

Equity Research

Prospect Capital Corporation

PSEC: The More Things Change, The More They Stay The Same

Underperform

Sector: BDC
Overweight

Company Note

• **The More Things Change, The More They Stay The Same—Reiterate Underperform on the Shares.** Since mid-January, PSEC stock has seen a substantial amount of change (or perhaps volatility is the better word) including: (1) a sizeable (24%) price decline, while the S&P 500 and BDC index declined 3.6%/10.1% respectively; (2) a 36% reversal of that decline while the S&P & BDC index increased 11.5%/17.3% respectively; and (3) a meaningful increase in management ownership of shares (up roughly 22MM shares or 6.3% of shares outstanding from 1.8% at 9/30/15). These changes are non-negative, in our opinion, *particularly when one considers the significant insider ownership.* That said, there is one major sticking point that remains the same—which in our view is a major point of concern amongst institutional investors. **PSEC continues to hold its CLOs at substantial premiums (30+pts in some cases) relative to other BDCs despite having similar collateral.** In the event PSEC marked its CLO collateral in line with its BDC peers that also own CLO collateral—we estimate that PSEC shareholders would experience roughly \$0.82/share losses. What's more, we believe potential investor concerns surrounding PSEC's CLO valuation process/marks may lead to near-term selling—*thus, we reiterate our Underperform rating* as well as our \$5.00-\$5.50/share valuation range. Now, the clear risk to our thesis is that distressed energy/cyclical loan marks—and by extension CLO equity—rally meaningfully. That said, we believe there are several other BDCs where investors may focus that provide the same amount of upside potential and hold potentially less credit risk.

• **PSEC CLO Valuation Concerns Persist.** Our concerns related to PSEC's CLO securities are based on three items: (1) PSEC's high CLO FVs (as a % of par) when compared to other BDC holders—PSEC holds its CLOs at an 18pt premium relative to other BDCs in aggregate; (2) sizeable CLO valuation premiums relative to other managers that own CLO control stakes—relative to Eagle Point (ECC), another well respected control equity CLO investor, PSEC's CLOs are carried at a 21pt premium...despite both managers investing in very similar collateral, (3) those CLOs with the highest risk of violating OC tests (i.e. shutting off cash flows to the equity) are still held at premiums to peers—if we segment risk as it relates to an OC test trip, we see that PSEC is valuing its "highest risk" CLOs about 21-37pts higher than its peers.

• **Share repurchases appear beneficial on the surface, but shareholders will likely need to wait and see the effects.** Over the last several months, PSEC management has purchased over \$100MM in PSEC stock. While this is a "non-negative," we believe the real question of incentive alignment should be answered by management's actions over the next several months.

Valuation Range: \$5.00 to \$5.50

PSEC' valuation range reflects our target NAV multiple of 0.50-0.55x based on perceived concerns related to PSEC's CLO marks which remain significant premiums to peers. Risks to our valuation range include a significant deterioration in credit quality, dilutive equity issuance, or an extended period of capital markets illiquidity.

Investment Thesis:

We rate PSEC Underperform. We believe that there are significant credit risks not currently accounted for in share prices.

Please see page 13 for rating definitions, important disclosures and required analyst certifications
All estimates/forecasts are as of 04/06/16 unless otherwise stated.

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| | 2015A | | 2016E | | 2017E | |
|------------------|--------|----------|-------|-------|--------|-------|
| | | | Curr. | Prior | Curr. | Prior |
| CASH EPS | | | | | | |
| Q1 (Sep.) | \$0.28 | \$0.26 A | NC | | \$0.24 | NC |
| Q2 (Dec.) | 0.26 | 0.28 A | NC | | 0.24 | NC |
| Q3 (Mar.) | 0.24 | 0.25 | NC | | 0.24 | NC |
| Q4 (June) | 0.25 | 0.24 | NC | | 0.24 | NC |
| FY | \$1.03 | \$1.03 | NC | | \$0.95 | NC |
| CY | \$1.10 | NE | | | NE | |
| FY P/E | 7.0x | 7.0x | | | 7.6x | |
| Rev.(MM) | \$791 | \$782 | | | \$729 | |

Source: Company Data, Wells Fargo Securities, LLC estimates, and Reuters
NA = Not Available, NC = No Change, NE = No Estimate, NM = Not Meaningful
V = Volatile, * = Company is on the Priority Stock List

Cash EPS is net operating income which excludes realized and unrealized gains and losses.

| | |
|----------------------------------|--------------|
| Ticker | PSEC |
| Price (04/05/2016) | \$7.17 |
| 52-Week Range: | \$5-9 |
| Shares Outstanding: (MM) | 341.2 |
| Market Cap.: (MM) | \$2,446.4 |
| S&P 500: | 2,045.17 |
| Avg. Daily Vol.: | 2,692,390 |
| Dividend/Yield: | \$1.32/18.4% |
| LT Debt: (MM) | \$2,749.8 |
| LT Debt/Total Cap.: | 44.5% |
| ROE: | 10.0% |
| 3-5 Yr. Est. Growth Rate: | 0.0% |
| CY 2016 Est. P/C. EPS-to-Growth: | NM |
| Last Reporting Date: | 02/09/2016 |
| | After Close |

Source: Company Data, Wells Fargo Securities, LLC estimates, and Reuters

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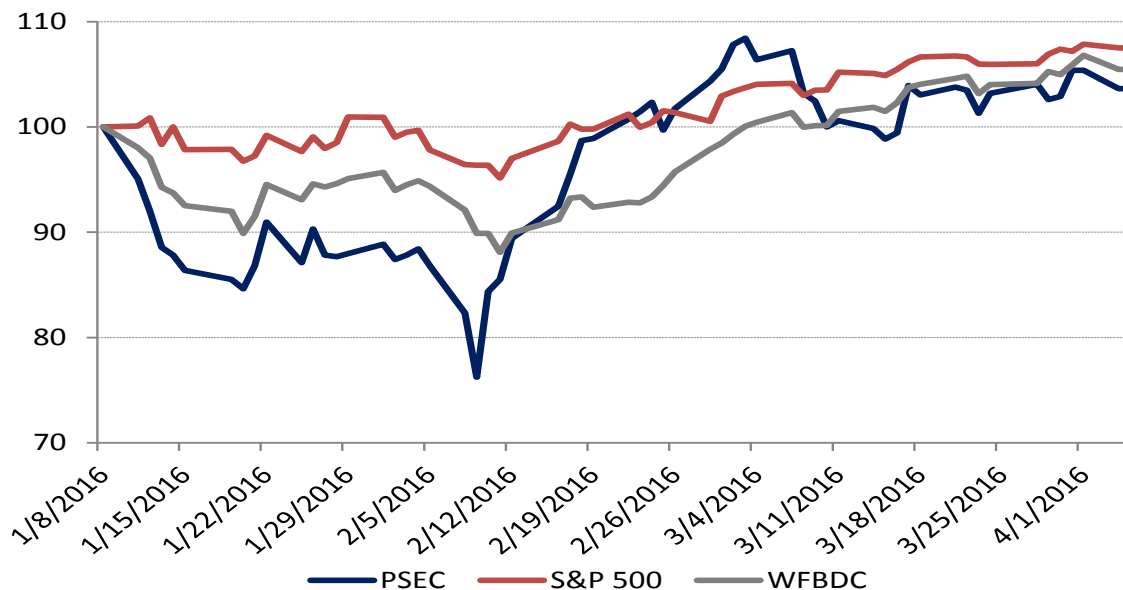
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Together we'll go far



PSEC CLO Valuation Concerns Persist. Since mid-January we've seen significant volatility in PSEC shares, dipping ~24% before a ~42% rally, with shares ultimately appreciating about 3%—the S&P and BDC index is up 7.5%/5.5% since 1/11/16—driven by both market volatility as well as sizeable shareholder repurchases. Notably, the share repurchases by PSEC have been considerable by sheer dollars allocated as PSEC's founder/CEO purchased over \$49MM worth of shares YTD and over \$98MM over the last 6 months. Yet, despite these changes, PSEC stock price sits at \$7.18/share or roughly 4% higher than it was on 1/8/16. See **Figure 1**. What's more, PSEC continues to hold its CLOs at a very sizeable valuation premium (~76% of par) relative to other BDCs who currently hold their collateral at much lower values (~54% of par). It brings to mind the quote, "the more things change, the more they stay the same". And, in light of that quote, we remain steadfast in our Underperform thesis on PSEC as we believe the mark to market/valuation process concerns likely outweigh the upside present in PSEC shares.

Figure 1. PSEC Stock Performance (indexed to 100) (as of 4/4/16)



Source: FactSet and Wells Fargo Securities, LLC

In short, our concerns related to PSEC's CLO securities are based on three items: (1) PSEC's high CLO FVs (as a % of par) when compared to other BDC holders in aggregate—PSEC holds its CLOs at an 18 pt premium relative to other BDCs in aggregate; (2) sizeable CLO valuation premiums relative to other managers that own CLO control stakes—relative to Eagle Point (ECC), another well respected control equity CLO investor, PSEC's CLOs are carried at a 21pt premium...despite both managers investing in very similar collateral; (3) those CLOs with the highest risk of violating OC tests (i.e. shutting off cash flows to the equity) are still held at premiums to peers—if we segment risk as it relates to an OC test trip, we find that PSEC is valuing its "highest risk" CLOs by 21-37pts higher relative to BDC peers.

Concern #1 – PSEC Continues To Mark Their CLOs at High FVs (as a % of par) Relative to the BDC Industry Overall

Over the last several quarters we have begun to see some divergence in CLO marks across the space, particularly when it comes to PSEC. In 4Q14, PSEC's CLOs were marked around 8% higher than the rest of the BDC space. Now, while this valuation disparity was noticeable, the market generally took management comments at face value that the value of the call is worth some price premium. Recall, when CLO liability spreads decline, PSEC (through control of the equity) holds the option to effectively "refinance" the CLO provided that the CLO assets at that moment in time are worth MORE than the principal liabilities. In early 2014, as the CLO collateral (i.e. loans) exceeded the value of the underlying CLO liabilities (AAA, mezz notes outstanding), there was likely an argument that allowed PSEC to hold their CLOs at a slight premium to the rest of the group...as there was actual NAV value at the underlying CLO that allowed the CLO equity to refinance.

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Now, let's fast forward to today. Since 2014, broad leveraged loan declines have led to meaningful declines in CLO NAVs—*simply a result of the high levels of leverage embedded in the CLO structure (10x)*. What's more, if the CLO had a high amount of exposure to more stressed loans (i.e., energy / metals / etc.), the markdowns to the CLO Equity are often even more acute or pronounced (assuming the collateral is marked correctly). PSEC's CLOs are clearly not immune from NAV declines as 23 out of 38 CLOs traded at a negative NAV, as of 3/31/16. See **Figure 2**.

Said differently, as a result of broad leveraged loan price declines and exposure to distressed energy/metals-industry loans, the value of the collateral within PSEC's CLOs (i.e., the loans) is now LESS than the principal value of its liabilities. What's more, several of PSEC's CLOs have DEEPLY NEGATIVE NAVs including: (1) -77% for the Halcyon 2014-1 CLO; (2) -57% for the Halcyon 2014-2 CLO; and (3) -52% for the Washington Mill CLO...among several others.

Figure 2. PSEC CLO NAVs (as of 3/31/16) (\$ in Thousands)

| CLO Position | 12/31/2015 | | | 12/31/2015 | NAV |
|-------------------------------------------|------------------|------------------|------------------|----------------|------------|
| | Par | Cost | Fair Value | FV as % of Par | |
| Halcyon Loan Advisors Funding 2014-1 Ltd. | 24,500 | 19,723 | 18,826 | 76.8% | -77% |
| Halcyon Loan Advisors Funding 2014-2 Ltd. | 41,164 | 32,877 | 31,761 | 77.2% | -57% |
| Washington Mill CLO Ltd. | 22,600 | 19,327 | 17,231 | 76.2% | -53% |
| Halcyon Loan Advisors Funding 2013-1 Ltd. | 40,400 | 33,466 | 34,394 | 85.1% | -41% |
| Cent CLO 21 Limited | 48,528 | 40,592 | 36,245 | 74.7% | -34% |
| Mountain View CLO 2013-1 Ltd. | 43,650 | 35,469 | 35,326 | 80.9% | -34% |
| Brookside Mill CLO Ltd. | 26,000 | 20,620 | 20,596 | 79.2% | -32% |
| Babson CLO Ltd. 2014-III | 52,250 | 45,695 | 41,377 | 79.2% | -31% |
| Sudbury Mill CLO Ltd. | 28,200 | 21,605 | 19,601 | 69.5% | -27% |
| HarbourView CLO VII, Ltd. | 19,025 | 14,542 | 13,129 | 69.0% | -24% |
| Halcyon Loan Advisors Funding 2012-1 Ltd. | 23,188 | 19,097 | 21,150 | 91.2% | -22% |
| Voya CLO 2014-1, Ltd. | 32,383 | 27,246 | 25,687 | 79.3% | -22% |
| Octagon Investment Partners XVIII, Ltd. | 28,200 | 21,084 | 21,386 | 75.8% | -15% |
| Cent CLO 20 Limited | 40,275 | 34,219 | 28,675 | 71.2% | -15% |
| Galaxy XVII CLO, Ltd. | 39,905 | 32,104 | 28,571 | 71.6% | -11% |
| Cent CLO 17 Limited | 24,870 | 19,561 | 18,240 | 73.3% | -8% |
| Apidos CLO XV | 36,515 | 32,554 | 26,304 | 72.0% | -6% |
| Jefferson Mill CLO Ltd. | 19,500 | 17,027 | 13,682 | 70.2% | -6% |
| Symphony CLO XIV Ltd. | 49,250 | 41,284 | 36,281 | 73.7% | -6% |
| CIFC Funding 2014-IV Investor, Ltd. | 41,500 | 33,081 | 30,264 | 72.9% | -4% |
| Galaxy XVI CLO, Ltd. | 24,575 | 19,763 | 17,885 | 72.8% | -4% |
| Halcyon Loan Advisors Funding 2015-3 Ltd. | 39,598 | 38,786 | 37,099 | 93.7% | -3% |
| Apidos CLO XII | 44,063 | 36,216 | 32,126 | 72.9% | 0% |
| LCM XIV Ltd. | 30,500 | 24,013 | 23,257 | 76.3% | 2% |
| Octagon Investment Partners XV, Ltd. | 32,921 | 27,092 | 26,460 | 80.4% | 8% |
| Voya CLO 2012-3, Ltd. | 46,632 | 35,732 | 33,757 | 72.4% | 9% |
| Voya CLO 2012-4, Ltd. | 40,613 | 31,502 | 30,668 | 75.5% | 11% |
| Voya CLO 2012-2, Ltd. | 38,070 | 28,929 | 28,465 | 74.8% | 12% |
| Apidos CLO XI | 38,340 | 30,547 | 27,324 | 71.3% | 14% |
| CIFC Funding 2013-III, Ltd. | 44,100 | 33,696 | 29,800 | 67.6% | 15% |
| Mountain View CLO IX Ltd. | 47,830 | 46,175 | 42,110 | 88.0% | 17% |
| Galaxy XV CLO, Ltd. | 39,275 | 29,703 | 28,831 | 73.4% | 18% |
| CIFC Funding 2013-IV, Ltd. | 45,500 | 34,608 | 33,242 | 73.1% | 18% |
| Apidos CLO IX | 23,525 | 20,400 | 20,618 | 87.6% | 18% |
| Apidos CLO XXII | 31,350 | 27,440 | 24,338 | 77.6% | 25% |
| Madison Park Funding IX, Ltd. | 31,110 | 23,043 | 23,580 | 75.8% | 30% |
| Symphony CLO IX Ltd. | 45,500 | 33,587 | 31,970 | 70.3% | 34% |
| Symphony CLO XV, Ltd. | 50,250 | 45,302 | 38,901 | 77.4% | 51% |
| Total CLO Portfolio | 1,375,655 | 1,127,707 | 1,049,157 | 76.3% | -7% |

More Potential for Credit Stress

Less Potential for Credit Stress

Source: Company Reports and Wells Fargo Securities, LLC

Now, you would think that with (1) a pronounced decline in other BDC's CLO investments and/or (2) continued loan market volatility that PSEC would (as of 12/31/15) be more willing to write down the value of its CLO securities simply in line with the rest of the BDC space that holds similar "control" collateral. Unfortunately, this was not the case. In fact, PSEC again pointed to the "value of the call" as a justification for their CLO marks (See **Figure 3**)—again, this is with nearly 61% of PSEC's CLO collateral trading at a negative

NAV. In short, PSEC notes that because they “own the call” and can wait years to call a transaction in an optimal fashion this affords some ability to make the CLO equity at a premium. That sounds right doesn’t it? The only problem is that the value of the call option (and in this case PSEC’s CLO equity) is more likely driven on whether or not you can actually call the security—and in this environment we believe PSEC would not.

Figure 3. Quote from PSEC Press Release (as of 2/9/16)

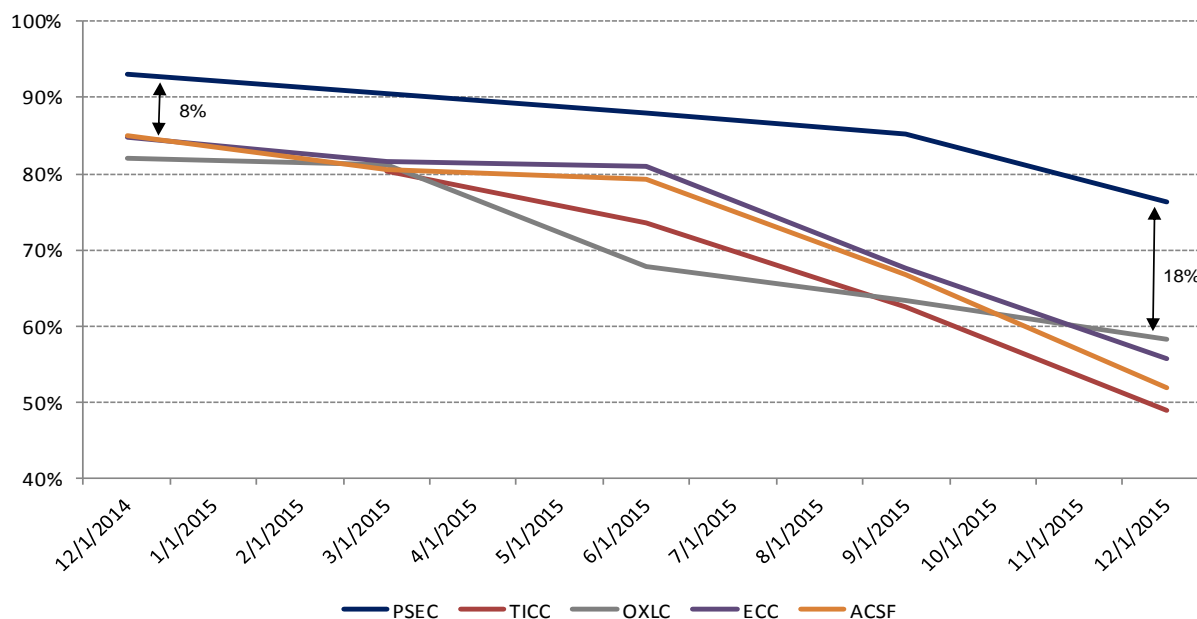
“As a majority holder, Prospect controls the ability to call a transaction in Prospect’s sole discretion in the future. Prospect has the option of waiting years to call a transaction in an optimal fashion rather than when loan asset valuations might be temporarily low.”

Source: Company reports and Wells Fargo Securities, LLC

Let’s put it this way: Imagine that investors currently own a 10% bond that is callable at 108. Now, let’s say that interest rates rise to 12% and the underlying credit quality of the paper declines slightly (likely making it even harder for the bond to refi). In this scenario can an investor still mark that bond at 108 simply because “*it has the option of waiting years*” to eventually receive that call—should rates/credit quality rebound? Our guess is...probably not. In our view, the similarities to PSEC’s logic are similar in that...Today, PSEC is unable to call its CLO securities as a result of low NAV, but PSEC is still holding these CLOs at meaningful premiums to the BDC peer group because they “have the option of waiting” for an optimal time to call the deal—even though that option likely holds very little value today.

Interestingly enough, if we look at PSEC’s CLO values relative to other BDCs who hold CLOs over time (*many of whom also own control CLO stakes*), we will see that today PSEC holds their CLO collateral at an 18% premium to other BDC peers. See **Figure 4**. In our view, large valuation disparities like the ones outlined below do get rectified over time—as *this is simply not sustainable*.

Figure 4. CLO Marks comparisons (as of 12/31/15)



Source: Company Reports and Wells Fargo Securities, LLC

Concern #2 – PSEC continues to hold its CLOs at sizeable valuation premiums relative to other managers that own CLO control stakes

While we have mentioned that PSEC held its CLOs at valuation premiums relative to peers, this section puts PSEC next to a manager that, we believe, approaches the CLO market in a very similar way. Recall, Eagle Point Credit Company is a closed end fund that exclusively focuses on CLO investments. This fund is part of the broader Eagle Point platform, which also manages institutional capital invested in the CLO asset class. Often, Eagle Point applies substantial rigor as it structures/originates primary CLO equity transactions—and often

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implements many of the “bells and whistles” PSEC espouses in their CLO investment strategy (controlling the call, etc). Yet despite very similar collateral (control CLO equity stakes), we see that PSEC’s investment marks relative to ECC’s could not be more different. As evidenced in **Figure 5**, PSEC marked its CLOs at 93.1% vs. Eagle point’s CLOs at 84.7% as of 12/31/14; however, as credit volatility mounted in the levered loan space (particularly in energy related loans), ECC chose to mark their CLO securities down to 55.6% of par relative to PSEC who only marked their CLOs down to 76.3%. In short, ECC (despite having very similar collateral) chose to markdown its investments by 29.1 pts while PSEC only marked the securities down by 17.1 pts. Putting it into numeric terms today, this means that PSEC’s management benefited from an additional \$290MM of AUM (and related fees) than they otherwise would have had they marked their CLOs in line with Eagle Point’s at the 55% of par level.

Figure 5. PSEC vs. ECC CLO Portfolio Comparison (as of 12/31/15)

| ECC CLO Portfolio | | | PSEC CLO Portfolio | | |
|--------------------------------------|------------------|------------|-------------------------------------------|------------------|------------|
| CLO Position | Fair Value Marks | | CLO Position | Fair Value Marks | |
| | 12/31/2014 | 12/31/2015 | | 12/31/2014 | 12/31/2015 |
| Apidos CLO XIV | 89.8% | 57.7% | Apidos CLO IX | 92.4% | 87.6% |
| Avery Point V CLO | 81.8% | 30.9% | Apidos CLO XI | 89.4% | 71.3% |
| Babson CLO 2013-II | 85.6% | 54.3% | Apidos CLO XII | 92.6% | 72.9% |
| BlueMountain CLO 2013-2 | 88.7% | 60.2% | Apidos CLO XV | 96.4% | 72.0% |
| Battalion CLO IX | NA | 73.8% | Apidos CLO XXII | NA | 77.6% |
| CIFC Funding 2013-I | 87.8% | 55.2% | Babson CLO Ltd. 2014-III | 96.3% | 79.2% |
| CIFC Funding 2013-II | 91.5% | 55.9% | Brookside Mill CLO Ltd. | 94.1% | 79.2% |
| CIFC Funding 2014 | 81.8% | 51.7% | Cent CLO 17 Limited | 93.1% | 73.3% |
| CIFC Funding 2014 | 76.0% | 48.5% | Cent CLO 20 Limited | 94.5% | 71.2% |
| CIFC Funding 2014-III | NA | 56.2% | Cent CLO 21 Limited | 92.1% | 74.7% |
| CIFC Funding 2014-IV | 84.1% | 50.6% | CIFC Funding 2013-III, Ltd. | 94.4% | 67.6% |
| CIFC Funding 2015-III | NA | 72.7% | CIFC Funding 2013-IV, Ltd. | 87.4% | 73.1% |
| Cutwater 2015-I | NA | 68.7% | CIFC Funding 2014-IV Investor, Ltd. | 91.3% | 72.9% |
| Flagship CLO VIII | 85.4% | 41.2% | Galaxy XV CLO, Ltd. | 87.4% | 73.4% |
| Flagship CLO VIII | 79.5% | 35.2% | Galaxy XVI CLO, Ltd. | 88.0% | 72.8% |
| Galaxy XVIII CLO | 70.7% | 28.5% | Galaxy XVII CLO, Ltd. | 87.2% | 71.6% |
| GoldenTree Loan Opportunities VIII | NA | 56.4% | Halcyon Loan Advisors Funding 2012-1 Ltd. | 98.6% | 91.2% |
| Halcyon Loan Advisors Funding 2014-3 | 89.8% | 35.4% | Halcyon Loan Advisors Funding 2013-1 Ltd. | 100.1% | 85.1% |
| Marathon CLO VI | 100.8% | 59.5% | Halcyon Loan Advisors Funding 2014-1 Ltd. | 93.6% | 76.8% |
| Marathon CLO VII | 92.0% | 57.4% | Halcyon Loan Advisors Funding 2014-2 Ltd. | 95.6% | 77.2% |
| Marathon CLO VIII | NA | 84.8% | Halcyon Loan Advisors Funding 2015-3 Ltd. | NA | 93.7% |
| Octagon Investment Partners XIV | 73.6% | 41.7% | HarbourView CLO VII, Ltd. | NA | 69.0% |
| Octagon Investment Partners XIV | 72.1% | 39.6% | Jefferson Mill CLO Ltd. | NA | 70.2% |
| Octagon Investment Partners XIX | 83.8% | 47.1% | LCM XIV Ltd. | 90.7% | 76.3% |
| Octagon Investment Partners XVII | 88.0% | 43.0% | Madison Park Funding IX, Ltd. | 84.5% | 75.8% |
| Octagon Investment Partners XX | 89.4% | 55.6% | Mountain View CLO 2013-I Ltd. | 96.9% | 80.9% |
| OHA Credit Partners IX | 82.3% | 49.1% | Mountain View CLO IX Ltd. | NA | 88.0% |
| Regatta III Funding | 78.4% | 36.0% | Octagon Investment Partners XV, Ltd. | 96.1% | 80.4% |
| Sheridan Square CLO | 83.6% | 71.2% | Octagon Investment Partners XVII, Ltd. | NA | 75.8% |
| Symphony CLO XII | 88.2% | NA | Sudbury Mill CLO Ltd. | 89.6% | 69.5% |
| THL Credit Wind River 2013-2 CLO | 80.2% | 36.4% | Symphony CLO IX Ltd. | 93.5% | 70.3% |
| THL Credit Wind River 2013-2 CLO | 37.8% | 53.4% | Symphony CLO XIV Ltd. | 96.1% | 73.7% |
| THL Credit Wind River 2014-3 CLO | 89.8% | 70.3% | Symphony CLO XV, Ltd. | 97.1% | 77.4% |
| Voya CLO 2014-4 | 87.9% | 55.2% | Voya CLO 2012-2, Ltd. | 89.6% | 74.8% |
| Zais CLO 3 | NA | 51.0% | Voya CLO 2012-3, Ltd. | 89.6% | 72.4% |
| Total CLO Portfolio | 84.7% | 55.6% | Voya CLO 2012-4, Ltd. | 94.1% | 75.5% |
| | | | Voya CLO 2014-1, Ltd. | 98.3% | 79.3% |
| | | | Washington Mill CLO Ltd. | 95.0% | 76.2% |
| | | | | 93.1% | 76.3% |

As of 12/31/15, PSEC was holding their overall CLO portfolio over 20 points higher than ECC, despite the two CLO portfolio having similar underlying asset composition.

Source: Company Reports and Wells Fargo Securities, LLC

PSEC may say, “well, our CLOs are simply just better than Eagle Point’s” to justify its valuation premium; however, as investors start to compare a few data sets it’s possible that they may find this not to be the case. Now, let’s be clear, we aren’t saying that PSEC’s CLO collateral is necessarily bad, there are opportunities for upside potential in many CLO securities in the event of market deflation (provided they were marked appropriately in the first place). What is simply stated here is that there is the possibility that PSEC’s CLO collateral is just “not good enough” to justify a 21pt+ price premium to ECC’s collateral. We’ll look at this two ways...

NAV / Adjusted NAV. To quell the complaints we would get if we just compared NAVs, we decided to look at PSEC/ECC's CLOs on both a NAV / Adjusted NAV basis. Recall, the adjusted NAV concept effectively tries to help investors differentiate between CLO NAV losses caused by technical dislocations vs. actual credit problems. Think about it this way. In today's environment, it is the stressed loans below 75% (particularly oil and gas) that will likely generate losses/defaults within the CLO structure. Said differently, if a loan traded down from 99 to 95, that likely does not institute significant credit risk as it may have been impacted by market technical forces (fund flows / etc), thus we'd want to help investors determine how much of a CLO's NAV is determined by "true credit risk" vs. "technical risk" forced. To measure this concept, we believe it is important to take a look at the CLO on an "adjusted NAV" basis. To make an adjusted NAV calculation, this assumes that (1) loans in the CLO trading above 85% of par would eventually "pull to par", (2) loans in the CLO trading at 75%-85% of par would be carried at 80% of par—assuming a loss of 20%, and (3) loans in the CLO trading at 75% of par or lower would be carried at 65%—assuming a 35% loss rate. In **Figure 6**, we break out the NAV and Adjusted NAV for both ECC and PSEC. Interestingly enough, we see that PSEC/ECC's adjusted NAVs are relatively close (30% for ECC vs. 32% for PSEC) potentially implying that the true underlying credit risk (i.e. exposure to truly stressed loans) is very similar for both ECC/PSEC CLOs—yet PSEC still holds their CLOs at a 21pt premium to Eagle Point.

Figure 6. PSEC vs. ECC CLO NAV Comparison (as of 3/31/16)

| ECC CLO Portfolio | | | PSEC CLO Portfolio | | |
|--------------------------------------|---------------|--------------|-------------------------------------------|--------------|--------------|
| CLO Position | NAV | Adj. NAV | CLO Position | NAV | Adj. NAV |
| Halcyon Loan Advisors Funding 2014-3 | -71.8% | -4.0% | Halcyon Loan Advisors Funding 2014-1 Ltd. | -77.3% | -10.3% |
| Galaxy XVIII CLO | -44.9% | 3.2% | Washington Mill CLO Ltd. | -52.8% | -0.4% |
| Avery Point V CLO | -39.5% | 7.2% | Brookside Mill CLO Ltd. | -31.9% | 9.0% |
| Flagship CLO VIII | -29.6% | 12.1% | Sudbury Mill CLO Ltd. | -27.3% | 10.9% |
| Flagship CLO VIII | -29.6% | 12.1% | Halcyon Loan Advisors Funding 2014-2 Ltd. | -57.2% | 12.1% |
| Regatta III Funding | -34.2% | 15.6% | Mountain View CLO 2013-I Ltd. | -33.5% | 14.6% |
| Octagon Investment Partners XIV | -22.4% | 17.0% | HarbourView CLO VII, Ltd. | -24.0% | 18.6% |
| Octagon Investment Partners XIV | -22.4% | 17.0% | Cent CLO 21 Limited | -33.9% | 19.6% |
| Octagon Investment Partners XVII | -18.7% | 18.6% | Symphony CLO XIV Ltd. | -5.7% | 21.9% |
| Marathon CLO VI | -41.3% | 19.5% | Halcyon Loan Advisors Funding 2013-1 Ltd. | -40.8% | 22.3% |
| Octagon Investment Partners XIX | -12.0% | 22.3% | Voya CLO 2014-1, Ltd. | -22.0% | 22.5% |
| CIFC Funding 2013-II | -12.6% | 25.7% | Galaxy XVII CLO, Ltd. | -11.4% | 25.0% |
| Babson CLO 2013-II | -14.2% | 26.6% | Octagon Investment Partners XVIII, Ltd. | -15.4% | 28.1% |
| Marathon CLO VII | -14.0% | 28.0% | Galaxy XVI CLO, Ltd. | -3.6% | 28.6% |
| CIFC Funding 2014 | -7.7% | 29.6% | Babson CLO Ltd. 2014-III | -30.6% | 29.3% |
| CIFC Funding 2014 | -7.7% | 29.6% | Apidos CLO XII | -0.2% | 31.2% |
| THL Credit Wind River 2013-2 CLO | -1.2% | 29.7% | Halcyon Loan Advisors Funding 2012-1 Ltd. | -22.4% | 32.3% |
| THL Credit Wind River 2013-2 CLO | -1.2% | 29.7% | Apidos CLO XV | -6.4% | 33.4% |
| Sheridan Square CLO | -5.5% | 29.9% | CIFC Funding 2014-IV Investor, Ltd. | -4.0% | 33.6% |
| Octagon Investment Partners XX | -4.1% | 30.6% | Cent CLO 20 Limited | -14.6% | 33.7% |
| Zais CLO 3 | -27.0% | 32.8% | Jefferson Mill CLO Ltd. | -6.1% | 38.1% |
| CIFC Funding 2014-IV | -4.0% | 33.6% | Octagon Investment Partners XV, Ltd. | 7.6% | 39.1% |
| Marathon CLO VIII | -2.8% | 36.8% | Voya CLO 2012-3, Ltd. | 9.5% | 39.5% |
| Voya CLO 2014-4 | -9.2% | 36.9% | Cent CLO 17 Limited | -7.5% | 39.7% |
| Apidos CLO XIV | 2.4% | 37.4% | LCM XIV Ltd. | 2.3% | 40.2% |
| Battalion CLO IX | -0.3% | 39.6% | Galaxy XV CLO, Ltd. | 17.6% | 41.3% |
| BlueMountain CLO 2013-2 | 4.7% | 43.3% | Voya CLO 2012-2, Ltd. | 11.7% | 41.3% |
| CIFC Funding 2013-I | 5.3% | 43.7% | CIFC Funding 2013-III, Ltd. | 14.5% | 41.7% |
| GoldenTree Loan Opportunities VIII | 3.9% | 44.2% | Voya CLO 2012-4, Ltd. | 10.9% | 42.1% |
| CIFC Funding 2014-III | 15.3% | 46.7% | Halcyon Loan Advisors Funding 2015-3 Ltd. | -3.4% | 42.9% |
| OHA Credit Partners IX | 11.9% | 46.8% | Apidos CLO XI | 13.9% | 43.0% |
| Cutwater 2015-I | -1.8% | 52.5% | CIFC Funding 2013-IV, Ltd. | 18.2% | 47.0% |
| THL Credit Wind River 2014-3 CLO | 23.2% | 62.3% | Mountain View CLO IX Ltd. | 17.3% | 48.3% |
| CIFC Funding 2015-III | 33.3% | 62.5% | Apidos CLO IX | 18.4% | 49.1% |
| Total Portfolio: | -11.2% | 30.0% | Symphony CLO IX Ltd. | 34.2% | 53.9% |
| | | | Madison Park Funding IX, Ltd. | 30.0% | 56.7% |
| | | | Symphony CLO XV, Ltd. | 50.5% | 59.5% |
| | | | Apidos CLO XXII | 25.3% | 60.4% |
| | | | Total Portfolio: | -6.6% | 32.6% |

With the adjusted NAVs being very close, we believe that the true underlying credit risk is likely very similar.

Source: Company Reports and Wells Fargo Securities, LLC

Oil & Gas Exposure / Loans Below 80% of Par. A second comparison between PSEC/ECC CLOs looks at each CLO portfolio's exposure to oil and gas loans as well as loans below 80 (a commonly used measure to identify stress). As evidenced in **Figure 7**, both ECC/PSEC CLOs have roughly 4.5% exposure to oil & gas loans as well as 10% exposure to loans below 80% of par. Again, in our view, this makes it hard to justify why PSEC's CLOs deserve a 21+pt premium to Eagle Point's as of 12/31/15.

Figure 7. PSEC vs. ECC CLO Oil and Gas / Loan Below 80 Comparison (as of 3/31/16)

| ECC CLO Portfolio | | | PSEC CLO Portfolio | | |
|--------------------------------------|------------------------|------------------|-------------------------------------------|------------------------|------------------|
| CLO Position | Oil and Gas Exposure % | Loans Below 80 % | CLO Position | Oil and Gas Exposure % | Loans Below 80 % |
| Apidos CLO XIV | 2.85 | 6.49 | Apidos CLO IX | 3.24 | 6.80 |
| Avery Point V CLO | 4.57 | 13.76 | Apidos CLO XI | 2.90 | 9.18 |
| Babson CLO 2013-II | 6.33 | 9.53 | Apidos CLO XII | 2.97 | 7.93 |
| BlueMountain CLO 2013-2 | 1.01 | 10.10 | Apidos CLO XV | 3.01 | 9.44 |
| Battalion CLO IX | 1.78 | 9.36 | Apidos CLO XXII | 2.68 | 3.02 |
| CIFC Funding 2013-I | 4.51 | 7.72 | Babson CLO Ltd. 2014-III | 7.01 | 10.27 |
| CIFC Funding 2013-II | 4.51 | 8.66 | Brookside Mill CLO Ltd. | 5.37 | 17.74 |
| CIFC Funding 2014 | 4.68 | 8.11 | Cent CLO 17 Limited | 2.35 | 12.77 |
| CIFC Funding 2014 | 4.68 | 8.11 | Cent CLO 20 Limited | 2.15 | 12.31 |
| CIFC Funding 2014-III | 5.07 | 9.06 | Cent CLO 21 Limited | 2.70 | 12.11 |
| CIFC Funding 2014-IV | 5.97 | 9.22 | CIFC Funding 2013-III, Ltd. | 4.65 | 7.52 |
| CIFC Funding 2015-III | 1.80 | 0.95 | CIFC Funding 2013-IV, Ltd. | 5.20 | 8.40 |
| Cutwater 2015-I | 2.89 | 3.75 | CIFC Funding 2014-IV Investor, Ltd. | 5.97 | 9.22 |
| Flagship CLO VIII | 5.94 | 12.23 | Galaxy XV CLO, Ltd. | 4.15 | 9.75 |
| Flagship CLO VIII | 5.94 | 12.23 | Galaxy XVI CLO, Ltd. | 4.03 | 13.33 |
| Galaxy XVIII CLO | 5.92 | 16.59 | Galaxy XVII CLO, Ltd. | 4.83 | 14.77 |
| GoldenTree Loan Opportunities VIII | 3.22 | 12.01 | Halcyon Loan Advisors Funding 2012-1 Ltd. | 10.19 | 12.89 |
| Halcyon Loan Advisors Funding 2014-3 | 12.20 | 15.24 | Halcyon Loan Advisors Funding 2013-1 Ltd. | 12.32 | 15.69 |
| Marathon CLO VI | 4.15 | 15.95 | Halcyon Loan Advisors Funding 2014-1 Ltd. | 12.96 | 16.90 |
| Marathon CLO VII | 4.03 | 14.63 | Halcyon Loan Advisors Funding 2014-2 Ltd. | 9.12 | 14.35 |
| Marathon CLO VIII | 4.94 | 11.09 | Halcyon Loan Advisors Funding 2015-3 Ltd. | 5.71 | 8.71 |
| Octagon Investment Partners XIV | 4.15 | 11.00 | HarbourView CLO VII, Ltd. | 5.40 | 11.96 |
| Octagon Investment Partners XIV | 4.15 | 11.00 | Jefferson Mill CLO Ltd. | 2.67 | 6.52 |
| Octagon Investment Partners XIX | 2.54 | 8.88 | LCM XIV Ltd. | 3.45 | 4.55 |
| Octagon Investment Partners XVII | 3.41 | 11.39 | Madison Park Funding IX, Ltd. | 3.56 | 7.23 |
| Octagon Investment Partners XX | 3.25 | 10.14 | Mountain View CLO 2013-I Ltd. | 7.84 | 14.65 |
| OHA Credit Partners IX | 4.33 | 9.16 | Mountain View CLO IX Ltd. | 5.56 | 6.62 |
| Regatta III Funding | 6.35 | 11.88 | Octagon Investment Partners XV, Ltd. | 3.37 | 11.33 |
| Sheridan Square CLO | 1.76 | 8.98 | Octagon Investment Partners XVIII, Ltd. | 2.82 | 8.91 |
| THL Credit Wind River 2013-2 CLO | 3.51 | 9.73 | Sudbury Mill CLO Ltd. | 4.70 | 16.20 |
| THL Credit Wind River 2013-2 CLO | 3.51 | 9.73 | Symphony CLO IX Ltd. | 1.54 | 6.23 |
| THL Credit Wind River 2014-3 CLO | 2.84 | 5.31 | Symphony CLO XIV Ltd. | 1.30 | 6.94 |
| Voya CLO 2014-4 | 4.11 | 8.87 | Symphony CLO XV, Ltd. | 0.41 | 1.05 |
| Zais CLO 3 | 4.73 | 11.61 | Voya CLO 2012-2, Ltd. | 3.73 | 8.97 |
| Total Portfolio: | 4.28 | 10.07 | Voya CLO 2012-3, Ltd. | 3.49 | 8.71 |
| | | | Voya CLO 2012-4, Ltd. | 3.92 | 8.63 |
| | | | Voya CLO 2014-1, Ltd. | 4.85 | 9.67 |
| | | | Washington Mill CLO Ltd. | 5.90 | 12.70 |
| | | | Total Portfolio: | 4.68 | 10.10 |

PSEC has both a higher amount of oil and gas and higher exposure to loans below 80.

Source: Company Reports and Wells Fargo Securities, LLC

Concern #3 – those CLOs with the highest risk of violating OC tests (i.e. shutting off cash flows to the equity) are still held at premiums to peers.

Ok, the last point to focus on—and the last acronym to learn—relates to “the OC” (which refers to *overcollateralization test for a CLO*). In short, this is a test that measures a CLO's asset value relative to the value of its liabilities. In many cases, the “OC test” is a measure that many/many CLO equity investors choose to focus on because a CLO's future performance on this test will (in many cases) determine how much longer a CLO will continue its payments to the equity. For example, if a CLO violates the OC test it will shut off cash flow to the equity and pay down the CLO liabilities until it is back in compliance with the test. Two primary items determine success on the OC and they are: (1) LOSSES – to the extent a CLO has loan defaults on its underlying collateral it would be forced to carry the defaulted loan at typically 40% of par or the current

market value whichever is lower as well as trading losses on loans sold out of the CLO and (2) DOWNGRADES – to the extent loans in the CLO are downgraded to CCC (or lower) and the CLO begins to exceed the allotted totals of CCC loans (typically 7.5%) then the CLO manager is forced to carry its excess CCC assets at market value for the purposes of the OC test. Notice that in either case (defaults or downgrades), the underlying CLO book values are likely to fall...which increases the potential to violate the OC test and have cash flows to the CLO shut off.

Now that we understand the OC test as a potential measure of risk to CLO equity, it's probably worthwhile to look at the CLO market in aggregate to determine a base measure of risk related to the OC test. In **Figure 8**, we outline aggregate stats for all US BSL CLOs. Notice that the current average min OC cushion is roughly 416 basis points. Said differently, to the extent that the average CLO experiences a 416bp decline in the value of its asset base through either (1) defaults or, more likely, (2) CCC downgrades exceeding the CLO's CCC basket (forcing the CLO manager to then mark its excess CCC assets at market value)--this is likely to lead to a violation of the OC test. Thus, it is important to look at CLO valuations that fall above / below that Min. OC test average.

Figure 8. US BSL CLO Stats (as of 3/24/16)

| Vintage | # Deals | \$ (mm) | Wt. Avg. Spread (bps) | NAV | Adj. NAV | Div. Score | Min. OC Cushion (bps) |
|------------|----------------|------------|-----------------------|--------------|-----------|------------|-----------------------|
| 2011 Q2 | 3 | 1,123 | 309 | 56.9% | 68.6% | 53 | 739 |
| 2011 Q3 | 5 | 2,628 | 364 | 41.4% | 68.0% | 54 | 891 |
| 2011 Q4 | 6 | 1,983 | 331 | 32.9% | 55.4% | 60 | 461 |
| 2012 Q1 | 10 | 3,769 | 349 | 24.4% | 49.4% | 64 | 496 |
| 2012 Q2 | 23 | 9,217 | 364 | 13.7% | 45.5% | 58 | 441 |
| 2012 Q3 | 22 | 9,792 | 366 | 12.9% | 46.5% | 69 | 416 |
| 2012 Q4 | 43 | 22,238 | 374 | 4.7% | 39.2% | 70 | 430 |
| 2013 Q1 | 54 | 27,207 | 380 | -0.5% | 35.9% | 71 | 420 |
| 2013 Q2 | 28 | 13,612 | 379 | -12.1% | 27.2% | 70 | 399 |
| 2013 Q3 | 32 | 14,576 | 379 | -9.6% | 26.2% | 66 | 424 |
| 2013 Q4 | 43 | 20,734 | 379 | -13.0% | 28.6% | 68 | 362 |
| 2014 Q1 | 36 | 17,530 | 390 | -17.6% | 23.8% | 68 | 387 |
| 2014 Q2 | 63 | 35,062 | 382 | -16.5% | 24.5% | 68 | 371 |
| 2014 Q3 | 63 | 35,666 | 386 | -8.4% | 30.9% | 70 | 396 |
| 2014 Q4 | 59 | 30,322 | 388 | -1.3% | 41.2% | 65 | 404 |
| 2015 Q1 | 38 | 19,708 | 390 | 11.2% | 49.8% | 65 | 419 |
| 2015 Q2 | 58 | 30,618 | 389 | 13.5% | 51.8% | 63 | 433 |
| 2015 Q3 | 44 | 23,611 | 386 | 20.9% | 56.7% | 65 | 429 |
| 631 | 319,424 | 382 | 0.0% | 38.7% | 67 | 416 | |

Source: Company Reports and Wells Fargo Securities, LLC

Understanding that the average Min. OC (overcollateralization) cushion for CLOs today is 416bps, it's perhaps worthwhile for us to look at PSEC's CLO marks and compare them to the amount of OC cushion relative to the 416 bps average. In **Figure 9**, we rank PSEC's CLOs according to amount of OC cushion and look at their aggregate mark. Investors will also notice the Min. OC Cushion for the CLO average (416bps) in the graph as well. **Interestingly, as investors look at the data, they will find that the group of CLOs with the LOWEST level of OC Cushion with OC cushions ranging from 1.93 – 3.13% (the top of the chart shaded in blue) are valued at 73% of par.** Note that the average OC cushion for this group of 2.6% is roughly 40% lower than the CLO average OC cushion of 4.16%. What's more, if we look at PSEC's CLOs with the highest level of OC cushion (shaded in green) we find that this group of CLOs, with OC cushions ranging from 4.94% to 7.49% are valued at just 77.4% of par. Note that the average OC of this group is 5.44% or roughly a 30% premium to the CLO average OC cushion of 4.16%! Here's what is hard to understand. In our view, investors would likely have expected to see much more valuation disparity between the groups with the lowest OC cushion (indicating a *higher risk* of loss of cash flows to the equity) and the group with the highest amount of OC cushion (indicating a *lower risk* of loss of cash flows to the equity). Yet, PSEC's difference between those CLOs is just 4pts. **Said differently, PSEC's marks effectively state that the group with an OC cushion that is 40% LOWER than the average CLO is somehow worth just 4pts less than CLOs with OC cushions that are 30% above the CLO average.** In our view, that is likely very hard for investor to comprehend...hence the reason for skepticism on the current CLO marks.

Figure 9 – PSEC CLOs Grouped By OC Cushion (as of 3/31/16)

| CLO Position | Fair Value | FV Mark as % of Par | NAV | Adj. NAV | OC Cushion | Average FV Mark |
|-------------------------------------------|------------------|---------------------------|--------------|--------------|---------------|--------------------|
| Cent CLO 17 Limited | 18,240 | 73.3% | -7.51 | 39.69 | 1.93 | 73.3% |
| Cent CLO 21 Limited | 36,245 | 74.7% | -33.90 | 19.61 | 2.09 | |
| Cent CLO 20 Limited | 28,675 | 71.2% | -14.60 | 33.73 | 2.10 | |
| Sudbury Mill CLO Ltd. | 19,601 | 69.5% | -27.30 | 10.87 | 2.41 | |
| Brookside Mill CLO Ltd. | 20,596 | 79.2% | -31.87 | 9.01 | 2.85 | |
| Halcyon Loan Advisors Funding 2014-1 Ltd. | 18,826 | 76.8% | -77.29 | -10.31 | 2.89 | |
| Octagon Investment Partners XVlll, Ltd. | 21,386 | 75.8% | -15.40 | 28.08 | 2.92 | |
| Jefferson Mill CLO Ltd. | 13,682 | 70.2% | -6.07 | 38.12 | 3.06 | |
| HarbourView CLO Vll, Ltd. | 13,129 | 69.0% | -23.97 | 18.59 | 3.13 | |
| Average OC Cushion | | | | | 2.60 | |
| Washington Mill CLO Ltd. | 17,231 | 76.2% | -52.80 | -0.44 | 3.54 | 76.1% |
| Mountain View CLO 2013-I Ltd. | 35,326 | 80.9% | -33.54 | 14.56 | 3.55 | |
| Babson CLO Ltd. 2014-lll | 41,377 | 79.2% | -30.58 | 29.32 | 3.61 | |
| Symphony CLO XIV Ltd. | 36,281 | 73.7% | -5.74 | 21.88 | 3.69 | |
| LCM XIV Ltd. | 23,257 | 76.3% | 2.32 | 40.16 | 3.82 | |
| Apidos CLO XV | 26,304 | 72.0% | -6.41 | 33.42 | 3.83 | |
| Symphony CLO XV, Ltd. | 38,901 | 77.4% | 50.55 | 59.49 | 4.04 | |
| CIFC Funding 2014-IV Investor, Ltd. | 30,264 | 72.9% | -4.03 | 33.62 | 4.08 | |
| Average Min. OC Cushion: | | | | | 4.16 | |
| Apidos CLO XI | 27,324 | 71.3% | 13.86 | 42.95 | 4.19 | 78.0% |
| Apidos CLO IX | 20,618 | 87.6% | 18.38 | 49.12 | 4.23 | |
| Symphony CLO IX Ltd. | 31,970 | 70.3% | 34.20 | 53.87 | 4.27 | |
| Halcyon Loan Advisors Funding 2012-1 Ltd. | 21,150 | 91.2% | -22.41 | 32.31 | 4.29 | |
| CIFC Funding 2013-lll, Ltd. | 29,800 | 67.6% | 14.54 | 41.67 | 4.44 | |
| Octagon Investment Partners XV, Ltd. | 26,460 | 80.4% | 7.63 | 39.13 | 4.44 | |
| Mountain View CLO IX Ltd. | 42,110 | 88.0% | 17.30 | 48.32 | 4.74 | |
| CIFC Funding 2013-IV, Ltd. | 33,242 | 73.1% | 18.19 | 46.97 | 4.75 | |
| Apidos CLO XXll | 24,338 | 77.6% | 25.29 | 60.37 | 4.77 | |
| Apidos CLO XII | 32,126 | 72.9% | -0.20 | 31.24 | 4.90 | |
| Average OC Cushion | | | | | 5.44 | |
| Halcyon Loan Advisors Funding 2014-2 Ltd. | 31,761 | 77.2% | -57.22 | 12.14 | 4.94 | 77.4% |
| Voya CLO 2012-2, Ltd. | 28,465 | 74.8% | 11.68 | 41.32 | 4.96 | |
| Voya CLO 2012-4, Ltd. | 30,668 | 75.5% | 10.87 | 42.06 | 5.03 | |
| Voya CLO 2012-3, Ltd. | 33,757 | 72.4% | 9.48 | 39.54 | 5.08 | |
| Voya CLO 2014-1, Ltd. | 25,687 | 79.3% | -22.01 | 22.51 | 5.15 | |
| Halcyon Loan Advisors Funding 2013-1 Ltd. | 34,394 | 85.1% | -40.81 | 22.30 | 5.21 | |
| Halcyon Loan Advisors Funding 2015-3 Ltd. | 37,099 | 93.7% | -3.36 | 42.90 | 5.22 | |
| Galaxy XVI CLO, Ltd. | 17,885 | 72.8% | -3.55 | 28.56 | 5.38 | |
| Galaxy XVII CLO, Ltd. | 28,571 | 71.6% | -11.40 | 24.96 | 5.47 | |
| Galaxy XV CLO, Ltd. | 28,831 | 73.4% | 17.65 | 41.29 | 5.94 | |
| Madison Park Funding IX, Ltd. | 23,580 | 75.8% | 29.96 | 56.75 | 7.49 | |
| Average OC Cushion | | | | | 5.44 | |
| Total Portfolio: | 1,777,616 | 76.0% | -6.68 | 32.54 | 4.09 | |

Source: Company Reports and Wells Fargo Securities, LLC

What's more, if we compare PSEC's CLO marks (by OC cushion ranking) with other BDCs CLO marks (by OC cushion ranking), we find that PSEC holds their higher risk CLOs (i.e. low OC cushion) at 73% while other BDCs price similar CLO equity roughly 20-30pts lower DESPITE very similar OC cushion averages. See Figure 10. For example, ECC's higher risk group of CLOs (those with the lowest OC cushions) have an average FV of roughly 47.3% of par and have an average OC cushion of 2.37. Notice that the OC cushion average is very similar to PSEC's, but PSEC holds its CLO equity at 73.3% of par. Now to be fair, we should point out that PSEC's average OC cushion in their higher risk (low OC bucket) is higher (i.e. better) than the other BDCs in the sample (it is 2.6% vs. a range of 2.2-2.4%). That said, the question investors may be asking is...is it really that much better to justify a 20-30 point valuation premium to BDC peers...and it's quite

possible the answer is no. What's more, we find that the differential between each BDC's higher risk CLOs (i.e. low OC cushion) is often much wider for other BDCs than for PSEC. For example, the average differential between higher risk CLOs and lower risk CLOs (as measured by OC test) is roughly 15-18pts of CLO value. Notice that in ACSF there is only 5.2pts, but what's interesting about that situation is ACSF values even their highest quality (highest OC cushion) CLOs at 53% of par. **Lastly, we also find it interesting that PSEC holds its HIGHEST risk (i.e. lowest OC) CLO equity at a price that is HIGHER (i.e. more valuable) than the LOWEST risk (i.e. highest OC) CLO equity held at the other BDCs.** Similar to a statement we made before, we believe that is very hard for investors to comprehend; hence the reason for skepticism in PSEC's CLO marks.

Figure 10 – PSEC CLOs Grouped By OC Cushion vs. Other BDCs (as of 3/31/16)

| CLO Position | Fair Value | FV Mark as % of Par | NAV | Adj. NAV | OC Cushion | PSEC | ECC | ACSF | OXLC | TICC | ACAS | | | | | | |
|-------------------------------------------|------------------|---------------------------|--------------|--------------|---------------|--------------------|--------------------|--------------------|--------------------|--------------------|-------|------|-------|------|-------|-------|-------|
| | | | | | | Average FV Mark | Average FV Mark | Average FV Mark | Average FV Mark | Average FV Mark | | | | | | | |
| Cent CLO 17 Limited | 18,240 | 73.3% | -7.51 | 39.69 | 1.93 | 73.3% | 47.3% | 48.0% | 44.8% | 35.7% | 52.1% | | | | | | |
| Cent CLO 21 Limited | 36,245 | 74.7% | -33.90 | 19.61 | 2.09 | | | | | | | | | | | | |
| Cent CLO 20 Limited | 28,675 | 71.2% | -14.60 | 33.73 | 2.10 | | | | | | | | | | | | |
| Sudbury Mill CLO Ltd. | 19,601 | 69.5% | -27.30 | 10.87 | 2.41 | | | | | | | | | | | | |
| Brookside Mill CLO Ltd. | 20,596 | 79.2% | -31.87 | 9.01 | 2.85 | | | | | | | | | | | | |
| Halcyon Loan Advisors Funding 2014-1 Ltd. | 18,826 | 76.8% | -77.29 | -10.31 | 2.89 | | | | | | | | | | | | |
| Octagon Investment Partners XVIII, Ltd. | 21,386 | 75.8% | -15.40 | 28.08 | 2.92 | | | | | | | | | | | | |
| Jefferson Mill CLO Ltd. | 13,682 | 70.2% | -6.07 | 38.12 | 3.06 | | | | | | | | | | | | |
| HarbourView CLO VII, Ltd. | 13,129 | 69.0% | -23.97 | 18.59 | 3.13 | | | | | | | | | | | | |
| Average OC Cushion | | | | | | 2.60 | 2.37 | 2.41 | 2.31 | 2.34 | 2.19 | | | | | | |
| Washington Mill CLO Ltd. | 17,231 | 76.2% | -52.80 | -0.44 | 3.54 | 76.1% | 48.7% | 58.0% | 54.8% | 40.6% | 66.1% | | | | | | |
| Mountain View CLO 2013-I Ltd. | 35,326 | 80.9% | -33.54 | 14.56 | 3.55 | | | | | | | | | | | | |
| Babson CLO Ltd. 2014-III | 41,377 | 79.2% | -30.58 | 29.32 | 3.61 | | | | | | | | | | | | |
| Symphony CLO XIV Ltd. | 36,281 | 73.7% | -5.74 | 21.88 | 3.69 | | | | | | | | | | | | |
| LCM XIV Ltd. | 23,257 | 76.3% | 2.32 | 40.16 | 3.82 | | | | | | | | | | | | |
| Apidos CLO XV | 26,304 | 72.0% | -6.41 | 33.42 | 3.83 | | | | | | | | | | | | |
| Symphony CLO XV, Ltd. | 38,901 | 77.4% | 50.55 | 59.49 | 4.04 | | | | | | | | | | | | |
| CIFC Funding 2014-IV Investor, Ltd. | 30,264 | 72.9% | -4.03 | 33.62 | 4.08 | | | | | | | | | | | | |
| Average Min. OC Cushion: | | | | | | 4.16 | | | | | | | | | | | |
| Apidos CLO XI | 27,324 | 71.3% | 13.86 | 42.95 | 4.19 | 78.0% | 50.3% | 60.1% | 57.8% | 54.3% | 67.0% | | | | | | |
| Apidos CLO IX | 20,618 | 87.6% | 18.38 | 49.12 | 4.23 | | | | | | | | | | | | |
| Symphony CLO IX Ltd. | 31,970 | 70.3% | 34.20 | 53.87 | 4.27 | | | | | | | | | | | | |
| Halcyon Loan Advisors Funding 2012-1 Ltd. | 21,150 | 91.2% | -22.41 | 32.31 | 4.29 | | | | | | | | | | | | |
| CIFC Funding 2013-III, Ltd. | 29,800 | 67.6% | 14.54 | 41.67 | 4.44 | | | | | | | | | | | | |
| Octagon Investment Partners XV, Ltd. | 26,460 | 80.4% | 7.63 | 39.13 | 4.44 | | | | | | | | | | | | |
| Mountain View CLO IX Ltd. | 42,110 | 88.0% | 17.30 | 48.32 | 4.74 | | | | | | | | | | | | |
| CIFC Funding 2013-IV, Ltd. | 33,242 | 73.1% | 18.19 | 46.97 | 4.75 | | | | | | | | | | | | |
| Apidos CLO XXII | 24,338 | 77.6% | 25.29 | 60.37 | 4.77 | | | | | | | | | | | | |
| Apidos CLO XII | 32,126 | 72.9% | -0.20 | 31.24 | 4.90 | | | | | | | | | | | | |
| Halcyon Loan Advisors Funding 2014-2 Ltd. | 31,761 | 77.2% | -57.22 | 12.14 | 4.94 | 77.4% | 62.4% | 53.2% | 63.4% | 55.3% | 70.9% | | | | | | |
| Voya CLO 2012-2, Ltd. | 28,465 | 74.8% | 11.68 | 41.32 | 4.96 | | | | | | | | | | | | |
| Voya CLO 2012-4, Ltd. | 30,668 | 75.5% | 10.87 | 42.06 | 5.03 | | | | | | | | | | | | |
| Voya CLO 2012-3, Ltd. | 33,757 | 72.4% | 9.48 | 39.54 | 5.08 | | | | | | | | | | | | |
| Voya CLO 2014-1, Ltd. | 25,687 | 79.3% | -22.01 | 22.51 | 5.15 | | | | | | | | | | | | |
| Halcyon Loan Advisors Funding 2013-1 Ltd. | 34,394 | 85.1% | -40.81 | 22.30 | 5.21 | | | | | | | | | | | | |
| Halcyon Loan Advisors Funding 2015-3 Ltd. | 37,099 | 93.7% | -3.36 | 42.90 | 5.22 | | | | | | | | | | | | |
| Galaxy XVI CLO, Ltd. | 17,885 | 72.8% | -3.55 | 28.56 | 5.38 | | | | | | | | | | | | |
| Galaxy XVII CLO, Ltd. | 28,571 | 71.6% | -11.40 | 24.96 | 5.47 | | | | | | | | | | | | |
| Galaxy XV CLO, Ltd. | 28,831 | 73.4% | 17.65 | 41.29 | 5.94 | | | | | | | | | | | | |
| Madison Park Funding IX, Ltd. | 23,580 | 75.8% | 29.96 | 56.75 | 7.49 | | | | | | | | | | | | |
| Average OC Cushion | | | | | | | | | | | | 5.44 | 5.41 | 5.21 | 5.09 | 5.04 | 9.62 |
| Total Portfolio: | 1,777,616 | 76.0% | -6.68 | 32.54 | 4.09 | | | | | | | | | | | | |
| Difference in Fair Value Mark | | | | | | | | | | | | 4.1% | 15.2% | 5.2% | 18.6% | 19.6% | 18.8% |

Source: Company Reports and Wells Fargo Securities, LLC

Management purchases appear beneficial; however shareholders will likely need to wait and see the effects of alignment. In our view, management will likely again point to the significant insider purchases as evidence of significant investor alignment. It goes without saying that the insider purchases are significant in absolute dollar terms where both the firm's founder/CEO (John Barry) and president (Grier Eliasek) purchased over \$98MM and 3.7MM worth of PSEC stock respectively. See **Figure 11**. These repurchases have brought Barry's ownership in PSEC up to nearly 6.3%.

Figure 11. Management's Share Purchases (as of 4/5/16)

| Grier Eliasek | | | | John Barry III | | | |
|---------------|----------------|-------|------------------|----------------|-------------------|-------|-------------------|
| Date | Shares | Price | Value | Date | Shares | Price | Value |
| 12/9/2015 | 30,000 | 6.79 | 203,700 | 12/9/2015 | 150,000 | 6.71 | 1,006,950 |
| 12/15/2015 | 20,000 | 6.28 | 125,600 | 12/11/2015 | 155,000 | 6.65 | 1,031,370 |
| 12/17/2015 | 30,000 | 6.78 | 203,400 | 12/14/2015 | 165,000 | 6.21 | 1,023,825 |
| 12/18/2015 | 75,000 | 6.74 | 505,500 | 12/15/2015 | 322,500 | 6.38 | 2,058,163 |
| 12/21/2015 | 50,000 | 6.74 | 337,000 | 12/16/2015 | 560,000 | 6.60 | 3,701,598 |
| 12/22/2015 | 50,000 | 6.78 | 339,000 | 12/17/2015 | 790,000 | 6.76 | 5,339,926 |
| 12/23/2015 | 50,000 | 7.10 | 355,000 | 12/18/2015 | 744,000 | 6.70 | 4,985,544 |
| 2/11/2016 | 15,000 | 5.70 | 85,499 | 12/21/2015 | 1,032,500 | 6.77 | 6,987,960 |
| 2/12/2016 | 15,000 | 6.22 | 96,300 | 12/22/2015 | 1,029,000 | 6.86 | 7,053,795 |
| 2/16/2016 | 15,000 | 6.30 | 94,500 | 12/23/2015 | 1,028,924 | 7.15 | 7,357,630 |
| 2/17/2016 | 15,000 | 6.69 | 100,350 | 12/24/2015 | 1,032,500 | 7.38 | 7,615,617 |
| 2/19/2016 | 15,000 | 6.79 | 101,850 | 2/11/2016 | 1,060,000 | 5.70 | 6,044,120 |
| 2/22/2016 | 15,000 | 6.92 | 103,800 | 2/12/2016 | 1,058,000 | 6.15 | 6,502,362 |
| 2/23/2016 | 15,000 | 6.91 | 103,650 | 2/16/2016 | 1,115,000 | 6.36 | 7,091,400 |
| 2/24/2016 | 15,000 | 6.89 | 103,350 | 2/17/2016 | 1,109,000 | 6.71 | 7,446,159 |
| 2/25/2016 | 15,000 | 7.00 | 105,000 | 2/18/2016 | 1,114,000 | 6.77 | 7,544,008 |
| 2/26/2016 | 15,000 | 6.93 | 103,950 | 2/19/2016 | 1,114,700 | 6.83 | 7,616,745 |
| 3/1/2016 | 15,000 | 7.25 | 108,750 | 2/22/2016 | 1,100,000 | 6.93 | 7,618,160 |
| Total: | 470,000 | | 3,176,199 | Total: | 14,680,124 | | 98,025,332 |

Source: Company Reports and Wells Fargo Securities, LLC

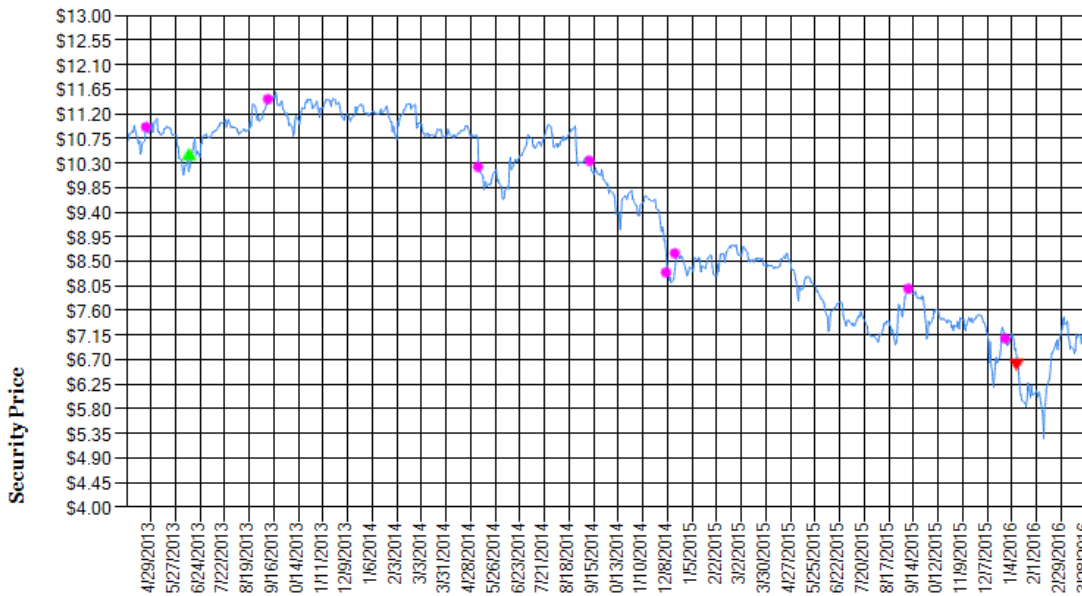
Clear advocates of PSEC will likely point out that this creates meaningfully aligned incentives between shareholders and the external manager. In our view, alignment largely depends on where the vast preponderance of an executive's wealth lies. For example, if the value of the external manager (which collects fees from the BDC) is significantly larger than the value of the equity stake in the BDC, then it is possible for an incentive misalignment to exist. Now, to be clear, this isn't the first case of incentive misalignment in the BDC space—and it is worth noting that PSEC's executives were willing to purchase stock as opposed to simply keeping the cash—which we believe is admirable. Bottom line, time will tell on whether or not the potential incentive alignment created through management's significant stock purchases will actually lead to a higher valuation—*particularly when investors consider the other risks surrounding the name (i.e. the potential for mismarks on the CLO equity collateral).*

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Prospect Capital Corporation (PSEC) 3-yr. Price Performance



Date

| Date | Published Price (\$) | Rating Code | Val. Rng. Low | Val. Rng. High | Close Price (\$) |
|------------|----------------------|-------------|---------------|----------------|------------------|
| 4/2/2013 | NA | Bock | | | |
| 4/2/2013 | | 3 | 10.50 | 11.00 | 10.89 |
| 4/24/2013 | 10.88 | 3 | 10.00 | 11.00 | 10.94 |
| 6/14/2013 | 10.29 | 2 | 10.00 | 11.00 | 10.41 |
| 9/10/2013 | 11.43 | 2 | 11.50 | 12.00 | 11.44 |
| 5/7/2014 | 10.20 | 2 | 9.50 | 10.50 | 10.20 |
| 9/11/2014 | 10.31 | 2 | 10.50 | 11.00 | 10.31 |
| 12/8/2014 | 8.27 | 2 | 9.50 | 10.50 | 8.27 |
| 12/18/2014 | 8.35 | 2 | 9.00 | 9.50 | 8.63 |
| 9/10/2015 | 7.93 | 2 | 8.00 | 8.50 | 7.97 |
| 12/28/2015 | 7.13 | 2 | 6.75 | 7.25 | 7.07 |
| 1/11/2016 | 6.90 | 3 | 5.00 | 5.50 | 6.56 |

Source: Wells Fargo Securities, LLC estimates and Reuters data

Symbol Key

- ▼ Rating Downgrade
- ▲ Rating Upgrade
- ◆ Initiation, Resumption, Drop or Suspend
- Analyst Change
- ◆ Valuation Range Change
- Split Adjustment

Rating Code Key

- 1 Outperform/Buy
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As of: April 5, 2016

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