PROSPECT ENERGY CORP
Form 497H2
December 15, 2006

Filed Pursuant to Rule 497(h)
Registration No. 333-132575

PROSPECTUS SUPPLEMENT
(To Prospectus dated August 10, 2006)

6,000,000 Shares

Common Stock

We are selling 6,000,000 shares of our common stock to repay debt and fund additional investments from our investment pipeline and to use for general corporate purposes. Our common stock is quoted on the NASDAQ Global Market under the symbol PSEC. On December 12, 2006, the last sale price reported for our common stock on the NASDAQ Global Market was $18.39 per share.

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

Investing in our common stock involves risks. See Risk Factors beginning on page S-9 of this prospectus supplement and on page 10 of the accompanying prospectus.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus supplement is truthful or complete. Any representation to the contrary is a criminal offense.

	Per Share	Total
Public offering price	$ 17.70	$ 106,200,000
Underwriting discount (sales load)	$ 0.85	$ 5,100,000
Proceeds to us before expenses[1]	$ 16.85	$ 101,100,000

(1) Before deducting estimated expenses payable by us of $200,000.

The underwriter has the option to purchase up to an additional 900,000 shares of common stock at the public offering price, less the underwriting discount, within 30 days from the date of this prospectus supplement solely to cover

over-allotments. If the over-allotment option is exercised in full, the total public offering price will be $122,130,000, and the total underwriting discount (sales load) will be $5,865,000. The proceeds to us would be $116,265,000, before deducting estimated expenses payable by us of $200,000.

The underwriter expects to deliver the shares on or about December 20, 2006.

Morgan Keegan & Company, Inc.

The date of this prospectus supplement is December 14, 2006.

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PROSPECTUS SUPPLEMENT

PROSPECTUS

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PROSPECTUS SUMMARY

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

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

The Company

We are a financial services company that lends to and invests in companies in the energy industry. We are organized as a non-diversified closed-end management investment company that has elected to be treated as a business development company under the Investment Company Act of 1940, or the 1940 Act.

We concentrate on making investments in energy companies having annual revenues of less than $250 million. Our typical investment involves a secured loan of less than $30 million with some form of equity participation. In most cases, companies in which we invest are privately held or have thinly traded public securities at the time we invest in them. We refer to these companies as middle market companies and these investments as middle market investments.

We seek to maximize returns to our investors by applying rigorous credit analysis and asset-based lending techniques to make and monitor our investments in asset intensive energy companies. We do not intend to invest directly in any energy company engaged exclusively in (1) oil and gas exploration, (2) speculative risks or (3) speculative trading in oil, gas and/or other commodities, although some of the energy companies in which we invest may be involved in some exploration or development activity.

As of September 30, 2006, we held investments having an aggregate value of approximately $157 million in 17 portfolio companies. For the quarter ended September 30, 2006, the weighted average yield on all of our outstanding investments in long-term debt securities issued by our portfolio companies was 14.6% (16.9% including dividend paying equity securities). As of November 30, 2006, we have executed non-binding letters of intent with two companies to make investments aggregating approximately $60 million. The proposed investments are subject to due diligence, approval of our investment committee and negotiation and execution of definitive investment agreements. We may consummate less than all or none of the investments that are subject to these non-binding letters of intent.

The Energy Industry

We invest primarily in the North American energy industry. We believe the energy industry is one of the largest, most dynamic and important industries in North America. The energy industry consists of companies in the direct energy value chain as well as companies that sell products and services to, or acquire products and services from, the direct energy value chain. In this prospectus, we refer to all of these companies as energy companies and assets in these companies as energy assets. The categories of energy companies in this value chain are described below. The direct energy value chain includes upstream businesses, midstream businesses and downstream businesses:

Upstream businesses find, develop and extract energy resources, including natural gas, crude oil and coal, which are typically found underground or offshore in geological reservoirs.

Midstream businesses gather, process, refine, store and transmit energy resources and their byproducts in a form that is usable by wholesale power generation, utility, petrochemical, industrial and gasoline customers.

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Downstream businesses include the power and electricity segment as well as businesses that process, refine, market or distribute hydrocarbons or other energy resources, such as customer-ready natural gas, propane and gasoline, to end-user customers.

Our Competitive Advantages

We believe we have the following competitive advantages over others investing in middle market energy companies:

our team of investment professionals has more than 125 years of combined experience in the energy industry;

our focus on the energy industry distinguishes us from generalist private equity and mezzanine capital providers;

we avoid widely marketed auctions to achieve better pricing and terms;

we focus on transactions where we can obtain meaningful equity participation as additional consideration for our loans;

we believe we lower our risk by taking first or second lien security interests on strategic assets within the energy industry;

as a public company, our cost of capital is likely to be lower than the cost of capital of a private equity or private mezzanine fund;

our status as a business development company provides us with greater flexibility in customizing one-stop and other financing solutions for energy companies; and

our willingness to invest across all sub-sectors of the energy industry enhances portfolio diversification, decreasing risk and providing us a wider spectrum of investment opportunities.

Our Investment Objective and Policies

Our investment objective is to generate both current income and long-term capital appreciation through debt and equity investments. We focus on making investments in energy companies and will invest, under normal circumstances, at least 80% of our assets (including the amount of any borrowings for investment purposes) in these companies. Prospect Energy is a non-diversified company within the meaning of the 1940 Act, which means that from time to time a greater portion of our assets may consist of portfolio companies in which we have invested more than 5% of our net asset value and/or hold more than 10% of the outstanding voting securities than would be the case if we were a diversified company.

We seek to maximize returns to our investors by applying rigorous credit analysis and asset-based lending techniques, such as taking first or second priority security interests in energy assets. We do not invest directly in any energy company exclusively involved in (1) speculative oil and gas exploration, (2) speculative risks or (3) speculative trading in oil, gas and/or other commodities. Some of the energy companies in which we invest are involved in some exploration or development activity. While the structure of our investments varies, we invest primarily in secured senior and subordinated loans, generally referred to as mezzanine loans, which often include equity interests such as warrants or options received in connection with these loans, and dividend-paying equity securities, such as common and preferred stock and convertible securities, of middle market energy companies. Our investments typically range between $5 million and $30 million each, although this investment size may vary proportionately as the size of our capital base changes.

While we primarily seek current income through investment in the debt and/or dividend-paying equity securities of privately held or thinly traded public energy companies and long-term capital appreciation by acquiring accompanying warrants, options or other equity securities of such companies, we may invest up to 30% of our assets in opportunistic investments in order to seek enhanced returns for stockholders. Such investments may include debt and equity instruments of public companies that are not thinly traded. We expect that these public companies generally will have debt securities that are non-investment grade. Within this 30% basket, we may also invest in debt and equity securities of middle-market companies located outside of the United States.

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Our investments typically include equity components that provide us with opportunities to share in the growth in value of portfolio companies. Equity components may include warrants or options to acquire common shares in a portfolio company, payment of a portion of the contractual interest on debt securities in common shares of the portfolio company, or contractual payment rights or rights to receive a proportional interest in the revenue, operating cash flow or net income of such company. When determined by the Investment Adviser to be in our best interest, we may acquire a controlling interest in a portfolio company. Any warrants or options we receive may require only a nominal cost to exercise, and thus, as a portfolio company appreciates in value, we may achieve additional investment return from this equity interest. In many cases, we have structured, and may seek to include, in all warrants provisions protecting our rights as a minority-interest or, if applicable, controlling-interest holder, as well as puts. We may also seek to include in all warrants rights to sell such securities back to the company, upon the occurrence of specified events. In many cases, we obtain registration rights in connection with these equity interests, which may include demand and piggyback registration rights.

We plan to hold most of our investments to maturity or repayment, but may sell our investments earlier if a liquidity event takes place, such as the sale or recapitalization of a portfolio company, or if the Investment Adviser deems such sale to be in our best interest.

We have qualified and elected to be treated for federal income tax purposes as a regulated investment company, or a RIC, under Subchapter M of the Internal Revenue Code of 1986, as amended (the Code). As a RIC, we generally do not pay corporate-level federal income taxes on any ordinary income or capital gains that we distribute to our stockholders as dividends. To continue to qualify as a RIC, we must, among other things, meet certain source-of-income and asset diversification requirements (as described below). In addition, to qualify for RIC tax treatment we must distribute to our stockholders, for each taxable year, at least 90% of our investment company taxable income, which is generally our ordinary income plus the excess of our realized net short-term capital gains over our realized net long-term capital losses.

The Investment Adviser

Prospect Capital Management manages our investment activities. John F. Barry III, our Chairman and Chief Executive Officer, is majority owner of Prospect Capital Management. Prospect Capital Management is an investment adviser registered under the Investment Advisers Act of 1940, or the Advisers Act. Under an investment advisory agreement between the Company and Prospect Capital Management (the Investment Advisory Agreement), we have agreed to pay Prospect Capital Management investment advisory fees, which will consist of an annual base management fee based on our gross assets including assets purchased with borrowed funds, as well as a two-part incentive fee based on our performance. On May 15, 2006, the Board of Directors of the Company voted unanimously to renew the Investment Advisory Agreement for the one year period beginning June 24, 2006. Our headquarters are located at 10 East 40th Street, 44th Floor, New York, NY 10016, and our telephone number is (212) 448-0702. Our web site is www.prospectenergy.com. The information on our web site is not part of this prospectus supplement.

Recent Developments

Since September 30, 2006, we have made investments totaling $43.0 million, including $15.5 million in TLOGH, L.P. (TLOGH), a Barnett Shale gas development company based in Dallas, Texas; $5.0 million in Conquest Cherokee LLC, an oil and gas production company focused on coalbed methane production in the Cherokee Basin in Kansas; $6.5 million in Jettco Marine Services LLC, an offshore supply vessel company based in Morgan City, Louisiana; $6.2 million in Stryker Energy LLC, an Appalachian gas production company based in Cleveland, Ohio; and $9.8 million in other existing portfolio companies.

The Offering

Common stock offered by us	6,000,000 shares.
Common stock outstanding prior to this offering	12,867,341 shares.
Common stock outstanding after this offering	18,867,341 shares.
Use of proceeds	We expect to use $11.2 million of the net proceeds of this offering to repay amounts outstanding under our revolving credit facility. After such repayment, our revolving credit facility will be fully available to fund additional investments. We expect to use the remainder of the net proceeds to fund investments from our investment pipeline and for general corporate purposes. See Use of Proceeds.
The NASDAQ Global Market symbol	PSEC
Risk factors	See Risk Factors in this prospectus supplement and other information in this prospectus supplement and the accompanying prospectus for a discussion of factors you should carefully consider before deciding to invest in shares of our common stock.
Current distribution rate	For the first fiscal quarter of 2007, our Board of Directors declared a quarterly dividend of $0.38 per share. Our dividend is subject to change or discontinuance at any time in the discretion of our Board of Directors. Our future earnings and operating cash flow may not be sufficient to support a dividend.

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Fees and Expenses

The following tables are intended to assist you in understanding the costs and expenses that an investor in this offering will bear directly or indirectly. In these tables, we assume no borrowings outstanding under our credit facility. Except where the context suggests otherwise, whenever this prospectus supplement contains a reference to fees or expenses paid by you, us or Prospect Energy, or that we will pay fees or expenses, Prospect Energy will pay such fees and expenses out of our net assets and, consequently, you will indirectly bear such fees or expenses as an investor in Prospect Energy. However, you will not be required to deliver any money or otherwise bear personal liability or responsibility for such fees or expenses.

Stockholder Transaction Expenses:

Sales load (as a percentage of offering price)(1)	4.80%
Offering expenses borne by us (as a percentage of offering price)(2)	0.20%
Dividend reinvestment plan expenses(3)	
Total stockholder transaction expenses (as a percentage of offering price)	5.00%

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

Base management fee	2.01%(5)	
Incentive fees payable under Investment Advisory Agreement (20% of realized capital gains and 20% of pre-incentive fee net investment income)	1.76%(6)	
Total management fees		3.77%
Interest payments on borrowed funds		None(7)
Other expenses		3.75%(8)
Total annual expenses (estimated)		7.52%(6)(8)

Example:

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

	1 Year	3 Years	5 Years	10 Years
You would pay the following expenses on a $1,000 investment, assuming a 5% annual return	$ 121.6	$ 275.7	$ 445.6	$ 950.5

While the table assumes, as required by the SEC, a 5% annual return, our performance will vary and may result in a return greater or less than 5%. The income incentive fee under the Investment Advisory Agreement would be zero at the 5% annual return assumption required by the SEC for this table, since no incentive fee is paid until the annual return exceeds 7%. However, we have reflected in the example the income incentive fee earned during our fiscal year ended June 30, 2006 as if the annual return were at the level recently achieved, which is higher than 5%. Accordingly, the resulting calculations overstate expenses at the 5% annual return as these calculations do not reflect the provisions of the Investment Advisory Agreement as it would actually be applied in the case of a 5% annual return. This table assumes that we will not realize any capital gains computed net of all realized capital losses and unrealized capital depreciation in any of the indicated time periods. If we achieve sufficient returns on our investments, including through the realization of capital gains, to trigger an incentive fee of a material amount, our expenses, and returns to our investors after such expenses, would be higher. In addition, while the example assumes reinvestment of all dividends and distributions at net asset value, participants in our dividend reinvestment plan will receive a number of shares of our common stock, determined by dividing the total dollar amount of the dividend payable to a participant by the market price per share of our common stock at the close of trading on the valuation date for the dividend. See Dividend Reinvestment Plan for additional information regarding our dividend reinvestment plan.

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

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

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

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

(4) Net assets attributable to our common stock equal net assets (i.e., total assets less liabilities other than liabilities for money borrowed for investment purposes) at September 30, 2006. See Capitalization.

(5) Our base management fee is 2.00% of our gross assets (which include any amount borrowed, i.e., total assets without deduction for any liabilities). Assuming that we have borrowed $50 million (the size of our credit facility), the 2.00% management fee of gross assets equals 2.52% of net assets. See Management Investment Advisory Agreement in the accompanying prospectus and footnote 7 below.

(6) Based on the level of incentive fee paid during our last fiscal year, all of which consisted of an income incentive fee. For a more detailed discussion of the calculation of the two-part incentive fee, see Management Investment Advisory Agreement in the accompanying prospectus.

(7) We may borrow additional money before and after the proceeds of this offering are substantially invested, but, in general, will utilize debt to the maximum extent reasonably possible before issuing equity. After this offering, we will have no amounts outstanding under our $50 million credit facility, which has a one year term expiring July 19, 2007, subject to our lender s option to extend the credit facility for an additional two years. For more information, see Risk Factors Changes in interest rates may affect our cost of capital and net investment income below and Management s Discussion and Analysis of Financial Condition and Results of Operations Financial Condition, Liquidity and Capital Resources, Capital Raising Activities. The table above assumes that we have not borrowed under our credit facility. If we borrow amounts following this offering (up to $50 million) our base management fee, as a percentage of net assets attributable to common stock, will increase from the percentage shown in the table above, as borrowings are likely to represent a larger proportion of our overall assets.

(8) Other expenses is based on our expenses during our last fiscal year. See Management Administration Agreement in the accompanying prospectus.

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SELECTED CONDENSED FINANCIAL AND OTHER DATA

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

	Twelve Months Ended June 30, 2006(1)	Three Months Ended September 30, 2006	2005
	(Audited)	*(Unaudited)*	*(Unaudited)*
	(dollars in thousands, except per share data)		
Statement of operations data			
Investment income			
Interest income	$ 7,818	$ 2,079	$ 1,529
Interest income, controlled entities	4,838	2,246	828
Interest income, affiliated entities	612	981	
Dividend income	289		146
Dividend income, controlled entities	3,099	850	556
Dividend income, money market funds	213	276	50
Total investment income	16,869	6,432	3,109
Operating expenses			
Investment advisory fees			
Base management fee	2,082	616	510
Income incentive fee	1,786	818	
Total investment advisory fees	3,868	1,434	510
Interest expense and credit facility costs	642	662	
Chief Compliance Officer and sub-administration fees	310	119	81
Legal fees	1,835	280	719
Valuation services	193	93	41
Sarbanes-Oxley compliance expenses		45	
Other professional fees	485	292	122
Insurance expense	365	75	98
Directors fees	220	63	55
Other general and administrative expenses	393	95	68

Total operating expenses		8,311		3,158		1,694
Net investment income		8,558		3,274		1,415
Net realized gain (loss)		303		1,951		(18)
Net unrealized appreciation (depreciation)		4,035		(1,261)		76
Net increase in net assets	$	12,896	$	3,964	$	1,473
Increase in net assets per share diluted and basic	$	1.83	$	0.40	$	0.21
Balance sheet data and other information						
Cash and cash equivalents	$	1,608	$	33,453	$	22,632
Total investments at fair value		133,969		156,957		80,616
Total credit facility drawn		28,500				
Net asset value		108,270		191,174		103,029
NAV per share	$	15.31	$	14.86	$	14.60
Number of portfolio companies		15		17		8

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

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The following is a schedule of financial highlights for the periods indicated below:

	For the Twelve Months Ended June 30, 2006	For the Three Months Ended September 30, 2006	For the Three Months Ended September 30, 2005
Per share data[(1)]			
Net asset value at beginning of period	$ 14.59	$ 15.31	$ 14.59
Costs related to the initial public offering	0.01		
Costs related to the secondary offering		(0.47)	
Net investment income	1.21	0.33	0.20
Realized gain	0.04	0.20	
Net unrealized appreciation (depreciation)	0.58	(0.13)	0.01
Dividends declared and paid	(1.12)	(0.38)	(0.20)
Net asset value at end of period	$ 15.31	$ 14.86	$ 14.60
Per share market value at end of period	$ 16.99	$ 15.54	$ 13.35
Total return based on market value[(2)]	44.79%	6.33%	7.54%
Total return based on net asset value[(2)]	13.27%	0.60%	1.44%
Shares outstanding at end of period	7,069,873	12,867,341	7,055,100
Weighted average shares outstanding during period	7,056,846	9,856,132	7,055,100
Other data			
Net assets at end of period (in thousands)	$ 108,270	$ 191,174	$ 103,029
Annualized ratio of operating expenses to average net assets	8.19%	7.02%	6.99%
Annualized ratio of operating income to average net assets	7.90%	10.28%	5.50%

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

(2) Total return based on market value calculates the total return as a percentage for the period shown using the change in market price per share from the opening to the ending market price per share in each period assuming that dividends are reinvested in accordance with Prospect Energy s dividend reinvestment plan. Total return based on net asset value calculates the total return as a percentage for the period shown using the change in net asset value per share from the opening to the ending net asset value per share in each period assuming that dividends are reinvested in accordance with Prospect Energy s dividend reinvestment plan. The total return is not annualized.

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RISK FACTORS

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

Our portfolio investments have not been valued by our Board of Directors or independent valuation firm since September 30, 2006, and our net asset value may have changed significantly since our last independent valuation at September 30, 2006.

Our Board of Directors determines the fair value of our portfolio investments on a quarterly basis based on input from our Investment Adviser, the audit committee of our Board of Directors and a third party independent valuation firm. The last such determination of fair value was as of September 30, 2006, and, while the Board of Directors will review our net asset value per share in connection with this offering, it will not have the benefit of input from the independent valuation firm when it does so. In the period since the independent valuation firm last conducted an evaluation of our investment portfolio, the fair value of individual investments in our portfolio and the aggregate fair value of our investments may have changed significantly. Subsequent to completion of this offering, our audit committee and Board of Directors expect to receive from the independent valuation firm an analysis of the valuation of our investment portfolio at December 31, 2006. Based in part on that analysis, as well as the analysis performed by the Investment Adviser and the Audit Committee, our Board of Directors will determine the fair value of our investments at December 31, 2006. All of these steps will occur after completion of this offering. If our Board of Directors determines that the fair value of our investment portfolio at December 31, 2006 was less than such fair value at September 30, 2006, then we will record unrealized loss on our investment portfolio and report a lower net asset value per share than is reflected in the Selected Condensed Financial Data and the financial statements included elsewhere in this prospectus supplement. If our board of directors determines that the fair value of our investment portfolio at December 31, 2006 was greater than such fair value at September 30, 2006, we will record unrealized gain on our investment portfolio and report a greater net asset value per share than so reflected elsewhere in this prospectus supplement and the accompanying prospectus. Upon publication of this information in connection with our announcement of operating results for our fiscal quarter ended December 31, 2006, the market price of our common stock may fluctuate materially, and may be substantially less than the price per share you pay for our common stock in this offering.

Potential writedowns or losses with respect to three portfolio investments that are on our credit watch list, or on other portfolio investments, existing and to be made in the future could adversely affect our results of operations, cash flows, dividend level, net asset value and stock price.

As of the date of this prospectus supplement, loans we have made to Unity Virginia Holdings LLC (Unity), Whymore Coal Company (Whymore) and Genesis Coal Company, LLC (Genesis) are on our credit watch list due to existing or potential payment and existing or potential covenant defaults under the contracts governing such investments. Unity has filed a voluntary bankruptcy petition under Chapter 11 of the U.S. Bankruptcy Code and is currently in default under the contract governing the investment. Unity is in the process of liquidating its assets. Our security interest in Unity s assets is a second priority lien, and the net proceeds from the sale or liquidation of Unity s assets may not satisfy in full the debt owed to the holder of the first priority lien on Unity s assets. Our lack of control over the liquidation of Unity s assets, our second lien security position in such assets and the prospect that Unity s assets have substantially decreased in value could result in our losing our entire investment in Unity. In addition, if the bankruptcy court were to set aside as preferential payments or we were otherwise deemed not to have recognized any amounts previously paid to us by Unity, our net investment income could be materially adversely affected. As of September 30, 2006, Unity was valued at $1.5 million, which represented 0.8% of our net asset value. Whymore and Genesis have experienced liquidity problems, and the Investment Adviser believes both portfolio companies could continue to experience covenant and/or payment defaults under the contracts governing our investments in those companies. We have provided, and may in the future provide, additional capital to Whymore and Genesis to provide liquidity to those portfolio companies, to enable them to pay operating expenses, including debt service, and for capital expenditures. While we have a first priority security interest in the assets of both Whymore and Genesis, the net realizable value of such collateral may be substantially less than the balances outstanding on the loans to those entities. Moreover, either of those portfolio companies may fail to pay principal and/or interest on their outstanding debts to us. Upon further analysis of the values of these investments, we could determine that the fair value of these investments should be reduced substantially, possibly to zero. If any of these events were to occur, our results of operations and cash flows could be materially adversely affected, our net asset value could be substantially reduced, our dividend could be reduced or limited and the market price for our stock could be substantially adversely affected.

Risks Relating To Our Business And Structure

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

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

Our Investment Adviser and its senior management have limited experience managing a business development company under the 1940 Act.

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

We are a relatively new company with limited operating history.

We were incorporated in April 2004 and have conducted investment operations since July 2004. We are subject to all of the business risks and uncertainties associated with any new business enterprise, including the risk that we may not achieve our investment objective and that the value of your investment in us could decline substantially or fall to zero. We completed our initial public offering on July 27, 2004. with the remainder invested in U.S. government and money market securities. If we do not realize yields in excess of our expenses, we may incur operating losses and the market price of our shares may decline.

If our primary investments are deemed not to be qualifying assets, we could lose our status as a business development company or be precluded from investing according to our current business plan.

In order to maintain our status as a business development company, we must not acquire any assets other than qualifying assets unless, at the time of and after giving effect to such acquisition, at least 70% of our total assets are qualifying assets. If we acquire mezzanine loans or dividend-paying equity securities from an issuer that has outstanding marginable securities at the time we make an investment, these acquired assets cannot be treated as qualifying assets. See Regulation Qualifying Assets in the accompanying prospectus.

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This result follows the definition of eligible portfolio company under the 1940 Act, which in part looks to whether a company has outstanding marginable securities.

Amendments promulgated in 1998 by the Board of Governors of the Federal Reserve System to Regulation T under the Exchange Act expanded the definition of marginable security to include any non-equity security. These amendments have raised questions as to whether a private company that has outstanding debt securities would qualify as an eligible portfolio company.

We believe that the mezzanine loans and equity instruments that we have acquired and expect to continue to acquire should constitute qualifying assets because the privately held companies to which we lend do not, at the time of our investment, have outstanding marginable securities. Until the questions raised by the amendments to Regulation T have been clarified through SEC rulemaking or addressed by legislative, administrative or judicial action, we intend to treat as qualifying assets only those mezzanine loans that are not investment grade, do not have a public secondary market, and are issued by a private issuer that does not have outstanding a class of margin eligible securities at the time of our investment. Likewise, we treat equity securities issued by a portfolio company as qualifying assets only if such securities are issued by a private company that has no marginable securities outstanding at the time we purchase such securities.

To date, we do not believe that either the SEC or its staff has taken any position with respect to our analysis of the issues discussed above and neither the SEC or its staff has indicated that they concur with our analysis. We intend to adjust our investment focus as needed to comply with and/or take advantage of any future administrative position, judicial decision or legislative action.

If there were a court ruling or regulatory decision that conflicts with our interpretations, we could lose our status as a business development company or be precluded from investing in the manner described in this prospectus, either of which would have a material adverse effect on our business, financial condition and results of operations. See Regulations governing our operation as a business development company affect our ability to raise, and the way in which we raise, additional capital in the accompanying prospectus. Such a ruling or decision also may require that we dispose of investments that we made based on our interpretation of Regulation T. Such dispositions could have a material adverse effect on us and our stockholders. We may need to dispose of such investments quickly, which would make it difficult to dispose of such investments on favorable terms. In addition, because these types of investments will generally be illiquid, we may have difficulty in finding a buyer and, even if we do find a buyer, we may have to sell the investments at a substantial loss. See The lack of liquidity in our investments may adversely affect our business in the accompanying prospectus.

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

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

We operate in a highly competitive market for investment opportunities.

A large number of entities compete with us to make the types of investments that we make in middle market energy companies. We compete with other business development companies, public and private funds, commercial and investment banks and commercial financing companies. Additionally, because competition for investment opportunities generally has increased among alternative investment vehicles, such as hedge funds, those entities have begun to invest in areas in which they have not traditionally invested, including investments in middle-market companies. As a result of these new entrants, competition for investment opportunities in middle-market companies has intensified, and we expect that trend to continue. Many of our existing and potential competitors are substantially larger and have considerably greater financial, technical and marketing resources than we do. For example, some competitors may have a lower cost of funds and access to funding sources that are not available to us. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more relationships than us. Furthermore, many of our competitors are not subject to the regulatory restrictions that the 1940 Act imposes on us as a business development company. We cannot assure you that the competitive pressures we face will not have a material adverse effect on our business, financial condition and results of operations. Also, as a result of existing and increasing competition, we may not be able to take advantage of attractive investment opportunities from time to time, and we can offer no assurance that we will be able to identify and make investments that are consistent with our investment objective.

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

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

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

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

In addition, we may in the future seek to securitize our loans to generate cash for funding new investments. To securitize loans, we may create a wholly owned subsidiary and contribute a pool of loans to such subsidiary. This could include the sale of interests in the subsidiary on a non-recourse basis to purchasers who we would expect to be willing to accept a lower interest rate to invest in investment grade loan pools. We would retain a portion of the equity in the securitized pool of loans. An inability to successfully securitize our loan portfolio could limit our ability to grow our business and fully execute our business strategy, and could decrease our earnings, if any. Moreover, the successful securitization of our loan portfolio might expose us to losses because the residual loans in which we do not sell interests may tend to be those that are riskier and more likely to generate losses.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

We may experience fluctuations in our quarterly results.

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

Potential conflicts of interest could impact our investment returns.

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

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

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

The income incentive fee payable by Prospect Energy is computed and paid on income that may include interest that has been accrued but not yet received in cash. If a portfolio company defaults on a loan that has a deferred interest feature, it is possible that interest accrued under such loan that has previously been included in the calculation of the income incentive fee will become uncollectible. If this happens, our Investment Adviser is not required to reimburse us for any such income incentive fee payments. If we do not have sufficient liquid assets to pay this incentive fee or distributions to stockholders on such accrued income, we may be required to liquidate assets in order to do so. This fee structure could give rise to a conflict of interest for our Investment Adviser to the extent that it may encourage the Investment Adviser to favor debt financings

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that provide for deferred interest, rather than current cash payments of interest. In addition, the amount of the Investment Adviser s compensation under the incentive fee, is due, in part to the amount of unrealized depreciation accrued by the Company.

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

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

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

Risks Related To Our Investments

We may not realize gains or income from our investments.

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

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

As of November 30, 2006, we held investments in 19 portfolio companies. A consequence of this lack of diversification is that the aggregate returns we realize may be significantly adversely affected if a small number of such investments perform poorly or if we need to write down the value of any one investment. Beyond our income tax diversification requirements, we do not have fixed guidelines for diversification, and our investments are concentrated in relatively few portfolio companies. We estimate that, once we have invested substantially all of the net proceeds of this offering and fully utilized our credit facility, we will have invested in approximately 25 to 35 portfolio companies, depending on the availability of appropriate investment opportunities consistent with our investment objective and market conditions. In addition, we concentrate on making investments in the energy industry and will invest, under normal circumstances, at least 80% of the value of our net assets (including the amount of any borrowings for investment purposes) in energy companies. As a result, a downturn in the energy industry could materially adversely affect us.

The energy industry is subject to many risks.

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

Commodity Pricing Risk. While we generally do not invest in companies that accept completely unhedged commodity risk, energy companies in general are directly affected by energy commodity prices, such as the market prices of crude oil, natural gas and wholesale electricity, especially for those who own the underlying energy commodity. In addition, the volatility of commodity prices can affect other energy companies due to the impact of prices on the volume of commodities transported, processed, stored or distributed and on the cost of fuel for power generation companies. The volatility of commodity prices can also affect energy companies ability to access the capital markets in light of market perception that their performance may be directly tied to commodity prices. Historically, energy commodity prices have been cyclical and exhibited significant volatility. Currently, crude oil prices are near record high levels. Although we require adherence to strict risk controls, including appropriate commodity and other hedges, by each of our portfolio companies, some of our portfolio companies may not engage in hedging transactions to minimize their exposure to commodity price risk. For those companies that engage in such hedging transactions, they remain subject to market risks, including market liquidity and counterparty creditworthiness.

Regulatory Risk. The profitability of energy companies could be adversely affected by changes in the regulatory environment. The businesses of energy companies are heavily regulated by federal, state and local governments in diverse manners, such as the way in which energy assets are constructed, maintained and operated and the prices energy companies may charge for their products and services. Such regulation can change over time in scope and intensity. For example, a particular by-product of an energy process may be declared hazardous by a regulatory agency, which can unexpectedly increase production costs. Moreover, many state and federal environmental laws provide for civil and criminal penalties as well as regulatory remediation, thus adding to the potential liability an energy company and its officers may face. In addition, the deregulation of energy markets and the unresolved regulatory issues related to some power markets such as California create uncertainty in the regulatory environment as rules and regulations may be adopted on a transitional basis. We cannot assure you that the deregulation of energy markets will continue and if it continues, whether its impact on energy companies profitability will be positive.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

As a result, many of our portfolio companies may be susceptible to economic slowdowns or recessions and may be unable to repay our loans or meet other obligations during these periods. Therefore, our non-performing assets are likely to increase, and the value of our portfolio is likely to decrease, during these periods. Adverse economic conditions also may decrease the value of collateral securing some of our loans and the value of our equity investments. Economic slowdowns or recessions could lead to financial losses in our portfolio and a decrease in revenues, net income and assets. Unfavorable economic conditions also could increase our funding costs, limit our access to the capital markets or result in a decision by lenders not to extend credit to us. These events could prevent us from increasing investments and harm our operating results.

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

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

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

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

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

- since our debt investments are primarily made in the form of mezzanine loans, our liens on the collateral, if any, are subordinated to those of the senior secured debt of the portfolio companies, if any. As a result, we may not be able to control remedies with respect to the collateral;
- the collateral may not be valuable enough to satisfy all of the obligations under our secured loan, particularly after giving effect to the repayment of secured debt of the portfolio company that ranks senior to our loan;
- bankruptcy laws may limit our ability to realize value from the collateral and may delay the realization process;
- our rights in the collateral may be adversely affected by the failure to perfect security interests in the collateral;
- how effectively the collateral would be liquidated and the value received could be impaired or impeded by the need to obtain regulatory and contractual consents; and
- by its nature, some or all of the collateral may be illiquid and may have no readily ascertainable market value. The liquidity and value of the collateral could be impaired as a result of changing economic conditions, competition, and other factors, including the availability of suitable buyers.

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

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

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

We have not yet identified all of the potential investments for our portfolio.

We have not yet identified all of the potential investments for our portfolio, and, thus, you will not be able to evaluate all of our potential investments prior to purchasing our common stock. This factor will increase the uncertainty, and thus the risk, of investing in our common stock.

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

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

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

We may employ hedging techniques to mitigate certain risks, but it may not be possible to hedge fully or perfectly against such risks.

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

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

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

Because we borrow money to make investments, our net investment income is dependent upon the difference between the rate at which we borrow funds and the rate at which we invest these funds. As a result, there can be no assurance that a significant change in market interest rates will not have a material adverse effect on our net investment income. In periods of rising interest rates, our cost of borrowed funds would increase, which would reduce our net investment income. We use a combination of short-term borrowings and equity capital to finance our investing activities. We utilize our revolving line of credit as a means to bridge to long-term financing. These risks are in addition to risks associated with fluctuating interest rates, which can adversely affect the interest income we are owed and that we must pay, in addition to the ability of portfolio companies to pay us, and our ability to pay our debt service and dividends, which could adversely affect us and our stock price. We may use interest rate risk management techniques in an effort to limit our exposure to interest rate fluctuations. Such techniques may include various interest rate hedging activities to the extent permitted by the 1940 Act.

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Risks Relating To Our Common Stock

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

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

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

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

Additionally, under our charter, our Board of Directors is divided into three classes serving staggered terms and no director may be removed except for cause and upon vote of stockholders holding 662/3% of the shares of common stock entitled to vote on the election of directors. The inability to remove directors and the maintenance of a staggered board could discourage others from pursuing a merger or other change-of-control transaction. Our Board of Directors may, without stockholder action, authorize the issuance of shares of stock in one or more classes or series, including preferred stock; and our Board of Directors may, without stockholder action, amend our charter to increase the number of shares of stock of any class or series that we have authority to issue. The existence of these provisions, among others, may have a negative impact on the price of our common stock and may discourage third party bids for ownership of our Company. These provisions may prevent any premiums being offered to you for shares of our common stock.

Investing in our common stocks may involve a high degree of risk.

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

The market price of our common stock may fluctuate significantly.

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

- significant volatility in the market price and trading volume of securities of business development companies or other companies in the energy industry, which are not necessarily related to the operating performance of these companies;

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changes in regulatory policies or tax guidelines, particularly with respect to RICs or business development companies;

loss of RIC status;

changes in earnings or variations in operating results;

changes in the value of our portfolio of investments;

any shortfall in revenue or net income or any increase in losses from levels expected by investors or securities analysts;

termination of the Investment Advisory Agreement with Prospect Capital Management, or departure of one or more of Prospect Capital Management s key personnel;

operating performance of companies comparable to us;

changes in prevailing interest rates;

litigation matters;

general economic trends and other external factors; and

loss of a major funding source.

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

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

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

As of November 30, 2006, we had 12,867,341 shares of common stock outstanding and will have 18,867,341 million shares outstanding after this offering. Sales of substantial amounts of our common stock or the availability of such common stock for sale could adversely affect the prevailing market price for our common stock. If this occurs and continues, it could impair our ability to raise additional capital through the sale of common stock should we desire to do so.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

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

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

For the Three Months Ended September 30, 2006

Overview

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

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

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

Investments:

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

b) Valuation:

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

2) Short-term investments 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.

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 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.

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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.

In determining the fair value of our portfolio investments at September 30, 2006, the Audit Committee considered valuations from the independent valuation firm and from management having an aggregate range of $150.6 million to $161.1 million.

As of September 30, 2006, we continue to pursue our investment strategy and 82.1% of our net assets are invested in energy companies.

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

Our portfolio generated an annualized current yield of 16.9% and 19.1% across all our long-term debt and equity investments as of September 30, 2006 and September 30, 2005, respectively. This yield includes interest from all of our long-term investments as well as dividends from GSHI in both years and GSHI and Unity Virginia (Unity) in 2005. We expect this number to decline over time as we increase the size of the portfolio. Monetization of, or dividends from, other equity positions that we hold is not included in this yield estimate. In each of our portfolio companies, we hold equity positions, ranging from minority interests to majority stakes, which we expect over time to contribute significantly to our investment returns. Many of these equity positions include features such as contractual minimum internal rate of returns, preferred distributions, flip structures and other features expected to generate additional investment returns, as well as contractual protections and preferences over junior equity, in addition to the yield and security offered by our cash flow and collateral debt protections. Set forth below are several views of our investment portfolio, classified by type of investment, geographic diversification and energy sector diversification at September 30, 2006 and September 30, 2005, respectively:

Type of Investment	**9/30/06 Fair Value (000s)**	**% of Portfolio**	**9/30/05 Fair Value (000s)**	**% of Portfolio**
Cash and Cash Equivalents	$ 33,453	17.6%	$ 13,045	13.9%
Senior Secured Debt	113,819	59.8%	44,118	47.1%
Subordinated Secured Debt	19,885	10.4%	21,617	23.1%
Common Stock	20,039	10.5%	12,231	13.1%
Preferred Stock	1,756	0.9%	1,262	1.3%
Warrants	1,458	0.8%	1,389	1.5%
Total Portfolio	$ 190,410	100.0%	$ 93,662	100.0%

	9/30/06		**9/30/05**	

Geographic Exposure	Fair Value (000s)	% of Portfolio	Fair Value (000s)	% of Portfolio
Midwest U.S.	$ 29,136	15.3%	$ 14,526	15.5%
Northeast U.S.	20,222	10.6%	10,500	11.2%
Southeast U.S.	21,193	11.1%	12,972	13.9%
Southwest U.S.	61,168	32.1%	42,619	45.5%
Canada	25,238	13.3%		
Cash and Cash Equivalents	33,453	17.6%	13,045	13.9%
Total Portfolio	$ 190,410	100.0%	$ 93,662	100.0%

Energy Sector	9/30/06 Fair Value (000s)	% of Portfolio	9/30/05 Fair Value (000s)	% of Portfolio
Biofuels/Ethanol	$ 8,000	4.2%	$	
Biomass Power	20,222	10.6%	10,500	11.2%
Construction Services	19,284	10.1%		
Gas Gathering and Processing	36,000	18.9%	29,700	31.7%
Manufacturing	11,014	5.8%		
Mining and Coal Production	14,514	7.6%	9,735	10.4%
Natural Gas Marketing	5,319	2.8%		
Oil and Gas Production	19,696	10.4%	21,618	23.1%
Production Services	18,712	9.8%		
Seismic Services	4,196	2.2%	9,064	9.7%
Cash and Cash Equivalents	33,453	17.6%	13,045	13.9%
Total Portfolio	$ 190,410	100.0%	$ 93,662	100.0%

Results of Operations

Investment Activity

We completed our tenth quarter on September 30, 2006, which was our ninth full quarter since completion of our initial public offering on July 30, 2004, with approximately 82.1% of our net assets or about $156.957 million invested in seventeen long-term portfolio investments and 17.5% of our net assets invested in money market funds. The remaining 0.4% of our net assets represents other assets in excess of liabilities.

Long-Term Portfolio Investments

On August 1, 2006, we obtained a controlling interest of the common equity of Whymore. As of September 28, 2006, we have provided an additional $0.649 million of senior secured debt financing to Whymore.

On August 2, 2006, we completed the sale of all Evolution Petroleum Corp. (formerly known as Natural Gas Systems, Inc.) registered common shares. The capital gain from these sales is approximately $2.273 million.

On August 31, 2006 we provided the remaining $3.000 million of the $9.250 million senior secured debt investment in Iron Horse, an oilfield services company based in Medicine Hat, Alberta. This disbursement is being utilized for Iron Horse s purchase of additional coiled tubing equipment.

On September 1, 2006 we provided $4.300 million in senior secured debt financing to Cypress, a seismic surveying company based in Houston, Texas. We received a net profit interest in Cypress as part of the investment.

On September 1, 2006, we provided $11.014 million in senior secured debt financing and acquired a controlling equity interest in NRG a leading fabricator of structures and vessels for oil and gas drilling applications based in Tomball, Texas.

During the quarter ended September 30, 2006, we completed two new investments in NRG and Cypress Consulting Services, Inc. (Cypress) and follow on investments in existing portfolio companies, totaling approximately $24.573 million.

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.

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As of September 30, 2006 we held a controlling interest in GSHI, NRG, WECO and Whymore. As of September 30, 2006 we held an affiliated interest in Advantage Oilfield Group, Ltd., Appalachian Energy Holdings, LLC and Iron Horse.

Level of Control	9/30/06 Fair Value (000s)	% of Portfolio	9/30/05 Fair Value (000s)	% of Portfolio
Control	$ 73,610	38.7%	$ 29,700	31.7%
Affiliate	28,383	14.9%		
Non-Control/Non-Affiliate	54,964	28.9%	50,916	54.4%
Cash and Cash Equivalents	33,453	17.5%	13,046	13.9%
Total Portfolio	$ 190,410	100.0%	$ 93,662	100.0%

We currently have a number of transactions in our pipeline. Our Investment Adviser continues to conduct due diligence and finalize terms regarding further transactions. However, we can offer no assurance as to when or if any of these transactions will close.

Investment Income

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

Investment income, which consists of interest income, dividend income and amortized loan origination fees, was $6.432 million and $3.109 million for the three months ended September 30, 2006 and September 30, 2005, respectively.

Operating Expenses

Our primary operating expenses consist of investment advisory fees (base and incentive fees), legal and professional fees and other operating and overhead-related expenses. These expenses include our allocable portion of overhead under the Administration Agreement with Prospect Administration under which Prospect Administration provides administrative services and facilities for Prospect Energy. Our investment advisory fees compensate our Investment Adviser for its work in identifying, evaluating, negotiating, closing and monitoring our investments. We bear all other costs and expenses of our operations and transactions in accordance with our Administration Agreement with Prospect Administration.

Operating expenses were $3.158 million and $1.694 million for the three months ended September 30, 2006 and September 30, 2005, respectively. These expenses consisted of investment advisory and administrative services fees, professional fees, insurance expenses, directors fees and other general and administrative expenses. The base investment advisory fees were $0.616 million and $0.510 million for the three months ended September 30, 2006 and September 30, 2005, respectively. The income incentive fees were $0.818 million and none for the three months ended September 30, 2006 and September 30, 2005, respectively. No capital gains incentive fee has yet been incurred pursuant to the Investment Advisory Agreement.

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

Prospect Energy s net investment income was $3.274 million and $1.415 million for the three months ended September 30, 2006 and September 30, 2005, respectively. Net investment income represents the difference between investment income and operating expenses and is directly impacted by the items described above. Net realized gains (losses) were $1.951 million and $(0.018) million for the three months ended September 30, 2006 and September 30, 2005, respectively. Net unrealized appreciation (depreciation) was

$(1.261) million and $0.076 million for the three months ended September 30, 2006 and September 30, 2005, respectively. Net increase in net assets resulting from operations represents the sum of the returns generated from net investment income, realized gains (losses) and the change in unrealized appreciation (depreciation).

Financial Condition, Liquidity and Capital Resources

The Company s liquidity and capital resources were generated primarily from the remaining net proceeds of its initial public offering, cash flows from operations and borrowings under its credit facility. We generated $96.961 million in cash from the net proceeds of our initial offering after accounting for organization and offering costs. Additionally, we generated $82.526 million in cash from the net proceeds of our secondary offering after accounting for offering costs. We used cash flows in operating activities totaling $50.440 million for the three months ended September 30, 2006 compared to $(1.411) million for the three months ended September 30, 2005. We paid down $28.500 million in cash from borrowings under the credit facility during the three months ended September 30, 2006. We declared and paid dividends totaling $3.586 million for the three months ended September 30, 2006 compared to $1.411 million for the three months ended September 30, 2005. In the future, we may continue to fund a portion of our investments through borrowings from banks, issuances of senior securities or secondary offerings. We may also securitize a portion of our investments in mezzanine or senior secured loans or other assets. Our objective is to put in place such borrowings in order to expand our portfolio. Our primary use of funds will be investments in portfolio companies and cash distributions to holders of our common stock.

At September 30, 2006, we held no cash in the segregated account maintained in conjunction with a limited indemnity issued to Citibank Texas, N.A. (formerly First American Bank, SSB). The limited indemnity with Citibank required us to indemnify Citibank for up to $12.0 million for any losses it realizes on its term loan to GSHI resulting only from potential legal claims that might or could be asserted by certain third parties. This limited indemnity was backed by the funds in the segregated account. During the quarter ended December 31, 2005, $9.587 million of previously segregated funds were released to the Company, respectively. These reductions reflected a waiver of the segregated funds requirement due to the developments related to legal claims and prior payments by GSHI to Citibank Texas, N.A.

For the Year Ended June 30, 2006

Overview

The following analysis of our financial condition and results of operations should be read in conjunction with our financial statements and the related notes thereto contained elsewhere in this prospectus supplement.

As of June 30, 2006, we continue to pursue our investment strategy and 123.7% of our net assets are invested in energy companies and 1.5% invested in a money market fund.

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

Our portfolio generated an annualized current yield of 17.0% and 21.8% across all our long-term debt and equity investments as of June 30, 2006 and June 30, 2005, respectively. This yield includes interest from all of our long-term investments as well as dividends from Gas Solutions Holdings, Inc. (GSHI) in both years and GSHI and Unity Virginia (Unity) in 2005. We expect this number to decline over time as we increase the size of the portfolio. Monetization of, or dividends from, other equity positions that we hold is not included in this yield estimate. In each of our portfolio companies, we hold equity positions, ranging from minority interests to majority stakes, which we expect over time to contribute significantly to our investment returns. Many of these equity positions include features such as contractual minimum internal rate of returns, preferred distributions, flip structures and other features expected to generate additional investment returns, as well as contractual protections and preferences over junior equity, in addition to the yield and security offered by our cash flow and collateral debt protections.

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Results of Operations

Investment Activity

We completed our second fiscal year and ninth quarter, which was our eighth full quarter since completion of our initial public offering on July 30, 2004, with approximately 123.7% of our net assets or about $134.0 million invested in fifteen long-term portfolio investments and 1.5% of our net assets invested in a money market fund. The remaining (25.2%) of our net assets represents liabilities in excess of other assets.

Long-Term Portfolio Investments

During the quarter ended June 30, 2006, we completed five new investments totaling approximately $42.75 million in Charlevoix Energy Trading LLC (Charlevoix), Iron Horse Coiled Tubing, Ltd. (Iron Horse), Central Illinois Energy, LLC (CIE), Conquest Cherokee, LLC (Conquest) and Advantage Oilfield Group, Ltd. (Advantage).

On April 20, 2006, we provided $5.5 million in senior secured debt financing to Charlevoix, a natural gas marketing company based in Charlevoix, Michigan. Charlevoix is a natural gas marketing company which has operated in Michigan since 1986. Charlevoix provides approximately 20 billion cubic feet of natural gas annually to approximately 300 commercial, industrial, governmental, and institutional customers. Charlevoix markets natural gas supplied by one of the world s largest oil and gas producers. This supplier provides wholesale natural gas to Charlevoix with back-to-back contracts, helping Charlevoix minimize commodity exposure. Prospect s capital has been used to support an acquisition of Charlevoix by Vishnu Energy, LLC (Vishnu). Vishnu invested equity in the acquisition as capital junior to Prospect. Prospect has also received a net profit interest in Charlevoix in conjunction with its loan.

On April 24, 2006, we provided $9.25 million in senior secured debt financing to Iron Horse, an oilfield services company based in Medicine Hat, Alberta. Iron Horse is an energy services company that focuses on fracture stimulation for gas wells, including coalbed methane and other types of wells. Iron Horse has a growing fleet of state-of-the-art coiled tubing rigs and ancillary equipment provided on an outsourced basis to larger oilfield service companies and gas production companies. The company currently has a multi-rig, multi-year contract with a major oilfield service company. Prospect s investment is secured by equipment and other assets of Iron Horse. Prospect has also received equity in Iron Horse in conjunction with its debt investment, which includes minimum preferred return requirements on Prospect s capital. As of June 30, 2006, Iron Horse had drawn down $6.25 million of the total $9.25 million in senior secured debt financing. Subsequently on August 31, 2006, Iron Horse drew down the remaining $3.0 million.

On April 25, 2006, we provided $8.0 million in senior secured debt financing to CIE, an ethanol production company based in Buckheart Township in Fulton County, Illinois. CIE is constructing a 37 million gallon per year ethanol and distillers grain production facility, expected to go into service in 2007. The majority equity owner of the project is an agricultural cooperative of corn farmers, who have agreed to subordinate their future corn prices to the project in favor of debt service to the lenders. In addition, the project will be a low-cost facility with energy requirements met with contracted waste coal in the vicinity of the plant. CIE has negotiated turn-key, fixed-price, date-certain engineering, procurement, and construction contracts for the facility. The project has an excellent location with access to the Illinois River, roads, and rail, as well as more than 85 million bushels of corn harvested annually in the three counties surrounding the project. Prospect s investment, together with other co-investors, is part of an approximately $87.5 million senior secured facility, secured by equipment, contracts, and other assets. Approximately $27.0 million of junior equity is also being invested into the CIE project.

On May 9, 2006 we provided $3.5 million in senior secured debt financing in Conquest, an oil and gas company based in Nashville, Tennessee, and Independence, Kansas. Conquest focuses on shallow coalbed methane (CBM) production in the Cherokee Basin in Southeastern Kansas, including Wilson, Montgomery, Neosho, Labette, and Chautauqua counties. Conquest has a proprietary software mapping and database system allowing it to select drilling targets throughout the Cherokee Basin. Prospect s investment, secured by existing wells, infrastructure, and acreage, is being deployed for development drilling. Third party junior equity is also being invested. Prospect is receiving an overriding royalty interest in Conquest s properties in conjunction with

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Prospect s debt instrument. Prospect s investment is expected to grow as Conquest s drilling and acquisition activities increase.

On May 22, 2006, Unity Virginia Holdings, LLC and affiliates (Unity) filed voluntarily for reorganization under Chapter 11 of Title 11 of the United States Code and is currently in default under the contract governing the loan we made to it. Prospect holds $2.8 million of second lien secured debt, representing approximately 2.5% of Prospect s net asset value as of June 30, 2006. PlainsCapital Bank has provided up to $5.4 million of senior bank debt, which benefits from personal guarantees from Karl Singer and Keller Smith of Unity Platform LP (Platform), a Dallas investment firm, as well as Coalline, an affiliate of the Bass family. Platform and Coalline have provided more than $7.0 million of equity capital to Unity. Unity is in the process of liquidating its assets. Our security interest in Unity s assets is a second priority lien, and the net proceeds from the sale or liquidation of Unity s assets may not satisfy in full the debt owed to the holder of the first priority lien on Unity s assets. Our lack of control over the liquidation of Unity s assets, our second lien security position in such assets and the prospect that Unity s assets have substantially decreased in value could result in our losing our entire investment in Unity. In addition, if the bankruptcy court were to set aside as preferential payments or we were otherwise deemed not to have recognized any amounts previously paid to us by Unity, our net investment income could be materially adversely affected.

On June 1, 2006 we provided $16.5 million in senior secured debt financing to Advantage, a pipeline and facility construction company based in Medicine Hat, Alberta. Advantage is one of the largest energy services companies engaged in oilfield and gasfield pipeline and facility construction in Western Canada. The largest private employer in Medicine Hat, with offices in Calgary and Lloydminster, Advantage has more than 200 employees and sub-contractors engaged across multiple crews. Typical engagements include construction of major pipeline gathering systems, construction of sales pipelines, and installations and upgrades of facilities in all Western Canadian geographic locations. Advantage has more than 140 pieces of equipment, including track hoes, sidebooms, graders, bulldozers, ditchers, rubber tire hoes, crew cabs, mechanical trucks, crew vans, highway tractors, job vans, and hot shot trucks. The company has a diversified list of customers and a significant backlog of business. Prospect s investment is secured by equipment, receivables, and other assets of Advantage. The investment is being utilized for general working capital and as a springboard for Advantage s next phase of growth. Prospect has also received equity in Advantage in connection with its debt investment, including minimum preferred return requirements on Prospect s capital.

On June 1, 2006, we received full repayment of our $5.0 million senior secured loan to Natural Gas Systems, Inc. (NGS) including a prepayment premium of $0.4 million. We originally extended $3.0 million to NGS on February 3, 2005, and subsequently funded an additional $2.0 million. In addition, we converted all series of warrants into 1,000,954 of registered and unregistered common shares of NGS stock.

GSHI owns and operates a major gas gathering and processing system in the East Texas Field in Gregg, Upshur, Rusk and Smith counties, Texas. This system consists of two processing facilities (the Longview Plant and the Chapel Hill Plant) and approximately 1,000 miles of associated gathering and transportation pipelines. GSHI controls the only independent gathering system in the East Texas Field serving all of the approximately 4,000 currently operating wells in the region. GSHI completed construction and started operation of the 22.5 mile Exxon Hawkins NGL Pipeline connecting the Exxon Hawkins gas plant to GSHI on June 6, 2005. Deliveries for 2005 averaged 650 barrels per day and during the first six months of 2006 have averaged 853 barrels per day. The Agreement with Exxon Gas & Power Marketing Company (Exxon) is effective as of June 30, 2004 and has a term of seven years with an annual renewal provision thereafter. Under the agreement, Exxon is to deliver a specified minimum number of barrels of natural gas liquids in the first five years and to pay a transportation, treating and fractionation fee which includes a capital recovery component. After five years or delivery of the specified minimum number of barrels, whichever comes first, the fee decreases to a base transportation, treating and fractionation rate for the remainder of the contract term. Total capital expenditures for the year ended December 31, 2005 were approximately $3.5 million of which $3.25 million was related to the construction of the Exxon Hawkins NGL Pipeline. Total capital expenditures for the six months ended June 30, 2006 and June 30, 2005 were $529,385 and $2,920,081, respectively. GSHI continues to perform according to expectations, benefiting from a strong commodity price environment. Operating Income for the trailing twelve months ended June 30, 2006 was $15.5 million. Operating Income for the six months ended June 30, 2006 and June 30, 2005 was $7.97 million and $5.58 million, respectively.

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Prospect Energy s investment in GSHI is comprised of $18.4 million in subordinated secured debt (Subordinated Debt) and 100% common equity shares, $14.7 million. The Subordinated Debt matures on December 22, 2011. The loan is paid in equal quarterly installments of $876,190 beginning December 31, 2006 and bears interest at 18%. Interest paid in 2005 was $3.312 million or $828,000 quarterly. Amounts outstanding on the Subordinated Debt at June 30, 2006 were $18.4 million. On December 22, 2004, GSHI entered into a $12.5 million senior secured term loan (Senior Debt) with Citibank Texas, N.A. (formerly known as First American Bank, SSB). The Senior Debt matures on December 22, 2010. The loan is paid in equal quarterly installments of $543,479 beginning on June 30, 2005 and bears interest at LIBOR plus 225 basis points. Interest paid on the Senior Debt during the six months ended June 30, 2006 was $366,460 and amounts outstanding at June 30, 2006 were $9.783 million. Additionally, on April 28, 2006, GSHI entered into a $2.5 million revolving line of credit (Revolver) with Citibank Texas, NA. The Revolver matures on April 28, 2007 and bears interest at LIBOR plus 225 basis points. Interest paid on the Revolver during the six months ended June 30, 2006 was $12,048 and amounts outstanding at June 30, 2006 were $1,004,750.

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.

As of June 30, 2006 we held a controlling interest in Gas Solutions Holdings, Inc. and Worcester Energy Partners, Inc. As of June 30, 2006 we held an affiliated interest in Advantage Oilfield Group, Ltd., Appalachian Energy Holdings, LLC and Iron Horse Coiled Tubing, Ltd. We have subsequently acquired a controlling interest in Whymore Coal.

We currently have a number of transactions in our pipeline. Our Investment Adviser continues to conduct due diligence and finalize terms regarding further transactions. However, we can offer no assurance as to when or if any of these transactions will close.

Investment Income

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

Investment income, which consists of interest income, dividend income and amortized loan origination fees, was $16.9 million and $8.1 million and none for the twelve months ended June 30, 2006 and June 30, 2005 and for the period from April 13, 2004 (inception) through June 30, 2004, respectively. The increase is attributable to the portfolio becoming substantially invested from inception through the end of the fiscal year.

Operating Expenses

Our primary operating expenses consist of investment advisory fees (base and incentive fees), legal and professional fees and other operating and overhead-related expenses. These expenses include our allocable portion of overhead under the Administration Agreement with Prospect Administration under which Prospect Administration provides administrative services and facilities for Prospect Energy. Our investment advisory fees compensate our Investment

Adviser for its work in identifying, evaluating, negotiating, closing and monitoring our investments. We bear all other costs and expenses of our operations and transactions in accordance with our Administration Agreement with Prospect Administration.

Operating expenses were $8.3 million, $5.7 million and $0.1 million for the twelve months ended June 30, 2006 and June 30, 2005 and for the period from April 13, 2004 (inception) through June 30, 2004, respectively. These expenses consisted of investment advisory and administrative services fees, professional fees, insurance expenses, directors fees and other general and administrative expenses. The base investment advisory fees were $2.1 million, $1.8 million and none for the twelve months ended June 30, 2006 and June 30, 2005 and for the period from April 13, 2004 (inception) through June 30, 2004, respectively. The income incentive fees were $1.8 million, none and none for the twelve months ended June 30, 2006 and June 30, 2005 and for the period from April 13, 2004 (inception) through June 30, 2004, respectively. No capital gains incentive fee has yet been incurred pursuant to the Investment Advisory Agreement. Legal fees declined during the twelve months ended June 30, 2006, as two legal proceedings against the Fund were dismissed. This has been offset slightly by an increase in other professional fees, as the Fund became subject to the internal control certification requirements of Section 404 of the Sarbanes Oxley Act for the current fiscal year.

Net Investment Income, Net Unrealized Appreciation and Net Increase in Stockholders Equity Resulting from Operations

Prospect Energy s net investment income (loss) was $8.6 million, $2.4 million and ($0.1) million for the twelve months ended June 30, 2006 and June 30, 2005 and for the period from April 13, 2004 (inception) through June 30, 2004, respectively. Net investment income represents the difference between investment income and operating expenses and is directly impacted by the items described above. Net unrealized appreciation was $4.0 million, $6.3 million and none during the twelve months ended June 30, 2006 and June 30, 2005 and for the period from April 13, 2004 (inception) through June 30, 2004, respectively. Net increase in stockholders equity resulting from operations represents the sum of the returns generated from net investment income loss, realized gains (loss) and from unrealized appreciation (depreciation).

Financial Condition, Liquidity and Capital Resources

The Company s liquidity and capital resources were generated primarily from the remaining net proceeds of its initial public offering, cash flows from operations and borrowings under its credit facility. We generated $97.0 million in cash from the net proceeds of our initial offering after accounting for offering costs. We used cash flows in operating activities totaling ($30.5) million for the twelve months ended June 30, 2006 compared to ($84.7) million for the twelve months ended June 30, 2005. We borrowed $28.5 million in cash from borrowings under the credit facility for the twelve months ended June 30, 2006. We declared and paid dividends totaling $7.9 million for the twelve months ended June 30, 2006 compared to $2.6 million for the twelve months ended June 30, 2005. Subsequent to June 30, 2006, we replaced our existing $30.0 million credit facility with a $50.0 million credit facility and we received net proceeds from a secondary offering of our common stock of approximately $83.1 million, approximately $29.3 million of which was used to repay all amounts outstanding on our credit facility. As a result, as of August 31, 2006, we had available for investment approximately $53.8 million of the proceeds of our secondary offering, as well as the full amount of our $50.0 million credit facility. In the future, we may continue to fund a portion of our investments through borrowings from banks, issuances of senior securities or secondary offerings. We may also securitize a portion of our investments in mezzanine or senior secured loans or other assets. Our objective is to put in place such borrowings in order to expand our portfolio. Our primary use of funds will be investments in portfolio companies and cash distributions to holders of our common stock.

At June 30, 2006, we held no cash in the segregated account maintained in conjunction with a limited indemnity issued to Citibank Texas, N.A. (formerly First American Bank, SSB). The limited indemnity with Citibank required us to indemnify Citibank for up to $12.0 million for any losses it realizes on its term loan to GSHI resulting only from potential legal claims that might or could be asserted by certain third parties. This limited indemnity was backed by the funds in the segregated account. During the quarters ended December 31, 2005 and June 30, 2005, $9.6 million and $3.3 million of previously segregated funds were released to the Company, respectively. These reductions reflected a waiver of the segregated funds requirement due to the developments related to legal claims and prior payments by GSHI to Citibank Texas, N.A.

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Critical Accounting Policies

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

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

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

Investments:

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

b) Valuation:

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

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.

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.

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.

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.

In determining the fair value of our portfolio investments at June 30, 2006, the audit committee considered valuations from the independent valuation firm and from management having an aggregate range of $127.3 million to $138.2 million.

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Contractual Obligations

The Company has purchase obligations for investment advisory and administration services. Such descriptions may be found under Investment Advisory Agreement (Page 6) and Administration Agreement (Page 10), respectively. The Company paid $2.1 million for investment advisory services. The company paid VFS $0.3 million under the subadministration agreement for administration and CFO services.

The Company had $28.5 million and none in borrowings at June 30, 2006 and June 30, 2005, respectively. The following table shows the facility amounts and outstanding borrowings at June 30, 2006 and June 30, 2005:

	June 30, 2006(1)		June 30, 2005(2)	
	Facility Amount		Facility Amount	
	Amount	Outstanding	Amount	Outstanding
	(dollars in thousands)		*(dollars in thousands)*	
Senior Secured Revolving Credit Facility	$ 30,000	$ 28,500	$	$

(1) 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 the $30.0 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. This Facility has a term of one year, expiring on July 19, 2007.

(2) The senior secured revolving facility was not established until February 21, 2006.

PORTFOLIO COMPANIES

The following is a listing of our portfolio companies at September 30, 2006. Values are as of September 30, 2006.

The portfolio companies are presented in three categories. Companies more than 25% owned are portfolio companies in which we directly or indirectly own more than 25% of the outstanding voting securities of such portfolio company and, therefore, are presumed to be controlled by us under the 1940 Act. Companies owned 5% to 25% are portfolio companies where we directly or indirectly own 5% to 25% of the outstanding voting securities of such portfolio company and/or hold one or more seats on the portfolio company s Board of Directors and, therefore, are deemed to be an affiliated person under the 1940 Act. Companies less than 5% owned are portfolio companies where we directly or indirectly own less than 5% of the outstanding voting securities of such portfolio company and where we have no other affiliations with such portfolio company. As of September 30, 2006, we owned 100% of the fully diluted common equity of Gas Solutions Holdings, Inc., 51% of the fully diluted common equity of Worcester Energy Partners, Inc. and certain of its affiliates, 100% of the fully diluted common equity of NRG Manufacturing Inc. and 100% of the fully diluted common equity of Whymore Coal Company, Inc. and therefore have a controlling interest in each case. We make available significant managerial assistance to our portfolio companies. We generally request and may receive rights to observe the meetings of our portfolio companies Boards of Directors.

Name of Portfolio Company	Nature of its Principal Business (Location)	Title and Class of Securities Held	Collateral Held	Investment Structure	Equity Securities Held, at Fair Value	Outstanding Principal Balance of all Loans (in millions)
Companies more than 25% owned						
Gas Solutions Holdings, Inc.	Gas gathering and processing (Texas)	Subordinated secured debt and common equity	Second priority lien on substantially all assets, subject to first priority lien of senior lender, Citibank Texas, N.A.	Common shares; Subordinated secured note, 18.00% due 12/22/2011	$ 17.6	$ 18.4
NRG Manufacturing, Inc.	Manufacturing (Texas)	Senior secured debt and	First priority lien on	Common shares; Senior	1.7	9.4

		common equity	substantially all assets	secured note, 16.5% due 8/31/2013		
Worcester Energy Partners, Inc.	Biomass power (Maine)	Senior secured debt convertible preferred stock and common equity	First priority lien on substantially all assets	Common shares; Preferred stock, convertible, Series A; Senior secured note, 12.50% due 12/31/2012		20.3
Whymore Coal Company	Mining and coal production (Kentucky)	Senior secured debt and preferred equity	First priority lien on substantially all assets	Preferred shares, convertible, Series A; Senior secured note, 16.31% due 12/31/2010		8.1
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, preferred shares, expiring 2/14/2016; Warrants, common shares, expiring 2/14/2016; Senior secured note, 14.00%, 3.00% PIK due 2/14/2011	0.4	3.0
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 note, 15.00% due	0.3	9.3

				4/30/09		
Advantage Oilfield Group, Ltd.	Construction Services (Alberta, Canada)	Senior secured debt and common stock	First priority lien on substantially all assets	Common shares; Senior secured note, 15.00% due 5/30/09	0.2	16.5
Companies less than 5% owned						
Arctic Acquisition Corp.	Production services (Texas)	Senior secured debt financing with warrants for common and preferred	First priority lien on substantially all assets	Warrants, common shares, expiring 7/19/2012; Warrants, preferred shares, expiring 7/19/2012; Senior secured note. 13.00% due 6/15/2009	1.0	9.5

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Name of Portfolio Company	Nature of its Principal Business (Location)	Title and Class of Securities Held	Collateral Held	Investment Structure	Equity Securities Held, at Fair Value	Outstanding Principal Balance of all Loans (in millions)
Miller Petroleum, Inc.	Oil and gas production (Tennessee)	Senior secured debt and warrants	N/A loan repaid	Warrants, expiring 5/4/2010, through 9/30/2011	0.1	
Stryker Energy II, LLC	Oil and gas production (Ohio)	Common shares, preferred shares and senior secured debt	First priority lien on substantially all assets	Common shares, Class A; Preferred shares, Class B; Senior secured note, 13.32% due 4/8/2010; senior secured term note, 12.00% due 4/8/2010	1.7	14.3
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 secured note, due 1/31/2009		3.6
Genesis Coal Company, LLC	Mining and coal production (Kentucky)	Senior secured debt and preferred equity	First priority lien on substantially all assets including equipment, although Prospect s lien on certain	Warrants, preferred shares, expiring 1/31/2016; Senior secured note, 16.49% due 12/31/2010		6.9

			equipment is second to $600K loan by First Tennessee Bank			
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 note, 12.5% due 3/31/11		5.4
Central Illinois Energy, LLC	Biofuels/Ethanol (Illinois)	Senior secured debt	First priority lien on substantially all assets	Senior secured note, 15.36688% due 3/31/14		8.0
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 note, 13.00% due 5/5/09		3.5
Cypress Consulting Services, Inc.	Seismic Services (Texas)	Senior secured debt	First priority lien on substantially all assets	Senior secured note, 13%, 2% PIK, due 4/19/2009		4.3
Evolution Petroleum Corp.	Oil and Gas Production (Texas)	Common shares	None	Common shares	0.3	

PRICE RANGE OF COMMON STOCK AND DISTRIBUTIONS

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

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

- 98% of our ordinary income for the calendar year,
- 98% of our capital gains in excess of capital losses for the one-year period ending on October 31 of the calendar year, and
- any ordinary income and net capital gains for preceding years that were not distributed during such years.

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

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

Income from origination, structuring, closing, commitment and other upfront fees associated with investments in portfolio companies has been treated as taxable income and, accordingly, distributed to shareholders. From our initial public offering through September 30, 2006, we have distributed approximately 94.0% of our taxable income to our stockholders. For the fiscal year ended June 30, 2006, we declared total dividends of $7.9 million.

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

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

Twelve Months Ended June 30, 2005	**NAV[1]**	**Stock Price High**	**Stock Price Low**	**Premium (Discount) of High to NAV**	**Premium (Discount) of Low To NAV**	**Dividend Declared**
First quarter	$ 13.67	15.45	$ 14.42	13.0%	5.5%	
Second quarter	13.74	15.15	11.63	10.3%	(15.4)%	$ 0.100
Third quarter	13.74	13.72	10.61	(0.1)%	(22.8)%	0.125
Fourth quarter	14.59	13.47	12.27	(7.7)%	(15.9)%	0.150
Twelve Months Ended June 30, 2006						
First quarter	$ 14.60	$ 13.60	$ 11.06	(6.8)%	(24.2)%	$ 0.200
Second quarter	14.69	15.46	12.84	5.2%	(12.6)%	0.280
Third quarter	14.81	16.64	15.00	12.4%	1.3%	0.300
Fourth quarter	15.31	17.07	15.83	11.5%	3.4%	0.340
Twelve Months Ending June 30, 2007						
First quarter	$ 14.86	$ 16.77	$ 15.30	12.9%	3.0%	$ 0.380
Second quarter (through December 12, 2006)	[2]	$ 18.97	$ 14.73			[3]

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

(2) Net asset value has not yet been determined for any day after September 30, 2006.

(3) The company has not declared its dividend for its second fiscal quarter ending December 31, 2006.

On December 12, 2006, the last reported sales price of our common stock was $18.39 per share. As of September 21, 2006, we had approximately 10,422 stockholders of record.

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USE OF PROCEEDS

The net proceeds from the sale of 6,000,000 shares of our common stock in this offering are $100,900,000 after deducting underwriting discounts of $5,100,000 and estimated offering expenses of approximately $200,000 payable by us.

We expect to use approximately $11.2 million of the net proceeds of this offering to repay borrowings under our credit facility. Such borrowings bear interest at (i) LIBOR plus the applicable spread at such time, or (ii) the greater of the lender prime rate or the federal funds effective rate plus the applicable spread at such time. Our credit facility matures on July 19, 2007, subject to our lender s option to extend the facility for an additional two years at the end of the initial term. We expect such repayment will occur within two business days after the closing of this offering. Once repaid, we expect the entire amount of our credit facility to be available to fund additional investments. We expect to use the remainder of the net proceeds of this offering to fund investments from our investment pipeline and for general corporate purposes.

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CAPITALIZATION

The following table sets forth (1) our actual capitalization at September 30, 2006 and (2) our capitalization as adjusted to reflect the effects of the sale of our common stock in this offering, after deducting the underwriting discounts and commissions and offering expenses payable by us. You should read this table together with Use of Proceeds and our balance sheet included in the accompanying prospectus.

	As of September 30, 2006	
	Actual	**As Adjusted**[1]
	(unaudited, in thousands)	
Long-term debt, including current maturities		
Borrowings under senior credit facility	$ 0	$ 0
Amount owed to affiliate	1,141	1,141
Total long-term debt	1,141	1,141
Components at net assets:		
Common stock, par value $.001 per share; 100,000,000 shares authorized, 12,867,341 shares outstanding, actual; 18,867,341 shares outstanding, as adjusted	13	18
Capital in excess of par value	181,059	281,953
Distributions in excess of net investment income	(1,266)	(1,266)
Accumulated realized gains on investments	2,252	2,252
Net unrealized appreciation	9,116	9,116
Total net assets	$ 191,174	$ 292,073
Total capitalization	$ 192,315	$ 293,214

(1) The above table reflects no debt outstanding as of September 30, 2006. However, as of the date of the offering, we had $11.2 million outstanding under our credit facility. A portion of the proceeds from the sale of our common stock in this offering will be used to repay all amounts outstanding under the credit facility.

MANAGEMENT

Our business and affairs are managed under the direction of our Board of Directors. Our Board of Directors currently consists of six directors, four of whom are not interested persons of Prospect Energy as defined in Section 2(a)(19) of the 1940 Act. We refer to these individuals as our independent directors. Our Board of Directors elects our officers to serve for a one-year term and until their successors are duly elected and qualified, or until their earlier removal or resignation.

Board Of Directors And Executive Officers

Under our charter, our directors are divided into three classes. Directors are elected for a staggered term of three years each, with a term of office of one of the three classes of directors expiring each year. At each annual meeting of our stockholders, the successors to the class of directors whose terms expire at such meeting are elected to hold office for a term expiring at the annual meeting of stockholders held in the third year following the year of their election. Each director holds office for the term to which he or she is elected and until his or her successor is duly elected and qualified.

Directors and Executive Officers

Our directors and executive officers and their positions are set forth below. The address for each director and executive officer is c/o Prospect Energy Corporation, 10 East 40th Street, 44th Floor, New York, NY 10016.

Independent Directors

Name and Age	Position(s) Held with the Company	Term of Office(1) and Length of Time Served	Principal Occupation(s) During Past 5 Years	Number of Portfolios in Fund Complex Overseen by Director	Other Directorships Held by Director(2)
F. Lee Liebolt, Jr., 65	Director	September 2006 to present	Lawyer in private practice; from September 2005 to August 2006, he was senior counsel at Harkins Cunningham LLP. Prior thereto, Mr. Liebolt practiced at Sidley Austin Brown & Wood LLP and certain predecessor firms as a partner (1976 to 2002) and as senior counsel (January 2003 to August 2005).	One	None
William J. Gremp, 64	Director	July 2006 to present	Merrill Lynch & Co. since 1999.	One	None
	Director			One	None

Walter V. E. Parker, 59	June 2004 to present	Executive Director of the Greenwich Land Trust, Inc., a not-for-profit organization focused on the preservation of open space since January 2005. From 1999 to 2004, Mr. Parker served as the founding principal of the Sippican Group LLC, a financial advisory firm.

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Interested Directors/

Name and Age	Position(s) Held with the Company	Term of Office[1] and Length of Time Served	Principal Occupation(s) During Past 5 Years	Number of Portfolios in Fund Complex Overseen by Director	Other Directorships Held by Director[2]
John F. Barry III[3], 54	Director, Chairman of the Board of Directors and Chief Executive Officer	April 2004 to present	Chairman and Chief Executive Officer of Prospect Energy, Managing Director of Prospect since 1990; Chairman of the Investment Committee of Prospect Capital Management.	One	None
M. Grier Eliasek[3], 33	Director, President and Chief Operating Officer	June 2004 to present	President and Chief Operating Officer of Prospect Energy, Managing Director of Prospect since 1999; Senior Professional of Prospect Capital Management.	One	None

(1) Our Board of Directors is divided into three classes of directors serving staggered three-year terms. Mr. Liebolt and Mr. Parker are Class I directors with terms that will expire in 2008, Mr. Eliasek and Mr. Gremp are Class II directors with terms that will expire in 2009 and Mr. Barry is a Class III director with a term that will expire in 2007.

(2) No director otherwise serves as a director of an investment company subject to the 1940 Act.

(3) Messrs. Barry and Eliasek are each considered an interested person under the 1940 Act by virtue of serving as one of our officers and having a relationship with the Investment Adviser.

Information about Executive Officers who are not Directors

Name and Age	Position(s) Held with the Company	Term of Office and Length of Time Served	Principal Occupation(s) During Past Five Years
William E. Vastardis, 51	Chief Compliance Officer, Chief Financial Officer,	January 2005 to present as Chief Compliance Officer and April 2005 to present as Chief Financial Officer	Mr. Vastardis is a founder and President of Vastardis Fund Services (formerly, EOS Fund Services LLC) (Vastardis) and of Vastardis Compliance Services LLC (formerly, EOS

Treasurer and Secretary	Compliance Services LLC) (Vastardis Compliance). Mr. Vastardis founded Vastardis in 2003 and Vastardis Compliance in June 2004. Vastardis Compliance performs chief compliance officer services for various registered investment companies and registered investment advisers. Prior to founding Vastardis, he managed a third-party fund administration firm, AMT Capital Services Inc., which was acquired by Investors Bank & Trust Company in 1998. Mr. Vastardis continued in the role of Managing Director at the renamed Investors Capital Services until he departed in 2003 to found Vastardis.

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Independent Directors

William J. Gremp. Mr. Gremp s career as an investment banker, with over 30 years of corporate finance experience in originating and executing transactions and advisory assignments for energy and utility related clients, has spanned years of significant change in the energy industry. Since 1999, Mr. Gremp has been responsible for traditional banking services, credit and lending, private equity and corporate cash management with Merrill Lynch & Co. From 1996 to 1999, he served at Wachovia as senior vice president, managing director and co-founder of the utilities and energy investment banking group, responsible for origination, structuring, negotiation and successful completion of transactions utilizing investment banking, capital markets and traditional commercial banking products. From 1989 to 1996, Mr. Gremp was the managing director of global power and project finance at JPMorgan Chase & Co., where he was responsible for the origination, delivery and successful implementation of all corporate finance and investment banking products and services to the utility and energy industries. He advised clients on corporate strategy, project financing, mergers and acquisitions and equity and lease finance. From 1970 to 1989, Mr. Gremp was with Merrill Lynch & Co., starting out as an associate in the mergers and acquisitions department, then in 1986 becoming the senior vice president, managing director and head of the regulated industries group. From 1965 to 1970, Mr. Gremp served in roles at the United States Army, the Mobil Oil Corporation and a New York management consulting firm. Mr. Gremp received his MBA from New York University and his Bachelor of Science degree from the University of Minnesota.

F. Lee Liebolt, Jr. Mr. Liebolt is a lawyer in private practice. From September 2005 to August 2006, he was senior counsel at Harkins Cunningham LLP. Prior thereto, Mr. Liebolt practiced at Sidley Austin Brown & Wood LLP and certain predecessor firms as a partner (1976 to 2002) and as senior counsel (January 2003 to August 2005).

Walter V. E. Parker. Mr. Parker has 35 years of experience in the energy and finance industries. Mr. Parker currently serves as executive director of the Greenwich Land Trust, Inc., a not for profit organization focused on the preservation of open space since January 2005. From 1999 to 2004, Mr. Parker served as a founding principal in the Sippican Group, LLC, a financial advisory firm. While at Sippican, he advised clients on business development, and financial matters. From 2000 to 2001, Mr. Parker served as interim chief operating officer of Avienda Technologies, Inc. From 1997 to 1999, Mr. Parker served as managing director of Claymore Partners, Inc., a long-standing financial advisory firm addressing the needs of troubled businesses. From 1993 to 1997, Mr. Parker served as a subsidiary board member and the credit officer at Parrish Leasing and Finance Corporation, a joint venture with the Travelers Group focused on large-scale project-based and asset-based transactions. From 1991 to 1993, Mr. Parker served as vice president and senior credit officer of the Corporate Finance Division for Xerox Credit, Inc., which provided project finance, equipment leasing, high-yield corporate debt, secured loans, and real estate financing to a diverse group of US and international companies, including energy companies. Mr. Parker received Xerox s President s Award for timely achievement of liquidity and value enhancement goals. From 1989 to 1991, Mr. Parker was a vice president for the Project and Lease Finance Group of Kidder Peabody & Co., where he focused on energy transactions. From 1971 to 1989, Mr. Parker served in several roles, including as a senior credit officer, at Manufacturers Hanover Trust Company and the United States Trust Company of New York. Mr. Parker is a graduate of the Xerox Advanced Management School and the American Management Association s Time Based Accounting series. Mr. Parker received his MBA from Columbia University, where he received honors ratings for course work in banking and finance, and his Bachelor of Arts degree from Colgate University.

Interested Directors

John F. Barry III. Mr. Barry is Chairman and Chief Executive Officer of Prospect Energy and is majority owner of Prospect Capital Management and Managing Director of Prospect Administration. Mr. Barry is chairman of Prospect s investment committee and has been an officer of Prospect since 1990. In addition to overseeing Prospect, Mr. Barry has served on the boards of directors of twelve private and public Prospect portfolio companies. Mr. Barry has served on the board of advisors of USEC Inc., a publicly traded energy company. Mr. Barry has served as chairman and chief executive officer of Bondnet Trading Systems. From 1988 to 1989, Mr. Barry managed the investment bank of L.F. Rothschild & Company, focusing on private equity and debt financings for energy and other companies. From 1983 to 1988, Mr. Barry was a senior investment and merchant banker at Merrill Lynch & Co., where he was a founding member of the project finance group, executing more than $4 billion in energy and other financings. From 1979 to 1983, Mr. Barry was a corporate securities attorney at Davis Polk & Wardwell, where he advised energy companies and their commercial and investment bankers. From 1978 to 1979, Mr. Barry served as law clerk to Circuit Judge, formerly Chief Judge, J. Edward Lumbard of the U.S. Court of Appeals for the Second Circuit in New York City. Mr. Barry is Chairman of the Board of Directors of the Mathematics Foundation of America, a non-profit foundation which enhances opportunities in mathematics education for students from diverse backgrounds. Mr. Barry received his JD cum laude from Harvard Law School, where he was an editor of the Harvard Law Review, and his Bachelor of Arts magna cum laude from Princeton University, where he was a University Scholar.

M. Grier Eliasek. Mr. Eliasek is president and chief operating officer of Prospect Energy and a managing director of Prospect Capital Management and Prospect Administration. At Prospect Energy, Mr. Eliasek is responsible for various administrative and investment management functions and leads and supervises other Prospect professionals in origination and assessment of investments. Mr. Eliasek has served as a senior investment professional at Prospect since 1999. Prior to joining Prospect, Mr. Eliasek assisted the chief financial officer of Amazon.com in 1999 in corporate strategy, customer acquisition, and new product launches. From 1995 to 1998, Mr. Eliasek served as a consultant with Bain & Company, a global strategy consulting firm, where he managed engagements for companies in several different industries. At Bain, Mr. Eliasek analyzed new lines of businesses, developed market strategies, revamped sales organizations and improved operational perform