

PENNANTPARK INVESTMENT CORP  
Form 10-K  
November 14, 2012  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-K**

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2012

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
FOR THE TRANSITION PERIOD FROM            TO

COMMISSION FILE NUMBER: 814-00736

**PENNANTPARK INVESTMENT CORPORATION**

(Exact name of registrant as specified in its charter)

**MARYLAND**  
(State or other jurisdiction)

**20-8250744**  
(I.R.S. Employer

of incorporation or organization)

Identification No.)

**590 Madison Avenue,**

**15<sup>th</sup> Floor New York, N.Y.**  
(Address of principal executive offices)

**10022**  
(Zip Code)

Registrant's telephone number, including area code (212)-905-1000

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value \$0.001 per share	The NASDAQ Stock Market LLC
Securities registered pursuant to Section 12(g) of the Act: None	

## Edgar Filing: PENNANTPARK INVESTMENT CORP - Form 10-K

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No .

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No .

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No .

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No .

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller Reporting Company

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

The aggregate market value of common stock held by non-affiliates of the Registrant on September 30, 2012 based on the closing price on that date of \$10.61 on the NASDAQ Global Select Market was approximately \$685.4 million. For the purposes of calculating this amount only, all directors and executive officers of the Registrant have been treated as affiliates. There were 66,356,911 shares of the Registrant's common stock outstanding as of November 14, 2012.

Documents Incorporated by Reference: Portions of the Registrant's Proxy Statement relating to the Registrant's 2013 Annual Meeting of Stockholders to be filed not later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K are incorporated by reference into Part III of this Report.

**Table of Contents**

**PENNANTPARK INVESTMENT CORPORATION**

**FORM 10-K**

**FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2012**

**TABLE OF CONTENTS**

**PART I**

<b>Item 1.</b>	<u>Business</u>	1
<b>Item 1A.</b>	<u>Risk Factors</u>	19
<b>Item 1B.</b>	<u>Unresolved Staff Comments</u>	37
<b>Item 2.</b>	<u>Properties</u>	37
<b>Item 3.</b>	<u>Legal Proceedings</u>	37
<b>Item 4.</b>	<u>Mine Safety Disclosures</u>	37

**PART II**

<b>Item 5.</b>	<u>Market For Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	38
<b>Item 6.</b>	<u>Selected Financial Data</u>	41
<b>Item 7.</b>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	42
<b>Item 7A.</b>	<u>Quantitative And Qualitative Disclosures About Market Risk</u>	53
<b>Item 8.</b>	<u>Consolidated Financial Statements and Supplementary Data</u>	54
<b>Item 9.</b>	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	84
<b>Item 9A.</b>	<u>Controls and Procedures</u>	84
<b>Item 9B.</b>	<u>Other Information</u>	84

**PART III**

<b>Item 10.</b>	<u>Directors, Executive Officers and Corporate Governance</u>	85
<b>Item 11.</b>	<u>Executive Compensation</u>	85
<b>Item 12.</b>	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	85
<b>Item 13.</b>	<u>Certain Relationships and Related Transactions, and Director Independence</u>	85
<b>Item 14.</b>	<u>Principal Accountant Fees and Services</u>	85

**PART IV**

<b>Item 15.</b>	<u>Exhibits and Financial Statement Schedules</u>	86
	<u>Signatures</u>	87

**Table of Contents**

**PART I**

*In this annual report on Form 10-K, or the Report, except where the context suggests otherwise, the terms we, us or our refer to PennantPark Investment Corporation and its consolidated subsidiaries; references to PennantPark Investment refer only to PennantPark Investment Corporation; SBIC LP and our SBIC refer to our wholly owned, consolidated Small Business Investment Company, or SBIC, subsidiary, PennantPark SBIC LP and its general partner PennantPark SBIC GP, LLC or SBIC GP ; PennantPark Investment Advisers or the Investment Adviser refers to PennantPark Investment Advisers, LLC; PennantPark Investment Administration or the Administrator refers to PennantPark Investment Administration, LLC. References to our portfolio and investments include investments we make through our consolidated subsidiaries. Some of the statements in this annual report constitute forward-looking statements, which apply to us and relate to future events, future performance or future financial condition. The forward-looking statements involve risks and uncertainties for us and actual results could differ materially from those projected in the forward-looking statements for any reason, including those factors discussed in Risk Factors and elsewhere in this Report.*

**Item 1. Business**

**General Business of PennantPark Investment Corporation**

PennantPark Investment Corporation is a business development company, or BDC, whose objectives are to generate both current income and capital appreciation through debt and equity investments primarily in U.S. middle-market companies in the form of senior secured loans, mezzanine debt and equity investments.

We believe the middle-market offers attractive risk-reward to investors due to the limited amount of capital available for such companies. We seek to create a diversified portfolio that includes senior secured loans, mezzanine debt and equity investments by investing approximately \$10 million to \$50 million of capital, on average, in the securities of middle-market companies. We expect this investment size to vary proportionately with the size of our capital base. We use the term middle-market to refer to companies with annual revenues between \$50 million and \$1 billion. The companies in which we invest are typically highly leveraged, and, in most cases, are not rated by national rating agencies. If such companies were rated, we believe that they would typically receive a rating below investment grade (between BB and CCC under the Standard & Poor's system) from the national rating agencies. In addition, we expect our debt investments to generally range in maturity from three to ten years.

Our investment activity depends on many factors, including the amount of debt and equity capital available to middle-market companies, the level of merger and acquisition activity for such companies, the general economic environment and the competitive environment for the types of investments we make. Turmoil in the credit markets over the last several years has adversely affected each of these factors and has resulted in a broad-based reduction in the demand for, and valuation of, middle-market debt instruments. These conditions have presented us with and may continue to offer attractive investment opportunities, as we believe that there are many middle-market companies that need senior secured and mezzanine debt financing. We have used, and expect to continue to use, our credit facility, or Credit Facility, the Small Business Administration, or SBA, debentures, proceeds from the rotation of our portfolio and proceeds from public and private offerings of securities to finance our investment objectives.

As of September 30, 2012, our portfolio totaled \$990.5 million and consisted of \$291.7 million of senior secured loans, \$191.3 million of second lien secured debt, \$400.7 million of subordinated debt and \$106.8 million of preferred and common equity investments. Our debt portfolio consisted of 69% fixed-rate and 31% variable-rate investments (including 26% with a London Interbank Offered Rate, or LIBOR, or prime floor). Our overall portfolio consisted of 54 companies with an average investment size of \$18.3 million, a weighted average yield on debt investments of 13.2%, and was invested 30% in senior secured loans, 19% in second lien secured debt, 40% in subordinated debt and 11% in preferred and common equity investments.

As of September 30, 2011, our portfolio totaled \$827.5 million and consisted of \$296.5 million of senior secured loans, \$165.3 million of second lien secured debt, \$309.3 million of subordinated debt and \$56.4 million of preferred and common equity investments. Our debt portfolio consisted of 61% fixed-rate and 39% variable-rate investments (including 31% with a LIBOR or prime floor). Our overall portfolio consisted of 48 companies with an average investment size of \$17.2 million, a weighted average yield on debt investments of 13.3%, and was invested 36% in senior secured loans, 20% in second lien secured debt, 37% in subordinated debt and 7% in preferred and common equity investments.

For the fiscal year ended September 30, 2012, we purchased \$328.3 million of investments issued by 13 new and 17 existing portfolio companies with an overall weighted average yield of 13.3% on debt investments. For the fiscal years ended September 30, 2011 and 2010, we purchased \$479.7 million of investments issued by 17 new and 11 existing portfolio companies with an overall average yield of 13.7% on debt investments and purchased \$309.5 million of investments, issued by 17 new and 12 existing portfolio companies with an overall average yield of 14.9% on debt investments, respectively.

For the fiscal year ended September 30, 2012, sales and repayments generated proceeds of \$201.7 million. For the fiscal years ended September 30, 2011 and 2010, sales and repayments generated proceeds of \$304.0 million and \$145.2 million, respectively.

---

## **Table of Contents**

### ***Organization and Structure of PennantPark Investment Corporation***

PennantPark Investment Corporation was organized under the Maryland General Corporation Law in January 2007. We are a closed-end, externally managed, non-diversified investment company that has elected to be treated as a BDC, under the Investment Company Act of 1940, as amended, or the 1940 Act. As such, we are required to comply with certain regulatory requirements. For instance, we generally have to invest at least 70% of our total assets in qualifying assets, including securities of U.S. private companies or thinly traded public companies, public companies with a market capitalization of less than \$250 million, cash, cash equivalents, U.S. government securities and high quality debt investments that mature in one year or less. In addition, for tax purposes we have elected to be treated, and intend to qualify annually, as a regulated investment company, or RIC, under the Internal Revenue Code of 1986, as amended, or the Code.

Our wholly owned SBIC subsidiary, PennantPark SBIC LP, was organized as a Delaware limited partnership in May 2010 and received a license from the SBA to operate as an SBIC under Section 301(c) of the Small Business Investment Act of 1958, as amended, or the 1958 Act, in July 2010. SBIC LP's objective is to generate both current income and capital appreciation through debt and equity investments. SBIC LP, generally, invests with us in SBA eligible businesses that meet the investment criteria used by PennantPark Investment.

### ***Our Investment Adviser and Administrator***

We utilize the investing experience and contacts of PennantPark Investment Advisers in developing what we believe is an attractive and diversified portfolio. The senior investment professionals of the Investment Adviser have worked together for many years, and average over 20 years of experience in the mezzanine lending, leveraged finance, distressed debt and private equity businesses. In addition, our senior investment professionals have been involved in originating, structuring, negotiating, managing and monitoring investments in each of these businesses across economic and market cycles. We believe this experience and history has resulted in a strong reputation with financial sponsors, management teams, investment bankers, attorneys and accountants, which should provide us with access to substantial investment opportunities across the capital markets. Our Investment Adviser has a rigorous investment approach, which is based upon intensive financial analysis with a focus on capital preservation, diversification and active management. Since our Investment Advisers inception in 2007, it has raised over \$1.5 billion in debt and equity capital and has invested over \$2.1 billion in more than 200 companies with over 100 different financial sponsors through its managed funds.

Our Administrator has experienced professionals with substantial backgrounds in finance and administration of registered investment companies. In addition to furnishing us with clerical, bookkeeping and record keeping services, the Administrator also oversees our financial records as well as the preparation of our reports to stockholders and reports filed with the Securities and Exchange Commission, or the SEC, and the SBA. The Administrator oversees the determination and publication of our net asset value, oversees the preparation and filing of our tax returns, monitors the payment of our expenses as well as the performance of administrative and professional services rendered to us by others. Furthermore, our Administrator provides, on our behalf, managerial assistance to those portfolio companies to which we are required to offer such assistance. See [Risk Factors](#) [Risks Relating to our Business and Structure](#) There are significant potential conflicts of interest which could impact our investment returns for more information.

### ***Market Opportunity***

We believe that the limited amount of capital available to the middle-market companies, coupled with the desire of these companies for flexible sources of capital, creates an attractive investment environment for us.

**We believe middle-market companies have faced increasing difficulty in raising debt through the capital markets.** While many middle-market companies were formerly able to raise funds by issuing high-yield bonds, we believe this approach to financing has become more difficult as institutional investors have sought to invest in larger, more liquid offerings. We believe this has made it harder for middle-market companies to raise funds by issuing high-yield debt securities.

**We believe middle-market companies have faced difficulty raising debt in private markets.** Banks, finance companies, hedge funds and collateralized loan obligation, or CLO, funds have withdrawn capital from the middle-market resulting in opportunities for alternative funding sources.

**We believe that the current credit market dislocation for middle-market companies improves the risk-adjusted returns of our investments.** In the current credit environment, market participants have reduced lending to middle-market and non-investment grade borrowers. As a result, we believe there is less competition in our market, more conservative capital structures, higher yields and stronger covenants.

**We believe there is a large pool of uninvested private equity capital likely to seek to combine their capital with sources of debt capital to complete private investments.** We expect that private equity firms will continue to be active investors in middle-market companies. These private equity funds generally seek to leverage their investments by combining their capital with senior secured loans and/or mezzanine debt provided by other sources, and we believe that we are well-positioned to partner with such equity investors. We expect such activity to be funded by the substantial

amounts of private equity capital that have been raised in recent years.

## **Table of Contents**

**We believe there is substantial supply of opportunities resulting from maturing loans that seek refinancing.** A high volume of financings were completed between the years 2004 and 2007, which will come due in the next few years. We believe this supply of opportunities coupled with a lack of demand offers attractive risk-adjusted returns to investors.

### ***Competitive Advantages***

We believe that we have the following competitive advantages over other capital providers in middle-market companies:

#### ***a. Experienced Management Team***

The senior investment professionals of our Investment Adviser have worked together for many years and average over 20 years of experience in mezzanine lending, leveraged finance, distressed debt and private equity businesses. These senior investment professionals have been involved in originating, structuring, negotiating, managing and monitoring investments in each of these businesses across economic and market cycles. We believe this extensive experience and history has resulted in a strong reputation across the capital markets.

#### ***b. Disciplined Investment Approach with Strong Value Orientation***

We employ a disciplined approach in selecting investments that meet the long-standing, consistent value-oriented investment criteria employed by our Investment Adviser. Our value-oriented investment philosophy focuses on preserving capital and ensuring that our investments have an appropriate return profile in relation to risk. When market conditions make it difficult for us to invest according to our criteria, we are highly selective in deploying our capital. We believe this approach continues to enable us to build an attractive investment portfolio that meets our return and value criteria over the long-term.

We believe it is critical to conduct extensive due diligence on investment targets. In evaluating new investments we, through our Investment Adviser, conduct a rigorous due diligence process that draws from our Investment Adviser's experience, industry expertise and network of contacts. Among other things, our due diligence is designed to ensure that each prospective portfolio company will be able to meet its debt service obligations. See *Investment Selection Criteria* for more information.

In addition to engaging in extensive due diligence, our Investment Adviser seeks to reduce risk by focusing on businesses with:

strong competitive positions;

positive cash flow that is steady and stable;

experienced management teams with strong track records;

potential for growth and viable exit strategies; and

capital structures offering appropriate risk-adjusted terms and covenants.

#### ***c. Ability to Source and Evaluate Transactions through our Investment Adviser's Research Capability and Established Network***

The management team of the Investment Adviser has long-term relationships with financial sponsors, management consultants and management teams that we believe enable us to evaluate investment opportunities effectively in numerous industries, as well as provide us access to substantial information concerning those industries. We identify potential investments both through active origination and through dialogue with numerous financial sponsors, management teams, members of the financial community and corporate partners with whom the professionals of our Investment Adviser have long-term relationships.

#### ***d. Flexible Transaction Structuring***

## Edgar Filing: PENNANTPARK INVESTMENT CORP - Form 10-K

We are flexible in structuring investments and tailor investments to meet the needs of a portfolio company while also generating attractive risk-adjusted returns. We can invest in any part of a capital structure, and our Investment Adviser has extensive experience in a wide variety of securities for leveraged companies throughout economic and market cycles.

Our Investment Adviser seeks to minimize the risk of capital loss without foregoing potential for capital appreciation. In making investment decisions, we seek to invest in companies that we believe can generate positive risk-adjusted returns.

We believe that the in-depth coverage and experience of our Investment Adviser will enable us to invest throughout various stages of the economic and market cycles and to provide us with ongoing market insights in addition to a significant investment sourcing engine.

### *Investment Selection Criteria*

We are committed to a value oriented philosophy used by the senior investment professionals who manage our portfolio and seek to minimize the risk of capital loss without foregoing potential for capital appreciation.



---

## **Table of Contents**

We have identified several criteria, discussed below, that we believe are important in identifying and investing in prospective portfolio companies. These criteria provide general guidelines for our investment decisions. However, we caution that not all of these criteria will be met by each prospective portfolio company in which we choose to invest. Generally, we seek to use our experience, relationships, and access to market information to identify investment candidates and to structure investments efficiently and effectively.

### ***a. Value orientation and positive cash flow***

Our investment philosophy places a premium on fundamental analysis and has a distinct value orientation. We focus on companies in which we can invest at relatively low multiples of operating cash flow and that are profitable at the time of investment on an operating cash flow basis. Typically, we do not expect to invest in start-up companies or companies having speculative business plans.

### ***b. Experienced management and established financial sponsor relationships***

We generally require that our portfolio companies have an experienced management team. We also require the portfolio companies to have proper incentives in place to induce management to succeed and to act in concert with our interests as investors, including having equity interests. In addition, we focus our investments in companies backed by strong financial sponsors that have a history of creating value and with whom members of our Investment Adviser have an established relationship.

### ***c. Strong and defensible competitive market positions***

We seek to invest in target companies that have developed leading market positions within their respective markets and are well positioned to capitalize on growth opportunities. We also seek companies that demonstrate significant competitive advantages versus their competitors, which should help to protect their market position and profitability.

### ***d. Viable exit strategy***

We seek to invest in companies that we believe will provide a steady stream of cash flow to repay our loans and reinvest in their respective businesses. We expect that such internally generated cash flow, leading to the payment of interest on, and the repayment of the principal of, our investments in portfolio companies to be a key means by which we exit from our investments over time. In addition, we also seek to invest in companies whose business models and expected future cash flows offer attractive exit possibilities. These companies include candidates for strategic acquisition by other industry participants and companies that may repay our investments through an initial public offering of common stock, refinancing or other capital market transaction.

## ***Competition***

Our primary competitors provide financing to middle-market companies and include other BDCs, commercial and investment banks, commercial finance companies, CLO funds and, to the extent they provide an alternative form of financing, private equity funds. Additionally, alternative investment vehicles, such as hedge funds, frequently invest in middle-market companies. As a result, competition for investment opportunities in middle-market companies can be intense. However, we believe that there has been a reduction in the amount of debt capital available to middle-market companies since the downturn in the credit markets, which began in mid-2007. We believe this has resulted in a less competitive environment for making new investments.

Many of our competitors are substantially larger and have considerably greater financial, technical and marketing resources than we do. For example, we believe some competitors have a lower cost of funds and access to funding sources that are not available to us. In addition, some of our competitors have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more relationships than us. Furthermore, many of our competitors are not subject to the regulatory restrictions that the 1940 Act imposes on us as a BDC. See [Risk Factors](#) [Risks Relating to our Business and Structure](#) We operate in a highly competitive market for investment opportunities for more information.

## ***Leverage***

We maintain a multi-currency \$380.0 million Credit Facility which matures in February 2016 and is secured by substantially all of our investment portfolio assets (excluding the assets of SBIC LP), under which we had \$145.0 million (including a \$35.5 million temporary draw) and \$240.9 million of debt outstanding with a weighted average interest rate of 3.49% and 1.27% at September 30, 2012 and 2011, respectively. Pricing of borrowings under our current Credit Facility is set at 275 basis points over LIBOR. As of September 30, 2012 and 2011, we had \$235.0 million and \$74.1 million, respectively, available to us under our Credit Facility. We believe that our capital resources will provide us with the flexibility to take advantage of market opportunities when they arise. In addition, any future additional debt capital we incur, to the extent it is available, may be issued at a higher cost and on less favorable terms and conditions than our current Credit Facility.

## Edgar Filing: PENNANTPARK INVESTMENT CORP - Form 10-K

As of September 30, 2012 and 2011, SBIC LP had drawn \$150.0 million, with a weighted average interest rate of 3.70%, exclusive of 3.43% of upfront fees (4.04% inclusive of the upfront fees), and had no remaining borrowing capacity. SBA debentures offer competitive terms such as being non-recourse to us, a 10-year maturity, semi-annual interest payments, not requiring principal payments prior to maturity and may be prepaid at any time without penalty. The SBA debentures are secured by all the investment portfolio assets of SBIC LP and have a priority claim over such assets. See Regulation for more information.

---

## **Table of Contents**

### ***Investment Policy Overview***

We seek to create a diversified portfolio that includes senior secured loans, mezzanine debt and equity by targeting an investment size of \$10 million to \$50 million in securities, on average, of middle-market companies. We expect this investment size to vary proportionately with the size of our capital base. The companies in which we invest are typically highly leveraged, and, in most cases, are not rated by national rating agencies. If such companies were rated, we believe that they would typically receive a rating below investment grade (between BB and CCC under the Standard & Poor's system) from the national rating agencies. In addition, we expect our debt investments to range in maturity from three to ten years.

Over time, we expect that our portfolio will continue to consist primarily of senior secured loans, mezzanine debt and, to a lesser extent, equity investments in qualifying assets such as private or thinly traded or small market-capitalization, public U.S. companies. In addition, we may invest up to 30% of our portfolio in non-qualifying assets. See Regulation Qualifying Assets for more information. These non-qualifying assets may include investments in public companies whose securities are not thinly traded or do not have a market capitalization of less than \$250 million, securities of middle-market companies located outside of the United States and investment companies as defined in the 1940 Act. Moreover, we may acquire investments in the secondary market. See Investment Selection Criteria for more information.

Our board of directors has the authority to modify or waive certain of our operating policies and strategies without prior notice and without stockholder approval (except as required by the 1940 Act). However, absent stockholder approval, we may not change the nature of our business so as to cease to be, or withdraw our election as, a BDC. We cannot predict the effect any changes to our current operating policies and strategies would have on our business, operating results and value of our stock. Nevertheless, the effects of changes to our operating policies and strategies may adversely affect our business, and impact our ability to make distributions and the value of our stock.

### ***Senior Secured Debt***

Structurally, senior secured debt (which we define to include first lien debt) ranks senior in priority of payment to mezzanine debt and equity, and benefits from a senior security interest in the assets of the borrower. As such, other creditors rank junior to our investments in these securities in the event of insolvency. Due to its lower risk profile and often more restrictive covenants as compared to mezzanine debt, senior secured debt generally earns a lower return than mezzanine debt. In some cases senior secured lenders receive opportunities to invest directly in the equity securities of borrowers and from time to time may also receive warrants to purchase equity securities. We evaluate these investment opportunities on a case-by-case basis.

### ***Mezzanine Debt***

Structurally, mezzanine debt (which we define to include second lien secured debt and subordinated debt) usually ranks subordinate in priority of payment to senior secured loans. Our second lien secured debt is subordinated debt that benefits from a security interest in the borrower. As such, other creditors may rank senior to us in the event of insolvency. Mezzanine debt ranks senior to common and preferred equity in a borrower's capital structures. Due to its higher risk profile and often less restrictive covenants as compared to senior secured loans, mezzanine debt generally earns a higher return than senior secured loans. In many cases mezzanine investors receive opportunities to invest directly in the equity investments of borrowers and from time to time may also receive warrants to purchase equity investments. We evaluate these investment opportunities on a case-by-case basis.

### ***Operating and Regulatory Structure***

Our investment activities are managed by PennantPark Investment Advisers and supervised by our board of directors, a majority of whom are independent of us. Under our investment management agreement, or the Investment Management Agreement, we have agreed to pay our Investment Adviser an annual base management fee based on our average adjusted gross total assets as well as an incentive fee based on our investment performance. See Investment Management Agreement for more information.

We have also entered into an administration agreement, or the Administration Agreement, with the Administrator. Under our Administration Agreement, we have agreed to reimburse the Administrator for our allocable portion of overhead and other expenses incurred by the Administrator in performing its obligations under our Administration Agreement, including rent and our allocable portion of the costs of compensation and related expenses of our Chief Compliance Officer, Chief Financial Officer and their respective staffs. See Administration Agreement for more information.

If any of our contractual obligations discussed above are terminated, our costs under new agreements that we enter into may increase. In addition, we will likely incur significant time and expense in locating alternative parties to provide the services we expect to receive under our Investment Management Agreement and our Administration Agreement. Any new Investment Management Agreement would also be subject to approval by our stockholders.

As a BDC, we are required to comply with certain regulatory requirements. Also, while we are permitted to finance investments using debt, our ability to use debt is limited in certain significant respects. We have elected to be treated for federal income tax purposes under the Code as a RIC. Our wholly owned subsidiary, SBIC LP, received a license from the SBA to operate as an SBIC under Section 301(c) of the 1958 Act and is regulated by the SBA. PennantPark Investment serves as the investment adviser and administrator to SBIC LP. The SBA regulates, among other matters, SBIC LP's investing activities. See Regulation for more information.



**Table of Contents**

**Our Corporate Information**

Our address is 590 Madison Avenue, 15th Floor, New York, NY 10022. Our phone number is (212) 905-1000, and our internet address is [www.pennantpark.com](http://www.pennantpark.com). We make available, free of charge, on our website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports as well as proxy statements as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Information contained on our website is not incorporated by reference into this Report, and you should not consider information contained on our website to be part of this Report or any other report we file with the SEC. The SEC also maintains a website that contains reports, proxy and information statements and other information we file with the SEC at [www.sec.gov](http://www.sec.gov). Copies of these reports, proxy and information statements and other information may also be obtained, after paying a duplicating fee, by electronic request at the following e-mail address: [publicinfo@sec.gov](mailto:publicinfo@sec.gov), or by writing the SEC's Public Reference Section, 100 F Street, N.E., Washington, D.C. 20549-0102. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330.

**Our Consolidated Portfolio**

Our principal investment focus is to provide senior secured loans and mezzanine debt to U.S. middle-market companies in a variety of industries. We generally seek to target companies that generate positive cash flows from the broad variety of industries in which our Investment Adviser has direct expertise. The following is an illustrative list of the industries in which the Investment Adviser has invested:

- |   |   |
|---|---|
| Aerospace and Defense                                       | Environmental Services  |
| Auto Sector   | Financial Services  |
| Beverage, Food and Tobacco                                  | Grocery   |
| Broadcasting and Entertainment                              | Healthcare, Education and Childcare                               |
| Buildings and Real Estate                                   | Home & Office Furnishings, Housewares & Durable Consumer Products |
| Business Services   | Hotels, Motels, Inns and Gaming                                   |
| Cable Television  | Insurance   |
| Cargo Transportation  | Leisure, Amusement, Motion Picture, Entertainment                 |
| Chemicals, Plastics and Rubber                              | Logistics   |
| Communications  | Manufacturing/Basic Industries                                    |
| Consumer Products   | Media   |
| Containers Packaging & Glass                                | Mining, Steel, Iron and Non-Precious Metals                       |
| Distribution  | Oil and Gas   |
| Diversified/Conglomerate Manufacturing                      | Other Media   |
| Diversified/Conglomerate Services                           | Personal, Food and Miscellaneous Services                         |
| Diversified Natural Resources, Precious Metals and Minerals | Printing and Publishing   |
| Education   | Retail Stores   |
| Electronics   | Telecommunications  |
| Energy/Utilities  |   |

Listed below are our top ten portfolio companies and industries represented as a percentage of our consolidated portfolio assets (excluding cash equivalents) as of September 30,:

<b>Portfolio Company</b>	<b>2012</b>
Last Mile Funding, Corp. (3 PD, Inc.)	5%
Magnum Hunter Resources Corporation	
(Eureka Hunter Pipeline, LLC)	5%
LTI Flexible Products, Inc.	4%
New Service Champ Holdings, Inc. (Service Champ Inc.)	4%
Pre-Paid Legal Services, Inc.	4%
American Gilsonite Company	3%
Brand Energy and Infrastructure Services, Inc.	3%
Learning Care Group, Inc.	3%
Penton Media, Inc.	3%
Prince Mineral Holdings Corp.	3%
<b>Portfolio Company</b>	<b>2011</b>

## Edgar Filing: PENNANTPARK INVESTMENT CORP - Form 10-K

Magnum Hunter Resources Corporation	
(Eureka Hunter Pipeline, LLC)	6%
Last Mile Funding Corp. (3PD, Inc.)	5%
Pre-Paid Legal Services, Inc.	5%
Kadmon Pharmaceuticals LLC	
(f/k/a Three River Pharmaceuticals LLC)	4%
Learning Care Group, Inc.	4%
LTI Flexible Products, Inc.	4%
Veritext Corporation	4%
Instant Web, Inc.	3%
Penton Media, Inc.	3%
Prince Mineral Holdings Corp.	3%

**Table of Contents**

<b>Industry</b>	<b>2012</b>
Healthcare, Education & Childcare	8%
Electronics	7%
Energy/Utilities	7%
Auto Sector	6%
Business Services	6%
Cargo Transport	6%
Chemicals, Plastics and Rubber	5%
Consumer Products	5%
Distribution	4%
Personal, Food and Miscellaneous Services	4%
<b>Industry</b>	<b>2011</b>
Business Services	11%
Healthcare, Education & Childcare	10%
Energy/Utilities	9%
Cargo Transport	6%
Chemicals, Plastics and Rubber	6%
Consumer Products	5%
Oil and Gas	5%
Personal, Food and Miscellaneous Services	5%
Printing and Publishing	5%
Aerospace and Defense	4%

Our executive officers and directors, as well as the senior investment professionals of the Investment Adviser and Administrator, may serve as officers, directors or principals of entities that operate in the same or a related line of business as we do. Currently, the executive officers and directors, as well as the current senior investment professionals of the Investment Adviser and Administrator, serve as officers and directors of PennantPark Floating Rate Capital Ltd., a publicly traded BDC and other managed funds, as applicable. Accordingly, they may have obligations to investors in the fulfillment of which obligations might not be in the best interest of us or our stockholders. In addition, we note that any affiliated investment vehicle currently existing, or formed in the future, and managed by the Investment Adviser and or its affiliates may, notwithstanding different stated investment objectives, have overlapping investment objectives with our own and, accordingly, may invest in asset classes similar to those targeted by us. As a result, the Investment Adviser may face conflicts in allocating investment opportunities among us and such other entities. Although the Investment Adviser will endeavor to allocate investment opportunities in a fair and equitable manner, it is possible that, in the future, we may not be given the opportunity to participate in investments made by investment funds managed by the Investment Adviser or its affiliates. In any such case, when the Investment Adviser identifies an investment, it will choose which investment fund should receive the allocation. See

**Risk Factors** Risks Relating to our Business and Structure There are significant potential conflicts of interest which could impact our investment returns for more information.

We may invest, to the extent permitted by law, in the securities and instruments of other investment companies and companies that would be investment companies but are excluded from the definition of an investment company provided in Section 3(c) of the 1940 Act. We may also co-invest in the future on a concurrent basis with our affiliates, subject to compliance with applicable regulations and our trade allocation procedures. Some types of negotiated co-investments may be made only if we receive an order from the SEC permitting us to do so. We have not sought, and there can be no assurance that we would obtain, any such order.

**Due diligence**

We believe it is critical to conduct extensive due diligence on investment targets and in evaluating new investments. Our Investment Adviser conducts a rigorous due diligence process that is applied to prospective portfolio companies and draws from our Investment Adviser's experience, industry expertise and network of contacts. In conducting due diligence, our Investment Adviser uses information provided by companies, financial sponsors and publicly available information as well as information from relationships with former and current management teams, consultants, competitors and investment bankers.

Our due diligence typically includes:

review of historical and prospective financial information;

## Edgar Filing: PENNANTPARK INVESTMENT CORP - Form 10-K

research relating to the company's management, industry, markets, products and services and competitors.;

interviews with management, employees, customers and vendors of the potential portfolio company;

on-site visits;

review of loan documents; and

background checks.

Upon the completion of due diligence and a decision to proceed with an investment in a portfolio company, the team leading the investment presents the investment opportunity to our Investment Adviser's investment committee. This committee determines whether to pursue the potential investment. All new investments are required to be reviewed by the investment committee of our Investment Adviser. The members of the investment committee receive no compensation from us. These members are employees of our Investment Adviser and receive compensation from our Investment Adviser.



## **Table of Contents**

Additional due diligence with respect to any investment may be conducted on our behalf by attorneys and independent auditors prior to the closing of the investment, as well as other outside advisers, as appropriate.

The Investment Adviser monitors credit risk of each portfolio company regularly and periodically with a goal toward identifying early, and when able and appropriate, selling other investments with potential credit problems. This monitoring process may include reviewing: (1) a portfolio company's financial resources and operating history; (2) comparing a portfolio company's current operating results with the Investment Adviser's initial thesis for the investment and its expectations for the performance of the investment; (3) a portfolio company's sensitivity to economic conditions; (4) the performance of a portfolio company's management; (5) a portfolio company's debt maturities and borrowing requirements; (6) a portfolio company's interest and asset coverage; and (7) the relative value of an investment based on a portfolio company's anticipated cash flow.

The Investment Adviser seeks to achieve our investment objective through a disciplined approach to the selection of credit investments and its evaluation of portfolio companies. The Investment Adviser also gains exposure to portfolio companies across a broad range of industries and of varying operating and financial characteristics and return profiles, as well as active management of such investments in light of economic developments and trends. However, we are classified as "non-diversified" under the 1940 Act, and our investment portfolio may be more concentrated than the portfolios of other issuers. We may take certain actions if short-term interest rates increase or market conditions otherwise change (or if we anticipate such a change) and our use of leverage, if any, begins (or is expected) to adversely affect our common stockholders. To offset any potentially negative impact of leverage on common stockholders, we may shorten the average maturity of our investment portfolio (by investing in short-term securities) or may reduce our indebtedness or unwind other leveraged transactions. We may also attempt to reduce our use of leverage by redeeming or otherwise purchasing outstanding preferred stock or debt securities, if any.

### ***Investment structure***

Once we determine that a prospective portfolio company is suitable for investment, we work with the management of that company and its other capital providers, including senior, junior and equity capital providers, to structure an investment. We negotiate among these parties to agree on how our investment is structured relative to the other capital in the portfolio company's capital structure.

We expect our senior secured loans to have terms of three to ten years. We generally obtain security interests in the assets of our portfolio companies tha