

PROSPECT CAPITAL CORP  
Form N-14 8C  
January 14, 2014

Use these links to rapidly review the document

[Table of Contents](#)

[INDEX TO FINANCIAL STATEMENTS](#)

[TABLE OF CONTENTS](#)

[Table of Contents](#)

As filed with the Securities and Exchange Commission on January 13, 2014

Registration No. 333-

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

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**Form N-14**

REGISTRATION STATEMENT  
UNDER  
THE SECURITIES ACT OF 1933  
Pre-Effective Amendment No. 0  
Post-Effective Amendment No. 0  
(Check appropriate box or boxes)

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**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)

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Copies to:

**Richard T. Prins, Esq.**  
**Skadden, Arps, Slate, Meagher & Flom LLP**  
**Four Times Square**  
**New York, New York 10036**  
**Telephone: (212) 735-5000**  
**Facsimile: (212) 777-2790**

**Todd B. Pfister**  
**Foley & Lardner LLP**  
**321 North Clark Street, Suite 2800**  
**Chicago, Illinois 60654**  
**Telephone: (312) 832-4579**  
**Facsimile: (312) 832-4700**

**Approximate Date of Proposed Public Offering:**

**As soon as practicable after this registration statement becomes effective and upon completion of the arrangement described in the enclosed documents.**

**CALCULATION OF REGISTRATION FEE**

<b>Title of Each Class of Securities to be Registered</b>	<b>Amount to be Registered(1)</b>	<b>Proposed Maximum Offering Price per Unit</b>	<b>Proposed Maximum Aggregate Offering Price(2)</b>	<b>Amount of Registration Fee</b>
Common Stock, \$0.001 par value per share	21,703,607 shares	N/A	\$195,332,464.00	\$25,158.82

- (1) The number of shares to be registered represents an estimate of the maximum number of shares of the registrant's common stock issuable in connection with the arrangement agreement described in the enclosed documents. The estimate was calculated assuming \$9.00 is the volume-weighted average price ("VWAP") of the registrant's common stock for the 20 trading days prior to and ending on the trading day immediately preceding the effective time of the arrangement described in the enclosed documents. The actual VWAP used may be higher and therefore the actual number of shares issued pursuant to the arrangement may be less than the number of shares being registered.
- (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 of 1933, the proposed maximum aggregate offering price is equal to \$195,332,464.00, which is \$16.00 multiplied by 12,208,279, the maximum expected number of shares outstanding for Nicholas Financial, Inc. as of the effective time as defined in the arrangement 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.**

Table of Contents

**SUBJECT TO COMPLETION DATED JANUARY 13, 2014**

**Information contained herein is subject to completion or amendment. A registration statement relating to these securities has been filed with the United States Securities and Exchange Commission. These securities may not be sold nor may offers to buy be accepted prior to the time the registration statement becomes effective. This document shall not constitute an offer to sell or the solicitation of any offer to buy nor shall there be any sale of these securities in any jurisdiction in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of any such jurisdiction.**

**ARRANGEMENT PROPOSED YOUR VOTE IS VERY IMPORTANT**

Dear Nicholas Financial, Inc. shareholders and optionholders:

On behalf of the board of directors of Nicholas Financial, Inc. (the "Company" or "Nicholas Financial-Canada"), we are pleased to enclose this proxy circular/prospectus relating to the arrangement pursuant to which Prospect Capital Corporation ("Prospect") will acquire the Company.

In connection with the transaction, shareholders and optionholders of the Company are cordially invited to attend a special meeting of the shareholders and optionholders of the Company to be held on [ ] [ ], 2014 at [ ] a.m., local time, at the Company's corporate headquarters, located at 2454 McMullen Booth Road, Building C, Clearwater, Florida (the "special meeting").

At the special meeting, holders of Nicholas Financial-Canada Common Shares and options will be asked to adopt a special resolution approving the arrangement and the arrangement agreement (including the plan of arrangement attached thereto) with Prospect (the "Arrangement Resolution").

**The Company's board of directors has reviewed and considered the terms of the arrangement and the arrangement agreement and has unanimously determined that the arrangement agreement and the transactions contemplated by the arrangement agreement, including the arrangement, are fair to shareholders and optionholders of Nicholas Financial-Canada and in the best interests of Nicholas Financial-Canada and unanimously recommends that Nicholas Financial-Canada's shareholders and optionholders vote *FOR* the Arrangement Resolution and thereby approve the arrangement.**

The Arrangement Resolution must be approved by at least three-quarters (75%) of the votes cast by Nicholas Financial-Canada shareholders, as well as at least three-quarters (75%) of the votes cast by Nicholas Financial-Canada shareholders and optionholders (voting together as a group). Holders may vote either in person or by proxy at the special meeting and will be entitled to one vote for each share held and one vote for each share the holder has an option to acquire.

If the arrangement is completed, each outstanding Common Share of Nicholas Financial-Canada will be converted into the right to receive the number of shares of common stock of Prospect determined by dividing \$16.00 by the volume-weighted average price ("VWAP") of Prospect common stock for the 20 trading days prior to and ending on the trading day immediately preceding the effective time of the arrangement. Each option to acquire shares of Nicholas Financial-Canada common stock outstanding immediately prior to the effective time of the arrangement will be cancelled or transferred by the holder thereof in exchange for a cash amount equal to the amount by which (i) the product obtained by multiplying (x) the number of Common Shares of Nicholas Financial-Canada underlying such option by (y) \$16.00 exceeds (ii) the aggregate exercise price payable under such option. As of January 10, 2014, the last reported sales price for Prospect common stock was \$11.20.

Upon completion of the transaction, assuming the VWAP of Prospect's common stock for the 20 trading days prior to and ending on the record date, which was \$[ ], is the same as the VWAP used to determine the conversion rate, Prospect's stockholders immediately prior to the closing of the arrangement will own approximately [ ]% of Prospect's outstanding stock and former Nicholas Financial-Canada shareholders will own approximately [ ]% of Prospect's outstanding stock. Prospect common stock is traded on The NASDAQ Global Select Market under the symbol "PSEC."

Prospect is a financial services company that primarily lends to and invests in middle market privately-held companies. Prospect, a Maryland corporation, has been a closed-end investment company since April 13, 2004 and has filed an election to be treated as a business development company under the Investment Company Act of 1940 (the "1940 Act"), and is a non-diversified investment company within the meaning of the 1940 Act.

Common Shares of Nicholas Financial-Canada are traded on The NASDAQ Global Select Market under the symbol "NICK." As of January 10, 2014, the last reported sales price for the Nicholas Financial-Canada's Common Shares was \$15.74.



Table of Contents

Because of variable elements that will not be known until immediately prior to the consummation of the arrangement, at the time they vote on the Arrangement Resolution, holders of Nicholas Financial-Canada Common Shares will not know the exact number of shares of Prospect common stock that they will receive in the arrangement. Based on the formula that will be used to determine that number, the value of such Prospect common stock is expected to be equal to \$16.00 per Common Share of Nicholas Financial-Canada; however, the actual value of shares of Prospect common stock received may be greater than or less than \$16.00 on the day of the effective time of the arrangement.

**We urge you to read the accompanying proxy circular/prospectus, which includes important information about the arrangement and the special meeting of the Company's shareholders and optionholders. In particular, see "Risks Related to the Arrangement" beginning on page 25 of the accompanying proxy circular/prospectus which contains a description of the risks that you should consider in evaluating the transaction.**

**Your vote is very important.** Whether or not you expect to attend the special meeting of the Company, the details of which are described in the accompanying proxy circular/prospectus, please vote immediately. If you are a shareholder, you may vote by submitting your proxy by telephone or the Internet or by completing, signing, dating and returning your signed proxy card(s) in the enclosed prepaid return envelope. If you are an optionholder, you may vote by completing, signing, dating and returning your signed proxy card(s) in the enclosed prepaid return envelope.

If shareholders or optionholders of the Company have any questions or require assistance in voting their securities, they should call [ ] at 1-[ ]-[ ]-[ ].

Sincerely,

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Peter L. Vosotas  
*Chairman of the Board, Chief Executive Officer and President*

The accompanying proxy circular/prospectus contains important information about Prospect that you should know before voting to approve the Arrangement Resolution. Please read it before voting and keep it for future reference. Prospect files annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission. You may obtain such information free of charge by writing to Prospect at its principal executive offices, located at 10 East 40th Street, 44th Floor, New York, NY 10016, or by calling 212-448-0702.

**Neither the United States Securities and Exchange Commission nor any state securities commission has approved or disapproved of the transaction described in the proxy circular/prospectus or the securities to be issued pursuant to the transaction described in the proxy circular/prospectus or determined if the proxy circular/prospectus is accurate or adequate. Any representation to the contrary is a criminal offense.**

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The accompanying proxy circular/prospectus is dated , 2014 and is first being mailed to the Company's shareholders and optionholders on or about , 2014.

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Table of Contents

**NICHOLAS FINANCIAL, INC.**

**Building C  
2454 McMullen Booth Road  
Clearwater, FL 33759-1343  
(727) 726-0763**

**NOTICE OF SPECIAL MEETING OF SECURITYHOLDERS  
TO BE HELD ON [ ] [ ], 2014**

To the shareholders and optionholders of Nicholas Financial, Inc. (the "Company" or "Nicholas Financial-Canada"):

A special meeting of the holders of Nicholas Financial-Canada Common Shares and options will be held at Nicholas Financial-Canada's corporate headquarters, located at 2454 McMullen Booth Road, Building C, Clearwater, Florida, on [ ], [ ], 2014, at [ ] a.m., local time, for the following purposes:

1. To consider, pursuant to an interim order of the British Columbia Supreme Court, dated [ ] [ ], 2014, as the same may be amended (sometimes referred to as the "Interim Order"), and, if deemed advisable, to pass, with or without variation, a special resolution, the full text of which is attached to the accompanying proxy circular/prospectus as Annex A (sometimes referred to as the "Arrangement Resolution"), to approve an arrangement under the provisions of Division 5 of Part 9 of the *Business Corporations Act* (British Columbia) involving, among other things, the acquisition by a portfolio company of Prospect Capital Corporation ("Prospect") of all of the issued and outstanding Common Shares of Nicholas Financial-Canada; and
2. To transact such other business as may properly come before the special meeting or any postponement(s) or adjournment(s) of the special meeting.

The full text of the Arrangement Resolution is set out in Annex A to the accompanying proxy circular/prospectus. The Arrangement Resolution must be approved by at least three-quarters (75%) of the votes cast by shareholders, as well as at least three-quarters (75%) of the votes cast by shareholders and optionholders of the Company voting together as a group (collectively, the "Securityholders"). Holders may vote in person or by proxy at the special meeting and will be entitled to one vote for each share held and one vote for each share the holder has an option to acquire. The arrangement is described in the accompanying proxy circular/prospectus, which serves as (i) Nicholas Financial-Canada's management proxy circular in connection with management's solicitation of proxies, and (ii) a prospectus of Prospect relating to its issuance of common stock in connection with the arrangement.

**The Company's board of directors unanimously recommends that you vote FOR the Arrangement Resolution.** Securityholders of record as of [ ], 2014, the record date for the special meeting, will be entitled to vote at the meeting and at any postponement or adjournment thereof.

All registered Securityholders, whether or not they expect to be present at the meeting, are requested to sign, date, and mail the accompanying proxy in the envelope provided for this purpose or, if they are a shareholder, by following the procedures for either telephone or Internet voting provided in the accompanying proxy circular/prospectus. **Proxies must be received by the Company's transfer agent, Computershare Investor Services Inc. (Attention: Proxy Department, [ ], or by fax to Nicholas Financial, Inc., c/o Computershare Investor Services Inc. at ([ ]) [ ]-[ ] or 1-[ ]-[ ]-[ ] or by Internet at www. [ ].com), before 5:00 p.m. (Eastern Time), on [ ] [ ], 2014 (or the date that is two days, excluding Saturdays, Sundays and holidays, prior to the date set for any postponement or adjournment of the original meeting).**

If you are a non-registered, beneficial shareholder, you must follow the instructions provided by your broker, investment dealer, bank, trust company or other intermediary to ensure that your vote is counted at the special meeting.

Table of Contents

TAKE NOTICE that in accordance with the Interim Order, registered holders of Nicholas Financial-Canada Common Shares and options have a right to dissent from the arrangement and to be paid an amount equal to the fair value of their shares or options, as applicable. This right is described in the accompanying proxy circular/prospectus. **Failure to comply strictly with the dissent procedures may result in the loss or unavailability of the right to dissent.** See "The Special Meeting Dissent Rights" in the accompanying proxy circular/prospectus.

**If you have any questions or require more information regarding the procedures for voting or completing your proxy or transmittal documentation, please contact [ ] at 1-[ ]-[ ]-[ ].**

**By Order of the Board of Directors**

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Ralph T. Finkenbrink

*Secretary*

In the accompanying proxy circular/prospectus, references to "\$" refer to United States dollars, unless otherwise noted.

**REFERENCES TO ADDITIONAL INFORMATION**

Prospect has filed a registration statement on Form N-14 to register with the United States Securities and Exchange Commission (the "SEC") the Prospect common stock, par value \$0.001 per share ("Prospect common stock"), to be issued to the Company's shareholders upon consummation of the arrangement. The accompanying proxy circular/prospectus is a part of that registration statement and constitutes a prospectus of Prospect in addition to being a proxy circular of the Company for its special meeting. As allowed by SEC rules, this proxy circular/prospectus does not contain all the information you can find in the registration statement or the exhibits to the registration statement.

The accompanying proxy circular/prospectus incorporates important business and financial information about Prospect and the Company from other documents that are not included in or delivered with this proxy circular/prospectus. This information is available to you without charge upon your written or oral request. You can obtain copies of the accompanying proxy circular/prospectus, as well as the documents incorporated by reference into the accompanying proxy circular/prospectus through the SEC website at [www.sec.gov](http://www.sec.gov), or by requesting them in writing or by telephone from the appropriate company at the following addresses and telephone numbers:

**Prospect Capital Corporation**

Attention: Brian H. Oswald  
10 East 40th Street, 44th Floor  
New York, New York 10016  
(212) 448-0702

**Nicholas Financial, Inc.**

Attention: Ralph T. Finkenbrink  
2454 McMullen Booth Road, Building C  
Clearwater, Florida 33759  
(727) 726-0763

*If you would like to request documents, please do so by [ ] [ ], 2014, in order to receive them before the Company's special meeting.*

See "Where You Can Find More Information" beginning on page 317 of the accompanying proxy circular/prospectus.

**SUBMITTING PROXIES BY MAIL, TELEPHONE OR INTERNET**

Nicholas Financial-Canada shareholders of record may submit their proxies:

by telephone, by calling the toll-free number 1-[ ]-[ ]-[ ] on a touch-tone phone and following the recorded instructions;

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Table of Contents

by accessing the Internet website at www.[ ] .com and following the instructions on the website; or

by mail, by indicating their voting preference on the proposals on each proxy card received, signing and dating each proxy card and returning each proxy card in the prepaid envelope that accompanied that proxy card.

Nicholas Financial-Canada optionholders may submit their proxies by mail, by indicating their voting preference on the proposals on each proxy card received, signing and dating each proxy card and returning each proxy card in the prepaid envelope that accompanied that proxy card.

Shareholders of the Company whose Common Shares are held in "street name" must provide their brokers with instructions on how to vote their shares; otherwise, their brokers will not vote their shares on any resolution before the special meeting. Shareholders should check the voting form provided by their brokers for instructions on how to vote their shares.

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**The accompanying proxy circular/prospectus does not constitute an offer to sell, or a solicitation of an offer to purchase, any securities, or the solicitation of a proxy, by any person in any jurisdiction in which such an offer or solicitation is not authorized or in which the person making the offer or solicitation is not qualified to do so or to any person to whom it is unlawful to make such an offer or solicitation.**

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Table of Contents

**TABLE OF CONTENTS**

	<b>Page No.</b>
<u>QUESTIONS AND ANSWERS ABOUT THE PROPOSED ARRANGEMENT</u>	<u>1</u>
<u>SUMMARY</u>	<u>6</u>
<u>COMPARATIVE FEES AND EXPENSE RATIOS</u>	<u>18</u>
<u>SELECTED FINANCIAL DATA OF PROSPECT</u>	<u>21</u>
<u>SELECTED FINANCIAL DATA OF THE COMPANY</u>	<u>23</u>
<u>RISKS RELATED TO THE ARRANGEMENT</u>	<u>25</u>
<u>RISKS RELATED TO PROSPECT</u>	<u>30</u>
<u>RISKS RELATED TO THE COMPANY</u>	<u>62</u>
<u>SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS</u>	<u>70</u>
<u>THE SPECIAL MEETING</u>	<u>71</u>
<u>CAPITALIZATION OF PROSPECT</u>	<u>77</u>
<u>THE ARRANGEMENT RESOLUTION PROPOSAL</u>	<u>79</u>
<u>DESCRIPTION OF THE ARRANGEMENT AGREEMENT</u>	<u>99</u>
<u>ACCOUNTING TREATMENT</u>	<u>116</u>
<u>CERTAIN UNITED STATES FEDERAL INCOME TAX CONSIDERATIONS</u>	<u>117</u>
<u>MARKET PRICE AND DIVIDEND INFORMATION</u>	<u>131</u>
<u>BUSINESS OF PROSPECT</u>	<u>137</u>
<u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u> <u>OF PROSPECT</u>	<u>167</u>
<u>PORTFOLIO COMPANIES OF PROSPECT</u>	<u>226</u>
<u>SENIOR SECURITIES OF PROSPECT</u>	<u>235</u>
<u>DETERMINATION OF PROSPECT'S NET ASSET VALUE</u>	<u>237</u>
<u>CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS OF PROSPECT</u>	<u>238</u>
<u>SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT OF PROSPECT</u>	<u>239</u>
<u>DESCRIPTION OF PROSPECT'S CAPITAL STOCK</u>	<u>241</u>
<u>REGULATION OF PROSPECT</u>	<u>249</u>
<u>SALES OF COMMON STOCK BELOW NET ASSET VALUE BY PROSPECT</u>	<u>255</u>
<u>PROSPECT'S DIVIDEND REINVESTMENT PLAN</u>	<u>260</u>
<u>BUSINESS OF NICHOLAS FINANCIAL-CANADA</u>	<u>262</u>
<u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u> <u>OF THE COMPANY</u>	<u>273</u>
<u>SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS OF COMPANY</u>	<u>289</u>
<u>DESCRIPTION OF NICHOLAS FINANCIAL-CANADA'S CAPITAL STOCK</u>	<u>291</u>
<u>COMPARISON OF SHAREHOLDER RIGHTS</u>	<u>295</u>
<u>CUSTODIAN, TRANSFER AND DIVIDEND PAYING AGENT AND REGISTRAR</u>	<u>316</u>
<u>BROKERAGE ALLOCATION AND OTHER PRACTICES</u>	<u>316</u>
<u>LEGAL MATTERS</u>	<u>316</u>
<u>INDEPENDENT REGISTERED ACCOUNTING FIRM</u>	<u>316</u>
<u>OTHER MATTERS</u>	<u>316</u>
<u>WHERE YOU CAN FIND MORE INFORMATION</u>	<u>317</u>
<u>INDEX TO FINANCIAL STATEMENTS</u>	<u>F-1</u>
<u>ANNEX A: ARRANGEMENT RESOLUTION</u>	<u>ANNEX A-1</u>
<u>ANNEX B: ARRANGEMENT AGREEMENT</u>	<u>ANNEX B-1</u>
<u>ANNEX C: SUMMARY OF CERTAIN PROVISIONS OF THE 1940 ACT APPLICABLE TO BUSINESS</u> <u>DEVELOPMENT COMPANIES</u>	<u>ANNEX C-1</u>
<u>ANNEX D: SHAREHOLDERS' DISSENT PROVISIONS</u>	<u>ANNEX D-1</u>
<u>ANNEX E: OPTIONHOLDERS' DISSENT PROVISIONS</u>	<u>ANNEX E-1</u>

Table of Contents

	<b>Page No.</b>
<u>ANNEX F: INTERIM ORDER</u>	<u>ANNEX F-1</u>
<u>ANNEX G: NOTICE OF APPLICATION FOR FINAL ORDER</u>	<u>ANNEX G-1</u>
<u>ANNEX H: OPINION OF JANNEY MONTGOMERY SCOTT LLC</u>	<u>ANNEX H-1</u>

Table of Contents

**QUESTIONS AND ANSWERS ABOUT THE PROPOSED ARRANGEMENT**

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

A: The special meeting of shareholders and optionholders will take place at Nicholas Financial, Inc.'s (the "Company" or "Nicholas Financial-Canada") corporate headquarters, located at 2454 McMullen Booth Road, Building C, Clearwater, Florida, on [ ], 2014, at [ ] a.m., local time.

**Q: What is happening at the special meeting?**

A: Nicholas Financial-Canada's shareholders and optionholders are being asked to consider and vote on the following item at the special meeting:

A proposal to adopt a special resolution, the full text of which is attached hereto as Annex A (the "Arrangement Resolution"), to approve the arrangement and the arrangement agreement, dated as of December 17, 2013, by and among Prospect Capital Corporation ("Prospect"), Watershed Acquisition LP ("USCo"), 0988007 B.C. Unlimited Liability Company (the "Purchaser"), NF Financial LLC (formerly known as Watershed Operating LLC) ("US New Opco," and together with Prospect, USCo and the Purchaser, the "Prospect Parties") and Nicholas Financial-Canada (collectively, the "Parties" and each a "Party"), as such agreement may be amended from time to time. The full text of the arrangement agreement is attached hereto as Annex B.

**Q: What will happen in the proposed arrangement?**

A: If the Arrangement Resolution is approved, Nicholas Financial-Canada and the Purchaser will amalgamate and form an entity ("Amalco"), which will be an unlimited liability company under the *Business Corporations Act* (British Columbia) (the "BCBCA"). Amalco will be the surviving entity and will succeed to and assume all of the rights and obligations of the Purchaser and Nicholas Financial-Canada. Amalco will be an indirect wholly-owned portfolio company of Prospect. As a result of the proposed arrangement, all Nicholas Financial-Canada's assets and liabilities immediately before the amalgamation will become assets and liabilities of Amalco immediately after the amalgamation, and Nicholas Financial-Canada's wholly-owned subsidiaries, Nicholas Financial, Inc., a Florida corporation, and Nicholas Data Services, Inc., a Florida corporation, will become direct subsidiaries of Amalco.

**Q: What will shareholders of Nicholas Financial-Canada receive in the arrangement?**

A: Each Nicholas Financial-Canada shareholder will receive for each Common Share of Nicholas Financial-Canada owned as of the time of consummation of the arrangement (the "effective time"), that number of shares of common stock, par value \$0.001 per share, of Prospect ("Prospect common stock") determined by dividing \$16.00 by the volume-weighted average price of Prospect common stock on the NASDAQ Global Select Market ("NASDAQ"), as displayed under the heading "Bloomberg VWAP" on Bloomberg Financial L.P. ("VWAP") for the 20 trading days prior to and ending on the trading day immediately preceding the effective time of the arrangement. Holders of Nicholas Financial-Canada Common Shares will not receive any fractional shares of Prospect common stock in the arrangement. Instead, each Nicholas Financial-Canada shareholder otherwise entitled to a fractional share interest in Prospect will be paid an amount in cash determined by multiplying such fraction by the amount equal to the VWAP as calculated above. *Pursuant to the arrangement agreement, Nicholas Financial-Canada has agreed, prior to completion or termination of the transaction, not to declare, set aside, pay or make any dividend or other distribution (whether in cash, stock or other property) with respect to any of its Common Shares.*



Table of Contents

Prospect is a financial services company that primarily lends to and invests in middle market privately-held companies. Prospect, a Maryland corporation, has been a closed-end investment company since April 13, 2004 and has filed an election to be treated as a business development company under the Investment Company Act of 1940 (the "1940 Act"), and is a non-diversified investment company within the meaning of the 1940 Act. Please see "Business of Prospect" for more information regarding Prospect and please see "Regulation of Prospect" and Annex C: Summary of Certain Provisions of the 1940 Act Applicable to Business Development Companies for more information regarding business development companies and the 1940 Act.

**Q:**

**What will optionholders of Nicholas Financial-Canada receive in the arrangement?**

Prospect will cash out holders of options to purchase Company Common Shares ("options") outstanding pursuant to the Nicholas Financial-Canada stock option plans. Such holders of options will receive a cash amount equal to the amount, if any, by which (i) the product obtained by multiplying (x) the number of Nicholas Financial-Canada Common Shares underlying such option by (y) \$16.00, exceeds (ii) the aggregate exercise price payable under such option by the optionholder to acquire the Nicholas Financial-Canada Common Shares underlying such option.

**Q:**

**What is a business development company ("BDC")?**

**A:**

A BDC is a specialized type of closed-end investment company regulated under certain provisions of the 1940 Act. The 1940 Act and the Investment Advisers Act of 1940 regulate BDCs through various restrictions on capitalization, types of investments, investment adviser compensation, director independence, transactions with affiliates and governance matters. As a BDC, Prospect is generally required to invest at least 70% of its assets in private or small domestic companies engaged primarily in non-financial businesses as well as in cash items, United States Government securities and high-quality short-term debt securities (and is required to offer managerial assistance to such companies). In addition, as a BDC, Prospect can have, and does have, multiple classes of debt outstanding and can incur a greater amount of leverage in the form of debt (as opposed to preferred stock) than a registered closed-end fund, which can only have one class of debt outstanding. See "Regulation of Prospect," "Business of Prospect" and Annex C: Summary of Certain Provisions of the 1940 Act Applicable to Business Development Companies.

**Q:**

**Is the consideration subject to any adjustment for shareholders?**

**A:**

No. However, the number of shares of Prospect common stock that a Nicholas Financial-Canada shareholder will receive will depend on the VWAP for the 20 trading days prior to and ending on the trading day immediately preceding the effective time of the arrangement and consequently the value of the shares of Prospect common stock received may be greater than or less than \$16.00 on the day of the effective time.

**Q:**

**Is Prospect required to make any other payments to any of the Parties in connection with the arrangement?**

**A:**

No. However, if Nicholas Financial-Canada terminates the arrangement agreement due to a breach by Prospect, Prospect could be obligated to pay a \$6,000,000 termination fee to Nicholas Financial-Canada. Please see "Description of the Arrangement Agreement Termination of the Arrangement Agreement."

Table of Contents

**Q: Who will pay the expenses relating to the preparation of this document and the solicitation of proxies?**

A: Whether or not the arrangement is consummated, each of Prospect and Nicholas Financial-Canada is responsible for its own fees and expenses relating to the arrangement, including the preparation of this document and the solicitation of the proxies. However, in the event the arrangement is not consummated, under certain conditions, a termination fee of \$6,000,000 will be paid by Nicholas Financial-Canada or Prospect, as applicable, to the other party in accordance with the arrangement agreement. Please see "Description of the Arrangement Agreement Termination of the Arrangement Agreement."

**Q: Are shareholders and optionholders able to exercise dissent rights?**

A: Yes. As further discussed below under "The Special Meeting Dissent Rights," shareholders and optionholders are able to exercise dissent rights. A written objection to the Arrangement Resolution must be received by Nicholas Financial-Canada not later than 5:00 pm (Vancouver time) on the last business day preceding the date of the special meeting. Shareholders and optionholders that are ultimately determined to be entitled to dissent rights and that have validly exercised their dissent rights will be paid in cash the fair value by the Purchaser for their shares or options, as applicable. See also [Annex D](#) and [Annex E](#) to this proxy circular/prospectus.

**Q: When do you expect to complete the proposed arrangement?**

A: We are working to complete the proposed arrangement early in the second quarter of 2014, assuming all regulatory approvals and other required matters are completed at such time.

**Q: What are the United States federal income tax consequences of the proposed arrangement?**

A: See "Certain United States Federal Income Tax Considerations" for important information regarding the United States federal income tax consequences relating to the proposed arrangement.

**Q: What shareholder and optionholder vote is required to approve the Arrangement Resolution?**

A: The Arrangement Resolution must be approved by at least three-quarters (75%) of the votes cast by Nicholas Financial-Canada shareholders, as well as at least three-quarters (75%) of the votes cast by Nicholas Financial-Canada shareholders and optionholders (voting together as a group). Holders may vote either in person or by proxy at the special meeting and will be entitled to one vote for each share held and one vote for each share the holder has an option to acquire. Nicholas Financial-Canada shareholders and optionholders who abstain, fail to return their proxies or do not otherwise vote will not have an effect on the vote. A quorum for the special meeting is at least two shareholders or proxyholders representing two shareholders, or one shareholder and a proxyholder representing another shareholder, holding at least 33<sup>1</sup>/<sub>3</sub>% of the total issued and outstanding shares of Nicholas Financial-Canada on the record date for the meeting.

**Q: Does Nicholas Financial-Canada's board of directors recommend approval of the Arrangement Resolution?**

A: Yes. Nicholas Financial-Canada's board of directors, including its independent directors, unanimously approved and adopted the Arrangement Resolution and unanimously recommends that Nicholas Financial-Canada's shareholders vote "FOR" approval of the Arrangement Resolution. In connection with Nicholas Financial-Canada's board of directors' consideration of this matter, it received an opinion from Janney Montgomery Scott LLC ("Janney") addressing the



Table of Contents

fairness, from a financial point of view, of the consideration to be received by Nicholas Financial-Canada shareholders.

**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 or options?**

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 or options, as applicable, may be represented at the special meeting. If you are a shareholder, you may also vote (1) by telephone, by calling toll free 1-[ ]-[ ]-[ ] on a touch-tone phone and following the recorded instructions or (2) by accessing the Internet website at www.[ ].com and following the instructions on the website. If you are a record shareholder, you may also attend the special meeting in person and vote at the meeting instead of submitting a proxy. If your shares are held in a brokerage account or in "street name" and you wish to vote your shares in person at the special meeting, please see the answer to the next question.

**Unless your shares are held in a brokerage account or in "street name", 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 arrangement agreement and the arrangement. If your shares are held in a brokerage account or in "street name", please see the answer to the next question.**

If you fail either to return your proxy card and, if you are a shareholder, to vote via the telephone or the Internet, or if you "abstain" with respect to the Arrangement Resolution, you will not affect the outcome of the vote.

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

A: No. 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.

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. If your shares are held in a brokerage account or in "street name," you may vote your shares in person at the special meeting ONLY if you bring your proxy to the special meeting. The proxy would be provided by your broker, fiduciary, custodian or other nominee. You must request this proxy from your nominee, as they will not automatically send you one.

If you do not provide your broker with instructions and do not attend the special meeting, your failure will not have an effect on the outcome of the vote. Shares held in a brokerage account or in "street name" for which written authority to vote has not been obtained will be treated as not present and not entitled to vote with respect to the Arrangement Resolution and will, therefore, reduce the absolute number (but not the percentage) of the affirmative votes required for approval of the Arrangement Resolution. 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.



Table of Contents

**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. If you are a shareholder, you may also change your vote if you voted and revoke (1) by telephone, by calling the toll-free number 1-[ ]-[ ]-[ ] on a touch-tone phone and following the recorded instructions or (2) by accessing the Internet website at www.[ ].com and following the instructions on the website. 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 arrangement is completed and your Common Shares are represented by stock certificates, we will send you written instructions for exchanging your stock certificates for the appropriate number of shares of Prospect common stock.

**Q: Will a proxy solicitor be used?**

A: No. Nicholas Financial-Canada has not engaged a proxy solicitor to assist in the solicitation of proxies for the special meeting. Nicholas Financial-Canada's officers and employees may request the return of proxies by telephone or in person, but no additional compensation will be paid to them for doing so.

**Q: Who can I contact with any additional questions?**

A: You may call Nicholas Financial-Canada's Corporate Secretary, Ralph T. Finkenbrink, with respect to any additional questions at: 1-727-726-0763

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

A: You can find more information about Nicholas Financial-Canada and Prospect in the documents described under "Where You Can Find More Information."

Table of Contents

**SUMMARY**

*This summary highlights material information in this proxy circular/prospectus. 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 arrangement. See "Where You Can Find More Information." Unless otherwise noted, the terms "Nicholas Financial-Canada" or the "Company" refers to Nicholas Financial, Inc., a company existing under the laws of British Columbia; "Nicholas Financial" refers to Nicholas Financial, Inc., a Florida corporation; "NDS" refers to Nicholas Data Services, Inc., a Florida corporation; the "Company" also refers to Nicholas Financial-Canada, Nicholas Financial and NDS collectively, as appropriate in the context; "Prospect" refers to Prospect Capital Corporation, a Maryland corporation; "USCo" refers to Watershed Acquisition LP, a Delaware limited partnership; the "Purchaser" refers to 0988007 B.C. Unlimited Liability Company, an unlimited liability company existing under the laws of British Columbia; "US New Opco" refers to NF Financial LLC (formerly known as Watershed Operating LLC), a Delaware limited liability company; "Prospect Capital Management," "Investment Adviser" and "PCM" refer to Prospect Capital Management LLC; and "Prospect Administration" and the "Administrator" refer to Prospect Administration LLC. When discussing the arrangement agreement, the terms: "Prospect Parties" refers to Prospect, USCo, Purchaser and US New Opco; and "Parties" refers to Nicholas Financial-Canada and the Prospect Parties.*

**Information about the Companies**

*Nicholas Financial, Inc.*  
2454 McMullen Booth Road  
Building C  
Clearwater, FL 33759

Nicholas Financial-Canada is a Canadian holding company incorporated under the laws of British Columbia in 1986. Its business activities are conducted through two wholly-owned subsidiaries formed pursuant to the laws of the State of Florida, Nicholas Financial and NDS. Nicholas Financial is a specialized consumer finance company engaged primarily in acquiring and servicing retail installment sales contracts ("Contracts") for purchases of new and used cars and light trucks. To a lesser extent, Nicholas Financial also makes direct loans and sells consumer-finance related products. NDS is engaged in supporting and updating industry specific computer application software for small businesses located primarily in the Southeastern United States. For the fiscal years ended March 31, 2013 and 2012 and the six-month periods ended September 30, 2013 and 2012, the Company had consolidated revenues of \$82.1 million, \$80.5 million, \$41.4 million, and \$41.1 million, respectively. Nicholas Financial accounted for approximately 99% of the Company's consolidated revenues for each of such periods, and NDS sales accounted for less than 1% of consolidated revenues during each of the same periods.

The Company's principal business is providing financing programs primarily to purchasers of new and used cars and light trucks who meet the Company's credit standards, but who do not meet the credit standards of traditional lenders, such as banks and credit unions. Unlike these traditional lenders, which make lending decisions primarily based on the credit history of the borrower and typically finance new automobiles, the Company purchases Contracts of borrowers who may not have a good credit history or Contracts for older model and high mileage automobiles. This is typically referred to as the non-prime automobile finance market.

The non-prime automobile finance market is highly fragmented and historically has been serviced by a variety of financial entities, including captive finance subsidiaries of major automobile manufactures, banks, independent finance companies, and small loan companies. Many of these financial entities do not consistently provide financing to this market. Although prime borrowers represent a large segment of the automobile financing market, there are many potential purchasers of

Table of Contents

automobiles who do not qualify as prime borrowers. Purchasers the Company considers to be non-prime borrowers are generally unable to obtain credit from traditional sources of automobile financing. The Company believes that, because these potential purchasers represent a substantial market, there is a demand by automobile dealers with respect to financing for non-prime borrowers that has not been effectively served by traditional automobile financing sources.

The Company purchases Contracts from automobile dealers at a negotiated price that is less than the original principal amount being financed by the purchaser of the automobile. The Contracts are predominately for used vehicles. As of September 30, 2013, the average model year of vehicles collateralizing the portfolio was 2005. The average loan to value ratio, which expresses the amount of the Contract as a percentage of the value of the automobile, is approximately 93%. The initial terms of the Contracts range from 12 to 72 months. In addition, taxes, title fees and, if applicable, premiums for extended service contracts, accident and health insurance and credit life insurance can also be included in the amount financed.

The Company's automobile finance programs are currently conducted in 15 states through a total of 65 branches, including 20 in Florida, eight in Ohio, six in North Carolina, six in Georgia, three in Kentucky, three in Indiana, three in Missouri, three in Michigan, three in Alabama, two in Virginia, two in Tennessee, two in Illinois, two in South Carolina, one in Maryland and one in Kansas. Each office is budgeted (size of branch, number of employees and location) to handle up to 1,000 accounts and up to \$7.5 million in gross finance receivables. To date, 14 of the Company's branches meet that capacity. The Company continues to evaluate additional markets for future branch locations, and subject to market conditions, would expect to open additional branch locations during fiscal 2014. The Company remains open to acquisitions should an opportunity present itself.

In addition to the automobile finance program, the Company also provides direct loans. Direct loans are loans originated directly between the Company and the consumer. These loans are typically for amounts ranging from \$1,000 to \$9,000 and are generally secured by a lien on an automobile, water craft or other permissible tangible personal property. The average loan made to date by the Company had an initial principal balance of approximately \$3,000. The Company does not expect the average loan size to increase significantly within the foreseeable future. The majority of direct loans are originated with current or former customers under the Company's automobile financing program. The typical direct loan represents a significantly better credit risk than the Company's typical Contract due to the customer's historical payment history with the Company.

The Company is currently licensed to provide direct consumer loans in Florida and North Carolina. In addition, the Company continues to analyze the direct loan market in Ohio for possible future expansion into such market. The Company does not expect to pursue a direct loan license in any other state during the fiscal year ending March 31, 2014. The Company does not have any current plans to expand its strategy of soliciting current customers and expects total direct loans to remain approximately 2% of its total portfolio.

In connection with its direct loan program, the Company also makes available credit disability and credit life insurance coverage to customers through an unaffiliated third-party insurance carrier. Customers in approximately 77% of the 3,079 direct loan transactions outstanding as of September 30, 2013 had elected to purchase third-party insurance coverage made available by the Company. The cost of this insurance is included in the amount financed by the customer.

The Company's executive offices are located at 2454 McMullen Booth Road, Building C, Suite 501, Clearwater, Florida 33759, and the Company's telephone number is (727) 726-0763.

Table of Contents

*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. In this proxy circular/prospectus, the term "middle market" refers to companies with annual revenues between \$50 million and \$2 billion. Prospect is a closed-end investment company that has filed an election to be treated as a business development company under the 1940 Act. Prospect invests primarily in senior and subordinated debt and equity of companies in need of capital for acquisitions, divestitures, growth, development and recapitalization. Prospect works with management teams or financial sponsors to seek investments with historical cash flows, asset collateral or contracted pro forma cash flows.

Prospect currently has seven origination strategies in which it makes investments: (1) lending in private equity sponsored transactions, (2) lending directly to companies not owned by private equity firms, (3) control investments in corporate operating companies, (4) control investments in financial companies, (5) investments in structured credit, (6) real estate investments, and (7) investments in syndicated debt. Prospect continues to evaluate other origination strategies in the ordinary course of business with no specific tops down allocation to any single origination strategy.

**Lending in Private Equity Sponsored Transactions** Prospect makes loans to companies which are controlled by leading private equity firms. This debt can take the form of first lien, second lien, unitranche or mezzanine loans. In making these investments, Prospect looks for a diversified customer base, recurring demand for the product or service, barriers to entry, strong historical cash flow and experienced management teams. These loans typically have significant equity subordinate to Prospect's loan position. This strategy has comprised approximately 50%-60% of its business.

**Lending Directly to Companies** Prospect provides debt financing to companies owned by non private equity firms, the company founder, a management team or a family. Here, in addition to the strengths Prospect looks for in a sponsored transaction, Prospect also looks for the alignment with the management team with significant invested capital. This strategy often has less competition than the private equity sponsor strategy because such company financing needs are not easily addressed by banks and often require more diligence preparation. Direct lending can result in higher returns and lower leverage than sponsor transactions and may include warrants or equity to Prospect. This strategy generally has comprised approximately 5%-15% of its business.

**Control Investments in Corporate Operating Companies** This strategy involves acquiring controlling stakes in non financial operating companies. Prospect investments in these companies are generally structured as a combination of yield producing debt and equity. Prospect provides certainty of closure to Prospect's counterparties, gives the seller personal liquidity and generally looks for management to continue on in their current roles. This strategy has comprised approximately 10%-15% of its business.

**Control Investments in Financial Companies** This strategy involves acquiring controlling stakes in financial companies, including consumer direct lending, subprime auto lending and other strategies. Prospect's investments in these companies are generally structured as a combination of yield producing debt and equity. These investments are often structured in a tax efficient registered investment company compliant partnership, enhancing returns. This strategy has comprised approximately 10%-15% of its business.

**Investments in Structured Credit** Prospect makes investments in collateralized loan obligations ("CLOs"), generally taking a significant position in the subordinated interests (equity) of the CLOs. The CLOs include a diversified portfolio of broadly syndicated loans and do not have direct exposure

Table of Contents

to real estate, mortgages, sub prime debt, or consumer based debt. The CLOs in which Prospect invests are managed by top tier collateral managers that have been thoroughly diligenced prior to investment. This strategy has represented 10%-20% of its business.

**Real Estate Investments** Prospect makes investments in real estate through its tax efficient real estate investment trusts ("REITs"), American Property Holdings Corp., National Property Holdings Corp. and United Property Holdings Corp. Prospect's real estate investments are in various classes of fully developed and occupied real estate properties that generate current yields. Prospect seeks to identify properties that have historically high occupancy and steady cash flow generation. Prospect partners with established property managers with experience in managing the property type to manage such properties after acquisition. This is a more recent investment strategy that has represented approximately 5%-10% of its business.

**Investments in Syndicated Debt** On an opportunistic basis, Prospect makes investments in loans and high yield bonds that have been sold to a syndicate of buyers. Here Prospect looks for investments with attractive risk adjusted returns after it has completed a fundamental credit analysis. These investments are purchased with a long term, buy and hold outlook and Prospect looks to provide significant structuring input by providing anchoring orders. This strategy has represented approximately 5%-10% of the portfolio.

Prospect invests primarily in first and second lien senior loans and mezzanine debt which in some cases includes an equity component. First and second lien senior loans generally are senior debt instruments that rank ahead of subordinated debt of a given portfolio company. These loans also have the benefit of security interests in the assets of the portfolio company, which may rank ahead of or be junior to other security interests. Mezzanine debt and Prospect's investments in CLOs are subordinated to senior loans and are generally unsecured. Prospect invests in debt and equity positions of CLOs which are a form of securitization in which the cash flows of a portfolio of loans are pooled and passed on to different classes of owners in various tranches. Prospect's CLO investments are derived from portfolios of corporate debt securities which are generally risk rated from BB to B depending on the tranche.

Prospect also acquires controlling interests in companies in conjunction with making secured debt investments in such companies. These may be in several industries, including industrial, service, real estate and financial businesses.

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 regulated investment company ("RIC") under Subchapter M of the Internal Revenue Code of 1986, or the "Code."

**Terms of the Arrangement Agreement**

Pursuant to the terms of the proposed arrangement, Nicholas Financial-Canada and the Purchaser will amalgamate and form an entity ("Amalco"), which will be an unlimited liability company under the *Business Corporations Act* (British Columbia). Amalco will be the surviving entity and will succeed to and assume all of the rights and obligations of the Purchaser and Nicholas Financial-Canada. Amalco will be an indirect wholly-owned portfolio company of Prospect. As a result of the proposed arrangement, all Nicholas Financial-Canada's assets and liabilities immediately before the amalgamation will become assets and liabilities of Amalco immediately after the amalgamation and Nicholas Financial-Canada's wholly-owned subsidiaries, Nicholas Financial and NDS, will become direct subsidiaries of Amalco.

Table of Contents

Based on the number of shares of Prospect common stock issued and outstanding on the record date and the VWAP of Prospect's common stock over the 20 trading days prior to the record date, Nicholas Financial-Canada's shareholders will own approximately [ ]% of Prospect's common stock outstanding immediately after the consummation of the arrangement.

The arrangement agreement is attached as Annex B to this proxy circular/prospectus (the "arrangement agreement") and is part of this document. Nicholas Financial-Canada encourages its shareholders to read the arrangement agreement (including the plan of arrangement attached as Schedule B thereto) carefully and in its entirety, as it is the principal legal document governing the proposed arrangement. Please see "Description of the Arrangement Agreement."

**Nicholas Financial-Canada's Shareholders Will Receive Shares of Prospect's Common Stock in the Proposed Arrangement**

If the proposed arrangement is consummated, each Nicholas Financial-Canada shareholder will receive for each Common Share of Nicholas Financial-Canada owned as of the effective time, that number of shares of Prospect common stock determined by dividing \$16.00 by the VWAP of Prospect common stock on NASDAQ for the 20 trading days prior to and ending on the trading day immediately preceding the effective time. Holders of Common Shares of Nicholas Financial-Canada will not receive any fractional shares of Prospect common stock in the arrangement. Instead, each Nicholas Financial-Canada shareholder otherwise entitled to a fractional share interest in Prospect will be paid an amount in cash, based on a formula set forth in the arrangement agreement and rounded to the nearest cent. **Pursuant to the arrangement agreement, Nicholas Financial-Canada has agreed, prior to completion or termination of the transaction, not to declare, set aside, pay or make any dividend or other distribution (whether in cash, stock or other property) with respect to any of its Common Shares.**

**Reasons for the Proposed Arrangement**

In evaluating the arrangement proposal from Prospect, Nicholas Financial-Canada's board of directors considered numerous factors, including, among others, the ones described below, and, as a result, determined that the proposed arrangement was in the Company's best interests and the best interests of the Company's shareholders and optionholders. Ultimately, the Company's board of directors believed that the potential advantages of the proposed arrangement outweigh the negative factors, whether considered individually or collectively. For a more detailed discussion of the factors identified below, and for additional factors considered by the board, see "The Arrangement Resolution Proposal Reasons for the Arrangement."

The Company's board of directors did not attempt to quantify or otherwise assign relative weights to the specific factors it considered nor did it determine that any factor was of particular importance. A determination of various weightings would, in the view of the Company's board of directors, be impractical. In addition, individual members of the Company's board of directors may have given different weight to different factors. Rather, the Company's board of directors viewed its position and recommendations as being based on the totality of the information presented to, and considered by, the Company's board of directors.

The Company's board of directors considered the following factors in its deliberations concerning the arrangement:

The Company engaged in a thorough review of the potential strategic alternatives to a Prospect proposal, including, among other things, the possible sale of the Company or certain of its assets, potential acquisition and expansion opportunities and/or a possible debt or equity financing. Based on the company's lengthy and thorough review process, the Company's board of directors believes it has explored all possible strategic alternatives reasonably available to it.

Table of Contents

In evaluating the consideration payable to the Company's shareholders and optionholders pursuant to the arrangement, the Company's board of directors noted that \$16.00 represents a premium of approximately 21% to the average closing market price of the Company's Common Shares for the twenty trading days immediately prior to the March 20, 2013 announcement by the Company that its board of directors had retained Janney as its independent financial advisor to assist the Company in evaluating possible strategic alternatives.

The Company's recent financial performance, including recent trends in delinquencies, losses and gross margins, and their impact on the Company's operating results. The Company's board of directors also considered the fact that, as a result of the arrangement, existing shareholders would be unable to benefit directly from any future growth of the Company.

Because the Company's shareholders will be shareholders in Prospect following the arrangement, the Company's shareholders stand to participate in the future growth and prospects of Prospect and its portfolio companies, including the Company.

The oral opinion from Janney (which was subsequently confirmed by delivery of Janney's written opinion dated December 17, 2013) with respect to the fairness, from a financial point of view, of the transaction consideration to be received by the Company's shareholders pursuant to the arrangement.

The costs of remaining an independent public company, including the costs of compliance related to disclosure and corporate governance rules of the SEC and Nasdaq, auditing fees and directors' and officers' insurance.

The current lack of liquidity for the Company's shareholders, given the low trading volume of the Company's Common Shares, as compared to the significant trading market for Prospect common stock.

The terms of the arrangement agreement, including the representations, warranties and covenants of the parties, as well as the conditions to their respective obligations under the arrangement agreement, the likelihood of the consummation of the arrangement, the termination provisions of the arrangement agreement and the Company's board of directors' evaluation of the likely time period necessary to effect the arrangement.

The fact that dissent rights will be available to the Company's shareholders and optionholders in connection with the arrangement.

The Company's board of directors also considered the risks related to the proposed arrangement (see "Risks Related to the Arrangement"), and the following potentially material negative factors in its deliberations concerning the arrangement:

The limited ability of the Company under the arrangement agreement to provide information to, or enter into discussions with, other potential business combination parties who might make an unsolicited proposal to acquire the Company.

Prospect's obligation to complete the arrangement is subject to certain conditions, and it has the right to terminate the arrangement agreement in specified circumstances.

The substantial transaction costs to be incurred by the Company even if the arrangement is not consummated.

The announcement and pendency of the transaction could have an adverse effect on the Company's business, financial condition, results of operations or business prospects and on its stock price.





Table of Contents

The substantial management time and effort required to effectuate the arrangement and the related disruption to the Company's operations, including the disruption which would result if the arrangement were not consummated after the arrangement agreement had been entered into.

The fact that, as a result of the arrangement, existing Company shareholders and optionholders would be unable to benefit directly from any future growth or improved operating performance of the Company.

The restrictions on the conduct of the Company's business prior to the completion of the arrangement, requiring the Company to conduct its business only in the ordinary course, subject to specific limitations, which may delay or prevent the Company from undertaking business opportunities that may arise pending completion of the arrangement.

The fact that certain persons, including directors and officers of the Company, have interests in the arrangement that are different from, or in addition to, those of Company shareholders generally.

Because the Company currently does not anticipate asking Janney to update its opinion, the opinion will not address the fairness, from a financial point of view, of the consideration to be received by the Company's shareholders at the time the arrangement is completed.

Prospect is a business development company and is subject to substantially different risks than the Company.

**Risks Related to the Proposed Arrangement**

Below are certain of the material risks related to the proposed arrangement considered by Nicholas Financial-Canada's board of directors:

**Consideration:** Because the number of shares of Prospect common stock into which Nicholas Financial-Canada's Common Shares are exchangeable will be determined only at the effective time, Nicholas Financial-Canada shareholders cannot be sure of the precise value of the transaction consideration they will receive.

**Share Dilution:** Nicholas Financial-Canada shareholders will experience a reduction in percentage ownership and voting power with respect to their shares as a result of the arrangement.

**Restriction on Ability to Solicit Alternative Offers:** The arrangement agreement limits Nicholas Financial-Canada's ability to pursue alternatives to the transaction.

**Adverse Effect on Business:** The announcement and pendency of the transaction could have an adverse effect on the Company's businesses, financial conditions, results of operations or business prospects and on its stock price. In addition, the arrangement agreement does not permit Nicholas Financial-Canada to make any distributions to its shareholders without the written consent of Prospect.

**Opinion of Financial Advisor:** Certain financial projections considered by Nicholas Financial-Canada, Janney and Prospect may not be realized, which may adversely affect the market price of Prospect common stock following the consummation of the arrangement.

**Business Development Company:** Prospect is a business development company regulated under the 1940 Act and is subject to substantially different risks than the Company.



Table of Contents

**Completion of the Proposed Arrangement**

It is expected that the proposed arrangement will be completed shortly after Nicholas Financial-Canada's shareholders approve the Arrangement Resolution at the special meeting, assuming all regulatory approvals and other required matters are completed at such time. If approved by Nicholas Financial-Canada's shareholders, Prospect and Nicholas Financial-Canada will work to complete the proposed arrangement early in the second quarter of 2014. The arrangement agreement currently permits either party to terminate the arrangement agreement if the arrangement is not completed on or before June 12, 2014.

**Recommendation of the board of directors of Nicholas Financial-Canada**

Nicholas Financial-Canada's board of directors, including its independent directors, believes that the proposed arrangement is advisable and in the best interest of Nicholas Financial-Canada's shareholders and unanimously recommends that shareholders vote "FOR" approval of the Arrangement Resolution.

**Opinion of Nicholas Financial-Canada's Financial Advisor**

Nicholas Financial-Canada's financial advisor, Janney, rendered its oral opinion, subsequently confirmed in writing, that as of December 17, 2013, and based upon and subject to the procedures followed, assumptions made, qualifications and limitations on the review undertaken, and other matters considered by Janney in preparing its opinion, the consideration to be received by the holders of Nicholas Financial-Canada's common stock, as set forth in the arrangement agreement was fair, from a financial point of view, to such holders.

The full text of the written opinion of Janney, dated as of December 17, 2013, is attached to this proxy circular/prospectus as Annex H. The opinion sets forth the procedures followed, assumptions made, qualifications and limitations on the review undertaken, and other matters considered by Janney in preparing its opinion. However, neither Janney's written opinion nor the summary of its opinion and the related analyses set forth in this proxy circular/prospectus are intended to be, and they do not constitute, a recommendation as to or otherwise address how any holder of Nicholas Financial-Canada's Common Shares should vote or act in respect of the Arrangement Resolution or any related matter. Nicholas Financial-Canada encourages you to read carefully the entire opinion.

The opinion does not in any manner address the price at which Prospect common stock will trade at any time following consummation of the arrangement. Janney provided its opinion for the information and assistance of the Nicholas Financial-Canada's board of directors in connection with the directors' consideration of the arrangement and addresses only the fairness, from a financial point of view, of the transaction consideration pursuant to the arrangement agreement for holders of Nicholas Financial-Canada's Common Shares as of the date of the opinion. It does not address any other aspect of the arrangement. The summary of Janney's opinion set forth in this proxy circular/prospectus is qualified in its entirety by reference to the full text of its opinion.

Janney's opinion was necessarily based on financial, economic, market and other conditions as in effect on, and the information made available to it as of, December 17, 2013. Events occurring after December 17, 2013 may affect the opinion and the assumptions used in preparing it, and Janney did not assume any obligation to update, revise or reaffirm the opinion.

Nicholas Financial-Canada agreed to pay Janney a fee based upon the closing of an arrangement or sale. The engagement agreement provided that, if Nicholas Financial-Canada requested and Janney agreed, that Janney would provide a fairness opinion in regard to the transaction that would be credited against any fees due under the engagement agreement. Nicholas Financial-Canada has also agreed to reimburse Janney for reasonable out-of-pocket expenses and disbursements incurred in

Table of Contents

connection with its retention and to indemnify Janney for certain liabilities arising out of its engagement.

**Interests of Nicholas Financial-Canada's Management in the Proposed Arrangement**

In considering the recommendation of Nicholas Financial-Canada's board of directors to approve the Arrangement Resolution, you should be aware that certain of Nicholas Financial-Canada's directors and executive officers have interests in the transaction that are different from, or are in addition to, the interests of Nicholas Financial-Canada's shareholders and optionholders generally. Nicholas Financial-Canada's board of directors was aware of these interests and considered them along with other matters when they determined to recommend the arrangement.

The Company's two executive officers, Messrs. Vosotas and Finkenbrink, have entered into agreements with the Prospect Parties that will supersede their prior employment agreements upon consummation of the arrangement and which, among other things, will cause Mr. Vosotas and Mr. Finkenbrink not to receive any "change of control" payments upon the consummation of the arrangement. Mr. Vosotas entered into a consulting agreement pursuant to which he has agreed to make himself reasonably available for up to twenty hours per month to consult with Nicholas Financial and US New Opco regarding matters relating to the Company's business. During the term of the consulting agreement, Mr. Vosotas will be paid twelve monthly installments of \$10,000. Mr. Finkenbrink has entered into an employment agreement pursuant to which he will serve as the Chief Executive Officer of Amalco and US New Opco. The employment agreement has a five-year term commencing upon the effective time of the arrangement, and provides for a base salary of \$325,000 per annum. For more information regarding these arrangement, please see "Description of The Arrangement Interests of Nicholas Financial-Canada's Directors and Executive Officers in the Arrangement."

At Prospect's request, Mr. Vosotas has agreed to loan \$1,000,000 to Nicholas Financial and US New Opco at the effective time of the arrangement, as evidenced by a subordinated unsecured promissory note. Interest on the principal amount will accrue quarterly at a rate per annum equal to the sum of (i) the LIBOR Rate (as defined below) and (ii) a spread of 6.00%. The principal amount of the note, together with accrued and unpaid interest on such amount, will be due and payable on the third anniversary of the effective time of the arrangement. For more information regarding these arrangements, please see "Description of The Arrangement Interests of Nicholas Financial-Canada's Directors and Executive Officers in the Arrangement."

Optionholders will receive cash for their options. The only persons that hold options are Nicholas Financial-Canada's directors and executive officers. For more information regarding this term of the arrangement, please see "Description of The Arrangement Interests of Nicholas Financial-Canada's Directors and Executive Officers in the Arrangement."

**United States Federal Income Tax Consequences of the Arrangement**

See "Certain United States Federal Income Tax Considerations" for important information regarding the United States federal income tax consequences relating to the arrangement.

**Dividends and Other Distributions**

Pursuant to the arrangement agreement, Nicholas Financial-Canada has agreed, prior to completion or termination of the transaction, not to declare, set aside, pay or make any dividend or other distribution (whether in cash, stock or other property) with respect to any of its Common Shares.

Table of Contents

**Dissent Rights**

Shareholders and optionholders are able to exercise dissent rights. In order to exercise such rights, a shareholder or optionholder must send a written objection to the Arrangement Resolution to Nicholas Financial-Canada and such written objection must be received by Nicholas Financial-Canada not later than 5:00 pm (Vancouver time) on the last business day preceding the date of the special meeting. Shareholders and optionholders that have validly exercised their dissent rights will be paid in cash the fair value by the Purchaser for their shares or options, as applicable.

**Vote Required to Approve the Arrangement Resolution**

The Arrangement Resolution must be approved by at least three-quarters (75%) of the votes cast by Nicholas Financial-Canada shareholders, as well as at least three-quarters (75%) of the votes cast by Nicholas Financial-Canada shareholders and optionholders (voting as a group). Holders may vote either in person or by proxy at the special meeting and will be entitled to one vote for each share held and one vote for each share the holder has an option to acquire. Nicholas Financial-Canada shareholders and optionholders who abstain, or who fail to return their proxies and do not otherwise vote will not have an effect on the outcome of the vote. A quorum for the special meeting of the Company is at least two shareholders or proxyholders representing two shareholders, or one shareholder and a proxyholder representing another shareholder, holding at least 33<sup>1</sup>/<sub>3</sub>% of the total issued and outstanding shares of the Company on the record date for the special meeting.

**Voting Power of Nicholas Financial-Canada's Management**

At the close of business on the record date, Nicholas Financial-Canada's executive officers and directors owned and were entitled to vote [ ] Common Shares and [ ] options, representing [ ]% of the aggregate number of outstanding Common Shares and [ ]% of the combined number of Common Shares and options of Nicholas Financial-Canada on that date. None of Nicholas Financial-Canada's executive officers or directors has entered into any voting agreement relating to the proposed arrangement; however, each of Nicholas Financial-Canada executive officers and directors has indicated that he intends to vote his Common Shares and options, if any, in favor of the approval of the Arrangement Resolution.

**Conditions to the Arrangement**

There are certain obligations of Nicholas Financial-Canada and the Prospect Parties, both collectively and individually, to complete the proposed arrangement, which are subject to the satisfaction or, where permissible, waiver of certain conditions. Certain of these conditions applicable to Nicholas Financial-Canada and the Prospect Parties include:

the Interim Order having been granted in form and substance satisfactory to Nicholas Financial-Canada and the Prospect Parties;

approval of the Arrangement Resolution by Nicholas Financial-Canada's shareholders having been obtained in accordance with the provisions of the Interim Order;

the Final Order having been granted in form and substance reasonably satisfactory to Prospect and Nicholas Financial-Canada; and

the registration statement of Prospect of which this proxy circular/prospectus forms a part thereof will have become effective under the Securities Act.

Certain of these conditions applicable to Nicholas Financial-Canada include:

the representations and warranties of the Prospect Parties contained in the arrangement agreement being true and correct in all respects subject to certain qualifications;



Table of Contents

each of the Prospect Parties having performed in all material respects all obligations and complied in all material respects with all covenants required by the arrangement agreement; and

since the date of the arrangement agreement, except as contemplated by the arrangement agreement, there having not occurred a material adverse change to any of the Prospect Parties.

Certain of these conditions applicable to the Prospect Parties include:

the representations and warranties of the Nicholas Financial-Canada contained in the arrangement agreement being true and correct in all respects subject to certain qualifications;

Nicholas Financial-Canada having performed in all material respects all obligations and complied in all material respects with all covenants required by the arrangement agreement;

since the date of the arrangement agreement, except as contemplated by the arrangement agreement, there has not occurred a material adverse change to Nicholas Financial-Canada; and

no more than 10% of Nicholas Financial-Canada's common stock outstanding will have validly exercised dissenting rights.

Please see "Description of the Arrangement Agreement Conditions to the Arrangement" for a full description of the conditions to the arrangement.

**Termination of the Arrangement Agreement**

The arrangement agreement may be terminated at any time before completion of the arrangement, whether before or after approval of the Arrangement Resolution by Nicholas Financial-Canada shareholders, in a number of ways, including, but not limited to:

by mutual written consent of Nicholas Financial-Canada and the Prospect Parties;

by either Nicholas Financial-Canada or Prospect if (1) the arrangement is not completed prior to the termination deadline, except (i) the termination deadline will be automatically extended for a period not to exceed 45 days to the extent necessary to satisfy certain conditions and (ii) that the right to terminate will not be available to any Party that has breached in any material respect its obligations under the arrangement agreement or caused the failure of the arrangement to be consummated on or before such termination deadline; or (2) shareholders do not approve the Arrangement Resolution at the special meeting;

by Nicholas Financial-Canada or Prospect, as the case may be, if (i) the other Party is in material breach or failed to perform in any material respect its representations, warranties, covenants or other agreements contained in the arrangement agreement, (ii) such breach or failure to perform entitles the other Party to not consummate the arrangement, and (iii) such breach or failure to perform is not curable;

by Nicholas Financial-Canada or Prospect, as the case may be, in certain events such as the Nicholas Financial-Canada's board of directors withdrawing or modifying in a manner adverse to the Prospect Parties its recommendation to approve the Arrangement Resolution or entering into a superior proposal.

Please see "Description of the Arrangement Agreement Termination of the Arrangement Agreement" for a full description of the termination provisions, including termination fees in certain situations, under the arrangement agreement.

**Comparison of Shareholder Rights**

The rights of Nicholas Financial-Canada's shareholders are currently governed by British Columbia law and Nicholas Financial-Canada's Articles. When the proposed arrangement is completed, Nicholas



Table of Contents

Financial-Canada's shareholders will become stockholders of Prospect, a Maryland corporation, and their rights will be governed by Maryland law and Prospect's charter and bylaws. The rights of Nicholas Financial-Canada's shareholders and the rights of Prospect stockholders differ in many respects. See "Comparison of Shareholder Rights" for a discussion of the material differences between the rights of Nicholas Financial-Canada shareholders and the rights of Prospect stockholders.

**Post-Arrangement Recapitalization**

Upon consummation of the arrangement, Prospect intends to refinance the Company using proceeds from a newly committed \$250 million revolving credit facility from bank lenders and an operating company term loan that Prospect will provide. The aggregate net proceeds from this recapitalization will be used to repay the existing debt of the Company and return a portion of capital issued by Prospect to complete the transaction on the closing date. After receipt of the recapitalization cash distribution, Prospect will have a net investment in the transaction of approximately \$139 million. Prospect's post-arrangement recapitalization \$139 million investment in the Company is expected to consist of \$122 million of operating and holding company term loans and \$17 million of a holding company equity investment.

**Litigation**

*Jason Simpson v. Nicholas Financial, Inc., et al.*, Case No. 13-011726-CI (Circuit Court, Pinellas County, Florida), filed December 24, 2013; *Gabriella Rago v. Nicholas Financial, Inc., et al.*, Case No. 8:13-cv-03261-VMC-TGW (U.S. District Court, Tampa, Florida), filed December 30, 2013; *Matthew John Leonard v. Nicholas Financial, Inc., et al.*, Case No. 13-011811-CI (Circuit Court, Pinellas County, Florida), filed December 31, 2013; *Michelangelo Lombardo v. Nicholas Financial, Inc., et al.*, Case No. 14-000095-CI (Circuit Court, Pinellas County, Florida), filed January 3, 2014; and *Edward Opton v. Stephen Bragin, et al.*, Case No. 14-000139-CI (Circuit Court, Pinellas County, Florida), filed January 6, 2014. The five pending, substantially similar lawsuits were filed in connection with the arrangement contemplated by the arrangement agreement. Each plaintiff purports to represent a class of all Nicholas Financial-Canada shareholders other than the defendants and any person or entity related to or affiliated with any defendant. Four of the lawsuits name as defendants Nicholas Financial-Canada, Nicholas Financial-Canada's directors, Prospect, the Purchaser, USCo and US New Opco. The fifth lawsuit names those same parties as defendants, with the exception of the Purchaser and US New Opco. Each plaintiff alleges that the consideration to be paid for Nicholas Financial-Canada's shares is inadequate and that certain terms of the arrangement agreement are contrary to the interests of Nicholas Financial-Canada's public shareholders. Each plaintiff asserts a breach of fiduciary duty claim against Nicholas Financial-Canada's directors, and an aiding and abetting claim against Nicholas Financial-Canada and/or certain of the Prospect Parties. Each plaintiff seeks declaratory relief, injunctive relief, other equitable relief and/or damages with respect to the proposed transaction, and an award of attorneys' fees. The Prospect Parties, Nicholas Financial-Canada and Nicholas Financial-Canada's directors do not believe that there is any merit to any of the pending actions, and they intend to defend vigorously against such actions.

Table of Contents**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 stockholder will bear directly or indirectly by investing in Prospect's common stock and Prospect's costs and expenses that are expected to be incurred in the first year following the arrangement.

**Prospect's Expenses**

The table below illustrates the change in operating expenses expected as a result of the arrangement. The table sets forth (i) the annualized fees, expenses, and interest payments on borrowed funds of Prospect for the quarter ended September 30, 2013 and (ii) the pro forma annualized fees, expenses and interest payments on borrowed funds of Prospect for the quarter ended September 30, 2013 assuming consummation of the arrangement as of October 1, 2013.

	<b>Actual Prospect</b>	<b>Pro Forma Combined Prospect</b>
<i>Stockholder transaction expenses</i>		
Sales load (as a percentage of offering price)	None(1)	None(1)
Dividend reinvestment plan expenses	None(2)	None(2)
	<b>Actual Prospect</b>	<b>Pro Forma Combined Prospect</b>
<i>Annual expenses (as a percentage of net assets attributable to common stock):</i>		
Management fees(3)	3.79%	3.68%
Incentive fees(4)	2.83%	2.83%
Total advisory fees	6.62%	6.51%
Interest expense(5)	4.16%	3.90%
Acquired Fund Fees and Expenses(6)	0.01%	0.01%
Other expenses(7)	1.39%	1.31%
Total annual expenses	12.18%	11.72%

(1) Purchases of shares of common stock of 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 stockholders may have paid in connection with their purchase of shares of 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, including any borrowed amounts for non-investment purposes, for which purpose Prospect has not borrowed and has no intention of borrowing). Although Prospect has no intent to borrow the entire amount available under its line of credit, assuming that it borrowed \$2.4 billion, the 2% management fee of gross assets equals approximately 3.79% of net assets (actual) and 3.68% of net assets (pro forma). Based on Prospect's borrowings as of January 3, 2014 of \$1.8 billion, the 2% management fee of gross assets equals approximately 3.39% of net assets (actual) and 3.30% of net assets (pro forma). See "Business of Prospect Management Services Investment Advisory Agreement" and footnote 4 below.

Table of Contents

- (4) Based on the incentive fee paid during Prospect's fiscal year ended June 30, 2013, all of which consisted of an income incentive fee. The capital gain incentive fee is paid without regard to pre-incentive fee income. For a more detailed discussion of the calculation of those incentive fees, see "Business of Prospect Management Services Investment Advisory Agreement" in this proxy circular/prospectus.
- (5) As of January 3, 2014, Prospect has \$1.8 billion outstanding of its Senior Notes (as defined below) in various maturities, ranging from December 15, 2015 to December 15, 2043, and interest rates, ranging from 4.0% to 7.0%, some of which are convertible into shares of Prospect common stock at various conversion rates. Please see "Business of Prospect General" and "Risks Related to Prospect Risks Relating to Prospect's Business" below for more detail on the Senior Notes.
- (6) Prospect's stockholders indirectly bear the expenses of underlying investment companies in which Prospect invests. This amount includes the fees and expenses of investment companies in which Prospect is invested in as of June 30, 2013. When applicable, fees and expenses are based on historic fees and expenses for the investment companies and for those investment companies with little or no operating history, fees and expenses are based on expected fees and expenses stated in the investment companies' prospectus or other similar communication without giving effect to any performance. Future fees and expenses for certain investment companies may be substantially higher or lower because certain fees and expenses are based on the performance of the investment companies, which may fluctuate over time. The amount of Prospect's average net assets used in calculating this percentage was based on net assets of approximately \$2.9 billion as of September 30, 2013.
- (7) "Other expenses" are based on estimated amounts for the current fiscal year. The amount shown above represents annualized expenses during Prospect's three months ended June 30, 2013 representing all of Prospect's estimated recurring operating expenses (except fees and expenses reported in other items of this table) that are deducted from its operating income and reflected as expenses in Prospect's Statement of Operations. The estimate of Prospect's overhead expenses, including payments under an administration agreement with Prospect Administration, or the "Administration Agreement," based on Prospect's projected allocable portion of overhead and other expenses incurred by Prospect Administration in performing its obligations under the Administration Agreement. "Other expenses" does not include non-recurring expenses. See "Business of Prospect Management Services Administration Agreement."

**Example**

The following table demonstrates the projected dollar amount of cumulative expenses Prospect would pay out of net assets and that you would indirectly bear over various periods with respect to a hypothetical investment in Prospect's common stock before and after the consummation of the arrangement. In calculating the following expense amounts, Prospect has assumed it would have borrowed \$1.8 billion, that its annual operating expenses would remain at the levels set forth in the table above and that Prospect would pay the costs shown in the table above.

	1 Year	3 Years	5 Years	10 Years
Prospect	\$ 93.48	\$ 268.43	\$ 428.49	\$ 771.58
<i>Pro Forma</i> Combined Prospect(1)	\$ 88.86	\$ 256.35	\$ 411.08	\$ 748.27

- (1) The pro forma combined row shown assumes the arrangement is completed.

While the example assumes, as required by the SEC, a 5% annual return, Prospect's performance will vary and may result in a return greater or less than 5%. The income incentive fee under Prospect's Investment Advisory Agreement with Prospect Capital Management is unlikely to be material assuming

Table of Contents

a 5% annual return and is not included in the example. If Prospect achieves sufficient returns on its investments, including through the realization of capital gains, to trigger an incentive fee of a material amount, its distributions to its common stockholders and its expenses would likely be higher. In addition, while the example assumes reinvestment of all dividends and other distributions at net asset value, or "NAV," participants in Prospect's dividend reinvestment plan will receive a number of shares of its common stock determined by dividing the total dollar amount of the distribution payable to a participant by the market price per share of its common stock at the close of trading on the valuation date for the distribution. See "Prospect's Dividend Reinvestment Plan" for additional information regarding its dividend reinvestment plan.

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

Table of Contents**SELECTED FINANCIAL DATA OF PROSPECT**

You should read the condensed consolidated financial information of Prospect below with the consolidated financial statements and notes thereto included in this proxy circular/prospectus. Financial information below for the years ended June 30, 2013, 2012, 2011, 2010 and 2009 has been derived from the financial statements that were audited by Prospect's independent registered public accounting firm. The selected consolidated financial data at and for the three months ended September 30, 2013 and 2012 has been derived from unaudited financial data. Interim results for the three months ended September 30, 2013 are not necessarily indicative of the results that may be expected for the year ending June 30, 2014. Certain reclassifications have been made to the prior period financial information to conform to the current period presentation. See "Management's Discussion and Analysis of Financial Condition and Results of Operations of Prospect" for more information.

	For the Three Months Ended September 30,		For the Year Ended June 30,				
	2013	2012	2013	2012	2011	2010	2009
(in thousands except data relating to shares, per share and number of portfolio companies)							
<b>Performance Data:</b>							
Interest income	\$ 138,421	\$ 78,310	\$ 435,455	\$ 219,536	\$ 134,454	\$ 86,518	\$ 62,926
Dividend income	7,089	36,208	82,705	64,881	15,092	15,366	22,793
Other income	15,524	9,118	58,176	36,493	19,930	12,675	14,762
<b>Total investment income</b>	<b>161,034</b>	<b>123,636</b>	<b>576,336</b>	<b>320,910</b>	<b>169,476</b>	<b>114,559</b>	<b>100,481</b>
Interest and credit facility expenses	(27,407)	(13,511)	(76,341)	(38,534)	(17,598)	(8,382)	(6,161)
Investment advisory expense	(43,629)	(31,735)	(151,031)	(82,507)	(46,051)	(30,727)	(26,705)
Other expenses	(7,661)	(4,363)	(24,040)	(13,185)	(11,606)	(8,260)	(8,452)
<b>Total expenses</b>	<b>(78,697)</b>	<b>(49,609)</b>	<b>(251,412)</b>	<b>(134,226)</b>	<b>(75,255)</b>	<b>(47,369)</b>	<b>(41,318)</b>
Net investment income	82,337	74,027	324,924	186,684	94,221	67,190	59,163
Realized and unrealized (losses) gains	(2,437)	(26,778)	(104,068)	4,220	24,017	(47,565)	(24,059)
Net increase in net assets from operations	\$ 79,900	\$ 47,249	\$ 220,856	\$ 190,904	\$ 118,238	\$ 19,625	\$ 35,104
<b>Per Share Data:</b>							
Net increase in net assets from operations(1)	\$ 0.31	\$ 0.29	\$ 1.07	\$ 1.67	\$ 1.38	\$ 0.33	\$ 1.11
Distributions declared per share	\$ (0.33)	\$ (0.30)	\$ (1.28)	\$ (1.22)	\$ (1.21)	\$ (1.33)	\$ (1.62)
Average weighted shares outstanding for the period	258,084,153	162,492,894	207,069,971	114,394,554	85,978,757	59,429,222	31,559,905
<b>Assets and Liabilities Data:</b>							
Investments	\$ 4,553,136	\$ 2,846,123	\$ 4,172,852	\$ 2,094,221	\$ 1,463,010	\$ 748,483	\$ 547,168
Other assets	230,435	66,474	275,365	161,033	86,307	84,212	119,857
<b>Total assets</b>	<b>4,783,571</b>	<b>2,912,597</b>	<b>4,448,217</b>	<b>2,255,254</b>	<b>1,549,317</b>	<b>832,695</b>	<b>667,025</b>



Table of Contents

	For the Three Months Ended September 30,			For the Year Ended June 30,			
	2013	2012	2013	2012	2011	2010	2009
	(in thousands except data relating to shares, per share and number of portfolio companies)						
Amount drawn on credit facility	69,000		124,000	96,000	84,200	100,300	124,800
Senior convertible notes	847,500	647,500	847,500	447,500	322,500		
Senior unsecured notes	347,762	100,000	347,725	100,000			
InterNotes®	461,977	88,517	363,777	20,638			
Amount owed to related parties	1,789	12,045	6,690	8,571	7,918	9,300	6,713
Other liabilities	145,788	181,209	102,031	70,571	20,342	11,671	2,916
<b>Total liabilities</b>	<b>1,873,816</b>	<b>1,029,271</b>	<b>1,791,723</b>	<b>743,280</b>	<b>434,960</b>	<b>121,271</b>	<b>134,429</b>
Net assets	\$ 2,909,755	\$ 1,883,326	\$ 2,656,494	\$ 1,511,974	\$ 1,114,357	\$ 711,424	\$ 532,596

**Investment Activity****Data:**

No. of portfolio companies at period end	129	96	124	85	72	58	30
Acquisitions	\$ 556,843	\$ 747,937	\$ 3,103,217	\$ 1,120,659	\$ 953,337	\$ 364,788(2)	\$ 98,305
Sales, repayments, and other disposals	\$ 164,167	\$ 158,123	\$ 931,534	\$ 500,952	\$ 285,562	\$ 136,221	\$ 27,007
Total return based on market value(3)	6.49%	3.82%	6.2%	27.2%	17.2%	17.7%	(18.6)%
Total return based on net asset value(3)	2.96%	3.12%	10.9%	18.0%	12.5%	(6.8)%	(0.6)%
Weighted average yield at end of period(4)	12.5%	13.3%	13.6%	13.9%	12.8%	16.2%	14.6%

- (1) Per share data is based on average weighted shares for the period.
- (2) Includes \$207,126 of acquired portfolio investments from Patriot Capital Funding, Inc.
- (3) Total return based on market value is based on the change in market price per share between the opening and ending market prices per share in each period and assumes that dividends are reinvested in accordance with Prospect's dividend reinvestment plan. Total return based on net asset value is based upon the change in net asset value per share between the opening and ending net asset values per share in each period and assumes that dividends are reinvested in accordance with Prospect's dividend reinvestment plan.
- (4) Excludes equity investments and non-performing loans.

Table of Contents**SELECTED FINANCIAL DATA OF THE COMPANY**

You should read the condensed consolidated financial information below with the consolidated financial statements and notes thereto included in this proxy circular/prospectus. The following tables present selected consolidated financial data of the Company as of and for the fiscal years ended March 31, 2013, 2012, 2011, 2010 and 2009, and the six-month periods ended September 30, 2013 and 2012. The selected consolidated financial data have been derived from the Company's consolidated financial statements. All historical share and per share amounts have been restated for all periods presented to reflect a 10% stock dividend paid on December 7, 2009 to shareholders of record as of the close of business on November 20, 2009. See "Management's Discussion and Analysis of Financial Condition and Results of Operation of the Company" for more information.

	Six months ended September 30,		Fiscal Year ended March 31,				
	2013	2012	2013	2012	2011	2010	2009
<b>Statement of Operations Data</b>							
Interest income on finance receivables*	\$ 41,412,533	\$ 41,114,198	\$ 82,072,643	\$ 80,470,980	\$ 73,661,457	\$ 65,571,587	\$ 62,137,387
Sales	12,126	18,949	37,803	44,070	53,622	68,117	69,933
	41,424,659	41,133,147	82,110,446	80,515,050	73,715,079	65,639,704	62,207,320
Interest expense	2,847,804	2,442,371	5,120,827	4,891,854	5,599,951	5,169,736	5,384,532
Provision for credit losses*	6,614,895	6,364,987	13,391,875	12,367,593	15,611,544	20,567,707	25,571,453
Salaries and employee benefits	9,683,009	9,088,090	18,325,945	17,582,967	16,430,763	14,380,695	13,349,523
Change in fair value of interest rate swaps	(583,643)	683,120	504,852		(495,136)	(1,034,869)	1,530,005
Other expenses	6,394,085	5,376,766	12,280,792	9,524,361	9,280,923	8,984,047	8,900,260
	24,956,150	23,955,334	49,624,291	44,366,775	46,428,045	48,067,316	54,735,773
Operating income before income taxes*	16,468,509	17,177,813	32,486,155	36,148,275	27,287,034	17,572,388	7,471,547
Income tax expense*	6,451,464	6,620,219	12,545,209	13,926,516	10,518,740	6,755,850	2,803,627
Net income*	\$ 10,017,045	\$ 10,557,594	\$ 19,940,946	\$ 22,221,759	\$ 16,768,294	\$ 10,816,538	\$ 4,667,920
Earnings per share basic:	\$ 0.83	\$ 0.88	\$ 1.66	\$ 1.89	\$ 1.44	\$ 0.94	\$ 0.41
Weighted average shares outstanding	12,078,703	11,956,362	11,977,174	11,747,160	11,607,341	11,470,318	11,273,811
Earnings per share diluted:	\$ 0.82	\$ 0.87	\$ 1.63	\$ 1.85	\$ 1.41	\$ 0.93	\$ 0.41
Weighted average shares outstanding	12,273,582	12,189,301	12,218,416	12,033,131	11,893,518	11,689,123	11,440,313



Table of Contents

	As of and for the six months ended September 30,			As of and for the Fiscal Year ended March 31,			
	2013	2012	2013	2012	2011	2010	2009
<b>Balance Sheet Data</b>							
Total assets	\$ 276,601,552	\$ 264,468,664	\$ 263,835,468	\$ 256,560,144	\$ 242,975,768	\$ 213,505,606	\$ 197,199,732
Finance receivables, net	260,494,081	248,013,051	249,825,801	241,253,430	229,082,589	201,418,259	185,750,682
Line of credit	131,000,000	110,000,000	125,500,000	112,000,000	118,000,000	107,274,971	102,030,195
Share-holders' equity*	134,747,211	144,070,533	126,965,096	135,263,161	114,546,111	96,984,906	84,435,270
<b>Operating Data</b>							
Return on average assets	7.41%	8.11%	7.66%	8.90%	7.35%	5.27%	2.41%
Return on average equity	15.31%	15.12%	15.21%	17.79%	15.85%	11.92%	5.73%
Gross portfolio yield(1)*	28.77%	29.25%	29.22%	29.48%	29.35%	29.33%	29.96%
Pre-tax yield(1)*	11.09%	12.78%	11.82%	13.31%	10.75%	7.47%	4.46%
Total delinquencies over 30 days	5.58%	5.30%	3.73%	2.99%	2.19%	3.16%	4.20%
Write-off to liquidation(1)	7.05%	6.25%	6.81%	5.66%	6.18%	9.87%	12.39%
Net charge-off percentage(1)	6.13%	5.23%	5.88%	4.59%	4.65%	7.37%	9.93%
<b>Automobile Finance Data &amp; Direct Loan Origination</b>							
Contracts purchased/ direct loans originated	\$ 89,136,086	\$ 80,776,902	\$ 160,077,713	\$ 152,315,679	\$ 151,874,846	\$ 125,315,736	\$ 117,653,858
Average dealer discount*	8.43%	8.57%	8.54%	9.23%	9.55%	9.91%	9.84%
Weighted average contractual rate(1)	22.93%	23.48%	23.43%	23.93%	23.66%	23.62%	24.17%
Number of branch locations	65	63	64	60	56	52	48

(1) See the definitions set forth in the notes to the Portfolio Summary table under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operation of the Company Portfolio Summary."

\* The amounts for 2009 through 2012 and the amount for the six months ended September 30, 2012 have been revised as discussed in Note 2 to the Company's consolidated financial statements.

Table of Contents

**RISKS RELATED TO THE ARRANGEMENT**

***Because the number of shares of Prospect common stock into which Company Common Shares are exchangeable will be determined only at closing, Company shareholders cannot be sure prior to the effective time of the precise value of the transaction consideration they will receive.***

Under the terms of the arrangement agreement, the number of shares of Prospect common stock (or fraction thereof) into which Nicholas Financial-Canada common stock are exchangeable is determined by dividing \$16.00 by the VWAP of Prospect common stock for the 20 trading days prior to and ending on the trading day immediately preceding the effective time of the arrangement. In light of this uncertainty, holders of Nicholas Financial-Canada Common Shares will not be able to calculate the precise value of the consideration that they will receive upon completion of the arrangement until the effective time, and developments reducing the price of Prospect common stock could reduce the value of the consideration holders of Nicholas Financial-Canada Common Shares will receive.

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

Company shareholders will experience a substantial reduction in their respective percentage ownership interests and effective voting power relative to their respective percentage ownership interests in the Company prior to the arrangement. If the arrangement is consummated, based on the VWAP for the 20 days preceding the record date, which was \$[ ], and the number of shares of Prospect common stock issued and outstanding as of such date, Company shareholders will own approximately [ ]% of Prospect's outstanding common stock. In addition, both prior to and after completion of the arrangement, Prospect may issue additional shares of common stock in public offerings, mergers and acquisitions or otherwise (including at prices below its then current net asset value), all of which would further reduce the percentage ownership of Prospect held by former Company shareholders. The issuance or sale by Prospect of shares of its common stock at a discount to net asset value also poses a risk of dilution to stockholders. In particular, stockholders who do not purchase additional shares at or below the discounted price in proportion to their then 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 stockholders 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. Shareholders may also experience a reduction in the market price of Prospect's common stock.

***The arrangement agreement limits the Company's ability to pursue alternatives to the transaction.***

The arrangement agreement contains provisions that make it more difficult for the Company to sell its business to a party other than Prospect. These provisions include a general prohibition on the Company taking certain actions that might lead to or otherwise facilitate an acquisition proposal (as defined in "Description of the Arrangement Agreement Covenants of Nicholas Financial-Canada Regarding Non-Solicitation") and the requirement that the Company pay Prospect a termination fee of \$6.0 million in connection with the transaction if the arrangement agreement is terminated in specified circumstances. See "Description of the Arrangement Agreement Termination of the Arrangement Agreement."

These provisions may discourage a third party that might have an interest in acquiring all or a significant part of the stock, properties or assets of the Company from considering or proposing that acquisition, even if that party were prepared to pay consideration with a higher per share value than the current proposed transaction consideration. Prior to entering the arrangement agreement, the

Table of Contents

Company hired an investment banking firm, Janney, as its independent financial advisor and conducted a broad solicitation of parties potentially interested in acquiring the Company.

***Directors and executive officers of Nicholas Financial-Canada may have potential conflicts of interest in connection with the transaction.***

Some of the directors and executive officers of Nicholas Financial-Canada have interests in the arrangement that are different from, or are in addition to, the interests of Nicholas Financial-Canada's shareholders generally. These interests may create potential conflicts of interest. These interests may include positions as officers of Amalco or US New Opco, potential benefits under employment or consulting arrangements that may be available as a result of the arrangement and in conjunction with other events, the cash payment to be made to optionholders, and the right to continued indemnification and insurance coverage by the resulting company for acts or omissions occurring prior to the closing of the arrangement. See "The Arrangement Resolution Proposal Interests of Nicholas Financial-Canada's Directors and Executive Officers in the Arrangement."

***The announcement and pendency of the transaction could have an adverse effect on the Company's businesses, financial condition, results of operations or business prospects and on its stock price.***

The announcement and pendency of the transaction could disrupt the Company's businesses in the following ways, among others:

Company employees may experience uncertainty regarding their future roles with the resulting company, which might adversely affect the Company's ability to retain, recruit and motivate key personnel;

the attention of the Company's management may be directed towards the completion of the transaction and transaction-related considerations and may be diverted from the day-to-day business operations of the Company, and matters related to the transaction may require commitments of time and resources that could otherwise have been devoted to other opportunities that might have been beneficial to the Company; and

dealers and other third parties who have business relationships with the Company may decide not to renew such relationships or seek to terminate, change and/or renegotiate their relationships with the Company as a result of the transaction, whether pursuant to the terms of their existing agreements with the Company or otherwise.

Any of these matters could adversely affect the businesses, financial condition, results of operations or business prospects of the Company and its stock price.

***Prospect and the Company are engaged in significantly different businesses and Prospect's business may not perform as well as the Company would on its own.***

The Company is primarily in the business of making auto loans to consumers, whereas Prospect, which is much larger than the Company, is primarily in the business of making investments in companies it does not control. Further, Prospect is subject to a substantially different regulatory framework than is the Company. If Prospect's investments perform poorly, the Company's shareholders could have an interest in a company that is performing more poorly than the Company would have performed and that could decrease the value of the Company's shareholders' investment in Prospect below the value they would have had in the Company had the Company remained independent or completed a transaction with a different company than Prospect.

Table of Contents

***Failure to complete the transaction could negatively impact the stock price and the future business and financial results of the Company.***

If the arrangement is not completed, the ongoing business of the Company may be adversely affected and, without realizing any of the benefits of having completed the arrangement, the Company will be subject to a number of risks, including the following:

the Company may be required to pay Prospect a termination fee of \$6.0 million if the arrangement is terminated under certain circumstances, as described in the arrangement agreement and summarized in this proxy circular/prospectus;

the Company will be required to pay its costs relating to the arrangement, even if the arrangement is not completed;

under the arrangement agreement, the Company is subject to certain restrictions on the conduct of its business prior to completing the arrangement, which may affect its ability to execute certain of its business strategies;

matters relating to the arrangement may require substantial commitments of time and resources by the Company's management, which could otherwise be devoted to other opportunities that may be beneficial to the Company as an independent entity; and

since the Company announced on March 20, 2013 that it would retain an investment bank, Janney, as its independent financial advisor to help it consider its strategic alternatives, the Company has announced results from operations for the quarters ending June and September 2013 which were below the results for each respective prior quarter. Consequently, failure to complete the transaction might cause the price of the Company's common stock to decline.

***Prospect's stock price will fluctuate after the completion of the arrangement, and as a result, Company shareholders could lose a significant part or all of their investment.***

There can be no assurance that the price of Prospect common stock will not fluctuate or decline significantly in the future. The trading volume of Prospect common stock may fluctuate and cause significant price variations to occur. In addition, the stock market in general can experience considerable price and volume fluctuations that may be unrelated to Prospect's financial performance. The factors that could cause fluctuations in the stock price or trading volume of Prospect common stock include:

general market and economic conditions, including fluctuations in interest rates;

actual or expected variations in quarterly results of operations;

differences between actual results of operations and those expected by investors and securities analysts;

changes in recommendations by securities analysts;

operations and stock performance of industry participants;

accounting charges, including charges relating to the impairment of long-lived assets, including goodwill;

significant acquisitions or strategic alliances by Prospect;

sales of Prospect common stock, including sales by Prospect's directors and officers or significant investors; and

recruitment or departure of key personnel.

Table of Contents

The occurrence of any or all of these factors could cause the price of Prospect common stock to decline, with the result that shareholders of the Company who receive Prospect common stock from the transaction could suffer a decline in the value of their investment, which could be significant.

***Prospect will incur significant transaction costs in connection with the arrangement.***

Prospect expects to incur significant transaction costs, which it currently estimates to be approximately \$[ ] million, including the Company's transaction costs up to the consummation of the arrangement, in connection with the arrangement. The substantial majority of these costs will be non-recurring expenses related to the arrangement, including professional fees and other non-recurring expenses, which will be capitalized into Prospect's cost basis for the transaction.

***The regulatory approvals required for the completion of the arrangement may not be obtained, or may contain materially burdensome conditions that could have an adverse effect on either Prospect or the Company.***

Completion of the arrangement is conditional upon the receipt of certain regulatory approvals. Although Prospect and the Company have agreed to use their commercially reasonable efforts to obtain the requisite governmental and court approvals, there can be no assurance that these approvals will be obtained. In addition, the governmental authorities from which these approvals are required may impose conditions on the completion of the arrangement or require changes to the terms of the arrangement. If, although it is not required under the arrangement agreement to do so, Prospect agrees to such conditions in order to obtain any approvals required to complete the arrangement, then the business and results of operations of the combined company may be adversely affected.

***Certain financial projections considered by the Company, Janney and Prospect may not be realized, which may adversely affect the market price of Prospect common stock following the consummation of the arrangement.***

In arriving at its opinion regarding the fairness from a financial point of view of the transaction consideration to be received by the holders of Nicholas Financial-Canada Common Shares pursuant to the arrangement agreement, Janney relied upon, without independent verification, the accuracy and completeness of the information that was made available to Janney by the Company and Prospect. See "The Arrangement Resolution Proposal Opinion of Nicholas Financial-Canada's Financial Advisor." These financial projections were prepared by, or as directed by, the management of the Company and were also considered by the Company's board of directors and Prospect. None of these financial projections were prepared with a view towards public disclosure or compliance with the published guidelines of the SEC or the American Institute of Certified Public Accountants regarding projections and forecasts. The financial projections are inherently based on various estimates and assumptions that are subject to the judgment of those preparing them and are also subject to significant economic, competitive, industry and other uncertainties and contingencies, all of which are difficult or impossible to predict and many of which are beyond the control of Prospect and the Company. Accordingly, there can be no assurance that Prospect's or the Company's financial condition or results of operations will not be significantly worse than those set forth in such projections. Significantly worse financial results could have a material adverse effect on the market price of Prospect common stock following the consummation of the arrangement.

***Prospect is a business development company regulated under the 1940 Act and is subject to substantially different risks than the Company.***

An investment in Prospect common stock involves certain risks relating to Prospect's structure and investment objective. Prospect is a business development company regulated under the 1940 Act. As a business development company, Prospect is required to comply with various restrictions on its capitalization, types of investments and transactions with affiliates. For example, Prospect is generally

Table of Contents

required to, among other things, invest at least 70% of its assets in private or small domestic companies engaged primarily in non-financial businesses as well as in cash items, U.S. Government securities and high quality short term debt securities (and is required to offer managerial assistance to such companies). As such, Prospect's portfolio primarily includes securities issued by privately-held companies. These investments generally involve a high degree of business and financial risk, and are less liquid than public securities. Prospect is required to mark the carrying value of its investments to fair value on a quarterly basis, and economic events, market conditions and events affecting individual portfolio companies can result in quarter-to-quarter mark-downs and mark-ups of the value of individual investments that collectively can materially affect Prospect's net asset value, or NAV. Also, Prospect's determinations of fair value of privately-held securities may differ materially from the values that would exist if there was a ready market for these investments. A large number of entities compete for the same kind of investment opportunities as Prospect does. Moreover, Prospect's business requires a substantial amount of capital to operate and to grow and Prospect may seek additional capital from external sources. In addition, the failure to qualify as a RIC eligible for pass-through tax treatment under the Code on income distributed to stockholders could have a materially adverse effect on the total return, if any, obtainable from an investment in Prospect common stock. See "Risks Related to Prospect" and the other information included in this proxy circular/prospectus.

On the other hand, the Company is a specialized consumer finance company engaged primarily in acquiring and servicing retail installment sales contracts for purchase of new and used cars and light trucks. To a lesser extent, the Company also makes direct loans and sells consumer finance related products. The industry in which the Company operates is highly competitive. There are numerous financial service companies that provide consumer credit in the markets served by the Company, including banks, credit unions, other consumer finance companies and captive finance companies owned by automobile manufacturers and retailers. Many of these competitors have substantially greater financial resources than the Company. The Company may also experience high delinquency rates in its loan portfolios, which could reduce its profitability. Further, the Company's business is highly dependent upon its relationships with its dealers.

Overall, there are a significant number of differences between the risks related to investing in Prospect and the risks related to investing in the Company. Shareholders of the Company should carefully consider the risks related to investing in Prospect prior to submitting their vote.

Table of Contents

**RISKS RELATED TO PROSPECT**

**Risks Relating to Prospect's Business**

*Capital markets could experience a period of disruption and instability. Such market conditions have historically and could again have a material and adverse effect on debt and equity capital markets in the United States and abroad, which had, and may in the future have, a negative impact on Prospect's business and operations.*

The global capital markets have historically experienced an extended period of instability as evidenced by the periodic disruptions in liquidity in the debt capital markets, significant write-offs in the financial services sector, the re-pricing of credit risk in the broadly syndicated credit market and the failure of certain major financial institutions. Despite actions of the United States federal government and foreign governments during such period, these events contributed to worsening general economic conditions that materially and adversely impacted the broader financial and credit markets and reduced the availability of debt and equity capital for the market as a whole and financial services firms in particular. While recent market conditions have improved, there can be no assurance that adverse market conditions will not repeat themselves or worsen in the future. If these adverse and volatile market conditions repeat themselves or worsen in the future, Prospect and other companies in the financial services sector may have to access, if available, alternative markets for debt and equity capital in order to grow. Equity capital may be difficult to raise because, subject to some limited exceptions, as a BDC, Prospect is generally not able to issue additional shares of its common stock at a price less than net asset value without first obtaining approval for such issuance from its stockholders and its independent directors. At Prospect's annual meeting of stockholders held on December 6, 2013, subject to the condition that the maximum number of shares salable below net asset value pursuant to this authority in any particular offering that could result in such dilution is limited to 25% of Prospect's then outstanding common stock immediately prior to each such offering, Prospect's stockholders approved Prospect's ability to sell or otherwise issue shares of Prospect's common stock at a price below its then current net asset value per share for a twelve month period expiring on the anniversary of the date of stockholder approval. It should be noted that, theoretically, Prospect may offer up to 25% of its then outstanding common stock each day. In addition, Prospect's ability to incur indebtedness (including by issuing preferred stock) is limited by applicable regulations such that Prospect's asset coverage, as calculated in accordance with the 1940 Act, must equal at least 200% immediately after each time Prospect incurs indebtedness. The debt capital that will be available to Prospect in the future, if at all, may be at a higher cost and on less favorable terms and conditions than what it currently experiences. Any inability to raise capital could have a negative effect on Prospect's business, financial condition and results of operations.

Moreover, the re-appearance of market conditions similar to those experienced from 2007 through 2009 for any substantial length of time could make it difficult to extend the maturity of or refinance Prospect's existing indebtedness under similar terms and any failure to do so could have a material adverse effect on Prospect's business.

Given the extreme volatility and dislocation that the capital markets have historically experienced, many BDCs have faced, and may in the future face, a challenging environment in which to raise or access capital. In addition, significant changes in the capital markets, including the extreme volatility and disruption over the past several years, has had, and may in the future have, a negative effect on the valuations of Prospect's investments and on the potential for liquidity events involving Prospect's investments. While most of Prospect's investments are not publicly traded, applicable accounting standards require Prospect to assume as part of Prospect's valuation process that its investments are sold in a principal market to market participants (even if Prospect plans on holding an investment through its maturity). As a result, volatility in the capital markets can adversely affect Prospect's investment valuations. Further, the illiquidity of Prospect's investments may make it difficult for it to



Table of Contents

sell such investments to access capital if required. As a result, Prospect could realize significantly less than the value at which it has recorded its investments if it were required to sell them for liquidity purposes. An inability to raise or access capital could have a material adverse impact on Prospect's business, financial condition or results of operations.

The current financial market situation, as well as various social and political tensions in the United States and around the world, particularly in the Middle East, may continue to contribute to increased market volatility, may have long-term effects on the United States and worldwide financial markets, and may cause further economic uncertainties or deterioration in the United States and worldwide. Since 2010, several European Union countries, including Greece, Ireland, Italy, Spain, and Portugal have faced budget issues, some of which may have negative long-term effects for the economies of those countries and other European Union countries. There is continued concern about national-level support for the euro and the accompanying coordination of fiscal and wage policy among European Economic and Monetary Union member countries. Prospect does not know how long the financial markets will continue to be affected by these events and cannot predict the effects of these or similar events in the future on the United States economy and securities markets or on its investments. Prospect monitors developments and seeks to manage its investments in a manner consistent with achieving Prospect's investment objective, but there can be no assurance that it will be successful in doing so; and Prospect may not timely anticipate or manage existing, new or additional risks, contingencies or developments, including regulatory developments in the current or future market environment.

***Prospect may suffer credit losses.***

Investment in small and middle-market companies is highly speculative and involves a high degree of risk of credit loss. These risks are likely to increase during volatile economic periods, such as the United States and many other economies have recently been experiencing. See "Risks Relating to Prospect's Investments."

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

Prospect Capital Management 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. Prospect's ability to achieve its investment objective depends on its ability to grow, which depends, in turn, on the Investment Adviser's ability to continue to identify, analyze, invest in and monitor companies that meet Prospect's investment criteria. Accomplishing this result on a cost-effective basis is largely a function of the Investment Adviser'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 continues to grow, Prospect Capital Management will need to continue to hire, train, supervise and manage new employees. Failure to manage Prospect's 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 Prospect's future success.***

Prospect depends on the diligence, skill and network of business contacts of the senior management of the Investment Adviser. Prospect also depends, to a significant extent, on the Investment Adviser's access to the investment professionals and the information and deal flow generated by these investment professionals in the course of their investment and portfolio management activities. The senior management team of the Investment Adviser evaluates, negotiates, structures, closes, monitors and services Prospect's investments. Prospect's success depends to a significant extent on the continued service of the Investment Adviser's senior management team,

Table of Contents

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 Prospect's investment objective. In addition, Prospect can offer no assurance that Prospect Capital Management will remain the Investment Adviser or that Prospect 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 number of entities compete with Prospect to make the types of investments that it makes in middle-market companies. Prospect competes with other BDCs, public and private funds, commercial and investment banks, commercial financing companies, insurance companies, hedge funds, and, to the extent they provide an alternative form of financing, private equity funds. Many of Prospect's competitors are substantially larger and have considerably greater financial, technical and marketing resources than Prospect does. Some competitors may have a lower cost of funds and access to funding sources that are not available to Prospect. In addition, some of Prospect's competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more relationships than Prospect. Furthermore, many of Prospect's competitors are not subject to the regulatory restrictions that the 1940 Act imposes on Prospect as a BDC and that the Code imposes on Prospect as a RIC. Prospect cannot assure you that the competitive pressures it faces will not have a material adverse effect on Prospect's business, financial condition and results of operations. Also, as a result of this competition, Prospect may not be able to pursue attractive investment opportunities from time to time.

Prospect does not seek to compete primarily based on the interest rates it offers and Prospect believes that some of its competitors may make loans with interest rates that are comparable to or lower than the rates it offers. Rather, Prospect competes with its competitors based on its existing investment platform, seasoned investment professionals, experience and focus on middle-market companies, disciplined investment philosophy, extensive industry focus and flexible transaction structuring.

Prospect may lose investment opportunities if it does not match its competitors' pricing, terms and structure. If Prospect matches its competitors' pricing, terms and structure, it may experience decreased net interest income and increased risk of credit loss. As a result of operating in such a competitive environment, Prospect may make investments that are on less favorable terms than what it may have originally anticipated, which may impact Prospect's return on these investments.

***Prospect funds a portion of its investments with borrowed money, which magnifies the potential for gain or loss on amounts invested and may increase the risk of investing in Prospect.***

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

Table of Contents

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

A portion of the debt investments Prospect makes bears interest at fixed rates and other debt investments bear interest at variable rates with floors 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 Prospect's investments. As a result, an increase in market interest rates could both reduce the value of Prospect's portfolio investments and increase Prospect's cost of capital, which could reduce Prospect's net investment income or net increase in net assets resulting from operations.

***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 stockholders to maintain its status as a RIC for United States federal income tax purposes. 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, Prospect could be limited in its ability to grow, which may have an adverse effect on the value of Prospect's common stock. In addition, as a business development company, Prospect generally may not borrow money or issue debt securities or issue preferred stock unless immediately thereafter its ratio of total assets to total borrowings and other senior securities is at least 200%. This may restrict Prospect's ability to obtain additional leverage in certain circumstances.

***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 Prospect holds, the default rate on debt securities, the level of Prospect's expenses, variations in and the timing of the recognition of realized and unrealized gains or losses, the degree to which Prospect 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.

***Prospect's most recent NAV was calculated on September 30, 2013 and its NAV when calculated effective December 31, 2013 may be higher or lower.***

Prospect's most recently estimated NAV per share is \$10.76 on an as adjusted basis solely to give effect to its issuance of common stock since September 30, 2013 in connection with its dividend reinvestment plan and its issuance of 29,857,039 shares of common stock during the period from October 1, 2013 to December 30, 2013 (with settlement through January 3, 2014) under its at-the-market offering program, or the "ATM Program," \$0.04 higher than the \$10.72 determined by Prospect as of September 30, 2013. NAV per share as of December 31, 2013, may be higher or lower than \$10.76 based on potential changes in valuations, issuances of securities, dividends paid and earnings for the quarter then ended. Prospect's board of directors has not yet determined the fair value of portfolio investments at any date subsequent to September 30, 2013. Prospect's board of directors determines the fair value of its portfolio investments on a quarterly basis in connection with the preparation of quarterly financial statements and based on input from independent valuation firms, the Investment Adviser, the Administrator and the Audit Committee of Prospect's board of directors.

Table of Contents

***The Investment Adviser's liability is limited under the Investment Advisory Agreement, and Prospect is required to indemnify the Investment Adviser against certain liabilities, which may lead the Investment Adviser to act in a riskier manner on Prospect's behalf than it would when acting for its own account.***

The Investment Adviser has not assumed any responsibility to Prospect other than to render the services described in the Investment Advisory Agreement, and it will not be responsible for any action of Prospect's board of directors in declining to follow the Investment Adviser's advice or recommendations. Pursuant to the Investment Advisory Agreement, the Investment Adviser and its members and their respective officers, managers, partners, agents, employees, controlling persons and members and any other person or entity affiliated with it will not be liable to Prospect for their acts under the Investment Advisory Agreement, absent willful misfeasance, bad faith, gross negligence or reckless disregard in the performance of their duties. Prospect has agreed to indemnify, defend and protect the Investment Adviser and its members and their respective officers, managers, partners, agents, employees, controlling persons and members and any other person or entity affiliated with it with respect to all damages, liabilities, costs and expenses resulting from acts of the Investment Adviser not arising out of willful misfeasance, bad faith, gross negligence or reckless disregard in the performance of their duties under the Investment Advisory Agreement. These protections may lead the Investment Adviser to act in a riskier manner when acting on Prospect's behalf than it would when acting for its own account.

***Potential conflicts of interest could impact Prospect's investment returns.***

Prospect's executive officers and directors, and the executive officers of the Investment Adviser, may serve as officers, directors or principals of entities that operate in the same or related lines of business as Prospect does or of investment funds managed by Prospect's 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 Prospect's stockholders. Nevertheless, it is possible that new investment opportunities that meet Prospect's investment objective 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, under the Investment Advisory Agreement Prospect pays base management and incentive fees to Prospect Capital Management, and reimburses Prospect Capital Management for certain expenses it incurs. As a result of the Investment Advisory Agreement, there may be times when the senior management team of Prospect Capital Management has interests that differ from those of Prospect's stockholders, giving rise to a conflict.

The Investment Adviser 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 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 Prospect's investments remained constant or decreased. Subject to the receipt of any requisite stockholder

Table of Contents

approval under the 1940 Act, Prospect's board of directors may adjust the hurdle rate by amending the Investment Advisory Agreement.

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 stockholders on such accrued income, Prospect 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 Prospect's allocable portion of overhead and other expenses incurred by Prospect Administration in performing its obligations as Administrator under the Administration Agreement, 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 the Investment Adviser 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 the Investment Adviser 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 the Investment Adviser will receive an incentive fee based, in part, upon net capital gains realized on Prospect's investments, the Investment Adviser may invest more than would otherwise be appropriate in companies whose securities are likely to yield capital gains, as compared to income producing securities. Such a practice could result in 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 the Investment Adviser 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 Prospect 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 use may not have yet received in cash in the event of default may never receive.

Table of Contents

***Prospect may be obligated to pay its Investment Adviser incentive compensation even if Prospect incurs a loss.***

The Investment Adviser is entitled to incentive compensation for each fiscal quarter based, in part, on Prospect's pre-incentive fee net investment income if any, for the immediately preceding calendar quarter above a performance threshold for that quarter. Accordingly, since the performance threshold is based on a percentage of Prospect's net asset value, decreases in Prospect's net asset value make it easier to achieve the performance threshold. Prospect's pre-incentive fee net investment income for incentive compensation purposes excludes realized and unrealized capital losses or depreciation that Prospect may incur in the fiscal quarter, even if such capital losses or depreciation result in a net loss on Prospect's statement of operations for that quarter. Thus, Prospect may be required to pay the Investment Adviser incentive compensation for a fiscal quarter even if there is a decline in the value of Prospect's portfolio or Prospect incurs a net loss for that quarter.

***The Investment Adviser and Administrator have the right to resign on 60 days' notice, and Prospect may not be able to find a suitable replacement within that time, resulting in a disruption in Prospect's operations that could adversely affect Prospect's business, financial condition and results of operations.***

The Investment Adviser and Administrator have the right, under the Investment Advisory Agreement and Administration Agreement, respectively, to resign at any time upon not less than 60 days' written notice, whether Prospect has found a replacement or not. If the Investment Adviser or Administrator resigns, Prospect may not be able to find a replacement or hire internal management or administration with similar expertise and ability to provide the same or equivalent services on acceptable terms within 60 days, or at all. If Prospect is unable to do so quickly, Prospect's operations are likely to experience a disruption, Prospect's business, financial condition and results of operations as well as Prospect's ability to pay distributions are likely to be adversely affected and the market price of Prospect's shares may decline. In addition, the coordination of Prospect's internal management and investment activities or Prospect's internal administration activities, as applicable, is likely to suffer if Prospect is unable to identify and reach an agreement with a single institution or group of executives having the expertise possessed by the Investment Adviser and its affiliates or the Administrator and its affiliates. Even if Prospect is able to retain comparable management or administration, whether internal or external, the integration of such management or administration and their lack of familiarity with Prospect's investment objective may result in additional costs and time delays that may adversely affect Prospect's business, financial condition and results of operations.

***Changes in the laws or regulations governing Prospect's business or the businesses of Prospect's portfolio companies and any failure by Prospect or Prospect's portfolio companies to comply with these laws or regulations, could negatively affect the profitability of Prospect's operations or of Prospect's portfolio companies.***

Prospect is subject to changing rules and regulations of federal and state governments, as well as the stock exchange on which Prospect's common stock is listed. These entities, including the Public Company Accounting Oversight Board, the SEC and NASDAQ, have issued a significant number of new and increasingly complex requirements and regulations over the course of the last several years and continue to develop additional regulations. In particular, changes in the laws or regulations or the interpretations of the laws and regulations that govern BDCs, RICs or non-depository commercial lenders could significantly affect Prospect's operations and Prospect's cost of doing business. Prospect is subject to federal, state and local laws and regulations and are subject to judicial and administrative decisions that affect Prospect's operations, including Prospect's loan originations, maximum interest rates, fees and other charges, disclosures to portfolio companies, the terms of secured transactions, collection and foreclosure procedures and other trade practices. If these laws, regulations or decisions change, or if Prospect expands its business into jurisdictions that have adopted more stringent requirements than those in which Prospect currently conducts business, it may have to incur significant

Table of Contents

expenses in order to comply, or it might have to restrict its operations. In addition, if Prospect does not comply with applicable laws, regulations and decisions, it may lose licenses needed for the conduct of its business and be subject to civil fines and criminal penalties, any of which could have a material adverse effect upon its business, financial condition and results of operations.

***Foreign and domestic political risk may adversely affect Prospect's business.***

Prospect is exposed to political risk to the extent that Prospect Capital Management, on its behalf and subject to its investment guidelines, transacts in securities in the United States and foreign markets. The governments in any of these jurisdictions could impose restrictions, regulations or other measures, which may have a material adverse impact on Prospect's strategy.

**Risks Relating to Prospect's Operation as a Business Development Company**

***If Prospect does not invest a sufficient portion of its assets in qualifying assets, Prospect could fail to qualify as a BDC or be precluded from investing according to its current business strategy.***

As a BDC, Prospect may not acquire any assets other than "qualifying assets" unless, at the time of and after giving effect to such acquisition, at least 70% of Prospect's total assets are qualifying assets. Prospect believe that most of the investments that Prospect may acquire in the future will constitute qualifying assets. However, Prospect may be precluded from investing in what it believes are attractive investments if such investments are not qualifying assets for purposes of the 1940 Act. If Prospect does not invest a sufficient portion of its assets in qualifying assets, Prospect could be found to be in violation of the 1940 Act provisions applicable to BDCs, which would have a material adverse effect on its business, financial condition and results of operations. Similarly, these rules could prevent Prospect from making follow-on investments in existing portfolio companies (which could result in the dilution of its position) or could require Prospect to dispose of investments at inappropriate times in order to come into compliance with the 1940 Act. Because most of Prospect'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 Prospect fails to qualify as a RIC, it will have to pay corporate-level taxes on its income, and Prospect's income available for distribution would be reduced.***

To maintain Prospect's qualification for United States 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 securities or options thereon or foreign currencies, or other income derived with respect to Prospect's business of investing in such 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 ordinary income and net short-term capital gains in excess of net long-term capital losses, if any, to Prospect's stockholders 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 qualify for RIC tax treatment. If Prospect is unable to obtain cash from other sources, it may fail to qualify for RIC tax treatment and, thus, may be subject to corporate-level income tax on all of its taxable income.

To maintain Prospect's qualification as a RIC, it must also meet certain asset diversification requirements at the end of each quarter of its taxable year. Failure to meet these tests may result in

Table of Contents

Prospect having to dispose of certain investments quickly in order to prevent the loss of RIC status. Because most of Prospect's 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 would 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 stockholders. For additional information regarding asset coverage ratio and RIC requirements, see "Certain United States Federal Income Tax Considerations" and "Business Regulation as a Business Development Company."

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

For United States federal income tax purposes, Prospect includes in income certain amounts that it has not yet received in cash, such as original issue discount or payment-in-kind interest, which represents contractual interest added to the loan balance and due at the end of the loan term. Such amounts could be significant relative to Prospect's overall investment activities. 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 Prospect 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 distributing 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, as required 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. See "Certain United States Federal Income Tax Considerations" and "Business of Prospect Regulation as a Business Development Company".

***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 through the issuance of the Senior Notes and, in the future, may issue preferred stock or debt securities and/or borrow additional money from banks or other financial institutions, which Prospect 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 BDC, 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 Prospect's assets declines, it may be unable to satisfy this test, which would prohibit it from paying dividends in cash or other property and could prohibit it 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 or otherwise increase its net assets. In



Table of Contents

addition, issuance of additional common stock could dilute the percentage ownership of Prospect's current stockholders.

As a BDC 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 without stockholder approval. If Prospect's 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 (i)(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 Prospect approve the sale of its common stock at a price that is less than the current net asset value, and (2) a majority of Prospect's directors who have no financial interest in the transaction and a majority of Prospect's independent directors (a) determine that such sale is in Prospect's and its stockholders' 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 Prospect 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 or if (ii) a majority of the number of the beneficial holders of Prospect's common stock entitled to vote at its annual meeting, without regard to whether a majority of such shares are voted in favor of the proposal, approve the sale of Prospect's common stock at a price that is less than the current net asset value per share.

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. See "Securitization of Prospect's assets subjects it to various risks."

***Securitization of Prospect's assets subjects it to various risks.***

Prospect may securitize assets to generate cash for funding new investments. Prospect refers to the term securitize to describe a form of leverage under which a company such as Prospect (sometimes referred to as an "originator" or "sponsor") transfers income producing assets to a single-purpose, bankruptcy-remote subsidiary (also referred to as a "special purpose entity" or SPE), which is established solely for the purpose of holding such assets and entering into a structured finance transaction. The SPE then issues notes secured by such assets. The special purpose entity may issue the notes in the capital markets either publicly or privately to a variety of investors, including banks, non-bank financial institutions and other investors. There may be a single class of notes or multiple classes of notes, the most senior of which carries less credit risk and the most junior of which may carry substantially the same credit risk as the equity of the SPE.

An important aspect of most debt securitization transactions is that the sale and/or contribution of assets into the SPE be considered a true sale and/or contribution for accounting purposes and that a reviewing court would not consolidate the SPE with the operations of the originator in the event of the originator's bankruptcy based on equitable principles. Viewed as a whole, a debt securitization seeks to lower risk to the note purchasers by isolating the assets collateralizing the securitization in an SPE that is not subject to the credit and bankruptcy risks of the originator. As a result of this perceived reduction of risk, debt securitization transactions frequently achieve lower overall leverage costs for originators as compared to traditional secured lending transactions.

Table of Contents

In accordance with the above description, to securitize loans, Prospect may create a wholly owned subsidiary and contribute a pool of its assets to such subsidiary. The SPE may be funded with, among other things, whole loans and such loans may or may not be rated. The SPE would then sell its notes to purchasers who Prospect would expect to be willing to accept a lower interest rate and the absence of any recourse against Prospect to invest in a pool of income producing assets to which none of Prospect's creditors would have access. Prospect would retain all or a portion of the equity in the SPE. An inability to successfully securitize portions of Prospect's portfolio or otherwise leverage Prospect's portfolio through secured and unsecured borrowings could limit its ability to grow its business and fully execute its business strategy, and could decrease its earnings. However, the successful securitization of portions of Prospect's portfolio exposes it to a risk of loss for the equity it retains in the SPE and might expose it to greater risk on Prospect's remaining portfolio because the assets it retains 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 Prospect's business activities and may include limitations that could hinder Prospect's 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.

Interests Prospect holds in the SPE, if any, will be subordinated to the other interests issued by the SPE. As such, Prospect will only receive cash distributions on such interests if the SPE has made all cash interest and other required payments on all other interests it has issued. In addition, Prospect's subordinated interests will likely be unsecured and rank behind all of the secured creditors, known or unknown, of the SPE, including the holders of the senior interests it has issued. Consequently, to the extent that the value of the SPE's portfolio of assets has been reduced as a result of conditions in the credit markets, or as a result of defaults, the value of the subordinated interests Prospect retains would be reduced. Securitization imposes on Prospect the same risks as borrowing except that Prospect's risk in a securitization is limited to the amount of subordinated interests it retains, whereas in a borrowing or debt issuance by Prospect directly, Prospect would be at risk for the entire amount of the borrowing or debt issuance.

If the SPE is not consolidated with Prospect, Prospect's only interest will be the value of its retained subordinated interest and the income allocated to Prospect, which may be more or less than the cash Prospect receives from the SPE, and none of the SPE's liabilities will be reflected as Prospect's liabilities. If the assets of the SPE are not consolidated with Prospect's assets and liabilities, then Prospect's interest in the SPE may be deemed not to be a qualifying asset for purposes of determining whether 70% of Prospect's assets are qualifying assets and the leverage incurred by such SPE may or may not be treated as borrowings by Prospect for purposes of the requirement that Prospect not issue senior securities in an amount in excess of Prospect's net assets.

Prospect may also engage in transactions utilizing SPEs and securitization techniques where the assets sold or contributed to the SPE remain on Prospect's balance sheet for accounting purposes. If, for example, Prospect sells the assets to the SPE with recourse or provides a guarantee or other credit support to the SPE, its assets will remain on Prospect's balance sheet. Consolidation would also generally result if Prospect, in consultation with the SEC, determines that consolidation would result in a more accurate reflection of Prospect's assets, liabilities and results of operations. In these structures, the risks will be essentially the same as in other securitization transactions but the assets will remain Prospect's assets for purposes of the limitations described above on investing in assets that are not qualifying assets and the leverage incurred by the SPE will be treated as borrowings incurred by Prospect for purposes of Prospect's limitation on the issuance of senior securities.

The Investment Adviser may have conflicts of interest with respect to potential securitizations in as much as securitizations that are not consolidated may reduce Prospect's assets for purposes of determining its investment advisory fee although in some circumstances the Investment Adviser may be

Table of Contents

paid certain fees for managing the assets of the SPE so as to reduce or eliminate any potential bias against securitizations.

***Prospect's ability to invest in public companies may be limited in certain circumstances.***

As a BDC, Prospect must not acquire any assets other than "qualifying assets" specified in the 1940 Act unless, at the time the acquisition is made, at least 70% of its total assets are qualifying assets (with certain limited exceptions). Subject to certain exceptions for follow-on investments and distressed companies, an investment in an issuer that has outstanding securities listed on a national securities exchange may be treated as qualifying assets only if such issuer has a market capitalization that is less than \$250 million at the time of such investment.

**Risks Relating to Prospect's Investments**

***Prospect may not realize gains or income from its investments.***

Prospect seeks to generate both current income and capital appreciation. However, the securities Prospect invests in may not appreciate and, in fact, may decline in value, and the issuers of debt securities Prospect invests in may default on interest and/or principal payments. Accordingly, Prospect 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 experiences. See "Business of Prospect Prospect's Investment Objective and Policies".

***Most of Prospect's portfolio investments are recorded at fair value as determined in good faith under the direction of 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 Prospect may incur in any year, is to a degree subjective, and the Investment Adviser 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 the Investment Adviser, the Administrator, a third party independent valuation firm and Prospect's 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 Prospect's 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 Prospect ultimately realizes upon the disposal of such securities.

In addition, decreases in the market values or fair values of Prospect's investments are recorded as unrealized depreciation. Unprecedented declines in prices and liquidity in the corporate debt markets experienced during the recent financial crises resulted in significant net unrealized depreciation in Prospect's portfolio in the past. The effect of all of these factors on Prospect's portfolio reduced its NAV by increasing net unrealized depreciation in its portfolio. Depending on market conditions, Prospect could incur substantial realized losses and may continue to suffer additional unrealized losses

Table of Contents

in future periods, which could have a material adverse impact on Prospect's business, financial condition and results of operations. Prospect has no policy regarding holding a minimum level of liquid assets. As such, a high percentage of Prospect's portfolio generally is not liquid at any given point in time. See "The lack of liquidity in Prospect's investments may adversely affect its business."

***Price declines and illiquidity in the corporate debt markets have adversely affected, and may in the future adversely affect, the fair value of Prospect's portfolio investments, reducing Prospect's net asset value through increased net unrealized depreciation.***

As a BDC, Prospect is required to carry its investments at market value or, if no market value is ascertainable, at fair value as determined in good faith by or under the direction of its board of directors. As part of the valuation process, the types of factors that Prospect may take into account in determining the fair value of its investments include, as relevant and among other factors: available current market data, including relevant and applicable market trading and transaction comparables, applicable market yields and multiples, security covenants, call protection provisions, information rights, the nature and realizable value of any collateral, the portfolio company's ability to make payments, its earnings and discounted cash flows, the markets in which the portfolio company does business, comparisons of financial ratios of peer companies that are public, merger and acquisition comparables, Prospect's principal market (as the reporting entity) and enterprise values. Decreases in the market values or fair values of Prospect's investments are recorded as unrealized depreciation. The effect of all of these factors on Prospect's portfolio can reduce Prospect's net asset value by increasing net unrealized depreciation in its portfolio. Depending on market conditions, Prospect could incur substantial realized losses and may suffer additional unrealized losses in future periods, which could have a material adverse impact on its business, financial condition and results of operations.

***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 Prospect's 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 the Investment Adviser to obtain adequate information to evaluate these companies in making investment decisions. If the Investment Adviser 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;

Table of Contents

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;

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

changes in laws and regulations, as well as their interpretations, may adversely affect their business, financial structure or prospects; and

increased taxes, regulatory expense or the costs of changes to the way they conduct business due to the effects of climate change may adversely affect their business, financial structure or prospects.

In addition, Prospect's executive officers, directors and the Investment Adviser 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.

***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 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, Prospect 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 the Investment Adviser has or could be deemed to have material non-public information regarding such business entity.

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

Many of Prospect's portfolio companies may be susceptible to economic slowdowns or recessions and may be unable to repay Prospect's loans or meet other obligations during these periods. Therefore, Prospect's non-performing assets are likely to increase, and the value of Prospect's 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 Prospect's equity investments. Economic slowdowns or recessions could lead to financial losses in Prospect's portfolio and a decrease in revenues, net income and assets. Unfavorable economic conditions also could increase Prospect's funding costs, limit Prospect's access to the capital markets or result in a decision by lenders not to extend credit to Prospect. 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 Prospect's portfolio companies were to go bankrupt, even though Prospect may

Table of Contents

have structured Prospect's interest as senior debt or preferred equity, depending on the facts and circumstances, including the extent to which Prospect actually provided managerial assistance to that portfolio company, a bankruptcy court might re-characterize Prospect's debt or equity holding and subordinate all or a portion of Prospect's claim to those of other creditors.

***Investments in equity securities, many of which are illiquid with no readily available market, involve a substantial degree of risk.***

Prospect may purchase common and other equity securities. Although common stock has historically generated higher average total returns than fixed income securities over the long-term, common stock also has experienced significantly more volatility in those returns and in recent years has significantly underperformed relative to fixed income securities. The equity securities Prospect acquires may fail to appreciate and may decline in value or become worthless and Prospect's ability to recover its investment will depend on its portfolio company's success. Investments in equity securities involve a number of significant risks, including:

any equity investment Prospect makes in a portfolio company could be subject to further dilution as a result of the issuance of additional equity interests and to serious risks as a junior security that will be subordinate to all indebtedness (including trade creditors) or senior securities in the event that the issuer is unable to meet its obligations or becomes subject to a bankruptcy process;

to the extent that the portfolio company requires additional capital and is unable to obtain it, Prospect may not recover its investment; and

in some cases, equity securities in which Prospect invests will not pay current dividends, and Prospect's ability to realize a return on its investment, as well as to recover its investment, will be dependent on the success of the portfolio company. Even if the portfolio company is successful, Prospect's ability to realize the value of its investment may be dependent on the occurrence of a liquidity event, such as a public offering or the sale of the portfolio company. It is likely to take a significant amount of time before a liquidity event occurs or Prospect can otherwise sell its investment. In addition, the equity securities Prospect receives or invests in may be subject to restrictions on resale during periods in which it could be advantageous to sell them.

There are special risks associated with investing in preferred securities, including:

preferred securities may include provisions that permit the issuer, at its discretion, to defer distributions for a stated period without any adverse consequences to the issuer. If Prospect owns a preferred security that is deferring its distributions, Prospect may be required to report income for tax purposes before Prospect receives such distributions;

preferred securities are subordinated to debt in terms of priority to income and liquidation payments, and therefore will be subject to greater credit risk than debt;

preferred securities may be substantially less liquid than many other securities, such as common stock or United States government securities; and

generally, preferred security holders have no voting rights with respect to the issuing company, subject to limited exceptions.

Additionally, when Prospect invest in first lien senior secured loans (including unitranche loans), second lien senior secured loans or mezzanine debt, Prospect may acquire warrants or other equity securities as well. Prospect's goal is ultimately to dispose of such equity interests and realize gains upon Prospect's disposition of such interests. However, the equity interests Prospect receives may not appreciate in value and, in fact, may decline in value. Accordingly, Prospect may not be able to realize

Table of Contents

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 Prospect experiences.

Prospect may invest, to the extent permitted by law, in the equity securities of investment funds that are operating pursuant to certain exceptions to the 1940 Act and in advisers to similar investment funds and, to the extent Prospect so invests, will bear Prospect's ratable share of any such company's expenses, including management and performance fees. Prospect will also remain obligated to pay management and incentive fees to Prospect Capital Management with respect to the assets invested in the securities and instruments of such companies. With respect to each of these investments, each of Prospect's common stockholders will bear his or her share of the management and incentive fee of Prospect Capital Management as well as indirectly bearing the management and performance fees and other expenses of any such investment funds or advisers.

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

If one of Prospect's portfolio companies were to go bankrupt, even though Prospect may have structured its interest as senior debt, depending on the facts and circumstances, a bankruptcy court might re-characterize Prospect's debt holding as an equity investment and subordinate all or a portion of Prospect's claim to that of other creditors. In addition, lenders can be subject to lender liability claims for actions taken by them where they become too involved in the borrower's business or exercise control over the borrower. For example, Prospect could become subject to a lender's liability claim, if, among other things, Prospect actually renders significant managerial assistance.

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

Prospect's portfolio companies may have, or may be permitted to incur, other debt, or issue other equity securities, that rank equally with, or senior to, its investments. 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 Prospect is entitled to receive payments in respect of its investments. These debt instruments would usually prohibit the portfolio companies from paying interest on or repaying Prospect's investments in the event and during the continuance of a default under such debt. Also, in the event of insolvency, liquidation, dissolution, reorganization or bankruptcy of a portfolio company, holders of securities ranking senior to Prospect's investment in that portfolio company typically are entitled to receive payment in full before Prospect receives any distribution in respect of its investment. After repaying such 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 Prospect's investments, Prospect 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.

The rights Prospect may have with respect to the collateral securing any junior priority loans Prospect makes to its portfolio companies may also be limited pursuant to the terms of one or more intercreditor agreements (including agreements governing "first out" and "last out" structures) that Prospect enters into with the holders of senior debt. Under such an intercreditor agreement, at any time that senior obligations are outstanding, Prospect may forfeit certain rights with respect to the collateral to the holders of the senior obligations. These rights may include the right to commence enforcement proceedings against the collateral, the right to control the conduct of such enforcement proceedings, the right to approve amendments to collateral documents, the right to release liens on the collateral and the right to waive past defaults under collateral documents. Prospect may not have the ability to control or direct such actions, even if as a result Prospect's rights as junior lenders are adversely affected.

Table of Contents

***When Prospect is a debt or minority equity investor in a portfolio company, Prospect is often not in a position to exert influence on the entity, and other equity holders and management of the company may make decisions that could decrease the value of its portfolio holdings.***

When Prospect makes debt or minority equity investments, Prospect is subject to the risk that a portfolio company may make business decisions with which Prospect disagrees and the other equity holders and management of such company may take risks or otherwise act in ways that do not serve Prospect's interests. As a result, a portfolio company may make decisions that could decrease the value of Prospect's investment.

***Prospect's portfolio companies may be highly leveraged.***

Some of Prospect's portfolio companies may be highly leveraged, which may have adverse consequences to these companies and to Prospect as an investor. These companies may be subject to restrictive financial and operating covenants and the leverage may impair these companies' ability to finance their future operations and capital needs. As a result, these companies' flexibility to respond to changing business and economic conditions and to take advantage of business opportunities may be limited. Further, a leveraged company's income and net assets will tend to increase or decrease at a greater rate than if borrowed money were not used.

***Prospect's portfolio contains a limited number of portfolio companies, which subjects Prospect to a greater risk of significant loss if any of these companies defaults on its obligations under any of its debt securities.***

A consequence of the limited number of investments in Prospect's portfolio is that the aggregate returns Prospect realizes may be significantly adversely affected if one or more of Prospect's significant portfolio company investments perform poorly or if Prospect needs to write down the value of any one significant investment. Beyond Prospect's income tax diversification requirements, Prospect does not have fixed guidelines for diversification, and Prospect's portfolio could contain relatively few portfolio companies.

***Prospect's failure to make follow-on investments in its portfolio companies could impair the value of its portfolio.***

Following an initial investment in a portfolio company, Prospect may make additional investments in that portfolio company as "follow-on" investments, in order to: (1) increase or maintain in whole or in part Prospect's equity ownership percentage; (2) exercise warrants, options or convertible securities that were acquired in the original or subsequent financing or (3) attempt to preserve or enhance the value of Prospect's investment.

Prospect may elect not to make follow-on investments, may be constrained in its ability to employ available funds, or otherwise may lack sufficient funds to make those investments. Prospect has the discretion to make any follow-on investments, subject to the availability of capital resources. The failure to make follow-on investments may, in some circumstances, jeopardize the continued viability of a portfolio company and Prospect's initial investment, or may result in a missed opportunity for Prospect to increase its participation in a successful operation. Even if Prospect has sufficient capital to make a desired follow-on investment, it may elect not to make a follow-on investment because it may not want to increase its concentration of risk, because Prospect prefers other opportunities, or because Prospect is inhibited by compliance with BDC requirements or the desire to maintain Prospect's tax status.

***Prospect may be unable to invest the net proceeds raised from offerings and repayments from investments on acceptable terms, which would harm its financial condition and operating results.***

Until Prospect identifies new investment opportunities, it intends to either invest the net proceeds of future offerings and repayments from investments in interest-bearing deposits or other short-term



Table of Contents

instruments or use the net proceeds from such offerings to reduce then-outstanding obligations under Prospect's credit facility. Prospect cannot assure you that it will be able to find enough appropriate investments that meet its investment criteria or that any investment Prospect completes using the proceeds from an offering will produce a sufficient return.

***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 Prospect is required to rely on the ability of the Investment Adviser'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 of 2002 and other rules that govern public companies. If Prospect is unable to uncover all material information about these companies, Prospect may not make a fully informed investment decision, and Prospect may lose money on its investment.

***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, Prospect 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 may be 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, Prospect 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 Prospect's 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 United States investments.***

Prospect's investment strategy contemplates potential investments in securities of foreign companies, including those located in emerging market countries. Investing in foreign companies may expose Prospect to additional risks not typically associated with investing in United States 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. Such risks are more pronounced in emerging market countries.

Table of Contents

Although currently all of Prospect's investments are, and Prospect expects that most of its investments will be, United States dollar-denominated, 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 Prospect 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 Prospect's portfolio positions from changes in currency exchange rates and market interest rates. Hedging against a decline in the values of Prospect's 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 Prospect is not able to enter into a hedging transaction at an acceptable price. Furthermore, Prospect's ability to engage in hedging transactions may also be adversely affected by recent rules adopted by the United States Commodity Futures Trading Commission.

The success of Prospect's hedging transactions depends on its ability to correctly predict movements, currencies and interest rates. Therefore, while Prospect 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 Prospect 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 Prospect from achieving the intended hedge and expose Prospect 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 has no current intention of engaging in any of the hedging transaction described above, although it reserves the right to do so in the future.

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

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

Table of Contents

***Prospect's investments in CLOs may be riskier and less transparent to Prospect and its stockholders than direct investments in the underlying companies.***

Prospect invests in CLOs. Generally, there may be less information available to Prospect regarding the underlying debt investments held by CLOs than if Prospect had invested directly in the debt of the underlying companies. As a result, Prospect's stockholders will not know the details of the underlying securities of the CLOs in which Prospect will invest. Prospect's CLO investments are subject to the risk of leverage associated with the debt issued by such CLOs and the repayment priority of senior debt holders in such CLOs. Prospect's investments in portfolio companies may be risky, and Prospect could lose all or part of its investment.

***CLOs typically will have no significant assets other than their underlying Senior Secured Loans; payments on CLO investments are and will be payable solely from the cashflows from such Senior Secured Loans.***

CLOs typically will have no significant assets other than their underlying Senior Secured Loans. Accordingly, payments on CLO investments are and will be payable solely from the cashflows from such Senior Secured Loans, net of all management fees and other expenses. Payments to Prospect as a holder of CLO junior securities are and will be made only after payments due on the senior secured notes, and, where appropriate, the junior secured notes, have been made in full. This means that relatively small numbers of defaults of Senior Secured Loans may adversely impact Prospect's returns.

***Prospect's CLO investments are exposed to leveraged credit risk.***

Generally, Prospect is in a subordinated position with respect to realized losses on the Senior Secured Loans underlying Prospect's investments in CLOs. The leveraged nature of CLOs, in particular, magnifies the adverse impact of Senior Secured Loan defaults. CLO investments represent a leveraged investment with respect to the underlying Senior Secured Loans. Therefore, changes in the market value of the CLO investments could be greater than the change in the market value of the underlying Senior Secured Loans, which are subject to credit, liquidity and interest rate risk.

***There is the potential for interruption and deferral of cashflow from CLO investments.***

If certain minimum collateral value ratios and/or interest coverage ratios are not met by a CLO, primarily due to Senior Secured Loan defaults, then cashflow that otherwise would have been available to pay distributions to Prospect on its CLO investments may instead be used to redeem any senior notes or to purchase additional Senior Secured Loans, until the ratios again exceed the minimum required levels or any senior notes are repaid in full. This could result in an elimination, reduction or deferral in the distribution and/or principal paid to the holders of the CLO investments, which would adversely impact Prospect's returns.

***Investments in foreign securities may involve significant risks in addition to the risks inherent in United States investments.***

Prospect's CLO investment strategy involves investments in foreign CLOs. Investing in foreign entities may expose Prospect to additional risks not typically associated with investing in United States issuers. 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. Further, Prospect, and the CLOs in which Prospect invests, may have difficulty enforcing creditor's rights in foreign jurisdictions. In addition, the underlying companies of the CLOs in which Prospect invests may be foreign, which may create greater exposure for Prospect to foreign economic developments.

Table of Contents

***The payment of underlying portfolio manager fees and other charges on CLO investments could adversely impact Prospect's returns.***

Prospect may invest in CLO investments where the underlying portfolio securities may be subject to management, administration and incentive or performance fees, in addition to those payable by Prospect. Payment of such additional fees could adversely impact the returns Prospect achieves.

***The inability of a CLO collateral manager to reinvest the proceeds of the prepayment of Senior Secured Loans may adversely affect Prospect.***

There can be no assurance that for any CLO investment, in the event that any of the Senior Secured Loans of a CLO underlying such investment are prepaid, the CLO collateral manager will be able to reinvest such proceeds in new Senior Secured Loans with equivalent investment returns. If the CLO collateral manager cannot reinvest in new Senior Secured Loans with equivalent investment returns, the interest proceeds available to pay interest on the rated liabilities and investments may be adversely affected.

***Prospect's CLO investments are subject to prepayments and calls, increasing re-investment risk.***

Prospect's CLO investments and/or the underlying senior secured loans may be prepaid more quickly than expected, which could have an adverse impact on Prospect's value. Prepayment rates are influenced by changes in interest rates and a variety of economic, geographic and other factors beyond Prospect's control, and consequently cannot be predicted with certainty. In addition, for a CLO collateral manager there is often a strong incentive to refinance well performing portfolios once the senior tranches amortize. The yield to maturity of the investments will depend on the amount and timing of payments of principal on the loans and the price paid for the investments. Such yield may be adversely affected by a higher or lower than anticipated rate of prepayments of the debt.

Furthermore, Prospect's CLO investments generally do not contain optional call provisions, other than a call at the option of the holders of the equity tranches for the senior notes and the junior secured notes to be paid in full after the expiration of an initial period in the deal (referred to as the "non-call period").

The exercise of the call option is by the relevant percentage (usually a majority) of the holders of the equity tranches and, therefore, where Prospect does not hold the relevant percentage Prospect will not be able to control the timing of the exercise of the call option. The equity tranches also generally have a call at any time based on certain tax event triggers. In any event, the call can only be exercised by the holders of equity tranches if they can demonstrate (in accordance with the detailed provisions in the transaction) that the senior notes and junior secured notes will be paid in full if the call is exercised.

Early prepayments and/or the exercise of a call option other than at Prospect's request may also give rise to increased re-investment risk with respect to certain investments, as Prospect may realize excess cash earlier than expected. If Prospect is unable to reinvest such cash in a new investment with an expected rate of return at least equal to that of the investment repaid, this may reduce Prospect's net income and, consequently, could have an adverse impact on Prospect's ability to pay dividends.

***Prospect has limited control of the administration and amendment of Senior Secured Loans owned by the CLOs in which it invests.***

Prospect may not be able to directly enforce any rights and remedies in the event of a default of a Senior Secured Loan held by a CLO vehicle. In addition, the terms and conditions of the Senior Secured Loans underlying Prospect's CLO investments may be amended, modified or waived only by the agreement of the underlying lenders. Generally, any such agreement must include a majority or a

Table of Contents

super majority (measured by outstanding loans or commitments) or, in certain circumstances, a unanimous vote of the lenders. Consequently, the terms and conditions of the payment obligations arising from Senior Secured Loans could be modified, amended or waived in a manner contrary to Prospect's preferences.

***Prospect has limited control of the administration and amendment of any CLO in which it invests.***

The terms and conditions of target securities may be amended, modified or waived only by the agreement of the underlying security holders. Generally, any such agreement must include a majority or a super majority (measured by outstanding amounts) or, in certain circumstances, a unanimous vote of the security holders. Consequently, the terms and conditions of the payment obligation arising from the CLOs in which Prospect invests be modified, amended or waived in a manner contrary to Prospect's preferences.

***Senior Secured Loans of CLOs may be sold and replaced resulting in a loss to Prospect.***

The Senior Secured Loans underlying Prospect's CLO investments may be sold and replacement collateral purchased within the parameters set out in the relevant CLO indenture between the CLO and the CLO trustee and those parameters may typically only be amended, modified or waived by the agreement of a majority of the holders of the senior notes and/or the junior secured notes and/or the equity tranche once the CLO has been established. If these transactions result in a net loss, the magnitude of the loss from the perspective of the equity tranche would be increased by the leveraged nature of the investment.

***Prospect's financial results may be affected adversely if one or more of Prospect's significant equity or junior debt investments in a CLO vehicle defaults on its payment obligations or fails to perform as Prospect expects.***

Prospect expects that a majority of its portfolio will consist of equity and junior debt investments in CLOs, which involve a number of significant risks. CLOs are typically highly levered up to approximately 10 times, and therefore the junior debt and equity tranches that Prospect will invest in are subject to a higher risk of total loss. In particular, investors in CLOs indirectly bear risks of the underlying debt investments held by such CLOs. Prospect will generally have the right to receive payments only from the CLOs, and will generally not have direct rights against the underlying borrowers or the entities that sponsored the CLOs. Although it is difficult to predict whether the prices of indices and securities underlying CLOs will rise or fall, these prices, and therefore, the prices of the CLOs, will be influenced by the same types of political and economic events that affect issuers of securities and capital markets generally.

The investments Prospect makes in CLOs are thinly traded or have only a limited trading market. CLO investments are typically privately offered and sold, in the primary and secondary markets. As a result, investments in CLOs may be characterized as illiquid securities. In addition to the general risks associated with investing in debt securities, CLOs carry additional risks, including, but not limited to: (i) the possibility that distributions from the underlying Senior Secured Loans will not be adequate to make interest or other payments; (ii) the quality of the underlying Senior Secured Loans may decline in value or default; and (iii) the complex structure of the security may not be fully understood at the time of investment and may produce disputes with the CLO or unexpected investment results. Further, Prospect's investments in equity and junior debt tranches of CLOs are subordinate to the senior debt tranches thereof.

Investments in structured vehicles, including equity and junior debt instruments issued by CLOs, involve risks, including credit risk and market risk. Changes in interest rates and credit quality may cause significant price fluctuations. Additionally, changes in the underlying Senior Secured Loans held by a CLO may cause payments on the instruments Prospect holds to be reduced, either temporarily or

Table of Contents

permanently. Structured investments, particularly the subordinated interests in which Prospect invests, are less liquid than many other types of securities and may be more volatile than the Senior Secured Loans underlying the CLOs in which Prospect invests.

***Non-investment grade debt involves a greater risk of default and higher price volatility than investment grade debt.***

The Senior Secured Loans underlying Prospect's CLO investments typically are rated non-investment grade and, in limited circumstances, are unrated. Non-investment grade securities are predominantly speculative with respect to the issuer's capacity to pay interest and repay principal when due and therefore involve a greater risk of default and higher price volatility than investment grade debt.

***Prospect will have no influence on management of underlying investments managed by non-affiliated third party CLO collateral managers.***

Prospect is not responsible for and has no influence over the asset management of the portfolios underlying the CLO investments Prospect holds as those portfolios are managed by non-affiliated third party CLO collateral managers. Similarly, Prospect is not responsible for and have no influence over the day-to-day management, administration or any other aspect of the issuers of the individual securities. As a result, the values of the portfolios underlying Prospect's CLO investments could decrease as a result of decisions made by third party CLO collateral managers.

***Risks affecting investments in real estate.***

Prospect makes investments in commercial and multi-family residential real estate through three real estate investment trusts American Property Holdings Corp., National Property Holdings Corp. and United Property Holdings Corp. (collectively, the "Prospect REITs"). A number of factors may prevent each Prospect REIT's properties and assets from generating sufficient net cash flow or may adversely affect their value, or both, resulting in less cash available for distribution, or a loss, to Prospect. These factors include:

national economic conditions;

regional and local economic conditions (which may be adversely impacted by plant closings, business layoffs, industry slow-downs, weather conditions, natural disasters, and other factors);

local real estate conditions (such as over-supply of or insufficient demand for office space);

changing demographics;

perceptions by prospective tenants of the convenience, services, safety, and attractiveness of a property;

the ability of property managers to provide capable management and adequate maintenance;

the quality of a property's construction and design;

increases in costs of maintenance, insurance, and operations (including energy costs and real estate taxes);

changes in applicable laws or regulations (including tax laws, zoning laws, or building codes);

potential environmental and other legal liabilities;

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the level of financing used by the Prospect REITs in respect of their properties, increases in interest rate levels on such financings and the risk that a Prospect REIT will default on such financings, each of which increases the risk of loss to Prospect;

Table of Contents

the availability and cost of refinancing;

the ability to find suitable tenants for a property and to replace any departing tenants with new tenants;

potential instability, default or bankruptcy of tenants in the properties owned by the Prospect REITs;

potential limited number of prospective buyers interested in purchasing a property that a Prospect REIT wishes to sell; and

the relative illiquidity of real estate investments in general, which may make it difficult to sell a property at an attractive price or within a reasonable time frame.

**Risks Relating To Prospect's Securities**

*Senior securities, including debt, expose Prospect to additional risks, including the typical risks associated with leverage and could adversely affect Prospect's business, financial condition and results of operations.*

Prospect currently use its revolving credit facility to leverage its portfolio and Prospect 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. Prospect also has the Senior Notes (as defined below) outstanding, which are a form of leverage and are senior in payment rights to its common stock.

With certain limited exceptions, as a business development company, or a BDC, Prospect is only allowed to borrow amounts or otherwise issue senior securities such that Prospect's asset coverage, as defined in the 1940 Act, is at least 200% after such borrowing or other issuance. The amount of leverage that Prospect employ will depend on the Investment Adviser'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 stockholders, any of which could adversely affect Prospect's business, financial condition and results of operations, including the following:

a likelihood of greater volatility in the net asset value and market price of Prospect's common stock;

diminished operating flexibility as a result of asset coverage or investment portfolio composition requirements required by lenders or investors 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, such as the Senior Convertible Notes outstanding or those issued in the future may have rights, preferences and privileges more favorable than those of Prospect's common stock;

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 Prospect's liquidation before any proceeds will be distributed to Prospect's stockholders;



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making it more difficult for Prospect to meet its payment and other obligations under the Senior Notes and its other outstanding debt;

the occurrence of an event of default if Prospect fails to comply with the financial and/or other restrictive covenants contained in its debt agreements, including the credit agreement and each

Table of Contents

indenture governing the Senior Notes, which event of default could result in all or some of Prospect's debt becoming immediately due and payable;

reduced availability of Prospect's cash flow to fund investments, acquisitions and other general corporate purposes, and limiting Prospect's ability to obtain additional financing for these purposes;

the risk of increased sensitivity to interest rate increases on Prospect's indebtedness with variable interest rates, including borrowings under Prospect's amended senior credit facility; and

reduced flexibility in planning for, or reacting to, and increasing Prospect's vulnerability to, changes in Prospect's business, the industry in which Prospect operates and the general economy.

For example, the amount Prospect may borrow under its revolving credit facility is determined, in part, by the fair value of Prospect's investments. If the fair value of Prospect's investments declines, Prospect may be forced to sell investments at a loss to maintain compliance with Prospect's 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. The Investment Adviser and Prospect's board of directors in their best judgment nevertheless may determine to use leverage if they expect that the benefits to Prospect's stockholders of maintaining the leveraged position will outweigh the risks.

In addition, Prospect's ability to meet its payment and other obligations of the Senior Notes and its credit facility depends on Prospect's ability to generate significant cash flow in the future. This, to some extent, is subject to general economic, financial, competitive, legislative and regulatory factors as well as other factors that are beyond Prospect's control. Prospect cannot assure you that its business will generate cash flow from operations, or that future borrowings will be available to Prospect under its existing credit facility or otherwise, in an amount sufficient to enable Prospect to meet its payment obligations under the Senior Notes and its other debt and to fund other liquidity needs. If Prospect is not able to generate sufficient cash flow to service its debt obligations, Prospect may need to refinance or restructure its debt, including the Senior Notes, sell assets, reduce or delay capital investments, or seek to raise additional capital. If Prospect is unable to implement one or more of these alternatives, it may not be able to meet its payment obligations under the Senior Notes and its other debt.

*Illustration.* The following table illustrates the effect of leverage on returns from an investment in Prospect's common stock assuming various annual returns, net of interest expense. The calculations in the table below are hypothetical and actual returns may be higher or lower than those appearing below. The calculation assumes (i) \$5.0 billion in total assets, (ii) an average cost of funds of 5.69%, (iii) \$1.8 billion in debt outstanding and (iv) \$3.2 billion of stockholders' equity.

<b>Assumed Return on Prospect's Portfolio (net of expenses)</b>	<b>(10)%</b>	<b>(5)%</b>	<b>0%</b>	<b>5%</b>	<b>10%</b>
Corresponding Return to Stockholder	(18.8)%	(11.0)%	(3.2)%	4.6%	12.4%

The assumed portfolio return is required by regulation of the SEC and is not a prediction of, and does not represent, Prospect's projected or actual performance. Actual returns may be greater or less than those appearing in the table.

***The Senior Convertible Notes, the 2022 Notes and the 2023 Notes present other risks to holders of Prospect's common stock, including the possibility that such Senior Notes could discourage an acquisition of Prospect by a third party and accounting uncertainty.***

Certain provisions of the Senior Convertible Notes, the 2022 Notes and the 2023 Notes could make it more difficult or more expensive for a third party to acquire Prospect. Upon the occurrence of certain transactions constituting a fundamental change, holders of the Senior Convertible Notes, the 2022 Notes and the 2023 Notes will have the right, at their option, to require Prospect to repurchase all

Table of Contents

of their Senior Convertible Notes, the 2022 Notes and the 2023 Notes or any portion of the principal amount of such Senior Convertible Notes, the 2022 Notes and the 2023 Notes in integral multiples of \$1,000, in the case of the Senior Convertible Notes and the 2023 Notes, and \$25, in the case of the 2022 Notes. Prospect may also be required to increase the conversion rate or provide for conversion into the acquirer's capital stock in the event of certain fundamental changes with respect to the Senior Convertible Notes. These provisions could discourage an acquisition of Prospect by a third party.

The accounting for convertible debt securities is subject to frequent scrutiny by the accounting regulatory bodies and is subject to change. Prospect cannot predict if or when any such change could be made and any such change could have an adverse impact on Prospect's reported or future financial results. Any such impacts could adversely affect the market price of Prospect's common stock.

***Prospect may in the future determine to fund a portion of its investments with preferred stock, which would magnify the potential for gain or loss and the risks of investing in Prospect in the same way as Prospect's borrowings.***

Preferred stock, which is another form of leverage, has the same risks to Prospect's common stockholders as borrowings because the dividends on any preferred stock Prospect issues must be cumulative. Payment of such dividends and repayment of the liquidation preference of such preferred stock must take preference over any dividends or other payments to Prospect's common stockholders, and preferred stockholders are not subject to any of Prospect's expenses or losses and are not entitled to participate in any income or appreciation in excess of their stated preference.

***In addition to regulatory restrictions that restrict Prospect's ability to raise capital, its credit facility contains various covenants which, if not complied with, could accelerate repayment under the facility, thereby materially and adversely affecting Prospect's liquidity, financial condition and results of operations.***

The agreement governing Prospect's credit facility requires Prospect to comply with certain financial and operational covenants. These covenants include:

restrictions on the level of indebtedness that Prospect is permitted to incur in relation to the value of its assets;

restrictions on Prospect's ability to incur liens; and

maintenance of a minimum level of stockholders' equity.

As of September 30, 2013, Prospect was in compliance with these covenants. However, Prospect's continued compliance with these covenants depends on many factors, some of which are beyond its control. Accordingly, there are no assurances that Prospect will continue to comply with the covenants in its credit facility. Failure to comply with these covenants would result in a default under this facility which, if Prospect were unable to obtain a waiver from the lenders thereunder, could result in an acceleration of repayments under the facility and thereby have a material adverse impact on its business, financial condition and results of operations.

***Failure to extend Prospect's existing credit facility, the revolving period of which is currently scheduled to expire on March 27, 2015, could have a material adverse effect on Prospect's results of operations and financial position and Prospect's ability to pay expenses and make distributions.***

The revolving period for Prospect's credit facility with a syndicate of lenders is currently scheduled to terminate on March 27, 2015, with an additional two year amortization period (with distributions allowed) after the completion of the revolving period. During such two year amortization period, all principal payments on the pledged assets will be applied to reduce the balance. At the end of the two year amortization period, the remaining balance will become due if required by the lenders. If the credit facility is not renewed or extended by the participant banks by March 27, 2015, Prospect will not

Table of Contents

be able to make further borrowings under the facility after such date and the outstanding principal balance on that date will be due and payable on March 27, 2017. At January 3, 2014, Prospect had no outstanding borrowings under its credit facility. Interest on borrowings under the credit facility is one-month LIBOR plus 275 basis points with no minimum LIBOR floor. Additionally, the lenders charge a fee on the unused portion of the credit facility equal to either 50 basis points if at least half of the credit facility is drawn or 100 basis points otherwise. The credit facility requires Prospect to pledge assets as collateral in order to borrow under the credit facility. If Prospect is unable to extend its facility or find a new source of borrowing on acceptable terms, it will be required to pay down the amounts outstanding under the facility during the two-year term-out period through one or more of the following: (1) principal collections on Prospect's securities pledged under the facility, (2) at Prospect's option, interest collections on Prospect's securities pledged under the facility and cash collections on Prospect's securities not pledged under the facility, or (3) possible liquidation of some or all of Prospect's loans and other assets, any of which could have a material adverse effect on Prospect's results of operations and financial position and may force Prospect to decrease or stop paying certain expenses and making distributions until the facility is repaid. In addition, Prospect's stock price could decline significantly, Prospect would be restricted in its ability to acquire new investments and, in connection with Prospect's year-end audit, Prospect's independent registered accounting firm could raise an issue as to Prospect's ability to continue as a going concern.

***Failure to refinance Prospect's existing Senior Notes, could have a material adverse effect on Prospect's results of operations and financial position.***

Prospect's Senior Notes mature at various dates from December 15, 2015 to June 15, 2043. If Prospect is unable to refinance its Senior Notes or find a new source of borrowing on acceptable terms, Prospect will be required to pay down the amounts outstanding at maturity under the facility during the two-year term-out period through one or more of the following: (1) borrowing additional funds under Prospect's then current credit facility, (2) issuance of additional common stock or (3) possible liquidation of some or all of Prospect's loans and other assets, any of which could have a material adverse effect on Prospect's results of operations and financial position. In addition, Prospect's stock price could decline significantly; Prospect would be restricted in its ability to acquire new investments and, in connection with Prospect's year-end audit, Prospect's independent registered accounting firm could raise an issue as to its ability to continue as a going concern.

***Prospect's shares of common stock have traded at a discount from net asset value and may do so again in the future, which could limit Prospect's ability to raise additional equity capital.***

Shares of closed-end investment companies frequently trade at a market price that is less than the net asset value that is attributable to those shares. This characteristic of closed-end investment companies is separate and distinct from the risk that Prospect's net asset value per share may decline. It is not possible to predict whether any shares of Prospect's common stock will trade at, above, or below net asset value. During various periods, the stocks of BDCs as an industry, including at times shares of Prospect's common stock, have traded below net asset value. When Prospect's common stock is trading below its net asset value per share, Prospect is generally not be able to sell additional shares of its common stock at less than net asset value in the absence of approval for such sales from its stockholders and its independent directors. At Prospect's 2013 annual meeting of stockholders held on December 6, 2013, Prospect's stockholders approved Prospect's ability to sell shares of its common stock at any level of discount from net asset value per share during the 12 month period following December 6, 2013, subject to the condition that the maximum number of shares salable below net asset value pursuant to this authority in any particular offering that could result in such dilution is limited to 25% of its then outstanding common stock immediately prior to each such offering. It should be noted that, theoretically, Prospect may sell up to 25% of its then outstanding common stock each day during such period under this authority.

Table of Contents

***There is a risk that investors in Prospect's common stock may not receive dividends or that Prospect's dividends may not grow over time and investors in Prospect's debt securities may not receive all of the interest income to which they are entitled.***

Prospect intends to make distributions on a monthly basis to its stockholders out of assets legally available for distribution. Prospect cannot assure you 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. If Prospect declares a dividend and if more stockholders opt to receive cash distributions rather than participate in Prospect's dividend reinvestment plan, Prospect may be forced to sell some of its investments in order to make cash dividend payments.

In addition, due to the asset coverage test applicable to Prospect as a BDC, Prospect may be limited in its ability to make distributions. Further, if Prospect invests a greater amount of assets in equity securities that do not pay current dividends, it could reduce the amount available for distribution.

The above-referenced restrictions on distributions may also inhibit Prospect's ability to make required interest payments to holders of Prospect's debt, which may cause a default under the terms of Prospect's debt agreements. Such a default could materially increase Prospect's cost of raising capital, as well as cause Prospect to incur penalties under the terms of its debt agreements.

***Investing in Prospect's securities may involve a high degree of risk and is highly speculative.***

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 Prospect's shares may not be suitable for someone with low risk tolerance.

***Prospect's stockholders will experience dilution in their ownership percentage if they opt out of Prospect's dividend reinvestment plan.***

All dividends declared in cash payable to stockholders that are participants in Prospect's dividend reinvestment plan are automatically reinvested in shares of Prospect's common stock unless the stockholder opts out of such plan. As a result, Prospect's stockholders that opt out of Prospect's dividend reinvestment plan will experience dilution in their ownership percentage of Prospect's common stock over time.

***Sales of substantial amounts of Prospect's common stock in the public market may have an adverse effect on the market price of Prospect's common stock.***

Sales of substantial amounts of Prospect's common stock, or the availability of such common stock for sale (including as a result of the conversion of Prospect's Senior Convertible Notes into common stock), could adversely affect the prevailing market prices for Prospect's common stock. If this occurs and continues, it could impair Prospect's ability to raise additional capital through the sale of securities should Prospect desire to do so.

***If Prospect sells shares of its common stock or securities to subscribe for or are convertible into shares of its common stock at a discount to Prospect's net asset value per share, stockholders who do not participate in such sale will experience immediate dilution in an amount that may be material.***

At Prospect's 2013 annual meeting of stockholders held on December 6, 2013, Prospect's stockholders approved Prospect's ability to sell shares of its common stock at any level of discount from net asset value per share during the 12 month period following December 6, 2013, subject to the condition that the maximum number of shares salable below net asset value pursuant to this authority

Table of Contents

in any particular offering that could result in such dilution is limited to 25% of its then outstanding common stock immediately prior to each such offering. It should be noted that, theoretically, Prospect may offer up to 25% of its then outstanding common stock each day. The issuance or sale by Prospect of shares of its common stock or securities to subscribe for or are convertible into shares of its common stock at a discount to net asset value poses a risk of dilution to Prospect's stockholders. In particular, stockholders who do not purchase additional shares of common stock 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 of common stock if they do not participate at all). These stockholders 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. In addition, such sales may adversely affect the price at which Prospect's common stock trades. Prospect has sold shares of its common stock at prices below net asset value per share in the past and may do so to the future. Prospect has not sold any shares of its common stock at prices below net asset value per share since July 18, 2011.

***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 Prospect's 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 Prospect's independent directors. Subject to certain limited exceptions, Prospect is prohibited from buying or selling any security or other property from or to the Investment Adviser 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 and Priority Senior Secured Income Fund, Inc., Pathway Energy Infrastructure Fund, Inc., Prospect Capital Funding LLC, Prospect Capital Management LLC, Priority Senior Secured Income Management, LLC and Pathway Energy Infrastructure Management, LLC have submitted an exemptive application to the SEC to permit Prospect to participate in negotiated co-investments with other funds managed by Prospect Capital Management LLC, Priority Senior Secured Income Management, LLC or Pathway Energy Infrastructure Management, LLC or affiliated advisers in a manner consistent with Prospect's investment objective, strategies and restrictions as well as regulatory requirements and other pertinent factors, subject to the conditions therein. However, there is no assurance that Prospect will obtain such exemptive relief.

***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 Prospect's control and may not be directly related to Prospect's 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;

price and volume fluctuations in the overall stock market from time to time;

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

Table of Contents

loss of RIC qualification;

changes in earnings or variations in operating results;

changes in the value of Prospect's 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 Prospect;

short-selling pressure with respect to shares of Prospect's common stock or BDCs generally;

future sales of Prospect's securities convertible into or exchangeable or exercisable for Prospect's common stock or the conversion of such securities, including the Senior Convertible Notes;

uncertainty surrounding the strength of the United States economic recovery;

concerns regarding European sovereign debt;

changes in prevailing interest rates;

litigation matters;

general economic trends and other external factors; and

loss of a major funding source.

***In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has, from time to time, been brought against that company.***

If Prospect's stock price fluctuates significantly, Prospect may be the target of securities litigation in the future. Securities litigation could result in substantial costs and divert management's attention and resources from Prospect's business.

***There is a risk that you may not receive distributions or that Prospect's distributions may not grow over time.***

Prospect has made and intends to continue to make distributions on a monthly basis to its stockholders out of assets legally available for distribution. Prospect cannot assure you 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 Prospect as a business development company, Prospect 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 Prospect's 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 Prospect's stockholders or otherwise be in their best interest. These provisions may prevent stockholders from being able to sell shares of Prospect's common stock at a premium over the current of prevailing market prices.

Prospect's charter provides for the classification of Prospect's board of directors into three classes of directors, serving staggered three-year terms, which may render a change of control or removal of Prospect's incumbent management more difficult. Furthermore, any and all vacancies on Prospect's board of directors will be filled generally only by the affirmative vote of a majority of the remaining



Table of Contents

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 cause Prospect to issue shares of stock, to create and cause Prospect to 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 stockholder approval, to amend Prospect's charter to increase or decrease the number of shares of common stock that Prospect has authority to issue, which could have the effect of diluting a stockholder's ownership interest. Prior to the issuance of shares of preferred stock of each class or series, including any reclassified series, Prospect's board of directors is required by Prospect's governing documents to set the 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 Prospect's board of directors has the exclusive power to adopt, alter or repeal any provision of Prospect's 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 stockholder" (defined generally as any person who beneficially owns, directly or indirectly, 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 stockholder becomes an interested stockholder and, thereafter, imposes special minimum price provisions and special stockholder voting requirements on these combinations; and

The Maryland Control Share Acquisition Act, which provides that a holder of "control shares" of a Maryland corporation (defined as shares of common stock which, when aggregated with other shares of common stock controlled by the stockholder, entitles the stockholder to exercise one of three increasing ranges of voting power in electing directors, as described more fully below) acquired in a "control share acquisition" (defined as the direct or indirect acquisition of ownership or control of "control shares") has no voting rights with respect to such shares except to the extent approved by stockholders 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 Prospect and any other person will be exempt from the provisions of the Maryland Business Combination Act. Prospect's board of directors has adopted a resolution that any business combination between Prospect and any other person is exempted from the provisions of the Maryland Business Combination Act, provided that the business combination is first approved by the board of directors, including a majority of the directors who are not interested persons as defined in the 1940 Act. 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 Prospect's common stock. Although Prospect's bylaws include such a provision, such a provision may also be amended or eliminated by Prospect's board of directors at any time in the future, provided that Prospect will notify the Division of Investment Management at the SEC prior to amending or eliminating this provision. However, as noted above, the SEC has recently taken the position that the Maryland Control Share Acquisition Act is inconsistent with the 1940 Act and may not be invoked by a BDC. It is the view of the staff of the SEC that opting into the Maryland Control Share Acquisition Act would be acting in a manner inconsistent with section 18(i) of the 1940 Act.

Table of Contents

***Prospect may in the future choose to pay dividends in Prospect's own stock, in which case Prospect's stockholders 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. The Service has issued private letter rulings on cash/stock dividends paid by RICs and real estate investment trusts if certain requirements are satisfied, and Prospect has received such a ruling permitting Prospect to declare such taxable cash/stock dividends, up to 80% in stock, with respect to Prospect's taxable years ending August 31, 2012 and August 31, 2013. 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 Prospect's current and accumulated earnings and profits for United States federal income tax purposes. As a result, a U.S. Holder may be required to pay tax with respect to such dividends in excess of any cash received. If a U.S. Holder sells the stock it receives as a dividend in order to pay this tax, it may be subject to transaction fees (e.g., broker fees or transfer agent fees) and the sales proceeds may be less than the amount included in income with respect to the dividend, depending on the market price of its stock at the time of the sale. Furthermore, with respect to Non-U.S. Holders, 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 Prospect's stock in order to pay taxes owed on dividends, it may put downward pressure on the trading price of Prospect's stock. It is unclear whether and to what extent Prospect will be able to pay dividends in cash and Prospect's stock.

Table of Contents

**RISKS RELATED TO THE COMPANY**

*The Company operates in a competitive market.*

The non-prime consumer-finance industry is highly competitive. There are numerous financial service companies that provide consumer credit in the markets served by the Company, including banks, credit unions, other consumer finance companies and captive finance companies owned by automobile manufacturers and retailers. Many of these competitors have substantially greater financial resources than the Company. In addition, competitors often provide financing on terms more favorable to automobile purchasers or dealers than the Company offers. Many of these competitors also have long-standing relationships with automobile dealerships and may offer dealerships or their customers other forms of financing, including dealer floor-plan financing and leasing, which are not provided by the Company. Providers of non-prime consumer financing have traditionally competed primarily on the basis of:

interest rates charged;

the quality of credit accepted;

the flexibility of loan terms offered; and

the quality of service provided.

The Company's ability to compete effectively with other companies offering similar financing arrangements depends on the Company's ability to maintain close relationships with dealers of new and used vehicles. The Company may not be able to compete successfully in this market or against these competitors.

The Company has focused on a segment of the market composed of consumers who typically do not meet the more stringent credit requirements of traditional consumer financing sources and whose needs, as a result, have not been addressed consistently by such financing sources. When new and/or existing providers of consumer financing undertake significantly greater efforts to penetrate the Company's targeted market segment, the Company may have to reduce its interest rates and fees in order to maintain its market share. Any reduction in its interest rates, fees or dealer discount rates could have a material adverse impact on the Company's profitability or financial condition.

*The terms of the Company's indebtedness impose significant restrictions on the Company.*

The Company's existing outstanding indebtedness restricts its ability to, among other things:

sell or transfer assets;

incur additional debt

repay other debt;

make certain investments or acquisitions;

repurchase or redeem capital stock;

engage in mergers or consolidations; and

engage in certain transactions with subsidiaries and affiliates.

In addition, the Company's line of credit facility requires the Company to comply with certain financial ratios and covenants and to satisfy specified financial tests, including maintenance of asset quality and portfolio performance tests. The need to comply with such covenants and other provisions could impact the Company's ability to pay dividends to its shareholders. Moreover, the Company's ability to continue to meet those financial ratios and tests could be affected by events beyond the

Table of Contents

Company's control. Failure to meet any of these covenants, financial ratios or financial tests could result in an event of default under the Company's line of credit facility. If an event of default occurs under this credit facility, the Company's lenders may take one or more of the following actions:

- increase the Company's borrowing costs;
- restrict the Company's ability to obtain additional borrowings under the facility;
- accelerate all amounts outstanding under the facility; or
- enforce their interest against collateral pledged under the facility.

If the Company's lender accelerates the Company's debt payments, the Company's assets may not be sufficient to fully repay the debt.

***The Company will require a significant amount of cash to service its indebtedness and meet its other liquidity needs.***

The Company's ability to make payments on or to refinance its indebtedness and to fund its operations and planned capital expenditures depends on its future operating performance. The Company's primary cash requirements include the funding of:

- contract purchases and direct loans;
- interest payments under the Company's line of credit facility and other indebtedness;
- capital expenditures for technology and facilities;
- ongoing operating expenses;
- planned expansions by opening additional branch offices; and
- any required income tax payments.

In addition, because the Company expects to continue to require substantial amounts of cash for the foreseeable future, it may seek additional debt or equity financing. The type, timing and terms of the financing the Company selects will be dependent upon the Company's cash needs, the availability of other financing sources and the prevailing conditions in the financial markets. There is no assurance that any of these sources will be available to the Company at any given time or that the terms on which these sources may be available will be favorable. The Company's inability to obtain such additional financing on reasonable terms could adversely impact its ability to grow.

***The Company may experience high delinquency and loss rates in its loan portfolios, which could reduce its profitability.***

The Company's profitability depends, to a material extent, on the performance of Contracts that the Company purchases. Historically, the Company has experienced higher delinquency rates than traditional financial institutions because a large portion of its loans are to non-prime borrowers, who are unable to obtain financing from traditional sources due to their credit history. Although the Company attempts to mitigate these high credit risks with its underwriting standards and collection procedures, these standards and procedures may not offer adequate protection against the risk of default, especially in periods of economic uncertainty and high unemployment such as have existed over much of the past few years. In the event of a default, the collateral value of the financed vehicle usually does not cover the outstanding loan balance and costs of recovery. Higher than anticipated delinquencies and defaults on the Company's Contracts would reduce the Company's profitability.

In addition, in the event the Company were to make any bulk purchases of seasoned Contracts, it may experience higher than normal delinquency rates with respect to these loan portfolios due to its

Table of Contents

inability to apply its underwriting standards to each loan comprising the acquired portfolios. The Company would similarly attempt to mitigate the high credit risks associated with these loans, although no assurances can be given that the Company would be able to do so.

***The Company depends upon its relationships with its dealers.***

The Company's business depends in large part upon the Company's ability to establish and maintain relationships with reputable dealers who originate the Contracts the Company purchases. Although the Company believes it has been successful in developing and maintaining such relationships, such relationships are not exclusive, and many of them are not longstanding. There can be no assurances that the Company will be successful in maintaining such relationships or increasing the number of dealers with whom it does business, or that the Company's existing dealer base will continue to generate a volume of Contracts comparable to the volume of such Contracts historically generated by such dealers.

***The Company's success depends upon its ability to implement its business strategy.***

The Company's financial position depends on management's ability to execute the Company's business strategy. Key factors involved in the execution of the business strategy include achievement of the desired Contract purchase volume, the use of effective risk management techniques and collection methods, continued investment in technology to support operating efficiency, and continued access to significant funding and liquidity sources. The Company's failure or inability to execute any element of the business strategy could materially adversely affect its business and financial condition.

***The Company's business is highly dependent upon general economic conditions.***

The Company is subject to changes in general economic conditions that are beyond the Company's control. During periods of economic slowdown or high unemployment, such as has existed for much of the past few years, delinquencies, defaults, repossessions and losses generally increase, absent offsetting factors such as decreased competition. These periods also may be accompanied by decreased consumer demand for automobiles and declining values of automobiles securing outstanding loans, which weakens collateral coverage on the Company's loans and increases the amount of a loss the Company would experience in the event of default. Because the Company focuses on non-prime borrowers, the actual rates of delinquencies, defaults, repossessions and losses on these loans are higher than those experienced in the general automobile finance industry and could be more dramatically affected by a general economic downturn. In addition, during an economic slowdown or recession, the Company's servicing costs may increase without a corresponding increase in the Company's servicing income. While the Company seeks to manage the higher risk inherent in loans made to non-prime borrowers through the Company's underwriting criteria and collection methods, no assurances can be given that these criteria or methods will afford adequate protection against these risks. Any sustained period of increased delinquencies, defaults, repossessions or losses or increased servicing costs could materially adversely affect the Company's business and financial condition.

***Recent economic conditions may adversely affect the Company's business and financial condition.***

Over the past several years, the United States has experienced a period of economic uncertainty and high unemployment that may adversely affect the Company's business and financial condition. High unemployment and a lack of available credit could result in higher delinquencies and losses than the Company would otherwise experience.

Additionally, fluctuating gasoline prices, unstable real estate values, resets of adjustable rate mortgages and other factors have adversely impacted consumer confidence and disposable income. These conditions have increased loss frequency, decreased consumer demand for automobiles and

Table of Contents

could possibly weaken collateral values on certain types of vehicles. Because the Company focuses predominately on sub-prime borrowers, the actual rates of delinquencies, defaults, repossessions and losses on Contracts are higher than those experienced in the general automobile finance industry and have been materially affected by the recent economic downturn. If economic and credit conditions do not continue to improve, the Company's business and financial condition could be adversely affected.

***The auction proceeds the Company receives from the sale of repossessed vehicles and other recoveries are subject to fluctuation due to economic and other factors beyond the Company's control.***

If the Company repossess a vehicle securing a Contract, the Company typically has it transported to an automobile auction for sale. Auction proceeds from the sale of repossessed vehicles and other recoveries are usually not sufficient to cover the outstanding balance of the Contract, and the resulting deficiency is charged off. In addition, there is, on average, approximately a 30-day lapse between the time the Company repossesses a vehicle and the time it is sold by a dealer or at auction. The proceeds the Company receives from such sales depend upon various factors, including the supply of, and demand for, used vehicles at the time of sale. Such supply and demand are dependent on many factors. For example, the Consumer Assistance to Recycle and Save Act of 2009, which provided incentives to replace older vehicles with new, fuel-efficient vehicles in the second half of 2009, resulted in a temporary reduction in the supply of used vehicles, thus temporarily bolstering used automobile prices. At the same time, during periods of economic slowdown or recession, the demand for used cars may soften, resulting in decreased auction proceeds to the Company from the sale of repossessed automobiles. Furthermore, depressed wholesale prices for used automobiles may result from significant liquidations of rental or fleet inventories, and from increased volume of trade-ins due to promotional financing programs offered by new vehicle manufacturers. Decreased auction proceeds to the Company resulting from sales of used automobiles at depressed prices will result in higher or greater losses and, in turn, reduced profitability.

***An increase in market interest rates may reduce the Company's profitability.***

The Company's long-term profitability may be directly affected by the level of and fluctuations in interest rates. Sustained, significant increases in interest rates may adversely affect the Company's liquidity and profitability by reducing the interest rate spread between the rate of interest the Company receives on its Contracts and interest rates that the Company pays under its outstanding line of credit facility. As interest rates increase, the Company's gross interest rate spread on new originations will generally decline since the rates charged on the Contracts originated or purchased from dealers generally are limited by statutory maximums, restricting the Company's opportunity to pass on increased interest costs. The Company monitors the interest rate environment and, on occasion, enters into interest rate swap agreements relating to a portion of its outstanding debt. Such agreements effectively convert a portion of the Company's floating-rate debt to a fixed-rate, thus reducing the impact of interest rate changes on the Company's interest expense. During the fiscal year ended March 31, 2012, the Company had no interest rate swap agreements in place. On June 4, 2012 and July 30, 2012, the Company entered into interest rate swap agreements to convert a portion of its floating rate debt to a fixed rate, more closely matching the interest rate characteristics of finance receivables. The June 4, 2012 agreement provides for a five-year interest rate swap in which the Company pays a fixed rate of 1% and receives payments from the counterparty on the 1-month LIBOR rate. This swap has an effective date of June 13, 2012 and a notional amount of \$25 million. The July 30, 2012 agreement provides for a five-year interest rate swap in which the Company pays a fixed rate of 0.87% and receives payments from the counterparty on the 1-month LIBOR rate. This swap has an effective date of August 13, 2012 and a notional amount of \$25 million. The changes in the fair value of the interest rate swap agreements (unrealized gains and losses) are recorded in earnings. The Company will continue to evaluate interest rate swap pricing and may or may not enter into additional interest rate swap agreements in the future.



Table of Contents

***The Company's growth depends upon its ability to retain and attract a sufficient number of qualified employees.***

To a large extent, the Company's growth strategy depends on the opening of new offices that focus primarily on purchasing Contracts and making direct loans in markets the Company has not previously served. Future expansion of the branch office network depends, in part, upon the Company's ability to attract and retain qualified and experienced office managers and the ability of such managers to develop relationships with dealers that serve those markets. The Company generally does not open a new office until it has located and hired a qualified and experienced individual to manage the office. Typically, this individual will be familiar with local market conditions and have existing relationships with dealers in the area to be served. Although the Company believes that it can attract and retain qualified and experienced personnel as it proceeds with planned expansion into new markets, no assurance can be given that it will be successful in doing so. Competition to hire personnel possessing the skills and experience required by the Company could contribute to an increase in the Company's employee turnover rate. High turnover or an inability to attract and retain qualified personnel could have an adverse effect on the Company's origination, delinquency, default and net loss rates and, ultimately, the Company's business and financial condition.

***The loss of one of the Company's key executives could have a material adverse effect on the Company's business.***

The Company's growth and development to date have been largely dependent upon the services of Peter L. Vosotas, the Chairman of the Board, President and Chief Executive Officer, and Ralph T. Finkenbrink, the Chief Financial Officer and Senior Vice President-Finance. The Company does not maintain key-man life insurance policies on these executives. Although the Company believes that it has sufficient additional experienced management personnel to accommodate the loss or change of role of any key executive, the loss of services of one or more of these executives could have a material adverse effect on the Company's business and financial condition.

***The Company is subject to risks associated with litigation.***

As a consumer finance company, the Company is subject to various consumer claims and litigation seeking damages and statutory penalties, based upon, among other things:

usury laws;

disclosure inaccuracies;

wrongful repossession;

violations of bankruptcy stay provisions;

certificate of title disputes;

fraud;

breach of contract; and

discriminatory treatment of credit applicants.

Some litigation against the Company could take the form of class action complaints by consumers. As the assignee of Contracts originated by dealers, the Company may also be named as a co-defendant in lawsuits filed by consumers principally against dealers. The damages and penalties claimed by consumers in these types of actions can be substantial. The relief requested by the plaintiffs varies but may include requests for compensatory, statutory and punitive damages. The Company also is periodically subject to other kinds of litigation typically experienced by businesses such as it, including



Table of Contents

employment disputes and breach of contract claims. No assurances can be given that the Company will not experience material financial losses in the future as a result of litigation or other legal proceedings.

***The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") authorizes the newly created Consumer Financial Protection Bureau ("CFPB") to adopt rules that could potentially have a material adverse effect on the Company's operations and financial performance.***

Title X of the Dodd-Frank Act established the CFPB, which became operational on July 21, 2011. Under the Dodd-Frank Act, the CFPB has regulatory, supervisory and enforcement powers over providers of consumer financial products, such as Contracts and the direct loans that the Company offers, including explicit supervisory authority to examine and require registration of installment lenders such as the Company. Included among the powers afforded to the CFPB is the authority to adopt rules describing specified acts and practices as being "unfair," "deceptive" or "abusive," and hence unlawful. Although the Dodd-Frank Act expressly provides that the CFPB has no authority to establish usury limits, some consumer advocacy groups have suggested that certain forms of alternative consumer finance products, such as installment loans, should be a regulatory priority and it is possible that at some time in the future the CFPB could propose and adopt rules making such lending or other products that the Company may offer materially less profitable or impractical. Further, the CFPB may target specific features of loans by rulemaking that could cause the Company to cease offering certain products. Any such rules could have a material adverse effect on the Company's business, results of operation and financial condition. The CFPB could also adopt rules imposing new and potentially burdensome requirements and limitations with respect to any of the Company's current or future lines of business, which could have a material adverse effect on the Company's operations and financial performance.

In addition to the Dodd-Frank Act's grant of regulatory powers to the CFPB, the Dodd-Frank Act gives the CFPB authority to pursue administrative proceedings or litigation for violations of federal consumer financial laws. In these proceedings, the CFPB can obtain cease and desist orders (which can include orders for restitution or rescission of contracts, as well as other kinds of affirmative relief) and monetary penalties ranging from \$5,000 per day for minor violations of federal consumer financial laws (including the CFPB's own rules) to \$25,000 per day for reckless violations and \$1 million per day for knowing violations. If the Company is subject to such administrative proceedings, litigation, orders or monetary penalties in the future, this could have a material adverse effect on its operations and financial performance. Also, where a company has violated Title X of the Dodd-Frank Act or CFPB regulations under Title X, the Dodd-Frank Act empowers state attorneys general and state regulators to bring civil actions for the kind of cease and desist orders available to the CFPB (but not for civil penalties). If the CFPB or one or more state officials believe the Company has violated the foregoing laws, they could exercise their enforcement powers in ways that would have a material adverse effect on the Company.

***The Company is subject to many other laws and governmental regulations, and any material violations of or changes in these laws or regulations could have a material adverse effect on the Company's financial condition and business operations.***

The Company's financing operations are subject to regulation, supervision and licensing under various other federal, state and local statutes and ordinances. Additionally, the procedures that the Company must follow in connection with the repossession of vehicles securing Contracts are regulated by each of the states in which the Company does business. The various federal, state and local statutes, regulations, and ordinances applicable to the Company's business govern, among other things:

licensing requirements;

requirements for maintenance of proper records;

Table of Contents

payment of required fees to certain states;

maximum interest rates that may be charged on loans to finance new and used vehicles;

debt collection practices;

proper disclosure to customers regarding financing terms;

privacy regarding certain customer data;

interest rates on loans to customers;

telephone solicitation of direct loan customers; and

collection of debts from loan customers who have filed bankruptcy.

The Company believes that it maintains all material licenses and permits required for its current operations and is in substantial compliance with all applicable local, state and federal regulations. The Company's failure, or the failure by dealers who originate the Contracts the Company purchases, to maintain all requisite licenses and permits, and to comply with other regulatory requirements, could result in consumers having rights of rescission and other remedies that could have a material adverse effect on the Company's financial condition. Furthermore, any changes in applicable laws, rules and regulations, such as the passage of the Dodd-Frank Act and the creation of the CFPB, may make the Company's compliance therewith more difficult or expensive or otherwise materially adversely affect the Company's business and financial condition.

***The Company's Chief Executive Officer holds a significant percentage of the Company's Common Shares and may take actions adverse to shareholder interests.***

Peter L. Vosotas, the Company's Chairman of the Board, President and Chief Executive Officer, beneficially owned approximately 13.2% of the Company's Common Shares as of the record date for the special meeting. As a result, he may be able to influence matters requiring shareholder approval, including the election and removal of directors and approval of significant corporate transactions, such as the Arrangement. This concentration of ownership could have the effect of delaying, deferring or preventing a change in control or impeding a merger or consolidation, takeover or other business combination, which could cause the market price of the Company's Common Shares to fall or prevent shareholders from receiving a premium in such transaction.

***The Company's Common Shares are lightly traded, which may limit the ability of investors in the Company's Common Shares to sell their shares.***

The average daily trading volume of the Company's Common Shares on the NASDAQ Global Select Market for the fiscal year ended March 31, 2013 and the six months ended September 30, 2013 were approximately 23,487 shares and 25,689 shares, respectively. Thus, the Company's Common Shares are thinly traded. Thinly traded stock can be more volatile than stock trading in an active public market. Factors such as the Company's financial results, the introduction of new products and services by the Company or its competitors, and various factors affecting the consumer-finance industry generally may have a significant impact on the market price of the Company's Common Shares. In recent years, the stock market has experienced a high level of price and volume volatility, and market prices for the stocks of many companies, including the Company's, have experienced wide price fluctuations that have not necessarily been related to their operating performance. Therefore, the Company's shareholders may not be able to sell their shares at the volumes, prices, or times that they desire.

Table of Contents

***The Company's profitability and future growth depend on its continued access to bank financing.***

The profitability and growth of the business currently depend on the Company's ability to access bank debt at competitive rates. The Company currently depends on a \$150.0 million line of credit facility with a financial institution to finance a large portion of its purchases of Contracts and fund its direct loans. This line of credit currently has a maturity date of November 30, 2014 and is secured by substantially all of the Company's assets. At September 30, 2013, the Company had approximately \$131 million outstanding under the line of credit and approximately \$19 million available for additional borrowing.

The availability of the Company's credit facility depends, in part, on factors outside of the Company's control, including regulatory capital treatment for unfunded bank lines of credit and the availability of bank loans in general. Therefore, the Company cannot guarantee that this credit facility will continue to be available beyond the current maturity date on reasonable terms or at all. If the Company is unable to renew or replace its credit facility or find alternative financing at reasonable rates, it may be forced to liquidate. The Company will continue to depend on the availability of its line of credit, together with cash from operations, to finance its future operations.

***The Company's high level of indebtedness could have important adverse consequences for its business. For example,***

the Company may be unable to satisfy its obligations under its outstanding indebtedness;

the Company may find it more difficult to fund future working capital, capital expenditures, acquisitions, and general corporate needs;

the Company may have to dedicate a substantial portion of its cash resources to the payments on its outstanding indebtedness, thereby reducing the funds available for operations and future business opportunities; and

the Company may be more vulnerable to adverse general economic and industry conditions.

The Company's ability to make payments on, or to refinance, its indebtedness will depend on its future operating performance, including its ability to access additional debt and equity financing, which to a certain extent, is subject to economic, financial, competitive and other factors beyond the Company's control. If new debt is added to the Company's current levels, the risks described above could intensify.

***The Company may experience problems with its integrated computer systems or be unable to keep pace with developments in technology.***

The Company uses various technologies in its business, including telecommunication, data processing, and integrated computer systems. Technology changes rapidly. The Company's ability to compete successfully with other financing companies may depend on its ability to efficiently and cost-effectively implement technological changes. Moreover, to keep pace with its competitors, the Company may be required to invest in technological changes that do not necessarily improve the Company's profitability.

The Company utilizes integrated computer systems to respond to customer inquiries and to monitor the performance of its Contract and direct loan portfolios and the performance of individual customers under the Company's Contracts and direct loans. Problems with the Company's systems' operations could adversely impact the Company's ability to monitor its portfolios or collect amounts due under its Contracts and direct loans, which could have a material adverse effect on the Company's financial condition and results of operations.

Table of Contents

**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

Some of the statements in this proxy circular/prospectus 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 arrangement is completed and the anticipated timing of the completion of the proposed arrangement;

the period following the completion of the arrangement and the transactions contemplated by the arrangement agreement;

the ability of Nicholas Financial-Canada and Prospect's businesses to successfully integrate if the proposed arrangement is completed; and

Nicholas Financial-Canada's future operating results and business prospects if the proposed arrangement is not completed.

In addition, words such as "anticipate," "believe," "expect" and "intend" indicate a forward-looking statement, although not all forward-looking statements include these words. The forward-looking statements contained in this proxy circular/prospectus 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 "Risks Related to Prospect," and elsewhere in this document.

The forward-looking statements included in this proxy circular/prospectus have been based on information available to the Company and Prospect on the date of this document, as appropriate, and the Company and Prospect assume no obligation to update any such forward-looking statements. Although the Company 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 the Company and Prospect may make directly to you or through reports that the Company 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 proxy circular/prospectus are excluded from the safe harbor protection provided by Section 27A of the Securities Act of 1933 (the "Securities Act") and Section 21E of the Securities Exchange Act of 1934 (the "Exchange Act").

Table of Contents

**THE SPECIAL MEETING**

**Date, Time and Place of the Special Meeting**

The special meeting of the Securityholders will take place on [ ] [ ], 2014, at [ ] a.m. (Clearwater, Florida time), at Nicholas Financial-Canada's corporate headquarters, located at 2454 McMullen Booth Road, Building C, Clearwater, Florida.

**Purpose of the Special Meeting**

Securityholders are being asked to consider and to approve the following resolutions (collectively, the "Arrangement Resolution"):

The Arrangement under Part 9, Division 5 of the Business Corporations Act (British Columbia) (the "Arrangement") substantially as set forth in the Plan of Arrangement attached as Schedule B to the arrangement agreement, and as described in this proxy circular/prospectus, is hereby adopted and approved, and the board of directors of Nicholas Financial-Canada be and is hereby authorized to amend or revise the Arrangement in its discretion to the extent permitted by the arrangement agreement without further approval of the Securityholders;

The arrangement agreement is hereby ratified, confirmed and approved, and the board of directors be and is hereby authorized to amend or revise the arrangement agreement in its discretion to the extent permitted therein without further approval of the Securityholders;

Notwithstanding that the Arrangement has received the approval of the Supreme Court of British Columbia and the Securityholders, the board of directors of Nicholas Financial-Canada may, subject to the terms of the Arrangement, amend or decide not to proceed with the Arrangement or revoke this resolution at any time prior to the filing of the documents giving effect to the Arrangement, without further notice to or approval of the Securityholders; and

Any one director or officer of Nicholas Financial-Canada is hereby authorized to do all such acts and things and execute and file with all required regulatory authorities all other documents and instruments necessary or desirable to carry out these resolutions, including as may be applicable the Supreme Court of British Columbia, the Registrar of Companies for British Columbia, the SEC, and NASDAQ.

**Nicholas Financial-Canada's board of directors, including the independent directors, unanimously recommends that Nicholas Financial-Canada's Securityholders vote "FOR" approval of the Arrangement Resolution.**

**Record Date**

Only holders of record of Nicholas Financial-Canada Common Shares and options at the close of business on [ ], [ ], 2014, the "record date," are entitled to notice of and to vote at the special meeting. On the record date, [ ] Common Shares were issued and outstanding and held by approximately [ ] holders of record, and [ ] options were held by approximately [ ] holders of record.

**Quorum and Adjournments**

Proxies, and the power of attorney or other authority, if any, under which they are signed or a notarially certified copy thereof, must be deposited either at the office of the Registrar and Transfer Agent of Nicholas Financial-Canada, Computershare Investor Services Inc., 510 Burrard Street, Vancouver, British Columbia V6C 3B9, or at the Corporate Headquarters of Nicholas Financial-Canada at Building C, 2454 McMullen Booth Road, Clearwater, Florida 33759-1343 not less than 48 hours,

Table of Contents

Saturdays, Sundays and holidays excepted, prior to the time of the holding of the special meeting or any adjournment thereof.

Votes cast by proxy or in person at the special meeting will be tabulated by the inspector appointed for the special meeting, who will also determine whether a quorum is present for the transaction of business. Nicholas Financial-Canada's Articles provide that a quorum is present if two or more shareholders of Nicholas Financial-Canada are present in person (or represented by proxy) holding an aggregate of at least 33<sup>1</sup>/<sub>3</sub>% of the total issued and outstanding Common Shares of Nicholas Financial-Canada as of the record date for the special meeting. Abstentions will be counted as shares that are present and entitled to vote for purposes of determining whether a quorum is present. Shares held by nominees for beneficial owners will also be counted for purposes of determining whether a quorum is present if the nominee has the discretion to vote on at least one of the matters presented, even though the nominee may not exercise discretionary voting power with respect to other matters and even though voting instructions have not been received from the beneficial owner (a "broker non-vote"). Given that there are no discretionary matters to be voted on at the special meeting, there should not be any broker non-votes. Neither abstentions nor broker non-votes are counted in determining whether a proposal has been approved. The vote required for the proposal to approve the Arrangement Resolution is set forth below under the caption " Vote Required."

Securityholders are urged to indicate their votes in the spaces provided on the proxy card. Proxies solicited by the board of directors of Nicholas Financial-Canada will be voted in accordance with the directions given therein. **Unless your shares are held in a brokerage account or in "street name", 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 Arrangement Resolution.** Returning your completed proxy card will not prevent you from voting in person at the special meeting should you be present and wish to do so.

Only registered Securityholders or duly appointed proxyholders are permitted to vote at the special meeting. Most shareholders of Nicholas Financial-Canada are nominee, or "non-registered," shareholders because the Common Shares they own are not registered in their names but are instead registered in the names of the brokerage firms, banks or trust companies through which they purchased the shares. More particularly, a person is not a registered shareholder in respect of shares which are held on behalf of the person (the "Non-Registered Holder") but which are registered either: (a) in the name of an intermediary (an "Intermediary") that the Non-Registered Holder deals with in respect of the shares (Intermediaries include, among others, banks, trust companies, securities dealers or brokers and trustees or administrators of self-administered registered retirement savings plans, registered retirement income funds, registered education savings plans and similar plans); or (b) in the name of a clearing agency (such as The Canadian Depository for Securities Limited) ("CDS") of which the Intermediary is a participant. In accordance with the requirements as set out in National Instrument 54-101 (formerly National Policy Statement No. 41) of the Canadian Securities Administrators, Nicholas Financial-Canada has distributed copies of the Notice of special meeting, this proxy circular/prospectus and the proxy (collectively, the "Meeting Materials") to the clearing agencies and Intermediaries for onward distribution to Non-Registered Holders.

Intermediaries are required to forward the Meeting Materials to Non-Registered Holders unless a Non-Registered Holder has waived the right to receive them. Very often Intermediaries will use service companies to forward the Meeting Materials to Non-Registered Holders. Generally, Non-Registered Holders who have not waived the right to receive Meeting Material will either:

- (a) be given a form of proxy which has already been signed by the Intermediary (typically by a faxed, stamped signature), which is restricted as to the number of shares beneficially owned by the Non-Registered Holder but which is otherwise not completed. Because the Intermediary has already signed the form of proxy, this form of proxy is not required to be signed by the Non-Registered Holder when submitting the proxy. In this case, the Non-Registered Holder who



Table of Contents

wishes to submit a proxy should otherwise properly complete the form of proxy and deposit it with Nicholas Financial-Canada's Registrar and Transfer Agent as provided above; or

(b) more typically, be given a voting instruction form which is not signed by the Intermediary, and which, when properly completed and signed by the Non-Registered Holder and returned to the Intermediary or its service company, will constitute voting instructions (often called a "proxy authorization form") which the Intermediary must follow. Typically, the proxy authorization form will consist of a one page preprinted form. Sometimes instead of the one page preprinted form, the proxy authorization form will consist of a regular printed proxy form accompanied by a page of instructions, which contains a removable label containing a bar code and other information. In order for the form of proxy to validly constitute a proxy authorization form, the Non-Registered Holder must remove the label from the instructions and affix it to the form of proxy, properly complete and sign the form of proxy and return it to the Intermediary or its service company in accordance with the instructions of the Intermediary or its service company.

In either case, the purpose of this procedure is to permit Non-Registered Holders to direct the voting of the shares, which they beneficially own. Should a Non-Registered Holder who receives one of the above forms wish to vote at the special meeting in person, the Non-Registered Holder should strike out the names of the Management Proxyholders named in the form and insert the Non-Registered Holder's name in the blank space provided. In either case, Non-Registered Holders should carefully follow the instructions of their Intermediary, including those regarding when and where the proxy or proxy authorization form is to be delivered.

**Vote Required**

The Arrangement Resolution must be approved by at least three-quarters (75%) of the votes cast by Nicholas Financial-Canada shareholders, as well as at least three-quarters (75%) of the votes cast by Nicholas Financial-Canada shareholders and optionholders (voting together as a group). Holders may vote either in person or by proxy at the special meeting and will be entitled to one vote for each share held and one vote for each share the holder has an option to acquire. Securityholders who abstain, fail to return their proxies or do not otherwise vote, will not affect the voting on the Arrangement Resolution. Notwithstanding the foregoing, the Arrangement Resolution authorizes the board of directors of Nicholas Financial-Canada, without further notice to or approval of the Securityholders, subject to the terms of the arrangement, to amend the arrangement agreement or to decide not to proceed with the arrangement and to revoke the Arrangement Resolution at any time prior to the arrangement becoming effective pursuant to the provisions of the BCBCA.

**If more than 10% of the issued and outstanding Common Shares of Nicholas Financial-Canada becomes the subject of a right of dissent (see " Dissent Rights" below), the arrangement may be terminated by Prospect, and should the Securityholders fail to approve the Arrangement Resolution pursuant to the Interim Order, the arrangement will be terminated.**

**Voting of Management**

At the close of business on the record date, Nicholas Financial-Canada's executive officers and directors owned and were entitled to vote [ ] Common Shares and [ ] options of Nicholas Financial-Canada, representing [ ]% of the aggregate number of outstanding Common Shares and [ ]% of the aggregate number of outstanding Common Shares and options of Nicholas Financial-Canada on that date. None of Nicholas Financial-Canada's executive officers or directors has entered into any voting agreement relating to the proposed Arrangement; however, each of Nicholas Financial-Canada's executive officers and directors has indicated that he intends to vote his Common Shares and options, if any, in favor of the approval of the Arrangement Resolution.

Table of Contents

**Voting of Proxies**

All shares and options of Nicholas Financial-Canada 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 Securityholders giving those proxies. **Unless your shares are held in a brokerage account or in "street name", 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 Arrangement Resolution.**

**Revocability of Proxies**

Submitting a proxy on the enclosed form does not preclude a Securityholder from voting in person at the special meeting. A Securityholder may revoke a proxy by filing with Nicholas Financial-Canada a duly executed revocation of proxy at any time up to and including the last business day before the day for the holding of the special meeting, or by providing such revocation of proxy to the chair of the special meeting, at the special meeting. A Securityholder may revoke a proxy by any of these methods, regardless of the method used to deliver the Securityholder's previous proxy. Attendance at the special meeting without voting will not itself revoke a proxy.

**Solicitation of Proxies**

Nicholas Financial-Canada and/or Prospect will bear the expenses incurred in connection with the printing and furnishing of this document to its Securityholders. In addition to solicitation by mail, Nicholas Financial-Canada's executive officers, who will not be specially compensated, may solicit proxies from Nicholas Financial-Canada's Securityholders by telephone, facsimile, telegram or other electronic means or in person. 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 Common Shares held of record by these persons, and Nicholas Financial-Canada will reimburse them for their reasonable out-of-pocket expenses.

Nicholas Financial-Canada will mail a copy of this document, including the Notice of Special Meeting and the proxy card included in these materials, to each holder of record of its Common Shares and options on the record date.

**Dissent Rights**

Pursuant to the Interim Order, Securityholders may exercise rights of dissent ("Dissent Rights") under Sections 237 - 247 in Division 2 of Part 8 of the BCBCA, as the same may be modified by the Interim Order and set out herein, with respect to Common Shares and options in connection with the arrangement, provided that the written notice of dissent to the Arrangement Resolution by Securityholders who wish to dissent contemplated by Section 242 of the BCBCA (a "Dissent Notice") must be received by Nicholas Financial-Canada not later than 5:00 pm (Vancouver time) on the last business day preceding the date of the special meeting or any date to which the special meeting may be postponed or adjourned, and provided further that Securityholders who exercise such Dissent Rights (the "Dissenting Shareholders" or "Dissenting Optionholders" as the case may be, and collectively, the "Dissenting Securityholders") and who:

- (a) are ultimately determined to be entitled to be paid in cash the fair value by the Purchaser for the shares or options, as applicable, in respect of which they have validly exercised Dissent Rights will be deemed to have irrevocably transferred such shares or options (to the extent necessary to effect the transfer of such options by a Dissenting Optionholder to the Purchaser, the Stock Option Plans and the option agreements with respect to such options shall be amended to permit such transfer to the Purchaser without the need for any further act or formality), as applicable, to the Purchaser (free and clear of any liens), pursuant to Section 3.1(c) of the Plan of Arrangement as of the effective time (as defined in the arrangement agreement); or

Table of Contents

(b) are ultimately not entitled, for any reason, to be paid fair value by the Purchaser for the shares or options, or if such fair value for their options is equal to the Option Consideration (as defined in the arrangement agreement), as applicable, in respect of which they have exercised Dissent Rights, will be deemed to have participated in the arrangement on the basis set forth in Section 3.1(a) or 3.1(d) of the Plan of Arrangement, as applicable, on the same basis as the shareholders or optionholders who did not exercise Dissent Rights and will be deemed to have irrevocably transferred such shares to the Purchaser (free and clear of any liens) and to have such options cancelled pursuant to Sections 3.1(a) or 3.1(e) of the Plan of Arrangement, as applicable, as of the effective time; and

(c) but in no case will Nicholas Financial-Canada, Prospect, or any other person, including the depositary, Computershare Investor Services Inc., be required to recognize any Dissenting Shareholder or Dissenting optionholder as a holder of Common Shares or options, as applicable, after the effective time, and the names of each Dissenting Shareholder and Dissenting Optionholder will be removed from the securities registers of Nicholas Financial-Canada at the effective time. For greater certainty, and in addition to any other restriction under Section 242 of the BCBCA, neither (i) optionholders who vote, or who have instructed a proxyholder to vote, in favor of the Arrangement Resolution, or who have consented in writing to the arrangement, shall be entitled to exercise Dissent Rights, nor (ii) shareholders who vote, or who have instructed a proxyholder to vote, in favor of the Arrangement Resolution, shall be entitled to exercise Dissent Rights.

Pursuant to the terms of the arrangement agreement, the obligation of Prospect to complete the arrangement is subject to Nicholas Financial-Canada not having received notices of dissent in respect of more than 10% of the total issued and outstanding number of Common Shares, which requirement may be waived by Prospect. Should Prospect not complete the arrangement, whether as a result of the failure of Nicholas Financial-Canada's Securityholders to approve the Arrangement Resolution or Nicholas Financial-Canada receiving Dissent Notices in excess of 10% of the total outstanding Common Shares or for any other reason, Dissenting Shareholders and Dissenting Optionholders will not be entitled to receive fair value for their shares or options, as the case may be.

The terms and procedures contained in Sections 237 - 247 in Division 2 of Part 8 of the BCBCA for the right of dissent for the shareholders are set out more particularly in Annex D attached hereto (of which certain provisions have been modified by the Interim Order), and the terms and procedures for the right of dissent for the optionholders are set out more particularly in Annex E attached hereto.

All Dissent Notices of a Securityholder, in accordance with the provisions of the Plan of Arrangement, should be addressed to the registered office of Nicholas Financial-Canada at Suite 1750, 1185 W. Georgia St., Vancouver, British Columbia, V6E 4E6, Attention: Mr. Paul A. Bowes.

A Dissenting Shareholder or Dissenting Optionholder who has sent a demand for payment pursuant to a Dissent Notice, or Nicholas Financial-Canada or Prospect, may apply to the Supreme Court of British Columbia which may: (a) require the Dissenting Securityholder to sell, and Nicholas Financial-Canada to purchase, the shares or options in respect of which a Dissent Notice has been validly given; (b) set the price and terms of the purchase and sale, or order that the price and terms be established by arbitration, in either case having due regard for the rights of creditors; (c) join in the application of any other Dissenting Shareholder who has delivered a demand for payment; and (d) make consequential orders and give such directions as it considers appropriate. No Dissenting Shareholder who has delivered a demand for payment may vote or exercise or assert any rights of a shareholder in respect of the shares for which a demand for payment has been given, other than the rights to receive payment for those shares. No Dissenting Optionholder who has delivered a demand for payment may vote or exercise or assert any rights of an optionholder in respect of the options for which a demand for payment has been given, other than the rights to receive payment for those

Table of Contents

options. Once the arrangement becomes effective, and until a Dissenting Securityholder who has delivered a demand for payment is paid in full, that Dissenting Securityholder may exercise and assert all the rights of a creditor of Nicholas Financial-Canada. No Dissenting Securityholder may withdraw his or her demand for payment, unless Nicholas Financial-Canada consents.

Once the arrangement becomes effective, none of the resulting changes to Nicholas Financial-Canada will affect the rights of the Dissenting Securityholders or Nicholas Financial-Canada or Prospect, or the price to be paid for the Dissenting Securityholder's shares or options, as the case may be. If the Supreme Court of British Columbia determines that a person is not a Dissenting Securityholder or is not otherwise entitled to dissent, the Court, without prejudice to any acts or proceedings that Nicholas Financial-Canada, Prospect or the Securityholders may have taken during the intervening period, may make the order it considers appropriate to remove the restrictions on the Dissenting Securityholder from dealing with his or her shares or options.

**The foregoing summary does not purport to be a comprehensive statement of the procedures to be followed by a Dissenting Securityholder who seeks payment of the fair value of such Securityholder's shares or options, as the case may be, and is qualified in its entirety by reference to the detailed provisions set forth in the Interim Order and Sections 237 - 247 of the BCBCA, the full texts of which are attached to this proxy circular/prospectus, respectively, as Annex F and Annex D, the optionholders' rights of dissent attached as Annex E, and the Plan of Arrangement attached as Schedule B to the arrangement agreement attached to this proxy circular/prospectus as Annex B. The Dissent Rights as described herein require strict adherence to the procedures established and failure to do so may result in the loss of Dissent Rights. Accordingly, each Securityholder who might desire to exercise the Dissent Rights should carefully consider and comply with these provisions and should consult a legal advisor.**

Table of Contents**CAPITALIZATION OF PROSPECT**

The following table sets forth Prospect's capitalization as of September 30, 2013:

on an actual basis;

on an as adjusted basis giving effect to the issuance of 448,418 shares in connection with Prospect's dividend reinvestment plan during the period from September 30, 2013 to January 3, 2014 and Prospect's issuance of 29,857,039 shares of common stock during the period from October 1, 2013 to December 30, 2013 (with settlement through January 3, 2014) under Prospect's ATM Program, the issuance of \$141.8 million aggregate principal amount of Prospect Capital InterNotes® since September 30, 2013 (net of redemptions) and the repayment of \$69.0 million under Prospect's credit facility; and

on an as further adjusted basis giving effect to the transactions noted in the prior column and the proposed arrangement assuming \$11.27 is the VWAP per share of Prospect common stock for the 20 trading days ending on the trading day prior to the arrangement.

	Actual	As of September 30, 2013 As Adjusted for Issuances and Dividends Paid After September 30, 2013	As Further Adjusted for the Proposed Arrangement(3)
	(in thousands, except shares and per share data)		
	(unaudited)		
<b>Long-term debt, including current maturities:</b>			
Credit facility payable	\$ 69,000		(1)
Senior convertible notes	847,500	847,500	847,500
Senior unsecured notes	347,762	347,762	347,762
Prospect Capital InterNotes®	461,977	603,799(1)	603,799
Amount owed to affiliates	1,789	1,789	1,789
<b>Total long-term debt</b>	<b>1,728,028</b>	<b>1,800,850</b>	<b>1,800,850</b>
<b>Stockholders' equity:</b>			
Common stock, par value \$0.001 per share (500,000,000 common shares authorized; 271,404,289 shares outstanding actual, 301,709,746(2) shares outstanding as adjusted and 319,041,819(3) shares outstanding as further adjusted for the proposed amalgamation)	271	302	319
Paid-in capital in excess of par value	2,999,878	3,341,533	3,533,023
Undistributed net investment income	72,745	72,745	72,745
Accumulated realized losses on investments	(73,987)	(73,987)	(73,987)
Net unrealized depreciation on investments	(89,152)	(89,152)	(89,152)
<b>Total stockholders' equity</b>	<b>2,909,755</b>	<b>3,251,441</b>	<b>3,442,948</b>
<b>Total capitalization</b>	<b>\$ 4,637,783</b>	<b>\$ 5,052,291</b>	<b>\$ 5,243,798</b>

(1)

As of January 3, 2014, (1) Prospect had no borrowings outstanding under its credit facility, representing a \$69.0 million reduction of borrowings, and (2) issued \$141.8 million additional Prospect Capital InterNotes® (net of redemptions), in each case, subsequent to September 30, 2013.

(2)

Includes 448,418 shares of Prospect's common stock issued on October 24, 2013, November 21, 2013 and December 19, 2013 in connection with its dividend reinvestment plan, and 29,857,039

Table of Contents

shares in connection with the ATM Program from October 1, 2013 to December 30, 2013 (with settlement through January 3, 2014), resulting in net proceeds of \$196.2 million to Prospect of which \$0.18 million was recorded as common stock and \$196.0 million as paid-in capital in excess of par value.

- (3) On December 17, 2013, the Prospect Parties entered into an arrangement agreement with Nicholas Financial-Canada. The arrangement agreement contemplates the amalgamation of Nicholas Financial-Canada with and into an indirect, wholly owned portfolio company of Prospect. In the amalgamation, each outstanding share of Nicholas Financial-Canada common stock will be converted into the right to receive a number of shares of Prospect common stock determined by dividing \$16.00 by the VWAP per share of Prospect common stock for the 20 trading days ending on the trading day immediately prior to the amalgamation, subject the payment of cash in lieu of fractional shares of Prospect common stock. The table reflects 17,332,073 shares of Prospect common stock being issued, assuming \$11.27 is the VWAP per share of Prospect common stock for the 20 trading days ending on the trading day immediately prior to the amalgamation, in exchange for the 12,208,279 shares of Nicholas Financial-Canada common stock then outstanding; however, the number of shares of Prospect common stock that will be issued will depend on the actual VWAP per share of Prospect common stock for the 20 trading days immediately prior to the effective time of the arrangement and therefore may be different than \$11.27.

Table of Contents

**THE ARRANGEMENT RESOLUTION PROPOSAL**

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

**General Description of the Arrangement**

Pursuant to the arrangement agreement, at the effective time (as defined therein) Nicholas Financial-Canada and the Purchaser will amalgamate and form an entity, Amalco, which will be an unlimited liability company under the BCBCA. Amalco will be the surviving entity and will succeed to and assume all of the rights and obligations of the Purchaser and Nicholas Financial-Canada. Amalco will be a wholly-owned portfolio company of Prospect. As a result of the proposed arrangement, all Nicholas Financial-Canada's assets and liabilities immediately before the amalgamation will become assets and liabilities of Amalco immediately after the amalgamation, and Nicholas Financial-Canada's wholly-owned subsidiaries, Nicholas Financial and NDS, will become direct subsidiaries of Amalco. See "Description of the Arrangement Agreement."

Each Nicholas Financial-Canada shareholder will receive for each Common Share (or fraction thereof) of Nicholas Financial-Canada owned, as of the date of consummation of the arrangement (the "effective time"), that number of shares of Prospect common stock determined by dividing \$16.00 by the VWAP of Prospect common stock on NASDAQ for the 20 trading days prior to and ending on the trading day immediately preceding the effective time. Holders of Common Shares of Nicholas Financial-Canada will not receive any fractional shares of Prospect's common stock in the arrangement. Instead, each Nicholas Financial-Canada shareholder otherwise entitled to a fractional share interest in Prospect will be paid an amount in cash, based on a formula set forth in the arrangement agreement and rounded to the nearest cent.

Based on the number of shares of Prospect common stock issued and outstanding as of the record date and the VWAP of Prospect common stock over the 20 trading days prior to the record date, Nicholas Financial-Canada's shareholders will own approximately [ ]% of the aggregate Prospect common stock outstanding immediately after the consummation of the arrangement.

**Court Approvals**

The Company obtained the Interim Order in the form which is attached as Annex F to this proxy circular/prospectus (the "Interim Order"). Subject to the terms of the arrangement agreement and, if the Arrangement Resolution is approved at the special meeting, the Company will apply to the Supreme Court of British Columbia (the "Court") for the final order for approval of the Plan of Arrangement (the "Final Order") at the Court House, 800 Smithe Street, Vancouver, British Columbia, on [ ], 2014, at 9:45 a.m. (Vancouver time) or as soon thereafter as counsel may be heard. See the Notice of Application for Final Order attached as Annex G for further information on participating or presenting evidence at the hearing for the Final Order.

Securityholders of the Company, as well as its creditors, will be entitled to appear in person or by counsel at the hearing for the Final Order, and to make a submission regarding the arrangement, subject to filing and serving an Appearance and satisfying any other applicable requirements.

At the hearing for the Final Order, the Court will also consider, among other things, the fairness of the terms and conditions of the arrangement and the rights and interests of every person affected. The Court may approve the arrangement either as proposed, or make the arrangement subject to such terms and conditions as the Court considers appropriate, or may dismiss the application.



Table of Contents

**Background of the Arrangement**

The Company's board of directors and senior management, as part of their ongoing activities, regularly review and discuss the Company's business strategies and the strategic alternatives available to the Company, including continuing as an independent public company and engaging in potential strategic transactions.

On January 9, 2013, the Company received a written non-binding indication of interest, or IOI, from Prospect to acquire the Company in exchange for shares of Prospect common stock valued at \$15.72 per Common Share, which represented approximately a 13% premium over the closing price of the Company's Common Shares on that date.

On February 15, 2013, the Company's board of directors held a special meeting at which all of the Company's directors were present, along with a representative from Foley & Lardner LLP, the Company's outside corporate counsel ("Foley"), to, among other things, consider the IOI received from Prospect and whether to retain a financial advisor to assist with the development and evaluation of potential strategic alternatives. The Company's board of directors considered a number of issues facing the Company, including the cost of being a public company, the competitive environment, the dependence of expansion upon the availability of credit, the volatility and volume of the trading of the Company's Common Shares, and the history and valuations of other companies in the industry, among other factors. The Company's board of directors also authorized management to arrange interviews with a select group of potential financial advisors to assist the Company's board of directors in developing and evaluating potential strategic alternatives to the Prospect IOI.

On February 19, 2013, the Company's board of directors declared a quarterly cash dividend equal to \$0.12 per Common Share, payable on March 29, 2013 to shareholders of record as of March 22, 2013.

The Company communicated to Prospect that the Company's board of directors had reviewed Prospect's bid of \$15.72 per Common Share, but decided to consider possible strategic alternatives. On March 1, 2013, the Company received a revised IOI from Prospect pursuant to which Prospect increased its proposed offer price from \$15.72 per Common Share to a range of \$16.25 to \$16.50 per Common Share, payable in shares of Prospect common stock. The price range set forth in the revised IOI represented an approximately 20% to 22% premium over the closing price of the Company's Common Shares on that date.

Shortly thereafter, at the request of the Company's board of directors, a committee of the board comprised of Messrs. Vosotas, Finkenbrink and Neal interviewed five financial advisory firms to assist the Company's board of directors in reviewing possible strategic alternatives for the Company as an alternative to the Prospect IOI.

On March 14, 2013, the Company's board of directors held a special meeting, at which all of the Company's directors were present, to review the results of such interview process. The Company's board of directors believed that, among other things, Janney had significant relevant experience in the industry and the capability of efficiently and effectively advising the Company's board of directors on possible strategic alternatives. After further discussion, the Company's board of directors unanimously agreed to engage Janney as the Company's independent financial advisor and authorized senior management to negotiate the terms of such engagement. Prior to making such decision, the Company's board of directors had been fully advised by Janney of the fact that Janney provided services to Prospect in connection with an unrelated public offering of Prospect common stock in 2007.

On March 20, 2013, the Company publicly announced that the Company's board of directors had retained Janney as the Company's independent financial advisor to assist the Company's board of directors in evaluating possible strategic alternatives for the Company, including but not limited to, the possible sale of the Company or certain of its assets, potential acquisition and expansion opportunities

Table of Contents

and/or a possible debt or equity financing. At the same time, the Company announced that it had received an unsolicited, non-binding indication of interest, or IOI, from a potential third-party acquirer. The stock price increased from a close of \$13.24 per Common Share on March 20, 2013, the date of the announcement, to a close of \$14.84 per Common Share on March 21, 2013.

Between the Company's public announcement on March 20, 2013 and April 9, 2013, Janney contacted, or was contacted by, 88 potential strategic and financial buyers.

On April 3, 2013, Prospect executed a confidentiality agreement with the Company and commenced due diligence on the Company and its business.

On April 5, 2013, the Company's board of directors held a special meeting at which all of the Company's directors were present, along with representatives from Foley and Janney who participated telephonically. During the meeting, Janney provided an overview of certain strategic alternatives available to the Company, including (i) continuing to pursue the Company's existing business plan, (ii) undergoing a recapitalization transaction, (iii) expanding through significant acquisitions, and (iv) a sale of the Company or a consummation of a strategic merger or other business combination. Further, Janney discussed with the Company's board of directors the general state of the mergers and acquisitions market, the Company's historical stock price and valuations, relative valuation of the Company to peer companies, other automobile finance company transactions, and Janney's valuation analysis, among other considerations. Janney also reviewed in detail with the Company's board of directors the results of its process conducted to date. Of the potential third-party acquirers contacted, 21 interested parties were provided a bid instruction letter requesting that they submit an IOI based on publicly available information. The Company's board of directors discussed the relative merits of the various strategic alternatives available to the Company, and the Company's board of directors authorized and directed Janney to continue the process of soliciting potential strategic and financial buyers regarding their interest in pursuing a possible strategic transaction with the Company.

As of the April 9, 2013 deadline for submitting an IOI, Janney had received preliminary written IOIs from four interested parties, other than Prospect, to acquire all of the outstanding Common Shares of the Company. Additionally, Prospect reaffirmed its March 1, 2013 IOI. In mid April, a sixth investment group ("Company E") submitted an IOI but failed to provide Janney with the information necessary to qualify as a serious and credible bidder and, thus, was not included in the interested party group. Of the five interested parties, four were financial buyers and one was a strategic buyer. The non-binding IOIs submitted by such parties, including Prospect, reflected valuations of the Company's outstanding Common Shares ranging from \$13.25 to \$17.00 per share.

On April 15, 2013, the Company's board of directors held a special telephonic meeting at which all of the Company's directors were present, along with representatives from Foley and Janney. During this meeting, the Company's board of directors engaged in a detailed review and discussion of the merits of each IOI. The Company's board of directors agreed with Janney's recommendation to exclude one of the five interested parties from the ongoing process due to the pricing set forth in its IOI falling below what the Company's board of directors determined to be an acceptable range to warrant further consideration. The Company's board of directors also directed Janney to continue discussions with the four remaining interested parties, including Prospect.

Shortly thereafter, each of the three remaining interested parties, other than Prospect, executed confidentiality agreements with the Company and commenced preliminary due diligence on the Company and its business, which included a review of certain financial projections for the Company. In addition, between April 25 and May 1, 2013, all four remaining interested parties, including Prospect, met with senior management of the Company in Clearwater, Florida.

Between April 15 and May 13, 2013, the Company's board of directors met three additional times, twice telephonically and once in person, to review and discuss the ongoing process. Representatives of

Table of Contents

Janney were present telephonically at two of such meetings and a representative of Foley was present telephonically at one of such meetings.

On May 7, 2013, the Company's board of directors declared a quarterly cash dividend equal to \$0.12 per Common Share, payable on June 28, 2013 to shareholders of record as of June 21, 2013.

On May 21, 2013, at the direction of the Company's board of directors, Janney distributed final bid instructions and a proposed form of arrangement agreement to the four remaining bidding parties asking each to submit a firm, non-binding letter of intent by June 10, 2013.

On May 21, 2013, Company E, which had generally disregarded the process established by the Company's board of directors, sought to rejoin the process and executed a confidentiality agreement with the Company. However, Company E continued to disregard Janney's requests for qualifying information, did not seek access to the Company's virtual data room or otherwise request non-public information regarding the Company, failed to meet the process deadlines as set forth by the Company's board of directors and did not submit a final letter of intent, as requested. The Company's board of directors considered Company E's sporadic communications in the ensuing eight months, but continued to conclude that Company E did not qualify as a serious and credible bidder.

On or about June 10, 2013, three of the four interested parties submitted written non-binding letters of intent. On June 12, 2013, the Company's board of directors held a special meeting at which all of the Company's directors were present, along with representatives from Foley and Janney who participated telephonically, to review the three letters of intent received as of that date. The Company's board of directors discussed, among other things, how best to proceed to maximize the existing offers. The Company's board of directors also determined to delay further consideration of the three letters of intent received to date until after the receipt of the proposal from Company C, which proposal the Company's board of directors expected to receive within the next week. On June 24, 2013, the Company's board of directors held a special meeting at which all of the Company's directors were present, along with representatives from Foley and Janney, who participated telephonically, to review and discuss the respective merits of the four letters of intent received from the remaining parties. The final letters of intent contained offers ranging from \$14.25 to \$17.00 per Common Share. Following such review and discussion, the Company's board of directors determined to proceed exclusively with Company C, whose letter of intent consisted of an all-cash bid of \$17.00 per Common Share, with no financing contingency.

Thereafter, the Company and Company C spent more than one month negotiating the terms of the letter of intent. During this negotiation process, Company C began its confirmatory due diligence process.

During July 2013, the Company's board of directors met six times, once telephonically and five times in person, to review and discuss the ongoing process, including, among other things, the status of negotiations with Company C and the progress of Company C's due diligence review of the Company. Representatives of Foley and Janney participated telephonically in each of such meetings.

On August 1, 2013, the Company's board of directors held a special telephonic meeting at which all of the Company's directors were present, along with representatives from Foley and Janney, to consider an unsolicited revised letter of intent received from Prospect of \$17.10 per Common Share, payable in a combination of cash and Prospect common stock, as well as the status of the ongoing negotiations with Company C. The Company's board of directors instructed Janney to contact Company C to see whether it would increase its \$17.00 offer.

On August 5, 2013, the Company's board of directors held a special telephonic meeting at which all of the Company's directors were present, along with representatives from Foley and Janney, to review and discuss the relative merits of the revised Prospect letter of intent and the Company C offer, which Company C was unwilling to increase. Following such review and discussion, and based upon

Table of Contents

various factors, including (i) the fact that each of Prospect and Company C was only willing to proceed on an exclusive basis, (ii) the fact that the Company and Company C were unable to negotiate and execute a letter of intent after more than 30 days of discussions and negotiations, (iii) an assessment that there would be a greater likelihood of finalizing a transaction with Prospect, especially given Prospect's demonstrated experience in closing transactions, and (iv) the recommendation of Janney, the Company's board of directors decided to commence negotiations with Prospect and authorized senior management to work with Janney and Foley to negotiate and execute a letter of intent.

On August 13, 2013, the Company's board of directors declared a quarterly cash dividend equal to \$0.12 per Common Share, payable on September 27, 2013 to shareholders of record as of September 20, 2013.

On August 15, 2013, the Company executed a letter of intent with Prospect, which reiterated Prospect's willingness to acquire the Company for \$17.10 per outstanding Common Share, payable one-half in cash and one-half in shares of Prospect common stock, and granted Prospect an exclusive right to conduct due diligence and negotiate with the Company through September 30, 2013.

On September 27, 2013, the Company's board of directors held a special telephonic meeting, at which all of the Company's directors were present, to consider Prospect's request for an additional 30 days of exclusivity. Based upon the fact that due diligence and negotiations between the parties were moving forward, the Company's board of directors approved an amendment to the letter of intent extending the exclusivity period through October 30, 2013.

On October 4, 2013, the Company provided Prospect with updated management financial projections, including management's expectations regarding the Company's financial results for the fiscal quarter-ending September 30, 2013, which indicated that the Company's earnings would be lower than previously projected for the fiscal quarter ended September 30, 2013 and for future periods.

On October 30, 2013, Prospect notified the Company that, based upon the results of its confirmatory due diligence findings and the Company's lower earnings and revised (and lower) financial projections, Prospect was revising its letter of intent to \$15.75 per outstanding Common Share, with 100% of the consideration to be paid in shares of Prospect common stock. Alternatively, Prospect was willing to pay \$14.60 per outstanding Common Share, if the consideration were to be paid one-half in cash and one-half in shares of Prospect common stock.

Thereafter, on October 31, 2013, the Company's board of directors held a special telephonic meeting at which all of the Company's directors were present, along with representatives from Foley and Janney. During the meeting the Company's board of directors reviewed and discussed Prospect's letter of intent and considered the alternatives available to the Company. Following such discussion, the Company's board of directors directed Janney to contact the four other third parties that had submitted IOIs in April 2013 to reassess their interest in a possible transaction based upon the Company's revised financial projections. The Company's board of directors also directed Janney to continue negotiating with Prospect with a view toward getting Prospect to increase its revised \$15.75 all-stock offer.

On October 31, 2013, the Company announced its financial results for the fiscal quarter ended September 30, 2013, which included net earnings of \$4.3 million, a decrease of 16% from the same period for the preceding fiscal year. The following day, the Company's Common Shares closed trading at \$15.24 per share.

On November 11, 2013, the Company's board of directors held a regular quarterly meeting at which all of the Company's directors were present, along with representatives from Foley and Janney, who participated telephonically, to consider the responses received from the other interested parties contacted by Janney. While Company C did not respond, the other three interested parties indicated interest at prices below their previously submitted letters of intent. Among the reasons given were the updated financial projections and declining earnings. Thus, Prospect's offer of \$15.75 per Common

Table of Contents

Share was the best offer, in the opinion of the Company's board of directors. The Company's board of directors considered the various alternatives available to the Company, including continuing to operate as an independent public company and whether to wait for another time to seek strategic alternatives, and decided to continue negotiations with Prospect. Thereafter, the Company's board of directors directed Janney to negotiate with Prospect to increase its offer.

On November 11, 2013, the Company and Prospect agreed to continue to pursue a potential transaction at an increased price of \$16.00 per outstanding Common Share, with 100% of the consideration to be paid in shares of Prospect common stock.

On November 22, 2013, the Company and Prospect executed a revised letter of intent that reflected Prospect's increased offer of \$16.00 per outstanding Common Share, payable 100% in shares of Prospect common stock, and granted Prospect the exclusive right to continue negotiations with the Company through December 12, 2013.

Between November 22, 2013 and December 12, 2013, the Company and Prospect continued to conduct due diligence and negotiate the terms of the arrangement agreement and related documentation.

On December 12, 2013, the Company's board of directors held a special meeting in Clearwater, Florida at which all of the Company's directors were present, along with representatives from Foley and Janney, to consider, among other things, the form of arrangement agreement, including the Plan of Arrangement, pursuant to which Prospect would acquire the Company. At the request of the Company's board of directors, Janney reviewed and discussed the process to date and its financial analyses of Prospect and the proposed arrangement as well as responded to questions from the Company's board of directors. After the representatives of Janney excused themselves from the meeting, a representative of Foley reviewed in detail with the board of directors the proposed arrangement agreement, as well as related documentation and issues, and in connection therewith, a representative of Foley reviewed with the Company's board of directors its fiduciary obligations, as counsel had at multiple prior meetings during the relevant period. A discussion of the proposed arrangement agreement and related matters ensued, during which the Foley representative responded to numerous questions from the members of the Company's board of directors. At the conclusion of the meeting, the Company's board of directors instructed management, Janney and Foley to seek to resolve all remaining issues with Prospect.

On December 17, 2013, the Company's board of directors held a special telephonic meeting at which all of the Company's directors were present, along with representatives from Foley and Janney. The Company's legal counsel updated the Company's board of directors regarding changes to, and the status of, the arrangement agreement and related documentation. Also, during this meeting, Janney updated the Company's board of directors regarding Janney's financial analyses of Prospect and the proposed arrangement.

During the evening of December 17, 2013, the Company's board of directors held a special telephonic meeting at which a representative of Foley reviewed the final changes to the arrangement agreement and related documentation. Following a discussion of such documentation, the Company's board of directors requested that Janney update its financial analyses of Prospect and the proposed arrangement previously delivered to the Company's board of directors. Thereafter, Janney, at the request of the Company's board of directors, rendered its oral opinion as of December 17, 2013 to the Company's board of directors, which was subsequently confirmed by delivery of Janney's written opinion dated the same date, with respect to the fairness, from a financial point of view, of the consideration to be received by the holders of Common Shares of the Company pursuant to the arrangement agreement, including the Plan of Arrangement. The full text of Janney's written opinion, dated December 17, 2013, is attached to this proxy circular/prospectus as Annex H. The Company's

Table of Contents

shareholders are encouraged to read this opinion carefully in its entirety for a description of the assumptions made, procedures followed, matters considered and limitations on the review undertaken.

Following a discussion of numerous factors, including the various factors described elsewhere in this proxy circular/prospectus, and based upon a thorough and exhaustive evaluation process conducted, the Company's board of directors unanimously declared the arrangement agreement (including the Plan of Arrangement) and arrangement contemplated thereby, to be fair and in the best interests of the Company and the Securityholders, and approved and adopted the arrangement agreement, including the Plan of Arrangement, and authorized the execution and delivery thereof.

Following the meeting of the Company's board of directors, the Company and Prospect executed the arrangement agreement on December 17, 2013.

Before the opening of trading of the Company's Common Shares on December 18, 2013, each of the Company and Prospect issued a press release announcing the execution of the arrangement agreement.

**Reasons for the Proposed Arrangement**

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

*Thorough Review of Strategic Alternatives.* The Company engaged in a thorough review of the potential strategic alternatives to the Prospect proposal, including, among other things, the possible sale of the Company or certain of its assets, potential acquisition and expansion opportunities and/or a possible debt or equity financing. In furtherance of the evaluation and proposal solicitation process, the Company publicly announced on March 20, 2013 that it was actively evaluating possible strategic alternatives thereby putting potential parties on notice that the Company was open to discussing such potential alternatives. Lastly, at the request of the Company's board of directors, Janney contacted 88 potential parties in order to determine whether they might be interested in pursuing a transaction with the Company. Of the 88 potential parties contacted, five submitted non-binding indications of interest as of April 9, 2013 and four parties executed non-disclosure agreements in April 2013, including Prospect. These four parties received confidential information concerning the Company's business, management, assets, liabilities, financial condition and results of operations and were invited to perform in-depth due diligence, including meeting with management. On or about April 15, 2013, the Company received a bid from Company E, which the Company's board of directors determined not to be a serious and credible bidder. On or about June 10, 2013, the Company received four other final bids. Based on this lengthy and thorough process, the Company's board of directors believes it explored all possible strategic alternatives reasonably available to the Company. See " Background of the Arrangement."

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

the current financial condition of the Company;

Table of Contents

the current and prospective business and economic environments in which the Company operates, including challenging national, regional, and local economic conditions, the competitive environment for specialized auto finance companies characterized by intensifying competition from new entrants into the industry and large financial institutions offering consumer finance products, the regulatory burdens on consumer finance companies, and the uncertainties in the regulatory climate going forward;

the current trading price of the Company's Common Shares;

the results that the Company could expect to obtain if it continued to operate independently, and the likely benefits to the Company's Securityholders of that course of action, as compared with the value of the arrangement consideration offered by Prospect;

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 other possible strategic alternatives reasonably available to the Company;

the financial terms of the Prospect proposal, including the form and amount of consideration, the proposed exchange ratio and Prospect's ability to negotiate and consummate a transaction;

the business and legal due diligence review of Prospect's operations, its portfolio companies and other corporate and financial matters conducted by the Company and its legal and financial advisors;

the benefits of being part of a larger and more diversified organization and the risks of continuing to be an independent company, given the Company's limited financial resources and access to capital relative to Prospect;

the likelihood of Prospect consummating the arrangement based upon Prospect's history of completing similar transactions; and

the fact that no stockholder approval of Prospect's stockholders would be required.

*Market Price and Premium.* In evaluating the consideration payable to the Company's Securityholders pursuant to the arrangement, the Company's board of directors noted that \$16.00 represents a premium of approximately 21% to the average closing market price of the Company's Common Shares for the 20 trading days immediately prior to the March 20, 2013 announcement by the Company that its board of directors had retained Janney as its independent financial advisor to assist the Company's board of directors in evaluating possible strategic alternatives for the Company.

*Historical and Projected Financial Performance.* The Company's board of directors considered the Company's recent financial performance, including recent trends in delinquencies, losses and gross margins, and their impact on the Company's operating results. The Company's board of directors also considered the fact that, as a result of the Arrangement, existing shareholders would be unable to benefit directly from any future growth of the Company. In this regard, the Company's board of directors considered its understanding of the Company's business, historical, current and projected financial performance, competitive and operating environment, operations, prospects and management strengths, along with current trends in the industry in which the Company operates, including the current regulatory environment, as well as the execution risks of continuing with the Company's current strategy in light of the foregoing.

*Strategic and Business Considerations.* Because the Company's shareholders will be shareholders in Prospect following the Arrangement, the Company's shareholders stand to participate in the



Table of Contents

future growth and prospects of Prospect and its portfolio companies, including the Company. Prospect is an established company with a strong capital position and performance history. Given that the shares of Prospect common stock to be received by the Company's shareholders in the Arrangement will be registered under the Securities Act, they generally should be freely tradable immediately following the consummation of the transaction.

*Opinion of the Company's Financial Advisor.* In connection with the arrangement, the Company's board of directors received an oral opinion from Janney (which was subsequently confirmed by delivery of Janney's written opinion dated the same date) with respect to the fairness, from a financial point of view, of the transaction consideration to be received by the Company's shareholders pursuant to the arrangement. The full text of Janney's written opinion, dated December 17, 2013, is attached to this proxy circular/prospectus as Annex H. You are encouraged to read this opinion carefully in its entirety for a description of the assumptions made, procedures followed, matters considered and limitations on the review undertaken. See also "The Arrangement Proposal Opinion of Nicholas Financial-Canada's Financial Advisor."

*High Costs of Being a Public Company.* The Company's board of directors considered the costs of remaining an independent public company, including the costs of compliance related to disclosure and corporate governance rules of the SEC and Nasdaq, auditing fees and directors' and officers' insurance.

*Liquidity Considerations.* In evaluating entering into the arrangement agreement with Prospect, the Company's board of directors gave specific consideration to the current lack of liquidity for the Company's shareholders, given the low trading volume of the Company's Common Shares, to the fact that the shares of Prospect common stock to be received by the Company shareholders pursuant to the proposed arrangement will be registered under the Securities Act and to the significant trading market for Prospect common stock.

*Prior Offers.* The Company's board of directors considered the prior offers and negotiations with third parties, and the failure of those negotiations to result in a superior binding offer, in its decision to approve and recommend the arrangement agreement and the arrangement. See " Background of the Arrangement Agreement."

*Terms of the Arrangement Agreement.* The Company's board of directors considered the terms of the Arrangement Agreement, including the representations, warranties and covenants of the parties, as well as the conditions to their respective obligations under the arrangement agreement, the likelihood of the consummation of the proposed arrangement, the termination provisions of the arrangement agreement and the board of directors' evaluation of the likely time period necessary to effect the Arrangement. In this regard, the Company's board of directors also considered:

the efforts made by the Company and its advisors to negotiate and execute an arrangement agreement favorable to the Company;

the financial and other terms and conditions of the arrangement agreement as reviewed by our board of directors and the fact that they were the product of arm's-length negotiations between the parties; and

the fact that, subject to compliance with the terms and conditions of the arrangement agreement, the Company is permitted to terminate the arrangement agreement, before the completion of the proposed arrangement, in order to approve an alternative transaction proposed by a third party that is a "superior proposal" (as defined in the arrangement agreement), or which the Company's board of directors concludes in good faith (after consultation with its financial advisors) would reasonably be expected to result in a "superior proposal," upon the payment to Prospect of a \$6.0 million termination fee

Table of Contents

(representing approximately three percent (3%) of the total equity value of the transaction) (see "The Arrangement Agreement Termination Fees and Expenses").

*Availability of Dissent Rights.* The Company's board of directors also considered the fact that dissenters' rights will be available to the Company's Securityholders in connection with the proposed arrangement. See "Dissenters' Rights."

*Effect on Employees, Creditors and Customers.* As permitted under the BCBCA, the Company's board of directors considered the likely effects of the proposed arrangement on the Company's employees, creditors and customers.

The Company's board of directors also considered the risks related to the proposed arrangement (see "Risks Related to the Arrangement"); and the following potentially material negative factors in its deliberations concerning the proposed arrangement:

*Limited Ability to Consider Unsolicited Business Combination Proposals.* The Company's board of directors considered the limited ability of the Company under the arrangement agreement to provide information to, or enter into discussions with, other potential business combination parties who might make an unsolicited proposal to acquire the Company. The arrangement agreement obligates the Company to pay a termination fee of \$6.0 million if it later chooses to pursue a more attractive business combination proposal or if the arrangement agreement is terminated under certain circumstances. In addition to being costly, the obligation to pay this termination fee potentially could discourage other potential acquirers from making a proposal to acquire the Company that might be more advantageous to the Company's shareholders, or could reduce the consideration received by the Company's shareholders in an alternative transaction.

*Potential Right of Prospect to Terminate.* Prospect's obligation to complete the proposed arrangement is subject to certain conditions, and it has the right to terminate the arrangement agreement in specified circumstances.

*Costs Associated with the Proposed Arrangement.* The Company's board of directors also considered the significant costs required to complete the proposed arrangement, especially in light of the need to obtain the Company Securityholder approval required under the BCBCA and the arrangement agreement. The board of directors also considered the substantial transaction costs to be incurred by the Company even if the proposed arrangement is not consummated.

*Disruption of Operations.* The Company's board of directors evaluated the substantial management time and effort required to effectuate the proposed arrangement and the related disruption to the Company's operations, including the disruption which would result if the proposed arrangement were not consummated after the arrangement agreement had been entered into. The Company's board of directors also considered that the announcement and pendency of the transaction could have an adverse effect on the Company's business, financial operations, or business prospects and on its stock price; and various risks to the Company if the proposed arrangement were not consummated, including potential employee attrition, the potential impact on relationships with dealers and customers, and the potential impact on the Company's ability to extend, renew or replace its existing credit facility.

*Inability of Shareholders to Benefit Directly from Any Future Growth or Improved Operating Performance, Rather than Indirectly Through Prospect.* The Company's board of directors also considered the fact that, as a result of the proposed arrangement, existing Company Securityholders would be unable to benefit directly, through increases in the Company's common stock price, dividends, or otherwise, from any future growth or improved operating performance of the Company, whether due to interest rate changes, reduced competition, expanded operations into existing or new markets, or any other factors, and instead would only benefit indirectly through Prospect, to the extent shareholders choose to retain their Prospect shares.

Table of Contents

*Restrictions on Conduct of Business Pending Completion of Proposed Arrangement.* The Company's board of directors considered the restrictions on the conduct of the Company's business prior to the completion of the proposed arrangement, requiring the Company to conduct its business only in the ordinary course, subject to specific limitations, which may delay or prevent the Company from undertaking business opportunities that may arise pending completion of the proposed arrangement.

*Nature of Prospect.* The Company's board of directors considered that Prospect is a business development company regulated under the 1940 Act and is subject to substantially different risks than Nicholas Financial-Canada.

*Potential Conflicts of Interest.* The Company's board of directors considered the fact that certain persons, including directors and officers of the Company, have interests in the Arrangement that are different from, or in addition to, those of Company shareholders generally. See "Interests of Nicholas Financial-Canada's Management in the Proposed Arrangement."

*No Bring-Down of Opinion of the Company's Financial Advisor.* Because the Company currently does not anticipate asking Janney to update its opinion, the opinion will not address the fairness, from a financial point of view, of the consideration to be received by the Company's shareholders at the time the proposed arrangement is completed.

The Company's board of directors believed that the potential advantages of the proposed arrangement outweigh the negative factors, whether considered individually or collectively.

The foregoing discussion of the information and factors considered by the Company's board of directors is not intended to be exhaustive, but includes the material factors considered by the board of directors. The Company's board of directors did not attempt to quantify or otherwise assign relative weights to the specific factors it considered nor did it determine that any factor was of particular importance. A determination of various weightings would, in the view of the Company's board of directors, be impractical. In addition, individual members of the Company's board of directors may have given different weight to different factors. Rather, the Company's board of directors viewed its position and recommendations as being based on the totality of the information presented to, and considered by, the board. **It should be noted that this explanation of the Company's board of directors' reasoning and other information presented in this section is forward-looking in nature and, therefore, should be read in light of the factors discussed under the heading "Special Note Regarding Forward-Looking Statements."**

#### **Recommendation of the Board of Directors**

After careful consideration of the information and factors noted above, Nicholas Financial-Canada's board of directors, including its independent directors, concluded that the proposed arrangement is advisable and in the best interest of its shareholders and optionholders and unanimously recommends that shareholders and optionholders vote "FOR" approval of the Arrangement Resolution.

#### **Opinion of Nicholas Financial-Canada's Financial Advisor**

On December 17, 2013, Janney rendered its oral opinion to the Nicholas Financial-Canada board of directors (which was subsequently confirmed by delivery of Janney's written opinion dated the same date) to the effect that, as of December 17, 2013, and based upon and subject to the procedures followed, assumptions made, qualifications and limitations on the review undertaken, and other matters considered by Janney in preparing its opinion, the consideration to be received by the holders of Nicholas Financial-Canada's Common Shares, pursuant to the arrangement as set forth in the arrangement agreement (the "Transaction Consideration") was fair, from a financial point of view, to such holders.

Janney's opinion was directed to the Nicholas Financial-Canada board of directors (in its capacity as such) and only addressed the fairness, from a financial point of view, to the holders of Nicholas

Table of Contents

Financial-Canada Common Shares of the Transaction Consideration and did not address any other terms, aspects, or implications of the arrangement. The summary of Janney's opinion in this proxy circular/prospectus is qualified in its entirety by reference to the full text of its written opinion, which is included as Annex H to this proxy circular/prospectus and sets forth the procedures followed, assumptions made, qualifications and limitations on the review undertaken, and other matters considered by Janney in preparing its opinion. However, neither Janney's written opinion nor the summary of its opinion and the related analyses set forth in this proxy circular/prospectus are intended to be, and they do not constitute, a recommendation as to or otherwise address how any holder of Nicholas Financial-Canada's Common Shares should vote or act in respect of the Arrangement Resolution or any related matter.

In rendering its opinion, Janney, among other things:

reviewed the financial terms of a draft, dated December 17, 2013 (and prior drafts), of the arrangement agreement and Plan of Arrangement as provided to Janney as of such date;

reviewed certain publicly available business and financial information relating to Nicholas Financial-Canada and Prospect;

reviewed certain financial statements of Nicholas Financial-Canada and Prospect and certain other business, financial and operating information relating to Nicholas Financial-Canada and Prospect provided to Janney by the managements of Nicholas Financial-Canada and Prospect;

reviewed certain publicly available business and financial information relating to the industries in which Nicholas Financial-Canada and Prospect operate;

reviewed certain business, financial and other information relating to Nicholas Financial-Canada and Prospect, including financial forecasts for Nicholas Financial-Canada through March 31, 2018 provided to or discussed with Janney by the management of Nicholas Financial-Canada;

reviewed certain financial and stock trading data and information for Nicholas Financial-Canada and Prospect and compared that data and information with corresponding data and information for companies with publicly traded securities that Janney deemed relevant;

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

discussed with certain members of senior management of Nicholas Financial-Canada and Prospect the strategic aspects of the arrangement; and

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

In connection with its review, Janney assumed and relied upon the accuracy and completeness of all of the financial and other information provided or otherwise made available to it, discussed with or reviewed by it, or that was publicly available, and Janney did not independently verify the accuracy or completeness of any such information. Janney relied upon assurances of management that they were not aware of any facts or circumstances that would make such information inaccurate or misleading in any respect material to Janney's analyses or opinion. With respect to the financial forecasts, projections, and estimates relating to Nicholas Financial-Canada's future financial performance through March 31, 2018 prepared by and discussed with management and utilized in Janney's analyses, Janney was advised and, at Nicholas Financial-Canada's direction, assumed that they were reasonably prepared and reflected the best currently available estimates, judgments, and assumptions of management as to Nicholas Financial-Canada's future financial performance. Janney assumed no responsibility for, and expressed no view as to, such forecasts, projections, or estimates or the judgments or assumptions upon which they were based. Janney also

assumed that there were no material changes in the condition (financial or otherwise), results of operations, business, or prospects of Nicholas Financial-Canada since the respective dates of the most recent financial statements and other information provided to it. In

Table of Contents

arriving at its opinion, Janney did not conduct any physical inspection of any of the properties or assets or obtain any independent evaluations or appraisals of any of Nicholas Financial-Canada's assets or liabilities (contingent or otherwise), nor did Janney make any determination as to the solvency of any party to the arrangement.

Nicholas Financial-Canada does not publicly disclose internal management projections of the type provided to Janney in connection with its review of the arrangement. As a result, such projections were not prepared with a view towards public disclosure. The projections were based on numerous variables and assumptions, which are inherently uncertain, including factors related to general economic and competitive conditions. Accordingly, actual results could vary significantly from those set forth in the projections.

Janney's opinion only addressed the fairness, from a financial point of view, to the holders of the Company's Common Shares of the Transaction Consideration to be received by such holders in the arrangement pursuant to the arrangement agreement to the extent expressly specified in the opinion and did not address any other terms, aspects, or implications of the arrangement or any agreements, arrangements, or understandings entered into in connection with the arrangement or otherwise, including, without limitation, the form or structure of the arrangement or the financing arrangements of Prospect for the arrangement. In addition, the opinion does not address the fairness (financial or otherwise) of the amount or nature of, or any other aspect relating to, any compensation to be received by any officers, directors, or employees of any parties to the arrangement, or class of such persons, relative to the consideration or otherwise. Janney gave no opinion, counsel, or interpretation as to matters that require legal, regulatory, accounting, insurance, tax, or other similar professional advice and assumed that such opinions, counsel, or interpretations were or would be obtained from the appropriate professional sources. Furthermore, Janney, with Nicholas Financial-Canada's consent, relied upon the assessments by Nicholas Financial-Canada and Nicholas Financial-Canada's advisors as to all legal, regulatory, accounting, insurance, and tax matters with respect to Nicholas Financial-Canada and the arrangement. The opinion does not address the merits of the underlying decision by Nicholas Financial-Canada or its board of directors to enter into the arrangement or the relative merits of the arrangement as compared with alternative business strategies or transactions available to Nicholas Financial-Canada. Janney's opinion does not constitute a recommendation as to or otherwise address how any holder of Common Shares should vote or act in respect of the arrangement or any related matter. The issuance of Janney's opinion was approved by an authorized committee of Janney.

In rendering its opinion, Janney assumed, with Nicholas Financial-Canada's consent, that the final form of the arrangement agreement would not differ from the draft reviewed by Janney in any respect material to its analyses, that the arrangement would be consummated in accordance with the arrangement agreement and in compliance with all applicable laws, without waiver, modification, or amendment of any terms or conditions material to its analyses, and that, in the course of obtaining any necessary legal, regulatory, or third party consents or approvals for the arrangement, no delays, limitations, restrictions, or conditions would be imposed that would have an adverse effect on Nicholas Financial-Canada or the contemplated benefits of the arrangement that would be material to its analyses or this opinion.

Janney's opinion was necessarily based on economic, market, financial, and other conditions existing, and the information made available to it, as of the date of its opinion. Although subsequent developments may affect its opinion, Janney has no obligation to update, revise, or reaffirm the opinion.

Janney's opinion was for the information and use of the board (in its capacity as such) in connection with its evaluation of the arrangement and should not be construed as creating, and Janney shall not be deemed to have any fiduciary duty to the board, Nicholas Financial-Canada, any security holder or creditor of Nicholas Financial-Canada, or any other person, regardless of any prior or ongoing advice or relationships.

Table of Contents

In performing its analyses, Janney made numerous assumptions with respect to industry performance, general business, economic, market and financial condition and other matters, which are beyond the control of Janney, Nicholas Financial-Canada and Prospect. Any estimates contained in the analyses performed by Janney are not necessarily indicative of actual values or future results, which may be significantly more or less favorable than suggested by these analyses. Additionally, estimates of the value of businesses or securities do not purport to be appraisals or to reflect the prices at which such businesses or securities might actually be sold. Accordingly, these analyses and estimates are inherently subject to substantial uncertainty. In addition, the Janney opinion was among several factors taken into consideration by the board in making its determination to approve the arrangement. Consequently, the analyses described below should not be viewed as determinative of the decision of the board with respect to the fairness of the consideration.

The following is a summary of the material analyses presented by Janney to Nicholas Financial-Canada's board of directors on December 17, 2013, in connection with its fairness opinion. The summary is not a complete description of the analyses underlying the Janney opinion or the presentation made by Janney to the Company's board of directors, but summarizes the material analyses performed and presented in connection with such opinion. The preparation of a fairness opinion is a complex analytic process involving various determinations as to the most appropriate and relevant methods of financial analysis and the application of those methods to the particular circumstances. Therefore, a fairness opinion is not readily susceptible to partial analysis or summary description. In arriving at its opinion, Janney did not attribute any particular weight to any analysis or factor that it considered, but rather made qualitative judgments as to the significance and relevance of each analysis and factor. The financial analyses summarized below include information presented in tabular format. Accordingly, Janney believes that its analyses and the summary of its analyses must be considered as a whole and selecting portions of its analyses and factors or focusing on the information presented below in tabular format, without considering all analyses and factors or the full narrative description of the financial analyses, including the methodologies and assumptions underlying the analyses, could create a misleading or incomplete view of the process underlying its analyses and opinion. The tables alone do not constitute a complete description of the financial analyses.

**Summary of Proposal**

Pursuant to the terms of the arrangement agreement, Nicholas Financial-Canada's shareholders are to receive (subject to applicable dissent rights under the BCBCA), in exchange for each Common Share of Nicholas Financial-Canada held immediately prior to the effective time of the arrangement, the number of shares of Prospect common stock (or fraction thereof) determined by dividing \$16.00 by the VWAP of Prospect common stock for the 20 trading days prior to and ending on the trading day immediately preceding the effective time of the arrangement. In addition, each and every option to acquire Common Shares of Nicholas Financial-Canada outstanding immediately prior to the effective time of the arrangement will be cancelled or transferred by the holder thereof to the Purchaser (subject to applicable dissent rights under the BCBCA) in exchange for a cash amount equal to the amount by which (i) the product obtained by multiplying (x) the number of Common Shares of Nicholas Financial-Canada underlying each option by (y) \$16.00 exceeds (ii) the aggregate exercise price payable under such option.

**Comparable Public Company Trading Analysis**

Using publicly available information, Janney compared the financial condition and market performance of Nicholas Financial-Canada to selected publicly traded automotive finance companies in the United States deemed, in Janney's professional judgment, to be relevant to Nicholas Financial-Canada. Companies included in this group were:

America's Car-Mart, Inc. (CRMT)

Consumer Portfolio Services, Inc. (CPSS)

Table of Contents

## Credit Acceptance Corporation (CACC)

To perform this analysis, Janney used financial information as of the twelve-month period ended September 30, 2013, and market price information as of the close of the stock markets on December 16, 2013. Certain financial data prepared by Janney, and as referenced in the tables presented below, may not correspond to the data presented in historical financial statements as a result of the different periods, assumptions and methods used by Janney to compute the financial data presented.

Janney's analysis showed the following concerning Nicholas Financial-Canada's financial condition relative to its selected peers:

	Nicholas Financial- Canada Peer Minimum	Nicholas Financial- Canada Peer Maximum	Implied Equity Value Per Share Range
Price / Book Value	1.8x	4.3x	\$ 19.79 - \$47.24
Price / LTM Pre-Tax EPS	5.8x	7.9x	\$ 15.87 - \$21.52
Price / 2013E Pre-Tax EPS	5.0x	9.4x	\$ 12.45 - \$23.45
Price / 2014E Pre-Tax EPS	3.1x	7.6x	\$ 8.19 - \$19.99
Price / LTM EPS	12.5x	12.6x	\$ 19.69 - \$19.92
Price / 2013E EPS	12.3x	12.5x	\$ 19.35 - \$19.75
Price / 2014E EPS	7.9x	12.3x	\$ 12.76 - \$19.86

Taking into account the results of the comparable public company trading analysis, Janney applied multiple ranges to corresponding financial data for Nicholas Financial-Canada, resulting in an implied equity value per share of \$8.19 to \$47.24.

Janney also reviewed other operating and financial metrics for informational purposes and content, but did not rely on these additional data points in assessing fairness. Although Janney compared the trading of selected public companies to those implied for Nicholas Financial-Canada, none of the selected public companies is identical to Nicholas Financial-Canada. Accordingly, any analysis of the selected publicly traded companies necessarily involved complex considerations and judgments concerning the differences in financial and operating characteristics and other factors that would necessarily affect the analysis of trading multiples of the selected publicly traded companies.

**Precedent Transaction Analysis**

Janney also considered the financial terms of business combinations and other transactions since October 2009 deemed relevant by Janney. The selected transactions were chosen because the target businesses were deemed to be similar to Nicholas Financial-Canada in one or more respects, including but not limited to their business, size, financial performance or geographic focus. No specific numeric of other similar criteria were used to select the selected transactions, and all criteria were evaluated in their entirety without application of definitive qualifications or limitations on individual criteria. As a result, a transaction involving the acquisition of a significantly larger or smaller company with substantially similar lines of businesses and business focus may have been included while a transaction involving the acquisition of a similarly sized company with less similar lines of business and greater diversification may have been excluded.

To the extent information was publicly available, Janney derived and compared, among other things, the following implied ratios for the determination of a range of equity values for Nicholas Financial-Canada's Common Shares:

price per common share paid for the acquired company to book value per share of the acquired company based on the latest publicly available financial statements of Nicholas Financial-Canada available prior to the announcement of the acquisition;

price per common share paid for the acquired company to last twelve months pre-tax net income per share of the acquired company based on the latest publicly available financial



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### Table of Contents

statements of Nicholas Financial-Canada available prior to the announcement of the acquisition; and

price per common share paid for the acquired company to last twelve months net income per share of the acquired company based on the latest publicly available financial statements of Nicholas Financial-Canada available prior to the announcement of the acquisition.

<b>Acquiror</b>	<b>Acquiree</b>
Parthenon Capital Partners	White River Capital Inc
Aquiline Capital Partners LLC	First Investors Financial Services Group
RedRidge Finance Group	Excel Finance
KKR, Warburg Pincus and Centerbridge	Santander Consumer
CIVC Partners L.P.	Honor Finance
TCF Bank	Gateway One Lending & Finance LLC
Blackstone Group LP	Exeter Finance Corp.
Marubeni Corp.	Westlake Financial Services
Jacobs Asset Management	Investors Financial Services
Perella Weinberg Partners	Car Finance Capital
Altamont Capital	J.D. Byrider Systems, Inc.
Pine Brook Road Partners, LLC	United PanAm Financial Corp.
TD Financial	Chrysler Financial
General Motors Corporation	AmeriCredit Financial Services, Inc.
Perella Weinberg Partners	Flagship Credit Acceptance LLC

Dollar Financial Group Inc.

Dealers' Fin. Svcs; Military Fin. Svcs

The results of the analysis are set forth in the following table:

	Range	Median	Implied Equity Value Per Share Range
Price / Book Value	0.8x - 1.4x	1.2x	\$ 9.34 - \$15.31
Price / LTM Pre-Tax EPS	5.7x - 9.4x	6.7x	\$ 15.50 - \$25.69
Price / LTM EPS	7.6x - 15.1x	9.5x	\$ 12.01 - \$23.82

No company or transaction used as a comparison in the above analysis is identical to Nicholas Financial-Canada or the arrangement. Accordingly, an analysis of these results is not mathematical. Instead, it involves complex considerations and judgments concerning differences in financial and operating characteristics of the companies.

Taking into account the results of the precedent transactions analysis, Janney applied multiple ranges to corresponding financial data for Nicholas Financial-Canada, resulting in an implied equity value per shares of \$9.34 to \$25.69.

### Equity Discounted Cash Flow Analysis

Janney performed an equity discounted cash flow analysis for the purpose of determining the implied equity value per share of Nicholas Financial-Canada to estimate a range of the present values of after-tax cash flows that Nicholas Financial-Canada could theoretically produce to equity holders through March 31, 2018 on a stand-alone basis. Janney assumed discount rates ranging from 14.0% to 20.0%. The calculated cost of equity was derived from publicly-trade consumer finance companies and included a company-specific size and risk adjustment as determined necessary in Janney's judgment. The group necessarily involved companies with businesses other than auto finance due to the small number of publicly-traded subprime auto finance companies with adequate market capitalization and trading volume to produce meaningful data for the analysis. The range of values was determined by adding the present value of projected cash flows to Nicholas Financial-Canada's shareholders from 2014 through 2018 and the present value of a terminal value. In calculating the terminal value, Janney applied multiples ranging from 4.5 to 7.5 times 2018 projected pre-tax net income. The range of

Table of Contents

multiples was based on the equity value to pre-tax net income multiples of certain publicly-traded auto finance companies, selected prior auto finance acquisition transactions, and other factors that Janney considered appropriate, including Nicholas Financial-Canada's historical and projected financial performance. This resulted in a range of values for Nicholas Financial-Canada from \$15.40 to \$24.64 per share. The equity discounted cash flow value analysis is a widely used valuation methodology that relies on numerous assumptions, including growth rates, terminal values and discount rates. The analysis did not purport to be indicative of the actual values or expected values of Nicholas Financial-Canada.

**Information Regarding Janney**

Janney, as part of its investment banking services, is regularly engaged in the independent valuation of businesses and securities in connection with mergers, acquisitions, private placements and valuations for corporate and other purposes. Nicholas Financial-Canada and Janney entered into an engagement agreement on March 20, 2013 pursuant to which Nicholas Financial-Canada engaged Janney to act as its exclusive financial advisor in connection with its consideration of strategic alternatives, including (without limitation) the possible sale of all or substantially all of the outstanding stock of Nicholas Financial-Canada. Janney is entitled to receive a fee of approximately \$1.5 million for its services upon the closing of the arrangement. Janney also became entitled to receive a fee of \$250,000 upon the rendering of its fairness opinion, which will be credited against the fee payable to it upon the consummation of the arrangement. Nicholas Financial-Canada has also agreed to reimburse Janney for reasonable out-of-pocket expenses and disbursements incurred in connection with its retention and to indemnify Janney for certain liabilities arising out of its engagement. In the five years preceding the date of its opinion to Nicholas Financial-Canada, Janney did not perform any services for or receive any compensation from Nicholas Financial-Canada (other than in connection with the arrangement) for investment banking services. Janney performed services for Prospect in connection with an unrelated public offering of Prospect common stock in 2007, which Janney advised the Company's board of directors of before being engaged. Janney has not performed any services for Prospect in the five years preceding the date of Janney's December 17, 2013 opinion.

**Interests of Nicholas Financial-Canada's Directors and Executive Officers in the Arrangement**

In considering the recommendation of Nicholas Financial-Canada's board of directors to approve the Arrangement Resolution, Securityholders should be aware that certain of Nicholas Financial-Canada's directors and executive officers have interests in the transaction that are different from, or are in addition to, the interests of Nicholas Financial-Canada's shareholders and optionholders generally. Nicholas Financial-Canada's board of directors was aware of these interests and considered them along with other matters when it unanimously determined to recommend the arrangement. These are discussed in the following paragraphs.

**Prior Employment Agreements**

The Company has change of control provisions in its existing employment agreements with Messrs. Vosotas and Finkenbrink. The completion of the arrangement will constitute a "change of control" within the meaning of each of these employment agreements. However, Mr. Vosotas has entered into a consulting agreement that, effective as of the effective time, will supersede his prior employment agreement without the making of any change of control payment, and Mr. Finkenbrink has entered into an employment agreement that, effective as of the effective time, will supersede his prior employment agreement without the making of any change of control payment.

**Consulting Agreement**

Pursuant to the consulting agreement, Mr. Vosotas will make himself reasonably available for up to twenty hours per month for a period of twelve months to consult with Nicholas Financial and US New Opco regarding matters relating to the Company's business. These entities will pay to Mr. Vosotas

Table of Contents

twelve monthly installments of \$10,000. In addition, Mr. Vosotas will be entitled to certain perquisites consistent with those he is currently receiving.

Nicholas Financial and US New Opco have the right to terminate the consulting agreement in the event of a material breach by Mr. Vosotas of any provision, representation, warranty or covenant provided in the consulting agreement, if Mr. Vosotas has not cured such breach within the thirty day period following written notice of such breach delivered to Mr. Vosotas by Nicholas Financial and US New Opco. In the event of the death of Mr. Vosotas during the term of the consulting agreement, all remaining monthly payments under the employment agreement will be accelerated, and such lump sum will be paid to the estate of Mr. Vosotas or as Mr. Vosotas shall otherwise direct, in writing, during the term of the consulting agreement.

For a period of three years beginning with the effective date of the arrangement and ending on the third anniversary of the effective date, Mr. Vosotas may not, directly or indirectly, anywhere in the world, manage, operate, join, control, be employed by or participate in the management, operation or control of, or be connected in any manner with, including, without limitation, holding any position as a shareholder, director, officer, consultant, independent contractor, employee, partner or investor in, any business that is either (i) in competition with the business of the Company or (ii) proposed to be conducted by the Company in its business plan as in effect at any time during Mr. Vosotas' last year of employment with the Company; provided that Mr. Vosotas may participate as a passive investor in any entity, and he may own five percent or less of the outstanding securities of a public company.

**Subordinated Unsecured Promissory Note**

At Prospect's request, Mr. Vosotas will loan \$1,000,000 to Amalco and US New Opco at the effective time of the arrangement, as evidenced by a subordinated unsecured promissory note. Interest on the principal amount will accrue quarterly at a rate per annum equal to the sum of (i) the LIBOR Rate and (ii) a spread of 6.00%. The principal amount of the note, together with accrued and unpaid interest on such amount, will be due and payable on the third anniversary of the effective time of the arrangement. For the purpose of the subordinated unsecured promissory note, LIBOR Rate means the daily weighted average of the rate per annum for each day during the period equal to the rate determined by US New Opco to be the offered rate that appears on the page of the Reuters Screen that displays an average British Bankers Association Interest Settlement Rate (such page currently being LIBOR01) for deposits in United States dollars (for delivery on the first day of such period) with a one-month period, determined as of approximately 11 :00 a.m. (London time) two business days prior to the first day of such period.

**New Employment Agreements and Restrictive Covenants Agreements**

Pursuant to the new employment agreement for Mr. Finkenbrink, Mr. Finkenbrink will serve as the Chief Executive Officer of Nicholas Financial and US New Opco. The employment agreement has a five-year term commencing upon the effective time of the arrangement. Following this initial five-year term, the employment agreement will be automatically extended on each anniversary for an additional one-year term unless terminated ninety days prior to the renewal.

Mr. Finkenbrink's base salary under the employment agreement will be \$325,000 per annum. He will also be eligible to receive an annual bonus in accordance with a cash bonus pool, which will be based on attaining certain earnings targets, and to participate in an equity incentive plan. During the term of the employment agreement, Mr. Finkenbrink will be entitled to the retirement and welfare benefits, and other perquisites consistent with those he is currently receiving.

Mr. Finkenbrink or Nicholas Financial and US New Opco may terminate the employment agreement at any time and for any reason, subject to certain requirements for advance notice of such termination. If Mr. Finkenbrink's employment is terminated by Nicholas Financial and US New Opco other than for cause (excluding death or disability) or is terminated by Mr. Finkenbrink for good reason, he is entitled to certain benefits and payments in connection with such termination.

Table of Contents

Mr. Finkenbrink also signed a restrictive covenants agreement, by which he agreed to certain confidentiality, non-competition, and other covenants.

In addition to Mr. Vosotas' consulting agreement and Mr. Finkenbrink's new employment agreement, the Company entered into an employment agreement with Kevin Bates, a non-executive officer employee (who also signed a restrictive covenants agreement). These three agreements constitute the "Key Employee Agreements" referenced in the arrangement agreement.

**Options**

As noted in this proxy circular/prospectus, optionholders will receive cash for their options. Specifically, each option to acquire Common Shares of the Company outstanding immediately prior to the effective time of the arrangement will be cancelled or transferred by the holder thereof to the Purchaser in exchange for a cash amount equal to the amount by which (i) the product obtained by multiplying (x) the number of Common Shares of Nicholas Financial-Canada underlying such option by (y) \$16.00 exceeds (ii) the aggregate exercise price payable under such option.

The table below sets forth the number of options held by each director and executive officer of Nicholas Financial-Canada as of the record date and the aggregate cash payment that is payable in exchange for such options.

Name	Number of Options*	Aggregate Cash Payment
Peter L. Vosotas	82,500	\$ 1,289,500
Ralph T. Finkenbrink	57,700	686,530
Alton R. Neal	5,000	22,800
Scott Fink	5,000	22,800
Stephen Bragin	8,250	84,450

\*

Of the 158,450 options held by directors and executive officers of Nicholas Financial-Canada, 151,784 are presently exercisable, including all of the options held by Messrs. Vosotas and Finkenbrink.

**Indemnification of the Company's Directors and Executive Officers**

The Purchaser has agreed to:

indemnify and hold harmless all current and former officers and directors of the Company and its subsidiaries, to the same extent such persons are indemnified and held harmless as of the date of the arrangement agreement pursuant to Nicholas Financial-Canada's Articles (except on a mandatory basis instead of at the discretion of the company), for acts or omissions occurring at or prior to the completion of the arrangement, including those in respect of the arrangement and the other transactions contemplated by the arrangement agreement; and

make proper provisions to ensure that, if Amalco or any of its successors or assigns (a) consolidates with or merges into any other corporation or entity and is not the continuing or surviving corporation or entity of such consolidation or merger or (b) transfers all or substantially all of its properties and assets to any individual, corporation or other entity, then such successors and assign will assume the obligations to provide indemnification for the Company's officers and directors.

More specifically, from and after the effective time of the arrangement, Amalco will indemnify, defend and hold harmless the officers and directors of Nicholas Financial-Canada against all losses, claims, damages, costs, expenses (including attorneys' fees and expenses), liabilities or judgments or amounts that are paid in settlement of, or otherwise in connection with any threatened or actual claim, action, suit, proceeding or investigation based on or arising out of the fact that such person is or was a director or officer of Nicholas Financial-Canada or any subsidiary of Nicholas Financial-Canada at or

Table of Contents

prior to the effective time of the arrangement, whether asserted or claimed prior to, or at or after, the effective time of the arrangement, including all such indemnified liabilities based on, or arising out of, or pertaining to the arrangement agreement or the transactions contemplated by the arrangement agreement, in each case to the full extent permitted under applicable law. The Articles of the Purchaser, which will govern Amalco following consummation of the arrangement, provide for such indemnification.

The Prospect Parties have agreed that the provisions with respect to indemnification set forth in the Articles of the Purchaser will not be amended, repealed or otherwise modified for a period of six years after the effective time in any manner that would adversely affect the rights thereunder of individuals who at any time prior to the effective time were directors, officers or employees of Nicholas Financial-Canada or any of its subsidiaries. The indemnification provisions of the Articles of the Purchaser are more favorable than the Company's indemnification provisions because they require the Purchaser to advance expenses to directors and officers in advance of a final disposition of any suit, and they provide that the Purchaser must indemnify a director or officer against any liability in relation to a claim that is statutorily imposed on such director or officer, regardless of such director's or officer's conduct and whether such director or officer is at fault.

The foregoing obligations of the Purchaser are guaranteed by US New Opco and Nicholas Financial pursuant to a Guaranty Agreement.

**Insurance**

For six years after the effective time, Prospect will provide, or will cause to be provided, directors' and officers' liability insurance coverage in respect of acts or omissions occurring prior to the effective time, including the transactions contemplated by the arrangement agreement, covering each person currently covered by Nicholas Financial-Canada's directors' and officers' liability insurance policies, and each person who becomes covered by Nicholas Financial-Canada's directors' and officers' liability insurance policies prior to the effective time, on the same terms as Nicholas Financial-Canada's existing policies or, if such insurance coverage is unavailable, coverage that is on terms no less favorable to such persons than those of Nicholas Financial-Canada's existing policies. In satisfying its obligation with respect to insurance, Prospect will not be obligated to pay annual premiums in excess of two hundred percent (200%) of the aggregate annual premiums that Nicholas Financial-Canada and/or any of its subsidiaries were paying with respect to Nicholas Financial-Canada's directors' and officers' insurance policies for the policy period that includes the date of the arrangement agreement, but in such case Prospect will purchase, or will cause to be purchased, as much coverage as possible for such amount.

In lieu of maintaining such policies, Prospect may purchase, or cause to be purchased, tail policies to the directors' and officers' liability insurance policies as of the date of the arrangement agreement maintained at such time by Nicholas Financial-Canada, which tail policies (i) will be effective for a period from the effective time through and including the date six years after the effective time with respect to claims arising from facts or events that existed or occurred prior to or at the effective time, and (ii) will contain coverage that is at least as protective to each person covered by Nicholas Financial-Canada's directors' and officers' liability insurance policies as of the date of the arrangement agreement, and each person who becomes covered by Nicholas Financial-Canada's directors' and officers' liability insurance policies prior to the effective time, as the coverage provided by such existing policies; provided, that Prospect will not be obligated to pay for coverage for any 12-month period with aggregate premiums for insurance in excess of two hundred percent (200%) of the aggregate annual premiums that Nicholas Financial-Canada and/or its subsidiaries paid with respect to Nicholas Financial-Canada's directors' and officers' insurance policy for the policy period as of the date of the arrangement agreement.

The foregoing obligations of the Prospect Parties are guaranteed by US New Opco and Nicholas Financial pursuant to a Guaranty Agreement.

Table of Contents

**DESCRIPTION OF THE ARRANGEMENT AGREEMENT**

*The following summary, which includes all of the material terms of the arrangement agreement, is qualified by reference to the complete text of the arrangement agreement, which is attached as Annex B to this document and is incorporated by reference in this proxy circular/prospectus.*

**Structure of the Arrangement**

Subject to the terms and conditions of the arrangement agreement, Nicholas Financial-Canada and the Purchaser will amalgamate and form an entity, Amalco, which will be an unlimited liability company under the Business Corporations Act of British Columbia. Amalco will be the surviving entity and will succeed to and assume all of the rights and obligations of the Purchaser and Nicholas Financial-Canada. Amalco will be an indirect wholly-owned portfolio company of Prospect. As a result of the proposed arrangement, all of Nicholas Financial-Canada's assets and liabilities immediately before the amalgamation will become assets and liabilities of Amalco immediately after the amalgamation, and Nicholas Financial-Canada's wholly-owned subsidiaries, Nicholas Financial and NDS, will become direct subsidiaries of Amalco.

**Closing; Completion of the Proposed Arrangement**

Subject to the satisfaction of various conditions to closing (including approval by Nicholas Financial-Canada's Securityholders), the completion of the proposed arrangement, if approved by Nicholas Financial-Canada's Securityholders, will occur no later than the third business day after the satisfaction or waiver of the conditions set forth in the arrangement agreement or at another date or time as may be agreed to by Nicholas Financial-Canada and Prospect. If the Arrangement Resolution is approved at the special meeting, and the other conditions to the closing of the arrangement are satisfied, the parties expect to complete the arrangement early in the second quarter of 2014.

**Arrangement Consideration**

If the proposed arrangement is consummated, each Nicholas Financial-Canada shareholder will receive for each Common Share (or fraction thereof) of Nicholas Financial-Canada owned as of the date of consummation of the arrangement, the effective time, that number of shares of Prospect common stock determined by dividing \$16.00 by the VWAP of Prospect common stock for the 20 trading days prior to and ending on the trading day immediately preceding the effective time of the arrangement. Holders of Common Shares of Nicholas Financial-Canada will not receive any fractional shares of Prospect common stock in the arrangement. Instead, each Nicholas Financial-Canada shareholder otherwise entitled to a fractional share interest in Prospect will be paid an amount in cash (without interest) determined by multiplying such fraction by an amount equal to the VWAP, as calculated above.

On December 17, 2013, the last full trading day before the public announcement of the proposed arrangement, the VWAP for Prospect's common stock for the 20 trading days prior to and ending on December 16, 2013 was \$11.2681. Based upon this VWAP, each Common Share of Nicholas Financial-Canada common stock would be exchanged for 1.4199 shares of Prospect common stock. Since the value of the consideration that shareholders of Nicholas Financial-Canada will receive is based on the VWAP for Prospect common stock for the 20 trading days prior to and ending on the trading day immediately preceding the effective time of the arrangement, the value of the shares of Prospect common stock that are received by such shareholders may be greater than or less than \$16.00 on the day of the effective time.

Nicholas Financial-Canada's optionholders will be cashed out as described below.

Table of Contents

**Treatment of Nicholas Financial-Canada Stock Options**

Prospect will cash out holders of Nicholas Financial-Canada's options ("options") outstanding pursuant to the (i) 2006 Nicholas Financial, Inc. Equity Incentive Plan, (ii) 1999 Nicholas Financial, Inc. Non-Employee Director Stock Option Plan and (iii) 1999 Nicholas Financial, Inc. Employee Stock Option Plan (the "Company Stock Option Plans"). Such holders of options will receive a cash amount equal to the amount, if any, by which (i) the product obtained by multiplying (x) the number of Nicholas Financial-Canada shares underlying such option by (y) \$16.00, exceeds (ii) the aggregate exercise price payable under such option by the optionholder to acquire the Common Shares underlying such option ("Option Consideration").

Immediately prior to the effective time of the arrangement, Nicholas Financial-Canada will terminate the Company Stock Option Plans.

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

At or before the effective time, Nicholas Financial-Canada and Prospect will enter into an agreement with a depository, which will provide that Prospect will deposit with such depository at or before the effective time:

- (i) for the sole benefit of the optionholders, cash required with respect to the payment of the aggregate Option Consideration (calculated without reference to whether any optionholders have exercised dissent rights); and
- (ii) for the sole benefit of the Nicholas Financial-Canada shareholders, shares of Prospect common stock to satisfy the aggregate arrangement consideration (calculated without reference to whether any Nicholas Financial-Canada shareholders have exercised dissent rights).

Such cash, in the case of optionholders, and shares of Prospect common stock, in the case of Nicholas Financial-Canada shareholders, will be held solely for the purpose of satisfying, as applicable, payment of the Option Consideration to optionholders and the obligation of the arrangement consideration to Nicholas Financial shareholders.

The conversion of outstanding Common Shares of Nicholas Financial-Canada into the right to receive the arrangement consideration will occur automatically at the effective time of the arrangement. The depository will exchange certificates representing Common Shares of Nicholas Financial-Canada for the arrangement consideration upon receipt of an appropriately completed letter of transmittal (discussed below) and perform other duties as explained in the arrangement agreement and Plan of Arrangement set forth in Schedule B of the arrangement agreement.

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

Common Shares of Nicholas Financial-Canada held in 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 arrangement, the depository will mail a letter of transmittal to each holder of a Nicholas Financial-Canada Common Share certificate at the effective time of the arrangement. This mailing will contain instructions on how to surrender Nicholas Financial-Canada Common Share 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



Table of Contents

shares of Prospect common stock. When you deliver your Nicholas Financial-Canada stock certificates to the depository along with a properly executed letter of transmittal and any other required documents, your Nicholas Financial-Canada 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 arrangement agreement. You also will receive a cash payment for any fractional shares of Prospect common stock that would have been otherwise issuable to you as a result of the arrangement.

Holders of Nicholas Financial-Canada Common Shares should not submit their Nicholas Financial-Canada stock certificates for exchange until they receive the transmittal instructions and a form of letter of transmittal from the depository.

If a certificate for Nicholas Financial-Canada Common Shares has been lost, stolen or destroyed, the depository will issue the consideration properly payable under the arrangement agreement upon receipt of appropriate evidence as to that loss, theft or destruction and appropriate and customary indemnification.

After completion of the arrangement, there will be no further transfers on the stock transfer books of Nicholas Financial-Canada, except as required to settle trades executed prior to completion of the arrangement.

**Withholding**

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

**Dividends and Other Distributions**

Until Nicholas Financial-Canada Common Share certificates are surrendered for exchange, any dividends or other distributions declared after the completion of the arrangement with respect to those shares of Prospect common stock into which Common Shares of Nicholas Financial-Canada have been converted will accrue, without interest, but will not be paid. Prospect will pay to former Nicholas Financial-Canada shareholders any unpaid dividends or other distributions, without interest, only after they have duly surrendered their Nicholas Financial-Canada stock certificates.

**Representations and Warranties**

The arrangement agreement contains customary representations and warranties by each of Nicholas Financial-Canada and the Prospect Parties relating to, among other things:

due organization, valid existence and good standing of such party and subsidiaries of such party;

authorization to enter into the arrangement agreement and required Securityholder approval by Nicholas Financial-Canada Securityholders to complete the arrangement;

capitalization;

derivative and other securities outstanding of the parties;

compliance with SEC reporting requirements, internal controls and the Sarbanes-Oxley Act;

absence of certain changes or events;

financial statements, guarantees and commitments;

Table of Contents

no conflict or violation of organizational documents, material agreements or applicable laws as a result of the arrangement agreement or the completion of the arrangement;

permits and compliance with laws;

no material legal proceedings;

material agreements, including the investment advisory agreement and administration agreement in the case of Prospect;

tax matters;

employee benefits;

board approval;

other required approvals;

intellectual property, software and other technology;

real property, leaseholds, properties and assets;

insurance;

affiliated transactions;

the proxy circular/prospectus and the registration statement; and

environmental matters.

The arrangement agreement also contains additional customary representations and warranties made by Nicholas Financial-Canada relating to, among other things:

financial advisors;

opinion of financial advisor;

labor matters;

loans; and

no Canada operations.

The arrangement agreement also contains additional customary representations and warranties made by the Prospect Parties relating to, among other things:

portfolio companies;

broker's or finder's fees payable in connection with the arrangement;

advertisements;

capitalization of USCo, the Purchaser and US New Opco;

BDC election;

investment adviser and administrator;

compliance with money laundering laws and OFAC;

trading market;

Foreign Corrupt Practices Act; and

ownership of Nicholas Financial-Canada shares.

Table of Contents

The representations and warranties described above and included in the arrangement agreement were made by each of Nicholas Financial-Canada and the Prospect Parties to the other. These representations and warranties were made as of specific dates, may be subject to important qualifications and limitations agreed to by Nicholas Financial-Canada and the Prospect Parties in connection with negotiating the terms of the arrangement agreement, and may have been included in the arrangement agreement for the purpose of allocating risk between Nicholas Financial-Canada and the Prospect Parties rather than to establish matters as facts. The arrangement agreement is described in, and included as an appendix to, this proxy circular/prospectus only to provide you with information regarding its terms and conditions, and not to provide any other factual information regarding Nicholas Financial-Canada and the Prospect Parties or their respective businesses. Accordingly, the representations and warranties and other provisions of the arrangement 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 proxy circular/prospectus. See "Where You Can Find More Information."

**Covenants of Nicholas Financial-Canada**

Under the arrangement agreement, Nicholas Financial-Canada has agreed that, during the period before the completion of the arrangement, except as expressly contemplated by the arrangement agreement, it will, and will cause its subsidiaries to:

(i) conduct their respective businesses in the ordinary course of business consistent with past practice, in each case in all respects material to Nicholas Financial-Canada and its subsidiaries taken as a whole, (ii) use commercially reasonable efforts to operate and maintain all of its leased real property, improvements and other material tangible personal assets consistent with past practice, in all respects material to Nicholas Financial-Canada and its subsidiaries taken as a whole, and (iii) use commercially reasonable efforts to preserve intact its business organization, retain the services of its present key employees and preserve the existing relationships and goodwill of those with whom or which it has material business relationships and governmental entities;

not amend its organizational documents;

not declare, set aside, pay or make any dividend or other distribution with respect to any Nicholas Financial-Canada Common Shares;

not make changes to its share capital;

not (i) amend any provision of any employee benefit plan, (ii) adopt or enter into any arrangement that would be an employee benefit plan or (iii) increase the compensation or benefits of any director, employee or consultant, except, in each case, (A) as required under the terms of any agreements, trusts, plans, funds or other arrangements existing as of the date of the arrangement agreement, (B) as required by applicable law, (C) with respect to employees that are not executive officers of Nicholas Financial-Canada, for increases in compensation or benefits associated with a promotion or material increase in responsibility or (D) with respect to employees that are not executive officers of Nicholas Financial-Canada, for increases in annual base salary or bonuses in the ordinary course of business;

except for the issuance of Nicholas Financial-Canada Common Shares upon the exercise of options outstanding on the date of the arrangement agreement, not (i) grant, issue or sell any securities of the Company or (ii) issue any securities convertible into or exchangeable for, or options, warrants or other rights to purchase from the Company relating to, or enter into any contract with respect to the issuance of, any securities of the Company;

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### Table of Contents

not (i) incur any material indebtedness for borrowed money, except in the ordinary course of business consistent with past practice under facilities existing on the date of the arrangement agreement, or (ii) make any loans, guarantees or advances to any other person, except in the ordinary course of business consistent with past practice and not in excess of \$100,000 outstanding principal amount at any time to any single person;

not make any capital contributions to, or investments in, any other person (other than Nicholas Financial-Canada or any of its subsidiaries) in excess of \$50,000 in the aggregate;

not make or agree to make capital expenditures in an amount that in the aggregate exceeds \$100,000, other than any capital expenditure (or series of related capital expenditures) consistent in all material respects with Nicholas Financial-Canada's fiscal 2014 capital expenditure budget;

other than capital expenditure transactions discussed above, not acquire (by merger, consolidation, purchase of stock or assets or otherwise), or agree to so acquire, any entity, business or assets that constitute a business or division of any person, or all or a substantial portion of the assets of any person (or business or division thereof);

other than in the ordinary course of business, not transfer, assign, sell, lease, license, encumber or otherwise dispose of (by merger, consolidation, sale of stock or assets or otherwise), or agree to transfer, assign, sell, lease, license, encumber or otherwise dispose of, any entity, business or assets;

not merge or consolidate Nicholas Financial-Canada or any of its subsidiaries with and into any other person, other than, in the case of a subsidiary, to effect any acquisition or any disposition permitted above and other than transactions among Nicholas Financial-Canada and its subsidiaries;

except for a merger or consolidation discussed above, not adopt or enter into a plan of complete or partial liquidation, dissolution, merger, consolidation, restructuring, recapitalization or other reorganization of Nicholas Financial-Canada or any of its subsidiaries;

other than in the ordinary course of business, not enter into any contract containing (i) any restriction on the ability of Nicholas Financial-Canada or any of its subsidiaries to conduct its business as it is presently being conducted or currently contemplated to be conducted after the arrangement, (ii) any provisions granting "most favored nation" status, or (iii) a non-competition provision restricting Nicholas Financial-Canada or any of its subsidiaries, in each case that is material to such entities, taken as a whole;

with respect to any tax return that is filed Nicholas Financial-Canada or any of its subsidiaries after the date of the arrangement agreement and on or before the effective date, share drafts of such tax return with Prospect and consider any comments Prospect has in good faith;

not (i) make any tax election that results in an adverse change in a tax liability or tax refund that is material to Nicholas Financial-Canada and its subsidiaries taken as a whole, (ii) waive any restriction on any assessment period relating to an amount of taxes that is material to Nicholas Financial-Canada and its subsidiaries taken as a whole or (iii) settle or compromise any amount of income tax or other tax liability or refund that is material to Nicholas Financial-Canada and its subsidiaries taken as a whole, in the case of (ii) and (iii), in a manner that is materially adverse to Nicholas Financial-Canada and its subsidiaries taken as a whole.

not implement or adopt any change in its accounting principles, practices or methods that is material to Nicholas Financial-Canada and its subsidiaries taken as a whole, except as required by U.S. GAAP, the rules or policies of the Public

Company Accounting Oversight Board or applicable laws;

Table of Contents

subject to applicable laws, not enter into, materially amend or terminate any of the Company's material contracts or any contract or agreement that if entered into prior to the date of the arrangement agreement would have been a material contract, except in the ordinary course of business consistent with past practice;

not pay, discharge or satisfy any material claims, liabilities or obligations, except in the ordinary course of business consistent with past practice or in accordance with their terms, or settle any material claim, action, proceed or investigation, except in the ordinary course of business consistent with past practice;

not settle, release, waive or compromise any pending or threatened claim, action, suit arbitration or proceeding requiring payments by Nicholas Financial-Canada and its subsidiaries of an amount in excess of US \$100,000, except as required under the terms of applicable insurance policies where the liability of Nicholas Financial-Canada or its subsidiaries in respect thereof does not exceed, in the aggregate, the applicable deductible under such insurance policy required to be paid by Nicholas Financial-Canada or its subsidiaries; and

not authorize or enter into any legally binding agreement, commitment or arrangement to do any of the foregoing.

**Covenants of Nicholas Financial-Canada Regarding Non-Solicitation**

Nicholas Financial-Canada has agreed to cease and cause to be terminated any solicitation, encouragement, discussion, negotiation or process with any person that may be ongoing with respect to any proposal that constitutes, or would reasonably be expected to constitute, an acquisition proposal. For the purposes of the arrangement agreement, an "acquisition proposal" means any discussion, negotiations, proposal or offer by any person or "group" (as defined in Rule 13d-5 under the Exchange Act), other than Prospect or its subsidiaries, (i) to purchase or otherwise acquire, directly or indirectly, Nicholas Financial-Canada's Common Shares representing more than fifteen percent (15%) of the combined voting power of such Common Shares outstanding after giving effect to the consummation of such purchase or other acquisition, including pursuant to a tender offer or exchange offer by any person or "group" (other than Prospect and its subsidiaries) that, if consummated in accordance with its terms, would result in such person or "group" beneficially owning more than fifteen percent (15%) of the combined voting power of Nicholas Financial-Canada's Common Shares outstanding after giving effect to the consummation of such tender offer or exchange offer, (ii) to purchase or otherwise acquire, directly or indirectly, more than fifteen percent (15%) of the consolidated assets of the Company taken as a whole (measured by the fair market value thereof, the related revenues applicable to such assets or the related net income applicable to such assets, in each case as of the date of such sale, transfer, acquisition or disposition) or (iii) to effect any merger, joint venture, partnership, consolidation, amalgamation, recapitalization, reorganization, business combination, dissolution, or other similar transaction involving Nicholas Financial-Canada pursuant to which any person or "group," other than Prospect or its subsidiaries, would, directly or indirectly, hold more than fifteen percent (15%) of the combined voting power of Nicholas Financial-Canada's outstanding Common Shares.

Nicholas Financial-Canada has further agreed to discontinue access to any other third party (other than the Prospect Parties and their representatives) to any data room (virtual or otherwise) and, subject to the terms and conditions of any applicable confidentiality agreements, promptly request the return or deletion from all data retrieval systems and data bases or destruction of all confidential information regarding Nicholas Financial-Canada or its subsidiaries previously provided to any person (other than the Prospect Parties). Nicholas Financial-Canada further agreed not to waive, amend or terminate, or release any such person from, any standstill or confidentiality agreement or provision to which such person is a party with Nicholas Financial-Canada and to take commercially reasonable actions to enforce such standstill and confidentiality agreements and provisions.



Table of Contents

Nicholas Financial-Canada agreed that it and its subsidiaries will not, directly or indirectly:

make, solicit, initiate, encourage, entertain, promote, facilitate or assist the making of, including by way of furnishing any information, any proposal that constitutes or would reasonably be expected to lead to an acquisition proposal;

engage in or otherwise participate, directly or indirectly, in any discussions or negotiations regarding any acquisition proposal;

withdraw, modify, qualify or change in a manner adverse to the Prospect Parties, or publicly state that it intends to withdraw, modify, qualify or change in a manner adverse to the Prospect Parties, Nicholas Financial-Canada's board's recommendation;

approve or recommend any acquisition proposal; or

enter into any agreement, written or oral, related to any acquisition proposal or requiring Nicholas Financial-Canada to abandon, terminate or fail to consummate the arrangement and the transactions contemplated in the arrangement agreement or providing for the payment of any break, termination or other fee or expense to any person (other than the Prospect Parties) in the event that Nicholas Financial-Canada completes the arrangement or the other transactions contemplated in the arrangement agreement or any other transaction with Prospect agreed to prior to the termination of the arrangement agreement.

In addition, Nicholas Financial-Canada will not, directly or indirectly, consider, discuss, negotiate, accept, approve or recommend an acquisition proposal or provide information to any person proposing an acquisition proposal, in each case after the date of the approval of the Arrangement Resolution by its shareholders.

Notwithstanding the foregoing, if Nicholas Financial-Canada receives a written acquisition proposal, its board of directors may, prior to the approval of the Arrangement Resolution by Nicholas Financial-Canada's shareholders, consider and participate, directly or indirectly, in any discussions or negotiations with, or provide information to, or permit any visit to the properties or facilities of Nicholas Financial-Canada by, any person who has delivered a bona fide written acquisition proposal: (i) which was not solicited after the date of the arrangement agreement; (ii) did not otherwise result from a breach of the arrangement agreement; and (iii) that is a superior proposal; *provided, however*, that prior to taking any such action, Nicholas Financial-Canada must give notice to the Purchaser of such acquisition proposal and obtain a confidentiality agreement from the person making such acquisition proposal.

For the purpose of the arrangement agreement, a "superior proposal" means any bona fide written acquisition proposal that is not solicited by Nicholas Financial-Canada in violation of the arrangement agreement and that a majority of Nicholas Financial-Canada's board of directors determines in good faith, after consultation with its financial advisor and outside legal counsel: (i) is reasonably capable of being completed in accordance with such acquisition proposal's terms, taking into account all legal, financial, regulatory and other aspects of such proposal and the person making such proposal and other relevant factors, including, among other things, all of the terms and conditions of such acquisition proposal and the arrangement agreement (in each case taking into account any changes to the arrangement agreement or the transactions contemplated thereby (or any other proposals) made or proposed in writing by Prospect prior to the time of determination), including financing, regulatory approvals and termination fee provisions; and (ii) would, if completed in accordance with such acquisition proposal's terms, result in a transaction more favorable to Nicholas Financial-Canada's shareholders than the arrangement from a financial point of view; *provided* that for purposes of the definition of "superior proposal," the references to "fifteen percent (15%)" in the definition of acquisition proposal in the arrangement agreement are deemed to be references to "eighty-five percent (85%)."

Table of Contents

From and after the date of the arrangement agreement, Nicholas Financial-Canada will promptly (and in any event within forty-eight (48) hours) notify the Purchaser, at first orally and promptly thereafter in writing, of any inquiry, proposal or offer constituting an acquisition proposal, or any request for non-public information relating to Nicholas Financial or its subsidiaries. Such notice will provide the identity of the person making such proposal, inquiry or offer and will include a description of the material terms and conditions of any such proposal, inquiry or offer. Nicholas Financial-Canada will keep the Purchaser fully informed on a prompt basis (and in any event within forty-eight (48) hours) of the status, including any change to the material terms, of any such inquiry, proposal or offer.

However, nothing contained in the arrangement agreement relieves Nicholas Financial-Canada from its obligation to proceed to call and hold the special meeting and to hold a vote of its shareholders and holders of options on the Arrangement Resolution (provided that Nicholas Financial-Canada will be relieved from its obligations to actively solicit proxies in favor of the Arrangement Resolution if its board of directors determines, in good faith, that soliciting proxies in favor of the Arrangement Resolution is not consistent with its fiduciary duties under applicable laws), except in circumstances where the arrangement agreement is terminated in accordance with the terms hereof prior to the date of the special meeting.

**Right to Accept a Superior Proposal**

If Nicholas Financial-Canada has complied with the arrangement agreement regarding non-solicitation, Nicholas Financial-Canada's board of directors may accept, approve, recommend or enter into any agreement, understanding or arrangement in respect of a superior proposal, may withdraw or refrain from affirming its recommendation to approve the Arrangement Resolution prior to shareholder approval of the Arrangement Resolution and terminate the arrangement agreement if, and only if: (i) Nicholas Financial-Canada has provided the Purchaser with a copy of the document containing the superior proposal; (ii) ten (10) business days have elapsed from the later of: (A) the date the Purchaser received written notice advising the Purchaser that the board of directors has resolved, subject to compliance with the arrangement agreement, to accept, approve, recommend or enter into an agreement in respect of such superior proposal and specifying the material terms and conditions of such superior proposal and certain other matters as required by the arrangement agreement; and (B) the date the Purchaser received a copy of the document containing such superior proposal; (iii) a majority of the members of the board of directors has determined in good faith (after consultation with its financial advisor and outside legal counsel) that failing to take such action would constitute a breach of its fiduciary duties under applicable laws; and (iv) taking into account any revised proposal made by the Prospect Parties since their receipt of such notice regarding the superior proposal, the board of directors has determined in good faith and after consultation with its financial advisor and outside legal counsel that such superior proposal remains a superior proposal.

In the event that Nicholas Financial-Canada provides the Purchaser with a notice of a superior proposal on a date that is less than five (5) business days prior to the special meeting, Nicholas Financial-Canada will adjourn the special meeting to a date that is not less than five (5) business days and not more than fifteen (15) business days after the date of receipt by the Purchaser of such notice.

**Conditions to the Arrangement**

Certain of the conditions to the arrangement are subject to whether a material adverse effect has occurred. In determining whether a material adverse effect has occurred or would reasonably be expected to occur, the parties will disregard any effects resulting from (i) general national or regional political, economic or financial or capital market conditions, or political, economic or financial or capital market conditions in any jurisdiction in which the Company or Prospect and its subsidiaries (as applicable) is organized or operates or carries on its business, and any changes in any of the foregoing

Table of Contents

(except to the extent that the effects of such conditions are disproportionately adverse to such party as compared to other companies in such industries or geographic markets in which such party conducts business); (ii) any change or proposed change in any applicable laws, including the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), or the interpretation, application or non-application of any applicable laws by any governmental entity; (iii) any general changes or developments in the industry in which the Company or Prospect and its subsidiaries (as applicable) operate (except to the extent that the effects of such changes or developments are disproportionately adverse to such party as compared to other companies in such industries or geographic markets in which such party conducts business); (iv) the execution and delivery of the arrangement agreement and the announcement of the execution of the arrangement agreement or the transactions contemplated thereby, the performance of any obligation contemplated thereunder or the completion of any of the transactions contemplated thereby; (v) political instability or acts of war or terrorism (except to the extent that the effects of such instability or acts are disproportionately adverse to such party as compared to other companies in such industries or geographic markets in which such party conducts business); (vi) actions required to be taken under applicable laws or contracts; (vii) the failure of the Company or Prospect and its subsidiaries (as applicable) to meet or achieve the results set forth in any projection or forecast (provided that clause (vii) shall not prevent a determination that any change or effect underlying such failure to meet projections or forecasts has resulted in a material adverse effect) (except to the extent that the effects of such failure are disproportionately adverse to such party as compared to other companies in such industries or geographic markets in which such party conducts business); (viii) any of the historical facts disclosed in the Company's or Prospect's SEC filings (as applicable); (ix) earthquakes, hurricanes or other natural disasters; (x) a decline in the price of Nicholas Financial-Canada's Common Shares or Prospect's common stock; and (xi) changes in U.S. GAAP or interpretations thereof.

***Conditions to Each Party's Obligations to Effect the Arrangement***

The obligations of Nicholas Financial-Canada and the Prospect Parties to complete the proposed arrangement are subject to the satisfaction or, where permissible, waiver of the following conditions:

the Interim Order will have been granted in form and substance satisfactory to Nicholas Financial-Canada and the Prospect Parties, acting reasonably, and will not have been set aside or modified in a manner unacceptable to Nicholas Financial-Canada and the Prospect Parties, acting reasonably, on appeal or otherwise;

approval of the Arrangement Resolution by Nicholas Financial-Canada's Securityholders will have been obtained in accordance with the provisions of the Interim Order;

the Final Order will have been granted in form and substance reasonably satisfactory to Prospect and Nicholas Financial-Canada, and will not have been set aside or modified in a manner unacceptable to Prospect and Nicholas Financial-Canada, on appeal or otherwise;

no applicable laws or order (whether temporary, preliminary or permanent) will have been enacted, entered, promulgated, adopted, issued or enforced by any governmental entity that is then in effect and has the effect of making the arrangement illegal or otherwise prohibiting the consummation of the arrangement;

there will have been no action taken under any applicable laws or by any governmental entity which: (i) makes it illegal or otherwise directly or indirectly restrains, enjoins or prohibits the completion of the arrangement; or (ii) results in a judgment, order or decree relating to the arrangement which would prevent or materially impede the consummation of the arrangement;

Table of Contents

all waiting periods applicable to the arrangement under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act") or other regulatory laws shall have expired or been terminated, and all actions by or in respect of, or filings with, any governmental entity under the HSR Act or any other regulatory law that are required to permit the consummation of the arrangement will have been (or are deemed to have been) taken, waived, made or obtained; and

the registration statement of Prospect of which this proxy circular/prospectus forms a part will have become effective under the Securities Act and no stop order suspending the effectiveness of such registration statement will have been issued and no proceedings for that purpose will have been initiated or threatened in writing by the SEC.

***Conditions to the Obligations of Nicholas Financial-Canada to Effect the Arrangement***

The obligations of Nicholas Financial-Canada to complete the arrangement are subject to the satisfaction or, where permissible, waiver of the following conditions:

the representations and warranties of the Prospect Parties contained in the arrangement agreement will be true and correct in all respects (without giving effect to any qualifications or limitations indicated by the words "material adverse effect," "in all material respects," "material," "materially" or other, similar qualifiers or limitations) as of the date of the arrangement agreement and at the effective time as if made on and as of such date or time (except (i) to the extent that such representations and warranties represent and warrant certain facts or information as of a specified date, in which event such representations and warranties shall truly and correctly represent and warrant such facts and information as of such specified date), and (ii) for any failures of any such representations and warranties to be so true and correct that, individually or in the aggregate, would not prevent or materially impede or delay the consummation of the transactions contemplated by the arrangement agreement, including the arrangement), and each of the Prospect Parties will have provided to Nicholas Financial-Canada a certificate of a duly authorized executive officer thereof certifying to such effect on the effective date;

each of the Prospect Parties will have performed in all material respects all obligations and complied in all material respects with all covenants required by the arrangement agreement to be performed or complied with by it at or prior to the effective time, and each of the Prospect Parties will have provided to Nicholas Financial-Canada a certificate of a duly authorized executive officer thereof certifying that, as of the effective time, each Prospect Party has so complied with this condition;

since the date of the arrangement agreement, except as contemplated by the arrangement agreement, there will not have occurred any development, effect or change that is reasonably expected to have a material adverse effect on any of the Prospect Parties; and

all consents, waivers, permits, exemptions, orders and approvals of, and any registrations and filings with, any governmental entity under any applicable laws (other than the HSR Act or any other applicable regulatory law) and the expiration of any related waiting periods required to permit the completion of the arrangement, the failure of which to obtain or the non-expiration of which, either individually or in the aggregate, would or would reasonably be expected to prevent or materially impede the completion of the arrangement, will have been obtained or received.

Table of Contents

***Conditions to the Obligations of the Prospect Parties to Effect the Arrangement***

The obligations of the Prospect Parties to complete the arrangement are subject to the satisfaction or, where permissible, waiver of the following conditions:

(i) representations and warranties of Nicholas Financial-Canada regarding ownership of its subsidiaries, voting securities, authority, capitalization and derivative and other securities will be true and correct in all respects as of the date of the arrangement agreement and at the effective time as if made on and as of such date (except to the extent that any such representations and warranties represent and warrant certain facts or information as of a specified date, in which event such representations and warranties will truly and correctly represent and warrant such facts and information as of such specified date), except for any failures of any of the representations or warranties regarding ownership of its subsidiaries, voting securities, authority, capitalization, derivative and other securities, the opinion of Nicholas Financial-Canada's financial advisor and outstanding loans of Nicholas Financial-Canada to be true and correct that, individually or in the aggregate, are de minimis relative to each such representation and warranty; (ii) each of the other representations and warranties of Nicholas Financial-Canada contained in the arrangement agreement will be true and correct (without giving effect to any qualifications or limitations indicated by the words "material adverse effect," "in all material respects," "material," "materially," or other, similar qualifiers or limitations) as of the date of the arrangement agreement and at the effective time as if made on and as of such date or time (except (A) to the extent that any such representations and warranties represent and warrant certain facts or information as of a specified date, in which event such representations and warranties will truly and correctly represent and warrant such facts and information as of such specified date, (B) for changes specifically permitted by the arrangement agreement and (C) for any failures of any such representations and warranties to be so true and correct that, individually or in the aggregate, have not had and would not reasonably be expected to have a material adverse effect); and (iii) Nicholas Financial-Canada will have provided to the Prospect Parties a certificate of a duly authorized executive officer of Nicholas Financial-Canada certifying to such effect on the effective date;

Nicholas Financial-Canada will have performed in all material respects all obligations and complied in all material respects with all covenants required by the arrangement agreement to be performed or complied with by it at or prior to the effective time, and Nicholas Financial-Canada will have provided to the Prospect Parties a certificate of a duly authorized executive officer thereof certifying that, as of the effective time, Nicholas Financial-Canada has so complied with this condition;

all consents, waivers, permits, exemptions, orders and approvals of, and any registrations and filings with any governmental entity under any applicable laws (other than the HSR Act or any other applicable regulatory law) and the expiration of any related waiting periods required to permit the completion of the arrangement, the failure of which to obtain or the non-expiration of which, either individually or in the aggregate, would or would reasonably be expected to prevent or materially impede the completion of the Arrangement, will have been obtained or received;

since the date of the arrangement agreement, except as contemplated by the arrangement agreement, there will not have occurred any material adverse change to Nicholas Financial-Canada and its subsidiaries;

Nicholas Financial-Canada will have received the consent of the lender under its existing debt facility; and

Table of Contents

dissent rights will have been exercised in respect of not more than 10% of Nicholas Financial-Canada's Common Shares outstanding.

**Termination of the Arrangement Agreement**

***Right to Terminate***

The arrangement agreement may be terminated at any time before completion of the arrangement, whether before or after approval of the Arrangement Resolution by Nicholas Financial-Canada Securityholders, as follows:

by mutual written consent of Nicholas Financial-Canada and the Prospect Parties;

by either Nicholas Financial-Canada or Prospect if:

the arrangement is not completed prior to June 12, 2014 (the "termination deadline"), except (i) the termination deadline will be automatically extended for a period not to exceed 45 days to the extent necessary to satisfy certain conditions regarding applicable laws, orders and resolving any material adverse changes and (ii) that the right to terminate will not be available to any Party that has breached in any material respect its obligations under the arrangement agreement or any of such Party's representations and warranties in any manner that will have been a substantial cause of, or substantially contributed to, the failure of the arrangement to be consummated on or before such termination deadline; or

Securityholders do not approve the Arrangement Resolution at the special meeting[2];

by Prospect if:

(i) Nicholas Financial-Canada's board of directors withdraws or modifies in a manner adverse to the Prospect Parties its recommendation to approve the Arrangement Resolution (in accordance with the arrangement agreement), (ii) Nicholas Financial-Canada's board of directors approves, adopts, declares advisable or recommends an acquisition proposal, or (iii) in the event that an acquisition proposal is structured as a tender or exchange offer for Nicholas Financial-Canada's Common Shares and is commenced by a person unaffiliated with Prospect and, within 10 business days after the public announcement of the commencement of such proposed acquisition proposal, Nicholas Financial-Canada has not issued a public statement (and filed a Schedule 14D-9 pursuant to Rule 14e-2 and Rule 14d-9 promulgated under the Exchange Act) reaffirming its board of directors' recommendation to approve the Arrangement Resolution and recommending that the shareholders of Nicholas Financial-Canada reject such acquisition proposal and not tender any Nicholas Financial-Canada common stock into such tender or exchange offer[1];

all of the following occurs and provided that none of the Prospect Parties is not then in breach of any of its representations, warranties, covenants or other agreements contained in the arrangement agreement: (i) Nicholas Financial-Canada has breached or failed to perform in any material respect any of its representations, warranties, covenants or other agreements contained in the arrangement agreement, (ii) such breach or failure to perform would entitle Prospect not to consummate the arrangement pursuant to certain provisions of the arrangement agreement, and (iii) such breach or failure to perform is incapable of being cured by Nicholas Financial-Canada prior to the termination deadline or, if such breach or failure to perform is capable of being cured by Nicholas Financial-Canada prior to the termination deadline, Nicholas Financial-Canada does not cure such breach or failure to perform within 30 days after receipt of written notice thereof (but no later than the termination deadline)[2];



Table of Contents

by Nicholas Financial-Canada:

in order to enter into a definitive written agreement with respect to a superior proposal, subject to compliance with the arrangement agreement[1];

if all of the following occur and provided that Nicholas Financial-Canada is not then in breach of any of its representations, warranties, covenants or other agreements contained in the arrangement agreement: (i) none of the Prospect Parties has breached or failed to perform in any material respect any of its or their representations, warranties, covenants or other agreements contained in the arrangement agreement, (ii) such breach or failure to perform would entitle Nicholas Financial-Canada not to consummate the arrangement under certain provisions of the arrangement agreement and (iii) such breach or failure to perform is incapable of being cured by the Prospect Parties prior to the termination deadline or, if such breach or failure to perform is capable of being cured by the Prospect Parties prior to the termination deadline, the Prospect Parties have not cured such breach or failure to perform within 30 days after receipt of written notice thereof (but no later than the termination deadline)[3];

if any of the conditions set forth in arrangement agreement regarding closing have not been, or if it becomes reasonably apparent that any of such conditions cannot be, fulfilled by the termination deadline, unless such failure is due to the failure of Nicholas Financial-Canada to perform or comply with any of the covenants, agreements or conditions to be performed or complied with by it prior to the effective date[2];

by Prospect and the Purchaser, if any of the conditions set forth in arrangement agreement regarding closing have not been, or if it becomes reasonably apparent that any of such conditions cannot be, fulfilled by the termination deadline, unless such failure is due to the failure of the Prospect Parties to perform or comply with any of the covenants, agreements or conditions to be performed or complied with by it prior to the effective date[2]; and

by either Prospect or Nicholas Financial-Canada if:

an applicable law is enacted, entered or promulgated prohibiting the consummation of the arrangement substantially on the terms contemplated by the arrangement agreement;

an order, judgment, plan, writ, injunction, ruling or decree has been enacted, entered, promulgated or issued by a governmental entity permanently restraining, enjoining or otherwise prohibiting the consummation of the arrangement substantially on the terms contemplated by the arrangement agreement, and such order, judgment, plan, writ, injunction, ruling or decree has become final and non-appealable; provided, however, that the Party seeking to terminate the arrangement agreement pursuant to this clause has used its commercially reasonable efforts to remove such order, judgment, plan, writ, injunction, ruling or decree; or

a governmental entity failed to issue an order, judgment, plan, writ, injunction, ruling or decree, or take any other action, and such denial of a request to issue such order, judgment, plan, writ, injunction, ruling or decree, or take such other action has become final and non-appealable, that is necessary to fulfill certain conditions of the arrangement agreement; provided, however, that the right to terminate the arrangement agreement pursuant to this clause is not available to any Party whose failure to comply with certain provisions of the arrangement agreement is a substantial cause of, or substantially contributed to, such inaction; and, provided further, that the right to terminate the arrangement agreement pursuant to the arrangement agreement applies only if the applicable law, order, judgment, plan, writ, injunction, ruling or decree, or act or omission of the governmental entity, as the case may be, causes the failure of any conditions required pursuant to the arrangement





Table of Contents

agreement to be satisfied and the Party is entitled to rely on such condition does not elect to waive such condition.

Because the Parties expect that all conditions to the arrangement other than Securityholder approval, issuance of the Final Order and potential regulatory approvals are likely to be satisfied prior to the special meeting, the parties anticipate that in the event either Party is entitled to terminate the arrangement agreement pursuant to the provisions described above, such Party would decide whether to exercise or waive that termination right as soon as possible following the special meeting, or, if later, as soon as possible following the satisfaction of all of the other conditions to closing contained in the arrangement agreement.

***Effect of Termination and Termination Fees***

If the arrangement agreement is terminated pursuant to the terms and conditions therein, it (other than certain designated provisions of the arrangement agreement, including, but not limited to, the confidential treatment of information, which provisions will survive such termination) will become void and of no further force and effect, with no liability on the part of any Party, except that if applicable, Prospect or Nicholas Financial-Canada, as applicable, would be entitled to a termination fee as discussed below.

In the event of termination by the applicable Party pursuant to the rights to terminate marked with a [1] above, Prospect will be entitled to a termination fee from Nicholas Financial-Canada. In the event that of a termination by the applicable Party pursuant to the rights to terminated marked with a [2] above, if prior to the eighteen-month anniversary of such termination Nicholas Financial-Canada consummates a transaction contemplated by an acquisition proposal that was received by Nicholas Financial-Canada prior to the termination of the arrangement agreement, Prospect will also be entitled to a termination fee from Nicholas Financial-Canada. In the event of termination by Nicholas Financial-Canada pursuant to the rights to terminate marked with a [3] above, it will be entitled to a termination fee from Prospect. The termination fee pursuant to the arrangement agreement is \$6,000,000.

***Termination Deadline***

If the arrangement is not consummated on or before the termination deadline, the arrangement agreement will terminate on notice by a Party hereto to the other Parties. The right to terminate the arrangement agreement pursuant to the arrangement agreement is not available to any Party whose action or failure to act has been a substantial cause of or resulted in the failure of the consummation of the arrangement on or before the termination deadline and such action or failure to act constitutes a breach of the arrangement agreement. Notwithstanding the foregoing, if the arrangement agreement has not previously been validly terminated in accordance with the arrangement agreement, any Party has the right, in its sole discretion, upon written notice to the other Parties in advance of the termination deadline to extend the termination deadline for a period of 10 days beyond the termination deadline and the other Parties will not be entitled to terminate the arrangement agreement until the expiration of such revised termination deadline.

**Waiver and Amendment of the Arrangement Agreement**

The arrangement agreement and the Plan of Arrangement may, at any time and from time to time before or after the holding of the special meeting but not later than the effective time, be amended by mutual written agreement of all of the Parties, and any such amendment may, subject to the Interim Order and the Final Order and applicable laws, without limitation:

change the time for the performance of any of the obligations or acts of any of the Parties;

Table of Contents

waive any inaccuracies or modify any representations or warranty contained in the arrangement agreement or in any document delivered pursuant thereto;

waive compliance with or modify any of the covenants contained in the arrangement agreement and waive or modify the performance of any of the obligations of any of the Parties; or

waive compliance with or modify any mutual conditions precedent contained in the arrangement agreement.

At any time before the completion of the arrangement, the parties may, in writing:

extend the time for the performance of any of the obligations or other acts of the other Parties; or

waive compliance with any of the covenants or agreements of the other Parties or with any conditions to its own obligations, but in each case only to the extent such obligations, agreements and conditions are intended for its benefit.

**Indemnification; Directors' and Officers' Insurance**

From and after the effective time of the arrangement, the Purchaser will indemnify, defend and hold harmless the officers and directors of Nicholas Financial-Canada against all losses, claims, damages, costs, expenses (including attorneys' fees and expenses), liabilities or judgments or amounts that are paid in settlement of, or otherwise in connection with any threatened or actual claim, action, suit, proceeding or investigation based on or arising out of the fact that such person is or was a director or officer of Nicholas Financial-Canada or any subsidiary of Nicholas Financial-Canada at or prior to the effective time of the arrangement, whether asserted or claimed prior to, or at or after, the effective time of the arrangement, including all such indemnified liabilities based on, or arising out of, or pertaining to the arrangement agreement or the transactions contemplated by the arrangement agreement, in each case to the full extent permitted under applicable law. The Articles of the Purchaser as of the date of the arrangement agreement provide for such indemnification and will be the Articles of Amalco. The Prospect Parties have agreed that the provisions with respect to indemnification set forth in the Articles of the Purchaser will not be amended, repealed or otherwise modified for a period of six (6) years after the effective time in any manner that would adversely affect the rights thereunder of individuals who at any time prior to the effective time were directors, officers or employees of Nicholas Financial-Canada or any of its subsidiaries. In addition, all rights to indemnification and exculpation from liabilities for acts or omissions occurring at or prior to the effective time now existing in favor of such indemnified parties as provided in any indemnification agreements will be assumed by Amalco, without further action, as of the effective time and will survive the arrangement and will continue in full force and effect in accordance with their respective terms.

For six (6) years after the effective time, Prospect will provide, or will cause to be provided, directors' and officers' liability insurance coverage in respect of acts or omissions occurring prior to the effective time, including the transactions contemplated by the arrangement agreement, covering each person currently covered by Nicholas Financial-Canada's directors' and officers' liability insurance policy(ies), and each person who becomes covered by Nicholas Financial-Canada's directors' and officers' liability insurance policy(ies) prior to the effective time, on the same terms as Nicholas Financial-Canada's existing policy(ies) or, if such insurance coverage is unavailable, coverage that is on terms no less favorable to such persons than those of Nicholas Financial-Canada's existing policy(ies). In satisfying its obligation with respect to insurance, Prospect will not be obligated to pay annual premiums in excess of two hundred percent (200%) of the aggregate annual premiums that Nicholas Financial-Canada and/or any of its subsidiaries were paying with respect to Nicholas Financial-Canada's directors' and officers' insurance policy(ies) for the policy period that includes the date of the arrangement agreement, but in such case Prospect will purchase, or will cause to be purchased, as

Table of Contents

much coverage as possible for such amount. In lieu of maintaining such policies, Prospect may purchase, or cause to be purchased, tail policies to the directors' and officers' liability insurance policies as of the date of the arrangement agreement maintained at such time by Nicholas Financial-Canada, which tail policies (i) will be effective for a period from the effective time through and including the date six (6) years after the effective time with respect to claims arising from facts or events that existed or occurred prior to or at the effective time, and (ii) will contain coverage that is at least as protective to each person covered by Nicholas Financial-Canada's directors' and officers' liability insurance policy(ies) as of the date of the arrangement agreement, and each person who becomes covered by Nicholas Financial-Canada's directors' and officers' liability insurance policy(ies) prior to the effective time, as the coverage provided by such existing policies; provided, that Prospect will not be obligated to pay for coverage for any 12-month period with aggregate premiums for insurance in excess of two hundred percent (200%) of the aggregate annual premiums that Nicholas Financial-Canada and/or its subsidiaries paid with respect to Nicholas Financial-Canada's directors' and officers' insurance policy for the policy period as of the date of the arrangement agreement.

Nicholas Financial and US New Opco have entered into a guaranty agreement pursuant to which, effective as of the effective time, they will jointly and severally guarantee the foregoing obligations of the Purchaser.

Table of Contents

**ACCOUNTING TREATMENT**

Following the effective time, Nicholas Financial-Canada will be owned by USCo, which is an independently managed, private portfolio company of Prospect. Following the effective time, Prospect will have an equity and a debt investment in USCo. Prospect intends to include its investment in USCo in its portfolio of investments, and intends to earn current interest and dividend income from its investment.

Table of Contents

**CERTAIN UNITED STATES FEDERAL INCOME TAX CONSIDERATIONS**

The following discussion is a summary of certain United States federal income tax consequences to U.S. Holders and to Non-U.S. Holders (each as defined below) with respect to (i) the exchange of Nicholas Financial-Canada Common Shares for Prospect common stock and cash in lieu of fractional shares pursuant to the arrangement, and (ii) the ownership and disposition of Prospect common stock. This summary is based upon the Code, Treasury regulations, rulings of the Service, and judicial decisions in existence on the date hereof, all of which are subject to change. Any such change could apply retroactively and could affect adversely the tax consequences described below. No assurance can be given that the Service will agree with the views expressed in this summary, or that a court will not sustain any challenge by the Service in the event of litigation. No advance tax ruling has been sought or obtained from the Service regarding the tax consequences of the transactions described herein.

For purposes of this summary, a "U.S. Holder" is a beneficial owner of Nicholas Financial-Canada Common Shares or (after the arrangement) Prospect common stock that is (a) an individual who is a citizen of the United States or who is resident in the United States for United States federal income tax purposes, (b) an entity that is classified for United States federal income tax purposes as a corporation and that is organized under the laws of the United States, any state thereof, or the District of Columbia, or is otherwise treated for United States federal income tax purposes as a domestic corporation, (c) an estate the income of which is subject to United States federal income taxation regardless of its source, or (d) a trust (i) whose administration is subject to the primary supervision of a court within the United States and all substantial decisions of which are subject to the control of one or more United States persons as described in Section 7701(a)(30) of the Code ("United States persons"), or (ii) that has a valid election in effect under applicable Treasury regulations to be treated as a United States person.

For purposes of this summary, a "Non-U.S. Holder" is a beneficial owner of Nicholas Financial-Canada Common Shares or (after the arrangement) Prospect common stock that is not a U.S. Holder and that is not an entity that is classified for United States federal income tax purposes as a partnership or as an entity disregarded from its owner. If an entity classified for United States federal income tax purposes as a partnership or as an entity disregarded from its owner owns Nicholas Financial-Canada Common Shares, the tax treatment of a member of the entity will depend on the status of the member and the activities of the entity. The tax treatment of such an entity, and the tax treatment of any member of such an entity, are not addressed in this summary. Any entity that is classified for United States federal income tax purposes as a partnership or as an entity disregarded from its owner and that owns Nicholas Financial-Canada Common Shares, and any members of such an entity, are encouraged to consult their tax advisors.

This summary does not discuss all United States federal income tax considerations that may be relevant to U.S. Holders and Non-U.S. Holders in light of their particular circumstances or that may be relevant to certain beneficial owners that may be subject to special treatment under United States federal income tax law (for example, tax-exempt organizations, insurance companies, banks and other financial institutions, dealers in securities, traders in securities that elect to use a mark-to-market method of accounting, real estate investment trusts, regulated investment companies, individual retirement accounts, qualified pension plans, persons who hold Nicholas Financial-Canada Common Shares as part of a straddle, hedging, constructive sale, conversion, or other integrated transaction, persons who acquired Nicholas Financial-Canada Common Shares as a result of the exercise of employee stock options or otherwise as compensation or through a tax-qualified retirement plan, U.S. Holders whose functional currency is not the U.S. dollar, controlled foreign corporations, passive foreign investment companies, and corporations that accumulate earnings to avoid United States federal income tax). Furthermore, this summary does not discuss any alternative minimum tax consequences, and does not address any aspects of U.S. state or local taxation. This summary only applies to those beneficial owners that hold Nicholas Financial-Canada Common Shares, or (after the arrangement) Prospect common stock, as "capital assets" within the meaning of the Code. Except as

Table of Contents

specifically addressed below under the heading " Effects of Section 367", this summary does not address the tax consequences of the arrangement to any U.S. Holder that at any time during the five-year period prior to the arrangement has owned, directly or constructively (under the attribution rules of Section 958 of the Code), 10% or more of the combined voting power of the Nicholas Financial-Canada Common Shares. In the case of any Non-U.S. Holder who is an individual, this summary assumes that this individual was not formerly a United States citizen, and was not formerly a resident of the United States for United States federal income tax purposes.

In connection with the closing of the arrangement, Foley & Lardner LLP intends to deliver an opinion to Nicholas Financial-Canada and to Prospect that the arrangement will qualify as a "reorganization" within the meaning of Section 368(a) of the Code (the "Foley Tax Opinion"). The Foley Tax Opinion will be based in part on representation letters provided by Nicholas Financial-Canada and by Prospect and on customary factual assumptions. If any of those assumptions or representations is inaccurate, incomplete, or untrue, the conclusions contained in this opinion or stated below could be affected. The Foley Tax Opinion will also assume that none of the terms and conditions contained in the arrangement agreement and the Plan of Arrangement will have been waived or modified in any respect on or prior to the closing date.

Foley & Lardner LLP is under no obligation to update the Foley Tax Opinion as a result of a change in law or discovery of any inaccuracy in such representations. Neither the Foley Tax Opinion nor the discussion that follows will be binding on the Service or any court. Except as otherwise specified below under the heading "Certain United States Federal Tax Consequences of the Arrangement Treatment if Foley & Lardner LLP Does Not Deliver the Foley Tax Opinion," the following discussion assumes that Foley & Lardner LLP delivers the Foley Tax Opinion as of the closing of the arrangement and that the Service will not successfully assert a position contrary to one or more of the conclusions set forth therein.

**BENEFICIAL OWNERS OF NICHOLAS FINANCIAL-CANADA COMMON SHARES ARE ENCOURAGED TO SEEK ADVICE FROM AN INDEPENDENT TAX ADVISOR REGARDING THE UNITED STATES FEDERAL INCOME TAX CONSEQUENCES OF THE ARRANGEMENT BASED ON THEIR PARTICULAR CIRCUMSTANCES.**

**Certain United States Federal Income Tax Consequences of the Arrangement**

*In General*

Subject to the discussion below under the headings " Effects of Section 367" and " PFIC Considerations," and assuming that the arrangement qualifies as a reorganization within the meaning of Section 368(a) of the Code, the following are certain United States federal income tax consequences of the arrangement to holders that own Nicholas Financial-Canada Common Shares:

A U.S. Holder or Non-U.S. Holder that receives Prospect common stock in exchange for its Nicholas Financial-Canada Common Shares in the arrangement should not recognize gain or loss on the exchange, except to the extent the U.S. Holder or Non-U.S. Holder receives cash instead of a fractional share interest in Prospect common stock.

The aggregate tax basis of the Prospect common stock received in the arrangement (including any fractional shares deemed received and redeemed for cash as described below) by a U.S. Holder or Non-U.S. Holder should equal the aggregate tax basis in the Nicholas Financial-Canada Common Shares surrendered in exchange for the Prospect common stock.

The holding period in the Prospect common stock received in the arrangement (including any fractional shares deemed received and redeemed for cash as described below) by a U.S. Holder or Non-U.S. Holder should include the holding period of the Nicholas Financial-Canada Common Shares surrendered in exchange for Prospect common stock.

A U.S. Holder or Non-U.S. Holder that receives cash instead of a fractional share should be treated as if such U.S. Holder or Non-U.S. Holder had received a fractional share of Prospect

Table of Contents

common stock and had then exchanged such fractional share of Prospect common stock for cash in a redemption by Prospect, with the tax consequences of the redemption determined under Section 302 of the Code. Assuming that the deemed redemption of a fractional share of Prospect common stock is treated as a sale or exchange, and not as a dividend, a U.S. Holder or Non-U.S. Holder should recognize capital gain or loss on such deemed redemption in an amount equal to the difference between the amount of cash received instead of the fractional share and the tax basis of the fractional share of Prospect common stock deemed received. Such capital gain or loss should be long-term capital gain or loss if the Nicholas Financial-Canada Common Shares exchanged were held for more than one year at the effective time of the arrangement. The deductibility of capital losses is subject to limitations. Any gain recognized by a Non-U.S. Holder on such deemed redemption should be treated in the same way as gain recognized by a Non-U.S. Holder on a disposition of Nicholas Financial-Canada Common Shares pursuant to the exercise of dissent rights as described below under " Payment for Dissenting Shares."

See " Treatment if Foley & Lardner LLP Does Not Deliver the Foley Tax Opinion" below regarding United States federal income tax consequences if the arrangement does not qualify as a reorganization within Section 368(a) of the Code.

***Payment for Dissenting Shares***

For United States federal income tax purposes, U.S. Holders that receive payment for their Nicholas Financial-Canada Common Shares pursuant to the exercise of dissent rights should recognize gain or loss on their disposition of such shares. Subject to the discussion below under the heading " PFIC Considerations," any such gain or loss should constitute capital gain or loss in an amount equal to the difference between the amount realized by the U.S. Holder (other than any portion of the payment that represents interest) and the U.S. Holder's tax basis in its Nicholas Financial-Canada Common Shares. Gain or loss should be determined separately for each block of Nicholas Financial-Canada Common Shares (i.e., Nicholas Financial-Canada Common Shares acquired at the same cost in a single transaction). Capital gains recognized by an individual upon the disposition of Nicholas Financial-Canada Common Shares that have been held for more than one year are generally eligible for reduced rates of United States federal income taxation. The deductibility of capital losses is subject to limitations.

For United States federal income tax purposes, Non-U.S. Holders that receive payment for their Nicholas Financial-Canada Common Shares pursuant to the exercise of dissent rights should recognize gain or loss on their disposition of such shares. Any such gain or loss should constitute capital gain or loss in an amount equal to the difference between the amount realized by the Non-U.S. Holder (other than any portion of the payment that represents interest) and the Non-U.S. Holder's tax basis in its Nicholas Financial-Canada Common Shares. Gain or loss should be determined separately for each block of Nicholas Financial-Canada Common Shares (i.e., Nicholas Financial-Canada Common Shares acquired at the same cost in a single transaction). Any gain that is recognized on a disposition of Nicholas Financial-Canada Common Shares pursuant to the exercise of dissent rights by a Non-U.S. Holder should not be subject to United States federal income tax unless:

the gain is effectively connected with the conduct of a trade or business (and, if an applicable United States income tax treaty applies, is attributable to a permanent establishment maintained) within the United States by the Non-U.S. Holder; or

in the case of a Non-U.S. Holder who is an individual, such individual is present in the United States for 183 days or more in the taxable year of the sale, and certain other conditions are met.

In the case of a Non-U.S. Holder that is described in the first bullet point immediately above, any gain should be subject to United States federal income tax at regular graduated rates, and (if the Non-U.S. Holder is classified as a corporation for United States federal income tax purposes) may also



Table of Contents

be subject to United States branch profits tax at a rate of 30% of effectively connected earnings and profits or at such lower rate as may be specified by an applicable income tax treaty. However, such effectively connected income should not be subject to United States federal income tax withholding, provided that the Non-U.S. Holder furnishes a properly completed Internal Revenue Service Form W-8ECI (or a suitable substitute form) to the person that otherwise would be required to withhold U.S. tax.

A Non-U.S. Holder that is described in the second bullet point immediately above should be subject to a flat 30% tax on any gain, which may be offset by U.S.-source capital losses (even though such Non-U.S. Holder is not considered a resident of the United States).

A beneficial owner of Nicholas Financial-Canada Common Shares who receives payment pursuant to the exercise of dissent rights may also receive an amount of interest income. See "Description of the Arrangement Agreement - Rights of Dissent." Any such interest income that is received by a U.S. Holder should be subject to United States federal income tax at ordinary income rates. Any such interest income that is received by a Non-U.S. Holder should not be subject to United States federal income tax unless the interest income is effectively connected with the conduct of a trade or business (and, if a United States income tax treaty applies, is attributable to a permanent establishment maintained) within the United States by the Non-U.S. Holder, in which event the interest income should be subject to United States federal income tax at regular graduated rates. If the Non-U.S. Holder is classified as a corporation for United States federal income tax purposes, such income should also be taken into account for purposes of determining the amount of United States branch profits tax, which is imposed at a rate of 30% (or at a lower rate under an applicable income tax treaty) on effectively connected earnings and profits, subject to certain adjustments. However, such effectively connected income should not be subject to United States federal income tax withholding, provided that the Non-U.S. Holder furnishes a properly completed Internal Revenue Service Form W-8ECI (or a suitable substitute form) to the person that otherwise would be required to withhold U.S. tax.

*Effects of Section 367*

Section 367 of the Code applies to certain non-recognition transactions involving foreign corporations. Under Section 367, United States federal income tax may be imposed on certain United States persons in connection with transactions that would otherwise be tax-free.

*U.S. Holder that owns 10 percent or more of the voting power of Nicholas Financial-Canada.* A U.S. Holder who on the day of the consummation of the arrangement beneficially owns (directly, indirectly, or constructively) 10% or more of the total combined voting power of all classes of outstanding Nicholas Financial-Canada shares (a "U.S. 10% Shareholder") should include in income as a dividend the "all earnings and profits amount" attributable to its Nicholas Financial-Canada Common Shares. A U.S. Holder's ownership of stock options should be taken into account in determining whether such holder owns 10% or more of the total combined voting power of all classes of outstanding Nicholas Financial-Canada shares. Complex attribution rules apply in determining whether a U.S. Holder owns 10% or more of the total combined voting power of all classes of outstanding Nicholas Financial-Canada shares for United States federal income tax purposes.

A U.S. 10% Shareholder's "all earnings and profits amount" with respect to its Nicholas Financial-Canada Common Shares is the net positive earnings and profits of Nicholas Financial-Canada (as determined under Treasury Regulation Section 1.367(b)-2(d)(2)) attributable to the shares (as determined under Treasury Regulation Section 1.367(b)-2(d)(3)) but without regard to any gain that would be realized on a sale or exchange of such shares. Treasury Regulation Section 1.367(b)-2(d)(3) provides that the "all earnings and profits amount" attributable to a shareholder's stock is determined according to the principles of Section 1248 of the Code. In general, Section 1248 of the Code and the Treasury regulations thereunder provide that the amount of earnings and profits attributable to a block of stock in a foreign corporation is the ratably allocated portion of the foreign corporation's earnings and profits generated during the period the shareholder held the block of stock (not including any earnings and profits that have been previously distributed or deemed distributed by the foreign corporation).

Table of Contents

Accordingly, under Treasury Regulation Section 1.367(b)-3(b)(3), a U.S. 10% Shareholder should be required to include in income as a deemed dividend the "all earnings and profits amount" (as defined in Treasury Regulation Section 1.367(b)-2(d)) with respect to its Nicholas Financial-Canada Common Shares. See " Determination of the all earnings and profits amount" below.

*U.S. Holder that owns Nicholas Financial-Canada Common Shares with a fair market value of less than \$50,000.* A U.S. Holder who on the date of the consummation of the arrangement beneficially owns Nicholas Financial-Canada Common Shares with a fair market value less than \$50,000 should not be required to recognize any gain or loss under Section 367 of the Code in connection with the arrangement, and should not be required to include any part of the "all earnings and profits amount" in income.

*U.S. Holder that owns Nicholas Financial-Canada Common Shares with a fair market value of \$50,000 or more, but less than 10% of the voting power of Nicholas Financial-Canada.* A U.S. Holder who on the date of the consummation of the arrangement beneficially owns Nicholas Financial-Canada Common Shares with a fair market value of \$50,000 or more and who beneficially owns (directly, indirectly or constructively) less than 10% of the total combined voting power of all classes of outstanding Nicholas Financial-Canada shares may elect to recognize gain with respect to the receipt of Prospect common stock in the arrangement or, in the alternative, to recognize the "all earnings and profits" amount as described below.

Unless such a U.S. Holder makes the "all earnings and profits" election as described below, such holder should recognize gain (but not loss) with respect to the receipt of Prospect common stock in the arrangement. Any such gain should constitute capital gain in an amount equal to the amount realized by the U.S. Holder (that is, the fair market value of the Prospect common stock received and the amount of cash received in lieu of fractional shares) minus the U.S. Holder's tax basis in its Nicholas Financial-Canada Common Shares. Gain should be determined separately for each block of Nicholas Financial-Canada Common Shares (i.e., Nicholas Financial-Canada Common Shares acquired at the same cost in a single transaction). Capital gains recognized by an individual upon the disposition of Nicholas Financial-Canada Common Shares that have been held for more than one year are generally eligible for reduced rates of United States federal income taxation.

In lieu of recognizing any gain as described in the preceding paragraph, such a U.S. Holder may elect under Section 367(b) to include in income as a deemed dividend the "all earnings and profits amount" attributable to its Nicholas Financial-Canada Common Shares exchanged pursuant to the arrangement (the "Deemed Dividend Election"). There are, however, strict conditions for making this election. The election must comply with applicable Treasury regulations and generally must include, among other things: (i) a statement that the transaction is a Section 367(b) exchange; (ii) a complete description of the transaction; (iii) a description of any stock, securities or other consideration transferred or received in the transaction; (iv) a statement describing the amounts required to be taken into account for United States federal income tax purposes; (v) a statement that the U.S. Holder is making the election that includes (A) a copy of information provided by Nicholas Financial-Canada (or a successor to Nicholas Financial-Canada) establishing and substantiating the U.S. Holder's "all earnings and profits amount" with respect to the U.S. Holder's Nicholas Financial-Canada Common Shares, and (B) a representation that the U.S. Holder has notified Nicholas Financial-Canada (or a successor to Nicholas Financial-Canada) that the U.S. Holder is making the election; and (vi) certain other information required to be furnished with the U.S. Holder's tax return or otherwise furnished pursuant to the Code or the Treasury regulations thereunder. In addition, the election must be attached by the U.S. Holder to its timely filed United States federal income tax return for the year the arrangement is consummated and the U.S. Holder is required to send notice to Nicholas Financial-Canada (or a successor to Nicholas Financial-Canada) of the election no later than the date such tax return is filed.

Table of Contents

*Determination of the "all earnings and profits amount".* The earnings and profits of Nicholas Financial-Canada have historically consisted almost exclusively of dividends received from NDS. Because Nicholas Financial-Canada has historically immediately redistributed all such amounts to its shareholders, based on all available information, it believes that no U.S. Holder should have a positive "all earnings and profits amount" with respect to its Nicholas Financial-Canada Common Shares at the time of the consummation of the arrangement. However, it is possible that the amount of Nicholas Financial-Canada's earnings and profits through the consummation of the arrangement could be greater than expected, or could be adjusted as a result of an examination by the Service. Accordingly, there can be no assurance that each U.S. Holder's "all earnings and profits amount" with respect to its Nicholas Financial-Canada Common Shares will not be positive. In addition, because Nicholas Financial-Canada does not expect to have any earnings and profits between the date of this proxy circular/prospectus and the consummation of the arrangement, the statements in this proxy circular/prospectus will be the only information provided to U.S. Holders with respect to the "all earnings and profits amount" and there can be no assurance that the Service will not challenge the adequacy of such information.

**U.S. HOLDERS ARE STRONGLY ENCOURAGED TO CONSULT THEIR OWN TAX ADVISORS REGARDING THE APPLICABILITY AND THE CONSEQUENCES OF SECTION 367(B), INCLUDING THE AVAILABILITY AND ADVISABILITY OF THE DEEMED DIVIDEND ELECTION.**

*PFIC Considerations*

Notwithstanding the foregoing, a U.S. Holder may be subject to certain adverse United States federal income tax consequences in respect of a disposition of Nicholas Financial-Canada common stock pursuant to the arrangement if Nicholas Financial-Canada was classified as a PFIC for any taxable year during which the U.S. Holder held Nicholas Financial-Canada Common Shares and did not have certain elections in effect. In general, a non-U.S. corporation, such as Nicholas Financial-Canada, will be classified as a PFIC for United States federal income tax purposes for any taxable year in which, after applying certain look-through rules, either (i) 75% or more of its gross income for such year consists of certain types of "passive" income or (ii) 50% or more of the value of its assets (determined on the basis of a quarterly average) during such year produce or are held for the production of passive income. Passive income generally includes dividends, interest, royalties, rents, annuities, net gains from the sale or exchange of property producing such income and net foreign currency gains.

Nicholas Financial-Canada believes that it has never been a PFIC, nor does it expect to become a PFIC prior to the consummation of the arrangement. However, the PFIC classification rules are complex and highly fact dependent, and accordingly there can be no assurance that Nicholas Financial-Canada will not be considered a PFIC for the current or any past taxable year.

In the case of a U.S. Holder that receives Prospect common stock in exchange for Nicholas Financial-Canada Common Shares pursuant to the arrangement, if Nicholas Financial-Canada were a PFIC for any taxable year in which such holder owned Nicholas Financial-Canada Common Shares (or an option that was exercised to acquire Nicholas Financial-Canada Common Shares), the U.S. Holder generally would be required to recognize taxable gain (but not loss) as a result of the arrangement, even if the arrangement qualifies as a reorganization within the meaning of Section 368(a) of the Code. Under Section 1291 of the Code, any such gain must be ratably allocated to each day in the U.S. Holder's holding period for the respective Nicholas Financial-Canada Common Shares. The amount of any such gain allocated to the taxable year of disposition and to taxable years before Nicholas Financial-Canada became a PFIC, if any, would be taxed as ordinary income. The amounts allocated to any other taxable year would be subject to United States federal income tax at the highest tax rate applicable to ordinary income in each such taxable year, and an interest charge would be imposed on the tax liability for each such taxable year, calculated as if such tax liability had been due in each such taxable year.

Table of Contents

In the case of a U.S. Holder that receives a payment pursuant to the exercise of dissent rights with respect to Nicholas Financial-Canada Common Shares, if Nicholas Financial-Canada were a PFIC for any taxable year in which such holder owned Nicholas Financial-Canada Common Shares (or an option that was exercised to acquire Nicholas Financial-Canada Common Shares), the U.S. Holder generally would be required to recognize taxable gain (but not loss) and to pay an interest charge in a manner similar to that described in the immediately preceding paragraph.

**U.S. HOLDERS SHOULD CONSULT THEIR OWN TAX ADVISORS REGARDING THE POSSIBLE TREATMENT OF NICHOLAS FINANCIAL-CANADA AS A PFIC AND THE CONSEQUENCES OF SUCH TREATMENT.**

***Information Reporting and Backup Withholding***

In general, information reporting requirements should apply with respect to payments of cash in lieu of fractional shares of Prospect common stock. In addition, a U.S. Holder may be subject to a backup withholding tax on such payments if the U.S. Holder fails to supply its correct taxpayer identification number in the manner required by applicable law, fails to certify that it is not subject to the backup withholding tax, or otherwise fails to comply with applicable backup withholding tax rules.

Any amounts withheld from a U.S. Holder under the backup withholding provisions may be credited against the United States federal income tax liability, if any, of the U.S. Holder, and may entitle the U.S. Holder to a refund, provided that the required information is timely furnished to the Service.

**Treatment if Foley & Lardner LLP Does Not Deliver the Foley Tax Opinion**

If Foley & Lardner LLP does not deliver the Foley Tax Opinion to Prospect, Prospect intends to treat the arrangement as a taxable transaction for United States federal income tax purposes and not as a "reorganization." Assuming the transaction does not qualify as a reorganization within the meaning of Section 368(a) of the Code, for United States federal income tax purposes, a U.S. Holder should recognize capital gain or loss, if any, equal to the difference between the fair market value of the Prospect common stock received together with any cash received in lieu of fractional shares and the holder's adjusted tax basis in Nicholas Financial-Canada Common Shares exchanged therefor. Gain or loss should be determined separately for each block of Nicholas Financial-Canada Common Shares (i.e., Nicholas Financial-Canada Common Shares acquired at the same cost in a single transaction). Capital gains recognized by an individual upon the disposition of Nicholas Financial-Canada Common Shares that have been held for more than one year are generally eligible for reduced rates of United States federal income taxation. The deductibility of capital losses is subject to limitations.

Similarly, in such a case, for United States federal income tax purposes, a Non-U.S. Holder should recognize gain or loss on its disposition of such shares. Any such gain or loss should constitute capital gain or loss in an amount equal to the difference between the fair market value of the Prospect common stock received together with any cash received in lieu of fractional shares and the holder's adjusted tax basis in Nicholas Financial-Canada Common Shares exchanged therefor. Gain or loss should be determined separately for each block of Nicholas Financial-Canada Common Shares (i.e., Nicholas Financial-Canada Common Shares acquired at the same cost in a single transaction). Any such gain that is recognized on a disposition of Nicholas Financial-Canada Common Shares should not be subject to United States federal income tax unless:

the gain is effectively connected with the conduct of a trade or business (and, if an applicable United States income tax treaty applies, is attributable to a permanent establishment maintained) within the United States by the Non-U.S. Holder; or

in the case of a Non-U.S. Holder who is an individual, such individual is present in the United States for 183 days or more in the taxable year of the sale, and certain other conditions are met.

Table of Contents

In the case of a Non-U.S. Holder that is described in the first bullet point immediately above, any gain should be subject to United States federal income tax at regular graduated rates, and (if the Non-U.S. Holder is classified as a corporation for United States federal income tax purposes) may also be subject to a United States branch profits tax at a rate of 30% of effectively connected earnings and profits or at such lower rate as may be specified by an applicable income tax treaty. However, such effectively connected income should not be subject to United States federal income tax withholding, provided that the Non-U.S. Holder furnishes a properly completed Internal Revenue Service Form W-8ECI (or a suitable substitute form) to the person that otherwise would be required to withhold U.S. tax.

A Non-U.S. Holder that is described in the second bullet point immediately above should be subject to a flat 30% tax on any gain, which may be offset by U.S.-source capital losses (even though such Non-U.S. Holder is not considered a resident of the United States).

**United States Federal Income Tax Considerations Relating to Ownership and Disposition of Prospect Common Stock**

*Election To Be Taxed As A RIC*

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

*Taxation As A RIC*

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

qualify to be treated as a business development company or be registered as a management investment company under the 1940 Act at all times during each taxable year;

derive in each taxable year at least 90% of its gross income from dividends, interest, payments with respect to certain securities loans, gains from the sale or other disposition of stock or other securities or currencies or other income derived with respect to its business of investing in such stock, securities or currencies and net income derived from an interest in a "qualified publicly traded partnership" (as defined in the Code) (the "90% Income Test"); and

diversify its holdings so that at the end of each quarter of the taxable year:

at least 50% of the value of its assets consists of cash, cash equivalents, United States Government securities, securities of other RICs, and other securities if such other securities of any one issuer do not represent more than 5% of the value of its assets or more than 10% of the outstanding voting securities of the issuer (which for these purposes includes the equity securities of a "qualified publicly traded partnership"); and

no more than 25% of the value of its assets is invested in the securities, other than United States Government securities or securities of other RICs, (i) of one issuer, (ii) of two or more issuers that are controlled, as determined under applicable tax rules, by Prospect and

Table of Contents

that are engaged in the same or similar or related trades or businesses or (iii) of one or more "qualified publicly traded partnerships."

To the extent that Prospect invests in entities treated as partnerships for United States federal income tax purposes (other than a "qualified publicly traded partnership"), Prospect generally must include the items of gross income derived by the partnerships for purposes of the 90% Income Test, and the income that is derived from a partnership (other than a "qualified publicly traded partnership") will be treated as qualifying income for purposes of the 90% Income Test only to the extent that such income is attributable to items of income of the partnership which would be qualifying income if realized by Prospect directly. In addition, Prospect generally must take into account its proportionate share of the assets held by partnerships (other than a "qualified publicly traded partnership") in which Prospect is a partner for purposes of the asset diversification tests. If the partnership is a "qualified publicly traded partnership," the net income derived from such partnership will be qualifying income for purposes of the 90% Income Test, and interests in the partnership will be "securities" for purposes of the diversification tests. Prospect intends to monitor its investments in equity securities of entities that are treated as partnerships for United States federal income tax purposes to prevent Prospect's disqualification as a RIC.

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

Provided that Prospect qualifies as a RIC and satisfies the Annual Distribution Requirement, Prospect will not be subject to United States federal income tax on the portion of its investment company taxable income and net capital gain (which Prospect defines as net long-term capital gains in excess of net short-term capital losses) that Prospect timely distributes to stockholders. Prospect will be subject to United States federal income tax at the regular corporate rates on any investment company taxable income and net capital gain not distributed (or deemed distributed) to its stockholders.

Prospect will be subject to a 4% non-deductible United States federal excise tax on certain undistributed income unless Prospect distributes during each calendar year an amount at least equal to the sum of (1) 98% of its ordinary income for the calendar year and (2) 98.2% of its capital gain net income for the one-year period ending October 31 in that calendar year and (3) any income realized, but not distributed, in preceding years. In addition, the minimum amounts that must be distributed in any year to avoid the excise tax will be increased or decreased to reflect any under-distribution or over-distribution, as the case may be, from the previous year.

Prospect may be required to recognize taxable income in circumstances in which Prospect does not receive cash. For example, if Prospect holds debt obligations that are treated under applicable tax rules as having original issue discount, Prospect must include in income each year a portion of the original issue discount that accrues over the life of the obligation, regardless of whether cash representing such income is received by Prospect in the same taxable year. Because any original issue discount accrued will be included in Prospect's investment company taxable income for the year of accrual, Prospect may be required to make a distribution to its stockholders in order to satisfy the Annual Distribution Requirement, even though Prospect will not have received any corresponding cash amount.

Gain or loss realized by Prospect from warrants acquired by Prospect as well as any loss attributable to the lapse of such warrants generally will be treated as capital gain or loss. Such gain or loss generally will be long-term or short-term, depending on how long Prospect held a particular warrant. As a RIC, Prospect is not allowed to carry forward or carry back a net operating loss for purposes of computing its investment company taxable income in other taxable years.

Table of Contents

Although Prospect does not presently expect to do so, Prospect is authorized to borrow funds and to sell assets in order to satisfy distribution requirements. However, under the 1940 Act, Prospect is not permitted to make distributions to its stockholders while its debt obligations and other senior securities are outstanding unless certain "asset coverage" tests are met. Moreover, Prospect's ability to dispose of assets to meet its distribution requirements may be limited by (1) the illiquid nature of its portfolio and/or (2) other requirements relating to its status as a RIC, including the diversification tests. If Prospect disposes of assets in order to meet the Annual Distribution Requirement or to avoid the excise tax, Prospect may make such dispositions at times that, from an investment standpoint, are not advantageous.

If Prospect fails to satisfy the Annual Distribution Requirement or otherwise fails to qualify as a RIC in any taxable year, Prospect would be subject to tax on all of its taxable income at regular corporate rates. Prospect would not be able to deduct distributions to stockholders, nor would Prospect be required to make distributions. Distributions would generally be taxable to Prospect's individual and other non-corporate taxable stockholders as ordinary dividend income eligible for the reduced maximum rate applicable to "qualified dividend income" to the extent of Prospect's current and accumulated earnings and profits, provided certain holding period and other requirements are met. Subject to certain limitations under the Code, corporate distributees would be eligible for the dividends-received deduction. To qualify again to be taxed as a RIC in a subsequent year, Prospect would be required to distribute to its stockholders its accumulated earnings and profits attributable to non-RIC years reduced by an interest charge on 50% of such earnings and profits payable by Prospect as an additional tax. In addition, if Prospect failed to qualify as a RIC for a period greater than two taxable years, then, in order to qualify as a RIC in a subsequent year, Prospect would be required to elect to recognize and pay tax on any net built-in gain (the excess of aggregate gain, including items of income, over aggregate loss that would have been realized if Prospect had been liquidated) or, alternatively, be subject to taxation on such built-in gain recognized for a period of ten years.

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

Prospect may invest in preferred securities or other securities the United States federal income tax treatment of which may be unclear or may be subject to recharacterization by the Service. To the extent the tax treatment of such securities or the income from such securities differs from the expected tax treatment, it could affect the timing or character of income recognized, requiring Prospect to purchase or sell securities, or otherwise change its portfolio, in order to comply with the tax rules applicable to RICs under the Code.

***Taxation of U.S. Holders***

Distributions by Prospect generally are taxable to U.S. Holders as ordinary income or capital gains. Distributions of Prospect's "investment company taxable income" (which is, generally, Prospect's ordinary income plus realized net short-term capital gains in excess of realized net long-term capital losses) will be taxable as ordinary income to U.S. Holders to the extent of Prospect's current and accumulated earnings and profits, whether paid in cash or reinvested in additional shares of Prospect common stock. Provided that certain holding period and other requirements are met, such distributions

Table of Contents

(if designated by Prospect) may qualify (i) for the dividends received deduction available to corporations, but only to the extent that Prospect's income consists of dividend income from U.S. corporations, and (ii) in the case of individual shareholders, as qualified dividend income eligible to be taxed at long-term capital gain rates to the extent that Prospect receives qualified dividend income (generally, dividend income from taxable domestic corporations and certain qualified foreign corporations). There can be no assurance as to what portion, if any, of Prospect's distributions will qualify for favorable treatment as qualified dividend income.

Distributions of Prospect's net capital gain (which is generally Prospect's realized net long-term capital gains in excess of realized net short-term capital losses) properly designated by Prospect as "capital gain dividends" will be taxable to a U.S. Holder as long-term capital gains, regardless of the U.S. Holder's holding period for its Prospect common stock and regardless of whether paid in cash or reinvested in additional shares of Prospect common stock. Distributions in excess of Prospect's current and accumulated earnings and profits first will reduce a U.S. Holder's adjusted tax basis in such stockholder's Prospect common stock and, after the adjusted basis is reduced to zero, will constitute capital gains to such U.S. Holder.

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

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

If a U.S. Holder receives shares of Prospect common stock shortly before the record date of a distribution, the price of the shares will include the value of the distribution and the investor will be subject to tax on the distribution even though it represents a return of its investment.



Table of Contents

A U.S. Holder generally will recognize taxable gain or loss if such U.S. Holder sells or otherwise disposes of its shares of Prospect common stock. Any gain or loss arising from such sale or taxable disposition generally will be treated as long-term capital gain or loss if the U.S. Holder has held its shares for more than one year. Otherwise, it would be classified as short-term capital gain or loss. However, any capital loss arising from the sale or taxable disposition of shares of Prospect common stock held for six months or less will be treated as long-term capital loss to the extent of the amount of capital gain dividends received, or undistributed capital gain deemed received, with respect to such shares. In addition, all or a portion of any loss recognized upon a taxable disposition of shares of Prospect common stock may be disallowed if other substantially identical shares are purchased (whether through reinvestment of distributions or otherwise) within 30 days before or after the disposition. Capital losses are deductible only to the extent of capital gains (subject to an exception for individuals under which a limited amount of capital losses may be offset against ordinary income).

In general, individual U.S. Holders currently are subject to a preferential rate on their net capital gain, or the excess of realized net long-term capital gain over realized net short-term capital loss for a taxable year, including long-term capital gain derived from an investment in Prospect common stock. Such rate is lower than the maximum rate on ordinary income currently payable by individuals. Corporate U.S. Holders currently are subject to United States federal income tax on net capital gain at ordinary income rates.

Certain U.S. Holders who are individuals, estates or trusts and whose income exceeds certain thresholds will be required to pay a 3.8% Medicare tax on all or a portion of their "net investment income," which includes dividends received from Prospect and capital gains from the sale or other disposition of Prospect common stock.

Prospect will send to each of its U.S. Holders, as promptly as possible after the end of each calendar year, a notice detailing, on a per share and per distribution basis, the amounts includible in such U.S. Holder's taxable income for such year as ordinary income and as long-term capital gain. In addition, the amount and the United States federal tax status of each year's distributions generally will be reported to the Service. Distributions may also be subject to additional state, local and foreign taxes depending on a U.S. Holder's particular situation.

Payments of dividends, including deemed payments of constructive dividends, or the proceeds of the sale or other taxable disposition of Prospect common stock generally are subject to information reporting unless the U.S. Holder is an exempt recipient. Such payments may also be subject to United States federal backup withholding at the applicable rate if the recipient of such payment fails to supply a taxpayer identification number and otherwise comply with the rules for establishing an exemption from backup withholding. Backup withholding is not an additional tax, and any amounts withheld under the backup withholding rules generally will be allowed as a refund or credit against the holder's United States federal income tax liability, provided that certain information is provided timely to the Service.

***Taxation Of Non-U.S. Holders***

Holding Prospect common stock by a Non-U.S. Holder may have adverse tax consequences. Non-U.S. Holders should consult their tax advisers regarding the United States federal tax consequences of acquiring, holding, and disposing of Prospect common stock.

Distributions of Prospect's investment company taxable income to Non-U.S. Holders that are not "effectively connected" with a United States trade or business conducted by the Non-U.S. Holder, will generally be subject to withholding of United States federal income tax at a rate of 30% (or lower applicable treaty rate) to the extent of Prospect's current and accumulated earnings and profits.

For Prospect's taxable years beginning before January 1, 2014 (and, if extended as has happened in the past, for taxable years covered by such extension), properly designated dividends are generally

Table of Contents

exempt from United States federal withholding tax where they (i) are paid in respect of Prospect's "qualified net interest income" (generally, Prospect's U.S.-source interest income, other than certain contingent interest and interest from obligations of a corporation or partnership in which Prospect is at least a 10% stockholder, reduced by expenses that are allocable to such income) or (ii) are paid in respect of Prospect's "qualified short-term capital gains" (generally, the excess of Prospect's net short-term capital gain over its long-term capital loss for such taxable year). There can be no assurance that this provision will be extended. In addition, even if this provision were extended, depending on the circumstances, Prospect may designate all, some or none of its potentially eligible dividends as such qualified net interest income or as qualified short-term capital gains, and/or treat such dividends, in whole or in part, as ineligible for this exemption from withholding. In order to qualify for this exemption from withholding, a Non-U.S. Holder needed to comply with applicable certification requirements relating to its non-U.S. status (including, in general, furnishing an Internal Revenue Service Form W-8BEN or substitute form). In the case of shares of Prospect common stock held through an intermediary, the intermediary may withhold even if Prospect reports the payment as qualified net interest income or qualified short-term capital gain. Non-U.S. Holders should contact their intermediaries with respect to the application of these rules to their accounts. There can be no assurance as to what portion of Prospect's distributions will qualify for favorable treatment as qualified net interest income or qualified short-term capital gains.

Actual or deemed distributions of Prospect's net capital gain to a Non-U.S. Holder, and gains recognized by a Non-U.S. Holder upon the sale of Prospect common stock, that are not effectively connected with a United States trade or business conducted by the Non-U.S. Holder will generally not be subject to United States federal withholding tax and generally will not be subject to United States federal income tax unless the Non-U.S. Holder is a nonresident alien individual and is physically present in the United States for 183 or more days during the taxable year and meets certain other requirements. A Non-U.S. Holder that is so present in the U.S. will be subject to tax as described in the following paragraph.

Distributions of Prospect's investment company taxable income and net capital gain (including deemed distributions) to Non-U.S. Holder, and gains recognized by Non-U.S. Holders upon the sale of Prospect common stock, that are effectively connected with a United States trade or business conducted by the Non-U.S. Holder will be subject to United States federal income tax at the graduated rates applicable to U.S. citizens, residents and domestic corporations. In addition, if such Non-U.S. Holder is a foreign corporation, it may also be subject to a 30% (or lower applicable treaty rate) United States branch profits tax on its effectively connected earnings and profits for the taxable year, subject to adjustments, if its investment in Prospect common stock is effectively connected with its conduct of a United States trade or business.

If Prospect distributes its net capital gain in the form of deemed rather than actual distributions (which Prospect may do in the future), a Non-U.S. Holder will be entitled to a United States federal income tax credit or tax refund equal to the stockholder's allocable share of the tax Prospect pays on the capital gains deemed to have been distributed. In order to obtain the refund, the Non-U.S. Holder must obtain a United States taxpayer identification number and file a United States federal income tax return even if the Non-U.S. Holder would not otherwise be required to obtain a United States taxpayer identification number or file a United States federal income tax return.

Legislation enacted in 2010 and existing guidance issued thereunder will require, after June 30, 2014, withholding at a rate of 30% on dividends in respect of, and, after December 31, 2016, gross proceeds from the sale of, Prospect common stock held by or through certain foreign financial institutions (including investment funds), unless such institution enters into an agreement with the Treasury to report, on an annual basis, information with respect to interests in, and accounts maintained by, the institution to the extent such interests or accounts are held by certain United States persons and by certain non-U.S. entities that are wholly or partially owned by United States persons

Table of Contents

and to withhold on certain payments. An intergovernmental agreement between the United States and an applicable foreign country, or future Treasury regulations or other guidance, may modify these requirements. Accordingly, the entity through which Prospect common stock is held will affect the determination of whether such withholding is required. Similarly, dividends in respect of, and gross proceeds from the sale of, Prospect common stock held by an investor that is a non-financial non-U.S. entity that does not qualify under certain exemptions will be subject to withholding at a rate of 30%, unless such entity either (i) certifies to Prospect that such entity does not have any "substantial United States owners" or (ii) provides certain information regarding the entity's "substantial United States owners," which Prospect will in turn provide to the Internal Revenue Service. Prospect will not pay any additional amounts to holders in respect of any amounts withheld. Holders are encouraged to consult their tax advisors regarding the possible implications of the legislation on their investment in Prospect common stock.

A Non-U.S. Holder generally will be required to comply with certain certification procedures to establish that such holder is not a United States person in order to avoid backup withholding with respect to payments of dividends, including deemed payments of constructive dividends, or the proceeds of a disposition of Prospect common stock. In addition, Prospect is required to annually report to the Service and each Non-U.S. Holder the amount of any dividends or constructive dividends treated as paid to such Non-U.S. Holder, regardless of whether any tax was actually withheld. Copies of the information returns reporting such dividend or constructive dividend payments and the amount withheld may also be made available to the tax authorities in the country in which a Non-U.S. Holder resides under the provisions of an applicable income tax treaty. Backup withholding is not an additional tax, and any amounts withheld under the backup withholding rules generally will be allowed as a refund or credit against a Non-U.S. Holder's United States federal income tax liability, if any, provided that certain required information is provided timely to the Service.

*Failure To Obtain RIC Tax Treatment*

If Prospect were unable to obtain tax treatment as a RIC, Prospect would be subject to tax on all of its taxable income at regular corporate rates. Prospect would not be able to deduct distributions to stockholders, nor would such distributions be required to be made. Distributions would generally be taxable to Prospect's stockholders as ordinary dividend income eligible for the reduced maximum rate applicable to qualified dividend income to the extent of Prospect's current and accumulated earnings and profits. Subject to certain limitations under the Code, corporate distributees would be eligible for the dividends-received deduction.

Distributions in excess of Prospect's current and accumulated earnings and profits would be treated first as a return of capital to the extent of the stockholder's tax basis, and any remaining distributions would be treated as a capital gain.

**THE DISCUSSION SET FORTH HEREIN DOES NOT CONSTITUTE TAX ADVICE, AND POTENTIAL INVESTORS SHOULD CONSULT THEIR OWN TAX ADVISORS CONCERNING THE TAX CONSIDERATIONS RELEVANT TO THEIR PARTICULAR SITUATION.**

Table of Contents**MARKET PRICE AND DIVIDEND INFORMATION**

Prospect common stock trades on the NASDAQ Global Select Market under the symbol "PSEC" and Nicholas Financial-Canada's Common Shares trade on the NASDAQ Global Select Market under the symbol "NICK". The following tables set forth, for each fiscal quarter since the beginning of each company's last two full fiscal years, the range of high and low sales prices of both Prospect Common stock and Nicholas Financial-Canada's Common Shares, each as reported on the NASDAQ Global Select Market. The stock quotations are interdealer quotations and do not include markups, markdowns or commissions.

Also set forth below are the dividend policies of Nicholas Financial-Canada and Prospect as well as the distributions declared and paid by each company since the beginning of such Company's last two full fiscal years. After the arrangement is complete, the distribution policy of Prospect will remain the same and will govern former Nicholas Financial-Canada shareholders.

**Nicholas Financial-Canada**

**Price Range of Nicholas Financial-Canada's Common Shares.** Nicholas Financial-Canada's Common Shares is quoted on the NASDAQ Global Select Market under the symbol "NICK." The table below sets forth for the periods indicated the high and low sales prices of Nicholas Financial-Canada's Common Shares as reported by The NASDAQ Global Select Market.

	High	Low
<b>Fiscal year ended March 31, 2012</b>		
First Quarter	\$ 13.61	\$ 11.40
Second Quarter	\$ 12.60	\$ 9.26
Third Quarter	\$ 12.92	\$ 9.08
Fourth Quarter	\$ 14.41	\$ 12.17
<b>Fiscal year ended March 31, 2013</b>		
First Quarter	\$ 13.60	\$ 12.07
Second Quarter	\$ 14.30	\$ 12.50
Third Quarter	\$ 14.80	\$ 11.71
Fourth Quarter	\$ 15.15	\$ 12.50
<b>First three quarters of fiscal year ending March 31, 2014</b>		
First Quarter	\$ 16.96	\$ 13.60
Second Quarter	\$ 16.79	\$ 14.82
Third Quarter	\$ 17.20	\$ 15.01
Fourth Quarter (through January 3, 2014)	\$ 15.78	\$ 15.68

On January 10, 2014, the last reported sales price of Nicholas Financial-Canada's Common Shares was \$15.74 per share. As of the record date, Nicholas Financial-Canada had approximately [ ] shareholders of record.

**Dividend History** Nicholas Financial-Canada's dividends, if any, are determined by its board of directors. Any payments of future cash dividends and the amounts thereof will be dependent upon the Company's earnings, financial measurements as described in its current line of credit facility, and other factors deemed relevant by the board of directors; provided, however, that pursuant to the arrangement agreement, Nicholas Financial-Canada may not issue dividends without the prior written consent of Prospect.

During the six months ended September 30, 2013, two quarterly cash dividends were declared and paid. On May 7, 2013, Nicholas Financial-Canada's board of directors declared a quarterly cash dividend of \$0.12 per Common Share paid on June 28, 2013. On August 13, 2013, Nicholas

Table of Contents

Financial-Canada's board of directors declared a quarterly cash dividend of \$0.12 per Common Share paid on September 27, 2013.

During the fiscal year ended March 31, 2013, four quarterly cash dividends and a one-time special cash dividend were declared and paid. On May 2, 2012, Nicholas Financial-Canada's board of directors declared a quarterly cash dividend of \$0.10 per Common Share paid on June 6, 2012. On August 8, 2012, Nicholas Financial-Canada's board of directors declared a quarterly cash dividend of \$0.12 per Common Share paid on September 6, 2012. On November 9, 2012, Nicholas Financial-Canada's board of directors declared a quarterly cash dividend of \$0.12 per Common Share paid on December 6, 2012. On December 11, 2012, Nicholas Financial-Canada's board of directors declared a special dividend of \$2.00 per Common Share paid on December 28, 2012. Finally, on February 19, 2013, Nicholas Financial-Canada's board of directors declared a quarterly cash dividend of \$0.12 per Common Share paid on March 29, 2013.

During the fiscal year ended March 31, 2012, three quarterly cash dividends were declared and paid. On August 30, 2011, the board of directors declared a quarterly cash dividend of \$0.10 per Common Share paid on September 20, 2011. On October 27, 2011, the board of directors declared a cash dividend of \$0.10 per Common Share paid on December 20, 2011. Finally, on January 31, 2012, the board of directors declared a cash dividend of \$0.10 per Common Share paid on March 20, 2012.

Payment of cash dividends results in a 5% withholding tax payable by the Company under the Canada-United States Income Tax Convention, which tax is included in earnings under the caption of dividend tax.

***Prospect***

***Price Range of Prospect's Common Stock.*** Prospect common stock is quoted on the NASDAQ Global Select Market under the symbol "PSEC." The following table sets forth, for the periods indicated, Prospect's NAV per share of common stock and the high and low sales prices per share of Prospect common stock as reported on the NASDAQ Global Select Market. Prospect common stock historically trades at prices both above and below its NAV per share. There can be no assurance, however, that such premium or discount, as applicable, to NAV per share will be maintained. Common stock of business development companies, like that of closed-end investment companies, frequently trades at a discount to current NAV per share. In the past, Prospect common stock has traded at a discount to its NAV per share. The risk that Prospect common stock may continue to trade at a

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Table of Contents

discount to its NAV per share is separate and distinct from the risk that its NAV per share may decline.

	NAV(1)	Stock Price High(2) Low(2)		Premium (Discount) of High to NAV	Premium (Discount) of Low to NAV	Dividends Declared
<b>Twelve Months Ending June 30, 2012</b>						
First quarter	\$ 10.41	\$ 10.18	\$ 7.41	(2.2)%	(28.8)%	\$ 0.303900
Second quarter	10.69	9.88	7.99	(7.6)%	(25.3)%	0.304125
Third quarter	10.82	11.39	9.43	5.3%	(12.8)%	0.304350
Fourth quarter	10.83	11.39	10.55	5.2%	(2.5)%	0.304575
<b>Twelve Months Ending June 30, 2013</b>						
First quarter	\$ 10.88	\$ 12.21	\$ 10.83	12.2%	(0.5)%	\$ 0.304800
Second quarter	10.81	11.98	9.89	10.8%	(8.5)%	0.313325
Third quarter	10.71	11.49	10.91	7.3%	1.9%	0.330150
Fourth quarter	10.72	11.11	10.08	3.6%	(6.0)%	0.330375
<b>Twelve Months Ending June 30, 2014</b>						
First quarter	\$ 10.72	\$ 11.61	\$ 10.76	8.3%	0.4%	\$ 0.330600
Second quarter	(3)(4)	11.48	10.80	(4)	(4)	0.330825(5)
Third quarter (through January 3, 2014)	(3)(4)	11.20	11.16	(4)	(4)	0.331050(5)

- (1) Net asset value per share is determined as of the last day in the relevant quarter and therefore may not reflect the net asset value per share on the date of the high or low sales price. The NAVs shown are based on outstanding shares of Prospect common stock at the end of each period.
- (2) The High/Low Stock Price is calculated as of the closing price on a given day in the applicable quarter.
- (3) Prospect's most recently estimated NAV per share is \$10.76 on an as adjusted basis solely to give effect to Prospect's issuance of common stock since September 30, 2013 in connection with Prospect's dividend reinvestment plan and Prospect's issuance of 29,857,039 shares of common stock during the period from October 1, 2013 to December 30, 2014 (with settlement through January 3, 2014) under Prospect's ATM Program, \$0.04 higher than the \$10.72 determined by Prospect as of September 30, 2013. NAV per share as of December 31, 2013, may be higher or lower than \$10.76 based on potential changes in valuations, issuances of securities, dividends paid and earnings for the quarter then ended.
- (4) NAV has not yet been finally determined for any day after September 30, 2013.
- (5) On June 17, 2013, Prospect announced the declaration of a monthly dividend in the following amount and with the following date:
- \$0.110300 per share for December 2013 to holders of record on December 31, 2013 with a payment date of January 23, 2014.
- On August 21, 2013, Prospect announced the declaration of monthly dividends in the following amounts and with the following dates:
- \$0.110325 per share for January 2014 to holders of record on January 31, 2014 with a payment date of February 20, 2014;

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\$0.110350 per share for February 2014 to holders of record on February 28, 2014 with a payment date of March 20, 2014;  
and

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### Table of Contents

\$0.110375 per share for March 2014 to holders of record on March 31, 2014 with a payment date of April 17, 2014. On January 10, 2014, the last reported sales price of Prospect common stock was \$11.20 per share.

As of the record date, Prospect had approximately [ ] stockholders of record.

The below table sets forth each class of Prospect's outstanding securities as of the record date including sales of shares under its ATM Program which will settle through [ ].

Title of Class	Amount Authorized	Amount Held by Registrant or for its Account	Amount Outstanding
Common Stock	500,000,000	0	[ ]

**Dividend History.** Through March 2010, Prospect made quarterly distributions to its stockholders out of assets legally available for distribution. In June 2010, Prospect changed its distribution policy from a quarterly payment to a monthly payment and intends to continue with monthly distributions. Prospect's distributions, if any, will be determined by its board of directors. Certain amounts of the monthly distributions may from time to time be paid out of Prospect's capital rather than from earnings for the quarter as a result of Prospect's deliberate planning or by accounting reclassifications.

As a RIC, Prospect generally is not subject to United States federal income tax on income and gains it distributes each taxable year to its stockholders, provided that in such taxable year it distributes at least 90% of its ordinary income and net short-term capital gains in excess of realized net long-term capital losses. In order to avoid certain excise taxes imposed on RICs, Prospect is required to timely distribute with respect to each calendar year an amount at least equal to the sum of

98% of its ordinary income for the calendar year,

98.2% of its capital gains in excess of capital losses for the one-year period ending on October 31 of the calendar year, and

any ordinary income and net capital gains for preceding years that were not distributed during such years.

At December 31, 2012, Prospect accrued, and subsequently paid, \$4,500,000 for the undistributed ordinary income retained at December 31, 2012. Through September 30, 2013, Prospect has accrued an additional \$3,000,000 as it expects to again retain undistributed ordinary income at December 31, 2013.

In addition, although Prospect currently intends to distribute realized net capital gains (which it defines as net long-term capital gains in excess of short-term capital losses), if any, at least annually, out of the assets legally available for such distributions, Prospect may decide in the future to retain such capital gains for investment. In such event, the consequences of Prospect's retention of net capital gains are as described under "Certain United States Federal Income Tax Considerations." Prospect can offer no assurance that it will achieve results that will permit the payment of any cash distributions and, if it issues senior securities, Prospect may be prohibited from making distributions if doing so causes it to fail to maintain the asset coverage ratios stipulated by the 1940 Act or if distributions are limited by the terms of any of its borrowings.

Prospect maintains an "opt out" dividend reinvestment plan for its common stockholders. As a result, if Prospect declares a distribution, then stockholders' cash distributions will be automatically reinvested in additional shares of Prospect common stock, unless they specifically "opt out" of the dividend reinvestment plan so as to receive cash distributions. Stockholders who receive distributions in the form of stock are subject to the same United States federal, state and local tax consequences as are stockholders who elect to receive their distributions in cash. See "Prospect's Dividend Reinvestment



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### Table of Contents

Plan." To the extent prudent and practicable, Prospect intends to declare and pay dividends on a monthly basis.

With respect to the distributions paid to stockholders, income from origination, structuring, closing, commitment and other upfront fees associated with investments in portfolio companies were treated as taxable income and accordingly, distributed to stockholders. During the fiscal year ended June 30, 2013, Prospect declared total distributions of approximately \$271.5 million.

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

The following table reflects the distributions per share that Prospect has declared on its common stock to date. In June 2010, Prospect changed its distribution policy from a quarterly payment to a monthly payment.

<b>Declaration Date</b>	<b>Record Date</b>	<b>Pay Date</b>	<b>Rate</b>	<b>Amount (in thousands)</b>
8/20/2013	3/31/2014	4/17/2014	0.110375	*
8/20/2013	2/28/2014	3/20/2014	0.110350	*
8/20/2013	1/31/2014	2/20/2014	0.110325	*
6/17/2013	12/31/2013	1/23/2014	0.110300	\$ 33,229
6/17/2013	11/29/2013	12/19/2013	0.110275	32,189
6/17/2013	10/31/2013	11/21/2013	0.110250	31,224
6/17/2013	9/30/2013	10/24/2013	0.110225	29,916
5/6/2013	8/30/2013	9/19/2013	0.110200	28,759
5/6/2013	7/31/2013	8/22/2013	0.110175	28,001
5/6/2013	6/28/2013	7/18/2013	0.110150	27,299
5/6/2013	5/31/2013	6/19/2013	0.110125	27,280
2/7/2013	4/30/2013	5/23/2013	0.110100	26,619
2/7/2013	3/29/2013	4/18/2013	0.110075	26,267
2/7/2013	2/28/2013	3/21/2013	0.110050	25,307
11/7/2012	1/31/2013	2/20/2013	0.110025	24,641
11/7/2012	12/31/2012	1/23/2013	0.110000	23,669
11/7/2012	11/30/2012	12/20/2012	0.101675	21,308
8/21/2012	10/31/2012	11/22/2012	0.101650	17,736
8/21/2012	9/30/2012	10/24/2012	0.101625	17,597
5/7/2012	8/31/2012	9/21/2012	0.101600	16,897
5/7/2012	7/31/2012	8/24/2012	0.101575	16,886
5/7/2012	6/29/2012	7/24/2012	0.101550	14,180
5/7/2012	5/31/2012	6/22/2012	0.101525	12,395
2/6/2012	4/30/2012	5/24/2012	0.101500	12,384
2/6/2012	3/30/2012	4/20/2012	0.101475	12,372
2/6/2012	2/29/2012	3/23/2012	0.101450	12,361
11/7/2011	1/31/2012	2/17/2012	0.101425	11,134
11/7/2011	12/31/2011	1/25/2012	0.101400	11,122
11/7/2011	11/30/2011	12/22/2011	0.101375	11,111
8/24/2011	10/31/2011	11/22/2011	0.101350	11,098
8/24/2011	9/30/2011	10/25/2011	0.101325	11,087
5/9/2011	8/31/2011	9/23/2011	0.101300	11,074
5/9/2011	7/29/2011	8/26/2011	0.101275	11,060
5/9/2011	6/30/2011	7/22/2011	0.101250	10,896

Table of Contents

<b>Declaration Date</b>	<b>Record Date</b>	<b>Pay Date</b>	<b>Rate</b>	<b>Amount (in thousands)</b>
5/9/2011	5/31/2011	6/24/2011	0.101225	9,871
2/8/2011	4/29/2011	5/31/2011	0.101200	9,861
2/8/2011	3/31/2011	4/29/2011	0.101175	8,939
2/8/2011	2/28/2011	3/31/2011	0.101150	8,930
11/8/2010	1/31/2011	2/28/2011	0.101125	8,919
11/8/2010	12/31/2010	1/31/2011	0.101000	8,899
11/8/2010	11/30/2010	12/31/2010	0.100875	8,668
8/26/2010	10/29/2010	11/30/2010	0.100750	8,347
8/26/2010	9/30/2010	10/29/2010	0.100625	7,889
6/18/2010	8/31/2010	9/30/2010	0.100500	7,620
6/18/2010	7/30/2010	8/31/2010	0.100250	7,330
Prior to 6/30/2010				215,157
<b>Since Inception</b>			<b>\$</b>	<b>917,528</b>

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Not yet determinable

Table of Contents

**BUSINESS OF PROSPECT**

**General**

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

Prospect currently has seven origination strategies in which it makes investments: (1) lending in private equity sponsored transactions, (2) lending directly to companies not owned by private equity firms, (3) control investments in corporate operating companies, (4) control investments in financial companies, (5) investments in structured credit, (6) real estate investments, and (7) investments in syndicated debt. Prospect continues to evaluate other origination strategies in the ordinary course of business with no specific tops-down allocation to any single origination strategy.

**Lending in Private Equity Sponsored Transactions** Prospect makes loans to companies which are controlled by leading private equity firms. This debt can take the form of first lien, second lien, unitranche or mezzanine loans. In making these investments, Prospect looks for a diversified customer base, recurring demand for the product or service, barriers to entry, strong historical cash flow and experienced management teams. These loans typically have significant equity subordinate to Prospect's loan position. This strategy has represented approximately 50%-60% of Prospect's business.

**Lending Directly to Companies** Prospect provides debt financing to companies owned by non-private equity firms, the company founder, a management team or a family. Here, in addition to the strengths it looks for in a sponsored transaction, Prospect also looks for alignment with the management team with significant invested capital. This strategy often has less competition than the private equity sponsor strategy because such company financing needs are not easily addressed by banks and often require more diligence preparation. Direct lending can result in higher returns and lower leverage than sponsor transactions and may include warrants or equity to Prospect. This strategy generally has comprised approximately 10%-15% of Prospect's business.

**Control Investments in Corporate Operating Companies** This strategy involves acquiring controlling stakes in non financial operating companies. Prospect's investments in these companies are generally structured as a combination of yield producing debt and equity. Prospect provides certainty of closure to Prospect's counterparties, gives the seller personal liquidity and generally looks for management to continue on in their current roles. This strategy has comprised approximately 10%-15% of its business.

**Control Investments in Financial Companies** This strategy involves acquiring controlling stakes in financial companies, including consumer direct lending, subprime auto lending and other strategies. Prospect's investments in these companies are generally structured as a combination of yield-producing debt and equity. These investments are often structured in a tax-efficient RIC (as defined below) compliant partnership, enhancing returns. This strategy has comprised approximately 10%-15% of Prospect's business.

**Investments in Structured Credit** Prospect makes investments in collateralized loan obligations ("CLOs"), generally taking a significant position in the subordinated interests (equity) of the CLOs. The CLOs include a diversified portfolio of broadly syndicated loans and do not have direct exposure to real estate, mortgages, sub-prime debt, or consumer based debt. The CLOs in which Prospect invests are managed by top-tier collateral managers that have been thoroughly diligenced prior to investment. This strategy has represented 10%-20% of Prospect's business.

Table of Contents

**Real Estate Investments** Prospect makes investments in real estate through its tax efficient real estate investment trusts ("REITs"), American Property Holdings Corp., National Property Holdings Corp. and United Property Holdings Corp. Prospect's real estate investments are in various classes of fully developed and occupied real estate properties that generate current yields. Prospect seeks to identify properties that have historically high occupancy and steady cash flow generation. Prospect partners with established property managers with experience in managing the property type to manage such properties after acquisition. This is a more recent investment strategy that has represented approximately 5%-10% of its business.

**Investments in Syndicated Debt** On an opportunistic basis, Prospect makes investments in loans and high yield bonds that have been sold to a syndicate of buyers. Here, Prospect looks for investments with attractive risk-adjusted returns after it has completed a fundamental credit analysis. These investments are purchased with a long term, buy-and-hold outlook and Prospect looks to provide significant structuring input by providing anchoring orders. This strategy has represented approximately 5%-10% of the portfolio.

Typically, Prospect concentrates on making investments in companies with annual revenues of less than \$750 million and enterprise values of less than \$1 billion. Prospect's typical investment involves a secured loan of less than \$250 million. Prospect also 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 refers to these companies as "target" or "middle market" companies and these investments as "middle market investments".

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. Prospect is currently pursuing multiple investment opportunities, including purchases of portfolios from private and public companies, as well as originations and secondary purchases of particular securities. Prospect also regularly evaluates control investment opportunities in a range of industries, and some of these investments could be material to Prospect. There can be no assurance that Prospect will successfully consummate any investment opportunity it is currently pursuing. If any of these opportunities are consummated, there can be no assurance that investors will share Prospect's view of valuation or that any assets acquired will not be subject to future write downs, each of which could have an adverse effect on its stock price.

Prospect seeks to be a long-term investor with its portfolio companies. From its July 27, 2004 inception to the fiscal year ended June 30, 2007, Prospect invested primarily in industries related to the industrial/energy economy. Since then, Prospect has widened its strategy to focus in other sectors of the economy and continue to reduce its exposure to the energy industry, and its holdings in the energy and energy related industries now represent less than 7% of its investment portfolio.

Prospect has been organized as a closed-end investment company since April 13, 2004 and has filed an election to be treated as a business development company under the 1940 Act. Prospect is a non-diversified company within the meaning of the 1940 Act. Its headquarters are located at 10 East 40th Street, 44th Floor, New York, NY 10016, and its telephone number is (212) 448-0702. Prospect's investment adviser is Prospect Capital Management LLC.

On July 27, 2004, Prospect completed its initial public offering ("IPO") and sold 7 million shares of common stock at a price of \$15.00 per share, less underwriting discounts and commissions totaling \$1.05 per share. An additional 55,000 shares were issued through the exercise of an over-allotment option with respect to the IPO on August 27, 2004. Since the IPO and the exercise of the related over-allotment option, Prospect has made other common stock share offerings (including options exercised by underwriters) resulting in the issuance of 206,744,448 shares at prices ranging from \$7.75 to \$17.70. Prospect issued the 2015 Notes on December 21, 2010, the 2016 Notes on February 18, 2011,

Table of Contents

the 2017 Notes on April 16, 2012, the 2022 Notes on May 1, 2012, the 2018 Notes on August 14, 2012, the 2019 Notes on December 21, 2012, the 2023 Notes on March 15, 2013 and has issued Prospect Capital InterNotes® with a range of maturities since February 16, 2012.

*Senior Convertible Notes*

On December 21, 2010, February 18, 2011, April 16, 2012, August 14, 2012 and December 21, 2012, Prospect issued the 2015 Notes, the 2016 Notes, the 2017 Notes, the 2018 Notes and the 2019 Notes, respectively. Prospect refers to the 2015 Notes, the 2016 Notes, the 2017 Notes, the 2018 Notes and the 2019 Notes collectively as the Senior Convertible Notes. The Senior Convertible Notes were issued only to qualified institutional investors under Rule 144A of the Securities Act. The 2015 Notes mature on December 15, 2015, the 2016 Notes mature on August 15, 2016, the 2017 Notes mature on October 15, 2017, the 2018 Notes mature on March 15, 2018 and the 2019 Notes mature on January 15, 2019, in each case unless previously converted in accordance with their terms. The Senior Convertible Notes are general unsecured obligations of Prospect, rank equally in right of payment with Prospect's existing and future senior unsecured debt, and rank senior in right of payment to any potential subordinated debt, should any be issued in the future. Prospect may not redeem the Senior Convertible Notes prior to maturity. The net proceeds from the offerings of the Senior Convertible Notes were approximately \$825.8 million which was used initially to maintain balance sheet liquidity, including repayment of debt under Prospect's credit facility, if any, investments in high quality short-term debt instruments or a combination thereof, and to make long-term investments in accordance with Prospect's investment objective.

The interest rate on the 2015 Notes is 6.25% per year, payable semiannually in arrears on June 15 and December 15 of each year, commencing June 15, 2011. Holders may convert their 2015 Notes at any time on or prior to the close of business on the business day immediately preceding the maturity date at an initial conversion rate of 88.0902 shares of common stock per \$1,000 principal amount of 2015 Notes (equivalent to an initial conversion price of approximately \$11.35 per share). The conversion rate is subject to adjustment in certain events and in no event will the total number of shares of common stock issuable upon conversion exceed 96.8992 per \$1,000 principal amount of the 2015 Notes, or the "conversion rate cap," except that, to the extent Prospect receives written guidance or a no-action letter from the staff of the SEC permitting it to adjust the conversion rate in certain instances without regard to the conversion rate cap, and to make the 2015 Notes convertible into certain reference property in accordance with certain reclassifications, business combinations, asset sales and corporate events of Prospect without regard to the conversion rate cap, it will make such adjustments without regard to the conversion rate cap and will also, to the extent that it makes any such adjustment without regard to the conversion rate cap pursuant to such written guidance or a no-action, adjust the conversion rate cap accordingly. Prior to obtaining the previously mentioned written guidance or no-action letter from the staff of the SEC, Prospect will not engage in certain transactions that would result in an adjustment to the conversion rate of the 2015 Notes increasing the conversion rate beyond what it would have been in the absence of such transaction unless Prospect has engaged in a reverse stock split or share combination transaction such that in its reasonable best estimation, the conversion rate following the adjustment for such transaction will not be any closer to the conversion rate cap than it would have been in the absence of such transaction. At June 30, 2013, the 2015 Notes are convertible into 88.1429 shares of common stock per \$1,000 principal amount of 2015 Notes (equivalent to a conversion price of approximately \$11.35 per share). The conversion price in effect at June 30, 2013 was last calculated on the anniversary of the issuance (December 21, 2012) and will next be adjusted on the next anniversary, unless the exercise price shall have changed by more than 1% before the anniversary.

The interest rate on the 2016 Notes is 5.50% per year, payable semiannually in arrears on February 15 and August 15 of each year, commencing August 15, 2011. Holders may convert their 2016

Table of Contents

Notes at any time on or prior to the close of business on the business day immediately preceding the maturity date at an initial conversion rate of 78.3699 shares of common stock per \$1,000 principal amount of 2016 Notes (equivalent to an initial conversion price of approximately \$12.76 per share). The conversion rate is subject to adjustment in certain events. At June 30, 2013, the 2016 Notes are convertible into 78.5395 shares of common stock per \$1,000 principal amount of 2016 Notes (equivalent to a conversion price of approximately \$12.73 per share). The conversion price in effect at June 30, 2013 was last calculated on the anniversary of the issuance (February 14, 2013) and will next be adjusted on the next anniversary, unless the exercise price shall have changed by more than 1% before the anniversary.

The interest rate on the 2017 Notes is 5.375% per year, payable semiannually in arrears on April 15 and October 15 of each year, commencing October 15, 2012. Holders may convert their 2017 Notes at any time on or prior to the close of business on the business day immediately preceding the maturity date at an initial conversion rate of 85.8442 shares of common stock per \$1,000 principal amount of 2017 Notes (equivalent to an initial conversion price of approximately \$11.65 per share). The conversion rate is subject to adjustment in certain events. At June 30, 2013, the 2017 Notes are convertible into 86.1162 shares of common stock per \$1,000 principal amount of 2017 Notes (equivalent to a conversion price of approximately \$11.61 per share). The conversion price in effect at June 30, 2013 was last calculated on the anniversary of the issuance (April 16, 2013) and will next be adjusted on the next anniversary, unless the exercise price shall have changed by more than 1% before the anniversary.

The interest rate on the 2018 Notes is 5.75% per year, payable semiannually in arrears on March 15 and September 15 of each year, commencing March 15, 2013. Holders may convert their 2018 Notes at any time on or prior to the close of business on the business day immediately preceding the maturity date at an initial conversion rate of 82.3451 shares of common stock per \$1,000 principal amount of 2018 Notes (equivalent to an initial conversion price of approximately \$12.14 per share). The conversion rate is subject to adjustment in certain events. At June 30, 2013, the 2018 Notes are convertible into 82.8631 shares of common stock per \$1,000 principal amount of 2018 Notes (equivalent to a conversion price of approximately \$12.07 per share) and will be adjusted on the next anniversary, unless the exercise price shall have changed by more than 1% before the anniversary.

The interest rate on the 2019 Notes is 5.875% per year, payable semiannually in arrears on January 15 and July 15 of each year, commencing July 15, 2013. Holders may convert their 2019 Notes at any time on or prior to the close of business on the business day immediately preceding the maturity date at an initial conversion rate of 79.7766 shares of common stock per \$1,000 principal amount of 2019 Notes (equivalent to an initial conversion price of approximately \$12.54 per share). The conversion price has not been adjusted since the issuance (December 21, 2012) and will be adjusted on the first anniversary, unless the exercise price shall have changed by more than 1% before the anniversary.

***Senior Unsecured Notes***

On May 1, 2012, Prospect issued the 2022 Notes pursuant to its effective shelf registration statement. The 2022 Notes are listed on the New York Stock Exchange under the symbol "PRY." The 2022 Notes are general unsecured obligations and rank *pari passu* with all outstanding and future unsecured unsubordinated indebtedness issued by Prospect. The 2022 Notes will mature on November 15, 2022. Prospect will pay interest on the 2022 Notes on February 15, May 15, August 15 and November 15 of each year, beginning August 15, 2012. Prospect may redeem the 2022 Notes in whole or in part at any time or from time to time on or after May 15, 2015, at a redemption price as specified in the indenture governing the 2022 Notes. The 2022 Notes were issued in minimum denominations of \$25 and integral multiples of \$25 in excess thereof.

Table of Contents

On March 15, 2013, Prospect issued the 2023 Notes pursuant to its effective shelf registration statement. The 2023 Notes are general unsecured obligations and rank *pari passu* with all outstanding and future unsecured unsubordinated indebtedness issued by Prospect. The 2023 Notes will mature on March 15, 2023. Prospect will pay interest on the 2023 Notes on September 15 and March 15 of each year, commencing on September 15, 2013.

***Prospect Capital InterNotes®***

On March 4, 2013, Prospect entered into a Second Amended and Restated Selling Agent Agreement, as amended from time to time, (the "Selling Agent Agreement") with Incapital LLC and Merrill Lynch, Pierce, Fenner & Smith Incorporated, as purchasing agents for Prospect's issuance and sale from time to time of up to \$500 million of Prospect Capital InterNotes® (the "InterNotes® Offering"). The initial Selling Agent Agreement was entered into on February 16, 2012. Citigroup Global Markets Inc. joined the Selling Agent Agreement by the Agent Joinder Letter dated April 15, 2013. Additional agents appointed by Prospect from time to time in connection with the InterNotes® Offering may become parties to the Selling Agent Agreement. On August 23, 2013, Prospect amended the Selling Agent Agreement to increase the aggregate principal amount of notes that may be issued from time to time under such agreement from \$500.0 million to \$1.0 billion. On October 15, 2013, Prospect entered into a Third Amended and Restated Selling Agent Agreement on substantially similar terms to provide for such issuances under its current shelf registration statement.

These Prospect Capital InterNotes® are and will be Prospect's direct unsecured senior obligations and will and do rank equally with all of Prospect's unsecured senior indebtedness from time to time outstanding. Each series of Prospect Capital InterNotes® will be issued by a separate supplemental indenture. The Prospect Capital InterNotes® bear interest at fixed interest rates and offer a variety of maturities no less than twelve months from the original date of issuance. Since the inception of the InterNotes® Offering and through January 3, 2014, Prospect has issued \$603.8 million in aggregate principal amount of Prospect Capital InterNotes® for net proceeds of approximately \$591.5 million. The Prospect Capital InterNotes® were issued with variable and fixed interest rates ranging from 3.28% to 7.00% with an average rate of 5.63%, and maturities ranging from July 15, 2018 to August 15, 2043. Such Prospect Capital InterNotes® may be issued with a Survivor's Option, which is a provision in such Senior Note's supplemental indenture pursuant to which Prospect will repay that Senior Note, if requested by the authorized representative of the beneficial owner of that Senior Note, following the death of the beneficial owner of the Senior Note, so long as the Senior Note was owned by that beneficial owner or the estate of that beneficial owner at least six months prior to the request. Each of the Prospect Capital InterNotes® issued thus far includes a Survivor's Option.

Under each indenture governing the Senior Notes, there are certain events of default, the occurrence of which may lead to the Senior Notes being due and payable immediately. An event of default under an indenture could have a material adverse effect on Prospect's business, financial conditions and results of operations.

If Prospect undergoes a "fundamental change" as described in the indenture for each of the Senior Convertible Notes or Unsecured Senior Notes, holders may require it to repurchase all or part of their Senior Convertible Notes or Unsecured Senior Notes at a price equal to 100% of the principal amount of the Senior Convertible Notes or Unsecured Senior Notes, plus accrued and unpaid interest (including additional interest, if any).

**Prospect's Investment Objective and Policies**

Prospect's investment objective is to generate both current income and long-term capital appreciation through debt and equity investments. It focuses on making investments in private companies, and is a non-diversified company within the meaning of the 1940 Act.

Table of Contents

Prospect invests primarily in first and second lien senior loans and mezzanine debt. First and second lien senior loans generally are senior debt instruments that rank ahead of subordinated debt of a given portfolio company. These loans also have the benefit of security interests in the assets of the portfolio company, which may rank ahead of or be junior to other security interests. Mezzanine debt and Prospect's investments in CLOs are subordinated to senior loans and are generally unsecured. Prospect's investments have generally ranged between \$5 million and \$250 million each, although the investment size may be more or less than this range. Prospect's investment sizes are expected to grow as its capital base expands.

Prospect also acquires controlling interests in companies in conjunction with making secured debt investments in such companies. These may be in several industries, including industrial, service, real estate and financial businesses.

Prospect seeks to maximize returns and minimize risk for its investors by applying rigorous analysis to make and monitor its investments. While the structure of its investments varies, Prospect can invest in senior secured debt, senior unsecured debt, subordinated secured debt, subordinated unsecured debt, mezzanine debt, convertible debt, convertible preferred equity, preferred equity, common equity, warrants and other instruments, many of which generate current yield. While Prospect's primary focus is to seek current income through investment in the debt and/or dividend-paying equity securities of eligible privately-held, thinly-traded or distressed companies and long-term capital appreciation by acquiring accompanying warrants, options or other equity securities of such companies, it may invest up to 30% of the portfolio in opportunistic investments in order to seek enhanced returns for stockholders. Such investments may include investments in the debt and equity instruments of broadly-traded public companies. Prospect expects that these public companies generally will have debt securities that are non-investment grade. Such investments may also include purchases (either in the primary or secondary markets) of the equity and junior debt tranches of a type of such pools known as CLOs. Structurally, CLOs are entities that are formed to hold a portfolio of senior secured loans ("Senior Secured Loans") made to companies whose debt is rated below investment grade or, in limited circumstances, unrated. The Senior Secured Loans within a CLO are limited to Senior Secured Loans which meet specified credit and diversity criteria and are subject to concentration limitations in order to create an investment portfolio that is diverse by Senior Secured Loan, borrower, and industry, with limitations on non-U.S. borrowers. Within this 30% basket, Prospect has and may make additional investments in debt and equity securities of financial companies and companies located outside of the United States.

Prospect's investments may include other equity investments, such as warrants, options to buy a minority interest in a portfolio company, or contractual payment rights or rights to receive a proportional interest in the operating cash flow or net income of such company. When determined by the Investment Adviser to be in Prospect's best interest, Prospect may acquire a controlling interest in a portfolio company. Any warrants Prospect receives with its debt securities may require only a nominal cost to exercise, and thus, as a portfolio company appreciates in value, Prospect may achieve additional investment return from this equity interest. Prospect has structured, and will continue to structure, some warrants to include provisions protecting its rights as a minority-interest or, if applicable, controlling-interest holder, as well as puts, or rights to sell such securities back to the company, upon the occurrence of specified events. In many cases, Prospect obtains registration rights in connection with these equity interests, which may include demand and "piggyback" registration rights.

Prospect plans to hold many of its investments to maturity or repayment, but will sell an investment earlier if a liquidity event takes place, such as the sale or recapitalization of a portfolio company, or if it determines a sale of such investment to be in its best interest.

Prospect has qualified and elected to be treated for United States federal income tax purposes as a regulated investment company ("RIC"), under Subchapter M of the Code. As a RIC, Prospect



Table of Contents

generally does not have to pay corporate-level United States federal income taxes on any ordinary income or capital gains that it distributes to its stockholders as dividends. To continue to qualify as a RIC, Prospect must, among other things, meet certain source-of-income and asset diversification requirements (as described below). In addition, to qualify for RIC tax treatment Prospect must distribute to its stockholders, for each taxable year, at least 90% of its "investment company taxable income," which is generally its ordinary income plus the excess of its realized net short-term capital gains over its realized net long-term capital losses.

For a discussion of the risks inherent in Prospect's portfolio investments, see "Risks Related to Prospect Risks Relating to Prospect's Investments."

**Industry Sectors**

While Prospect's original investments were concentrated in industrial and energy related companies, it continues to widen its focus in other sectors of the economy to diversify its portfolio holdings. Prospect's portfolio is now well diversified into 36 industry categories with no individual industry comprising more than 14.6% of the portfolio on either a cost or fair value basis.

**Ongoing Relationships with Portfolio Companies**

*Monitoring*

Prospect Capital Management monitors Prospect's portfolio companies on an ongoing basis. Prospect Capital Management will continue to monitor the financial trends of each portfolio company to determine if it is meeting its business plan and to assess the appropriate course of action for each company.

Prospect Capital Management employs several methods of evaluating and monitoring the performance and value of Prospect's investments, which may include, but are not limited to, the following:

Assessment of success in adhering to the portfolio company's business plan and compliance with covenants;

Regular contact with portfolio company management and, if appropriate, the financial or strategic sponsor, to discuss financial position, requirements and accomplishments;

Attendance at and participation in board meetings of the portfolio company; and

Review of monthly and quarterly financial statements and financial projections for the portfolio company.

*Investment Valuation*

To value its assets, Prospect follows the guidance of Accounting Standards Codification ("ASC") 820 that defines fair value, establishes a framework for measuring fair value in conformity with U.S. GAAP and requires disclosures about fair value measurements.

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

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

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

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

Table of Contents

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

ASC 820 applies to fair value measurements already required or permitted by other standards.

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

Prospect's board of directors has established procedures for the valuation of its investment portfolio. These procedures are detailed below.

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

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

1. each portfolio company or investment is reviewed by Prospect's investment professionals with an independent valuation firm engaged by Prospect's board of directors;
2. the independent valuation firms conduct independent appraisals and make their own independent assessment;
3. the Audit Committee of Prospect's board of directors reviews and discusses the preliminary valuation of the Investment Adviser and that of the independent valuation firms; and
4. the board of directors discusses valuations and determines the fair value of each investment in Prospect's portfolio in good faith based on the input of the Investment Adviser, the respective independent valuation firm and the Audit Committee.

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

Prospect's investments in CLOs are classified as ASC 820 level 3 securities, and are valued using discounted cash flow model. The valuations have been accomplished through the analysis of the CLO deal structures to identify the risk exposures from the modeling point of view. For each security, the most appropriate valuation approach has been chosen from alternative approaches to ensure the most accurate valuation for each security. To value a CLO, both the assets and liabilities of the CLO capital

Table of Contents

structure need be modeled. Prospect uses a waterfall engine to store the collateral data, generate collateral cash flows from the assets, and distributes the cash flow to the liability structure based on the payment priorities, and discount them back using proper discount rates that incorporate all the risk factors. The main risk factors are: default risk, interest rate risk, downgrade risk, and credit spread risk.

For a discussion of the risks inherent in determining the value of securities for which readily available market values do not exist, see "Risks Related to Prospect Risks Relating to Prospect's Business Most of Prospect's portfolio investments are recorded at fair value as determined in good faith under the direction of its board of directors and, as a result, there is uncertainty as to the value of its portfolio investments."

*Valuation of Other Financial Assets and Financial Liabilities*

ASC Subtopic 820-10-05-1, *The Fair Value Option for Financial Assets and Financial Liabilities*, ("ASC 820-10-05-1") permits an entity to elect fair value as the initial and subsequent measurement attribute for many assets and liabilities for which the fair value option has been elected and similar assets and liabilities measured using another measurement attribute. Prospect has elected not to value some assets and liabilities at fair value as would be permitted by ASC 820-10-05-1.

*Managerial Assistance*

As a business development company, Prospect offers, and must provide upon request, managerial assistance to certain of its portfolio companies. This assistance could involve, among other things, monitoring the operations of its portfolio companies, participating in board and management meetings, consulting with and advising officers of portfolio companies and providing other organizational and financial guidance. Prospect Administration provides such managerial assistance on Prospect's behalf to portfolio companies when it is required to provide this assistance. Prospect is also deemed to be providing managerial assistance to all portfolio companies that it controls, either by itself or in conjunction with others.

**Investment Adviser**

Prospect Capital Management manages Prospect's investments as the Investment Adviser. Prospect Capital Management is a Delaware limited liability corporation that has been registered as an investment adviser under the Investment Adviser Act of 1940 (the "Advisers Act") since March 31, 2004. Prospect Capital Management is led by John F. Barry III and M. Grier Eliasek, two senior executives with significant investment advisory and business experience. Both Messrs. Barry and Eliasek spend a significant amount of their time in their roles at Prospect Capital Management working on Prospect's behalf. The principal executive offices of Prospect Capital Management are 10 East 40th Street, 44th Floor, New York, NY 10016. Prospect depends on the due diligence, skill and network of business contacts of the senior management of the Investment Adviser. Prospect also depends, to a significant extent, on the Investment Adviser's investment professionals and the information and deal flow generated by those investment professionals in the course of their investment and portfolio management activities. The Investment Adviser's senior management team evaluates, negotiates, structures, closes, monitors and services Prospect's investments. Prospect's future success depends to a significant extent on the continued service of the senior management team, particularly John F. Barry III and M. Grier Eliasek. The departure of any of the senior managers of the Investment Adviser 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 the Investment Adviser or that it will continue to have access to its investment professionals or its information and deal flow. Under the Investment Advisory Agreement, Prospect pays Prospect Capital Management investment advisory fees, which consist of an annual base management fee based on Prospect's gross assets as well

Table of Contents

as a two-part incentive fee based on Prospect's performance. Mr. Barry currently controls Prospect Capital Management.

**Administrator**

Messrs. Barry and Eliasek each also serves as an officer of Prospect Administration and performs his respective functions under the terms of the Administration Agreement. In addition, Prospect reimburses Prospect Administration for its allocable portion of expenses incurred by Prospect Administration in the performance of its obligations under the Administration Agreement, including rent and Prospect's allocable portion of the costs of its chief executive officer, president, chief financial officer, chief operating officer, chief compliance officer, treasurer and secretary and their respective staffs. See "Business of Prospect Management Services Administration Agreement."

**Staffing**

Mr. John F. Barry III, Prospect's chairman and chief executive officer, Mr. Grier Eliasek, Prospect's chief operating officer and president, and Mr. Brian H. Oswald, Prospect's chief financial officer, chief compliance officer, treasurer and secretary, comprise Prospect's senior management. Over time, Prospect expects to add additional officers.

**Properties**

Prospect does not own any real estate or other physical properties materially important to its operation. Its corporate headquarters are located at 10 East 40th Street, 44th Floor, New York, NY 10016, where it occupies an office space pursuant to the Administration Agreement.

**Legal Proceedings**

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

Prospect is not aware of any material pending legal proceeding, and no such material proceedings are contemplated to which Prospect is a party or of which any of its property is subject.

**Management**

Prospect's business and affairs are managed under the direction of its board of directors. Prospect's board of directors currently consists of five directors, three of whom are not "interested persons" of Prospect as defined in Section 2(a)(19) of the 1940 Act. Prospect refers to these individuals as its independent directors. Prospect's board of directors elects its officers to serve for a one-year term and until their successors are duly elected and qualify, or until their earlier removal or resignation.

**Board Of Directors And Executive Officers**

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

Table of Contents**Directors and Executive Officers**

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

**Independent Directors**

<b>Name and Age</b>	<b>Position(s) Held with Prospect</b>	<b>Term of Office(1) and Length of Time Served</b>	<b>Principal Occupation(s) During Past 5 Years</b>	<b>Number of Portfolios in Fund Complex Overseen by Director</b>	<b>Other Directorships Held by Director</b>
William J. Grep, 70	Director	Class II Director from 2006 to 2009; Class I Director since April 2010; Term expires 2014	Mr. Grep is responsible for traditional banking services, credit and lending, private equity and corporate cash management with Merrill Lynch & Co. from 1999 to present.	One	Priority Senior Secured Income Fund, Inc. since October 28, 2012(2), Pathway Energy Infrastructure Fund, Inc. since February 19, 2013(2)
Eugene S. Stark, 55	Director	Class III Director since September 2008; Term expires 2016	Principal Financial Officer, Chief Compliance Officer and Vice President Administration of General American Investors Company, Inc. from May 2005 to present.	One	Priority Senior Secured Income Fund, Inc. since October 28, 2012(2), Pathway Energy Infrastructure Fund, Inc. since February 19, 2013(2)
Andrew C. Cooper, 51	Director	Class II Director since February 2009; Term expires 2015	Mr. Cooper is an entrepreneur, who over the last 15 years has founded, built, run and sold three companies. He is Co-Chief Executive Officer of Unison Energy, LLC, a company that develops, owns and operates, distributed combined heat and power co-generation solutions.	One	Priority Senior Secured Income Fund, Inc. since October 28, 2012(2), Pathway Energy Infrastructure Fund, Inc. since February 19, 2013(2)

(1) Prospect's board of directors is divided into three classes of directors serving staggered three-year terms. Mr. Grep is a Class I director with a term that will expire in 2014, Mr. Eliasek and Mr. Cooper are Class II directors with terms that will expire in 2015 and Mr. Barry and Mr. Stark are Class III directors with terms that will expire in 2016.

(2) An investment company registered under the 1940 Act.

Table of Contents

**Interested Directors**

<b>Name and Age</b>	<b>Position(s) Held with Prospect</b>	<b>Term of Office(1) and Length of Time Served</b>	<b>Principal Occupation(s) During Past 5 Years</b>	<b>Number of Portfolios in Fund Complex Overseen by Director</b>	<b>Other Directorships Held by Director</b>
John F. Barry III, 61(2)	Director, Chairman of the board of directors, and Chief Executive Officer	Class III Director since June 2004; Term expires 2016	Chairman and Chief Executive Officer of Prospect; Managing Director of Prospect Capital Management and Prospect Administration since June 2004	One	None
M. Grier Eliasek, 40(2)	Director, Chief Operating Officer	Class II Director since June 2004; Term expires 2015	President and Chief Operating Officer of Prospect, Managing Director of Prospect Capital Management and Prospect Administration, President and CEO of Priority Senior Secured Income Fund, Inc., President and COO of Priority Senior Secured Income Management, LLC, President and CEO of Pathway Energy Infrastructure Fund, Inc., President and COO of Pathway Energy Infrastructure Management, LLC.	One	Priority Senior Secured Income Fund, Inc. since October 28, 2012(2), Pathway Energy Infrastructure Fund, Inc. since February 19, 2013(2)

- (1) Prospect's board of directors is divided into three classes of directors serving staggered three-year terms. Mr. Grep is a Class I director with a term that will expire in 2014, Mr. Eliasek and Mr. Cooper are Class II directors with terms that will expire in 2015 and Mr. Barry and Mr. Stark are Class III directors with terms that will expire in 2016.
- (2) Messrs. Barry and Eliasek are each considered an "interested person" under the 1940 Act by virtue of serving as one of Prospect's officers and having a relationship with Prospect Capital Management.
- (3) An investment company registered under the 1940 Act.

**Information about Executive Officers who are not Directors**

<b>Name and Age</b>	<b>Position(s) Held with Prospect</b>	<b>Term of Office and Length of Time Served</b>	<b>Principal Occupation(s) During Past Five Years</b>
Brian H. Oswald, 52	Chief Financial Officer, Chief Compliance Officer, Treasurer and Secretary	November 2008 to present as Chief Financial Officer, Treasurer and Secretary and October 2008 to present as Chief Compliance Officer.	Joined Prospect Administration as Managing Director in June 2008.

*Board Leadership Structure*

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The board of directors believes that the combined position of Chief Executive Officer and Chairman of the board of directors of Prospect is a superior model that results in greater efficiency regarding Prospect's management, reduced confusion due to the elimination of the need to transfer

Table of Contents

substantial information quickly and repeatedly between a chief executive officer and chairman, and business advantages to Prospect arising from the specialized knowledge acquired from the duties of the dual roles. The need for efficient decision making is particularly acute in Prospect's line of business, whereby multiple factors including market factors, interest rates and innumerable other financial metrics change on an ongoing and daily basis.

Prospect's board of directors does not currently have a designated lead independent director. Instead, all of the independent directors play an active role on the board of directors. The independent directors compose a majority of Prospect's board of directors, and are closely involved in all material board-level deliberations related to Prospect. The board of directors believes that, with these practices, each independent director has an equal stake in the Board's actions and oversight role and equal accountability to Prospect and its stockholders. Prospect believes that Eugene Stark acts as the de facto lead independent director, by virtue of his role as an accounting expert and Chairman of the Audit Committee.

*Director Independence*

On an annual basis, each member of Prospect's board of directors is required to complete an independence questionnaire designed to provide information to assist the board of directors in determining whether the director is independent. Prospect's board of directors has determined that each of its directors, other than Messrs. Barry and Eliasek, is independent under the 1940 Act.

*Role of the Chairman and Chief Executive Officer*

As Chairman of the board of directors and Chief Executive Officer, Mr. Barry assumes a leading role in mid- and long-term strategic planning and supports Prospect's major transaction initiatives. Mr. Barry also manages Prospect's day-to-day operations, with the support of the other executive officers. As Chief Executive Officer, Mr. Barry has general responsibility for the implementation of Prospect's policies, as determined by the board of directors, and for the management of Prospect's business and affairs. The board of directors has determined that its leadership structure, in which the majority of the directors are not affiliated with Prospect, Prospect Capital Management or Prospect Administration, is appropriate in light of the services that Prospect Capital Management and Prospect Administration and their affiliates provide to Prospect and the potential conflicts of interest that could arise from these relationships.

*Experience, Qualifications, Attributes and/or Skills that Led to the Board's Conclusion that such Members Should Serve as Directors of Prospect*

The Board believes that, collectively, the directors have balanced and diverse experience, qualifications, attributes and skills, which allow the Board to operate effectively in governing Prospect and protecting the interests of its stockholders. Below is a description of the various experiences, qualifications, attributes and/or skills with respect to each director considered by the Board.

*John F. Barry III*

The Board benefits from Mr. Barry's years of experience in the investment banking and the financial advisory industries, as well as his service on multiple boards for various companies. In addition to overseeing Prospect, Mr. Barry has served on the boards of directors of private and public companies, including financial services, financial technology and energy companies. Mr. Barry also managed an investment bank, focusing on private equity and debt financing for energy and other companies, and was the founding member of the project finance group at Merrill Lynch & Co. The Board also benefits from Mr. Barry's past experience as a corporate securities lawyer at a premiere United States law firm, advising energy companies and their commercial and investment bankers.



Table of Contents

Mr. Barry is also chairman of the board of directors of the Mathematics Foundation of America, a non-profit foundation which enhances opportunities in mathematics education for students from diverse backgrounds. Mr. Barry's longstanding service as Chairman and Chief Executive Officer of Prospect and as a Managing Director of Prospect Capital Management and Prospect Administration provide him with a specific understanding of Prospect, its operation, and the business and regulatory issues it faces.

*M. Grier Eliasek*

Mr. Eliasek brings to the Board business leadership and experience and knowledge of senior loan, mezzanine, bridge loan, private equity and venture capital investments, as well as a knowledge of diverse management practices. Mr. Eliasek is the President and Chief Operating Officer of Prospect and a Managing Director of Prospect Capital Management and Prospect Administration. He is also responsible for leading the origination and assessment of investments for Prospect. The Board also benefits from Mr. Eliasek's experience as a consultant with Bain & Company, a global strategy consulting firm, where he managed engagements for companies in several different industries, by providing Prospect with unique views on investment and management issues. At Bain & Company, Mr. Eliasek analyzed new lines of businesses, developed market strategies, revamped sales organizations, and improved operational performance for Bain & Company clients. Mr. Eliasek's longstanding service as director, President and Chief Operating Officer of Prospect and as a Managing Director of Prospect Capital Management and Prospect Administration provide him with a specific understanding of Prospect, its operation, and the business and regulatory issues it faces.

*Andrew C. Cooper*

Mr. Cooper's over 25 years of experience in venture capital management, venture capital investing and investment banking provides the Board with a wealth of leadership, business investing and financial experience. Mr. Cooper's experience as the co-founder, director and former co-CEO of Unison Site Management LLC, a leading cellular site owner with 2,000 plus cell sites which generate more than \$40 million in annual cash flow, and as co-founder, CFO and VP of business development for Avesta Technologies, an enterprise, information and technology management software company bought by Visual Networks in 2000, provides the Board with the benefit of leadership and experience in finance and management. Mr. Cooper also serves on the board of Brand Asset Digital, Aquatic Energy and the Madison Square Boys and Girls Club of New York. Further, Mr. Cooper's time as a director of CSG Systems, Protection One Alarm, LionBridge Technologies and Weblink Wireless, provides the Board with a wealth of experience and an in-depth understanding of management practices. Mr. Cooper's knowledge of financial and accounting matters qualifies him to serve on Prospect's Audit Committee and his independence from Prospect, Prospect Capital Management and Prospect Administration enhances his service as a member of the Nominating and Corporate Governance Committee.

*William J. Grempe*

Mr. Grempe brings to the Board a broad and diverse knowledge of business and finance as a result of his career as an investment banker, spanning over 40 years working in corporate finance and originating and executing transactions and advisory assignments for energy and utility related clients. Since 1999, Mr. Grempe has been responsible for traditional banking services, credit and lending, private equity and corporate cash management with Merrill Lynch & Co. From 1996 to 1999, he served at Wachovia as senior vice president, managing director and co-founder of the utilities and energy investment banking group, responsible for origination, structuring, negotiation and successful completion of transactions utilizing investment banking, capital markets and traditional commercial banking products. From 1990 to 1996, Mr. Grempe was the managing director of global power and project finance at JPMorgan Chase & Co., and from 1970 to 1990, Mr. Grempe was with Merrill Lynch & Co., starting out as an associate in the mergers and acquisitions department, then in 1986

Table of Contents

becoming the senior vice president, managing director and head of the regulated industries group. Mr. Grempp's knowledge of financial and accounting matters qualifies him to serve on Prospect's Audit Committee and his independence from Prospect, Prospect Capital Management and Prospect Administration enhances his service as a member of the Nominating and Corporate Governance Committee.

*Eugene S. Stark*

Mr. Stark brings to the Board over 25 years of experience in directing the financial and administrative functions of investment management organizations. The Board benefits from his broad experience in financial management; SEC reporting and compliance; strategic and financial planning; expense, capital and risk management; fund administration; due diligence; acquisition analysis; and integration activities. Since May 2005, Mr. Stark's position as the Principal Financial Officer, Chief Compliance Officer and Vice President of Administration at General American Investors Company, Inc., where he is responsible for operations, compliance, and financial functions, allows him to provide the Board with added insight into the management practices of other financial companies. From January to April of 2005, Mr. Stark was the Chief Financial Officer of Prospect, prior to which he worked at Prudential Financial, Inc. between 1987 and 2004. His many positions within Prudential include 10 years as Vice President and Fund Treasurer of Prudential Mutual Funds, 4 years as Senior Vice President of Finance of Prudential Investments, and 2 years as Senior Vice President of Finance of Prudential Amenities. Mr. Stark is also a Certified Public Accountant. Mr. Stark's knowledge of financial and accounting matters qualifies him to serve on Prospect's Audit Committee and his independence from Prospect, Prospect Capital Management and Prospect Administration enhances his service as a member of the Nominating and Corporate Governance Committee. Mr. Stark is also a member of Mount Saint Mary Academy's Finance Committee.

*Means by Which the Board of Directors Supervises Executive Officers*

The board of directors is regularly informed on developments and issues related to Prospect's business, and monitors the activities and responsibilities of the executive officers in various ways.

At each regular meeting of the board of directors, the executive officers report to the board of directors on developments and important issues. Each of the executive officers, as applicable, also provide regular updates to the members of the board of directors regarding Prospect's business between the dates of regular meetings of the board of directors.

Executive officers and other members of Prospect Capital Management, at the invitation of the board of directors, regularly attend portions of meetings of the board of directors and its committees to report on Prospect's financial results, operations, performance and outlook, and on areas of the business within their responsibility, including risk management and management information systems, as well as other business matters.

*The Board's Role in Risk Oversight*

Prospect's board of directors performs its risk oversight function primarily through (a) its two standing committees, which report to the entire board of directors and are comprised solely of independent directors and (b) monitoring by Prospect's Chief Compliance Officer in accordance with its compliance policies and procedures.

As set forth in the descriptions regarding the Audit Committee and the Nominating and Governance Committee, the Audit Committee and the Nominating and Governance Committee assist the board of directors in fulfilling its risk oversight responsibilities. The Audit Committee's risk oversight responsibilities include reviewing and discussing with management and the independent accountants Prospect's annual audited financial statements, including disclosures made in management's

Table of Contents

discussion and analysis; reviewing and discussing with management and the independent accountants Prospect's quarterly financial statements prior to the filings of its quarterly reports on Form 10-Q; pre-approving the independent accountants' engagement to render audit and/or permissible non-audit services; and evaluating the qualifications, performance and independence of the independent accountants. The Nominating and Governance Committee's risk oversight responsibilities include selecting qualified nominees to be elected to the board of directors by stockholders; selecting qualified nominees to fill any vacancies on the board of directors or a committee thereof; developing and recommending to the board of directors a set of corporate governance principles applicable to Prospect; and overseeing the evaluation of the board of directors and management. Both the Audit Committee and the Nominating and Governance Committee consist solely of independent directors.

Prospect's board of directors also performs its risk oversight responsibilities with the assistance of the Chief Compliance Officer. Prospect's Chief Compliance Officer prepares a written report annually discussing the adequacy and effectiveness of Prospect's compliance policies and procedures and certain of its service providers. The Chief Compliance Officer's report, which is reviewed by the board of directors, addresses at a minimum (a) the operation of Prospect's compliance policies and procedures and certain of its service providers since the last report; (b) any material changes to such policies and procedures since the last report; (c) any recommendations for material changes to such policies and procedures as a result of the Chief Compliance Officer's annual review; and (d) any compliance matter that has occurred since the date of the last report about which the board of directors would reasonably need to know to oversee Prospect's compliance activities and risks. In addition, the Chief Compliance Officer meets separately in executive session with the independent directors at least once each year.

Prospect believes that its board of directors' role in risk oversight is effective and appropriate given the extensive regulation to which it is already subject as a business development company, or BDC, under the 1940 Act. Specifically, as a BDC Prospect must comply with certain regulatory requirements that control certain types of risk in its business and operations. For example, Prospect's ability to incur indebtedness is limited such that its asset coverage must equal at least 200% immediately after each time it incurs indebtedness, and it generally has to invest at least 70% of its total assets in "qualifying assets." In addition, Prospect elected to be treated as a regulated investment company, or RIC, under Subchapter M of the Code. As a RIC, Prospect must, among other things, meet certain income source and asset diversification requirements.

Prospect believes that the extent of its board of directors' (and its committees') role in risk oversight complements its Board's leadership structure because it allows Prospect's independent directors to exercise oversight of risk without any conflict that might discourage critical review through the two fully independent board committees, auditor and independent valuation providers, and otherwise.

Prospect believes that a board's roles in risk oversight must be evaluated on a case by case basis and that the board of directors' practices concerning risk oversight is appropriate. However, Prospect continually re-examines the manners in which the Board administers its oversight function on an ongoing basis to ensure that they continue to meet Prospect's needs.

**Committees of the Board of Directors**

Prospect's board of directors has established an Audit Committee and a Nominating and Corporate Governance Committee. For the fiscal year ended June 30, 2013, Prospect's board of directors held 17 board of director meetings, 9 Audit Committee meetings, and 1 Nominating and Corporate Governance Committee meeting. All directors attended at least 75% of the aggregate number of meetings of the board of directors and of the respective committees on which they served. Prospect requires each director to make a diligent effort to attend all board and committee meetings,

Table of Contents

as well as each annual meeting of stockholders. Three directors attended last year's annual meeting of stockholders in person.

*The Audit Committee.* The Audit Committee operates pursuant to a charter approved by the board of directors. The charter sets forth the responsibilities of the Audit Committee, which include selecting or retaining each year an independent registered public accounting firm, or independent accountants, to audit Prospect's accounts and records; reviewing and discussing with management and the independent accountants Prospect's annual audited financial statements, including disclosures made in management's discussion and analysis, and recommending to the board of directors whether the audited financial statements should be included in Prospect's annual report on Form 10-K; reviewing and discussing with management and the independent accountants Prospect's quarterly financial statements prior to the filings of its quarterly reports on Form 10-Q; pre-approving the independent accountants' engagement to render audit and/or permissible non-audit services; and evaluating the qualifications, performance and independence of the independent accountants. The Audit Committee is presently composed of three persons: Messrs. Cooper, Grempe and Stark, each of whom is not an "interested person" as defined in the 1940 Act and is considered independent under applicable NASDAQ rules, with Mr. Stark serving as chairman of the committee. The board of directors has determined that Mr. Stark is an "audit committee financial expert" as that term is defined under Item 407 of Regulation S-K. The Audit Committee may delegate its pre-approval responsibilities to one or more of its members. The member(s) to whom such responsibility is delegated must report, for informational purposes only, any pre-approval decisions to the Audit Committee at its next scheduled meeting. Messrs. Cooper, Grempe and Stark were added to the Audit Committee concurrent with their election to the board of directors on February 12, 2009, April 1, 2010 and September 4, 2008, respectively.

The function of the Audit Committee is oversight. Prospect's management is primarily responsible for maintaining appropriate systems for accounting and financial reporting principles and policies and internal controls and procedures that provide for compliance with accounting standards and applicable laws and regulations. The independent accountants are primarily responsible for planning and carrying out a proper audit of Prospect's annual financial statements in accordance with U.S. GAAP. The independent accountants are accountable to the board of directors and the Audit Committee, as representatives of Prospect's stockholders. The board of directors and the Audit Committee have the ultimate authority and responsibility to select, evaluate and, where appropriate, replace Prospect's independent accountants (subject, if applicable, to stockholder ratification).

In fulfilling their responsibilities, it is recognized that members of the Audit Committee are not Prospect full-time employees or management and are not, and do not represent themselves to be, accountants or auditors by profession. As such, it is not the duty or the responsibility of the Audit Committee or its members to conduct "field work" or other types of auditing or accounting reviews or procedures, to determine that the financial statements are complete and accurate and are in accordance with U.S. GAAP, or to set auditor independence standards. Each member of the Audit Committee shall be entitled to rely on (a) the integrity of those persons within and outside Prospect and management from which it receives information; (b) the accuracy of the financial and other information provided to the Audit Committee absent actual knowledge to the contrary (which shall be promptly reported to the board of directors); and (c) statements made by Prospect's officers and employees, its investment adviser or other third parties as to any information technology, internal audit and other non-audit services provided to Prospect by the independent accountants.

*The Nominating and Corporate Governance Committee.* The Nominating and Corporate Governance Committee, or Nominating and Governance Committee, is responsible for selecting qualified nominees to be elected to the board of directors by stockholders; selecting qualified nominees to fill any vacancies on the board of directors or a committee thereof; developing and recommending to the board of directors a set of corporate governance principles applicable to Prospect; overseeing the

Table of Contents

evaluation of the board of directors and management; and undertaking such other duties and responsibilities as may from time to time be delegated by the board of directors to the Nominating and Governance Committee. The Nominating and Governance Committee takes into consideration the educational, professional and technical backgrounds and diversity of each nominee when evaluating such nominees to be elected to the board of directors. The Nominating and Governance Committee does not have a formal policy with respect to diversity. The Nominating and Governance Committee is presently composed of three persons: Messrs. Cooper, Grempe and Stark, each of whom is not an "interested person" as defined in the 1940 Act and is considered independent under applicable NASDAQ rules, with Mr. Grempe serving as chairman of the committee. Messrs. Cooper, Grempe and Stark were added to the Nominating and Governance Committee concurrent with their election to the board of directors on February 12, 2009, April 1, 2010 and September 4, 2008, respectively.

The Nominating and Governance Committee will consider stockholder recommendations for possible nominees for election as directors when such recommendations are submitted in accordance with Prospect's Bylaws and any applicable law, rule or regulation regarding director nominations. Nominations should be sent to the Corporate Secretary c/o Prospect Capital Corporation, 10 East 40th Street, 44th Floor, New York, New York 10016. When submitting a nomination to Prospect for consideration, a stockholder must provide all information that would be required under applicable Commission rules to be disclosed in connection with election of a director, including the following minimum information for each director nominee: full name, age and address; principal occupation during the past five years; current directorships on publicly held companies and investment companies; number of shares of Prospect's common stock owned, if any; and, a written consent of the individual to stand for election if nominated by the board of directors and to serve if elected by the stockholders. Criteria considered by the Nominating and Governance Committee in evaluating the qualifications of individuals for election as members of the board of directors include compliance with the independence and other applicable requirements of the NASDAQ rules and the 1940 Act and all other applicable laws, rules, regulations and listing standards, the criteria, policies and principles set forth in the Nominating and Corporate Governance Committee Charter, and the ability to contribute to the effective management of Prospect, taking into account its needs and such factors as the individual's experience, perspective, skills, expertise and knowledge of the industries in which Prospect operates, personal and professional integrity, character, business judgment, time availability in light of other commitments, dedication, and conflicts of interest. The Nominating and Governance Committee also may consider such other factors as it may deem to be in Prospect's best interests and those of its stockholders. The board of directors also believes it is appropriate for certain key members of Prospect's management to participate as members of the board of directors.

**Corporate Governance**

*Corporate Governance Guidelines.* Upon the recommendation of the Nominating and Governance Committee, the board of directors has adopted Corporate Governance Guidelines on behalf of Prospect. These Corporate Governance Guidelines address, among other things, the following key corporate governance topics: director responsibilities; the size, composition, and membership criteria of the board of directors; composition and responsibilities of directors serving on committees of the board of directors; director access to officers, employees, and independent advisors; director orientation and continuing education; director compensation; and an annual performance evaluation of the board of directors.

*Code of Conduct.* Prospect has adopted a code of conduct which applies to, among others, its senior officers, including its Chief Executive Officer and Chief Financial Officer, as well as all of its employees. Prospect's code of conduct is an exhibit to its Annual Report on Form 10-K filed with the SEC, and can be accessed via the Internet site of the SEC at <http://www.sec.gov>. Prospect intends to disclose amendments to or waivers from a required provision of the code of conduct on Form 8-K.

Table of Contents

*Code of Ethics.* Prospect, Prospect Capital Management and Prospect Administration have each adopted a code of ethics pursuant to Rule 17j-1 under the 1940 Act that establishes procedures for personal investments and restricts certain personal securities transactions. Personnel subject to each code may invest in securities for their personal investment accounts, including securities that may be purchased or held by Prospect, so long as such investments are made in accordance with the code's requirements.

*Internal Reporting and Whistle Blower Protection Policy.* Prospect's Audit Committee has established guidelines and procedures regarding the receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters, collectively, Accounting Matters, and the confidential, anonymous submission by Prospect's employees of concerns regarding questionable accounting or auditing matters. Persons with complaints or concerns regarding Accounting Matters may submit their complaints to Prospect's Chief Compliance Officer, or CCO. Persons who are uncomfortable submitting complaints to the CCO, including complaints involving the CCO, may submit complaints directly to Prospect's Audit Committee Chairman. Complaints may be submitted on an anonymous basis.

The CCO may be contacted at: Prospect Capital Corporation, Chief Compliance Officer, 10 East 40th Street, 44th Floor, New York, New York 10016.

The Audit Committee Chairman may be contacted at: Prospect Capital Corporation, Audit Committee Chairman, 10 East 40th Street, 44th Floor, New York, New York 10016.

***Independent Directors***

The board of directors, in connection with the 1940 Act and the applicable Marketplace Rules of NASDAQ, has considered the independence of members of the board of directors who are not employed by Prospect Capital Management and has concluded that Messrs. Cooper, Grempe and Stark are not "interested persons" as defined by the 1940 Act and therefore qualify as independent directors under the standards promulgated by the Marketplace Rules of NASDAQ. In reaching this conclusion, the board of directors concluded that Messrs. Cooper, Grempe and Stark had no relationships with Prospect Capital Management or any of its affiliates, other than their positions as directors of Prospect and, if applicable, investments in Prospect that are on the same terms as those of other stockholders.

**Proxy Voting Policies and Procedures**

Prospect has delegated its proxy voting responsibility to Prospect Capital Management. The guidelines are reviewed periodically by Prospect Capital Management and Prospect's non-interested directors, and, accordingly, are subject to change. See "Regulation of Prospect Proxy Voting Policies and Procedures."

Table of Contents**Compensation of Directors and Officers**

The following table sets forth information regarding the compensation received by Prospect's directors and executive officers for the fiscal year ended June 30, 2013. No compensation is paid to the interested directors by Prospect.

Name and Position	Aggregate Compensation from Prospect	Pension or Retirement Benefits Accrued as Part of Prospect's Expenses(1)	Total Compensation Paid to Director/ Officer
<b><i>Interested Directors</i></b>			
John F. Barry III(2)	None	None	None
M. Grier Eliasek(2)	None	None	None
<b><i>Independent Directors</i></b>			
Andrew C. Cooper(3)	\$ 100,000	None	\$ 100,000
William J. Grempp(4)	\$ 100,000	None	\$ 100,000
Eugene S. Stark(5)	\$ 100,000	None	\$ 100,000
<b><i>Executive Officers</i></b>			
Brian H. Oswald(2)	None	None	None

(1) Prospect does not have a bonus, profit sharing or retirement plan, and directors do not receive any pension or retirement benefits.

(2) Prospect has not paid, and does not intend to pay, any annual cash compensation to its executive officers for their services as executive officers. Messrs. Barry and Eliasek are compensated by Prospect Capital Management from the income Prospect Capital Management receives under the management agreement between Prospect Capital Management and Prospect. Mr. Oswald is compensated from the income Prospect Administration receives under the administration agreement.

(3) Mr. Cooper joined Prospect's board of directors on February 12, 2009.

(4) Mr. Grempp joined Prospect's board of directors on April 1, 2010.

(5) Mr. Stark joined Prospect's board of directors on September 4, 2008.

No compensation was paid to directors who are interested persons of Prospect as defined in 1940 Act. In addition, Prospect purchases directors' and officers' liability insurance on behalf of the directors and officers.

**Management Services*****Investment Advisory Agreement***

Prospect has entered into the Investment Advisory Agreement with Prospect Capital Management under which the Investment Adviser, subject to the overall supervision of Prospect's board of directors, manages the day-to-day operations of, and provides investment advisory services to, Prospect. Under the terms of the Investment Advisory Agreement, Prospect's Investment Adviser: (i) determines the composition of Prospect's portfolio, the nature and timing of the changes to the portfolio and the manner of implementing such changes, (ii) identifies, evaluates and negotiates the structure of the investments Prospect makes (including performing due diligence on its prospective portfolio companies); and (iii) closes and monitors investments Prospect makes.

Prospect Capital Management's services under the Investment Advisory Agreement are not exclusive, and it is free to furnish similar services to other entities so long as its services to Prospect are not impaired. For providing these services the Investment Adviser receives a fee from Prospect,





Table of Contents

consisting of two components: a base management fee and an incentive fee. The base management fee is calculated at an annual rate of 2% on Prospect's gross assets (including amounts borrowed). For services rendered under the Investment Advisory Agreement, the base management fee is payable quarterly in arrears. The base management fee is calculated based on the average value of Prospect's gross assets at the end of the two most recently completed calendar quarters and appropriately adjusted for any share issuances or repurchases during the current calendar quarter. Base management fees for any partial month or quarter are appropriately prorated.

The incentive fee has two parts. The first part, the income incentive fee, which is payable quarterly in arrears, will equal 20% of the excess, if any, of Prospect's pre-incentive fee net investment income that exceeds a 1.75% quarterly (7% annualized) hurdle rate, subject to a "catch up" provision measured as of the end of each calendar quarter. In the three months ended September 30, 2013, Prospect paid an incentive fee of \$20.5 million (see calculation below). For this purpose, pre-incentive fee net investment income means interest income, dividend income and any other income (including any other fees (other than fees for providing managerial assistance), such as commitment, origination, structuring, diligence and consulting fees and other fees that Prospect receives from portfolio companies) accrued during the calendar quarter, minus Prospect's operating expenses for the quarter (including the base management fee, expenses payable under the Administration Agreement described below, and any interest expense and dividends paid on any issued and outstanding preferred stock, but excluding the incentive fee). Pre-incentive fee net investment income includes, in the case of investments with a deferred interest feature (such as original issue discount, debt instruments with payment in kind interest and zero coupon securities), accrued income that Prospect has not yet received in cash. Pre-incentive fee net investment income does not include any realized capital gains, realized capital losses or unrealized capital appreciation or depreciation. Pre-incentive fee net investment income, expressed as a rate of return on the value of Prospect's net assets at the end of the immediately preceding calendar quarter, is compared to a "hurdle rate" of 1.75% per quarter (7% annualized).

Prospect expects the incentive fees it pays to increase to the extent it earns greater interest and dividend income through its investments in portfolio companies and, to a lesser extent, realizes capital gains upon the sale of warrants or other equity investments in its portfolio companies, and to decrease if its interest and dividend income and capital gains decrease. The "catch-up" provision requires Prospect to pay 100% of its pre-incentive fee net investment income with respect to that portion of such income, if any, that exceeds the hurdle rate but is less than 125% of the quarterly hurdle rate in any calendar quarter (8.75% annualized assuming an annualized hurdle rate of 7%). The catch-up provision is meant to provide Prospect Capital Management with 20% of Prospect's pre-incentive fee net investment income as if a hurdle rate did not apply when its pre-incentive fee net investment income exceeds 125% of the quarterly hurdle rate in any calendar quarter (8.75% annualized assuming an annualized hurdle rate of 7%). The income incentive fee will be computed and paid on income that may include interest that is accrued but not yet received in cash. If interest income is accrued but never paid, the board of directors would decide to write off the accrual in the quarter when the accrual is determined to be uncollectible. The write off would cause a decrease in interest income for the quarter equal to the amount of the prior accrual. The Investment Adviser is not under any obligation to reimburse Prospect for any part of the incentive fee it received that was based on accrued income that Prospect never receives as a result of a default by an entity on the obligation that resulted in the accrual of such income.

The net investment income used to calculate this part of the incentive fee is also included in the amount of the gross assets used to calculate the 2% base management fee. Prospect pays the

Table of Contents

Investment Adviser an income incentive fee with respect to its pre-incentive fee net investment income in each calendar quarter as follows:

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

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

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

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

The second part of the incentive fee, the capital gains incentive fee, is determined and payable in arrears as of the end of each calendar year (or upon termination of the Investment Advisory Agreement, as of the termination date), and equals 20% of Prospect's realized capital gains for the calendar year, if any, computed net of all realized capital losses and unrealized capital depreciation at the end of such year. In determining the capital gains incentive fee payable to the Investment Adviser, Prospect calculates the aggregate realized capital gains, aggregate realized capital losses and aggregate unrealized capital depreciation, as applicable, with respect to each investment that has been in its portfolio. For the purpose of this calculation, an "investment" is defined as the total of all rights and claims which may be asserted against a portfolio company arising out of Prospect's participation in the debt, equity, and other financial instruments issued by that company. Aggregate realized capital gains, if any, equals the sum of the differences between the aggregate net sales price of each investment and the aggregate cost basis of such investment when sold or otherwise disposed. Aggregate realized capital losses equal the sum of the amounts by which the aggregate net sales price of each investment is less than the aggregate cost basis of such investment when sold or otherwise disposed. Aggregate unrealized capital depreciation equals the sum of the differences, if negative, between the aggregate valuation of each investment and the aggregate cost basis of such investment as of the applicable calendar year-end. At the end of the applicable calendar year, the amount of capital gains that serves as the basis for Prospect's calculation of the capital gains incentive fee involves netting aggregate realized capital gains against aggregate realized capital losses on a since-inception basis and then reducing this amount by the aggregate unrealized capital depreciation. If this number is positive, then the capital gains incentive fee payable is equal to 20% of such amount, less the aggregate amount of any capital gains incentive fees paid since inception.

The actual transfer or sale of assets by Prospect to a SPE established by Prospect and consolidated with Prospect is disregarded for purposes of calculating the incentive fee.

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### Table of Contents

The following is a calculation of the most recently paid incentive fee paid in September and November 2013 (for the quarter ended September 30, 2013) (in thousands):

Prior Quarter Net Asset Value (adjusted for stock offerings during the quarter)	\$ 2,749,220
Quarterly Hurdle Rate	1.75%
Current Quarter Hurdle	\$ 48,111
125% of the Quarterly Hurdle Rate	2.1875%
125% of the Current Quarter Hurdle	\$ 60,139
Current Quarter Pre Incentive Fee Net Investment Income	\$ 102,921
Incentive Fee "Catch-Up"	\$ 12,028
Incentive Fee 20% in excess of 125% of the Current Quarter Hurdle	\$ 8,556
Total Current Quarter Incentive Fee	\$ 20,584

The total base management fees earned by and paid to Prospect Capital Management during the twelve months ended June 30, 2013, June 30, 2012 and June 30, 2011 were \$69.8 million, \$35.8 million and \$22.5 million, respectively.

The income incentive fees were \$81.2 million, \$46.7 million and \$23.6 million for the twelve months ended June 30, 2013, June 30, 2012 and June 30, 2011, respectively. No capital gains incentive fees were earned for the twelve months ended June 30, 2013, June 30, 2012 and June 30, 2011.

The total investment advisory fees were \$151.0 million, \$82.5 million and \$46.1 million for the twelve months ended June 30, 2013, June 30, 2012 and June 30, 2011, respectively.

Because of the structure of the incentive fee, it is possible that Prospect may have to pay an incentive fee in a quarter where it incurs a loss. For example, if Prospect receives pre-incentive fee net investment income in excess of the hurdle rate for a quarter, it will pay the applicable income incentive fee even if it has incurred negative total return in that quarter due to realized or unrealized losses on its investments.

### ***Examples of Quarterly Incentive Fee Calculation***

Example 1: Income Incentive Fee(\*):

#### Alternative 1

Assumptions

Investment income (including interest, dividends, fees, etc.) = 1.25%

Hurdle rate(1) = 1.75%

Base management fee(2) = 0.50%

Other expenses (legal, accounting, custodian, transfer agent, etc.)(3) = 0.20%

(\*)

The hypothetical amount of pre-incentive fee net investment income shown is based on a percentage of total net assets.

(1)

Represents 7% annualized hurdle rate

(2)

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Represents 2% annualized base management fee.

(3)

Excludes organizational and offering expenses.

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### Table of Contents

Pre-incentive fee net investment income (investment income - (base management fee + other expenses)) = 0.55%

Pre-incentive net investment income does not exceed hurdle rate, therefore there is no income incentive fee.

#### Alternative 2

##### Assumptions

Investment income (including interest, dividends, fees, etc.) = 2.70%

Hurdle rate(1) = 1.75%

Base management fee(2) = 0.50%

Other expenses (legal, accounting, custodian, transfer agent, etc.)(3) = 0.20%

(1) Represents 7% annualized hurdle rate

(2) Represents 2% annualized base management fee.

(3) Excludes organizational and offering expenses.

Pre-incentive fee net investment income (investment income - (base management fee + other expenses)) = 2%

Pre-incentive net investment income exceeds hurdle rate, therefore there is an income incentive fee payable by Prospect to its Investment Adviser.

Income incentive Fee =  $100\% \times \text{"Catch Up"} + \text{the greater of } 0\% \text{ AND } (20\% \times (\text{pre-incentive fee net investment income} - 2.1875\%))$   
=  $(100\% \times (2\% - 1.75\%)) + 0\%$   
=  $100\% \times 0.25\% + 0\%$   
= 0.25%

#### Alternative 3

##### Assumptions

Investment income (including interest, dividends, fees, etc.) = 3%

Hurdle rate(1) = 1.75%

Base management fee(2) = 0.50%

Other expenses (legal, accounting, custodian, transfer agent, etc.)(3) = 0.20%

(1) Represents 7% annualized hurdle rate.

(2) Represents 2% annualized base management fee.

(3) Excludes organizational and offering expenses.

Pre-incentive fee net investment income (investment income - (base management fee + other expenses)) = 2.30%

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### Table of Contents

Pre-incentive net investment income exceeds hurdle rate, therefore there is an income incentive fee payable by Prospect to its Investment Adviser.

Income incentive Fee =  $100\% \times \text{"Catch Up"} + \text{the greater of } 0\% \text{ AND } (20\% \times (\text{pre-incentive fee net investment income} - 2.1875\%))$   
=  $(100\% \times (2.1875\% - 1.75\%)) + \text{the greater of } 0\% \text{ AND } (20\% \times (2.30\% - 2.1875\%))$   
=  $(100\% \times 0.4375\%) + (20\% \times 0.1125\%)$   
=  $0.4375\% + 0.0225\%$   
=  $0.46\%$

Example 2: Capital Gains Incentive Fee:

### Alternative 1

#### *Assumptions*

*Year 1:* \$20 million investment made

*Year 2:* Fair market value, or FMV of investment determined to be \$22 million

*Year 3:* FMV of investment determined to be \$17 million

*Year 4:* Investment sold for \$21 million

The impact, if any, on the capital gains portion of the incentive fee would be:

*Year 1:* No impact

*Year 2:* No impact

*Year 3:* Decrease base amount on which the second part of the incentive fee is calculated by \$3 million (unrealized capital depreciation)

*Year 4:* Increase base amount on which the second part of the incentive fee is calculated by \$4 million (\$1 million of realized capital gain and \$3 million reversal in unrealized capital depreciation)

### Alternative 2

#### *Assumptions*

*Year 1:* \$20 million investment made

*Year 2:* FMV of investment determined to be \$17 million

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*Year 3:* FMV of investment determined to be \$17 million

*Year 4:* FMV of investment determined to be \$21 million

*Year 5:* FMV of investment determined to be \$18 million

*Year 6:* Investment sold for \$15 million

The impact, if any, on the capital gains portion of the incentive fee would be:

*Year 1:* No impact

*Year 2:* Decrease base amount on which the second part of the incentive fee is calculated by \$3 million (unrealized capital depreciation)

*Year 3:* No impact



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### Table of Contents

*Year 4:* Increase base amount on which the second part of the incentive fee is calculated by \$3 million (reversal in unrealized capital depreciation)

*Year 5:* Decrease base amount on which the second part of the incentive fee is calculated by \$2 million (unrealized capital depreciation)

*Year 6:* Decrease base amount on which the second part of the incentive fee is calculated by \$3 million (\$5 million of realized capital loss offset by a \$2 million reversal in unrealized capital depreciation)

### Alternative 3

#### *Assumptions*

*Year 1:* \$20 million investment made in company A, or Investment A, and \$20 million investment made in company B, or Investment B

*Year 2:* FMV of Investment A is determined to be \$21 million, and Investment B is sold for \$18 million

*Year 3:* Investment A is sold for \$23 million

The impact, if any, on the capital gains portion of the incentive fee would be:

*Year 1:* No impact

*Year 2:* Decrease base amount on which the second part of the incentive fee is calculated by \$2 million (realized capital loss on Investment B)

*Year 3:* Increase base amount on which the second part of the incentive fee is calculated by \$3 million (realized capital gain on Investment A)

### Alternative 4

#### *Assumptions*

*Year 1:* \$20 million investment made in company A, or Investment A, and \$20 million investment made in company B, or Investment B

*Year 2:* FMV of Investment A is determined to be \$21 million, and FMV of Investment B is determined to be \$17 million

*Year 3:* FMV of Investment A is determined to be \$18 million, and FMV of Investment B is determined to be \$18 million

*Year 4:* FMV of Investment A is determined to be \$19 million, and FMV of Investment B is determined to be \$21 million

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*Year 5:* Investment A is sold for \$17 million, and Investment B is sold for \$23 million

The impact, if any, on the capital gains portion of the incentive fee would be:

*Year 1:* No impact

*Year 2:* Decrease base amount on which the second part of the incentive fee is calculated by \$3 million (unrealized capital depreciation on Investment B)

*Year 3:* Decrease base amount on which the second part of the incentive fee is calculated by \$1 million (\$2 million in unrealized capital depreciation on Investment A and \$1 million recovery in unrealized capital depreciation on Investment B)

Table of Contents

*Year 4:* Increase base amount on which the second part of the incentive fee is calculated by \$3 million (\$1 million recovery in unrealized capital depreciation on Investment A and \$2 million recovery in unrealized capital depreciation on Investment B)

*Year 5:* Increase base amount on which the second part of the incentive fee is calculated by \$1 million (\$3 million realized capital gain on Investment B offset by \$3 million realized capital loss on Investment A plus a \$1 million reversal in unrealized capital depreciation on Investment A from Year 4)

***Payment of Prospect's Expenses***

All investment professionals of the Investment Adviser and its staff, when and to the extent engaged in providing investment advisory and management services, and the compensation and routine overhead expenses of such personnel allocable to such services, will be provided and paid for by the Investment Adviser. Prospect bears all other costs and expenses of its operations and transactions, including those relating to: organization and offering; calculation of its net asset value (including the cost and expenses of any independent valuation firms); expenses incurred by Prospect Capital Management payable to third parties, including agents, consultants or other advisers (such as independent valuation firms, accountants and legal counsel), in monitoring Prospect's financial and legal affairs and in monitoring its investments and performing due diligence on its prospective portfolio companies; interest payable on debt, if any, and dividends payable on preferred stock, if any, incurred to finance Prospect's investments; offerings of Prospect's debt, as well as its preferred shares, common stock and other securities; investment advisory fees; fees payable to third parties, including agents, consultants or other advisors, relating to, or associated with, evaluating and making investments; transfer agent and custodial fees; registration fees; listing fees; taxes; independent directors' fees and expenses; costs of preparing and filing reports or other documents with the SEC; the costs of any reports, proxy statements or other notices to stockholders, including printing costs; Prospect's allocable portion of the fidelity bond, directors and officers errors and omissions liability insurance, and any other insurance premiums; direct costs and expenses of administration, including auditor and legal costs; and all other expenses incurred by Prospect, its Investment Adviser or by Prospect Administration in connection with administering its business, such as its allocable portion of overhead under the Administration Agreement, including rent and its allocable portion of the costs of its chief compliance officer and chief financial officer and his staff, including the internal legal staff.

***Duration and Termination***

The Investment Advisory Agreement was originally approved by Prospect's board of directors on June 23, 2004 and was recently re-approved by the board of directors on May 3, 2013 for an additional one-year term expiring June 22, 2014. Unless terminated earlier as described below, it will remain in effect from year to year thereafter if approved annually by Prospect's board of directors or by the affirmative vote of the holders of a majority of Prospect's outstanding voting securities, including, in either case, approval by a majority of its directors who are not interested persons. The Investment Advisory Agreement will automatically terminate in the event of its assignment. The Investment Advisory Agreement may be terminated by either party without penalty upon not more than 60 days' written notice to the other. See "Risks Related to Prospect Risks Relating to Prospect's Business Prospect is dependent upon Prospect Capital Management's key management personnel for Prospect's future success."

***Administration Agreement***

Prospect has also entered into an Administration Agreement with Prospect Administration under which Prospect Administration, among other things, provides (or arranges for the provision of) administrative services and facilities for Prospect. For providing these services, Prospect reimburses

Table of Contents

Prospect Administration for its allocable portion of overhead incurred by Prospect Administration in performing its obligations under the Administration Agreement, including rent and Prospect's allocable portion of the costs of its chief compliance officer and chief financial officer and his staff, including the internal legal staff. Under this agreement, Prospect Administration furnishes Prospect with office facilities, equipment and clerical, bookkeeping and record keeping services at such facilities. Prospect Administration also performs, or oversees the performance of, Prospect's required administrative services, which include, among other things, being responsible for the financial records that Prospect is required to maintain and preparing reports to Prospect's stockholders and reports filed with the Securities and Exchange Commission, or the SEC. In addition, Prospect Administration assists Prospect in determining and publishing its net asset value, overseeing the preparation and filing of its tax returns and the printing and dissemination of reports to its stockholders, and generally oversees the payment of its expenses and the performance of administrative and professional services rendered to Prospect by others. Under the Administration Agreement, Prospect Administration also provides on Prospect's behalf managerial assistance to those portfolio companies to which Prospect is required to provide such assistance. The Administration Agreement may be terminated by either party without penalty upon 60 days' written notice to the other party. Prospect Administration is a wholly owned subsidiary of Prospect's Investment Adviser.

Prospect reimbursed Prospect Administration \$8.7 million, \$6.8 million and \$5.0 million for the twelve months ended June 30, 2013, June 30, 2012 and June 30, 2011, respectively, for services it provided to Prospect at cost.

***Indemnification***

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

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

***Board of Directors Approval of the Investment Advisory Agreement***

On May 3, 2013, Prospect's board of directors voted unanimously to renew the Investment Advisory Agreement for the 12-month period ending June 22, 2014. In its consideration of the Investment Advisory Agreement, the board of directors focused on information it had received relating to, among other things: (a) the nature, quality and extent of the advisory and other services to be provided to Prospect by Prospect Capital Management; (b) comparative data with respect to advisory fees or expense ratios paid by other business development companies with similar investment objectives; (c) Prospect's projected operating expenses; (d) the projected profitability of Prospect Capital Management and any existing and potential sources of indirect income to Prospect Capital Management or Prospect Administration from their relationships with Prospect and the profitability of those relationships; (e) information about the services to be performed and the personnel performing such services under the Investment Advisory Agreement; (f) the organizational capability and financial

Table of Contents

condition of Prospect Capital Management and its affiliates and (g) the possibility of obtaining similar services from other third party service providers or through an internally managed structure. In approving the renewal of the Investment Advisory Agreement, the board of directors, including all of the directors who are not "interested persons," considered the following:

*Nature, Quality and Extent of Services.* The board of directors considered the nature, extent and quality of the investment selection process employed by Prospect Capital Management. The board of directors also considered Prospect Capital Management's personnel and their prior experience in connection with the types of investments made by Prospect. The board of directors concluded that the services to be provided under the Investment Advisory Agreement are generally the same as those of comparable business development companies described in the available market data.

*Investment Performance.* The board of directors reviewed Prospect's investment performance as well as comparative data with respect to the investment performance of other externally managed business development companies. The board of directors concluded that Prospect Capital Management was delivering results consistent with Prospect's investment objective and that Prospect's investment performance was satisfactory when compared to comparable business development companies.

*The reasonableness of the fees paid to Prospect Capital Management.* The board of directors considered comparative data based on publicly available information on other business development companies with respect to services rendered and the advisory fees (including the management fees and incentive fees) of other business development companies as well as Prospect's projected operating expenses and expense ratio compared to other business development companies. The board of directors, on behalf of Prospect, also considered the profitability of Prospect Capital Management. Based upon its review, the board of directors concluded that the fees to be paid under the Investment Advisory Agreement are reasonable compared to other business development companies.

*Economies of Scale.* The board of directors considered information about the potential of Prospect Capital Management to realize economies of scale in managing Prospect's assets, and determined that at this time there were not economies of scale to be realized by Prospect Capital Management.

Based on the information reviewed and the discussions detailed above, the board of directors (including all of the directors who are not "interested persons") concluded that the investment advisory fee rates and terms are fair and reasonable in relation to the services provided and approved the renewal of the Investment Advisory Agreement with Prospect Capital Management as being in the best interests of Prospect and its stockholders.

**Portfolio Managers**

The following individuals function as portfolio managers primarily responsible for the day-to-day management of Prospect's portfolio. Prospect's portfolio managers are not responsible for day-to-day management of any other accounts. For a description of their principal occupations for the past five years, see above.

Name	Position	Length of Service with Prospect (Years)
John F. Barry III	Chairman and Chief Executive Officer	9
M. Grier Eliasek	President and Chief Operating Officer	9

Mr. Eliasek receives no compensation from Prospect. Mr. Eliasek receives a salary and bonus from Prospect Capital Management that takes into account his role as a senior officer of Prospect and of

Table of Contents

Prospect Capital Management, his performance and the performance of each of Prospect Capital Management and Prospect. Mr. Barry receives no compensation from Prospect. Mr. Barry, as the sole member of Prospect Capital Management, receives a salary and/or bonus from Prospect Capital Management and is entitled to equity distributions after all other obligations of Prospect Capital Management are met.

The following table sets forth the dollar range of Prospect's common stock beneficially owned by each of the portfolio managers described above as of June 30, 2013.

Name	Aggregate Dollar Range of Common Stock Beneficially Owned by Prospect Capital Management
John F. Barry III	Over \$1,000,000
M. Grier Eliasek	Over \$1,000,000

***Managerial Assistance***

As a business development company, Prospect offers, and must provide upon request, managerial assistance to certain of its portfolio companies. This assistance could involve, among other things, participating in board and management meetings, consulting with and advising officers of portfolio companies and providing other organizational and financial guidance. Prospect billed \$5.3 million, \$1.6 million and \$1.3 million of managerial assistance fees for the years ended June 30, 2013, June 30, 2012 and June 30, 2011, respectively, of which \$1.3 million, \$165,000 and \$128,000 remains on the consolidated statement of assets and liabilities as of June 30, 2013, June 30, 2012 and June 30, 2011, respectively. These fees are paid to the Administrator so Prospect simultaneously accrues a payable to the Administrator for the same amounts, which remain on the consolidated statements of assets and liabilities.

***License Agreement***

Prospect entered into a license agreement with Prospect Capital Management, pursuant to which Prospect Capital Management agreed to grant Prospect a nonexclusive royalty free license to use the name "Prospect Capital." Under this agreement, Prospect has a right to use the Prospect Capital name, for so long as Prospect Capital Management or one of its affiliates remains Prospect's investment adviser. Other than with respect to this limited license, Prospect has no legal right to the Prospect Capital name. This license agreement will remain in effect for so long as the Investment Advisory Agreement with Prospect's Investment Adviser is in effect.

Table of Contents

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS OF PROSPECT**

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

The following discussion should be read in conjunction with the consolidated financial statements and notes thereto appearing elsewhere in this proxy circular/prospectus. Historical results set forth are not necessarily indicative of Prospect's future financial position and results of operations.

**Overview**

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

Prospect currently has seven origination strategies in which it makes investments: (1) lending in private equity sponsored transactions, (2) lending directly to companies not owned by private equity firms, (3) control investments in corporate operating companies, (4) control investments in financial companies, (5) investments in structured credit, (6) real estate investments, and (7) investments in syndicated debt. Prospect continues to evaluate other origination strategies in the ordinary course of business with no specific tops-down allocation to any single origination strategy.

**Lending in Private Equity Sponsored Transactions** Prospect makes loans to companies which are controlled by leading private equity firms. This debt can take the form of first lien, second lien, unitranche or mezzanine loans. In making these investments, Prospect looks for a diversified customer base, recurring demand for the product or service, barriers to entry, strong historical cash flow and experienced management teams. These loans typically have significant equity subordinate to Prospect's loan position. This strategy has comprised approximately 50%-60% of Prospect's business.

**Lending Directly to Companies** Prospect provides debt financing to companies owned by non-private equity firms, the company founder, a management team or a family. Here, in addition to the strengths Prospect looks for in a sponsored transaction, it also looks for the alignment with the management team with significant invested capital. This strategy often has less competition than the private equity sponsor strategy because such company financing needs are not easily addressed by banks and often require more diligence preparation. Direct lending can result in higher returns and lower leverage than sponsor transactions and may include warrants or equity to Prospect. This strategy generally has comprised approximately 5%-15% of Prospect's business.

**Control Investments in Corporate Operating Companies** This strategy involves acquiring controlling stakes in non financial operating companies. Prospect investments in these companies are generally structured as a combination of yield producing debt and equity. Prospect provides certainty of closure to Prospect's counterparties, gives the seller personal liquidity and generally looks for management to continue on in their current roles. This strategy has comprised approximately 10%-15% of its business.

**Control Investments in Financial Companies** This strategy involves acquiring controlling stakes in financial companies, including consumer direct lending, subprime auto lending and other strategies. Prospect's investments in these companies are generally structured as a combination of yield-producing debt and equity. These investments are often structured in a tax-efficient RIC-compliant partnership, enhancing returns. This strategy has comprised approximately 10%-15% of Prospect's business.

Table of Contents

**Investments in Structured Credit** Prospect makes investments in CLOs, generally taking a significant position in the subordinated interests (equity) of the CLOs. The CLOs include a diversified portfolio of broadly syndicated loans and do not have direct exposure to real estate, mortgages, sub-prime debt, or consumer based debt. The CLOs in which Prospect invests are managed by top-tier collateral managers that have been thoroughly diligenced prior to investment. This strategy has represented 10%-20% of Prospect's business.

**Real Estate Investments** Prospect makes investments in real estate through its wholly owned tax-efficient REIT, American Property Holdings Corp. ("APHC"). Prospect's real estate investments are in various classes of fully developed and occupied real estate properties that generate current yields. Prospect seeks to identify properties that have historically high occupancy and steady cash flow generation. Prospect partners with established property managers with experience in managing the property type to manage such properties after acquisition. This is a more recent investment strategy that has represented approximately 5%-10% of Prospect's business.

**Investments in Syndicated Debt** On an opportunistic basis, Prospect makes investments in loans and high yield bonds that have been sold to a syndicate of buyers. Here Prospect looks for investments with attractive risk-adjusted returns after it has completed a fundamental credit analysis. These investments are purchased with a long term, buy-and-hold outlook and Prospect looks to provide significant structuring input by providing anchoring orders. This strategy has represented approximately 5%-10% of Prospect's business.

Prospect invests primarily in first and second lien senior loans and mezzanine debt, which in some cases includes an equity component. First and second lien senior loans generally are senior debt instruments that rank ahead of subordinated debt of a given portfolio company. These loans also have the benefit of security interests in the assets of the portfolio company, which may rank ahead of or be junior to other security interests. Mezzanine debt and Prospect's investments in CLOs are subordinated to senior loans and are generally unsecured. Prospect invests in debt and equity positions of CLOs which are a form of securitization in which the cash flows of a portfolio of loans are pooled and passed on to different classes of owners in various tranches. Prospect's CLO investments are derived from portfolios of corporate debt securities which are generally risk rated from BB to B depending on the tranche.

Prospect seeks to be a long-term investor with its portfolio companies. The aggregate value of Prospect's portfolio investments was \$4,553,136 and \$4,172,852 as of September 30, 2013 and June 30, 2013, respectively. During the three months ended September 30, 2013, Prospect's net cost of investments increased by \$386,510 or 9.08%, as a result of thirteen new investments, five follow-on investments and one revolver advance of \$552,262, accrued of payment-in-kind interest of \$4,581, structuring fees of \$8,660 and net amortization of discounts and premiums of \$9,954, while Prospect received full repayment on seven investments, sold two investments for which it realized a gain of \$498, received \$3,252 from the release of escrow amounts which was recognized as a capital gain, and received several partial prepayments, amortization payments and a revolver repayment totaling \$18,394.

During the year ended June 30, 2013, Prospect's net cost of investments increased by \$2,156,465, or 102.7%, as a result of 68 new investments, 25 follow-on investments and several revolver advances of \$3,043,531, accrued of payment-in-kind interest of \$10,947, structuring fees of \$52,699 and amortization of discounts and premiums of \$11,016, while it received full repayment on 23 investments, sold ten investments, impaired one investment, and received several partial prepayments, amortization payments and a revolver repayment, totaling \$931,534.

From June 30, 2013 to September 30, 2013, net assets increased by \$253,261 or 9.53% during the three months ended September 30, 2013, from \$2,656,494 to \$2,909,755. This increase resulted from the issuance of new shares of Prospect's common stock (less offering costs) in the amount of \$256,043, dividend reinvestments of \$3,994, and another \$79,900 from operations. These increases, in turn, were



Table of Contents

offset by \$86,676 in dividend distributions to Prospect's stockholders. The \$79,900 increase in net assets resulting from operations is net of the following: net investment income of \$82,337, net realized gain on investments of \$3,789, and a decrease in net assets due to changes in net unrealized depreciation of investments of \$6,226.

From June 30, 2012 to June 20, 2013, net assets increased by \$1,144,520, or 75.7% during the year ended June 30, 2013, from \$1,511,974 to \$2,656,494. This increase resulted from the issuance of new shares of Prospect's common stock (less offering costs) in the amount of \$1,179,084, dividend reinvestments of \$16,087, and \$220,856 from operations. These increases, in turn, were offset by \$271,507 in dividend distributions to Prospect's stockholders. The \$220,856 increase in net assets resulting from operations is net of the following: net investment income of \$324,924, net realized loss on investments of \$26,234, and a decrease in net assets due to changes in net unrealized depreciation of investments of \$77,834.

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

**Fiscal 2014 First Quarter Highlights**

*Investment Transactions*

On July 1, 2013, Pre-Paid Legal Services, Inc. repaid the \$5,000 loan receivable to Prospect.

On July 9, 2013, Southern Management Corporation repaid the \$17,565 loan receivable to Prospect.

On July 12, 2013, Prospect provided \$11,000 of secured second lien financing to Water PIK, Inc., a leader in developing innovative personal and oral healthcare products. The second lien term loan bears interest in cash at the greater of 9.75% or Libor plus 8.75% and has a final maturity of January 8, 2021.

On July 23, 2013, Prospect made a \$2,000 investment in Carolina Beverage Group, LLC ("Carolina Beverage"), a contract beverage manufacturer. The senior secured note bears interest in cash at 10.5% and has a final maturity of July 23, 2018. On July 24, 2013, Prospect sold its \$2,000 investment in Carolina Beverage and realized a gain of \$45 on this investment.

On July 26, 2013, Prospect made a \$2,000 follow-on senior secured debt investment in Spartan Energy Services, Inc., a provider of thru tubing and flow control services to oil and gas companies. The first lien note bears interest in cash at the greater of 10.5% or Libor plus 9.0% and has a final maturity of December 28, 2017.

On July 26, 2013, Prospect made a \$20,000 follow-on secured second lien investment in Royal Adhesives & Sealants, LLC ("Royal"), a producer of proprietary, high-performance adhesives and sealants. The second lien term loan bears interest in cash at the greater of 9.75% or Libor plus 8.5% and has a final maturity of January 31, 2019.

On July 31, 2013, Prospect made a \$5,100 follow-on investment in Coverall North America, Inc., a franchiser of commercial cleaning businesses. The first lien note bears interest in cash at the greater of 11.5% or Libor plus 8.5% and has a final maturity of December 17, 2017.

On July 31, 2013, Royal repaid the \$28,364 subordinated unsecured loan receivable to Prospect.

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### Table of Contents

On July 31, 2013, Cargo Airport Services USA, LLC repaid the \$43,399 loan receivable to Prospect.

On August 1, 2013, Medical Security Card Company, LLC repaid the \$13,214 loan receivable to Prospect.

On August 2, 2013, Prospect made an investment of \$44,100 to purchase 90% of the subordinated notes in CIFIC Funding 2013-III, Ltd.

On August 2, 2013, Prospect provided \$81,273 of debt and \$12,741 of equity financing to support the recapitalization of CP Holdings of Delaware LLC ("CP Holdings"), an energy services company based in western Oklahoma. Through the recapitalization, Prospect acquired a controlling interest in CP Holdings for \$73,009 in cash and 1,918,342 unregistered shares of Prospect's common stock. After the financing, Prospect received repayment of the \$18,991 loan previously outstanding. The \$58,773 first lien note issued to CP Energy Services Inc. bears interest in cash at the greater of 9.0% or Libor plus 7.0% and interest payment in kind of 9.0% and has a final maturity of August 2, 2018. The \$22,500 first lien note issued to CP Well Testing Holding Company LLC bears interest in cash at the greater of 11.0% or Libor plus 9.0% and has a final maturity of August 2, 2018.

On August 9, 2013, Prospect provided \$80,000 in senior secured loans and a senior secured revolving loan facility, of which \$70,000 was funded at closing, for the recapitalization of Matrixx Initiatives, Inc., owner of Zicam, a developer and marketer of OTC cold remedy products under the Zicam brand. The \$35,000 Term Loan A note bears interest in cash at the greater of 7.5% or Libor plus 6.0% and has a final maturity of August 9, 2018. The \$35,000 Term Loan B note bears interest in cash at the greater of 12.5% or Libor plus 11.0% and has a final maturity of August 9, 2018. The \$10,000 senior secured revolver, which was unfunded at closing, bears interest in cash at the greater of 10.0% or Libor plus 8.5% and has a final maturity of February 9, 2014.

On August 15, 2013, Prospect made a \$14,000 follow-on investment in Totes Isotoner Corporation, a designer, distributor and retailer of high quality, branded functional accessories. The second lien term loan bears interest in cash at the greater of 10.75% or Libor plus 9.25% and has a final maturity of January 8, 2018.

On August 30, 2013, Prospect made a \$16,000 follow-on investment in System One Holdings, LLC, a provider of professional staffing services. The first lien note bears interest in cash at the greater of 11.0% or Libor plus 9.5% and has a final maturity of December 31, 2018.

On September 5, 2013, Prospect provided a \$50,382 senior secured term loan to United Bank Card, Inc. (d/b/a Harbortouch), a payments processor. The first lien term loan bears interest in cash at the greater of 11.5% or Libor plus 9.5% and has a final maturity of September 5, 2018.

On September 10, 2013, Prospect made a \$12,500 first lien secured investment in Photonis Technologies SAS, a world leader in the development, manufacture and sale of electro-optic components for the detection and intensification of very faint light sources. The first lien term loan bears interest in cash at the greater of 8.5% or Libor plus 7.5% and has a final maturity of September 18, 2019.

On September 11, 2013, Seaton Corp. repaid the \$13,310 loan receivable to Prospect.

On September 11, 2013, Prospect provided a \$75,000 senior secured term loan to support the recapitalization of American Broadband Holding Company and Cameron Holdings of NC, Inc., a provider of voice, video, and high-speed internet services. The first lien Term Loan B bears interest in cash at the greater of 11.0% or Libor plus 9.75% and has a final maturity of September 30, 2018.

On September 13, 2013, Prospect made an investment of \$36,515 to purchase 83.56% of the subordinated notes in Apidos CLO XV, Ltd.

Table of Contents

On September 19, 2013, Prospect provided \$41,042 of debt and \$6,943 of equity financing to support the recapitalization of MITY Holdings of Delaware Inc. ("Mity"), a designer, manufacturer and seller of multipurpose room furniture and specialty healthcare seating products. The \$22,792 first lien note issued to Mity bears interest in cash at the greater of 9.0% or Libor plus 7.0% and interest payment in kind of 9.0% and has a final maturity of September 19, 2019. The \$18,250 first lien note issued to Mity-Lite, Inc. bears interest in cash at the greater of 10.0% or Libor plus 7.0% and has a final maturity of March 19, 2019.

On September 25, 2013, Prospect made a \$12,000 subordinated secured second lien investment in NCP Finance Limited Partnership, a lender to short term loan providers in the alternative financial services industry. The subordinated secured term loan bears interest in cash at the greater of 11.0% or Libor plus 9.75% and has a final maturity of September 30, 2018.

On September 30, 2013, Prospect made an investment of \$20,945 to purchase 51.02% of the subordinated notes in Galaxy XVI CLO, Ltd.

On September 30, 2013, Prospect sold its investment in ADAPCO, Inc. for net proceeds of \$553, recognizing a realized gain of \$413 on the sale.

On September 30, 2013, Prospect made an \$18,818 follow-on investment in JHH Holdings, Inc., a provider of home healthcare services in Texas. The second lien term loan bears interest in cash at the greater of 11.25% or Libor plus 10.0% and interest payment in kind of 0.5% and has a final maturity of March 30, 2019.

*Equity Issuance*

During the period from July 1, 2013 to September 30, 2013, Prospect sold 21,293,338 shares of its common stock at an average price of \$11.18 per share, and raised \$238,036 of gross proceeds, under the ATM Program. Net proceeds were \$235,037 after commissions to the broker-dealer on shares sold and offering costs.

On July 22, 2013, August 22, 2013 and September 19, 2013, Prospect issued 109,437, 113,610 and 132,597 shares of its common stock in connection with the dividend reinvestment plan, respectively.

*Dividend*

On August 21, 2013, Prospect announced the declaration of monthly dividends in the following amounts and with the following dates:

\$0.110325 per share for January 2014 to holders of record on January 31, 2014 with a payment date of February 20, 2014;

\$0.110350 per share for February 2014 to holders of record on February 28, 2014 with a payment date of March 20, 2014;  
and

\$0.110375 per share for March 2014 to holders of record on March 31, 2014 with a payment date of April 17, 2014.

*Credit Facility*

On August 15, 2013, Prospect announced an increase of \$15,000 in commitments to its credit facility. The lenders have extended commitments of \$567,500 as of September 30, 2013; which was increased to \$587,500 in October 2013 and \$650,000 in December 2013 (see *Recent Developments*).

Table of Contents*Debt Issuance*

During the quarter ended September 30, 2013, Prospect issued \$98,255 in aggregate principal amount of its Prospect Capital InterNotes® for net proceeds of \$96,189, as follows:

<b>Date of Issuance</b>	<b>Principal Amount</b>	<b>Interest Rate Range</b>	<b>Weighted Average Interest Rate</b>	<b>Maturity Date</b>
July 5, 2013 - July 25, 2013	\$ 18,557	4.75% - 5.00%	4.96%	July 15, 2018
August 8, 2013 - August 22, 2013	11,885	5.00%	5.00%	August 15, 2018
September 6, 2013 - September 26, 2013	21,095	5.00%	5.00%	September 15, 2018
August 1, 2013	3,820	5.00%	5.00%	February 15, 2019
August 15, 2013 - August 22, 2013	1,800	5.50%	5.50%	February 15, 2020
July 5, 2013 - July 25, 2013	8,962	5.50% - 5.75%	5.65%	July 15, 2020
August 8, 2013	851	5.50%	5.50%	August 15, 2020
September 6, 2013 - September 26, 2013	4,586	5.50%	5.50%	September 15, 2020
August 1, 2013	1,996	5.75%	5.75%	February 15, 2021
August 15, 2013 - August 22, 2013	940	6.00%	6.00%	August 15, 2028
July 5, 2013 - July 25, 2013	2,960	6.25%	6.25%	July 15, 2031
August 1, 2013 - August 8, 2013	1,102	6.00% - 6.125%	6.09%	August 15, 2031
September 6, 2013 - September 26, 2013	1,127	6.00%	6.00%	September 15, 2033
August 15, 2013 - August 22, 2013	3,372	6.50%	6.50%	August 15, 2038
July 5, 2013 - July 25, 2013	7,337	6.75%	6.75%	July 15, 2043
August 1, 2013 - August 8, 2013	2,707	6.50% - 6.625%	6.57%	August 15, 2043
September 6, 2013 - September 26, 2013	5,158	6.50%	6.50%	September 15, 2043

\$ 98,255

**Investment Holdings**

As of September 30, 2013, Prospect continues to pursue its diversified investment strategy. At September 30, 2013, approximately \$4,553,136 or 156.5% of Prospect's net assets are invested in 129 long-term portfolio investments and CLOs and 5.2% of its net assets are invested in money market funds.

At June 30, 2013, approximately \$4,172,852 or 157.1% of Prospect's net assets are invested in 124 long-term portfolio investments and CLOs and 5.4% of its net assets are invested in money market funds.

During the three months ended September 30, 2013, Prospect originated \$556,843 of new investments, primarily composed of \$312,944 of secured lending to non-control investments, \$144,912 of debt and equity financing to controlled investments, and \$98,987 of subordinated notes in CLOs. Prospect's origination efforts are focused primarily on secured lending, to reduce the risk in the portfolio, investing primarily in first lien loans, and subordinated notes in CLOs, though Prospect also continues to close select junior debt and equity investments. Prospect's annualized current yield was 13.6% and 12.5% as of June 30, 2013 and September 30, 2013, respectively, across all performing interest bearing investments. The decrease in Prospect's current yield is primarily the result of senior secured loan refinancing activity that took place in the leveraged loan market and within its CLO portfolios during the first half of calendar year 2013. Monetization of equity positions that Prospect holds and loans on non-accrual status are not included in this yield calculation. In many of Prospect's portfolio companies it holds equity positions, ranging from minority interests to majority stakes, which it expects over time to contribute to its investment returns. Some of these equity positions include features such as contractual minimum internal rates of returns, preferred distributions, flip structures

Table of Contents

and other features expected to generate additional investment returns, as well as contractual protections and preferences over junior equity, in addition to the yield and security offered by Prospect's cash flow and collateral debt protections.

During the year ended June 30, 2013, Prospect originated \$3,103,217 of new investments. Prospect's origination efforts are focused primarily on secured lending, to reduce the risk in the portfolio, investing primarily in first lien loans, and subordinated notes in CLOs, though Prospect also continues to close select junior debt and equity investments. In addition to targeting investments senior in corporate capital structures with its new originations, Prospect has also increased its origination business mix of third party private equity sponsor owned companies, which tend to have more third party equity capital supporting its debt investments than non-sponsor transactions. Prospect's annualized current yield was 13.9% and 13.6% as of June 30, 2012 and June 30, 2013, respectively, across all performing interest bearing investments. The decrease in Prospect's current yield is primarily due to recent originations being at lower yields than the existing portfolio. Monetization of equity positions that Prospect holds and loans on non-accrual status are not included in this yield calculation. In many of its portfolio companies, Prospect holds equity positions, ranging from minority interests to majority stakes, which it expects over time to contribute to its investment returns. Some of these equity positions include features such as contractual minimum internal rates of returns, preferred distributions, flip structures and other features expected to generate additional investment returns, as well as contractual protections and preferences over junior equity, in addition to the yield and security offered by its cash flow and collateral debt protections.

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

As of September 30, 2013, Prospect owns controlling interests in AIRMALL USA, Inc. ("Airmall"), Ajax Rolled Ring & Machine, Inc. ("Ajax"), APH Property Holdings, LLC ("APH"), AWCNC, LLC, Borga, Inc. ("Borga"), CCPI Holdings, Inc., CP Holdings, Credit Central Holdings of Delaware, LLC, Energy Solutions Holdings, Inc. (f/k/a Gas Solutions Holdings, Inc.) ("Energy Solutions"), First Tower Holdings of Delaware, LLC ("First Tower Delaware"), The Healing Staff, Inc. ("THS"), Manx Energy, Inc. ("Manx"), MITY Holdings of Delaware Inc. ("Mity"), Nationwide Acceptance Holdings, LLC, NMMB Holdings, Inc., R-V Industries, Inc. ("R-V"), Valley Electric Holdings I, Inc. ("Valley Electric") and Wolf Energy Holdings, Inc. ("Wolf"). Prospect also own an affiliated interest in BNN Holdings Corp. (f/k/a Biotronic NeuroNetwork), Boxercraft Incorporated ("Boxercraft") and Smart, LLC.

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Table of Contents

The following is a summary of Prospect's investment portfolio by level of control at September 30, 2013 and June 30, 2013, respectively:

Level of Control	September 30, 2013				June 30, 2013			
	Cost	Percent of Portfolio	Fair Value	Percent of Portfolio	Cost	Percent of Portfolio	Fair Value	Percent of Portfolio
Control	\$ 970,400	20.9%	\$ 947,572	20.8%	\$ 830,151	19.5%	\$ 811,634	19.5%
Affiliate	49,324	1.1%	37,425	0.8%	49,189	1.2%	42,443	1.0%
Non-control/Non-affiliate	3,622,564	78.0%	3,568,139	78.4%	3,376,438	79.3%	3,318,775	79.5%
Total Portfolio	\$ 4,642,288	100.0%	\$ 4,553,136	100.0%	\$ 4,255,778	100.0%	\$ 4,172,852	100.0%

The following is Prospect's investments in interest bearing securities presented by type of security at September 30, 2013 and June 30, 2013, respectively:

Type of Investment	September 30, 2013				June 30, 2013			
	Cost	Percent of Portfolio	Fair Value	Percent of Portfolio	Cost	Percent of Portfolio	Fair Value	Percent of Portfolio
Revolving Line of Credit	\$ 13,238	0.3%	\$ 12,705	0.3%	\$ 9,238	0.2%	\$ 8,729	0.2%
Senior Secured Debt	2,524,504	54.4%	2,444,947	53.7%	2,262,327	53.1%	2,207,091	52.8%
Subordinated Secured Debt	1,032,693	22.3%	988,581	21.8%	1,062,386	25.0%	1,024,901	24.6%
Subordinated Unsecured Debt	130,444	2.8%	119,165	2.6%	88,470	2.1%	88,827	2.1%
CLO Debt	27,776	0.6%	29,320	0.6%	27,667	0.7%	28,589	0.7%
CLO Residual Interest	749,019	16.1%	777,678	17.1%	660,619	15.5%	658,086	15.8%
Preferred Stock	24,904	0.5%	4,827	0.1%	25,016	0.6%	14,742	0.4%
Common Stock	137,221	2.9%	141,910	3.1%	117,678	2.7%	108,494	2.6%
Membership Interests	216	0.0%	3,890	0.1%	216	0.0%	492	0.0%
Overriding Royalty Interests		%		%		%		%
Net Profits Interests		%	20,732	0.5%		%	20,959	0.5%
Escrows Receivable		%	2,031	0.0%		%	4,662	0.1%
Warrants	2,273	0.1%	7,350	0.1%	2,161	0.1%	7,280	0.2%
Total Portfolio	\$ 4,642,288	100.0%	\$ 4,553,136	100.0%	\$ 4,255,778	100.0%	\$ 4,172,852	100.0%

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Table of Contents

The following is Prospect's investments in interest bearing securities presented by type of security at September 30, 2013 and June 30, 2013, respectively:

Type of Investment	Cost	September 30, 2013		Percent of Debt Securities	Cost	June 30, 2013		Percent of Debt Securities
		Percent of Debt Securities	Fair Value			Percent of Debt Securities	Fair Value	
First Lien	\$ 2,537,742	56.7%	\$ 2,457,652	56.2%	\$ 2,271,565	55.3%	\$ 2,215,820	55.2