PROSPECT CAPITAL CORP
Form N-14 8C
September 04, 2009

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As filed with the Securities and Exchange Commission on September 4, 2009

Registration No. 333-

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Form N-14

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933
Pre-Effective Amendment No. o
Post-Effective Amendment No. o
(Check appropriate box or boxes)

Prospect Capital Corporation
(Exact Name of Registrant as Specified in Charter)

10 East 40th Street, 44th Floor
New York, NY 10016
(Address of Principal Executive Offices)

Telephone Number: (212) 448-0702
(Area Code and Telephone Number)

John F. Barry III
Brian H. Oswald
c/o Prospect Capital Management, LLC
10 East 40th Street, 44th Floor
New York, NY 10016
(212) 448-0702
(Name and Address of Agent for Service)

Copies to:

Richard T. Prins, Esq.
Skadden, Arps, Slate, Meagher & Flom LLP

Steven B. Boehm, Esq.
Harry S. Pangas, Esq.

Four Times Square
New York, New York 10036
Telephone: (212) 735-5000
Facsimile: (212) 777-2790

Sutherland Asbill & Brennan LLP
1275 Pennsylvania Ave., NW
Washington, DC 20004
Telephone: (202) 383-0100
Facsimile: (202) 637-3593

Approximate Date of Proposed Public Offering: As soon as practicable after this registration statement becomes effective and upon completion of the merger described in the enclosed document.

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount to be Registered(1)	Proposed Maximum Offering Price per Unit	Proposed Maximum Aggregate Offering Price(2)	Amount of Registration Fee
Common Stock, $0.001 par value	8,616,433 shares	$9.68	$83,407,071	$4,654.12

(1) The number of shares to be registered represents the maximum number of shares of the registrant s common stock estimated to be issuable in connection with the merger agreement described in the enclosed document.

(2) Estimated solely for the purpose of calculating the registration fee and calculated pursuant to Rules 457(c) and 457(f)(1) under the Securities Act, the proposed maximum aggregate offering price is equal to: (i) $9.68, the average of the high and low prices per share of the registrant s common stock on September 1, 2009, as reported on the NASDAQ Global Select Market, multiplied by (ii) 8,616,433, the maximum number of shares of the registrant s common stock expected to be issued in connection with the terms of the merger agreement.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until the Registration Statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

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MERGER PROPOSED   YOUR VOTE IS VERY IMPORTANT

Dear Shareholder,

On August 3, 2009, Prospect Capital Corporation (Prospect) and Patriot Capital Funding, Inc. (Patriot) announced a strategic business combination in which Patriot will merge with and into Prospect. If the merger is completed, holders of Patriot common stock will have a right to receive 0.3992 shares of Prospect common stock for each share of Patriot common stock held immediately prior to the merger. As more fully described in this document, the merger agreement requires that Patriot declare a final dividend prior to the closing of the merger in an amount equal to its undistributed investment company taxable income (if any), and the exchange ratio will be adjusted for any such dividend that Patriot may declare prior to closing. In connection with the merger, Prospect expects to issue approximately 8.6 million shares of common stock.

The market value of the merger consideration will fluctuate with the market price of Prospect common stock. The following table shows the closing sale prices of Prospect common stock and Patriot common stock as reported on the NASDAQ Global Select Market on July 31, 2009, the last trading day before public announcement of the merger, and on , 2009, the last practicable trading day before the distribution of this document. This table also shows the implied value of the merger consideration proposed for each share of Patriot common stock, which was calculated by multiplying the closing price of Prospect common stock on those dates by 0.3992, the exchange ratio (which will be adjusted for any dividends declared by Patriot prior to the closing).

	Prospect Common Stock	Patriot Common Stock	Implied Value of One Share of Patriot Common Stock
At July 31, 2009	$ 10.02	$ 1.95	$ 4.00
, 2009	$	$	$

The merger is intended to qualify as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code of 1986, or the Code, and holders of Patriot common stock are not expected to recognize any gain or loss for United States federal income tax purposes upon the exchange of shares of Patriot common stock for shares of Prospect common stock, except with respect to any cash received in lieu of fractional shares of Prospect common stock.

The market prices of both Prospect and Patriot common stock will fluctuate before the merger. You should obtain current stock price quotations for Prospect and Patriot common stock. Prospect common stock is quoted on the NASDAQ Global Select Market under the symbol PSEC. Patriot common stock is traded on the NASDAQ Global Select Market under the symbol PCAP.

At a special meeting of Patriot shareholders, Patriot shareholders will be asked to vote on the adoption of the merger agreement described in this document. Adoption of the merger agreement requires the affirmative vote of the holders of a majority of the outstanding shares of Patriot common stock entitled to vote.

After careful consideration, the board of directors of Patriot unanimously recommends that its shareholders vote FOR adoption of the merger agreement.

This document describes the special meeting, the merger, the documents related to the merger and other related matters. Please carefully read this entire document, including Risk Factors beginning on page 20 for a discussion of the risks relating to the proposed merger. You also can obtain information about Prospect and Patriot from documents that each has filed with the Securities and Exchange Commission.

Sincerely,

RICHARD P. BUCKANAVAGE
President and Chief Executive Officer
Patriot Capital Funding, Inc.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved the Prospect common stock to be issued under this document or determined if this document is accurate or adequate. Any representation to the contrary is a criminal offense.

The date of this document is , 2009, and it is first being mailed or otherwise delivered to Patriot shareholders on or about , 2009.

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Notice of Special Meeting of Shareholders

To the Shareholders:

On , 2009, Patriot Capital Funding, Inc. (Patriot) will hold a special meeting of shareholders (the special meeting) at the offices of , at a.m. (Eastern Daylight Time) to consider and vote upon the following matters:

1. A proposal to adopt the Agreement and Plan of Merger (the merger agreement), dated as of August 3, 2009, by and between Patriot and Prospect Capital Corporation (Prospect), as such merger agreement may be amended from time to time; and

2. A proposal to approve the adjournment of the special meeting, if necessary or appropriate, to solicit additional proxies, in the event that there are not sufficient votes at the time of the special meeting to adopt the foregoing proposal.

You have the right to receive notice of, and to vote at, the special meeting if you were a shareholder of record at the close of business on , 2009. **Whether or not you expect to be present in person at the special meeting, please sign the enclosed proxy and return it promptly in the envelope provided**. You may also vote by calling the proxy solicitor at ( ) . Instructions are shown on the proxy card. If you are present at the special meeting, you may change your vote at any time. In the event there are not sufficient votes for a quorum or to approve or ratify any of the foregoing proposals at the time of the special meeting, the special meeting may be adjourned in order to permit further solicitation of the proxies by Patriot.

The Patriot board of directors has unanimously approved the merger and the merger agreement and unanimously recommends that Patriot shareholders vote FOR approval of the merger agreement and the merger and FOR the adjournment of the Patriot special meeting if necessary or appropriate to permit further solicitation of proxies.

By order of the board of directors,

William E. Alvarez, Jr.
Secretary

Westport, CT
, 2009

This is an important meeting. To ensure proper representation at the meeting, please complete, sign, date and return the proxy card in the enclosed, self-addressed envelope. Even if you vote your shares prior to the meeting, you still may attend the meeting and vote your shares in person.

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QUESTIONS AND ANSWERS ABOUT THE PROPOSED MERGER

Q: When and where is the special meeting of shareholders?

A: The special meeting of shareholders will take place on , 2009, at a.m. (Eastern Daylight Time) at the offices of .

Q: What is happening at the special meeting?

A: Patriot shareholders are being asked to consider and vote on the following items at the special meeting:

A proposal to adopt the merger agreement by and between Patriot and Prospect, as such agreement may be amended from time to time; and

A proposal to approve the adjournment of the special meeting, if necessary or appropriate, to solicit additional proxies, in the event that there are not sufficient votes at the time of the special meeting to adopt the foregoing proposal.

Q: What will happen in the proposed merger?

A: If the merger is approved, Patriot will merge with and into Prospect. As a result of the merger:

Patriot will cease to exist; and

Prospect will survive the merger and own and operate the combined businesses of Prospect, Patriot and their respective subsidiaries.

Q: How does Prospect s investment objective and strategy differ from Patriot s?

A: Like Patriot, Prospect is a non-diversified, closed-end management investment company that has elected to be regulated as a business development company under the Investment Company Act of 1940, or the 1940 Act. Prospect s investment objective is similar to Patriot s and is to provide both current income and capital appreciation through debt and equity investments. Prospect and Patriot focus on making investments in privately-held companies, although many of Prospect s investments are in energy companies.

Prospect concentrates on making investments in companies having annual revenues of less than $500 million and enterprise values of less than $250 million, which it refers to as middle market companies. In most cases, these companies are privately held or have thinly traded public securities at the time Prospect invests in them. Prospect s investments primarily range between approximately $5 million and $50 million each, although this investment size may vary as the size of its capital base changes. Patriot s typical investments are in a range of $3 million to $20 million in companies with $10 million to $30 million in annual revenues that operate in diverse industries.

Q: What will Patriot shareholders receive in the merger?

A: Subject to adjustment, each Patriot shareholder will receive 0.3992 shares of Prospect common stock for each share of Patriot common stock owned. For example, if a Patriot shareholder currently owns 100 shares of Patriot common stock, then, as a result of the merger, the shareholder will receive 39 shares of Prospect common stock, plus cash in lieu of the fractional 0.92 share of Prospect common stock, in exchange for the shareholder s 100 shares of Patriot common stock. However, as more fully described in this document, the exchange ratio will be adjusted for any dividend that Patriot may declare prior to closing. Until the merger is completed, the value of shares of Prospect common stock to be received in the merger will continue to fluctuate.

On July 31, 2009, the last full trading day before the public announcement of the proposed merger, the closing price of Prospect s common stock on the NASDAQ Global Select Market was $10.02. Based upon this closing price, each share of Patriot common stock had a value of $4.00 per share, and the aggregate value of the stock consideration in the merger would have been approximately $86.3 million. On , 2009, the most recent practicable date prior to the printing of this document, the closing price of Prospect s common stock was $, and the closing price of Patriot s shares of common stock on the

NASDAQ Global Select Market was $. Until the merger is completed, the value of shares of Prospect common stock to be received in the merger will continue to fluctuate.

Q: Is the exchange ratio subject to any adjustment?

A: Yes. The exchange ratio will be adjusted for any dividend that Patriot may declare prior to closing. In this regard, as a regulated investment company, or RIC, under the Code, Patriot generally does not have to pay corporate-level federal income taxes on any net ordinary income or capital gains that it distributes to its stockholders as dividends if it meets certain source-of-income, income distribution and asset diversification requirements. As a result, Patriot will be required, to the extent necessary, to declare a dividend prior to the consummation of the merger in an amount equal to its undistributed net ordinary income and capital gains (if any) in order to preserve this favorable tax treatment. See Management s Discussion and Analysis of Financial Condition and Results of Operations of Patriot Recent Developments and Note 11. Income Taxes and Note 14. Subsequent Events to Patriot s unaudited financial statements for a detailed discussion regarding Patriot s undistributed net ordinary income and capital gains.

The terms of the merger agreement anticipate that any such dividends may be paid out in accordance with a recent revenue procedure issued by the Internal Revenue Service, or the IRS, pursuant to which up to 90% of the total dividend may be paid in shares of common stock with the remainder paid in cash. See Risk Factors Risks Related to Prospect Prospect may in the future choose to pay dividends in its own stock, in which case you may be required to pay tax in excess of the cash you receive and Risk Factors Risks Related to Patriot Patriot may in the future choose to pay dividends in its own stock, in which case you may be required to pay tax in excess of the cash you receive. Any such dividend, whether received in cash or common stock (including common stock of Prospect) will be taxable to shareholders as ordinary income (or capital gains, if such dividends are properly designated as capital gain dividends).

If any such dividends are declared by Patriot prior to closing, the exchange ratio will be adjusted as follows:

with respect to the cash portion of any such dividends, the numerator used to determine the exchange ratio will be reduced in an amount equal to the cash dividend per share paid or payable with respect to each share of Patriot s common stock and, as a result, the aggregate number of shares of Prospect common stock to be received by Patriot shareholders in the merger will decrease accordingly; and

with respect to the stock portion of any such dividends, the exchange ratio, after adjustment for any cash dividends as discussed above, will be proportionally adjusted to reflect any such dividends paid or payable in stock and, as a result, the number of shares of Prospect common stock to be issued for each outstanding share of Patriot common stock will be reduced, but the aggregate number of shares of Prospect common stock to be received by Patriot shareholders in the merger will remain unchanged.

For example, if (i) a Patriot shareholder currently owns 100 shares of Patriot common stock, (ii) Patriot declares a $0.30 dividend per share prior to the closing of the merger (of which $0.03 will be paid in cash and $0.27 will be paid in stock), and (iii) the market price of Patriot s common stock for purposes of the IRS revenue procedure described above is $4.00 per share, then, as a result of the merger, the shareholder will receive 39 shares of common stock of Prospect and cash in lieu of 0.89 share of Prospect common stock in exchange for the shareholder s original 100 shares of Patriot common stock.

Q: What other consideration is Prospect paying in connection with the merger?

A:

Pursuant to the terms of the merger agreement, Prospect is also required to (i) repay all principal and interest due under Patriot s second amended and restated securitization revolving credit facility, or the Amended Securitization Facility, which amounted to $115.7 million as of August 3, 2009, and (ii) up to $1.35 million in other costs, fees and expenses payable to the lenders under the terms of the Amended Securitization Facility.

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Q: Are shareholders able to exercise dissenters rights?

A: No. Shareholders will not be entitled to exercise dissenters rights with respect to any matter to be voted upon at the special meeting. Any shareholder may abstain from or vote against any of such matters.

Q: When do you expect to complete the proposed merger?

A: We are working to complete the proposed merger in the fourth quarter of 2009. We currently expect to complete the proposed merger promptly following approval of the merger agreement at the special meeting.

Q: What are the U.S. federal income tax consequences of the proposed merger?

A: The proposed merger is intended to qualify as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code of 1986, as amended (the Code). Both Prospect and Patriot will receive an opinion from Sutherland Asbill & Brennan LLP, dated as of the closing date, regarding the characterization of such merger as a reorganization within the meaning of Section 368(a) of the Code. If the merger so qualifies, in general, Patriot shareholders will recognize no gain or loss for U.S. federal income tax purposes to the extent such shareholders receive shares of Prospect common stock in exchange for your shares of Patriot common stock. Additionally, neither Prospect nor its shareholders will recognize any gain or loss for U.S. federal income tax purposes pursuant to the merger. You are strongly urged to consult with your tax advisor to determine the particular U.S. federal, state, local and foreign income or other tax consequences of the proposed merger to you. See U.S. Federal Income Tax Consequences of the Merger.

Q: Who must approve the merger agreement?

A: In addition to the approval by Patriot s board of directors (including its independent directors) and the board of directors of Prospect, both of which have already been obtained, the merger must be approved by Patriot s shareholders.

Q: What shareholder vote is required to approve the merger agreement and the merger?

A: The affirmative vote of the holders of a majority of the shares of Patriot s common stock outstanding and entitled to vote is required to approve the merger agreement and the proposed merger. Shareholders who abstain, fail to return their proxies or do not otherwise vote by calling the proxy solicitor at ( ) , will have the same effect as if they were voted against the merger agreement and the proposed merger.

Q: Does Patriot s board of directors recommend approval of the merger proposal?

A: Yes. Patriot s board of directors, including its independent directors, unanimously approved and adopted the merger agreement and the transactions contemplated by the merger agreement and recommends that Patriot shareholders vote FOR approval of these matters.

Q: What do I need to do now?

A: We urge you to read carefully this document, including its annexes. You also may want to review the documents referenced under Where You Can Find More Information and consult with your accounting, legal and tax advisors.

Q: How do I vote my shares?

A: You may indicate how you want to vote on your proxy card and then sign and mail your proxy card in the enclosed return envelope as soon as possible so that your shares may be represented at the special meeting. You may also vote by calling the proxy solicitor at (   )   . If you are a record shareholder, you may also attend the special meeting in person instead of submitting a proxy.

Unless your shares are held in a brokerage account, if you sign, date and send your proxy and do not indicate how you want to vote, your proxy will be voted for the approval of the merger agreement and the merger and for all other proposals to be voted on at the special meeting. If your shares are held in brokerage account, please see the answer to the next question.

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If you fail either to return your proxy card or vote by calling the proxy solicitor at (   )   , or if you abstain with respect to the merger, the effect will be a vote against the merger.

With respect to any other matter to be voted on at the special meeting, a vote to abstain will have the same effect as a vote against such other matters.

Q: If my shares are held in a brokerage account, or in street name, will my broker vote my shares for me?

A: With respect to the merger proposal, if you do not provide your broker with instructions on how to vote your street name shares, your broker will not be permitted to vote them. With respect to any other matter to be approved at the special meeting, if the broker has indicated on the proxy that it does not have discretionary authority to vote such street name shares, your broker will not be permitted to vote them. Either of these situations results in a broker non-vote.

A broker non-vote with respect to the merger will have the effect of a vote against the merger. With respect to any other matter to be voted on at the special meeting, a broker non-vote will not have any effect on the outcome of such matters.

You should, therefore, provide your broker with instructions on how to vote your shares or arrange to attend the special meeting and vote your shares in person to avoid a broker non-vote. Shareholders are urged to utilize telephonic or Internet voting if their broker has provided them with the opportunity to do so. See your voting instruction form for instructions. If your broker holds your shares and you attend the special meeting in person, please bring a letter from your broker identifying you as the beneficial owner of the shares and authorizing you to vote your shares at the special meeting.

Q: What do I do if I want to change my vote?

A: You may change your vote at any time before the vote takes place at the special meeting. To do so, you may either complete and submit a new proxy card or send a written notice stating that you would like to revoke your proxy. You may also change your vote if you voted by calling the proxy solicitor at (   )   simply by re-voting. The last recorded vote will be what is counted at the special meeting. In addition, you may elect to attend the special meeting and vote in person, as described above.

Q: If my shares are represented by stock certificates, should I send in my stock certificates now?

A: No. If the merger is completed and your shares of common stock are represented by stock certificates, we will send you written instructions for exchanging your stock certificates for the appropriate number of Prospect common stock certificates.

Q: Who can I contact with any additional questions?

A: You may call the proxy solicitor,   , at (   )   , with respect to any additional questions you may have.

Q: Where can I find more information about the companies?

A: You can find more information about Patriot and Prospect in the documents described under Where You Can Find More Information on page .

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SUMMARY

This summary highlights material information from this document. It may not contain all of the information that is important to you. We urge you to carefully read the entire document and the other documents to which we refer in order to fully understand the proposed merger. See Where You Can Find More Information. Unless otherwise noted, the term Patriot refers to Patriot Capital Funding, Inc. and Prospect refers to Prospect Capital Corporation.

Information about the Companies

Patriot Capital Funding, Inc.
274 Riverside Avenue
Westport, CT 06880
(203) 429-2700

Patriot is specialty finance company that provides customized financing solutions to small- to mid-sized companies. Patriot s ability to invest across a company s capital structure, from senior secured loans to equity securities, allows it to offer a comprehensive suite of financing solutions, including one-stop financings. Patriot s one-stop financing typically includes a revolving line of credit, one or more senior secured term loans and a subordinated debt investment. Patriot also makes equity co-investments of generally up to $3.0 million and investments in broadly syndicated loans. Patriot primarily finances privately-held companies in transactions initiated by private equity sponsors.

Patriot s investment objective is to generate both current cash income and capital appreciation. To accomplish this objective, Patriot seeks to provide its shareholders with current income primarily from the interest on its debt investments and related origination fees, and to enable its shareholders to participate in the capital appreciation and potential long-term growth of its portfolio companies through warrants and other equity interests it acquires.

Patriot is an internally managed, closed-end investment company that has filed an election to be treated as a business development company under the 1940 Act. As a result, Patriot does not have an investment adviser and is internally managed by its management team under the supervision of its board of directors. Therefore, Patriot does not pay investment advisory fees, but instead Patriot pays the operating costs associated with employing a management team and investment professionals. Patriot has also elected to be treated for federal income tax purposes as a RIC under Subchapter M of the Code.

Prospect Capital Corporation
10 East 40th Street, 44th Floor
New York, NY 10016
(212) 448-0702

Prospect is a financial services company that primarily lends to and invests in middle market privately-held companies. Prospect invests primarily in senior and subordinated debt and equity of companies in need of capital for acquisitions, divestitures, growth, development, project financing and recapitalization. Prospect works with the management teams of such companies or financial sponsors to seek investments with historical cash flows, asset collateral or contracted pro-forma cash flows.

Typically, Prospect concentrates on making investments in companies with annual revenues of less than $500 million and enterprise values of less than $250 million. Prospect s typical investment involves a secured loan of less than $50 million with some form of equity participation. From time to time, Prospect acquires controlling interests in companies in conjunction with making secured debt investments in such companies. In most cases, companies in which Prospect invests are privately held at the time it invests in them.

Prospect seeks to maximize total returns to its investors, including both current yield and equity upside, by applying rigorous credit analysis and asset-based and cash-flow based lending techniques to make and monitor its investments. A majority of Prospect s investments to date have been in energy-related industries.

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Prospect has made no investments to date in the real estate or mortgage industries, and it does not intend currently to focus on such investments.

Prospect is an externally managed, closed-end investment company that has filed an election to be treated as a business development company under the 1940 Act. Prospect Capital Management, LLC serves as Prospect s investment adviser and manages its investments, and Prospect Administration, LLC serves as Prospect s administrator and provides the administrative services necessary for it to operate. Prospect has also elected to be treated for federal income tax purposes as a RIC under Subchapter M of the Code.

Terms of the Merger Agreement

Pursuant to the terms of the proposed merger, Patriot will be merged with and into Prospect. Prospect will be the surviving entity in the merger, and Patriot will no longer exist as a separate corporation. As a result of the proposed merger, all Patriot s assets and liabilities immediately before the merger will become assets and liabilities of Prospect immediately after the merger, and our wholly-owned special purpose subsidiary, Patriot Capital Funding, LLC, will become a direct subsidiary of Prospect.

After the merger and based on the number of shares of Prospect common stock issued and outstanding on the date hereof, all persons who owned shares of Patriot s common stock before the merger will own approximately 15.2% of Prospect s common stock outstanding immediately after the merger. As a result of the merger, Prospect will continue the operations conducted by it and Patriot before the merger.

The merger agreement is attached as Annex A to this document and is incorporated by reference into this document. Patriot encourages its shareholders to read the merger agreement carefully and in its entirety, as it is the principal legal document governing the proposed merger.

Patriot Shareholders Will Receive Shares of Prospect s Common Stock in the Proposed Merger

If the proposed merger is consummated, each share of Patriot s common stock will be converted into the right to receive 0.3992 of a share of Prospect common stock. Subject to adjustment, each Patriot shareholder will receive 0.3992 shares of Prospect common stock for each share of Patriot common stock owned. However, as more fully described in this document, the merger agreement requires that Patriot declare, to the extent necessary, a final dividend prior to the closing of the merger in an amount equal to its undistributed investment company taxable income and net capital gain (if any), and the exchange ratio will be adjusted for any such dividends that Patriot may declare prior to closing. To the extent that Patriot shareholders have shares represented by stock certificates, they should not send in any stock certificates until they receive written instructions to do so after the consummation of the merger.

The closing prices and most recent net asset values per share of Patriot s common stock and Prospect common stock, as well as the implied value of Patriot s common stock based on the exchange ratio of 0.3992 (which will be adjusted for any dividends declared by Patriot prior to the closing), were, on the date before the merger was announced and the most recent date prior to mailing of this document, as follows:

	Prospect Common Stock	Patriot Common Stock	Implied Value of One Share of Patriot Common Stock

Closing Price at July 31, 2009	$	10.02	$	1.95	$	4.00
Net Asset Value per Share at June 30, 2009	$		$	7.66	$	
Closing Price at , 2009	$		$		$	

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The value of Prospect s common stock to be received in the proposed merger will continue to fluctuate and, as a result, Patriot shareholders will not know the value of Prospect s common stock they will receive in the proposed merger at the time they vote.

Reasons for the Proposed Merger

In evaluating the merger proposal from Prospect, the Patriot board of directors considered numerous factors, including the ones described below, and, as a result, determined that the proposed merger was in Patriot s best interests and the best interests of Patriot s shareholders:

Lack of Liquidity; Potential Impact on Tax Status. Since Patriot can no longer borrow amounts under the Amended Securitization Facility, and because all principal, interest and fees collected from the debt investments secured by the facility must be used to repay amounts outstanding under the facility, Patriot has limited liquidity and no potential sources of free cash flow. Thus, there is no assurance that Patriot will have sufficient cash and liquid assets to fund its operations and dividend distributions to its shareholders, which failure could, among other things, result in adverse tax consequences, including possible loss of its status as a RIC under the Code. In addition, without a strategic transaction, Patriot would likely be required to seek bankruptcy protection in the relatively near future.

Potential Actions by Patriot s Lenders. Substantially all of Patriot s debt investments are secured under the Amended Securitization Facility. As a result of the occurrence of a termination event under the Amended Securitization Facility, the lenders may, upon notice to Patriot, accelerate amounts outstanding under the facility and exercise other rights and remedies provided by the facility, including the right to sell the collateral under the facility. In such event, the Patriot board of directors is concerned that such forced sales of assets, particularly in the current economic environment, may be done at fire sale prices, thereby diminishing the amount of cash available to distribute to shareholders.

Thorough Review of Strategic Alternatives. Patriot engaged in a thorough review of the strategic alternatives available to Patriot, including, among other things, negotiations with its lenders under the Amended Securitization Facility, conversion to a bank holding company, the formation of a Small Business Investment Company subsidiary, a stock or cash merger, a significant equity investment, a refinancing of Patriot s debt, a purchase and sale of Patriot s assets, and a bankruptcy filing. In furtherance of the evaluation and proposal solicitation process, Patriot publicly announced that it was actively evaluating strategic alternatives (thereby putting potential strategic partners on notice that Patriot was open to discussing such alternatives with interested parties), and, at Patriot s request, Patriot s financial advisor, FBR Capital Markets & Co., or FBR , contacted 133 potential strategic partners, including business development companies, commercial finance companies, banks, private equity funds, hedge funds and other potential strategic partners, to assess whether they might be interested in pursuing a strategic transaction with Patriot. Of the 133 potential strategic partners contacted, 51 executed non-disclosure agreements with Patriot and received confidential information concerning Patriot s business, management, assets, liabilities, financial condition and results of operations. Of those 51 potential strategic partners, 22 submitted preliminary indications of interest, and 12 were invited to perform in-depth due diligence and submit final bids, eight of which submitted final bids. Based on this lengthy and thorough process, Patriot s board of directors believes it has explored all alternatives reasonably available to Patriot.

Best Alternative Reasonably Available to Patriot. Because Patriot publicly announced that it was actively evaluating strategic alternatives, and contacted such a large number of potential strategic partners to determine their level of interest in a strategic transaction involving Patriot, the Patriot board of directors strongly believes that, of all possible alternatives, and based on the proposed transactions submitted by potential strategic partners, the transaction with Prospect represents the best alternative that is reasonably available to Patriot. In making this determination, the Patriot board of directors considered:

- the existing termination event under the Amended Securitization Facility;

the current financial condition of Patriot, particularly the liquidity needed to fund its operations and, potentially, to make required distributions to shareholders;

the distinct possibility that Patriot will run out of available cash in the near future;

the current trading price of Patriot s common stock;

the lack of progress in negotiations with lenders under the Amended Securitization Facility;

the other alternatives reasonably available to Patriot;

the terms of the other proposals submitted, including the proposed economic terms, the conditions to closing, the expected timing of such transactions, and the likelihood of consummation;

the financial terms of the Prospect proposal, including the proposed exchange ratio and Prospect s ability and agreement to repay the full amount of principal and interest outstanding under the Amended Securitization Facility;

the fact that although the implied value of the merger consideration of $4.00 proposed for each share of Patriot common stock represented a discount to Patriot s net asset value for the quarter ended March 31, 2009 and the anticipated net asset value for the quarter ended June 30, 2009, which was based on information available to the board at the time (which value was later confirmed), such discount was generally comparable to the discount to net asset value at which many other business development companies traded;

the business and legal due diligence review conducted on Prospect by Patriot and its legal and financial advisors;

the financial strength of Prospect;

the lack of a financing contingency to closing in the Prospect proposal; and

the fact that no shareholder approval of Prospect s shareholders would be required.

Strategic and Business Considerations. Because the Patriot shareholders will be shareholders in Prospect following the merger, Patriot shareholders stand to participate in the future growth and prospects of the combined businesses of Patriot and Prospect, without the limitations currently restricting the operations of Patriot. Prospect is an established company with a strong capital position and performance history. The larger equity market capitalization of the combined companies should help create earnings stability and assist Prospect in its efforts to raise capital in the public equity and debt markets.

Terms of the Merger Agreement. The exchange ratio of 0.3992 of a share of Prospect common stock to be received in exchange for each share of Patriot common stock, which is subject to certain adjustments, represents a 105% premium to the closing price of Patriot common stock on July 31, 2009, based on the closing price of Prospect common stock on that date (which was the last trading day before public announcement of the merger).

Opinion of Patriot s Financial Advisor. The financial analysis reviewed and discussed with the board of directors of Patriot by representatives of FBR, as well as the oral opinion of FBR rendered to the board of directors of Patriot on August 3, 2009 (which was subsequently confirmed in writing by delivery of FBR s written opinion dated the same date) with respect to the fairness, from a financial point of view, to the holders of Patriot common stock of the exchange ratio set forth in the merger agreement. See The Merger Proposal Opinion of Patriot s Financial Advisor

Tax Free Treatment of Proposed Merger. The proposed merger is expected to be treated as a tax-free reorganization under Section 368(a) of the Code. If the transaction so qualifies, Patriot s shareholders generally will not recognize gain or loss to the extent that they receive shares of Prospect common stock in exchange for their shares of Patriot common stock. See U.S. Federal Income Tax Consequences of the Merger.

Repayment of Amended Securitization Facility. As part of the merger agreement, Prospect will repay (i) all principal and interest due under the Amended Securitization Facility, which amounted to $115.7 million as of August 3, 2009, and (ii) up to $1.35 million in other costs, fees and expenses payable to the lenders under the terms of the Amended Securitization Facility.

Risks Related to the Proposed Merger

Below are certain of the material risks related to the proposed merger considered by Patriot s board of directors:

Market Price. The implied market value of the per share merger consideration could decrease prior to the closing of the proposed merger if the market price of Prospect s common stock decreases.

Net Asset Value. The net asset value per share of Patriot s common stock, as of June 30, 2009, was $7.66, an amount higher than the implied market value of the merger consideration.

Restrictions on Ability to Solicit Alternative Offers. The restrictive non-solicitation provisions contained in the merger agreement prohibit Patriot from soliciting alternative offers from third parties, and permit Patriot to consider bona fide alternative proposals from third parties only in certain limited circumstances.

Lack of Dissenters Rights. There are no dissenters rights applicable to the proposed merger.

Completion of the Proposed Merger

It is expected that the proposed merger will be completed shortly after Patriot s shareholders approve the merger agreement at the special meeting, assuming all regulatory approvals and other required matters are completed at such time. If approved by Patriot s shareholders, Prospect and Patriot will work to complete the proposed merger during the fourth quarter of 2009. The merger agreement currently permits either party to terminate the merger agreement if the merger is not completed on or before December 15, 2009.

Recommendation of the Board of Directors of Patriot

Patriot s board of directors, including its independent directors, believes that the proposed merger is advisable and in the best interest of Patriot s shareholders and unanimously recommends that shareholders vote FOR approval of the merger agreement.

Opinion of Patriot s Financial Advisor

On August 3, 2009, FBR rendered its oral opinion to the board of directors of Patriot (which was subsequently confirmed in writing by delivery of FBR s written opinion dated the same date) to the effect that, as of August 3, 2009, the exchange ratio set forth in the merger agreement was fair, from a financial point of view, to the holders of Patriot common stock.

FBR s opinion was directed to the board of directors of Patriot, and only addressed the fairness, from a financial point of view, to the holders of Patriot common stock of the exchange ratio set forth in the merger agreement, and did not address any other aspect or implication of the merger. The summary of FBR s opinion in this document is qualified in its entirety by reference to the full text of its written opinion, which is included as Annex B to this document and sets forth the procedures followed, assumptions made, qualifications and limitations on the review undertaken and other matters considered by FBR in preparing its opinion. However,

neither FBR s written opinion nor the summary of its opinion and the related analyses set forth in this document are intended to be, and they do not constitute, advice or a recommendation to any holder of Patriot common stock as to how such holder should vote or act with respect to any matter relating to the merger.

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Interests of Patriot s Management in the Proposed Merger

Certain of Patriot s executive officers have interests in the proposed merger that are different in certain respects and may conflict with the interests of Patriot s shareholders. The Patriot board of directors was aware of these interests, and considered these interests, among other matters, in evaluating and negotiating the merger agreement and the merger, and in recommending to the shareholders that the merger agreement be adopted. These interests of the executive officers include:

Cancellation of all outstanding stock options in exchange for a cash payment of $0.01 for each share of Patriot common stock for which such option is exercisable.

Vesting of all unvested shares of Patriot restricted stock and, immediately prior to the effective time of the merger, cancellation of a portion of such restricted shares held by each executive officer in exchange for a cash payment from Prospect at the same value as the merger consideration in an amount sufficient to cover the federal, state and local taxes required to be withheld from the executive officer upon the vesting of the shares, with the remaining shares participating in the merger on the same basis as other shares of Patriot common stock.

Employment or severance agreements providing for severance payments and benefits upon a qualifying termination of employment following a change in control. The proposed merger would constitute a change in control for this purpose.

As of July 31, 2009, Patriot s directors and executive officers beneficially owned in the aggregate 3,380,320 shares of Patriot s common stock (including shares of restricted stock that will vest in connection with the consummation of the merger), representing 15.7% of Patriot s total outstanding shares. Each of Patriot s directors and executive officers has indicated that he intends to vote his shares in favor of the merger agreement and the proposed merger.

U.S. Federal Income Tax Consequences of the Merger

The merger is intended to qualify as a reorganization within the meaning of Section 368(a) of the Code. If the merger so qualifies, in general, Patriot shareholders will recognize no gain or loss for U.S. federal income tax purposes to the extent such shareholders receive shares of Prospect common stock in exchange for shares of Patriot s common stock. Additionally, neither Patriot nor its shareholders will recognize any gain or loss for U.S. federal income tax purposes in connection with the merger. It is a condition to the closing of the merger that Prospect and Patriot receive an opinion from Sutherland, Asbill and Brennan LLP, dated as of the closing date of the merger, regarding the characterization of the merger as a reorganization within the meaning of Section 368(a) of the Code. Tax matters are complicated, and the tax consequences of the proposed merger to you will depend on the facts of your own situation. We urge you to contact your own tax advisor to understand fully how the proposed merger will affect you, including how any state, local or foreign tax laws may apply to you.

Dividends and Distributions

In order to maintain Patriot s qualification as a RIC for U.S. Federal income tax purposes, Patriot generally must distribute to its shareholders annually at least 90% of its investment company taxable income, which is generally its net ordinary income plus the excess, if any, of realized net short-term capital gains over realized net long-term capital losses. As a result, Patriot will be required to declare, to the extent necessary, a dividend prior to the consummation of the merger in an amount equal to its undistributed investment company taxable income and net capital gain (if any) in order to preserve this favorable tax treatment and to eliminate its liability for U.S. federal income tax. See Management s Discussion and Analysis of Financial Condition and Results of Operations of Patriot Recent Developments and Note 11. Income Taxes and Note 14. Subsequent Events to Patriot s unaudited financial statements for a detailed discussion regarding Patriot s undistributed net ordinary income and capital gains.

The terms of the merger agreement anticipate that any such dividends may be paid out in accordance with a recent revenue procedure issued by the Internal Revenue Service, or the IRS, pursuant to which up to

90% of the total dividend may be paid in shares of common stock and the remainder will be paid in cash. Any such dividend, whether received in cash or common stock (including common stock of Prospect) will be taxable to shareholders as a ordinary income (or capital gains, if such dividends are properly designated as capital gain dividends). See Risk Factors Risks Related to Prospect Prospect may in the future choose to pay dividends in its own stock, in which case you may be required to pay tax in excess of the cash you receive and Risk Factors Risks Related to Patriot Patriot may in the future choose to pay dividends in its own stock, in which case you may be required to pay tax in excess of the cash you receive.

Dissenters Rights

Patriot s shareholders will not be entitled to exercise dissenters rights in connection with the proposed merger under Delaware law.

Vote Required to Approve the Merger Agreement

The affirmative vote of the holders of a majority of Patriot s outstanding shares entitled to vote is required to approve the merger agreement and the proposed merger. Shareholders who abstain, fail to return their proxies or do not otherwise vote either in person or by calling the proxy solicitor at ( ) - , will have the same effect as if they were voted against the merger agreement and the proposed merger.

Voting Power of Patriot s Management

On the record date, 21,584,251 shares of Patriot s common stock were outstanding, which includes shares of restricted stock that will vest upon the merger, of which 3,380,320 shares, or 15.7% of the total outstanding shares, were owned by Patriot s executive officers and directors. So long as the merger agreement is in effect, each of Patriot s executive officers and directors has indicated his intention to vote his shares in favor of the merger agreement and the proposed merger.

Conditions to the Merger

The proposed merger will be completed only if specific conditions, including, among other things, the following, are met or waived by Patriot s board of directors or the board of directors of Prospect, as applicable:

- no legal prohibition on completion of the merger is in effect;
- the registration statement, of which this document is a part, filed by Prospect with the SEC in connection with its offer and sale of shares to Patriot s shareholders in connection with the merger is declared effective by the SEC; and
- no pending suit, action or proceeding by any governmental entity seeking to enjoin or otherwise interfere with the merger that has a reasonable likelihood of success.

See Description of the Merger Agreement Conditions to the Merger for a discussion of conditions that Prospect and Patriot must individually meet, or be waived by the other party, in order for the proposed merger to be consummated.

Termination of the Merger Agreement

Patriot and Prospect may jointly agree to terminate the merger agreement at any time. Either Patriot or Prospect may also terminate the merger agreement if, among other things, any of the following occurs:

any regulatory authority of competent jurisdiction issues a judgment, injunction, order, decree, or action permanently restraining, enjoining or otherwise prohibiting the merger, and the judgment, injunction, order, decree or other action becomes final and nonappealable;

the merger is not completed prior to December 15, 2009, except that neither Patriot nor Prospect may terminate the merger agreement if its willful and material breach is the reason that the merger has not been completed;

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the required approval of the merger agreement by Patriot shareholders is not obtained at the special meeting; or

upon a violation or breach by the other party of any agreement, covenant, representation or warranty or if any representation or warranty of either party shall have become untrue, in either case so that the conditions to the completion of the merger would be incapable of being satisfied by the closing date and such violation or breach has not been waived by the terminating party.

In addition, the merger agreement may be terminated in the following circumstances:

by Prospect, prior to receipt of Patriot shareholder approval, within 10 days after the Patriot board of directors effects a change of recommendation; or, in the case an alternative proposal structured as a tender or exchange offer for Patriot common stock commenced by a person unaffiliated with the buyer is received; if the Patriot board of directors fails to issue within 10 days after the public announcement of the alternative proposal a public statement reaffirming the board recommendation and recommending that Patriot s shareholders reject the alternative proposal; or if Patriot breaches any of the no solicitation provisions of the merger agreement; and

by Patriot, if Patriot receives a superior proposal, the board authorizes Patriot to enter into an agreement to consummate the transaction contemplated by such superior proposal, and concurrently with such termination, Patriot pays the termination fee and enters into a definitive agreement to consummate the transaction contemplated by the superior proposal; or if the board effects a recommendation change in compliance with the no solicitation provisions of the merger agreement.

Patriot will pay Prospect a termination fee in the amount of $3.2 million or reimburse certain expenses and make certain other payments in certain circumstances.

Comparison of Shareholder Rights

The rights of Patriot s shareholders are currently governed by Delaware law, and Patriot s restated certificate of incorporation and restated bylaws. When the proposed merger is completed, Patriot s shareholders will become shareholders of Prospect, a Maryland corporation, and their rights will be governed by Maryland law, and Prospect s articles of incorporation and bylaws. The rights of Patriot s shareholders and the rights of Prospect shareholders differ in many respects.

COMPARATIVE FEES AND EXPENSE RATIOS

The purpose of the tables in this section is to assist you in understanding the various costs and expenses that a shareholder will bear directly or indirectly by investing in Patriot and Prospect s common stock and Prospect s costs and expenses that are expected to be incurred in the first year following the merger.

Patriot and Prospect s Expenses

The tables below illustrate the change in operating expenses expected as a result of the merger. The tables set forth (i) the annualized fees, expenses and interest payments on borrowed funds of Patriot for the nine-month period ended March 31, 2009; (ii) the annualized fees, expenses, and interest payments on borrowed funds of Prospect for the nine-month period ended March 31, 2009; and (iii) the *pro forma* annualized fees, expenses and interest payments on borrowed funds of Prospect for the nine-month period ended March 31, 2009.

	Actual		Pro Forma
	Patriot	**Prospect**	**Combined(1)**
Shareholder transaction expenses			
Sales load (as a percentage of offering price)	None(1)	None(1)	None(1)
Dividend reinvestment plan expenses	None(2)	None(2)	None(2)

	Actual		Pro Forma
	Patriot	**Prospect**	**Combined(1)**
Annual expenses (as a percentage of net assets attributable to common stock):			
Management fee(3)		2.72%	2.42%
Incentive fee(4)		3.54%	3.15%
Interest expense on borrowed funds	4.51%	1.45%	1.12%
Other expenses	4.34%	1.84%	1.99%
Total annual expenses	8.85%	9.55%	8.68%

(1) Purchases of shares of common stock of Patriot or Prospect on the secondary market are not subject to sales charges but may be subject to brokerage commissions or other charges. The table does not include any sales load (underwriting discount or commission) that shareholders may have paid in connection with their purchase of shares of Patriot or Prospect s common stock.

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

(3) Prospect s base management fee is 2% of its gross assets (which include any amount borrowed, i.e., total assets without deduction for any liabilities).

(4) Based on an annualized level of incentive fee paid by Prospect during the nine months ended March 31, 2009, all of which consisted of an income incentive fee.

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Example

The following example is intended to help you compare the costs of investing in Prospect *pro forma* after the merger with the costs of investing in Patriot and Prospect before the merger. An investor would pay the following expenses on a $1,000 investment in common shares, assuming (i) the operating expense ratio for Patriot and Prospect (as a percentage of net assets attributable to common shares) set forth in the table above for years 1 through 10, (ii) borrowings under Patriot s Amended Securitization Facility of $137.4 million and Prospect s revolving credit facility of $137.6 million prior to the merger, (iii) borrowings under Prospect s revolving credit facility of $112.0 million after the merger, and (iv) a 5% annual return throughout the period.

	1 Year	3 Years	5 Years	10 Years
Patriot	$ 88	$ 255	$ 410	$ 746
Prospect	$ 60	$ 178	$ 294	$ 574
Pro Forma Combined Prospect(1)	$ 55	$ 165	$ 273	$ 540

(1) The *pro forma* combined row shown assumes the merger is completed.

The example set forth above assumes the reinvestment of all dividends and other distributions at net asset and that the percentage of Prospect s assets represented by leverage of Prospect will remain the same pre-and post-merger. The example set forth above should not be considered a representation of past or future expenses or annual rates of return. Actual expenses or annual rates of return may be more or less than those assumed for purposes of the example.

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SELECTED FINANCIAL DATA OF PATRIOT

You should read this selected consolidated financial data in conjunction with the section entitled, Management s Discussion and Analysis of Financial Condition and Results of Operations of Patriot and the consolidated financial statements and notes thereto of Patriot included elsewhere in this document. The selected consolidated financial data at and for the fiscal years ended December 31, 2008, 2007, 2006, 2005 and 2004 have been derived from Patriot s audited financial statements. The selected consolidated financial data at and for the six months ended June 30, 2009 and 2008 have been derived from unaudited financial data, but in the opinion of Patriot s management, reflects all adjustments (consisting only of normal recurring adjustments) that are necessary to present fairly the results for such interim periods. Interim results at and for the six months ended June 30, 2009 are not necessarily indicative of the results that may be expected for the year ending June 30, 2009. Certain reclassifications have been made to the prior period financial information to conform to the current period presentation.

	For the Six Months Ended June 30,		Year Ended December 31,				
	2009	2008	2008	2007	2006	2005	2004
ne Statement							
tment Income:							
st income	$ 16,128,632	$ 21,123,051	$ 40,140,087	$ 37,147,275	$ 25,387,709	$ 13,035,673	$ 4,616
	454,698	355,784	1,409,613	1,280,361	270,176	366,830	241
investment ne	8,804	420,269	749,704	534,901	848,449	46,839	
Investment ne	16,592,134	21,899,104	42,299,404	38,962,537	26,506,334	13,449,342	4,858
nses:							
pensation expense	1,759,961	2,605,499	3,973,030	5,410,075	3,877,525	2,481,761	1,326
ulting fees[1]						554,796	1,000
st expense[2]	4,363,807	3,984,753	8,158,473	7,421,596	4,332,582	3,517,989	1,504
ssional fees	1,346,626	670,731	1,635,519	887,021	1,045,613	730,550	192
yment penalty[3]						3,395,335	
ral and nistrative expense	1,501,394	1,433,523	2,807,113	2,498,724	2,229,970	1,041,030	227
Expenses	8,971,788	8,694,506	16,574,135	16,217,416	11,485,690	11,721,461	4,251
nvestment income	7,620,346	13,204,598	25,725,269	22,745,121	15,020,644	1,727,881	606
ealized gain (loss) vestments	(12,013,473)	(433,767)	(882,588)	91,601	(3,262,966)		
nrealized ciation eciation) on ments	(16,870,174)	(13,219,509)	(39,992,921)	(3,637,706)	3,817,931	(2,965,175)	(876

nrealized gain on interest rate s	861,737	216,783	(2,335,019)	(775,326)	12,961		
ncome (loss)	$ (20,401,564)	$ (231,895)	$ (17,485,259)	$ 18,423,690	$ 15,588,570	$ (1,237,294)	$ (269
ngs (loss) per basic	$ (0.97)	$ (0.01)	$ (0.84)	$ 0.99	$ 1.10	$ (0.17)	$ (0
ngs (loss) per diluted	$ (0.97)	$ (0.01)	$ (0.84)	$ 0.98	$ 1.10	$ (0.17)	$ (0
nted average s outstanding,	20,940,294	20,671,896	20,713,540	18,670,904	14,145,200	7,253,632	3,847
nted average s outstanding, d	20,940,294	20,671,896	20,713,540	18,830,213	14,237,952	7,253,632	3,847

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	For the Six Months Ended June 30,		Year Ended December 31,				
	2009	2008	2008	2007	2006	2005	2
eet							
ments	$ 283,929,237	$ 322,410,700	$ 322,370,748	$ 384,725,753	$ 257,812,235	$ 138,302,852	$ 65
	302,540,169	335,098,619	354,262,646	398,378,808	271,086,364	151,007,186	72
	137,365,363	116,100,000	162,600,000	164,900,000	98,380,000	21,650,000	42
r s equity	160,495,644	208,621,626	180,117,170	221,597,684	164,108,629	127,152,365	27
lue per are	$ 7.66	$ 10.08	$ 8.65	$ 10.73	$ 10.37	$ 10.48	$
n:							
verage ot (4)	10.7%	12.3%	12.1%	12.4%	13.4%	13.5%	
portfolio	33	32	35	36	26	15	
	11	14	13	14	11	9	

(1) On July 27, 2005, we terminated the consulting agreements pursuant to which we incurred these fees.

(2) Patriot s capital structure at December 31, 2004 reflected a higher percentage of leverage than it is permitted to incur as a business development company. Patriot used a portion of the net proceeds it received from its initial public offering to repay all of its outstanding indebtedness, including the $3.4 million prepayment penalty, at the time of its initial public offering. Patriot is generally only allowed to borrow amounts such that its asset coverage, as defined in the 1940 Act, equals at least 200% after such borrowing.

(3) The prepayment penalty was incurred in connection with the repayment in full and termination of our $120.0 million financing agreement.

(4) Computed using actual interest income earned for the fiscal year, including amortization of deferred financing fees and original issue discount, divided by the weighted average fair value of debt investments.

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SELECTED FINANCIAL DATA OF PROSPECT

You should read this selected consolidated financial data in conjunction with the section entitled, Management s Discussion and Analysis of Financial Condition and Results of Operations of Prospect and the consolidated financial statements and notes thereto of Prospect included elsewhere in this document. The selected consolidated financial data at and for the fiscal years ended June 30, 2008, 2007, 2006, 2005 and 2004 have been derived from Prospect s audited financial statements. The selected consolidated financial data at and for the nine months ended March 31, 2009 and 2008 have been derived from unaudited financial data, but in the opinion of Prospect s management, reflects all adjustments (consisting only of normal recurring adjustments) that are necessary to present fairly the results for such interim periods. Interim results at and for the nine months ended March 31, 2009 are not necessarily indicative of the results that may be expected for the year ending June 30, 2009. Certain reclassifications have been made to the prior period financial information to conform to the current period presentation.

	For the Nine Months Ended March 31,		For the Year Ended June 30,				
	2009	2008	2008	2007	2006	2005	2004(
	(In thousands except data relating to shares, per share and number of portfolio companies)						
rformance Data:							
erest income	$ 50,862	$ 42,538	$ 59,033	$ 30,084	$ 13,268	$ 4,586	$
vidend income	13,833	7,507	12,033	6,153	3,601	3,435	
her income	13,986	5,909	8,336	4,444		72	
al investment ome	78,681	55,954	79,402	40,681	16,869	8,093	
erest and credit ility expenses	(4,828)	(4,719)	(6,318)	(1,903)	(642)		
estment advisory pense	(20,535)	(14,227)	(20,199)	(11,226)	(3,868)	(1,808)	
her expenses	(6,136)	(5,564)	(7,772)	(4,421)	(3,801)	(3,874)	(10
al expenses	(31,499)	(24,510)	(34,289)	(17,550)	(8,311)	(5,682)	(10
investment ome	47,182	31,444	45,113	23,131	8,558	2,411	(10
alized and ealized gains sses)	(11,329)	(27,839)	(17,522)	(6,403)	4,338	6,340	
increase in net ets from erations	$ 35,853	$ 3,864	$ 27,591	$ 16,728	$ 12,896	$ 8,751	$ (10

r Share Data(2):							
t increase in net ets from erations	$ 1.21	$ 0.16	$ 1.17	$ 1.06	$ 1.83	$ 1.24	n
tributions lared per share	$ (1.21)	$ (1.18)	$ (1.59)	$ (1.54)	$ (1.12)	$ (0.38)	n
erage weighted res outstanding the period	29,708,458	22,349,987	23,626,642	15,724,095	7,056,846	7,055,100	10
sets and abilities Data:							
estments	$ 555,041	$ 429,156	$ 497,530	$ 328,222	$ 133,969	$ 55,030	$
her assets	47,765	50,851	44,248	48,280	4,511	48,879	
al assets	602,806	480,007	541,778	376,502	138,480	103,909	
nount drawn on dit facility	137,567	90,667	91,167		28,500		
nount owed to ted parties	6,555	6,493	6,641	4,838	745	77	10
her liabilities	14,660	11,129	14,347	71,616	965	865	
al liabilities	158,782	108,289	112,155	76,454	30,210	942	10
t assets	$ 444,024	$ 371,718	$ 429,623	$ 300,048	$ 108,270	102,967	$ 9
estment Activity ta:							
. of portfolio npanies at period l	31	31	29(3)	24(3)	15	6	
quisitions	$ 90,376	$ 193,034	$ 311,947	$ 167,255	$ 83,625	$ 79,018	$
es, repayments, l other disposals	$ 23,859	$ 66,063	$ 127,212	$ 38,407	$ 9,954	$ 32,083	$
ighted-Average eld at period l(4)	15.1%	16.8%	15.5%	17.1%	17.0%	21.3%	n

(1) For the period April 13, 2004 (inception) through June 30, 2004.

(2) Per share data is based on average weighted shares for the period.

(3) Includes a net profits interest in Charlevoix Energy Trading LLC, remaining after loan was paid.

(4) Includes dividends from certain equity investments.

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UNAUDITED SELECTED PRO FORMA CONSOLIDATED FINANCIAL DATA

The following tables set forth unaudited pro forma condensed consolidated financial data for Prospect and Patriot as a consolidated entity, giving effect to the merger as if it had occurred on the dates indicated and after giving effect to the pro forma adjustments. The unaudited pro forma condensed consolidated operating data are presented as if the merger had been completed on July 1, 2007. The unaudited pro forma condensed consolidated balance sheet data at March 31, 2009 is presented as if the merger had occurred as of that date. In the opinion of management, all adjustments necessary to reflect the effect of these transactions have been made. The merger will be accounted for under the acquisition method of accounting as provided by Statement of Financial Accounting Standard No. 141(R), Business Combinations.

The unaudited pro forma condensed consolidated financial data should be read together with the respective historical audited and unaudited consolidated financial statements and financial statement notes of Patriot and Prospect in this document. The unaudited pro forma condensed consolidated financial data are presented for comparative purposes only and do not necessarily indicate what the future operating results or financial position of Prospect will be following completion of the merger. The unaudited pro forma condensed consolidated financial data does not include adjustments to reflect any cost savings or other operational efficiencies that may be realized as a result of the merger of Patriot and Prospect or any future merger related restructuring or integration expenses.

	For the Nine Months Ended March 31, 2009	For the Year Ended June 30, 2008
	(In thousands except data relating to earnings per share)	
Performance Data:		
Interest and dividend income	$ 92,071	$ 112,387
Fee income	1,220	942
Other income	14,325	8,867
Total investment income	107,616	122,196
Interest expense	(5,549)	(7,858)
Base management and income incentive fees	(29,622)	(33,133)
General and administrative expenses	(9,860)	(12,663)
Total expenses	(45,031)	(53,655)
Net investment income	62,585	68,541
Realized and unrealized gains (losses)	(56,678)	(35,598)
Net income	$ 5,907	$ 32,943
Per Share Data:		

Earnings per share	$ 0.11	$ 0.71
Average weighted shares outstanding for the period	52,496	46,415

	March 31, 2009
Assets and Liabilities Data:	
Investment securities	$ 751,364
Cash	38,751
Other assets	10,394
Total assets	800,509
Borrowings	111,959
Other liabilities	26,821
Total liabilities	138,780
Net assets	$ 661,728

UNAUDITED PRO FORMA PER SHARE DATA

The following selected unaudited pro forma per share information for the year ended June 30, 2008 and the nine months ended March 31, 2009 reflects the merger and related transactions as if they had occurred on July 1, 2007. The unaudited pro forma combined net asset value per common share outstanding reflects the merger and related transactions as if they had occurred on March 31, 2009.

Such unaudited pro forma combined per share information is based on the historical financial statements of Prospect and Patriot and on publicly available information and certain assumptions and adjustments as discussed in the section entitled Unaudited Pro Forma Condensed Consolidated Financial Statements. This unaudited pro forma combined per share information is provided for illustrative purposes only and is not necessarily indicative of what the operating results or financial position of Prospect or Patriot would have been had the merger and related transactions been completed at the beginning of the periods or on the dates indicated, nor are they necessarily indicative of any future operating results or financial position. The following should be read in connection with the section entitled Unaudited Pro Forma Condensed Consolidated Financial Statements and other information included in or incorporated by reference into this document.

	Comparative Per Share Data			
	Prospect	**Patriot**	**Pro Forma Combined**	**Per Equivalent Patriot Share[3]**
Year ended June 30, 2008:				
Basic and diluted income from continuing operations per share	$ 1.17	$ 0.36	$ 0.71	$ 0.28
Distributions per share declared to date[1]	$ 1.58875	$ 1.31	$ 1.58875	$ 0.63
Net asset value per share[2]	$ 14.55	$ 10.08	N/A	N/A
Average weighted shares outstanding for the period	23,627	20,051	46,415	
Nine months Ended March 31, 2009				
Basic and diluted income (loss) from continuing operations per share	$ 1.21	$ (1.33)	$ 0.11	$ 0.04
Distributions per share declared to date[1]	$ 1.21125	$ 0.58	$ 1.21125	$ 0.48
Net asset value per share	$ 14.19	$ 8.13	$ 12.24	$ 4.88
Average weighted shares outstanding for the period	29,708	20,812	52,496	

(1) The historical distributions declared per share for Prospect and Patriot is computed by dividing the distributions declared for the year ended June 30, 2008 and the nine months ended March 31, 2009 by their respective historical weighted average shares outstanding. The pro forma combined distributions declared is the distributions per share as declared by Prospect.

(2) The historical net asset value per share for Prospect and Patriot as of June 30, 2008 and the nine months ended March 31, 2009 are as previously reported by the companies. The pro forma combined net asset value per share as of March 31, 2009 is computed by dividing the pro forma combined net assets by the pro forma combined number of shares outstanding.

(3) The Patriot equivalent pro forma per share amount is calculated by multiplying the combined pro forma share amounts by the common stock exchange ratio of 0.3992.

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RISK FACTORS

Risks Related to the Merger

Patriot and Prospect have agreed to a fixed exchange ratio, and, as a result, the shares of Prospect common stock to be issued in the merger may have a market value that is lower than expected.

The exchange ratio of 0.3992 of a share of Prospect common stock for each share of Patriot common stock was fixed on August 3, 2009, the time of the signing of the merger agreement, and is not subject to adjustment based on changes in the trading price of Prospect or Patriot common stock before the closing of the proposed merger. As a result, the market price of Prospect s common stock at the time of the merger may vary significantly from the price on the date the merger agreement was signed or from the price on either the date of this document or the date of the special meeting. These variances may arise due to, among other things:

changes in the business, operations and prospects of Prospect or Patriot;

the financial condition of current or prospective portfolio companies of Prospect or Patriot;

interest rates, general market and economic conditions;

market assessments of the likelihood that the proposed merger will be completed and the timing of the merger; and

market perception of the future profitability of the combined company.

These factors are generally beyond the control of Prospect and Patriot. It should be noted that during the 12-month period ending August 3, 2009, the closing price per share of Prospect s common stock varied from a low of $5.73 to a high of $14.59. Historical trading prices are not necessarily indicative of future performance.

The proposed merger is subject to the receipt of payoff letters from the Amended Securitization Facility lenders that could delay completion of the proposed merger, cause abandonment of the merger or have other negative effects on Patriot and Prospect.

Completion of the merger is subject to the receipt of payoff letters from the Amended Securitization Facility lenders. A substantial delay in obtaining such payoff letters, the failure to obtain such payoff letters or the imposition of unfavorable terms or conditions in connection with the receipt of such payoff letters could have an adverse effect on the business, financial condition or results of operations of Patriot and Prospect, or may cause the abandonment of the merger. In this regard, the merger agreement obligates Prospect to pay off (i) all principal and interest due under the Amended Securitization Facility, which amounted to $115.7 million as of August 3, 2009, and (ii) up to $1.35 million (the Fee Cap) in other costs, fees and expenses payable to the lenders under the terms of the Amended Securitization Facility. However, immediately subsequent to Patriot s entry into the merger agreement with Prospect, the agent for the Amended Securitization Facility lenders notified Patriot that the Amended Securitization Facility lenders have not consented to the Fee Cap included in the merger agreement nor do they intend to release their liens on Patriot s investments unless and until all costs, fees and expenses payable to the lenders under the terms of the Amended Securitization Facility are paid in full in cash. Although Patriot intends to work with the Amended Securitization Facility lenders to resolve this issue, if (i) the Amended Securitization Facility lenders demand payment for costs, fees and expenses that are substantially in excess of the Fee Cap amount, (ii) Patriot does not have sufficient funds to pay such excess amount and (iii) the Amended Securitization Facility lenders refuse to provide Patriot with the payoff letters required by the merger agreement, the merger may be abandoned. If the merger is abandoned, Patriot may not have sufficient liquidity to operate its business or pursue other strategic transactions and, as a result, would likely be required to seek bankruptcy protection.

Patriot shareholders will experience a reduction in percentage ownership and voting power with respect to their shares as a result of the merger.

Patriot shareholders will experience a substantial reduction in their respective percentage ownership interests and effective voting power relative to their respective percentage ownership interests in Patriot prior to the merger. If the merger is consummated, based on the number of shares of Prospect common stock issued and outstanding on the date hereof, Patriot shareholders will own approximately 15.2% of the combined entity s outstanding common stock. In addition, both prior to and after completion of the merger, Prospect may issue additional shares of common stock in public offerings, mergers and acquisitions or otherwise, all of which would further reduce the percentage ownership of Prospect held by former Patriot shareholders.

Termination of the merger agreement could negatively impact Patriot.

If the merger agreement is terminated, there may be various consequences including:

Patriot s businesses may have been adversely impacted by the failure to pursue other beneficial opportunities due to the focus of management on the merger, without realizing any of the anticipated benefits of completing the merger;

the market price of Patriot s common stock might decline to the extent that the market price prior to termination reflects a market assumption that the merger will be completed;

Patriot may not be able to find a party willing to pay an equivalent or more attractive price than the price Prospect has agreed to pay in the merger; and

Patriot may not have sufficient liquidity to operate its business or pursue other strategic transactions and, as a result, would likely be required to seek bankruptcy protection.

Under certain circumstances, Patriot is obligated to pay Prospect a termination fee or other amounts upon termination of the merger agreement.

No assurance can be given that the merger will be completed. The merger agreement provides for the payment by Patriot of a break-up fee of $3.2 million or an expense reimbursement of up to $250,000 if the merger is terminated by Patriot under certain circumstances. In addition, in certain circumstances involving a sale of Patriot to a third party within one year of termination of the merger agreement, Patriot may be required make an additional payment equal to the termination fee when combined with any previously paid expense reimbursement. The obligation to make that payment may adversely affect the ability of Patriot to engage in another transaction in the event the merger is not completed and may have an adverse impact on the financial condition of Patriot.

The merger agreement severely limits Patriot s ability to pursue alternatives to the merger.

The merger agreement contains no shop and other provisions that, subject to limited exceptions, limit Patriot s ability to discuss, facilitate or commit to competing third-party proposals to acquire all or a significant part of Patriot. These provisions might discourage a potential competing acquiror that might have an interest in acquiring all or a significant part of Patriot from considering or proposing that acquisition even if it were prepared to pay consideration with a higher per share market price than that proposed in the merger. Patriot can consider and participate in discussions and negotiations with respect to an alternative proposal only in very limited circumstances. Among other things, prior to Patriot entering into any discussions with, or providing confidential information to, a third party in connection with an alternative proposal, the third party must enter into a confidentiality agreement with Patriot, must provide evidence of its commitment and ability to make a superior proposal for a sale or business combination transaction with Patriot without material contingencies, must agree to pay down in full the outstanding balance under the Amended Securitization Facility at closing of the relevant alternative sale or business combination transaction, and must provide Patriot with funds in an amount equal to the termination fee that would be payable upon the occurrence of certain termination events, as discussed elsewhere in this document.

The merger is subject to closing conditions, including stockholder approval, that, if not satisfied or waived, will result in the merger not being completed, which may result in material adverse consequences to Patriot s business and operations.

The merger is subject to closing conditions, including the approval of Patriot s shareholders that, if not satisfied, will prevent the merger from being completed. The closing condition that Patriot s shareholders adopt the merger agreement may not be waived under applicable law and must be satisfied for the merger to be completed. Patriot currently expects that all directors and executive officers of Patriot will vote their shares of Patriot common stock in favor of the proposals presented at the special meeting. If Patriot s shareholders do not adopt the merger agreement and the merger is not completed, the resulting failure of the merger could have a material adverse impact on Patriot s business and operations. In addition to the required approvals and consents from governmental entities and the approval of Patriot s shareholders, the merger is subject to a number of other conditions beyond Patriot s control that may prevent, delay or otherwise materially adversely affect its completion. Patriot cannot predict whether and when these other conditions will be satisfied.

Certain executive officers and directors of Patriot have interests in the completion of the proposed merger that may differ from or conflict with the interests of Patriot shareholders.

When considering the recommendation of the Patriot board of directors to vote FOR adoption of the merger agreement, Patriot shareholders should note that certain of the executive officers and directors of Patriot have interests in the merger that are different in certain respects from, and may conflict with, the interests of other Patriot shareholders. Patriot executive officers are entitled to receive certain benefits upon completion of the merger, including accelerated vesting and payout (in cash or merger consideration) of stock options and restricted stock. In addition, pursuant to employment or severance agreements they have with Patriot, assuming qualifying terminations of employment following completion of the merger, certain of Patriot s executive officers would receive severance payments and benefits. Based on the assumptions set forth in The Merger Proposal Interests of Patriot s Directors and Executive Officers in the Merger, Patriot s executive officers may be entitled to receive aggregate payments of up to approximately $2,453,613 for accelerated vesting and payout of stock options and restricted stock upon completion of the merger. The maximum amounts that would be payable to Patriot s named executive officers in the aggregate under each of their current employment agreements or severance agreements assuming that certain conditions regarding change of control and termination are met would be up to approximately $11,704,415. Certain existing executive officers of Patriot may, however, become paid employees of the merged company or its external investment adviser. See The Merger Proposal Interests of Patriot s Directors and Executive Officers in the Merger beginning on page for a further description of these interests, including the payments that each executive officer is or may be entitled to receive upon completion of the merger.

Including shares of restricted stock that will vest upon the merger, the directors and executive officers of Patriot, hold approximately 15.7% of the beneficial and record ownership of Patriot s common stock as of July 31, 2009, and intend to vote their shares in favor of the merger agreement and the transactions contemplated by the merger.

Patriot shareholders who do not timely exchange their Patriot common stock certificates for Prospect common stock after the completion of the merger will be deemed to have elected to receive dividends and other distributions declared after the completion of the merger with respect to Prospect common stock in the form of Prospect common stock in accordance with Prospect s dividend reinvestment plan, and, as a result, may suffer adverse tax consequences.

As soon as reasonably practicable after completion of the merger, the exchange agent will mail a letter of transmittal to each holder of a Patriot common stock certificate at the effective time of the merger. This mailing will contain instructions on how to surrender Patriot common stock certificates in exchange for statements indicating book-entry ownership of Prospect common stock and a check in the amount of cash to be paid instead of fractional shares. Until Patriot common stock is surrendered for exchange, any dividends or other distributions declared after the completion of the merger with respect to Prospect common stock into which shares of Patriot common stock may have been converted will accrue, without interest, but will not be

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paid. Prospect will pay to former Patriot shareholders any unpaid dividends or other distributions, without interest, only after they have duly surrendered their Patriot stock certificates. In addition, the merger agreement provides that any such unpaid dividends or other distributions will be payable in the form of shares of Prospect s common stock in accordance with Prospect s dividend reinvestment plan. Because shareholders who receive distributions in the form of stock generally will be subject to the same federal, state and local tax consequences as shareholders who elect to receive their distributions in cash, Patriot shareholders who do not timely exchange their Patriot common stock certificates for Prospect common stock after the completion of the merger may suffer adverse tax consequences.

Risks Related to Prospect

Recent developments may increase the risks associated with Prospect s business and an investment in Prospect.

The U.S. financial markets have been experiencing a high level of volatility, disruption and distress, which was exacerbated by the failure of several major financial institutions in the last few months of 2008. In addition, the U.S. economy has entered a recession, which is likely to be severe and prolonged. Similar conditions have occurred in the financial markets and economies of numerous other countries and could worsen, both in the U.S. and globally. These conditions have raised the level of many of the risks described in the risk factors contained in this document and could have an adverse effect on Prospect s portfolio companies as well as on its business, financial condition, results of operations, dividend payments, credit facility, access to capital, valuation of its assets and its stock price.

Prospect s financial condition and results of operations will depend on its ability to manage its future growth effectively.

Prospect Capital Management, Prospect s external investment adviser, has been registered as an investment adviser since March 31, 2004, and Prospect 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. Prospect s ability to achieve its investment objective depends on its ability to grow, which depends, in turn, on Prospect Capital Management s ability to continue to identify, analyze, invest in and monitor companies that meet its investment criteria. Accomplishing this result on a cost-effective basis is largely a function of Prospect Capital Management s structuring of investments, its ability to provide competent, attentive and efficient services to Prospect and its access to financing on acceptable terms. As Prospect grows, it will need to continue to hire, train, supervise and manage new employees. Failure to manage its future growth effectively could have a materially adverse effect on its business, financial condition and results of operations.

Prospect is dependent upon Prospect Capital Management s key management personnel for its future success.

Prospect depends on the diligence, skill and network of business contacts of the senior management of Prospect Capital Management. Prospect also depends, to a significant extent, on Prospect Capital Management 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. The senior management team of Prospect Capital Management evaluates, negotiates, structures, closes, monitors and services Prospect s investments. Prospect s 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 management team could have a materially adverse effect on Prospect s ability to achieve its investment objective. In addition, Prospect can offer no assurance that Prospect Capital Management will remain its investment adviser or that it will continue to have access to its investment professionals or its information and deal flow.

Prospect operates in a highly competitive market for investment opportunities.

A large number of entities compete with Prospect to make the types of investments that it makes in target companies. Prospect competes 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 they have not traditionally invested in, including investments in middle-market companies. As a result of these new entrants, competition for investment opportunities at middle-market companies has intensified, a trend Prospect expects to continue.

Many of Prospect s existing and potential competitors are substantially larger and have considerably greater financial, technical and marketing resources than it does. For example, some competitors may have a lower cost of funds and access to funding sources that are not available to Prospect. In addition, some of its competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more or fuller relationships with borrowers and sponsors than Prospect. Furthermore, many of its competitors are not subject to the regulatory restrictions that the 1940 Act imposes on it as a business development company. Prospect cannot assure its shareholders that the competitive pressures it faces will not have a materially adverse effect on its business, financial condition and results of operations. Also, as a result of existing and increasing competition and its competitors ability to provide a total package solution, it may not be able to take advantage of attractive investment opportunities from time to time, and it can offer no assurance that it will be able to identify and make investments that are consistent with its investment objective.

Prospect does not seek to compete primarily based on the interest rates that it offers, and it believes that some of its competitors make loans with interest rates that are comparable to or lower than the rates it offers. Prospect may lose investment opportunities if it does not match its competitors pricing, terms and structure. If it matches its competitors pricing, terms and structure, it may experience decreased net interest income and increased risk of credit loss.

Most of Prospect s portfolio investments are recorded at fair value as determined in good faith by its board of directors and, as a result, there is uncertainty as to the value of its portfolio investments.

A large percentage of Prospect s portfolio investments consist of securities of privately held companies. Hence, market quotations are generally not readily available for determining the fair values of such investments. The determination of fair value, and thus the amount of unrealized losses it may incur in any year, is to a degree subjective, and Prospect Capital Management has a conflict of interest in making the determination. Prospect values these securities quarterly at fair value as determined in good faith by its board of directors based on input from Prospect Capital Management, a third party independent valuation firm and its audit committee. Prospect s board of directors utilizes the services of an independent valuation firm to aid it in determining the fair value of any securities. The types of factors that may be considered in determining the fair values of its investments include the nature and realizable value of any collateral, the portfolio company s ability to make payments and its earnings, the markets in which the portfolio company does business, comparison to publicly traded companies, discounted cash flow, current market interest rates and other relevant factors. Because such valuations, and particularly valuations of private securities and private companies, are inherently uncertain, the valuations may fluctuate significantly over short periods of time due to changes in current market conditions. The determinations of fair value by Prospect s board of directors may differ materially from the values that would have been used if an active market and market quotations existed for these investments. Prospect s net asset value could be adversely affected if the determinations regarding the fair value of its investments were materially higher than the values that it ultimately realize upon the disposal of such securities.

Senior securities, including debt, expose Prospect to additional risks, including the typical risks associated with leverage.

Prospect currently uses its revolving credit facility to leverage its portfolio and it expects in the future to borrow from and issue senior debt securities to banks and other lenders and may securitize certain of its portfolio investments.

With certain limited exceptions, as a business development company, Prospect is only allowed to borrow amounts such that its asset coverage, as defined in the 1940 Act, is at least 200% after such borrowing. The amount of leverage that it employs will depend on Prospect Capital Management s and Prospect s board of directors assessment of market conditions and other factors at the time of any proposed borrowing. There is no assurance that a leveraging strategy will be successful. Leverage involves risks and special considerations for shareholders, including:

A likelihood of greater volatility in the net asset value and market price of its common stock;

Diminished operating flexibility as a result of asset coverage or investment portfolio composition requirements that are more stringent than those imposed by the 1940 Act;

The possibility that investments will have to be liquidated at less than full value or at inopportune times to comply with debt covenants or to pay interest or dividends on the leverage;

Increased operating expenses due to the cost of leverage, including issuance and servicing costs;

Convertible or exchangeable securities issued in the future may have rights, preferences and privileges more favorable than those of Prospect s common stock; and

Subordination to lenders superior claims on Prospect s assets as a result of which lenders will be able to receive proceeds available in the case of its liquidation before any proceeds are distributed to Prospect s shareholders.

For example, the amount Prospect may borrow under its revolving credit facility is determined, in part, by the fair value of its investments. If the fair value of Prospect s investments declines, it may be forced to sell investments at a loss to maintain compliance with its borrowing limits. Other debt facilities Prospect may enter into in the future may contain similar provisions. Any such forced sales would reduce Prospect s net asset value and also make it difficult for the net asset value to recover.

Prospect Capital Management and Prospect s board of directors in their best judgment nevertheless may determine to use leverage if they expect that the benefits to its shareholders of maintaining the leveraged position will outweigh the risks.

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

A significant portion of the debt investments Prospect makes bear interest at fixed rates and the value of these investments could be negatively affected by increases in market interest rates. In addition, as the interest rate on Prospect s revolving credit facility is at a variable rate based on an index, an increase in interest rates would make it more expensive to use debt to finance its investments. As a result, a significant increase in market interest rates could both reduce the value of its portfolio investments and increase its cost of capital, which would reduce Prospect s net investment income.

Prospect needs to raise additional capital to grow because it must distribute most of its income.

Prospect needs additional capital to fund growth in its investments. A reduction in the availability of new capital could limit Prospect s ability to grow. Prospect must distribute at least 90% of its ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, to its shareholders to maintain its RIC status. As a result, such earnings are not available to fund investment originations. Prospect has sought additional capital by borrowing from financial institutions and may issue debt securities or additional equity securities. If Prospect fails to obtain funds from such sources or from other sources to fund its investments, it could be limited in its ability to grow, which may have an adverse effect on

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the value of its common stock. In addition, as a business development company, Prospect is generally required to maintain a ratio of at least 200% of total assets to total borrowings, which may restrict its ability to borrow in certain circumstances.

The lack of liquidity in Prospect s investments may adversely affect its business.

Prospect generally makes 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 Prospect s investments may make it difficult for it to sell such investments if the need arises. In addition, if Prospect is required to liquidate all or a portion of its portfolio quickly, it may realize significantly less than the value at which it has previously recorded its investments. In addition, Prospect may face other restrictions on its ability to liquidate an investment in a portfolio company to the extent that Prospect or Prospect Capital Management has material non-public information regarding such portfolio company.

Prospect may experience fluctuations in its quarterly results.

Prospect could experience fluctuations in its quarterly operating results due to a number of factors, including the interest or dividend rates payable on the debt or equity securities it acquires, the default rate on debt securities, the level of its expenses, variations in and the timing of the recognition of realized and unrealized gains or losses, the degree to which it encounters competition in its markets, the seasonality of the energy industry, weather patterns, changes in energy prices and general economic conditions. 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 Prospect s investment returns.

Prospect s executive officers and directors, and the executive officers of Prospect Capital Management may serve as officers, directors or principals of entities that operate in the same or related lines of business as it does or of investment funds managed by its affiliates. Accordingly, they may have obligations to investors in those entities, the fulfillment of which might not be in Prospect s best interests or those of its shareholders. Nevertheless, it is possible that new investment opportunities that meet Prospect s investment objectives may come to the attention of one of 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 Prospect. However, as an investment adviser, Prospect Capital Management has a fiduciary obligation to act in the best interests of its clients, including Prospect. 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 Prospect s investing activities, it pays a base management and incentive fees to Prospect Capital Management in accordance with the terms of an investment advisory agreement, and reimburses Prospect Capital Management for certain expenses it incurs. As a result of these arrangements, there may be times when the senior management team of Prospect Capital Management has interests that differ from those of Prospect s shareholders, giving rise to a conflict.

Prospect Capital Management receives a quarterly income incentive fee based, in part, on Prospect s pre-incentive fee net investment income, if any, for the immediately preceding calendar quarter. This income incentive fee is subject to a fixed quarterly hurdle rate before providing an income incentive fee return to Prospect Capital Management. This fixed hurdle rate was determined when then current interest rates were relatively low on a historical basis. Thus, if interest rates rise, it would become easier for Prospect s investment income to exceed the hurdle rate and, as a result, more likely that Prospect Capital Management will receive an income incentive fee than if interest rates on its investments remained constant or decreased. Subject to the

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receipt of any requisite shareholder approval under the 1940 Act, Prospect s board of directors may readjust the hurdle rate by amending the investment advisory agreement between it and Prospect Capital Management.

The income incentive fee payable by Prospect 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, Prospect Capital Management is not required to reimburse Prospect for any such income incentive fee payments. If Prospect does not have sufficient liquid assets to pay this incentive fee or distributions to shareholders on such accrued income, it may be required to liquidate assets in order to do so. This fee structure could give rise to a conflict of interest for Prospect Capital Management to the extent that it may encourage Prospect Capital Management to favor debt financings that provide for deferred interest, rather than current cash payments of interest.

Prospect has entered into a royalty-free license agreement with Prospect Capital Management. Under this agreement, Prospect Capital Management agrees to grant Prospect a non-exclusive license to use the name Prospect Capital. Under the license agreement, Prospect has the right to use the Prospect Capital name for so long as Prospect Capital Management or one of its affiliates remains Prospect s investment adviser. In addition, Prospect rents office space from Prospect Administration, an affiliate of Prospect Capital Management, and pays Prospect Administration its allocable portion of overhead and other expenses incurred by Prospect Administration in performing its obligations as administrator under an administration agreement between Prospect and Prospect Administration, including rent and Prospect s allocable portion of the costs of its chief financial officer and chief compliance officer and their respective staffs. This may create conflicts of interest that Prospect s board of directors monitors.

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

The incentive fee payable by Prospect to Prospect Capital Management may create an incentive for Prospect Capital Management to make investments on Prospect s 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 Prospect Capital Management to use leverage to increase the return on Prospect s investments. Increased use of leverage and this increased risk of replacement of that leverage at maturity, would increase the likelihood of default, which would disfavor holders of Prospect s common stock. Similarly, because Prospect Capital Management will receive an incentive fee based, in part, upon net capital gains realized on Prospect s investments, Prospect Capital Management 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 Prospect s 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 Prospect to Prospect Capital Management could create an incentive for Prospect Capital Management to invest on Prospect s behalf in instruments, such as zero coupon bonds, that have a deferred interest feature. Under these investments, Prospect 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. Prospect s net investment income used to calculate the income incentive fee, however, includes accrued interest. For example, accrued interest, if any, on Prospect s investments in zero coupon bonds will be included in the calculation of its incentive fee, even though it 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 it may not have yet received in cash and in the event of default may never receive.

Changes in laws or regulations governing Prospect s operations may adversely affect its business.

Prospect and its portfolio companies are subject to regulation by laws at the local, state and U.S. 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 materially adverse effect on Prospect s business.

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Prospect may in the future choose to pay dividends in its own stock, in which case its shareholders may be required to pay tax in excess of the cash they receive.

Prospect may distribute taxable dividends that are payable in part in its stock. Under a recently issued IRS revenue procedure, up to 90% of any such taxable dividend for 2009 could be payable in its stock. Taxable stockholders receiving such dividends would be required to include the full amount of the dividend as ordinary income (or as long-term capital gain to the extent such distribution is properly designated as a capital gain dividend) to the extent of its current and accumulated earnings and profits for United States federal income tax purposes. As a result, a U.S. stockholder may be required to pay tax with respect to such dividends in excess of any cash received. If a U.S. stockholder sells the stock it receives as a dividend in order to pay this tax, the sales proceeds may be less than the amount included in income with respect to the dividend, depending on the market price of Prospect s stock at the time of the sale. Furthermore, with respect to non-U.S. stockholders, Prospect may be required to withhold U.S. tax with respect to such dividends, including in respect of all or a portion of such dividend that is payable in stock. In addition, if a significant number of Prospect s stockholders determine to sell shares of its stock in order to pay taxes owed on dividends, it may put downward pressure on the trading price of Prospect s stock.

Prospect Capital Management and its senior management team 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, with narrow exceptions, required to invest at least 70% of their total assets in securities of certain privately held, thinly traded or distressed U.S. companies, cash, cash equivalents, U.S. government securities and other high quality debt investments that mature in one year or less. Prospect Capital Management and its senior management team 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 Prospect s investment objective. In addition, Prospect s investment strategies differ in some ways from those of other investment funds that have been managed in the past by the investment adviser s investment professionals.

A failure on Prospect s part to maintain its status as a business development company would significantly reduce its operating flexibility.

If Prospect does not continue to qualify as a business development company, it might be regulated as a registered closed-end investment company under the 1940 Act. Prospect s failure to qualify as a business development company would make it subject to additional regulatory requirements, which may significantly decrease its operating flexibility by limiting its ability to employ leverage.

If Prospect fails to qualify as a RIC, it will have to pay corporate-level taxes on its income, and its income available for distribution would be reduced.

To maintain its qualification for U.S. Federal income tax purposes as a RIC under Subchapter M of the Code, and obtain RIC tax treatment, Prospect must meet certain source of income, asset diversification and annual distribution requirements.

The source of income requirement is satisfied if Prospect derives at least 90% of its annual gross income from interest, dividends, payments with respect to certain securities loans, gains from the sale or other disposition of stock, securities or options thereon or foreign currencies, or other income derived with respect to its business of investing in such stock, securities or currencies, and net income from interests in qualified publicly traded partnerships, as defined in the Code.

The annual distribution requirement for a RIC is satisfied if Prospect distributes at least 90% of its investment company taxable income (which generally is its ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses), if any, to its shareholders on an annual basis. Because Prospect uses debt financing, it is subject to certain asset coverage ratio requirements under the 1940 Act and financial covenants that could, under certain circumstances, restrict it from making distributions necessary to

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qualify for RIC tax treatment. If it is unable to obtain cash from other sources, Prospect may fail to qualify for RIC tax treatment and, thus, may be subject to corporate-level income tax.

To maintain its qualification as a RIC, Prospect must also meet certain asset diversification requirements at the end of each calendar quarter. Failure to meet these tests may result in its having to dispose of certain investments quickly in order to prevent the loss of RIC status. Because most of its investments are in private companies, any such dispositions could be made at disadvantageous prices and may result in substantial losses.

If Prospect fails to qualify as a RIC for any reason or become subject to corporate income tax, the resulting corporate taxes could substantially reduce its net assets, the amount of income available for distribution, and the actual amount of its distributions. Such a failure would have a materially adverse effect on Prospect and its shareholders.

Regulations governing Prospect s operation as a business development company affect its ability to raise, and the way in which it raises, additional capital.

Prospect has incurred indebtedness under its revolving credit facility and, in the future, may issue preferred stock and/or borrow additional money from banks or other financial institutions, which it refers to collectively as senior securities, up to the maximum amount permitted by the 1940 Act. Under the provisions of the 1940 Act, Prospect is permitted, as a business development company, to incur indebtedness or issue senior securities only in amounts such that its asset coverage, as defined in the 1940 Act, equals at least 200% after each issuance of senior securities. If the value of its assets declines, it may be unable to satisfy this test, which could prohibit it from paying dividends and could prohibit Prospect from qualifying as a RIC. If Prospect cannot satisfy this test, it may be required to sell a portion of its investments or sell additional shares of common stock at a time when such sales may be disadvantageous in order to repay a portion of its indebtedness. In addition, issuance of additional common stock could dilute the percentage ownership of its current shareholders in it.

As a business development company regulated under provisions of the 1940 Act, Prospect is not generally able to issue and sell its common stock at a price below the current net asset value per share. If its common stock trades at a discount to net asset value, this restriction could adversely affect its ability to raise capital. Prospect may, however, sell its common stock, or warrants, options or rights to acquire its common stock, at a price below the current net asset value of its common stock in certain circumstances, including if (1) the holders of a majority of its shares (or, if less, at least 67% of a quorum consisting of a majority of its shares) and a similar majority of the holders of its shares who are not affiliated persons of it approve the sale of its common stock at a price that is less than the current net asset value, and (2) a majority of its directors who have no financial interest in the transaction and a majority of its independent directors (a) determine that such sale is in its and its shareholders best interests and (b) in consultation with any underwriter or underwriters of the offering, make a good faith determination as of a time either immediately prior to the first solicitation by it or on its behalf of firm commitments to purchase such shares, or immediately prior to the issuance of such shares, that the price at which such shares are to be sold is not less than a price which closely approximates the market value of such shares, less any distributing commission or discount.

To generate cash for funding new investments, Prospect pledged a substantial portion of its portfolio investments under its revolving credit facility. These assets are not available to secure other sources of funding or for securitization. Prospect s ability to obtain additional secured or unsecured financing on attractive terms in the future is uncertain.

Alternatively, Prospect may securitize its future loans to generate cash for funding new investments. To securitize loans, it may create a wholly owned subsidiary and contribute a pool of loans to such subsidiary. This could include the sale of interests in the loans by the subsidiary on a non-recourse basis to purchasers who it would expect to be willing to accept a lower interest rate to invest in investment grade loan pools. Prospect would retain a portion of the equity in the securitized pool of loans. An inability to successfully securitize its loan portfolio could limit its ability to grow its business and fully execute its business strategy, and could decrease its earnings, if any. Moreover, the successful securitization of its loan portfolio exposes it to a risk of loss for the equity it retains in the securitized pool of loans and might expose it to losses because the residual loans in which it does not sell interests may tend to be those that are riskier and more likely to generate losses. A successful securitization may also impose financial and operating covenants that restrict its business activities and may include limitations that could hinder its ability to finance additional loans and investments or to make the distributions required to maintain its status as a RIC under Subchapter M of the Code. The 1940 Act may also impose restrictions on the structure of any securitizations.

Prospect s common stock may trade at a discount to its net asset value per share.

Common stock of business development companies, like that of closed-end investment companies, frequently trades at a discount to current net asset value. Recently, Prospect s common stock has traded at a discount to its net asset value. The risk that its common stock may continue to trade at a discount to its net asset value is separate and distinct from the risk that its net asset value per share may decline.

If Prospect sells common stock at a discount to its net asset value per share, shareholders who do not participate in such sale will experience immediate dilution in an amount that may be material.

At Prospect s annual meeting of shareholders held on February 12, 2009, its shareholders approved its ability to sell an unlimited number of shares of its common stock at any level of discount from net asset value per share during the 12 month period following such approval. The issuance or sale by Prospect of shares of its common stock at a discount to net asset value poses a risk of dilution to its shareholders. In particular, shareholders who do not purchase additional shares at or below the discounted price in proportion to their current ownership will experience an immediate decrease in net asset value per share (as well as in the aggregate net asset value of their shares if they do not participate at all). These shareholders will also experience a disproportionately greater decrease in their participation in Prospect s earnings and assets and their voting power than the increase Prospect experiences in its assets, potential earning power and voting interests from such issuance or sale. They may also experience a reduction in the market price of its common stock.

Prospect may have difficulty paying its required distributions if it recognizes income before or without receiving cash representing such income.

For U.S. federal income tax purposes, Prospect includes in income certain amounts that it has not yet received in cash, such as original issue discount, which may arise if it receives 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 its overall investment activities, or increases in loan balances as a result of payment-in-kind arrangements, are included in its taxable income before it receives any corresponding cash payments. Prospect also may be required to include in taxable income certain other amounts that it does not receive in cash. While Prospect focuses primarily on investments that will generate a current cash return, its investment portfolio currently includes, and it may continue to invest in, securities that do not pay some or all of their return in periodic current cash distributions.

The income incentive fee payable by Prospect 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 Prospect may recognize taxable income before or without receiving cash representing such income, it may have difficulty meeting the tax requirement to distribute at least 90% of its 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, Prospect may have to sell some of its investments at times it would not consider advantageous, raise additional debt or equity capital or reduce new investment originations to meet these distribution requirements. If Prospect is not able to obtain cash from other sources, it may fail to qualify for RIC treatment and thus become subject to corporate-level income tax.

Prospect s ability to enter into transactions with its affiliates is restricted.

Prospect is prohibited under the 1940 Act from knowingly participating in certain transactions with its affiliates without the prior approval of its independent directors. Any person that owns, directly or indirectly, 5% or more of its outstanding voting securities is Prospect s affiliate for purposes of the 1940 Act and Prospect is generally prohibited from buying or selling any security or other property from or to such affiliate, absent the prior approval of its independent directors. The 1940 Act also prohibits joint transactions with an affiliate, which could include investments in the same portfolio company (whether at the same or different times), without prior approval of its independent directors. Prospect is prohibited from buying or selling any security or other property from or to Prospect Capital Management and its affiliates and persons with whom Prospect is in a control relationship, or entering into joint transactions with any such person, absent the prior approval of the SEC.

Prospect may not realize gains or income from its investments.

Prospect seeks to generate both current income and capital appreciation. However, the securities it invests in may not appreciate and, in fact, may decline in value, and the issuers of debt securities it invests in may default on interest and/or principal payments. Accordingly, it may not be able to realize gains from its investments, and any gains that it does realize may not be sufficient to offset any losses it experience.

Prospect s portfolio is currently concentrated in a limited number of portfolio companies in the energy industry, which subject it to a risk of significant loss if any of these companies defaults on its obligations under any of the securities that it holds or if the energy industry experiences a downturn.

As of March 31, 2009, Prospect had invested in a number of companies in the energy and energy related industries. A consequence of this lack of diversification is that the aggregate returns it realizes may be significantly and adversely affected if a small number of such investments perform poorly or if it needed to write down the value of any one investment. Beyond its income tax diversification requirements, it does not have fixed guidelines for diversification, and its investments are concentrated in relatively few portfolio companies. In addition, to date Prospect has concentrated on making investments in the energy industry. While it expects to be less focused on the energy and energy related industries in the future, Prospect anticipates that it will continue to have significant holdings in the energy and energy related industries. As a result, a downturn in the energy industry could materially and adversely affect it.

The energy industry is subject to many risks.

Prospect has a significant concentration in the energy industry. Prospect s definition of energy, as used in the context of the energy industry, is broad, and different sectors in the energy industry may be subject to variable risks and economic pressures. As a result, it is difficult to anticipate the impact of changing economic and political conditions on Prospect s portfolio companies and, as a result, its 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:

Commodity Pricing 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 that 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. Although Prospect generally prefers risk controls, including appropriate commodity and other hedges, by certain of its portfolio companies, if available, some of its 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. In addition, such companies may also still have exposure to market prices if such companies do not produce volumes or other contractual obligations in accordance with such hedging contracts.

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 U.S. Federal, state and local governments in diverse ways, 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 U.S. Federal environmental laws provide for civil penalties as well as regulatory remediation, thus adding to the potential liability an energy company 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. Prospect cannot assure its shareholders 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, Organization of Petroleum Exporting Countries 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.

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 materially 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. In addition, hurricanes, storms, tornados, floods, rain, and other significant weather events could disrupt supply and other operations at its portfolio companies as well as customers or suppliers to such companies. 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, Prospect 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 U.S. 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 Prospect s 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 it.

Prospect s investments in prospective portfolio companies may be risky and it could lose all or part of its investment.

Some of Prospect s portfolio companies 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 and the value of Prospect s investment in them may decline substantially or fall to zero.

In addition, investment in the middle market companies that Prospect is 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 Prospect holds, which may be accompanied by a deterioration in the value of their securities or of any collateral with respect to any securities and a reduction in the likelihood of it realizing on any guarantees it may have obtained in connection with its 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, Prospect will depend on the ability of Prospect Capital Management to obtain adequate information to evaluate these companies in making investment decisions. If Prospect Capital Management is unable to uncover all material information about these companies, it may not make a fully informed investment decision, and Prospect may lose money on its 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 materially adverse impact on Prospect s portfolio company and, in turn, on Prospect;

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; and

they may have difficulty accessing the capital markets to meet future capital needs.

In addition, Prospect s executive officers, directors and Prospect Capital Management could, in the ordinary course of business, be named as defendants in litigation arising from proposed investments or from its investments in the portfolio companies.

Economic recessions or downturns could impair Prospect s portfolio companies and harm its operating results.

The U.S. and most other economies have entered a recessionary period, which may be prolonged and severe. Prospect s 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 Prospect s portfolio companies.

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

A portfolio company s failure to satisfy financial or operating covenants imposed by Prospect 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 Prospect holds. Prospect 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 its portfolio companies were to go bankrupt, even though it may have structured its interest as senior debt or preferred equity, depending on the facts and circumstances, including the extent to which it actually provided managerial assistance to that portfolio company, a bankruptcy court might re-characterize its debt or equity holding and subordinate all or a portion of its claim to those of other creditors.

The lack of liquidity in Prospect s investments may adversely affect its business.

Prospect makes investments in private companies. A portion of these investments may be subject to legal and other restrictions on resale, transfer, pledge or other disposition or will otherwise be less liquid than publicly traded securities. The illiquidity of its investments may make it difficult for Prospect to sell such investments if the need arises. In addition, if Prospect is required to liquidate all or a portion of its portfolio quickly, it may realize significantly less than the value at which it has previously recorded its investments. In addition, Prospect faces other restrictions on its ability to liquidate an investment in a business entity to the extent that it or its investment adviser has or could be deemed to have material non-public information regarding such business entity.

Prospect may have limited access to information about privately held companies in which it invests.

Prospect invests primarily in privately-held companies. Generally, little public information exists about these companies, and it is required to rely on the ability of Prospect Capital Management s investment professionals to obtain adequate information to evaluate the potential returns from investing in these companies. These companies and their financial information are not subject to the Sarbanes-Oxley Act and other rules that govern public companies. If

Prospect is unable to uncover all material information about these companies, it may not make a fully informed investment decision, and it may lose money on its investment.

Prospect may not be in a position to control a portfolio investment when it is a debt or minority equity investor and its management may make decisions that could decrease the value of its investment.

Prospect makes both debt and minority equity investments in portfolio companies. As a result, it is subject to the risk that a portfolio company may make business decisions with which it disagrees, 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 its interests. As a result, a portfolio company may make decisions that could decrease the value of its portfolio holdings.

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

Prospect may invest in mezzanine debt and dividend-paying equity securities issued by its portfolio companies. Prospect s 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 it invests. 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 it is entitled to receive payments in respect of the securities in which it invests. Also, in the event of insolvency, liquidation, dissolution, reorganization or bankruptcy of a portfolio company, holders of securities ranking senior to its investment in that portfolio company would typically be entitled to receive payment in full before it receives any distribution in respect of its investment. After repaying the senior security holders, the portfolio company may not have any remaining assets to use for repaying its obligation to Prospect. In the case of securities ranking equally with securities in which Prospect invests, it 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.

Prospect may not be able to fully realize the value of the collateral securing its debt investments.

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

Prospect s debt investments are primarily made in the form of mezzanine loans, therefore its liens on the collateral, if any, are subordinated to those of the senior secured debt of the portfolio companies, if any. As a result, it 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 Prospect s secured loan, particularly after giving effect to the repayment of secured debt of the portfolio company that ranks senior to its loan;

bankruptcy laws may limit Prospect s ability to realize value from the collateral and may delay the realization process;

Prospect s rights in the collateral may be adversely affected by the failure to perfect security interests in the collateral;

the need to obtain regulatory and contractual consents could impair or impede how effectively the collateral would be liquidated and could affect the value received; and

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.

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

Prospect s investment strategy contemplates potential investments in securities of foreign companies. Investing in foreign companies may expose it 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 most of Prospect s investments are, and Prospect expects that most of its investments will be, U.S. dollar-denominated, Prospect s 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.

Prospect may expose itself to risks if it engages in hedging transactions.

Prospect may employ hedging techniques to minimize certain investment risks, such as fluctuations in interest and currency exchange rates, but it can offer no assurance that such strategies will be effective. If it engages in hedging transactions, it may expose itself to risks associated with such transactions. Prospect 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 its portfolio positions from changes in currency exchange rates and market interest rates. Hedging against a decline in the values of its 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 transactions 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 it is not able to enter into a hedging transaction at an acceptable price.

The success of Prospect s hedging transactions depends on its ability to correctly predict movements, currencies and interest rates. Therefore, while it 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 it 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, Prospect may not seek to establish a perfect correlation between such hedging instruments and the portfolio holdings being hedged. Any such imperfect correlation may prevent it from achieving the intended hedge and expose it 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.

Prospect s board of directors may change its operating policies and strategies without prior notice or shareholder approval, the effects of which may be adverse to Prospect and could impair the value of its shareholders investment.

Prospect s board of directors has the authority to modify or waive its current operating policies and its strategies without prior notice and without shareholder approval. Prospect cannot predict the effect any changes to its current operating policies and strategies would have on its business, financial condition, and value of its common stock. However, the effects might be adverse, which could negatively impact its ability to pay dividends and cause shareholders to lose all or part of their investment.

Investing in Prospect s securities may involve a high degree of risk.

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

The market price of Prospect s securities may fluctuate significantly.

The market price and liquidity of the market for Prospect s securities may be significantly affected by numerous factors, some of which are beyond its control and may not be directly related to its 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;
- changes in regulatory policies or tax guidelines, particularly with respect to RICs or business development companies;
- loss of RIC qualification;
- changes in earnings or variations in operating results;
- changes in the value of its portfolio of investments;
- any shortfall in revenue or net income or any increase in losses from levels expected by investors or securities analysts;
- departure of one or more of Prospect Capital Management s key personnel;
- operating performance of companies comparable to it;
- changes in prevailing interest rates;
- litigation matters;
- general economic trends and other external factors; and
- loss of a major funding source.

There is a risk that shareholders may not receive dividends or that Prospect s dividends may not grow over time.

Prospect has made and intends to continue to make distributions on a quarterly basis to its shareholders out of assets legally available for distribution. Prospect cannot assure shareholders that it 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 it as a business development company, it may be limited in its ability to make distributions.

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

Prospect s charter and bylaws and the Maryland General Corporation Law contain provisions that may have the effect of delaying, deferring or preventing a transaction or a change in control that might involve a premium price for its shareholders or otherwise be in their best interest. These provisions may prevent shareholders from being able to sell shares of its common stock at a premium over the current of prevailing market prices.

Prospect s charter provides for the classification of its board of directors into three classes of directors, serving staggered three-year terms, which may render a change of control or removal of its incumbent management more difficult. Furthermore, any and all vacancies on its board of directors will be filled generally only by the affirmative vote of a majority of the remaining directors in office, even if the remaining directors do not constitute a quorum, and any director elected to fill a vacancy will serve for the remainder of the full term until a successor is elected and qualifies.

Prospect s board of directors is authorized to create and issue new series of shares, to classify or reclassify any unissued shares of stock into one or more classes or series, including preferred stock and, without shareholder approval, to amend its charter to increase or decrease the number of shares of common stock that it has authority to issue, which could have the effect of diluting a shareholder s ownership interest. Prior to the issuance of shares of common stock of each class or series, including any reclassified series, Prospect s board of directors is required by its governing documents to set the terms, preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms or conditions of redemption for each class or series of shares of stock.

Prospect s charter and bylaws also provide that its board of directors has the exclusive power to adopt, alter or repeal any provision of its bylaws, and to make new bylaws. The Maryland General Corporation Law also contains certain provisions that may limit the ability of a third party to acquire control of Prospect, such as:

The Maryland Business Combination Act, which, subject to certain limitations, prohibits certain business combinations between Prospect and an interested shareholder (defined generally as any person who beneficially owns 10% or more of the voting power of the common stock or an affiliate thereof) for five years after the most recent date on which the shareholder becomes an interested shareholder and, thereafter, imposes special minimum price provisions and special shareholder voting requirements on these combinations; and

The Maryland Control Share Acquisition Act, which provides that control shares of a Maryland corporation (defined as shares of common stock which, when aggregated with other shares of common stock controlled by the shareholder, entitles the shareholder to exercise one of three increasing ranges of voting power in electing directors) acquired in a control share acquisition (defined as the direct or indirect acquisition of ownership or control of control shares) have no voting rights except to the extent approved by shareholders by the affirmative vote of at least two-thirds of all the votes entitled to be cast on the matter, excluding all interested shares of common stock.

The provisions of the Maryland Business Combination Act will not apply, however, if Prospect s board of directors adopts a resolution that any business combination between it and any other person will be exempt from the provisions of the Maryland Business Combination Act. Although its board of directors has adopted such a resolution, there can be no assurance that this resolution will not be altered or repealed in whole or in part at any time. If the resolution is altered or repealed, the provisions of the Maryland Business Combination Act may discourage others from trying to acquire control of Prospect.

As permitted by Maryland law, Prospect s bylaws contain a provision exempting from the Maryland Control Share Acquisition Act any and all acquisitions by any person of its common stock. Although its bylaws include such a provision, such a provision may also be amended or eliminated by its Board of Directors at any time in the future.

Risks Related to Patriot

An event of termination occurred under Patriot s Amended Securitization Facility which allows Patriot s lenders to accelerate repayment of the outstanding obligations under the facility and exercise other rights and remedies provided by the Amended Securitization Facility, including the right to sell the collateral under the Amended Securitization Facility.

On April 3, 2009, a termination event occurred under Patriot s Amended Securitization Facility. As a result of the occurrence of the termination event under the Amended Securitization Facility, Patriot can no longer make additional advances under the Amended Securitization Facility. In addition, the interest rate payable under the Amended Securitization Facility increased from the commercial paper rate plus 1.75% to the prime rate plus 3.75%. Also, the terms of the Amended Securitization Facility require that all principal, interest and fees collected from the debt investments secured by the Amended Securitization Facility must be used to pay down amounts outstanding under the

Amended Securitization Facility within 24 months following the date of the termination event. Substantially all of Patriot s debt investments are secured under the Amended Securitization Facility. The Amended Securitization Facility also permits the lenders, upon notice to Patriot, to accelerate amounts outstanding under the Amended Securitization Facility and exercise other rights and remedies provided by the Amended Securitization Facility, including the right to sell the collateral under the

Amended Securitization Facility. As of the date hereof, Patriot has not received any such notice from the lenders; however, there can be no assurance that they will not accelerate repayment in the future. Patriot does not have sufficient cash resources to repay these obligations should the lenders accelerate these obligations. Acceleration of the amounts outstanding under the Amended Securitization Facility could have a material adverse impact on Patriot s liquidity, financial condition and operations.

There is substantial doubt about Patriot s ability to continue as a going concern.

Patriot s independent registered public accounting firm has issued an opinion on its consolidated financial statements that states that the consolidated financial statements were prepared assuming Patriot will continue as a going concern and further states that the uncertainty regarding the renewal of its liquidity facility raises substantial doubt about Patriot s ability to continue as a going concern. On April 3, 2009, a termination event occurred under its Amended Securitization Facility. As a result of the occurrence of the termination event under the Amended Securitization Facility, Patriot can no longer make additional advances under the Amended Securitization Facility. Also, the terms of the Amended Securitization Facility require that all principal, interest and fees collected from the debt investments secured by the Amended Securitization Facility must be used to pay down amounts outstanding under the Amended Securitization Facility within 24 months following the date of the termination event.

Because substantially all of Patriot s debt investments are secured by its Amended Securitization Facility, Patriot cannot provide any assurance that it would have sufficient cash and liquid assets to fund normal operations and dividend distributions to its shareholders during the period of time when it is required to repay amounts outstanding under the Amended Securitization Facility if such amounts became due.

We are currently in a period of capital markets disruption and recession and Patriot does not expect these conditions to improve in the near future. These conditions could adversely affect Patriot s financial position and operating results and impair its portfolio companies financial positions and operating results, which could, in turn, harm Patriot s financial position and operating results.

The capital markets have been experiencing extreme volatility and disruption since mid-2007 and the U.S. economy has entered into a recession. Disruptions in the capital markets have increased the spread between the yields realized on risk-free and higher risk securities, resulting in illiquidity in parts of the capital markets. Patriot believe these conditions may continue for a prolonged period of time or worsen in the future. A prolonged period of market illiquidity may have an adverse effect on Patriot s business, financial condition, and results of operations. Unfavorable economic conditions also could increase Patriot s funding costs, limit its access to the capital markets or result in a decision by lenders not to extend credit to Patriot. These events, including the non-renewal of the liquidity facility, could limit Patriot s investment originations, limit its ability to grow and pay dividends and negatively impact its operating results.

In addition, many of Patriot s portfolio companies are susceptible to economic slowdowns or recessions. An economic slowdown or recession, including the current one and any future slowdowns or recessions, may affect the ability of Patriot s portfolio companies to repay their loans or engage in a liquidity event such as a sale, recapitalization or initial public offering. Patriot s nonperforming assets are likely to increase and the value of its portfolio is likely to decrease during these periods. Adverse economic conditions also may decrease the value of any collateral securing some of its loans. These conditions could lead to losses of value in Patriot s portfolio and a decrease in its revenues, net income and assets.

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Because Patriot must distribute at least 90% of its taxable income to its shareholders in connection with its election to be treated as a RIC, Patriot will continue to need additional capital to finance its growth. If additional funds are unavailable or not available on favorable terms, Patriot s ability to grow will be impaired.

In order to qualify for treatment as a RIC under Subchapter M of the Code, Patriot must distribute annually to its shareholders at least 90% of its investment company taxable income. As a result, Patriot will likely need to raise capital from other sources to grow its business. As a business development company, Patriot generally is required to meet a coverage ratio of total assets, less liabilities and indebtedness not represented by senior securities to total senior securities, which includes all of its borrowings and any preferred stock Patriot may issue in the future, of at least 200%. This requirement limits the amount that Patriot may borrow. Because Patriot will continue to need capital to grow its investment portfolio, this limitation may prevent it from incurring debt and require it to raise additional equity at a time when it may be disadvantageous to do so. Patriot cannot assure its shareholders that debt and equity financing will be available to it on favorable terms, if at all. If additional funds are not available to Patriot, it could be forced to curtail or cease new investment activities, and its net asset value could decline.

Regulations governing Patriot s operation as a business development company will affect its ability to, and the way in which it, raises additional capital.

Patriot s business will require capital. Patriot may acquire additional capital from the following sources:

Senior Securities and Other Indebtedness. Patriot may issue debt securities or preferred stock and/or borrow money from banks or other financial institutions, which is referred to collectively as senior securities, up to the maximum amount permitted by the 1940 Act. If Patriot issues senior securities, including debt or preferred stock, it will be exposed to additional risks, including the following:

Under the provisions of the 1940 Act, Patriot is permitted, as a business development company, to issue senior securities only in amounts such that its asset coverage, as defined in the 1940 Act, equals at least 200% after each issuance of senior securities. If the value of Patriot s assets declines, it may be unable to satisfy this test. If that happens, Patriot will not be permitted to issue additional debt securities or preferred stock and/or make additional borrowings from banks or other financial institutions until it is able to satisfy this test.

Any amounts that Patriot uses to service its debt or make payments on preferred stock will not be available for dividends to its common shareholders.

It is likely that any senior securities or other indebtedness Patriot issues will be governed by an indenture or other instrument containing covenants restricting its operating flexibility. Additionally, some of these securities or other indebtedness may be rated by rating agencies, and in obtaining a rating for such securities and other indebtedness, Patriot may be required to abide by operating and investment guidelines that further restrict operating and financial flexibility.

Patriot and, indirectly, its shareholders will bear the cost of issuing and servicing such securities and other indebtedness.

Preferred stock or any convertible or exchangeable securities that Patriot issues in the future may have rights, preferences and privileges more favorable than those of its common stock, including separate voting rights and could delay or prevent a transaction or a change in control to the detriment of the holders of its common stock.

Additional Common Stock. Patriot is not generally able to issue and sell its common stock at a price below net asset value per share. Patriot may, however, sell its common stock, warrants, options or rights to acquire its common stock, at a price below the current net asset value of the common stock if its board of directors determines that such sale is in its best interests and that of its shareholders, and its shareholders approve such sale. In any such case, the price at which Patriot s securities are to be issued and sold may not be less than a price which, in the determination of its board of directors, closely approximates the market value of such securities (less any distributing commission or discount). Patriot may also make rights offerings to its shareholders at prices per share less than the net asset value per share, subject to applicable requirements of the 1940 Act. If Patriot raises additional funds by issuing more common stock or senior securities convertible into, or exchangeable for, its common stock, the percentage ownership of its shareholders at that time would decrease and they may experience dilution. Moreover, Patriot can offer no assurance that it will be able to issue and sell additional equity securities in the future, on favorable terms or at all.

Securitization of Loans. In addition to issuing securities to raise capital, Patriot will continue to seek to securitize its loans to generate cash for funding new investments. To securitize loans, Patriot would generally create a wholly-owned subsidiary and contribute a pool of loans to the subsidiary. This could include the sale of interests in the subsidiary on a non-recourse basis to purchasers who Patriot would expect to be willing to accept a lower interest rate to invest in investment grade loan pools, and it retains a portion of the equity in the securitized pool of loans. An inability to successfully securitize Patriot s loan portfolio could limit its ability to grow its business, fully execute its business strategy and adversely affect its earnings, if any. Moreover, the securitization of Patriot s loan portfolio might expose it to losses as the residual loans in which it does not sell interests will tend to be those that are riskier and more apt to generate losses.

Patriot is dependent upon its key investment personnel for its future success.

Patriot depends on the diligence, skill and network of business contacts of the investment professionals it employs for the sourcing, evaluation, negotiation, structuring and monitoring of its investments. Patriot s future success will also depend, to a significant extent, on the continued service and coordination of its senior management team, particularly, Richard P. Buckanavage, its president and chief executive officer, and Timothy W. Hassler, its chief investment officer. The departure of Mr. Buckanavage, Mr. Hassler or any member of Patriot s senior management team could have a material adverse effect on its ability to achieve its investment objective. In addition, if both of Messrs. Buckanavage and Hassler cease to be employed by Patriot, the lender under its Amended Securitization Facility could, absent a waiver or cure, terminate the facility.

Patriot s business model depends to a significant extent upon strong referral relationships with private equity sponsors, and its inability to maintain or develop these relationships, or the failure of these relationships to generate investment opportunities, could adversely affect its business.

Patriot expects that members of its management team will maintain their relationships with private equity sponsors, and it will rely to a significant extent upon these relationships to provide it with potential investment opportunities. If Patriot s management team fails to maintain its existing relationships or develop new relationships with other sponsors or sources of investment opportunities, it will not be able to grow its investment portfolio. In addition, individuals with whom members of Patriot s management team have relationships are not obligated to provide it with investment opportunities, and, therefore, there is no assurance that such relationships will generate investment opportunities for it.

Patriot operates in a competitive market for investment opportunities.

Patriot competes for investments with other business development companies and other investment funds (including private equity funds and mezzanine funds), as well as traditional financial services companies such as commercial banks and other sources of funding. Many of Patriot s competitors are substantially larger and have considerably greater financial, technical and marketing resources than it does. For example, some competitors may have a lower cost of funds and access to funding sources that are not available to Patriot, including from federal government agencies through federal rescue programs such as the U.S. Department of the Treasury s Financial Stability Plan (which was formerly known as the Trouble Asset Relief Program). In addition, some of Patriot s competitors may have higher risk tolerances or different risk assessments. These characteristics could allow Patriot s competitors to consider a wider variety of investments, establish more relationships and offer better pricing and more flexible structuring than it. Patriot may lose investment opportunities if it does not match its competitors pricing, terms and structure. If Patriot is forced to match its

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competitors pricing, terms and structure, it may not be able to achieve acceptable returns on its investments or may bear substantial risk of capital loss. Furthermore, many of Patriot s competitors have greater experience operating under, or are not subject to, the regulatory restrictions that the 1940 Act imposes on it as a business development company.

Patriot cannot assure its shareholders that the competitive pressures it faces will not have a material adverse effect on its business, financial condition and results of operations. Also, as a result of this competition, Patriot may not be able to take advantage of attractive investment opportunities from time to time, and it cannot assure its shareholders that it will continue to be able to identify and make investments that are consistent with its investment objective.

Patriot will be subject to corporate-level income tax if it fails to maintain its status as a RIC under Subchapter M of the Code.

To maintain RIC tax treatment under the Code, Patriot must meet the following annual distribution, income source and asset diversification requirements.

The annual distribution requirement for a RIC will be satisfied if Patriot distributes to its shareholders on an annual basis at least 90% of its investment company taxable income (which is generally net ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses), if any. In light of the termination event that occurred under the Amended Securitization Facility on April 3, 2009, it may not be possible for Patriot to continue to comply with the annual distribution requirement. If Patriot is unable to satisfy this requirement, it could fail to qualify as a RIC under Subchapter M of the Code and thus become subject to corporate-level income tax.

The income source requirement will be satisfied if Patriot obtains at least 90% of its income for each year from dividends, interest, and gains from the sale of stock or securities or similar sources.

The asset diversification requirement will be satisfied if Patriot meets certain asset diversification requirements at the end of each quarter of its taxable year. Failure to meet those requirements may result in Patriot having to dispose of certain investments quickly or delay the closing of new investments in order to prevent the loss of RIC status and could result in a loss of business. Because most of Patriot s investments will be in private companies, and therefore will be relatively illiquid, any such dispositions could be made at disadvantageous prices and could result in substantial losses.

If Patriot fails to qualify as a RIC under Subchapter M of the Code for any reason and is subject to corporate income tax, the resulting corporate taxes could substantially reduce its net assets, the amount of income available for distribution and the amount of its distributions.

Patriot may in the future choose to pay dividends in its own stock, in which case its shareholders may be required to pay tax in excess of the cash they receive.

Patriot may distribute taxable dividends that are payable in part in its stock. Under a recently issued IRS revenue procedure, up to 90% of any such taxable dividend for 2009 could be payable in stock. Taxable shareholders receiving such dividends would be required to include the full amount of the dividend as ordinary income (or as long-term capital gain to the extent such distribution is properly designated as a capital gain dividend) to the extent of Patriot s current and accumulated earnings and profits for United States federal income tax purposes. As a result, a U.S. shareholder may be required to pay tax with respect to such dividends in excess of any cash received. If a U.S. shareholder sells the stock it receives as a dividend in order to pay this tax, the sales proceeds may be less than the amount included in income with respect to the dividend, depending on the market price of Patriot s stock at the time of the sale. Furthermore, with respect to non-U.S. shareholders, Patriot may be required to withhold U.S. tax with respect to such dividends, including in respect of all or a portion of such dividend that is payable in stock. In addition, if a significant number of Patriot s shareholders determine to sell shares of its stock in order to pay taxes owed on dividends, it may put downward pressure on the trading price of its stock.

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Patriot may have difficulty paying its required distributions if its recognizes income before or without receiving cash representing such income.

For federal income tax purposes, Patriot will include in income certain amounts that it has not yet received in cash, such as original issue discount, which may arise if it receives warrants in connection with the origination of a loan or possibly in other circumstances, such as in connection with the receipt of contractual payment-in-kind, or PIK, interest or dividends, which represents contractually deferred interest added to the loan balance that is generally due at the end of the loan term or contractually deferred dividends added to Patriot s equity investment in the portfolio company. Such original issue discount or contractual payment-in-kind arrangements will result in the recognition of income before Patriot receives any corresponding cash payments. Patriot also may be required to include in income certain other amounts that it will not receive in cash.

Since, in certain cases, Patriot may recognize income before or without receiving cash representing such income, it may have difficulty meeting the annual distribution requirement necessary to qualify as a RIC under subchapter M of the Code. Accordingly, Patriot may have to (i) sell some of its investments at times and/or at prices it would not consider advantageous, (ii) raise additional debt or equity capital or (iii) reduce new investment originations for this purpose. If Patriot is not able to obtain cash from other sources, it may fail to qualify for RIC tax treatment and thus become subject to corporate-level income tax.

Patriot borrows money, which magnifies the potential for gain or loss on amounts invested and may increase the risk of investing in it.

Borrowings, also known as leverage, magnify the potential for gain or loss on amounts invested and, therefore, increase the risks associated with investing in Patriot. Patriot borrows from and issues senior debt securities to banks and other lenders. Holders of these senior securities have fixed dollar claims on its assets that are superior to the claims of its common shareholders. If the value of Patriot s assets increases, then leveraging would cause the net asset value attributable to its common stock to increase more sharply than it would have had it not leveraged. Conversely, if the value of its assets decreases, leveraging would cause net asset value to decline more sharply than it otherwise would have had it not leveraged. Similarly, any increase in Patriot s income in excess of interest payable on the borrowed funds would cause its net income to increase more than it would without the leverage, while any decrease in Patriot s income would cause net income to decline more sharply than it would have had it not borrowed. Such a decline could negatively affect Patriot s ability to make common stock dividend payments. Leverage is generally considered a speculative investment technique.

At June 30, 2009, Patriot had $137.4 million of indebtedness outstanding, which had a weighted average annualized interest cost of 7.5% for the quarter ended June 30, 2009. In order for Patriot to cover these annualized interest payments on indebtedness, Patriot must achieve annual returns on its assets of at least 3.5%.

Illustration. The following table illustrates the effect of leverage on returns from an investment in Patriot s common stock assuming various annual returns, net of expenses. The calculations in the table below are hypothetical and actual returns may be higher or lower than those appearing below. The calculation assumes (i) $302.5 million in total assets, (ii) a weighted average cost of funds of 7.5%, (iii) $137.4 million in debt outstanding and (iv) $160.5 million in stockholders equity.

Assumed Return on Patriot s Portfolio
(net of expenses)

	−10%	−5%	0%	5%	10%

Corresponding return to shareholder	–25%	–16%	–6%	3%	12%

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

Because Patriot borrows to fund its investments, a portion of its income is dependent upon the difference between the interest rate at which it borrows funds and the interest rate at which it invests these funds. A portion of Patriot s investments will have fixed interest rates, while a portion of its borrowings will likely have floating interest rates. As a result, a significant change in market interest rates could have a material adverse effect on Patriot s net investment income. In periods of rising interest rates, Patriot s cost of funds could increase, which would reduce its net investment income. Patriot may hedge against interest rate fluctuations by using standard hedging instruments such as futures, options and forward contracts, subject to applicable legal requirements, including without limitation, all necessary registrations (or exemptions from registration) with the Commodity Futures Trading Commission. These activities may limit Patriot s ability to participate in the benefits of lower interest rates with respect to the hedged portfolio. Adverse developments resulting from changes in interest rates or hedging transactions could have a material adverse effect on Patriot s business, financial condition and results of operations. Also, Patriot has limited experience in entering into hedging transactions, and it will initially have to rely on outside parties with respect to the use of such financial instruments or develop such expertise internally.

A significant portion of Patriot s investment portfolio is and will continue to be recorded at fair value as determined in good faith by its board of directors and, as a result, there is and will continue to be uncertainty as to the value of its portfolio investments.

Under the 1940 Act, Patriot is required to carry its portfolio investments at market value or, if there is no readily available market value, at fair value as determined by its board of directors. Patriot is not permitted to maintain a general reserve for anticipated losses. Instead, Patriot is required by the 1940 Act to specifically value each individual investment and record an unrealized loss for any asset Patriot believes has decreased in value. Typically there is not a public market for the securities of the privately-held companies in which Patriot has invested and will generally continue to invest. As a result, Patriot values its investments in privately-held companies on a quarterly basis based on a determination of their fair value made in good faith and in accordance with the written guidelines established by its board of directors. In accordance with Statement of Financial Accounting Standards No. 157, Fair Value Measurements, Patriot principally utilizes the market approach to estimate the fair value of its equity investments where there is not a readily available market and it principally utilize the income approach to estimate the fair value of its debt investments where there is not a readily available market. Under the market approach, Patriot estimates the enterprise value of the portfolio companies in which it invests. There is no one methodology to estimate enterprise value and, in fact, for any one portfolio company, enterprise value is best expressed as a range of fair values from which Patriot derives a single estimate of enterprise value. To estimate the enterprise value of a portfolio company, Patriot analyzes various factors, including the portfolio company s historical and projected financial results. Patriot generally requires portfolio companies to provide annual audited and quarterly and monthly unaudited financial statements, as well as annual projections for the upcoming fiscal year. Typically, private companies are valued based on multiples of EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization), cash flows, net income, revenues, or in limited cases, book value. The private equity industry uses financial measures such as EBITDA in order to assess a portfolio company s financial performance and to value a portfolio company. When using EBITDA to determine enterprise value, Patriot may adjust EBITDA for non-recurring items. Such adjustments are intended to normalize EBITDA to reflect the portfolio company s earnings power. Adjustments to EBITDA may include compensation to previous owners, acquisition, recapitalization, restructuring related items and, one-time non-recurring income or expense items.

Under the income approach, Patriot generally prepares and analyzes discounted cash flow models based on its projections of the future free cash flows of the business. Patriot also uses bond yield models to determine the present value of the future cash flow streams of its debt investments. Patriot reviews various sources of transactional data, including private mergers and acquisitions involving debt investments with similar characteristics, and assesses the information in the valuation process.

The types of factors that may be considered in determining the fair value of Patriot s investments include the nature and realizable value of any collateral, the portfolio company s earnings and its ability to make payments on its indebtedness, 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, may fluctuate over short periods of time and may be based on estimates, Patriot s determinations of fair value may differ materially from the values that would have been used if a ready market for these securities existed. Patriot s net asset value could be adversely affected if its determinations regarding the fair value of its investments were materially higher than the values that it ultimately realizes upon the disposal of such securities.

The lack of liquidity in Patriot s investments may adversely affect its business.

Patriot generally makes 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 Patriot s investments may make it difficult for Patriot to sell such investments if the need arises. In addition, if Patriot is required to liquidate all or a portion of its portfolio quickly, it may realize significantly less than the value at which it had previously recorded its investments. Patriot may also face other restrictions on its ability to liquidate an investment in a portfolio company to the extent that it has material non-public information regarding such portfolio company.

Patriot may experience fluctuations in its quarterly results.

Patriot could experience fluctuations in its quarterly operating results due to a number of factors, including its ability to make investments in companies that meet its investment criteria, the interest rate payable on the debt securities Patriot acquires, the level of its expenses, prepayments of its debt securities, variations in and the timing of the recognition of realized and unrealized gains or losses, the degree to which Patriot encounters competition in its markets and general economic conditions. As a result of these factors, results for any period should not be relied upon as being indicative of performance in future periods.

Changes in laws or regulations governing Patriot s operations may adversely affect its business.

Patriot and its portfolio companies are subject to local, state and federal laws and regulations. These laws and regulations, as well as their interpretation, may be changed from time to time. Accordingly, any change in these laws or regulations could have a material adverse affect on its business.

Patriot s board of directors may change its operating policies and strategies without prior notice or shareholder approval, the effects of which may be adverse.

Patriot s board of directors has the authority to modify or waive its current operating policies and strategies without prior notice and without shareholder approval. Patriot cannot predict the effect any changes to its current operating policies and strategies would have on its business, operating results and value of its stock. However, the effects might be adverse, which could negatively impact its ability to pay dividends and cause its shareholders to lose all or part of their investment.

Patriot s investments in portfolio companies may be risky, and it could lose all or part of its investment.

Investing in small- to mid-sized companies involves a number of significant risks. Among other things, these companies:

- may have limited financial resources and may be unable to meet their obligations under their debt instruments that Patriot holds, which may be accompanied by a deterioration in the value of any collateral and a reduction in the likelihood of it realizing any guarantees that it may have obtained in connection with its investment;

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;

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 its portfolio company and, in turn, on it;

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

generally have less publicly available information about their businesses, operations and financial condition. Patriot is required to rely on the ability of its management team and investment professionals to obtain adequate information to evaluate the potential returns from investing in these companies. If Patriot is unable to uncover all material information about these companies, it may not make a fully informed investment decision, and may lose all or part of its investment.

Patriot s portfolio is and may continue to be concentrated in a limited number of portfolio companies and industries, which will subject it to a risk of significant loss if any of these companies defaults on its obligations under any of its debt instruments or by a downturn in the particular industry.

Patriot s portfolio is and may continue to be concentrated in a limited number of portfolio companies and industries. Beyond the asset diversification requirements associated with Patriot s qualification as a RIC, it does not have fixed guidelines for diversification, and while Patriot is not targeting any specific industries, its investments are, and could continue to be, concentrated in relatively few industries. As a result, the aggregate returns Patriot realizes may be significantly adversely affected if a small number of investments perform poorly or if Patriot needs to write down the value of any one investment. Additionally, a downturn in any particular industry in which Patriot is invested could also significantly impact the aggregate returns it realizes.

Price declines and illiquidity in the large corporate leverage loan market have adversely affected, and may continue to adversely affect, the fair value of Patriot s syndicated loan portfolio, reducing its net asset value through increased net unrealized depreciation.

The continuing unprecedented declines in prices and illiquidity in the large corporate leverage loan market have resulted in significant unrealized depreciation in Patriot s syndicated loan portfolio. Conditions in the large corporate leverage loan market may continue to deteriorate which could cause pricing levels to continue to decline. As a result, Patriot may continue to suffer additional unrealized losses and could incur significant realized losses in future periods in connection with the sale of its syndicated loans, which could have a material adverse impact on its business, financial condition and results of operations.

Patriot s portfolio companies may incur debt that ranks equally with, or senior to, its investments in such companies.

Patriot invests primarily in senior secured loans, junior secured loans and subordinated debt issued by small- to mid-sized companies. Patriot s portfolio companies may have, or may be permitted to incur, other debt that ranks equally with, or senior to, the debt in which it invests. By their terms, such debt instruments may entitle the holders to receive payment of interest or principal on or before the dates on which Patriot is entitled to receive payments with respect to the debt instruments in which it invests. Also, in the event of insolvency, liquidation, dissolution, reorganization or bankruptcy of a portfolio company, holders of debt instruments ranking senior to Patriot s investment in that portfolio company would typically be entitled to receive payment in full before it receives any distribution. After repaying such senior creditors, such portfolio company may not have any remaining assets to use for repaying its obligation to Patriot. In the case of debt ranking equally with debt instruments in which Patriot invests, it would have to share on an equal basis any distributions with other creditors holding such debt in the event of an insolvency, liquidation, dissolution, reorganization or bankruptcy of the relevant portfolio company.

Second priority liens on collateral securing loans that Patriot makes to its portfolio companies may be subject to control by senior creditors with first priority liens. If there is a default, the value of the collateral may not be sufficient to repay in full both the first priority creditors and it.

Certain loans that Patriot makes to portfolio companies may be secured on a second priority basis by the same collateral securing senior secured debt of such companies. The first priority liens on the collateral will secure the portfolio company s obligations under any outstanding senior debt and may secure certain other future debt that may be permitted to be incurred by the portfolio company under the agreements governing the loans. The holders of obligations secured by the first priority liens on the collateral will generally control the liquidation of and be entitled to receive proceeds from any realization of the collateral to repay their obligations in full before Patriot. In addition, the value of the collateral in the event of liquidation will depend on market and economic conditions, the availability of buyers and other factors. There can be no assurance that the proceeds, if any, from the sale or sales of all of the collateral would be sufficient to satisfy the loan obligations secured by the second priority liens after payment in full of all obligations secured by the first priority liens on the collateral. If such proceeds are not sufficient to repay amounts outstanding under the loan obligations secured by the second priority liens, then Patriot, to the extent not repaid from the proceeds of the sale of the collateral, will only have an unsecured claim against the portfolio company s remaining assets, if any.

The rights Patriot may have with respect to the collateral securing the loans it makes to its portfolio companies with senior debt outstanding may also be limited pursuant to the terms of one or more intercreditor agreements that Patriot enters into with the holders of senior debt. Under such an intercreditor agreement, at any time that obligations that have the benefit of the first priority liens are outstanding, any of the following actions that may be taken in respect of the collateral will be at the direction of the holders of the obligations secured by the first priority liens: the ability to cause the commencement of enforcement proceedings against the collateral; the ability to control the conduct of such proceedings; the approval of amendments to collateral documents; releases of liens on the collateral; and waivers of past defaults under collateral documents. Patriot may not have the ability to control or direct such actions, even if its rights are adversely affected.

There may be circumstances where Patriot s debt investments could be subordinated to claims of other creditors or it could be subject to lender liability claims.

Even though Patriot may have structured certain of its investments as senior loans, if one of its portfolio companies were to go bankrupt, depending on the facts and circumstances, including the extent to which it actually provided managerial assistance to that portfolio company, a bankruptcy court might re-characterize its debt investment and subordinate all or a portion of its claim to that of other creditors. Patriot may also be subject to lender liability claims for actions taken by it with respect to a borrower s business or instances where Patriot exercises control over the borrower. It is possible that Patriot could become subject to a lender s liability claim, including as a result of actions taken in rendering significant managerial assistance.

Patriot may not control any of its portfolio companies.

Patriot may not control any of its portfolio companies, even though it may have board representation or board observation rights and its debt agreements may contain certain restrictive covenants. As a result, Patriot is subject to the risk that a portfolio company in which it invests may make business decisions with which it disagrees and the management of such company, as representatives of the equity shareholders, may take risks or otherwise act in ways that do not serve its interests as debt investors.

Defaults by Patriot s portfolio companies will harm its operating results.

A portfolio company s failure to satisfy financial or operating covenants imposed by Patriot 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 the portfolio company s ability to meet its obligations under the debt investments that Patriot holds. Patriot may incur expenses to the extent necessary to seek recovery upon default or to negotiate new terms with a defaulting portfolio company.

Prepayments of Patriot s debt investments by its portfolio companies could adversely impact its results of operations and reduce its return on equity.

Patriot is subject to the risk that the investments it makes in its portfolio companies may be repaid prior to maturity. When this occurs, Patriot will generally reinvest these proceeds in temporary investments, pending their future investment in new portfolio companies. These temporary investments will typically have substantially lower yields than the debt being prepaid and Patriot could experience significant delays in reinvesting these amounts. Any future investment in a new portfolio company may also be at lower yields than the debt that was repaid. As a result, Patriot s results of operations could be materially adversely affected if one or more of its portfolio companies elects to prepay amounts owed to it. Additionally, prepayments could negatively impact Patriot s return on equity, which could result in a decline in the market price of its common stock.

Patriot may not realize gains from its equity investments.

Certain investments that Patriot has made in the past and may make in the future include warrants or other equity securities. In addition, Patriot may from time to time make non-control, equity co-investments in companies in conjunction with private equity sponsors. Patriot s goal is ultimately to realize gains upon its disposition of such equity interests. However, the equity interests Patriot receives may not appreciate in value and, in fact, may decline in value. Accordingly, Patriot may not be able to realize gains from its equity interests, and any gains that it does realize on the disposition of any equity interests may not be sufficient to offset any other losses it experiences. Patriot also may be unable to realize any value if a portfolio company does not have a liquidity event, such as a sale of the business, recapitalization or public offering, which would allow it to sell the underlying equity interests.

There is a risk that Patriot s shareholders may not receive dividends or that Patriot s dividends may not grow over time.

Patriot cannot assure its shareholders that it will achieve investment results that will allow it to make a specified level of cash distributions or year-to-year increases in cash distributions. As a result of the termination event that occurred under the Amended Securitization Facility on April 3, 2009, Patriot is required to dedicate a significant portion of its operating cash flow to repay the principal amount outstanding under the Amended Securitization Facility by April 2011. As a result, it may be required to severely limit or otherwise cease making cash distributions to its shareholders. In addition, due to the asset coverage test applicable to it as a business development company and financial covenants contained in its loan agreements, Patriot may be limited in its ability to make distributions.

Investing in Patriot s shares may involve an above average degree of risk.

The investments Patriot makes in accordance with its investment objective may result in a higher amount of risk than alternative investment options and volatility or loss of principal. Patriot s investments in portfolio companies may be highly speculative and aggressive, and therefore, an investment in its shares may not be suitable for someone with lower risk tolerance.

The market price of Patriot s common stock may fluctuate significantly.

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

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

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

loss of RIC status for U.S. federal income tax purposes;

changes in earnings or variations in operating results;

changes in the value of its portfolio of investments;

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

departure of its key personnel;

operating performance of companies comparable to it;

general economic trends and other external factors; and

loss of a major funding source.

Shares of closed-end investment companies, including business development companies, may trade at a discount to their net asset value.

Shares of closed-end investment companies, including business development companies, may trade at a discount from net asset value. This characteristic of closed-end investment companies and business development companies is separate and distinct from the risk that Patriot s net asset value per share may decline. Patriot cannot predict whether its common stock will trade at, above or below net asset value. In recent quarters, the price of its common stock has traded at prices below its net asset value. It should be noted that share prices of many other business development companies have also traded at prices below their net asset value.

In addition, if Patriot s common stock trades below net asset value, it will generally not be able to issue additional common stock at the market price unless its shareholders approve such a sale and its board of directors makes certain determinations.

Patriot s common stock could be delisted from the NASDAQ Global Select Market if it is unable to maintain its compliance with NASDAQ listing requirements.

In recent months, many public companies whose securities trade on the NASDAQ Global Select Market have experienced significant volatility and sharp declines in their stock prices. In general, in order to meet NASDAQ s continued listing standards, the closing bid of a company s common stock must be at least $1.00 per share.

If the closing bid price per share for Patriot s common stock were to fall below $1.00 per share for 30 consecutive business days, it would receive notification from NASDAQ indicating that it is not in compliance with NASDAQ Marketplace Rule 4450(a)(5). In accordance with NASDAQ Marketplace Rule 4450(e)(2), Patriot would then be provided 180 calendar days to regain compliance.

To regain compliance with the minimum bid price requirement, the closing bid price of Patriot s common stock must remain at $1.00 per share or more for a minimum of ten consecutive business days. If Patriot were unable to regain compliance, it would be able to apply to list its common stock on the NASDAQ Capital Market and NASDAQ will determine whether it meets the NASDAQ Capital Market initial listing criteria as set forth in NASDAQ Marketplace Rule 4310(c), except for the minimum bid price requirement. If Patriot was able to meet the NASDAQ Capital Market initial listing criteria, NASDAQ may notify it that it has been granted an additional 180 calendar days to come into compliance with the minimum bid price requirement. If Patriot were not able to meet the initial listing criteria, NASDAQ may provide it with written notification that its common stock would be delisted. At that time, Patriot would be permitted to appeal NASDAQ s determination to delist its common stock to a NASDAQ Listings Qualifications Panel.

Delisting from the NASDAQ could have an adverse effect on Patriot s business and on the trading of its common stock. If a delisting of Patriot s common stock from NASDAQ were to occur, its common stock would trade on the Over-the-Counter Bulletin Board or on the pink sheets maintained by the National

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Quotation Bureau, Inc. Such alternatives generally are considered to be less efficient markets, and Patriot s stock price, as well as the liquidity of its common stock, could be affected adversely.

Terrorist attacks, acts of war or natural disasters may affect any market for Patriot s common stock, impact the businesses in which it invests and harm its business, operating results and financial condition.

Terrorist acts, acts of war or natural disasters may disrupt Patriot s operations, as well as the operations of the businesses in which it invests. Such acts have created, and continue to create, economic and political uncertainties and have contributed to global economic instability. Future terrorist activities, military or security operations, or natural disasters could further weaken the domestic/global economies and create additional uncertainties, which may negatively impact the businesses in which Patriot invests directly or indirectly and, in turn, could have a material adverse impact on its business, operating results and financial condition. Losses from terrorist attacks and natural disasters are generally uninsurable.

Certain provisions of Patriot s restated certificate of incorporation and restated bylaws as well as the Delaware General Corporation Law could deter takeover attempts and have an adverse impact on the price of its common stock.

Patriot s restated certificate of incorporation and its restated bylaws as well as the Delaware General Corporation Law contain provisions that may have the effect of discouraging a third party from making an acquisition proposal for it. These anti-takeover provisions may inhibit a change in control in circumstances that could give the holders of Patriot s common stock the opportunity to realize a premium over the market price for its common stock.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Some of the statements in this document may constitute forward-looking statements because they relate to future events or future performance or financial condition. These forward-looking statements may include statements as to:

- the likelihood that the proposed merger is completed and the anticipated timing of the completion of the proposed merger;
- the period following the completion of the merger and the transactions contemplated by the merger agreement;
- the ability of Patriot and Prospect s businesses to successfully integrate if the proposed merger is completed; and
- Patriot s future operating results and business prospects if the proposed merger is not completed;

In addition, words such as anticipate, believe, expect and intend indicate a forward-looking statement, although not forward-looking statements include these words. The forward-looking statements contained in this document involve risks and uncertainties. Actual results could differ materially from those implied or expressed in the forward-looking statements for any reason, including the factors set forth in Risk Factors and elsewhere in this document.

The forward-looking statements included in this document have been based on information available to Patriot and Prospect on the date of this document, as appropriate, and Patriot and Prospect assume no obligation to update any such forward-looking statements. Although Patriot and Prospect undertake no obligation to revise or update any forward-looking statements, whether as a result of new information, future events or otherwise, you are advised to consult any additional disclosures that Patriot and Prospect may make directly to you or through reports that Patriot and Prospect in the future may file with the SEC, including annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K. The forward-looking statements in this document are excluded from the safe harbor protection provided by Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934.

THE SPECIAL MEETING

Date, Time and Place of the Special Meeting

The special meeting of Patriot shareholders will take place on , , 2009, at a.m. (Eastern Daylight Time), at the offices of .

Purpose of the Special Meeting

Patriot shareholders are being asked to consider and vote on the following items at the special meeting:

- A proposal to adopt the Agreement and Plan of Merger, dated as of August 3, 2009, by and between Patriot and Prospect, as such agreement may be amended from time to time; and

- A proposal to approve the adjournment of the meeting, if necessary or appropriate, to solicit additional proxies, in the event that there are not sufficient votes at the time of the meeting to adopt the foregoing proposal.

See The Merger Proposal and Description of the Merger Agreement.

Patriot s board of directors, including the independent directors, unanimously recommends that shareholders vote FOR approval of the merger agreement and the transactions contemplated by the merger agreement.

Record Date

Only holders of record of Patriot s common stock at the close of business on , 2009, the record date, are entitled to notice of and to vote at the special meeting. On the record date, approximately shares of common stock were issued and outstanding and held by approximately holders of record.

Quorum and Adjournments

A quorum is required to be present in order to conduct business at the special meeting. A quorum will be present if a majority of the votes entitled to be cast are present, in person or by proxy. Proxies properly executed and marked with a positive vote, a negative vote or an abstention, as well as broker non-votes, will be considered to be present at the special meeting for purposes of determining whether a quorum is present for the transaction of all business at the special meeting. Broker non-votes exist where a broker proxy indicates that the broker is not authorized to vote on a particular proposal.

Shareholders will also be asked to consider a proposal to adjourn or postpone of the meeting for the solicitation of additional votes, if necessary. Any such adjournment will only be permitted if approved by the holders of shares representing a majority of the votes present in person or by proxy at the special meeting, whether or not a quorum exists. Abstentions and broker non-votes will be treated for purposes of the adjournment vote as votes cast against the adjournment.

Vote Required

Holders of record of Patriot s common shares on the record date are entitled to one vote per share.

Merger proposal. The affirmative vote of the holders of a majority of Patriot s outstanding shares entitled to vote is required to approve the merger agreement and the proposed merger. Shareholders who abstain, fail to return their proxies or do not otherwise vote, will be voting against the merger agreement and the proposed merger. Brokers who hold shares of stock in street name cannot vote those shares if the brokers are not provided with voting instructions in accordance with their procedures, and this would also be counted as a vote against the merger proposal.

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Voting of Management

At the close of business on , 2009, Patriot s executive officers and directors owned and were entitled to vote shares of Patriot s common stock, representing % of Patriot s outstanding shares of common stock on that date. None of Patriot s executive officers or directors has entered into any voting agreement relating to the proposed merger; however, each of Patriot s executive officers and directors has indicated that he intends to vote his shares of common stock in favor of the approval of the merger and the merger agreement as long as the merger agreement is in effect.

Voting of Proxies

All shares represented by properly executed proxies received in time for the special meeting will be voted at the special meeting in the manner specified by the shareholders giving those proxies. Properly executed proxies that do not contain voting instructions will be voted for the approval of each matter to be voted on at the special meeting, including approval of the proposed merger and the merger agreement. Shareholders may also vote by calling the proxy solicitor at ( ) - .

Patriot does not expect that any matters other than those discussed above will be brought before the special meeting. If, however, other matters are properly presented at the special meeting, the individuals named as proxies will vote on such matters in their discretion.

Revocability of Proxies

Submitting a proxy on the enclosed form does not preclude a shareholder from voting in person at the special meeting. A shareholder may revoke a proxy at any time before it is voted by filing with Patriot a duly executed revocation of proxy, by submitting a duly executed proxy to Patriot with a later date, by re-voting by calling the proxy solicitor at ( ) - , or by appearing at the special meeting and voting in person. Shareholders may revoke a proxy by any of these methods, regardless of the method used to deliver a shareholder s previous proxy. Attendance at the special meeting without voting will not itself revoke a proxy.

Solicitation of Proxies

Patriot will bear the expenses incurred in connection with the printing and furnishing of this document to its shareholders. In addition to solicitation by mail, Patriot s executive officers, who will not be specially compensated, may solicit proxies from Patriot s shareholders by telephone, facsimile, telegram or other electronic means or in person. Patriot has retained to assist in the solicitation of proxies from shareholders for fees and expenses of approximately $. Arrangements may also be made with brokerage houses and other custodians, nominees and fiduciaries for the forwarding of solicitation materials to the beneficial owners of shares held of record by these persons, and Patriot will reimburse them for their reasonable out-of-pocket expenses.

Patriot will mail a copy of this document, including the Notice of Annual Meeting and the proxy card included in these materials, to each holder of record of its common stock on the record date.

Dissenters Rights

Shareholders do not have the right to exercise dissenters rights with respect to any matter to be voted upon at the special meeting, including approval of the merger agreement.

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UNAUDITED PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Prospect announced on August 3, 2009 that it intends to acquire the outstanding shares of Patriot common stock. The merger agreement provides that the holders of Patriot s common stock will receive the right to receive 0.3992 shares of Prospect common stock. This is estimated to result in approximately 8.6 million shares of common stock being issued by Prospect. In connection with the transaction, Prospect will repay all the outstanding borrowings of Patriot, in compliance with the merger agreement. The unaudited pro forma condensed combined financial information has been derived from and should be read in conjunction with the historical consolidated combined financial statements and the related notes of both Patriot and Prospect, which are included elsewhere in this document.

The following unaudited pro forma condensed combined financial information and explanatory notes illustrate the effect of the merger on Prospect s financial position and results of operations based upon the companies respective historical financial positions and results of operations under the acquisition method of accounting with Prospect treated as the acquirer. Under this method of accounting, the assets and liabilities of Patriot will be recorded by Prospect at their estimated fair values as of the date the merger is completed. The unaudited pro forma condensed combined financial information of Prospect and Patriot reflects the unaudited combined condensed balance sheet as of March 31, 2009 and the unaudited combined condensed income statements for the year ended June 30, 2008 and the nine months ended March 31, 2009, updated where more timely information is available. The condensed consolidated balance sheet as of March 31, 2009 assumes the acquisition took place on that date. The condensed consolidated statements of income for the year ended June 30, 2008 and the nine months ended March 31, 2009 assume the acquisition took place on July 1, 2007.

The unaudited pro forma condensed combined financial information is presented for illustrative purposes only and does not indicate the financial results of the combined companies had the companies actually been combined at the beginning of each period presented, nor the impact of possible business model changes. The unaudited pro forma condensed combined financial information also does not consider any potential impacts of current market conditions on revenues, expense efficiencies, asset dispositions, and share repurchases, among other factors. In addition, as explained in more detail in the accompanying notes to the unaudited pro forma condensed combined financial information, the allocation of the pro forma purchase price reflected in the unaudited pro forma condensed combined financial information is subject to adjustment and may vary significantly from the actual purchase price allocation that will be recorded upon completion of the merger.

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Prospect Capital Corp and Subsidiaries

Pro Forma Condensed Consolidated Balance Sheet
Unaudited
March 31, 2009
(In Thousands)

	Prospect	Patriot[1]	Pro Forma Adjustments	Pro Forma
Assets and Liabilities Data				
Investment Securities	555,041	265,931	(69,608)[4]	751,364
Cash	39,703	5,396	131,540(2)	39,072
			(137,567)[3]	
Other Assets	8,062	2,011		10,073
Total Assets	602,806	273,338	(75,635)	800,509
Borrowings	137,567	111,959	(137,567)[3]	111,959
			111,959(4)	
			(111,959)[4]	
Other Liabilities	21,215	5,606		26,821
Total Liabilities	158,782	117,565	(137,567)	138,780
Net Assets	444,024	155,772	131,540(2)	661,728
			(69,608)[4]	

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Prospect Capital Corp and Subsidiaries
Pro Forma Condensed Consolidated Income Statement
Unaudited
Year Ended June 30, 2008
(In Thousands)

Performance Data	Year Ended June 30, 2008 Prospect	Patriot	Pro Forma Adjustments	Pro Forma
Interest and Dividend Income	71,066	41,321	(5)	112,387
Fee Income		942		942
Other Income	8,336	531		8,867
Total Investment Income	79,402	42,794		122,196
Interest Expense	(6,318)	(8,257)	6,717(6)	(7,858)
Base Management Fees	(8,921)		(7,077)(7)	(15,998)
Income Incentive Fees	(11,278)		(5,857)(8)	(17,135)
General and Administrative Expenses	(7,772)	(9,325)	4,434(9)	(12,663)
Total Expenses	(34,289)	(17,582)	(1,784)	(53,655)
Net Investment Income	45,113	25,212	(1,784)	68,541
Realized Gain/(Loss)	(16,222)	(426)		(16,648)
Unrealized Gain/(Loss)	(1,300)	(17,650)		(18,950)
Net Realized and Unrealized Gain/(Loss)	(17,522)	(18,076)		(35,598)
Net Income	27,591	7,136	(1,784)	32,943
Average Shares Outstanding	23,627	20,051	2,737(10)	46,415
Earnings Per Share	1.17	0.36		0.71

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Prospect Capital Corp and Subsidiaries
Pro Forma Condensed Consolidated Income Statement
Unaudited

Nine Months Ended March 31, 2009
(In Thousands)

	Nine Months Ended March 31, 2009		Pro Forma	
	Prospect	Patriot	Adjustments	Pro Forma
Interest and Dividend Income	64,695	27,376	(5)	92,071
Fee Income		1,220		1,220
Other Income	13,986	339		14,325
Total Investment Income	78,681	28,935		107,616
Interest Expense	(4,828)	(5,759)	5,038 (6)	(5,549)
Base Management Fees	(8,740)		(5,236) (7)	(13,976)
Income Incentive Fees	(11,795)		(3,851) (8)	(15,646)
General and Administrative Expenses	(6,136)	(5,537)	1,813 (9)	(9,860)
Total Expenses	(31,499)	(11,296)	(2,236)	(45,031)
Net Investment Income	47,182	17,639	(2,236)	62,585
Realized Gain/(Loss)	1,661	(12,049)		(10,388)
Unrealized Gain/(Loss)	(12,990)	(33,300)		(46,290)
Net Realized and Unrealized Gain/(Loss)	(11,329)	(45,349)		(56,678)
Net Income (Loss)	35,853	(27,710)	(2,236)	5,907
Average Shares Outstanding	29,708	20,812	1,976 (10)	52,496
Earnings Per Share	1.21	(1.33)		0.11

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Prospect Capital Corp and Subsidiaries

Notes to Pro Forma Condensed Consolidated Financial Statements
Unaudited
(In Thousands)

Note 1 To reflect Patriot s June 30, 2009 balance sheet, updated for estimated changes subsequent to June 30, 2009 to the acquisition date:

	PCAP Historical June 30, 2009	Adjustments(A)	PCAP June 30, 2009 As adjusted
Investment Securities	$ 283,929	$ (17,998)	$ 265,931
Cash and cash equivalents	8,150	(2,754)	5,396
Other Assets	10,461	(8,450)	2,011
Total Assets	$ 302,540	$ (29,202)	$ 273,338
Borrowings	$ 137,365	$ (25,406)	$ 111,959
Other Liabilities	4,680	926	5,606
Total Liabilities	142,045	(24,480)	117,565
Net Assets	160,495	(4,723)	155,772
	$ 302,540	$ (29,202)	$ 273,338

(A) *Primarily the result of sale of certain investments subsequent to June 30, 2009 and the use of the proceeds to repay outstanding borrowings.*

Note 2 To record the sale of 16,618 shares of Prospect common stock between April 1, and July 7, 2009. The sale of equity resulted in raising approximately $131,540 of cash.

Note 3 To record the repayment of Prospect s outstanding borrowings of approximately $137,567 with the cash raised resulting from the equity raises (Note 2).

Note 4 To reflect the acquisition of Patriot by the issuance of approximately 8.6 million shares of Prospect common stock and the payment of $111,959, which was used to pay Patriot outstanding borrowings. The $111,959 is expected to be funded by borrowing on Prospect s credit line. Below reflects the allocation of purchase price on the basis of the fair value of assets acquired and liabilities assumed:

Prospect Capital Corp and Subsidiaries

Notes to Pro Forma Condensed Consolidated Financial Statements (Continued)
Unaudited
(In Thousands)

Components of Purchase Price:

	Patriot Historical	Adjustments	Adjusted Values
Cash (to repay Patriot Debt)	$ 111,959	$	$ 111,959
Common Stock issued	86,165		86,165
Total Purchase Price	198,124		198,124
Assets acquired:			
Investments	265,931	(69,608)(A)	196,323
Cash and cash equivalents	5,075		5,075
Other assets	2,332		2,332
Assets acquired	273,338	(69,608)	203,730
Other Liabilities	(5,606)		(5,606)
	(5,606)		(5,606)
	267,732	(69,608)	198,124
Cost in Excess of assets acquired	$ (69,608)	$ 69,608	$

(A) To reflect the write down of Patriot s fair value of its investments to Prospect s determination of fair value. Prospect in conjunction with an independent valuation agent has determined that a fair value approximating the purchase price, which is approximately $70 million less than the value determined by Patriot, is appropriate. Patriot s fair values, some of which have been determined in conjunction with an independent valuation agent, were derived utilizing different market assumptions than those utilized by Prospect.

Note 5 The purchase price of the investments being acquired from Patriot is below the amortized cost of such investments. As a result, subsequent to the acquisition date Prospect will record the accretion to par value in interest income over the term of the investment. Interest income has not been adjusted to reflect the accretion to par value for the periods presented. The accretion for the first 12 months after acquisition is estimated to be approximately $17.0 million.

Note 6 To reflect the reduction of Patriot interest expense for the year ended June 30, 2008 and the nine months ended March 31, 2009 as though the repayment of the $111,959 occurred on July 1, 2007.

Note 7 Base management fees were computed based on 2% of Average Assets per Prospect s investment advisory agreement with Prospect Capital Management, LLC.

Note 8 Incentive management fees were recomputed based on the formula in Prospect s investment advisory agreement with Prospect Capital Management, LLC.

Note 9 Adjustments to general and administrative expenses were made to reflect investment professionals being retained by Prospect Capital Management, LLC and covered by the management fees.

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Prospect Capital Corp and Subsidiaries

Notes to Pro Forma Condensed Consolidated Financial Statements (Continued)
Unaudited
(In Thousands)

Note 10 Weighted average shares have been adjusted to reflect the following :

	Year Ended June 30, 2008	Nine Months Ended March 31, 2009
Prospect Weighted Average Shares Outstanding	23,627	29,708
Estimated shares issued to fund the repayment of Patriots Debt (reflected as outstanding for all periods presented)	14,172	14,172
Estimated shares issued in connection with the Merger, including any shares issued in satisfaction of any restricted stock agreements (reflected as outstanding for all periods presented)	8,616	8,616
Prospect Adjusted Weighted Average Shares Outstanding	46,415	52,496

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THE MERGER PROPOSAL

The discussion in this document, which includes all of the material terms of the proposed merger and the principal terms of the merger agreement, is subject to, and is qualified in its entirety by reference to, the merger agreement, a copy of which is attached as Annex A *to this document and is incorporated by reference in this document.*

General Description of the Merger

Pursuant to the merger agreement, at the effective time Patriot will merge with and into Prospect with Prospect as the surviving entity in the merger and Patriot will cease to exist as a separate corporation following the merger. In the merger, each outstanding share of Patriot common stock will be converted into the right to receive approximately 0.3992 shares of common stock of Prospect, subject the payment of cash in lieu of fractional shares of Prospect common stock resulting from the application of the foregoing exchange ratio. As more fully described in this document, the merger agreement requires that Patriot declare, to the extent necessary, a final dividend prior to the closing of the merger in amount equal to its undistributed investment company taxable income and net capital gain (if any), and the exchange ratio will be adjusted for any such dividend that Patriot may declare prior to closing. However, the exchange ratio will not be adjusted for dividends declared by Prospect, except in certain extraordinary circumstances.

If the merger is consummated, all the assets and liabilities of Patriot and Prospect immediately before the merger will become assets and liabilities of Prospect, as the surviving entity, immediately after the merger, and Patriot s wholly-owned subsidiary, Patriot Capital Funding LLC I, will become a direct wholly-owned subsidiary of Prospect after the merger. As a condition to closing, Prospect is obligated to repay the principal, interest and penalties under the Amended Securitization Facility and other amounts related to the Amended Securitization Facility not to exceed $1.35 million.

Following completion of the merger and based on the number of shares of Prospect common stock issued and outstanding on the date hereof, former Patriot shareholders will hold approximately 15.2% of the outstanding common shares of Prospect.

Background of the Merger

In late 2008, Patriot disclosed in its SEC filings that as a result of the unprecedented instability in the financial markets and the severe slowdown in the overall economy, it did not have adequate liquidity to operate its business. In early 2009, Patriot also disclosed in its SEC filings that it was shifting its short-term business focus from making debt and equity investments to preserving its liquidity position. Subsequent to such public disclosures, Patriot began to receive a number of unsolicited inquiries from potential acquirers and investors seeking to assess whether Patriot would be interested in engaging in a strategic transaction. Prior to April 2009, such informal inquiries were brought to the attention of Patriot s board of directors. However, given the facts that the market price of Patriot s common stock was substantially below the net asset value per share of its common stock and Patriot was not in violation of any of the covenants under the Amended Securitization Facility, it was determined that such inquiries were not in the best interests of Patriot and its shareholders and did not merit further consideration at such time.

In January 2009, Patriot began to negotiate the terms of the renewal of the liquidity facility that supported the Amended Securitization Facility with BMO Capital Markets Inc. (BMO), the agent of the lenders under the liquidity facility and the Amended Securitization Facility. The liquidity facility was provided by the lenders that participated in the Amended Securitization Facility for a period of 364 days and was renewable annually thereafter at the option of the lenders. If the liquidity facility was not renewed by the lenders on or before April 11, 2009, a termination event would occur under the Amended Securitization Facility, which would require, among other things, that all principal and interest collected from the debt investments secured by the facility be used to repay amounts outstanding under the facility by April 2011. In connection with these negotiations, BMO provided Patriot with a term sheet that outlined the lenders offer to extend the liquidity facility for an additional 364-day period. Over the course of the next few months, Patriot delivered various informational requests to BMO in order to secure approval of the terms and conditions as outlined in the term sheet provided. However, shortly before April 11, 2009, the offer to extend the liquidity facility was withdrawn without explanation by BMO leaving Patriot with few, if any, options to obtain alternative debt financing.

Because of the risk that the liquidity facility supporting the Amended Securitization Facility would not be renewed in the months leading up to its expiration on April 11, 2009, Patriot s board of directors and management began exploring various strategic alternatives. At its regularly scheduled March 3, 2009 board meeting, Patriot management presented the Patriot board of directors with two alternatives for obtaining additional liquidity for Patriot:

- converting to a bank holding company structure in order to access the U.S. Department of the Treasury s Troubled Asset Relief Program and other federal government programs that sought to provide liquidity to banks and other financial institutions, or

- forming a Small Business Investment Company, or SBIC, subsidiary in order to access the capital markets through the issuance of debentures guaranteed by the U.S. Small Business Administration.

At the same time, Patriot management was continuing to negotiate the renewal of the liquidity facility with the Amended Securitization Facility lenders as well as seeking alternative debt financing in the event the liquidity facility would not be renewed. After considerable discussion, the Patriot board of directors instructed management not to pursue a conversion to a bank holding company structure until there was more information as to whether the liquidity facility would be renewed. With respect to the SBIC subsidiary option, management was instructed to take the initial steps necessary to form an SBIC subsidiary; however, management noted that the entire process typically takes up to 12 months and cannot be accelerated, so forming an SBIC subsidiary would only be a viable alternative if the liquidity facility was renewed.

As a result of the potential non-renewal of the liquidity facility under the Amended Securitization Facility, Patriot disclosed in its annual report on Form 10-K for the year ended December 31, 2008 (which was filed with the SEC on March 16, 2009) that there was substantial doubt with respect to its ability to continue as a going concern unless it was able to renew the liquidity facility or otherwise negotiate with the lenders under the Amended Securitization Facility for repayment terms that would not require it to use all principal and interest collected from the debt investments secured by the facility to repay amounts outstanding under the facility.

On April 3, 2009, a termination event occurred under the Amended Securitization Facility that prohibited Patriot from making additional advances under the Amended Securitization Facility and required that all principal, interest and fees collected from the debt investments secured by the Amended Securitization Facility be used to pay down amounts outstanding under the Amended Securitization Facility within 24 months following the date of the termination event. In addition, the termination event permits the lenders under the facility, upon a 10-day notice to Patriot, to accelerate amounts outstanding under the Amended Securitization Facility and exercise other rights and remedies provided by the Amended Securitization Facility, including the right to sell the collateral under the Amended Securitization Facility.

As a result of the foregoing, Patriot filed a Form 8-K with the SEC on April 7, 2009 disclosing the fact that a termination event had occurred under the Amended Securitization Facility. Patriot also disclosed in the Form 8-K that it was currently evaluating other financing and/or strategic alternatives, including possible debt or equity financing, acquisition or disposition of assets, and other strategic transactions. In subsequent periodic reports filed with the SEC, Patriot indicated that, because substantially all of its debt investments were secured under the Amended Securitization Facility, Patriot could not provide any assurance that it would have sufficient cash and liquid assets to fund its operations and dividend distributions to its shareholders, which failure could, among other things, result in adverse tax consequences, including possible failure to qualify as a RIC under Subchapter M of the Code.

On April 24, 2009, the Patriot board of directors formally engaged FBR to act as its financial advisor in connection with the exploration of strategic alternatives. In that regard, at Patriot s request, FBR compiled a list of potential strategic partners among business development companies, commercial finance companies, banks, private equity funds and hedge funds and, at Patriot s request, contacted each of them to inquire as to whether they might be interested in pursuing a strategic transaction with Patriot, including, among other things, a stock or cash merger, a significant equity investment, a refinancing of Patriot s debt, or a purchase of assets.

Concurrent with the engagement of FBR, the Patriot board of directors also instructed management to continue forbearance discussions with the lenders in an effort to ensure that the lenders would not accelerate payments due under the Amended Securitization Facility.

On May 7, 2009, the Patriot board of directors held a regularly scheduled board meeting and asked for an update as to the forbearance discussions between management and BMO. Mr. Buckanavage indicated that BMO was requesting a number of actions be taken in order to avoid acceleration of the facility, including pledging all currently unpledged loans and equity positions as collateral under the facility, establishing a bank account with BMO and reducing compensation paid to board members. At the same meeting, Mr. Buckanavage provided an update with respect to the status of discussions with potential strategic partners. Mr. Buckanavage indicated that, at Patriot s instruction, FBR had contacted 133 potential strategic partners. Of the 133 potential strategic partners contacted, 51 had executed non-disclosure agreements with Patriot, which included, among other standard provisions, restrictions on their use of Patriot s confidential information, a prohibition on such party soliciting the employees of Patriot, an undertaking by such parties to abide by the rules of the evaluation process established by Patriot, and an agreement by such party to not acquire, or attempt to acquire, securities of Patriot except through the evaluation process. Following execution of the non-disclosure agreements, the relevant parties received or were given access to confidential information regarding, among other things, Patriot s business, management, assets, liabilities, financial condition and results of operations.

A special board meeting was held on May 18, 2009 attended by the entire Patriot board of directors as well as representatives of Alston & Bird, LLP (Alston), Patriot s counsel with respect to the Amended Securitization Facility. Mr. Buckanavage provided the Patriot board of directors with an update on his negotiations with BMO on the forbearance agreement. He noted that BMO had requested a number of additional terms in exchange for granting forbearance, including a $3 million payment to Patriot Capital Funding, LLC I (Patriot LLC) to assist it in paying down it obligations under the facility, a pledge of all Patriot s unencumbered assets, including all unrestricted cash, to support the facility, a 75 basis point fee (which would approximate $1 million), and a requirement that Patriot get BMO s consent before modifying the terms of the loans it has with any of its portfolio companies. Mr. Buckanavage noted that these additional terms would greatly weaken Patriot s cash position and hinder its ability to service its existing portfolio companies.

The Patriot board of directors considered the possibility of Patriot filing for bankruptcy protection and issues regarding the possibility of Patriot LLC filing concurrently with Patriot. Among other things, the Patriot board of directors noted that the independent directors of Patriot LLC would have to unanimously consent to a bankruptcy filing. After considering various issues relating to Patriot LLC s ability and willingness to file for bankruptcy protection, the Patriot board of directors expressed its strong preference to continue negotiations with BMO in an attempt to make the forbearance agreement more palatable rather than to seriously consider filing for bankruptcy protection.

A special board meeting was held on May 22, 2009 attended by the entire Patriot board of directors as well as representatives of FBR. Mr. Buckanavage updated the board of directors regarding discussions with BMO and stated that the conditions that BMO was asking for in exchange for forbearance were terms that Patriot may not be able to satisfy while protecting shareholder value. Specifically, BMO wanted access to the letters of interest, or LOIs, obtained from the potential strategic partners who had requested and received confidential information concerning Patriot. Representatives of FBR then updated the Patriot board of directors with respect to the status of discussions with potential strategic partners. FBR noted that Patriot had received 18 LOIs from 16 different parties. The Patriot board of directors discussed the various LOIs with the assistance of Patriot s financial advisors.

As a result of the increasing friction between BMO and Patriot, management became increasingly concerned that BMO might exercise its right to seize Patriot LLC s assets which would result in the lenders having control over

Patriot LLC s assets and allow them to separately engage in discussions regarding sales of such assets for the purpose of paying down Patriot s debt. In such event, the Patriot board of directors was concerned that BMO would likely seek to sell such assets over a short period of time in order to generate sufficient cash to payoff the Amended Securitization Facility without regard to maximizing the amount available to Patriot s shareholders. Such a sale would likely result in selling assets at fire sale prices, thereby diminishing or potentially eliminating the amount of cash available to distribute to shareholders. Based on that concern, the Patriot board of directors considered whether filing for bankruptcy protection would be advisable under the circumstances since such a filing would prevent the lenders from removing Patriot as servicer over its investment portfolio and would prevent the lenders from seizing any of the assets pledged as collateral under the facility. Patriot felt that retaining servicing rights over its investment portfolio provided the best opportunity to complete one or more strategic transactions that were in the best interests of its shareholders.

On May 26, 2009, the Patriot board of directors held a special meeting attended by the entire board as well as representatives of FBR. FBR noted that Patriot had received four additional LOIs, which raised the total number of LOIs received to 22. Mr. Melsheimer, chairman of the Patriot board of directors, recommended that the board establish key criteria for determining which of the 22 LOIs had characteristics that the board felt were most important. These factors were deemed to be (a) value to Patriot s common shareholders; (b) form of the consideration (i.e., cash or common stock); (c) whether the transaction would result in meaningful repayment of the Amended Securitization Facility; (d) whether the transaction could be completed quickly; (e) whether the transaction would require the approval of shareholders of either the strategic partner or Patriot; and (f) how existing employees of Patriot would be treated. After a detailed review and discussion of the merits and drawbacks of each of the 22 LOIs with the assistance of Patriot s financial advisors, the board authorized FBR to invite 12 of the 22 bidders to the second round and authorized management, with the assistance of Patriot s legal and financial advisors, to begin preliminary negotiations with each in an effort to determine which of the 12 potential strategic partners best satisfied the goals set forth by the board.

Following this discussion, Mr. Buckanavage reported that the negotiations relating to the forbearance agreement were not progressing as hoped and that he felt an acceptable forbearance agreement would be unlikely at this time. In light of this, the board decided that it was imperative that negotiations with the twelve potential strategic partners begin as soon as possible.

On May 29, 2009, the Patriot board of directors held a special meeting attended by the entire board. The board called the meeting to receive an update from Mr. Buckanavage as to his discussions with potential bankruptcy counsel. Mr. Buckanavage reported that he had spoken with three bankruptcy firms and, as a result of his discussions, recommended that the board consider engaging Young Conaway Stargatt & Taylor, LLP (Young Conaway). The board authorized Mr. Buckanavage to engage Young Conaway to provide advice in the event that Patriot was forced to seek bankruptcy protection. Separately, Mr. Buckanavage reported he had apprised the independent directors of Patriot LLC as to how negotiations were progressing with BMO and notified them that Patriot was considering a broad range of strategic options, including transactions proposed in the LOIs, further negotiations with BMO and a potential bankruptcy filing. The independent directors of Patriot LLC requested several items from Mr. Buckanavage, including Patriot s most recent SEC filings, its most recent valuation report from Duff & Phelps and the notice of termination under the Amended Securitization Facility.

On June 1, 2009, the Patriot board of directors held a special meeting attended by the entire board as well as representatives from Sutherland Asbill & Brennan LLP (Sutherland), Patriot s outside corporate counsel, and representatives of Young Conaway. Mr. Buckanavage reported that BMO had requested additional concessions from Patriot with respect to the forbearance agreement, including the addition of one more independent director to Patriot LLC approved by BMO and the identification of the specific parties who had submitted LOIs to Patriot. Previously Patriot had provided the details of the LOIs on a no-names basis. The Patriot board of directors was concerned that these actions were designed to allow BMO to negotiate directly with the potential strategic partners that had submitted LOIs and potentially to prevent Patriot from considering all alternatives available to Patriot, including the possibility of seeking bankruptcy protection. The board instructed Mr. Buckanavage to make clear to BMO that Patriot would seek a confidentiality agreement with BMO in the event Patriot agreed to release the names of the potential strategic partners to BMO.

On June 5, 2009, the Patriot board of directors held a special meeting attended by the entire board as well as representatives from Sutherland and representatives of Young Conaway. Mr. Buckanavage updated the board on forbearance negotiations with BMO. In connection with possible forbearance of Patriot s obligations under the facility, Mr. Buckanavage reported that BMO had requested loan documentation for all portfolio companies and placed onerous conditions on allowing Patriot to use any of its funds to assist two of its portfolio companies which included, among other things, a 20 basis point fee, an increase in the interest rate under the Amended Securitization Facility to prime rate plus 300 basis points, termination of Patriot s existing swap agreements, which would result in a realized loss of $3.3 million, and adding a third independent director to Patriot s wholly-owned subsidiary. The board of directors was concerned that providing loan documentation to BMO might be a precursor to BMO exercising its rights and remedies.

A representative of Young Conaway then reported his discussion with the outside legal counsel to the two independent managers of Patriot LLC relating to a possible joint bankruptcy filing, which the Patriot board of directors discussed and considered. The Patriot board of directors then determined that a bankruptcy filing, by Patriot without a simultaneous bankruptcy filing by Patriot LLC would not realize many benefits since a large portion of Patriot s assets are held by Patriot LLC.

On June 7, 2009, the Patriot board of directors held a special meeting attended by the entire board as well as a representative from Sutherland and representatives of Young Conaway. At the meeting. Mr. Buckanavage shared with the board of directors a request from BMO to be granted access to the LOIs received by Patriot and the terms of a draft confidentiality agreement BMO submitted to Mr. Buckanavage in this regard. The board of directors instructed Mr. Buckanavage to negotiate the terms of the draft confidentiality agreement that BMO provided.

A representative of Young Conaway next updated the Patriot board of directors regarding his discussions with the outside legal counsel to the independent managers of Patriot LLC. The independent managers of Patriot LLC indicated that they did not support filing for bankruptcy protection at this time, but also indicated that they agreed to have a joint board meeting with Patriot the following day to consider the proposal fully.

On June 8, 2009, the Patriot board of directors held a special joint meeting attended by the entire board of Patriot, the board of managers of Patriot LLC, a representative from Sutherland and representatives of Young Conaway. The meeting was held to discuss whether Patriot and Patriot LLC should jointly file for bankruptcy protection. After considerable discussion, the independent directors of Patriot LLC indicated that they did not support a bankruptcy filing at this time but were open to reconsideration if BMO exercised its rights and remedies under the facility.

At the meeting, Mr. Buckanavage announced that two potential bidders, Company A and Company B, included in their LOIs a provision that would result in the entire repayment of Patriot s obligations due under the facility. The Patriot board of directors determined that it was necessary to speed up the process of evaluating bids with the assistance of Patriot s legal and financial advisors in light of the increasing friction with BMO in connection with negotiating a forbearance agreement.

On June 9, 2009, the Patriot board of directors held a special meeting attended by the entire board as well as a representative from Sutherland and representatives from Young Conaway. Based on the prior day s joint board meeting, the board of directors decided to focus on speeding up negotiations with potential strategic partners. In connection with this, the Patriot board of directors instructed Mr. Buckanavage to request FBR to contact each of the 22 bidders, which included each of the entities that previously submitted LOIs, and re-commence discussions. In addition, the board approved a resolution allowing BMO to review the 22 LOIs, subject to a confidentiality and non-disclosure agreement.

On June 17, 2009, the Patriot board of directors held a special meeting attended by the entire board. Mr. Buckanavage provided the board with an update regarding the 22 bidders that the board previously requested FBR to contact. The proposals were classified into three groups: the first consisting of four proposals that warranted further consideration, the second consisting of eight proposals that would require adjustments in order to be seriously considered, and the third consisting of ten proposals that were not worth pursuing as currently contemplated because they failed to meet the standards previously set forth by the board.

Mr. Buckanavage noted that Patriot, with the assistance of its legal and financial advisors, would contact each potential strategic partner and compile a list of the strategic proposals deemed most likely to satisfy the board s criteria for consideration. Those potential strategic partners would be invited to commence diligence review of Patriot beginning June 29, 2009.

The board also considered whether any other alternatives to a merger, acquisition or significant investor may be a possibility since the conditions in the debt markets had shown signs of improvement. The board noted that a private or public debt offering would require the consent of BMO which, in the opinion of the board, would be difficult to obtain given BMO s refusal to consent to the release of debt documents of two of Patriot s portfolio companies which would have allowed Patriot to sell such investments and use the proceeds to pay down the facility.

On July 1, 2009, the Patriot board of directors held a special meeting attended by the entire board as well as representatives of FBR and a representative of Sutherland. The meeting was called to discuss a revised non-binding LOI from Prospect, a public business development company, that included a full pay-down of Patriot s obligations under the Amended Securitization Facility and a conversion of the Company s outstanding stock into 0.40 shares of Prospect s common stock. Based on the market price of Prospect s common stock at that time, the conversion ratio valued Patriot common stock at approximately $4.00 per share. It was noted that Prospect had requested that Patriot enter into exclusive negotiations regarding this proposal, begin negotiating the terms of the merger agreement and agree to reimburse certain expenses of Prospect in connection with the negotiation of the merger agreement and performing due diligence.

The board, after consulting with its legal and financial advisors, chose not to engage in exclusive negotiations with Prospect, but agreed to reimburse Prospect for certain expenses incurred as a result of negotiation of the merger agreement and due diligence in an amount not to exceed $250,000.

Between June 30, 2009 and July 24, 2009, Patriot s management met with 11 of the 12 second round participants in face-to-face due diligence meetings, responded to diligence requests and made available additional information about Patriot.

The Patriot board of directors then discussed the other proposals submitted by potential strategic partners with the assistance of Patriot s legal and financial advisors. At Patriot s instruction, FBR had previously informed each potential bidder that a full pay-down of Patriot s obligations under the Amended Securitization Facility would be an important factor in Patriot s consideration of their bids, as this had become an important prerequisite of BMO approving any transaction, and binding proposals were due on July 29, 2009.

Consideration of Specific Proposals

On July 29, 2009, the Patriot board of directors held a special meeting attended by the entire board as well as representatives of FBR and representatives of Sutherland. At that meeting, the board reviewed and discussed with the assistance of its legal and financial advisors the seven final proposals submitted by potential bidders.

Pursuant to the terms of the proposal submitted by Prospect, Prospect offered to issue Prospect common stock to Patriot shareholders in an amount that valued Patriot shares at $4.00 per share, with the exchange ratio to be fixed at the time of the signing of the merger agreement. The indicated exchange ratio would be approximately 0.40 shares of Prospect common stock for each share of Patriot common stock outstanding. In addition, pursuant to the terms of the proposal submitted by Prospect, Prospect agreed to fully repay all amounts outstanding under the Amended Securitization Facility with no financing conditions. Further, the board noted that Prospect had already completed its diligence, had submitted a mark-up of the proposed merger agreement, had engaged in discussions regarding the same, and had indicated a strong desire to negotiate and sign a merger agreement. Finally, Prospect s proposal would not require Prospect shareholder approval.

The board noted that this proposal satisfied most of the factors it deemed to be important. However, the board discussed its preference to have a minimum price per share exchange ratio rather than a fixed exchange ratio since the merger consideration to shareholders would decrease if the market price of Prospect common stock decreased.

Company B, a registered closed-end investment company, proposed to issue shares of Company B common stock with a stated net asset value of $6.00 per share, which, based on the discount to net asset value at which Company B s common stock was then trading, had an implied current market value of $4.99 per share of Patriot common stock as of July 31, 2009. However, although the proposal by Company B represented the highest implied per share offer, and included an agreement to repay amounts outstanding under the Amended Securitization Facility, such proposal was contingent upon: (i) Company B obtaining the consent of its lender to repay the amounts outstanding under the Amended Securitization Facility; (ii) Company B obtaining approval from its shareholders; (iii) Company B obtaining approval from its board of trustees; and (iv) Patriot agreeing to a 45-day exclusivity period to allow Company B to complete confirmatory legal and accounting due diligence of Patriot (including business due diligence on nine of Patriot s largest portfolio companies) and negotiate the terms of a definitive merger agreement. In addition, the mark-up of the merger agreement submitted by Company B indicated that certain price adjustments might apply and that Company B would require all directors and executive officers of Patriot to execute voting agreements pursuant to which they would agree to vote all shares of Patriot common stock held by them in favor of the merger with Company B. Finally, it was noted at the meeting that Company B did not plan to provide legal due diligence materials requested by Patriot unless and until it had an indication that Patriot was ready to move forward with Company B on an exclusive basis.

While the board noted that the implied per share merger consideration offered by Company B was higher than that offered by Prospect, Company B s proposal (like Prospect s proposal) did not have a minimum per share offer price which meant that the actual consideration could be lower based on the market price of Company B s common stock. In addition, the financing contingency related to repayment of Patriot s obligations under the Amended Securitization Facility, the 45-day exclusivity period, the need to obtain approval of Company B s shareholders, and the fact that Patriot had not yet been provided due diligence information from Company B were negative factors that called into question the viability of and time period in which the transaction could be completed, both of which weighed against Company B s proposal. In light of the foregoing, the board of directors of Patriot did not view Company B s proposal as a firm proposal.

Company C, a private hedge fund, offered cash in the amount of $3.00 per share to the Company s shareholders. Company C s proposal indicated it would negotiate with BMO regarding the terms of the Amended Securitization Facility but did not indicate the amount of Patriot s obligations to be repaid under the facility. Company C would also need to obtain shareholder approval to complete the transaction, although it had very few shareholders, so this was not deemed to be a negative point. Company C did not submit a mark-up of the proposed transaction agreement, as had been requested by Patriot as part of the evaluation process.

The board considered the fact that Company C was offering cash instead of common stock but felt that the offer price per share undervalued Patriot s assets and was not in the best interests of its shareholders. In addition, the lack of commitment to pay down Patriot s obligations under the Amended Securitization Facility was a negative factor that greatly disadvantaged this proposal as compared to the proposal from Prospect, since the board viewed it as unlikely that BMO would consent to such transaction.

Company D, a private commercial finance company, offered cash in the amount of $2.20 per share to Patriot s shareholders or, alternatively, an aggregate of approximately $46 million to purchase Patriot s assets. Company D s proposal indicated it would pay down Patriot s obligations under the Amended Securitization Facility with no financing necessary. Company D would not need to obtain shareholder approval to complete the transaction, but would need to obtain approval from its investment committee. Company D did not submit a mark-up of the proposed transaction agreement, as had been requested by Patriot as part of the evaluation process.

The board considered the fact that Company D was offering cash instead of common stock but felt that the offer price per share, which was lower than that offered by Company C, Company B and Prospect, undervalued Patriot s assets and was not in the best interests of its shareholders. The offer to pay down Patriot s obligations under the Amended Securitization Facility and the fact that Company D would not require shareholder approval were considered to be positive factors but did not outweigh the low offer price. As a result, the board deemed this offer to be less attractive than the proposal from Prospect.

Company E, a private hedge fund, offered to purchase Patriot s assets for $155 million of cash, with the proceeds of the purchase price to be used to pay down obligations under the Amended Securitization Facility. The balance of the purchase price after repayment of Patriot s obligations represented approximately $2.02 per share on a pro forma basis based on estimates as of August 3, 2009. Company E also agreed to fund the purchase of Patriot s assets with existing capital. Company E would not need to obtain shareholder approval to complete the transaction, but would need approval from its investment committee. Company E did not submit a mark-up of the proposed transaction agreement, as had been requested by Patriot as part of the evaluation process.

The board considered the fact that Company E was offering cash instead of common stock but felt that the offer price per share, which was lower than that offered by Company C, Company D, Company B and Prospect, undervalued Patriot s assets and was not in the best interests of its shareholders. The ability to use the proceeds from the sale of Patriot s assets to pay down Patriot s obligations under the Amended Securitization Facility and the fact that Company E would not require shareholder approval were considered to be positive factors but did not outweigh the low offer price. As a result, the board deemed this offer to be less attractive than the proposal from Prospect.

Company F, a private equity firm, offered to purchase five of Patriot s portfolio companies at 80% of the fair value of the portfolio companies measured as of the last quarterly valuation date. The board determined that this proposal did not address any of the primary factors previously set forth by the board and therefore deemed the offer to be significantly less attractive than the proposal from Prospect. Importantly, other than with the proceeds from the sale of the five portfolio companies, the proposal did not provide for repayment of Patriot s obligations under the Amended Securitization Facility. Company F did not submit a mark-up of the proposed transaction agreement, as had been requested by Patriot as part of the evaluation process.

Company G, a private commercial finance company, offered to provide Patriot with a new credit facility of up to $35 million which would allow Patriot to make new loan originations. In return Company G would receive 1 million warrants and $3 million worth of Patriot common stock based on the recent market price of $1.81 per share. Company G would not require any consents or approvals to complete its proposal. Company G did not submit a mark-up of the proposed transaction agreement, as had been requested by Patriot as part of the evaluation process.

The board considered Company G s proposal but determined that the proposal did not address any of the primary factors previously set forth by the board and therefore deemed the offer to be significantly less attractive than the proposal from Prospect. Importantly, the proposal did not provide for repayment of Patriot s obligations under the Amended Securitization Facility.

After considering the various proposals from the bidders noted above, the board discussed the merger agreement counterproposals made by Prospect including, among other things, two items that were being negotiated, the non-solicitation provision and the amount of break-up fees. The non-solicitation provision set forth limitations on the board s ability to seek offers from competing bidders. The board proposed alternative terms and asked to receive an update at its next meeting.

On July 31, 2009, the Patriot board of directors held a special meeting attended by the entire board as well as members of management of Patriot, representatives of FBR and representatives of Sutherland. The purpose of the meeting was to review the progress of negotiations with Prospect and discuss other bids, if any, that had been received. FBR informed the board that Patriot had received one additional bid from Company H. Company H offered to make an equity investment in Patriot which would allow Patriot to make a $50 million repayment of its obligations under the Amended Securitization Facility. Company H s ownership in Patriot would be approximately 51%. The board considered the merits of the proposal but decided that the proposal was less attractive than the proposal from Prospect.

The board then considered updates regarding negotiations with Prospect and ongoing discussions regarding the non-solicitation and related provisions. In light of the extensive evaluation process that had been conducted, Prospect took the position that a lock-up provision, coupled with a high termination fee if Prospect terminated in certain circumstances, were warranted to protect the substantial investment of, and value offered by, Prospect. The then current draft of the merger agreement, as proposed by Patriot, contained a provision permitting the board to consider and accept a proposal superior to Prospect s proposal, subject to meeting the conditions set forth therein. After considering the advice of counsel, the board further discussed this provision and its fiduciary duties under Delaware law in the context of the proposed transaction.

The board asked and was informed that no counter-proposals had been received from any of the other bidders, including Company B.

On August 2, 2009, the Patriot board of directors held two special meetings attended by the entire board as well as members of management of Patriot, representatives of FBR and representatives of Sutherland, to discuss the status of negotiations with Prospect. The board was informed that Prospect would agree to a termination fee of $3.2 million or approximately 4% of the equity consideration in the merger if Patriot were to terminate the proposed transaction in certain circumstances. In addition, Prospect would agree to a provision allowing the board to negotiate with, and accept an alternative proposal from, a third party so long as certain conditions were satisfied. In light of Prospect s insistence on the breakup fee as a condition to the merger, and the potential benefits of the transaction, and after consultation with its legal and financial advisors, the board determined to agree to the proposed termination fee. The board then had extensive discussions relating to the no solicitation provision in the merger agreement that restricted the board s ability to solicit alternative offers attractive to Patriot s shareholders. Specifically, the board considered the requirement that only fully funded superior proposals containing no material conditions to closing more burdensome than those included in the merger agreement allowed the board to exercise its fiduciary duties under Delaware law in the context of the proposed transaction. In light of the attractiveness of the terms of the offer from Prospect, the limited alternatives that Patriot had, Patriot s financial condition and lack of liquidity and the unwillingness of Prospect to compromise further on these issues, the board authorized Patriot s officers and counsel to accept this provision in order to be able to complete the proposed transaction. The board was advised that Prospect wanted to sign the merger agreement as soon as possible.

At approximately 7:30 a.m. on August 3, 2009, the Patriot board of directors held a special meeting attended by the entire board as well as members of management of Patriot, representatives of FBR and representatives of Sutherland, to consider the form of merger agreement pursuant to which Patriot would merge with Prospect. Representatives of Sutherland then reviewed the proposed form of merger agreement. Following a discussion of the proposed form of merger agreement during which representatives of Sutherland responded to numerous questions from members of the board, the board requested that FBR review and discuss its financial analyses of Prospect and the proposed merger. Following further discussion during which representatives of FBR responded to questions from members of the board regarding FBR s financial analyses, FBR, at the request of the board, rendered its oral opinion as of August 3, 2009 to the board of directors of Patriot (which was subsequently confirmed in writing by delivery of FBR s written opinion dated the same date) with respect to the fairness, from a financial point of view, to the holders of Patriot common stock of the exchange ratio set forth in the merger agreement.

On the morning of August 3, 2009, the board, given the thorough and exhaustive evaluation process conducted, the lack of counterproposals from other parties, the risks posed by the termination event that occurred under the Amended Securitization Facility, the substantial premium to Patriot s shareholders offered by Prospect s proposal, and the certainty and expediency that a transaction with Prospect provided, declared the merger agreement advisable and in the best interests of Patriot and its shareholders, approved and adopted the merger agreement, and authorized Mr. Buckanavage to sign the merger agreement with Prospect. Subsequent to the execution of the merger agreement by Patriot and Prospect, Prospect issued a press release publicly announcing the signing of the merger agreement with

Patriot.

Subsequent to entering into the merger agreement, Patriot received an unsolicited letter from Company B that referenced the final proposal it had previously submitted to Patriot and then expressed a willingness to further discuss its proposal. The Patriot board of directors held a meeting to consider the letter and determined that there was no further action required with respect to the letter as a result of the vagueness of the letter, the continuing deficiencies in Company B s final proposal and consistent with the terms of the merger agreement.

Reasons for the Merger

In light of the unprecedented instability in the financial markets and the severe slowdown in the overall economy, Patriot does not have adequate liquidity, including access to the debt and equity capital markets, to operate its business. In this regard, on April 3, 2009, a termination event occurred under the Amended Securitization Facility due to the amount of Patriot s advances outstanding under the facility exceeding the maximum availability under the facility for more than three consecutive business days. Among other things, the terms of the facility require that all principal, interest and fees collected from the debt investments securing the facility must be used to pay down amounts outstanding thereunder until all such amounts have been repaid, which may be no later than the date that is 24 months following the date of the termination event. Substantially all of Patriot s debt investments are securing the Amended Securitization Facility. The facility also permits the lenders, upon notice to Patriot, to accelerate amounts outstanding under the facility and exercise other rights and remedies provided by the facility, including the right to sell the collateral under the facility.

Moreover, Patriot s management estimated that Patriot will have used all of its available cash and other liquid assets that are not restricted by the terms of the Amended Securitization Facility by mid-December 2009 or sooner depending on the working capital needs of its portfolio companies. Although Patriot had engaged in active discussions with the Amended Securitization Facility lenders to seek relief from certain terms of the facility, including the requirement under the facility that Patriot use all principal, interest and fees collected from the debt investments secured by the facility to pay down amounts outstanding under the facility by April 3, 2011, it had been unable to obtain relief from any terms of the facility. In light of the foregoing, Patriot began to evaluate other financing and/or strategic alternatives, including possible debt or equity financing, acquisition or disposition of assets, and other strategic transactions.

In evaluating the merger proposal from Prospect, Patriot s board of directors considered numerous factors, including the ones described below, and, as a result, determined that the proposed merger was in Patriot s best interests and the best interests of Patriot s shareholders. The following discussion of the information and factors considered by Patriot s board of directors, including its independent directors, is not intended to be exhaustive, but includes all material factors considered by Patriot s board of directors in evaluating the Prospect merger proposal.

Lack of Liquidity; Potential Impact on Tax Status. Since Patriot can no longer borrow amounts under the Amended Securitization Facility, and because all principal, interest and fees collected from the debt investments secured by the facility must be used to repay amounts outstanding under the facility, Patriot has limited liquidity and no potential sources of free cash flow. Thus, there is no assurance that Patriot will have sufficient cash and liquid assets to fund its operations and dividend distributions to its shareholders, which failure could, among other things, result in adverse tax consequences, including possible failure to qualify as a regulated investment company, or RIC, under Subchapter M of the Code. In addition, without a strategic transaction, Patriot would likely be required to seek bankruptcy protection in the relatively near future.

Potential Actions by Patriot s Lenders. Substantially all of Patriot s debt investments are secured under the Amended Securitization Facility. As a result of the occurrence of a termination event under the Amended Securitization Facility, the lenders may, upon notice to Patriot, accelerate amounts outstanding under the facility and exercise other rights and remedies provided by the facility, including the right to sell the collateral under the facility. In such event, the Patriot board of directors is concerned that such forced sales of assets, particularly in the current economic environment, may be done at fire sale prices, thereby diminishing or potentially eliminating the amount of cash available to distribute to shareholders.

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Thorough Review of Strategic Alternatives. Patriot engaged in a thorough review of the strategic alternatives available to Patriot, including, among other things, negotiations with its lenders under the Amended Securitization Facility, conversion to a bank holding company, the formation of a Small Business Investment Company subsidiary, a stock or cash merger, a significant equity investment, a refinancing of Patriot s debt, a purchase and sale of Patriot s assets, and a bankruptcy filing. In furtherance of the evaluation and proposal solicitation process, Patriot publicly announced that it was actively evaluating strategic alternatives (thereby putting potential strategic partners on notice that Patriot was open to discussing such alternatives with interested parties), and, at Patriot s request, Patriot s financial advisor, FBR, had contacted 133 potential strategic partners, including business development companies, commercial finance companies, banks, private equity funds, hedge funds and other potential strategic partners, to assess whether they might be interested in pursuing a strategic transaction with Patriot. Of the 133 potential strategic partners contacted, 51 executed non-disclosure agreements with Patriot and received confidential information concerning Patriot s business, management, assets, liabilities, financial condition and results of operations. Of those 51 potential strategic partners, 22 submitted preliminary indications of interest, and 12 were invited to perform in-depth due diligence and submit final bids, eight of which submitted final bids. Based on this lengthy and thorough process, Patriot s board of directors believes it has explored all alternatives reasonably available to Patriot.

Best Alternative Reasonably Available to Patriot. Because Patriot had publicly announced that it was actively evaluating strategic alternatives, and had contacted such a large number of potential strategic partners to determine their level of interest in a strategic transaction involving Patriot, the Patriot board of directors strongly believes that, of all possible alternatives, and based on the proposed transactions submitted by potential strategic partners, the transaction with Prospect represents the best alternative that is reasonably available to Patriot. In making this determination, the Patriot board of directors considered:

the existing termination event under the Amended Securitization Facility;

the current financial condition of Patriot, particularly the liquidity needed to fund its operations and, potentially, to make required distributions to shareholders;

the distinct possibility that Patriot will run out of available cash in the near future;

the current trading price of Patriot s common stock;

the lack of progress in negotiations with the lenders under the Amended Securitization Facility;

the other alternatives reasonably available to Patriot;

the terms of the other proposals submitted, including the proposed economic terms, the conditions to closing, the expected timing of such transactions, and the likelihood of consummation;

the financial terms of the Prospect proposal, including the proposed exchange ratio and Prospect s ability and agreement to repay the full amount of principal and interest outstanding under the Amended Securitization Facility;

the tax-free nature of the merger;

the fact that although the implied value of the merger consideration of $4.00 proposed for each share of Patriot common stock represented a discount to Patriot s net asset value for the quarter ended March 31, 2009 and the anticipated net asset value for the quarter ended June 30, 2009, which was based on information available to the board at the time (which value was later confirmed), such discount was generally comparable to the discount to net asset value at which many other business development companies traded;

the fact that Patriot shareholders are not being cashed out and will continue as shareholders in the combined operations of Patriot and Prospect;

the business and legal due diligence review conducted on Prospect by Patriot and its legal and financial advisors;

the financial strength of Prospect;

the lack of a financing contingency to closing in the Prospect proposal; and

the fact that no shareholder approval of Prospect s shareholders would be required.

Business Prospects of Patriot. As noted above, the unprecedented economic conditions that faced companies in the financial services industry, coupled with the termination event under the Amended Securitization Facility, has made it impossible for Patriot to operate its business consistent with past practice. The proposed strategic combination with Prospect will eliminate the uncertainty created by the termination event under the Amended Securitization Facility, and will allow Patriot shareholders to participate in the combined operations of Patriot and Prospect following the merger.

Strategic and Business Considerations. Because the Patriot shareholders will be shareholders in Prospect following the merger, Patriot shareholders stand to participate in the future growth and prospects of the combined businesses of Patriot and Prospect, without the limitations currently restricting the operations of Patriot. Prospect is an established company with a strong capital position and performance history. The larger equity market capitalization of the combined companies should help create earnings stability and assist Prospect in its efforts to raise capital in the public equity and debt markets.

Terms of the Merger Agreement. The exchange ratio of 0.3992 shares of Prospect common stock to be received in exchange for each share of Patriot common stock, which is subject to certain adjustments, represents a 105% premium to the closing price of Patriot common stock on July 31, 2009, based on the closing price of Prospect common stock on that date (which was the last trading day before public announcement of the merger). In addition, this represented a 127% premium to the volume weighted average price of Patriot s common stock during the six months ended June 30, 2009, based on the closing price of Prospect common stock on July 31, 2009.

Opinion of Financial Advisor. The financial analysis reviewed and discussed with the board of directors of Patriot by representatives of FBR as well as the oral opinion of FBR rendered to the board of directors of Patriot on August 3, 2009 (which was subsequently confirmed in writing by delivery of FBR s written opinion dated the same date) with respect to the fairness, from a financial point of view, to the holders of Patriot common stock of the exchange ratio set forth in the merger agreement. See The Merger Proposal Opinion of Patriot s Financial Advisor.

Tax Free Treatment of Proposed Merger. The proposed merger is expected to be treated as a tax-free reorganization under Section 368(a) of the Code. If the transaction so qualifies, Patriot s shareholders generally will not recognize gain or loss to the extent that they receive shares of Prospect common stock in exchange for their shares of Patriot common stock. See U.S. Federal Income Tax Consequences of the Merger.

Repayment of Amended Securitization Facility. As part of the merger agreement, Prospect will repay (i) all principal and interest due under the Amended Securitization Facility, which amounted to $115.7 million as of August 3, 2009, and (ii) up to $1.35 million in other costs, fees and expenses payable to the lenders under the terms of the Amended Securitization Facility.

Patriot s board of directors considered the following negative factors relating to the merger:

Market Price. There is uncertainty regarding how the transaction will affect the trading in Prospect s common shares before the completion of the merger which may affect the value of the merger consideration to be paid to Patriot shareholders. As a result, the implied market value of the per share merger consideration could decrease prior to the closing of the proposed merger if the market price of Prospect s common stock decreases.

Net Asset Value. The net asset value per share of Patriot s common stock, as of June 30, 2009, was $7.66, an amount higher than the implied market value of the merger consideration.

Restrictions on Ability to Solicit Alternative Offers. The restrictive non-solicitation provisions contained in the merger agreement prohibit Patriot from soliciting alternative offers from third parties, and permit Patriot to consider bona fide alternative proposals from third parties only in certain limited circumstances. While these limitations ensure that only someone who is committed to making a superior proposal will attempt to re-open the evaluation process, these limitations may discourage third parties from making superior offers to acquire Patriot because of the increased price that such third party would have to pay.

Lack of Dissenters Rights. There are no dissenters rights applicable to the proposed merger.

Combined Company May Not Succeed. Certain of Patriot s shareholders may view the combined company as a different and less desirable investment vehicle for their capital, and sales of shares by such shareholders could depress the share price of Patriot s common stock. In addition, there can be no assurance that the combined company will succeed.

Patriot s board of directors also considered the following material factors relating to the proposed merger:

the review and analysis of each of Patriot s and Prospect s business, financial condition, earnings, risks and prospects;

the historical market prices and trading information with respect to the common stock of Patriot and Prospect;

the values and prospects of the portfolio company investments held by Patriot and Prospect;

the comparisons of historical financial measures for Patriot and Prospect, including earnings, return on capital and cash flow, and comparisons of historical operational measures; and

the current industry, economic and market conditions and how such conditions are expected to impact Patriot s and Prospect s ability to conduct their operations.

This discussion of the information and factors that Patriot s board of directors considered in making its decision is not intended to be exhaustive but includes all material factors considered by Patriot s board of directors. In view of the wide variety of factors considered in connection with its evaluation of the transaction and the complexity of those matters, Patriot s board of directors did not find it useful to, and did not attempt to, quantify, rank or otherwise assign relative weights to these factors. In addition, the individual members of Patriot s board of directors may have given different weights to different factors.

Patriot s board of directors believes that, overall, the positive factors of the transaction to Patriot and its shareholders substantially outweigh the risks related to the proposed merger, and, therefore, unanimously approved the merger agreement.

Recommendation of the Board of Directors

After careful consideration of the information and factors noted above, Patriot s board of directors, including its independent directors, concluded that the proposed merger is advisable and in the best interest of its shareholders and unanimously recommends that shareholders vote FOR approval of the merger agreement.

Opinion of Patriot s Financial Advisor

On August 3, 2009, FBR rendered its oral opinion to Patriot s board of directors (which was subsequently confirmed in writing by delivery of FBR s written opinion dated the same date) to the effect that, as of August 3, 2009, the exchange ratio set forth in the merger agreement was fair, from a financial point of view, to the holders of Patriot common stock.

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FBR s opinion was directed to Patriot s board of directors, and only addressed the fairness, from a financial point of view, to the holders of Patriot common stock of the exchange ratio set forth in the merger agreement, and did not address any other aspect or implication of the merger. The summary of FBR s opinion in this proxy statement/prospectus is qualified in its entirety by reference to the full text of its written opinion, which is included as Annex B to this proxy statement/prospectus and sets forth the procedures followed, assumptions made, qualifications and limitations on the review undertaken and other matters considered by FBR in preparing its opinion. However, neither FBR s written opinion nor the summary of its opinion and the related analyses set forth in this proxy statement/prospectus are intended to be, and they do not constitute, advice or a recommendation to any holder of Patriot common stock as to how such holder should vote or act with respect to any matter relating to the merger.

In arriving at its opinion, FBR:

reviewed a draft, dated August 3, 2009, of the Agreement and Plan of Merger by and between Patriot Capital Funding, Inc. and Prospect Capital Corporation;

reviewed certain financial statements of Patriot and Prospect and certain other business, financial and operating information relating to Patriot and Prospect provided to FBR by the managements of Patriot and Prospect;

reviewed certain publicly available business and financial information relating to the industries in which Patriot and Prospect operate;

met with certain members of the managements of Patriot and Prospect to discuss the business and prospects of Patriot and Prospect;

reviewed certain business, financial and other information relating to Patriot and Prospect, including financial forecasts for Patriot through December 31, 2009 provided to or discussed with FBR by the management of Patriot;

reviewed certain financial and stock trading data and information for Patriot and Prospect and compared that data and information with corresponding data and information for companies with publicly traded securities that FBR deemed relevant;

reviewed certain financial terms of the proposed merger and compared those terms with the financial terms of certain other business combinations and other transactions which have recently been effected or announced; and

considered such other information, financial studies, analyses and investigations and financial, economic and market criteria that FBR deemed relevant.

In connection with its review, FBR did not independently verify any of the foregoing information and FBR assumed and relied upon such information being complete and accurate in all material respects. With respect to the financial forecasts provided or discussed with FBR by Patriot that FBR used in its analyses, management of Patriot advised FBR, and FBR assumed, that such forecasts were reasonably prepared in good faith on bases reflecting the best currently available estimates and judgments of the management of Patriot as to the future financial performance of Patriot through December 31, 2009 and FBR expressed no view and assumed no responsibility for the assumptions, estimates and judgments on which such forecasts were based. As the board of directors of Patriot was aware, Prospect did not provide FBR with its management s forecasts as to the future financial performance of Prospect. FBR also assumed, with Patriot s consent, that, in the course of obtaining any regulatory or third party consents, approvals or agreements in connection with the merger, no delay, limitation, restriction or condition would be imposed that would have an adverse effect on Patriot, Prospect, or the contemplated benefits of the merger and that the merger would be consummated in accordance with the terms of the merger agreement without waiver, modification or amendment of any material term, condition or agreement thereof. FBR also assumed, with Patriot s consent, that the merger would be treated as a tax-free reorganization for federal income tax purposes and that the merger agreement, when executed by the parties thereto, would conform to the draft reviewed by FBR in all respects material to its analyses. In addition, Patriot advised FBR and for purposes of its analyses and its opinion, FBR assumed that (i) on April 3, 2009, a termination event occurred under Patriot s Amended Securitization Facility with an entity affiliated with BMO Capital Markets Corp. and Branch Banking and Trust Company, (ii) as a result of the occurrence of the termination event under the Amended Securitization Facility, Patriot could no longer make additional advances under the Amended Securitization Facility and all principal, interest and fees collected from the debt investments secured by the facility would have to be used to pay down amounts outstanding under the facility within 24 months following the date of the termination event, (iii) the lenders under the Amended Securitization Facility, upon notice to Patriot could accelerate amounts outstanding under the facility and exercise other rights and remedies provided by the facility, including the right to sell the collateral under the facility, (iv) Patriot was unable to obtain alternative sources of financing to replace the Amended Securitization Facility or otherwise provide access to ongoing liquidity and funding or eliminate the need for such liquidity and funding, and (v) given the nature of Patriot s various businesses, assets and financing arrangements and the expected actions of its counterparties, creditors and employees, if the merger was not consummated Patriot was unlikely to be able to continue to function as a going concern which could reasonably result in a voluntary or involuntary bankruptcy or liquidation of Patriot in which the holders of Patriot common stock would receive little or no value. FBR did not evaluate the solvency or fair value of any party to the merger agreement under any state or federal laws relating to bankruptcy, insolvency or similar matters and do not express any opinion as to the value of any asset of Patriot, whether at current market prices or in the future. FBR noted, however, that, under the ownership of a company with adequate liquidity and capital, such as Prospect, the value of Patriot and its subsidiaries could substantially improve, resulting in significant returns to Prospect if the merger is consummated. Patriot further advised FBR that, as a result of concerns regarding the viability of Patriot as a going concern, Patriot had not prepared, and consequently could not provide FBR with, forecasts as to its future financial performance beyond December 31, 2009.

FBR s opinion addressed only the fairness, from a financial point of view, to the holders of Patriot common stock of the exchange ratio set forth in the merger agreement and did not address any other aspect or implication of the merger or any agreement, arrangement or understanding entered into in connection with the merger or otherwise or the fairness of the amount or nature of, or any other aspect relating to, any compensation to any officers, directors or employees of any party to the merger, or class of such persons, relative to the exchange ratio or otherwise. In addition, FBR did not investigate or otherwise evaluate the potential affects of the merger on the federal, state or other taxes or tax rates payable by Patriot, Prospect or the holders of Patriot common stock or Prospect common stock and, with Patriot s consent, FBR assumed, that such taxes and tax rates would not be affected by or after giving effect to the merger. The issuance of FBR s opinion was approved by an authorized internal committee of FBR.

FBR s opinion was necessarily based upon information made available to it as of the date its opinion and financial, economic, market and other conditions as they existed and could be evaluated on such date. FBR did not express any opinion as to what the value of shares of Prospect common stock actually would be when issued to the holders of Patriot common stock pursuant to the merger or the prices at which shares of Prospect common stock would trade at any time. FBR s opinion did not address the relative merits of the merger as compared to alternative transactions or strategies that might be available to Patriot or any other party to the merger, nor did it address the underlying business decision of the board of directors of Patriot or any other party to the merger to proceed with the merger.

Furthermore, in connection with its opinion, FBR was not requested to make, and did not make, any physical inspection or independent appraisal or evaluation of any of the assets, properties or liabilities (contingent or otherwise) of Patriot, Prospect or any other party, nor was FBR provided with any such appraisal or evaluation. FBR did not estimate, and expressed no opinion regarding, the liquidation value of any entity.

FBR s opinion was provided for the information of Patriot s board of directors in connection with its consideration of the merger and FBR s opinion should not be construed as creating any fiduciary duty on the part of FBR to Patriot, Patriot s board of directors, any security holder of Patriot or any other party. FBR s opinion does not constitute advice or a recommendation to any investor or security holder of Patriot or any other person as to how such investor, security holder or other person should vote or act on any matter relating to the proposed merger or otherwise.

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In preparing its opinion to Patriot s board of directors, FBR performed a variety of analyses, including those described below. The summary of FBR s valuation analyses is not a complete description of the analyses underlying FBR s opinion. The preparation of a fairness opinion is a complex process involving various quantitative and qualitative judgments and determinations with respect to the financial, comparative and other analytic methods employed and the adaptation and application of those methods to the unique facts and circumstances presented. As a consequence, neither FBR s opinion nor the analyses underlying its opinion are readily susceptible to partial analysis or summary description. FBR arrived at its opinion based on the results of all analyses undertaken by it and assessed as a whole and did not draw, in isolation, conclusions from or with regard to any individual analysis, analytic method or factor. Accordingly, FBR believes that its analyses must be considered as a whole and that selecting portions of its analyses, analytic methods and factors, without considering all analyses and factors or the narrative description of the analyses, could create a misleading or incomplete view of the processes underlying its analyses and opinion.

In performing its analyses, FBR considered business, economic, industry and market conditions, financial and otherwise, and other matters as they existed on, and could be evaluated as of, the date of its opinion. No company or business used in FBR s analyses for comparative purposes is identical to Patriot, Prospect or the proposed transaction. While the results of each analysis were taken into account in reaching its overall conclusion with respect to fairness, FBR did not make separate or quantifiable judgments regarding individual analyses. The implied valuation metrics indicated by FBR s analyses are illustrative and not necessarily indicative of actual values nor predictive of future results or values, which may be significantly more or less favorable than those suggested by the analyses. In addition, any analyses relating to the value of assets, businesses or securities do not purport to be appraisals or to reflect the prices at which businesses or securities actually may be sold, which may depend on a variety of factors, many of which are beyond Patriot s control and the control of FBR. Much of the information used in, and accordingly the results of, FBR s analyses are inherently subject to substantial uncertainty.

FBR s opinion and analyses were provided to Patriot s board of directors in connection with its consideration of the proposed merger and were among many factors considered by Patriot s board of directors in evaluating the proposed merger. Neither FBR s opinion nor its analyses were determinative of the exchange ratio or of the views of Patriot s board of directors with respect to the proposed merger.

The following is a summary of the material valuation analyses performed in connection with the preparation of FBR s opinion rendered to Patriot s board of directors on August 3, 2009. The analyses summarized below include information presented in tabular format. The tables alone do not constitute a complete description of the analyses. Considering the data in the tables below without considering the full narrative description of the analyses, as well as the methodologies underlying and the assumptions, qualifications and limitations affecting each analysis, could create a misleading or incomplete view of FBR s analyses.

For purposes of its analyses, FBR reviewed a number of financial metrics including:

Enterprise Value generally the value as of a specified date of the relevant company s outstanding equity securities (taking into account its restricted units, outstanding options, warrants and other convertible securities) plus the value of its minority interests plus the amount of its net debt (the amount of its outstanding indebtedness, preferred stock and capital lease obligations less the amount of cash on its balance sheet) as of a specified date.

Unless the context indicates otherwise, common stock prices for the selected companies used in the Selected Companies Analysis described below were as of July 31, 2009, the final trading day prior to FBR rendering its opinion to the Board of Directors of Patriot.

Selected Companies Analysis. FBR considered certain financial data for Patriot and Prospect and selected internally-managed and externally-managed business development companies with publicly traded equity securities.

The financial data included:

- Stock Price as a multiple of Net Asset Value per Share; and
- Enterprise Value as a multiple of Total Assets.

The selected companies were selected because they had publicly traded equity securities and were deemed to be similar to Patriot and Prospect in one or more respects including the nature of their business, size, diversification, financial performance and geographic concentration. No specific numeric or other similar criteria were used to select the selected companies and all criteria were evaluated in their entirety without application of definitive qualifications or limitations to individual criteria. As a result, a significantly larger or smaller company with substantially similar lines of businesses and business focus may have been included while a similarly sized company with less similar lines of business and greater diversification may have been excluded. FBR identified a sufficient number of companies for purposes of its analysis but may not have included all companies that might be deemed comparable to Patriot and Prospect, respectively. The selected internally-managed business development companies were:

American Capital, Ltd.
Allied Capital Corporation
MCG Capital Corporation
Main Street Capital Corporation
Kohlberg Capital Corporation
Triangle Capital Corporation of Maryland

FBR noted the following multiples for the selected internally-managed business development companies as of July 31, 2009 and compared those multiples to the implied multiples for the merger based on the closing price of Prospect common stock on July 31, 2009:

	Selected Internally Managed Business Development Companies		**Implied Transaction**
Multiple Description	**Mean**	**Median**	**Multiple**
Stock Price as a multiple of Net Asset Value per Share	0.63x	0.52x	0.54x
Enterprise Value as a multiple of Assets	0.82x	0.76x	0.67x

The selected externally-managed business development companies were:

Apollo Investment Corporation
Ares Capital Corporation
BlackRock Kelso Capital Corporation
Fifth Street Finance Corp.
MVC Capital, Inc.
Gladstone Capital Corporation
PennantPark Investment Corporation
GSC Investment Corp.

FBR noted the following multiples for the selected externally-managed business development companies as of July 31, 2009 and compared those multiples to the implied multiples for the merger based on the closing price of Prospect common stock on July 31, 2009:

Multiple Description	Selected Externally Managed Business Development Companies Mean	Selected Externally Managed Business Development Companies Median	Implied Transaction Multiple
Stock Price as a multiple of Net Asset Value per Share	0.72x	0.77x	0.54x
Enterprise Value as a multiple of Assets	0.75x	0.82x	0.67x

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Contribution Analysis

FBR also noted the relative contributions of Patriot and Prospect to the pro forma combined entity resulting from the merger of certain financial and operating metrics and compared those contributions to the 15.2% of the pro forma combined entity that would be owned by the former holders of Patriot common stock after giving effect to the merger and the 84.8% of the pro forma combined entity that would be owned by the pre merger holders of Prospect common stock after giving effect to the merger:

	Patriot	**Prospect**
Equity Market Capitalization (as of July 31, 2009)	7.2%	92.8%
LTM Revenues	26.8%	73.2%
LTM Net Investment Income	24.9%	75.1%
LTM Net Income/Loss	NM	NM
LTM Total Assets	33.4%	66.6%
LTM Enterprise Value	33.0%	67.0%
LTM Net Asset Value	21.6%	78.4%
Investments at Cost (as reflected on Patriot s financial statements):		
3/31/09	38.0%	62.0%
12/31/08	39.0%	61.0%
9/30/08	38.8%	61.2%
6/30/08	40.6%	59.4%
Investments at Fair Value (as reflected on Patriot s financial statements):		
3/31/09	35.0%	65.0%
12/31/08	36.7%	63.3%
9/30/08	37.6%	62.4%
6/30/08	39.3%	60.7%

* NM denotes not meaningful

Other Considerations

Historical Exchange Ratios

FBR also noted the following historical exchange ratios based on the closing market prices of Prospect common stock and Patriot common stock and compared those historical exchange ratios to the exchange ratio provided for in the merger of 0.3992 of a share of Prospect common stock per share of Patriot common stock:

	Historical Exchange Ratios
Current (as of July 31, 2009)	0.1945
Last 3-Months Average	0.1930
2009 High	0.3151
2009 Low	0.1534
2009 Average	0.2191
High Since Patriot IPO	1.2577

Low Since Patriot IPO	0.1534
Average Since Patriot IPO	0.6735

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Historical Stock Trading Range

FBR also noted the following historical stock trading range information for Patriot common stock as of July 31, 2009:

	Past Three Months	Past Six Months	Last Twelve Months
Volume Weighted Average Price	$ 1.71	$ 1.76	$ 3.16
Total Volume Traded	11,537,477	16,731,613	30,779,318
Average Daily Volume	174,810	130,716	120,703
Shares Traded as a % of Shares Outstanding	55.1%	79.9%	146.9%

Premiums Paid Analysis

FBR also noted the implied premium reflected by the exchange ratio in the merger based on the closing price of Prospect common stock on July 31, 2009 relative to the following historical trading prices of Patriot common stock as of July 31, 2009:

	Premium
Current Price (as of July 31, 2009)	105.1%
30-Day Volume Weighted Average Price	146.4%
60-Day Volume Weighted Average Price	117.9%
52-Week High	(49.0)%
52-Week Low	354.5%

Other Matters

Pursuant to an engagement letter dated April 24, 2009, Patriot retained FBR as its financial advisor in connection with, among other things, the proposed merger. Patriot engaged FBR based on FBR s qualifications, experience and reputation as an internationally recognized investment banking and financial advisory firm. FBR will receive a fee for its services, a significant portion of which is contingent upon the consummation of the merger. FBR also became entitled to receive a fee upon the rendering of its opinion which is creditable against the fee payable upon the consummation of the merger. In addition, Patriot has agreed to indemnify FBR and certain related parties for certain liabilities and other items arising out of or related to its engagement. In addition, FBR and its affiliates may in the future provide financial advice and services to Patriot, Prospect and certain of their respective affiliates for which FBR and its affiliates would also expect to receive compensation. FBR is a full service securities firm engaged in securities trading and brokerage activities as well as providing investment banking and other financial services. In the ordinary course of business, FBR and its affiliates may acquire, hold or sell, for FBR and its affiliates own accounts and the accounts of customers, equity, debt and other securities and financial instruments (including bank loans and other obligations) of Patriot, Prospect and any other company that may be involved in the merger, as well as provide investment banking and other financial services to such companies.

Dividends and Distributions

In order to maintain Patriot s qualification as a RIC for U.S. federal income tax purposes, Patriot generally must distribute to its shareholders annually at least 90% of its investment company taxable income, which is generally its net ordinary income plus the excess, if any, of realized net short-term capital gains over realized net long-term capital losses. Prior to the closing date of the merger, Patriot will declare to the extent necessary a dividend to its shareholders, which together with all Patriot s previous dividends, will have the effect of distributing to Patriot s stockholders all of its investment company taxable income (computed without regard to the deduction for dividends paid) and net capital gains, if any, through the closing date of the merger and thus satisfy the annual RIC distribution requirements for the taxable year ending on the closing date of the merger. The final dividend may be made part in cash and part in common stock in accordance with a recent IRS revenue procedure. Shareholders will be required to include the full amount of any final dividend, whether

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paid entirely in cash or in a mixture of cash and common stock, as ordinary income (or long-term capital gain to the extent such final dividend is properly designated as a capital gain dividend) and the amount of U.S. federal income tax that each shareholder is required to pay with respect to such dividends that may exceed the cash received. If Patriot does not pay the final dividend prior to the closing date of the merger, then Prospect will pay the final dividend after the closing date of the merger. Shareholders are strongly urged to consult their own tax advisors in this regard.

See Risk Factors Risks Related to Prospect Prospect may in the future choose to pay dividends in its own stock, in which case you may be required to pay tax in excess of the cash you receive and Risk Factors Risks Related to Patriot Patriot may in the future choose to pay dividends in its own stock, in which case you may be required to pay tax in excess of the cash you receive.

Litigation Relating to the Merger

On August 4, 2009, Bruce Belodoff filed a putative class action complaint against Patriot, Patriot s directors and certain of Patriot s officers in the Stamford Superior Court of the State of Connecticut. The lawsuit alleges that the proposed merger between Patriot and Prospect is the product of a flawed sales process and that Patriot s directors and officers breached their fiduciary duty by agreeing to a structure that was not designed to maximize the value of Patriot s shares. In addition, the lawsuit asserts that Patriot aided and abetted its officers and directors breach of fiduciary duty.

On August 5, 2009, Brian Killion filed a putative class action complaint against Patriot, its directors and certain of its officers and Prospect in the Bridgeport Superior Court of the State of Connecticut. The lawsuit alleges that the consideration to be paid in the proposed merger between Patriot and Prospect is unfair and is the result of an unfair process. The lawsuit further alleges that Patriot s directors and officers breached their fiduciary duty by agreeing to a structure that is designed to deter higher offers from other bidders and for failing to obtain the highest and best price for Patriot s stockholders. In addition, the lawsuit asserts that Patriot and Prospect aided and abetted its officers and directors breach of fiduciary duty.

On August 11, 2009, Thomas Webster filed a putative class action lawsuit against Patriot, its directors and certain of its officers in the Superior Court of the State of Connecticut. This lawsuit is essentially identical to the class action lawsuit filed by Bruce Belodoff against Patriot on August 4, 2009, which is described above, and was filed by the same law firm that filed such lawsuit.

All three complaints seek to enjoin consummation of the merger or, in the event that the merger has been consummated prior to the entry of a judgment, to rescind the transaction and/or award rescissory damages.

At this time, Patriot is unable to determine whether an unfavorable outcome from these claims is probable or remote or to estimate the amount or range of potential loss, if any. However, Patriot believes that these claims are without merit and intends to vigorously defend against them.

Interests of Patriot s Directors and Executive Officers in the Merger

In considering the recommendation of the board of directors, Patriot s shareholders should be aware that certain of Patriot s directors and executive officers have interests in the transaction that are different from, and/or in addition to, the interests of Patriot s shareholders generally. The Patriot board of directors was aware of these potential conflicts of interest and considered them, among other matters, in evaluating and negotiating the merger agreement and the merger, and in reaching its decisions to approve the merger agreement and to recommend that the shareholders vote in favor of adopting the merger agreement.

Treatment of Stock Options

As of August 3, 2009, there were approximately 2,861,177 shares of Patriot common stock issuable pursuant to stock options granted under the Patriot Stock Option Plan to current executive officers, including both vested and unvested options. Pursuant to the terms of the Patriot Stock Option Plan, all outstanding stock options become fully vested upon a change in control. The completion of the proposed merger would be a change in control for this purpose. Thus, in accordance with the terms of the Stock Option Plan and the

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proposed merger agreement, each outstanding option held by an executive officer as of the completion of the merger will become fully vested (to the extent not already vested) and will be cancelled and exchanged for a cash payment equal to the number of shares of Patriot common stock underlying the option multiplied by $0.01, less any applicable taxes required to be withheld.

The following table identifies, for each person who was an executive officer of Patriot as of August 3, 2009, the aggregate number of shares of Patriot common stock subject to outstanding vested and unvested options as of such date, and the cash to be paid in exchange for such options in connection with the merger (without reduction for taxes required to be withheld). The information assumes that all such options remain outstanding on the closing date of the merger.

Name	Aggregate Number of Shares Subject to Vested and Unvested Options	Cash Payable in Exchange for Vested and Unvested Options
Executive Officers		
Richard B. Buckanavage	998,187	$ 9,982
William E. Alvarez, Jr.	181,761	$ 1,818
Timothy W. Hassler	983,256	$ 9,833
Matthew R. Colucci	530,512	$ 5,305
Clifford L. Wells	167,461	$ 1,675

Treatment of Restricted Stock

As of August 3, 2009, there were approximately 606,250 shares of restricted stock granted under Patriot s Restricted Stock Plan to Patriot s current executive officers. Pursuant to the terms of the restricted stock agreements under which the restricted stock was granted, and for certain executive officers, the terms of their employment agreements, the restricted stock becomes fully vested upon a change in control. The completion of the proposed merger would be a change in control for this purpose. Thus, in accordance with the restricted stock agreements, the employment agreements and the proposed merger agreement, each outstanding share of restricted stock held by an executive officer as of the completion of the merger will become fully vested. For each such executive officer, a portion of the shares that become vested will be cancelled and exchanged for a cash payment in an amount sufficient to cover all federal, state and local taxes required to be withheld on behalf of the executive officer upon the vesting of the shares. The remaining shares held by each executive officer will participate in the merger on the same basis as other shares of Patriot common stock.

The following table identifies, for each person who was an executive officer of Patriot as of August 3, 2009, the aggregate number of shares of restricted stock held as of August 3, 2009 and the value of such restricted stock that will become fully vested in connection with the merger, assuming a per share value of $4.00. The information assumes that all such shares of restricted stock remain outstanding on the closing date of the merger.

Name	Aggregate Shares of Restricted Stock	Value of Shares of Restricted Stock

Executive Officers		
Richard B. Buckanavage	226,500	$ 906,000
William E. Alvarez, Jr.	42,500	$ 170,000
Timothy W. Hassler	163,500	$ 654,000
Matthew R. Colucci	136,250	$ 545,000
Clifford L. Wells	37,500	$ 150,000

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Employment Agreements and Severance Agreement

Each of the current executive officers of Patriot (other than Mr. Wells) is party to an employment agreement with Patriot that provides for certain severance payments and benefits in the event of termination of the executive officer s employment under certain circumstances, including termination of the executive officer by Patriot or its successor without cause and termination by the executive officer for good reason. Mr. Wells and Patriot have entered into a severance agreement providing for certain severance payments and benefits in the event of his termination of employment by Patriot or its successor without cause or by him for good reason, as further described below. Each executive officer would be required to enter into an agreement with Patriot that provides for a general release of all legal claims that are or may be held by each such executive officer against Patriot in order for such executive officer to receive any severance payments and benefits pursuant to the employment or severance agreements. (Any reference in this description of the employment and severance agreements to Patriot should be read as a reference to Patriot or its successor where applicable to actions or payments after the proposed merger.)

The terms good reason and cause are generally defined in the employment and severance agreements as follows:

> Good reason means that, without the executive officer s written consent, any of the following events occurs: (1) any material change in the duties and responsibilities of the executive that is inconsistent in any material and adverse respect with his position, duties, responsibilities or status with Patriot; (2) a material and adverse change in the executive s titles or offices with Patriot; (3) an adverse change in his bonus opportunity or a reduction in the executive s salary unless Patriot is implementing an overall general salary reduction affecting all employees; (4) any requirement that the executive be relocated more than 35 miles from Patriot s office; or (5) the failure of a purchaser of Patriot or the successor to the obligations of the employment agreement to honor the terms of the employment agreement or, in the case of Mr. Wells, assume the obligations of the severance agreement.
>
> Cause refers to: (1) the executive s willful and continued failure to perform substantially his duties with Patriot after a written demand for substantial performance is delivered by Patriot; (2) the executive s willfully engaging in illegal conduct or gross misconduct which is demonstrably and materially injurious to the Patriot; (3) the executive s ineligibility to serve as an executive officer pursuant to Section 9 of the 1940 Act; or (4) the executive s conviction of a felony or crime of moral turpitude.

To comply with Section 409A of the Internal Revenue Code, to the extent severance payments are to be made in installments under the employment agreements, are deemed to provide a deferral of compensation under Section 409A, and the executive officer is a specified employee (as such term is defined in Section 409A) at the time of his termination, no payments would be provided until six months after the date of separation from service, at which point Patriot would make a lump sum payment of the delayed amounts.

Employment Agreements with Messrs. Buckanavage and Hassler

Pursuant to the employment agreements with Messrs. Buckanavage and Hassler, if either of these executive officers terminates his employment for good reason, or if Patriot terminates his employment without cause, he will be entitled to receive: (1) an amount equal to between one and one and one-half times the sum of his annual base salary in the then current year and the average of (a) his annual bonus plus (b) the value of annual restricted stock awards (Average Annual Bonus) during 2008 and the term of the agreement, paid in monthly installments; (2) an amount equal to a pro rata portion (based on length of service during the year in which the executive officer terminated employment) of his Average Annual Bonus during 2008 and the term of the agreement; (3) his accrued but unpaid base salary, bonuses, reimbursable expenses and benefits; and (4) continued medical and dental insurance for up to one and one-half years after termination. In addition, his options and restricted stock awards shall become fully vested upon termination.

If either executive officer terminates his employment for any reason in the seventh month after a change in control, he will be entitled to receive the amounts and benefits set forth in the immediately preceding

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paragraph. For this purpose, the proposed merger will be a change in control. If within one year following a change in control, the executive officer terminates his employment for good reason (for this purpose only, the term good reason includes only the last three reasons in the definition above), or if Patriot terminates his employment without cause, he will be entitled to receive: (1) an amount equal to three times the sum of his annual base salary in the then current year and his Average Annual Bonus during 2008 and the term of the agreement, paid over three years in monthly installments; (2) an amount equal to a pro rata portion (based on length of service during the year in which the executive officer terminated employment) of his Average Annual Bonus during 2008 and the term of the agreement; (3) his accrued but unpaid base salary, bonuses, reimbursable expenses and benefits; and (4) continued medical and dental insurance for up to three years after termination.

Employment Agreements with Messrs. Alvarez and Colucci

Pursuant to the employment agreements with Messrs. Alvarez and Colucci, if either of these executive officers terminates his employment for good reason, or if Patriot terminates his employment without cause, he will be entitled to receive: (1) an amount equal to the sum of, in the case of Mr. Alvarez, his annual base salary in the then current year and his Average Annual Bonus during the term of his agreement, paid in equal monthly installments, or in the case of Mr. Colucci, one and one-half times the sum of his annual base salary in the then current year and his Average Annual Bonus during the 2008 and term of the agreement, paid in equal monthly installments; (2) an amount equal to a pro rata portion (based on length of service during the year in which the executive officer terminated employment) of his Average Annual Bonus during the term of the agreement (and in 2008 for Mr. Colucci); (3) his accrued but unpaid base salary, bonuses, reimbursable expenses and benefits; and (4) continued medical and dental insurance for up to 12 months after termination for Mr. Alvarez and for up to 18 months after termination for Mr. Colucci. In addition, Mr. Alvarez s options shall become fully vested upon termination and, in the case of Mr. Colucci, his options and restricted stock awards shall become fully vested upon termination. Any restricted shares issued to Mr. Colucci will vest upon the occurrence of a change in control, and the proposed merger would be a change in control for this purpose.

There are two differences in the above definition of good reason under the employment agreements with Messrs. Alvarez and Colucci. For Mr. Alvarez, a relocation provides good reason if it is more than 50 miles from Patriot s offices. For Messrs. Alvarez and Colucci, the failure of the chief executive officer to determine performance objectives for the annual bonus within the first 60 days of the performance period would provide an additional good reason.

Severance Agreement with Mr. Wells

Patriot and Mr. Wells have entered into a severance agreement, pursuant to which if Mr. Wells s employment is terminated by Patriot or its successor without cause or by Mr. Wells for good reason within 30 days before or within six months after a change in control that occurs between July 31, 2009 and January 31, 2010, then Mr. Wells will be entitled to receive his monthly base salary in monthly installments for six months following his termination of employment. For purposes of this severance agreement, the completion of the proposed merger would be a change in control if it occurs during the period specified.

The table below summarizes the maximum termination and change in control amounts that would be payable to Patriot s named executive officers under each of their current employment agreements or severance agreements as if the change in control occurs on September 30, 2009 and employment of each terminates on that date or as otherwise specified in the table. The payments set forth in the table do not include payments in cancellation and exchange for unvested and vested options, which are made pursuant to the merger agreement.

Name	Termination for Good Reason by Executive Officer or We Terminate Employment Other Than for Cause	Termination in Connection with Change in Control Within 30 Days Before or Within Six Months After a Change in Control	Termination by Executive Officer in the Seventh Month After a Change in Control	Termination by Us Within 1 Year of Change in Control Without Cause or by Executive Officer for Good Reason
Richard P. Buckanavage	$ 2,849,389		$ 2,549,673	$ 4,804,417
William E. Alvarez, Jr.(1)	$ 983,360			
Timothy W. Hassler	$ 2,274,718		$ 2,021,353	$ 3,927,312
Matthew R. Colucci	$ 1,872,251			
Clifford L. Wells(1)	$ 117,075	$ 117,075		

(1) The payments to Messrs. Alvarez and Wells set forth in this table do not include payments in satisfaction of restricted stock in the amounts of $170,000 and $150,000, respectively. These payments are made pursuant to the merger agreement.

The foregoing estimates are based on a number of assumptions. Facts and circumstances at the time of any change in control transaction and termination thereafter as well as changes in the applicable executive officer s compensation history preceding such a transaction and/or a qualifying termination thereafter could materially impact the amounts to be paid.

Indemnification and Insurance

Prospect and the surviving corporation have agreed to jointly and severally indemnify, to the greatest extent permitted by law, each of our present and former officers, directors and employees against all expenses, losses and liabilities (and comply with all of Patriot s and its subsidiaries existing obligations to advance funds for expenses) incurred in connection with any claim, action, suit, proceeding or investigation arising out of, relating to, or in connection with, any acts or omission in their capacity as an officer, director or employee occurring on or before the effective time of the merger and against all expenses, losses and liabilities in connection with such persons serving as an officer, director or other fiduciary in any entity if such service was at the request of or for the benefit of the Patriot and its subsidiaries.

The merger agreement requires that Prospect purchase or cause there to be purchased, and that following the effective time of the merger the surviving corporation maintain, a tail policy to the current policy of directors and officers liability insurance maintained on the date hereof by Patriot (the current policy) containing the same coverage and in the same amount as the current policy and with a claims period of at least six years after the closing date with respect to claims arising from facts or events that existed or occurred prior to or at the effective time; provided, however, that in no event shall the surviving corporation be required to expend annually in excess of 300% of the annual premium currently paid by Patriot (the insurance amount) under the current policy; provided, however, that if the premium of such insurance coverage exceeds the insurance amount, Prospect shall be obligated to obtain, and the surviving corporation shall be obligated to maintain, a policy with the greatest coverage available for a cost not exceeding the insurance amount. The tail policy shall be purchased at Patriot s expense unless Patriot is unable to fund the cost for the entire six-year period, in which case Prospect shall fund the balance of the expense.

Continued Benefits

To the extent that any of Patriot s executive officers remain employed by the surviving corporation, they will be entitled to receive compensation and benefits following the merger. See Description of the Merger Agreement Additional Covenants Pending Completion of the Merger.

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DESCRIPTION OF THE MERGER AGREEMENT

The following summary, which includes all of the material terms of the merger agreement, is qualified by reference to the complete text of the merger agreement, which is attached as Annex A to this document and is incorporated by reference in this document.

Structure of the Merger

Subject to the terms and conditions of the merger agreement, Patriot will merge with and into Prospect and the separate corporate existence of Patriot will cease. Prospect will be the surviving entity and will succeed to and assume all of the rights and obligations of Patriot.

Closing; Completion of the Proposed Merger

Subject to the satisfaction of various conditions to closing (including approval by Patriot s shareholders), the completion of the proposed merger, if approved by Patriot s shareholders, will occur no later than the fifth business day after the satisfaction or waiver of the conditions set forth in the merger agreement or at another date or time as may be agreed to by Patriot and Prospect. If the merger agreement is approved at the special meeting, and the other conditions to the closing of the merger are satisfied, the parties expect to complete the merger during the fourth quarter of 2009, but in no event later than December 15, 2009.

Merger Consideration

If the proposed merger is consummated, each share of Patriot common stock will be converted into the right to receive approximately 0.3992 of a share of Prospect common stock. If the number of shares of Prospect common stock increase, decrease, change into or are exchanged for a different number or kind of shares or securities before the merger is completed as a result of a reclassification, stock dividend, stock split, reverse stock split, or other similar change (but excluding as a result of sales of Prospect common stock, sales of Prospect equity-linked securities, and the issuance of Prospect common stock pursuant to the Prospect dividend reinvestment plan or otherwise in lieu of a portion of any cash dividend declared by Prospect), then an appropriate and proportionate adjustment will be made to the number of shares of Prospect common stock into which each share of Patriot common stock will be converted.

Holders of shares of Patriot common stock will not receive any fractional shares of Prospect common stock in the merger. Instead, each Patriot shareholder otherwise entitled to a fractional share interest in Prospect will be paid an amount in cash, rounded to the nearest cent based on a formula set forth in the merger agreement.

In addition, the exchange ratio will be adjusted for any dividend that Patriot may declare prior to closing. In this regard, as a RIC, Patriot generally does not have to pay corporate-level federal income taxes on any net ordinary income or capital gains that it distributes to its stockholders as dividends if it meets certain source-of-income, income distribution and asset diversification requirements. As a result, Patriot will be required to declare, to the extent necessary, a dividend prior to the consummation of the merger in an amount equal to its undistributed investment company taxable income and its net capital gain (if any) in order to preserve this favorable tax treatment. See Management s Discussion and Analysis of Financial Condition and Results of Operations of Patriot Recent Developments and Note 11. Income Taxes and Note 14. Subsequent Events to Patriot s unaudited financial statements for a detailed discussion regarding Patriot s undistributed net ordinary income and capital gains.

The terms of the merger agreement anticipate that any such dividends may be paid out in accordance with a recent revenue procedure issued by the IRS, pursuant to which up to 90% of the total dividend may be paid in shares of common stock and the remainder will be paid in cash. Any such dividend, whether received in cash or common stock (including common stock of Prospect) will be taxable to shareholders as a ordinary income (or capital gains, if such dividends are properly designated as capital gain dividends). See Risk Factors Risks Related to Prospect Prospect may in the future choose to pay dividends in its own stock, in which case you may be required to pay tax in excess of the cash you receive and Risk Factors Risks

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Related to Patriot Patriot may in the future choose to pay dividends in its own stock, in which case you may be required to pay tax in excess of the cash you receive.

If any such dividends are declared by Patriot prior to closing, the exchange ratio will be adjusted as follows:

with respect to the cash portion of any such dividends, the numerator of the exchange ratio will bereduced in an amount equal to the cash dividend per share paid or payable with respect to each share of Patriot s common stock and, as a result, the aggregate number of shares of Prospect common stock to be received by Patriot shareholders in the merger will decrease accordingly; and

with respect to the stock portion of any such dividends, the exchange ratio, after adjustment for any cash dividends as discussed above, will be proportionally adjusted to reflect any such dividends paid or payable in stock and, as a result, the number of shares of Patriot common stock to be issued for each outstanding share of Patriot common stock will be reduced, but the aggregate number of shares of Prospect common stock to be received by Patriot shareholders in the merger will remain unchanged.

After the effective time of the merger, there will be no further registration of transfers on the stock transfer books of Patriot or its transfer agent of Patriot s common stock that was outstanding immediately prior to the effective time of the merger. Upon completion of the proposed merger, the outstanding shares of Patriot s common stock will evidence only the right to receive the merger consideration, and shares of Patriot s common stock will be cancelled and will cease to exist.

Treatment of Patriot Stock Options and Restricted Stock

Each outstanding option to acquire Patriot common stock granted under Patriot s stock option plan will be cancelled in exchange for a cash payment of $0.01 for each share of Patriot common stock for which such option is exercisable.

Restricted shares of Patriot common stock outstanding immediately prior to the effective time of the merger will vest at the effective time and a portion of those shares held by each of Patriot s executive officers and employees will be cancelled in exchange for a cash payment in an amount sufficient to cover the federal, state and local taxes required to be withheld from the executive officer or employee upon the vesting of the shares, with the remaining shares participating in the merger on the same basis as other shares of Patriot common stock.

Prior to the effective time of the merger, Patriot will terminate its stock option and restricted stock plans.

Conversion of Shares; Exchange of Certificates; Book-Entry Shares

The conversion of Patriot common stock into the right to receive the merger consideration will occur automatically at the effective time of the merger. Prior to the completion of the merger, Prospect will select a bank or trust company reasonably acceptable to Patriot to be the exchange agent, who will exchange certificates representing shares of Patriot common stock for the merger consideration upon receipt of an appropriately completed letter of transmittal (discussed below) and perform other duties as explained in the merger agreement.

Shares of Patriot common stock held in the Direct Registration System (DRS) will automatically be converted into whole shares of Patriot common stock in DRS form. An account statement will be mailed to you confirming this automatic conversion.

Shares of Patriot common stock held in the book-entry form will be automatically converted into whole shares of Prospect common stock in book-entry form. An account statement will be mailed to you confirming this automatic conversion.

Letter of Transmittal

As soon as reasonably practicable after completion of the merger, the exchange agent will mail a letter of transmittal to each holder of a Patriot common stock certificate at the effective time of the merger. This mailing will contain instructions on how to surrender Patriot common stock certificates in exchange for statements indicating book-entry ownership of Prospect common stock and a check in the amount of cash to be paid in lieu of fractional shares of Prospect common stock. If a holder of a Patriot common stock certificate makes a special request, however, Prospect will issue to the requesting holder a Prospect stock certificate in lieu of book-entry shares. When you deliver your Patriot stock certificates to the exchange agent along with a properly executed letter of transmittal and any other required documents, your Patriot stock certificates will be cancelled and you will receive statements indicating book-entry ownership of Prospect common stock, or, if requested, stock certificates representing the number of full shares of Prospect common stock to which you are entitled under the merger agreement. You also will receive a cash payment for any fractional shares of Patriot common stock that would have been otherwise issuable to you as a result of the merger.

Holders of Patriot common stock should not submit their Patriot stock certificates for exchange until they receive the transmittal instructions and a form of letter of transmittal from the exchange agent.

If a certificate for Patriot common stock has been lost, stolen or destroyed, the exchange agent will issue the consideration properly payable under the merger agreement upon receipt of appropriate evidence as to that loss, theft or destruction and appropriate and customary indemnification.

After completion of the merger, there will be no further transfers on the stock transfer books of Patriot, except as required to settle trades executed prior to completion of the merger.

Withholding

The exchange agent will be entitled to deduct and withhold from the cash in lieu of fractional shares payable to any Patriot shareholder the amounts it is required to deduct and withhold under any federal, state, local or foreign tax law. If the exchange agent withholds any amounts, these amounts will be treated for all purposes of the merger as having been paid to the shareholders from whom they were withheld.

Dividends and Distributions

Until Patriot common stock certificates are surrendered for exchange, any dividends or other distributions declared after the completion of the merger with respect to Prospect common stock into which shares of Patriot common stock may have been converted will accrue, without interest, but will not be paid. Prospect will pay to former Patriot shareholders any unpaid dividends or other distributions, without interest, only after they have duly surrendered their Patriot stock certificates. In addition, the merger agreement provides that any such unpaid dividends or other distributions will be payable in the form of shares Prospect s common stock in accordance with Prospect s dividend reinvestment plan.

In order to maintain Patriot s qualification as a RIC for U.S. federal income tax purposes, Patriot generally must distribute to its shareholders annually at least 90% of its investment company taxable income, which is generally its net ordinary income plus the excess, if any, of realized net short-term capital gains over realized net long-term capital losses. As a result, Patriot will be required to declare, to the extent necessary, a dividend prior to the consummation of the merger in an amount equal to its undistributed investment company taxable income and net capital gain (if any) in order to preserve this favorable tax treatment and to eliminate its liability for U.S. federal income tax. See Management s Discussion and Analysis of Financial Condition and Results of Operations of Patriot Recent Developments and Note 11. Income Taxes and Note 14. Subsequent Events to Patriot s unaudited financial statements for a detailed discussion regarding Patriot s undistributed net ordinary income and capital gains.

The terms of the merger agreement anticipate that any such dividends may be paid out in accordance with a recent revenue procedure issued by the IRS, pursuant to which up to 90% of the total dividend may be paid in shares of common stock and the remainder will be paid in cash. Any such dividend, whether received in cash or common stock (including common stock of Prospect) will be taxable to shareholders as a ordinary income (or capital gains, if such dividends are properly designated as capital gain dividends). See Risk Factors Risks Related to Prospect Prospect may in the future choose to pay dividends in its own stock, in which case you may be required to pay tax in excess of the cash you receive and Risk Factors Risks Related to Patriot Patriot may in the future choose to pay dividends in its own stock, in which case you may be required to pay tax in excess of the cash you receive.

Representations and Warranties

The merger agreement contains customary representations and warranties of Patriot and Prospect relating to their respective businesses. With the exception of certain representations that must be true and correct in all or virtually all respects, or in all material respects, no representation or warranty will be deemed untrue, inaccurate or incorrect as a consequence of the existence or absence of any fact, circumstance or event unless that fact, circumstance or event, individually or when taken together with all other facts, circumstances or events, has had or would reasonably be expected to have a material adverse effect on the financial condition, results of operations or business of the company making the representation. The representations and warranties in the merger agreement do not survive the completion of the merger.

In determining whether a material adverse effect has occurred or would reasonably be expected to occur since December 31, 2008, the parties will disregard any effects resulting from (1) changes in generally accepted accounting principles or regulatory accounting requirements applicable generally to companies in the industries in which the relevant party and its subsidiaries operate (except to the extent that the effects of such a change are disproportionately adverse to such party as compared to other companies in such industries), (2) changes after the date of the merger agreement in laws, rules or regulations of general applicability to companies in the industries in which the relevant party and its subsidiaries operate (except to the extent that the effects of such a change are disproportionately adverse to such party as compared to other companies in such industries), (3) actions or omissions taken with the prior written consent of the other party, (4) changes in global or national political conditions or in general, economic or market conditions generally affecting the industries in which the relevant party or its subsidiaries operate (except to the extent that the effects of such a change are disproportionately adverse to such party as compared to other companies in such industries), (5) conditions arising out of acts of terrorism, war, weather conditions or other force majeure events, (6) the public disclosure of the merger agreement or the transactions contemplated by the merger agreement, and, in the case of Patriot only, (7) any legal proceedings made or brought by any current or former shareholders of such party arising out of the merger agreement, (8) any changes in the liquidity position of Patriot that do not create new material liabilities for Patriot (excluding liabilities assumed or funded by Prospect), or (9) any events of default under the Amended Securitization Agreement in addition to already existing events of default.

The merger agreement contains customary representations and warranties by each of Patriot and Prospect relating to, among other things:

- due organization, valid existence and good standing;
- authorization to enter into the merger agreement and required shareholder approval by Patriot shareholders to complete the merger;
- compliance with SEC reporting requirements;
- required governmental consents;
- financial statements, internal controls and disclosure controls and procedures;

no breach of organizational documents or material agreements as a result of the merger agreement or the completion of the merger;

broker s fees payable in connection with the merger;

accuracy of information contained in the documents to be filed with the SEC;

capitalization;

absence of defaults under certain contracts;

taxes and tax returns;

tax treatment of the merger;

compliance with laws;

no changes since December 31, 2008 that would have a material adverse effect;

no material legal proceedings;

environmental matters;

insurance; and

no material undisclosed liabilities.

The merger agreement also contains additional customary representations and warranties made by Patriot relating to, among other things:

employee matters, including employee benefit plans;

investment securities;

owned and leased properties;

ownership of intellectual property rights reasonably necessary to conduct its business;

inapplicability of state takeover laws; and

interested party transactions.

In addition, the merger agreement contains a representation and warranty made by Prospect that it has and will have immediately available funds in cash or cash equivalents or available under lines of credit to pay off (i) all principal and interest due under the Amended Securitization Facility, which amounted to $115.7 million as of August 3, 2009, and (ii) up to $1.35 million in other costs, fees and expenses payable to the lenders under the terms of the Amended Securitization Facility, and includes certain representations and warranties concerning Prospect s investment adviser and administrator.

The representations and warranties described above and included in the merger agreement were made by each of Patriot and Prospect to the other. These representations and warranties were made as of specific dates, may be subject to important qualifications and limitations agreed to by Patriot and Prospect in connection with negotiating the terms of the merger agreement, and may have been included in the merger agreement for the purpose of allocating risk between Patriot and Prospect rather than to establish matters as facts. The merger agreement is described in, and included as an appendix to, this document only to provide you with information regarding its terms and conditions, and not to provide any other factual information regarding Patriot and Prospect or their respective businesses. Accordingly, the representations and warranties and other provisions of the merger agreement should not be read alone, but instead should be read only in conjunction with the information provided elsewhere in this document and in the documents incorporated by reference into this document. See Where You Can Find More Information.

Conduct of Business Pending Completion of the Merger

Under the merger agreement, Patriot has agreed that, during the period before the completion of the merger, except as expressly contemplated by the merger agreement, it will, and will cause its subsidiaries to:

- conduct its operations only in the ordinary course of business consistent with past practice; and
- seek to preserve intact its current business organizations and ongoing businesses.

Each of Patriot and Prospect have agreed to take no action that would reasonably be expected to adversely affect or materially delay its ability to obtain any necessary regulatory and governmental approvals, perform its covenants or complete the merger.

In addition, pending the merger, Patriot has agreed that, without Prospect s written consent or except as otherwise expressly contemplated by the merger agreement, it will not, and will cause its subsidiaries not to, among other things:

- amend its organizational documents;
- except as required under any contract or employee benefit plan (other than employment agreements with its executive officers), increase in any manner the compensation or benefits of any current or former officers, directors or employees; pay any amounts to any current or former officers, directors or employees not required by any current plan or agreement (other than base salary in the ordinary course of business); adopt any stock option plan or other stock-based compensation plan, compensation, severances, pension, retirement, profit-sharing, welfare benefit, or other employee benefit plan or agreement with or for the benefit of any employee; accelerate the vesting of any stock-based compensation or other long-term compensation; or hire any employee or terminate the employment of any employee;
- adjust, split, combine or reclassify any of its shares; make, declare or pay any dividend other than the distribution of the investment company taxable income and net capital gains for the taxable year ending on the date of the merger (which distribution is described elsewhere in this document), or make any other distribution on, or directly or indirectly redeem, purchase, or otherwise acquire, any shares of its capital stock or any securities convertible into any shares of its capital stock; grant any stock options or any restricted shares, or grant any right to acquire any shares of capital stock; or issue any additional shares of capital stock or other securities, except as pursuant to options granted under its stock option plan outstanding as of the merger agreement;
- transfer ownership or grant any intellectual property rights to any person;
- take any action, or omit to take any action, which action or omission would result in the merger not qualifying as a reorganization under Section 368(a) of the Code;
- sell or otherwise dispose of any asset or property, or cancel, release or assign any material amount of indebtedness, other than pursuant to existing contracts;
- amend any material contract, instrument or other agreement; create, renew or amend any agreement or contract or, except as required by law, other binding obligation containing any material restriction on the ability to conduct business as currently being conducted or on the ability to engage in any type of activity or business;

make any material investment or loan (other than funding existing unfunded commitments to its portfolio companies);

incur any additional indebtedness, make or change any tax election, or settle or compromise any tax liability;

commence or settle any material claim, action or proceeding;

file or amend any tax return other than in the ordinary course of business;

take any action or willfully fail to take any action that is intended or may reasonably be expected to result in a failure to meet the conditions required to consummate the merger; or

implement or adopt any change in tax accounting or financial accounting principles, other than as may be required by applicable law or regulatory guidelines.

Additional Covenants Pending Completion of the Merger

Each of Patriot and Prospect has agreed that it will, among other things:

cooperate and use reasonable efforts to promptly prepare and file all necessary documentation, to effect all applications, notices and filing, to obtain as promptly as practical all consents of all third parties that are necessary or advisable to consummate the merger, and to comply with the terms and conditions of all consents of all third parties;

take all necessary actions in case at any time after the completion of the merger any further action is necessary to carry out the purposes of the merger agreement;

upon request, furnish or cause to be furnished all information as may be reasonably necessary or advisable in connection with the any SEC filing or any other statement, filing, notice or application made to any governmental entity in connection with the merger;

promptly advise the other party upon receiving any communication from any governmental entity the consent or approval of which is required for consummation of the merger that causes the recipient party to believe that there is a reasonably likelihood that any requisite regulatory approvals will not be obtained or will be materially delayed;

afford to the other party reasonably access, during normal business hours prior to the merger, to all of its properties, books, commitments and records, and, during such party, make available to the other parties copies of all documents filed or received during such period pursuant to federal securities laws and all other information concerning its business, properties and personnel as the other party may reasonably request;

consult with each other and give each other reasonable advance notice and opportunity to review and comment upon any press release or other public statements with respect to the transactions contemplated by the merger agreement;