Registrant and Prospect Capital Management***
(k)(4)	Credit Agreement between Registrant, its domestic subsidiaries, certain Lenders and Bank of Montreal
(k)(5)	Credit Facility between Registrant and Rabobank dated June 6, 2007
(l)(1)	Opinion and Consent of Clifford Chance US LLP, counsel for Registrant
(l)(2)	Opinion and Consent of Venable LLP, as special Maryland counsel for Registrant
(m)	Not Applicable
(n)	Consent of independent registered public accounting firm for Registrant
(o)	Not Applicable
(p)	Not Applicable
(q)	Not Applicable
(r)	Code of Ethics***

**	Incorporated by reference to the corresponding exhibit number to the Registrants Registration Statement under the Securities Act of 1933, as amended, on Form N-2 (File No. 333-114552), filed on April 16, 2004.
***	Incorporated by reference to the corresponding exhibit number to the Registrants Pre-effective Amendment No. 2 to the Registration Statement under the Securities Act of 1933, as amended, on Form N-2 (File No. 333-114552), filed on July 6, 2004.
****	Incorporated by reference to the corresponding exhibit number to the Registrants Pre-effective Amendment No. 3 to the Registration Statement under the Securities Act of 1933, as amended, on Form N-2 (File No. 333-114552), filed on July 23, 2004.
*****	Incorporated by reference to the corresponding exhibit number to the Registrants Form 8-K under the Securities Act of 1933.
	To be filed by amendment.

ITEM 26. MARKETING ARRANGEMENTS

The information contained under the heading Plan of Distribution on this Registration Statement is incorporated herein by reference and any information concerning any underwriters will be contained in the accompanying prospectus supplement, if any.

ITEM 27. OTHER EXPENSES OF ISSUANCE AND DISTRIBUTION **

Commission registration fee	$ 15,350

NASDAQ National Market Listing Fee	22,500
NASD filing fee	50,500
Accounting fees and expenses	50,000
Legal fees and expenses	750,000
Printing and engraving	700,000
Financial advisory fee	10,000
Miscellaneous fees and expenses	15,000
Total	$ 1,613,350

** These amounts are estimates.

All of the expenses set forth above shall be borne by the Company.

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ITEM 28. PERSONS CONTROLLED BY OR UNDER COMMON CONTROL

The Registrant owns 100% of the outstanding common stock of Gas Solutions Holdings, Inc. and therefore has a controlling interest.

Prospect Capital Management, LLC, a Delaware limited liability company, owns shares of the Registrant, representing 0.14% of the common stock outstanding. Without conceding that Prospect Capital Management controls the Registrant, an affiliate of Prospect Capital Management is the general partner of, and may be deemed to control, the following entities:

Name	Jurisdiction of Organization
Prospect Street Ventures I, LLC	Delaware
Prospect Management Group LLC	Delaware
Prospect Street Broadband LLC	Delaware
Prospect Street Energy LLC	Delaware
Prospect Administration LLC	Delaware

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ITEM 29. NUMBER OF HOLDERS OF SECURITIES

The following table sets forth the approximate number of record holders of our common stock at May 14, 2007.

Title of Class	Number of Record Holders
Common Stock, par value $.001 per share	18,600

ITEM 30. INDEMNIFICATION

Maryland law permits a Maryland corporation to include in its charter a provision limiting the liability of its directors and officers to the corporation and its stockholders for money damages except for liability resulting from (a) actual receipt of an improper benefit or profit in money, property or services or (b) active and deliberate dishonesty established by a final judgment as being material to the cause of action. Our charter contains such a provision which eliminates directors and officers liability to the maximum extent permitted by Maryland law, subject to the requirements of the 1940 Act.

Our charter authorizes us, to the maximum extent permitted by Maryland law and subject to the requirements of the 1940 Act, to obligate ourselves to indemnify any present or former director or officer or any individual who, while a director or officer and at our request, serves or has served another corporation, real estate investment trust, partnership, joint venture, trust, employee benefit plan or other enterprise as a director, officer, partner or trustee, from and against any claim or liability to which that person may become subject or which that person may incur by reason of his or her service in any such capacity and to pay or reimburse their reasonable expenses in advance of final disposition of a proceeding. Our bylaws obligate us, to the maximum extent permitted by Maryland law and subject to the requirements of the 1940 Act, to indemnify any present or former director or officer or any individual who, while a director or officer and at our request, serves or has served another corporation, real estate investment trust, partnership, joint venture, trust, employee benefit plan or other enterprise as a director, officer, partner or trustee and who is made, or threatened to be made, a party to the proceeding by reason of his or her service in any such capacity from and against any claim or liability to which that person may become subject or which that person may incur by reason of his or her service in any such capacity and to pay or reimburse their reasonable expenses in advance of final disposition of a proceeding. The charter and bylaws also permit us to indemnify and advance expenses to any person who served a predecessor of us in any of the capacities described above and any of our employees or agents or any employees or agents of our predecessor. In accordance with the 1940 Act, we will not indemnify any person for any liability to which such person would be subject by reason of such person’s willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his office.

Maryland law requires a corporation (unless its charter provides otherwise, which our charter does not) to indemnify a director or officer who has been successful, on the merits or otherwise, in the defense of any proceeding to which he or she is made, or threatened to be made, a party by reason of his or her service in that capacity. Maryland law permits a corporation to indemnify its present and former directors and officers, among others, against judgments, penalties, fines, settlements and reasonable expenses actually incurred by them in connection with any proceeding to which they may be made, or threatened to be made, a party by reason of their service in those or other capacities unless it is established that (a) the act or omission of the director or officer was material to the matter giving rise to the proceeding and (1) was committed in bad faith or (2) was the result of active and deliberate dishonesty, (b) the director or officer actually received an improper personal benefit in money, property or services or (c) in the case of any criminal proceeding, the director or officer had reasonable cause to believe that the act or omission was unlawful. However, under Maryland law, a Maryland corporation may not indemnify for an adverse judgment in a suit by or in the right of the corporation or for a judgment of liability on the basis that a personal benefit was improperly received, unless in either case a court orders indemnification, and then only for expenses. In addition, Maryland law permits a corporation to advance reasonable expenses to a director or officer upon the corporation’s receipt of (a) a written affirmation by the director or officer of his or her good faith belief that he or she has met the standard of conduct necessary for indemnification by the corporation and (b) a written undertaking by him or her or on his or her behalf to repay the amount paid or reimbursed by the corporation if it is ultimately determined that the standard of conduct was not met.

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

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, LLC and its officers, manager, agents, employees, controlling persons, members and any other person or entity affiliated with it are entitled to indemnification from the Company for any damages, liabilities, costs and expenses (including reasonable attorneys’ fees and amounts reasonably paid in settlement) arising from the rendering of Prospect Administration, LLC’s services under the Administration Agreement or otherwise as administrator for the Company.

The Administrator is authorized to enter into one or more sub-administration agreements with other service providers (each a Sub-Administrator) pursuant to which the Administrator may obtain the services of the service providers in fulfilling its responsibilities hereunder. Any such sub-administration agreements shall be in accordance with the requirements of the 1940 Act and other applicable federal and state law and shall contain a provision requiring the Sub-Administrator to comply with the same restrictions applicable to the Administrator.

The Underwriting Agreement provides that each Underwriter severally agrees to indemnify, defend and hold harmless the Company, its directors and officers, and any person who controls the Company within the meaning of Section 15 of the Act or Section 20 of the Exchange Act, and the successors and assigns of all of the foregoing persons, from and against any loss, damage, expense, liability or claim (including the reasonable cost of investigation) which, jointly or severally the Company or any such person may incur under the Act, the Exchange Act, the 1940 Act, the common law or otherwise, insofar as such loss, damage, expense, liability or claim arises out of or is based upon any untrue statement or alleged untrue statement of a material fact contained in and in conformity with information concerning such Underwriter furnished in writing by or on behalf of such Underwriter through the managing Underwriter to the Company expressly for use in this Registration Statement (or in the Registration Statement as amended by any post-effective amendment hereof by the Company) or in the Prospectus contained in this Registration Statement, or arises out of or is based upon any omission or alleged omission to state a material fact in connection with such information required to be stated in this Registration Statement or such Prospectus or necessary to make such information not misleading.

Insofar as indemnification for liability arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the Company pursuant to the foregoing provisions, or otherwise, the Company has been advised that in the opinion of the SEC such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the Company of expenses incurred or paid by a director, officer or controlling person of the Company in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the Company will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final adjudication of such issue.

ITEM 31. BUSINESS AND OTHER CONNECTIONS OF INVESTMENT ADVISER

A description of any other business, profession, vocation or employment of a substantial nature in which the Adviser, and each managing member, director or executive officer of the Adviser, is or has been during the past two fiscal years, engaged in for his or her own account or in the capacity of director, officer, employee, partner or trustee, is set forth in Part A of this Registration Statement in the section entitled Management. Additional information regarding the Adviser and its officers and directors is set forth in its Form ADV, as filed with the Securities and Exchange Commission (SEC File No.801-62969), and is incorporated herein by reference.

ITEM 32. LOCATION OF ACCOUNTS AND RECORDS

All accounts, books and other documents required to be maintained by Section 31(a) of the Investment Company Act of 1940, and the rules thereunder are maintained at the offices of:

(1) the Registrant, Prospect Capital Corporation, 10 East 40th Street, 44th Floor, New York, NY 10016;

(2) the Transfer Agent, American Stock Transfer & Trust Company;

(3) the Custodian, U.S. Bank National Association; and

(4) the Adviser, Prospect Capital Management, LLC, 10 East 40th Street, 44th Floor, New York, NY 10016.

ITEM 33. MANAGEMENT SERVICES

Not Applicable.

ITEM 34. UNDERTAKINGS

1. The Registrant undertakes to suspend the offering of shares until the prospectus is amended if (1) subsequent to the effective date of its registration statement, the net asset value declines more than ten percent from its net asset value as of the effective date of the registration statement; or (2) the net asset value increases to an amount greater than the net proceeds as stated in the prospectus.

2. Any securities not taken in a rights offering by shareholders are to be reoffered to the public, an undertaking to supplement the prospectus, after the expiration of the subscription period, to set forth the results of the subscription offer, the transactions by underwriters during the subscription period, the amount of unsubscribed securities to be purchased by underwriters, and the terms of any subsequent reoffering thereof. If any public offering by the underwriters of the securities being registered is to be made on terms differing from those set forth on the cover page of the prospectus, we will file a post-effective amendment to set forth the terms of such offering.

3. The Registrant undertakes that:

(a) to file, during any period in which offers or sales are being made, a post-effective amendment to the registration statement:

(1) to include any prospectus required by Section 10(a)(3) of the 1933 Act;

(2) to reflect in the prospectus any facts or events after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement; and

(3) to include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement.

(b) that, for the purpose of determining any liability under the 1933 Act, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of those securities at that time shall be deemed to be the initial bona fide offering thereof;

(c) to remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering;

(d) that, for the purpose of determining liability under the 1933 Act to any purchaser, each prospectus filed pursuant to Rule 497(b), (c), (d) or (e) under the 1933 Act as part of a registration statement relating to an offering, other than prospectuses filed in reliance on Rule 430A under the 1933 Act, shall be deemed to be part of and included in the registration statement as of the date it is first used after effectiveness. *Provided, however*, that no statement made in a registration statement or prospectus that is part of the registration statement or made in a document incorporated or deemed incorporated by reference into the registration statement or prospectus that is part of the registration statement will, as to a purchaser with a time of contract of sale prior to such first use, supersede or modify any statement that was made in the registration statement or prospectus that was part of the registration statement or made in any such document immediately prior to such date of first use; and

(e) that, for the purpose of determining liability of the Registrant under the 1933 Act to any purchaser in the initial distribution of securities: The undersigned Registrant undertakes that in a primary offering of securities of the undersigned Registrant pursuant to this registration statement, regardless of the underwriting method used to sell the securities to the purchaser, if the securities are offered or sold to such purchaser by means of any of the following communications, the undersigned Registrant will be a seller to the purchaser and will be considered to offer or sell such securities to the purchaser: (1) any preliminary prospectus or prospectus of the undersigned Registrant relating to the offering required to be filed pursuant to Rule 497 under the 1933 Act; (2) the portion of any advertisement pursuant to Rule 482 under the 1933 Act relating to the offering containing material information about the undersigned Registrant or its securities provided by or on behalf of the undersigned Registrant; and (3) any other communication that is an offer in the offering made by the undersigned Registrant to the purchaser.

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SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, the Registrant has duly caused this Registration Statement on Form N-2 to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of New York, in the State of New York, on the 3rd day of August 2007.

PROSPECT CAPITAL CORPORATION

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

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Pursuant to the requirements of the Securities Act of 1933, this Registration Statement has been signed by the following persons in the capacities indicated on August 3, 2007. This document may be executed by the signatories hereto on any number of counterparts, all of which constitute one and the same instrument.

Signature	Title
/s/ John F. Barry III John F. Barry III	Chief Executive Officer and Chairman of the Board of Directors (principal executive officer)
/s/ M. Grier Eliasek M. Grier Eliasek	Chief Operating Officer and Director
/s/ William E. Vastardis William E. Vastardis	Chief Financial Officer, Treasurer and Secretary (principal financial and accounting officer)
/s/ F. Lee Liebolt, Jr. F. Lee Liebolt, Jr.	Director
/s/ William J. Gremp William J. Gremp	Director
/s/ Walter V. Parker Walter V. Parker	Director

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EXHIBIT INDEX

(a)(3)	Amended and restated Articles of Incorporation, to be filed by amendment.
(h)(1)	Form of Underwriting Agreement, to be filed by amendment.
(h)(2)	Form of Indenture, to be filed by amendment.
(k)(5)	Credit Facility between Registrant and Rabobank dated June 6, 2007, to be filed by amendment
(l)(1)	Opinion and Consent of Clifford Chance US LLP, counsel for Registrant, to be filed by amendment.
(2)	Opinion and Consent of Venable LLP special Maryland counsel for Registrant, to be filed by amendment.