

PENNANTPARK INVESTMENT CORP  
Form 10-Q  
August 09, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

\_\_\_\_\_  
**FORM 10-Q**  
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(Mark One)

**REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTER ENDED JUNE 30, 2007.**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

**COMMISSION FILE NUMBER: 814-00736**

\_\_\_\_\_  
**PENNANTPARK INVESTMENT CORPORATION**

(Exact name of registrant as specified in its charter)

\_\_\_\_\_

<b>MARYLAND</b> (State or other jurisdiction of incorporation or organization)	<b>20-8250744</b> (I.R.S. Employer Identification No.)
<b>445 Park Avenue, 10th Floor, New York, New York 10022</b>	

(Address of principal executive office)

(212) 307-3280 (Registrant's telephone number, including area code)

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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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer .

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. The number of shares of the issuer's Common Stock, \$0.001 par value, outstanding as of August 1, 2007 was 21,046,883.

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**PART I FINANCIAL INFORMATION**

We are filing this Report in compliance with Rule 13a-13 promulgated by the SEC. In this Report, PennantPark Investment , we , us and our refer to PennantPark Investment Corporation unless the context otherwise states.

**Table of Contents****ITEM 1. FINANCIAL STATEMENTS****PENNANTPARK INVESTMENT CORPORATION****CONSOLIDATED STATEMENT OF ASSETS AND LIABILITIES****(UNAUDITED)**

	<b>June 30,</b>
	<b>2007</b>
<b>Assets</b>	
Investments, at fair value (cost \$280,155,544)	\$ 275,043,692
Cash and cash equivalents (cost \$288,111,837)	288,104,949
Receivable for investments sold	13,574,352
Interest receivable	3,030,837
Prepaid expenses and other assets	1,469,254
<b>Total assets</b>	<b>581,223,084</b>
<b>Liabilities</b>	
Payable for cash equivalents purchased	281,783,538
Unfunded investments	8,591,972
Interest payable	15,208
Accrued other expenses	1,580,604
<b>Total liabilities</b>	<b>291,971,322</b>
<b>Net Assets</b>	
Common stock, par value \$.001 per share, 100,000,000 shares authorized and 21,046,883 shares issued and outstanding	21,047
Paid-in capital in excess of par	294,351,807
Undistributed net investment income	12,999
Accumulated net realized loss	(15,351)
Net unrealized depreciation on investments	(5,118,740)
<b>Total net assets</b>	<b>289,251,762</b>
<b>Total liabilities and net assets</b>	<b>\$ 581,223,084</b>
<b>Net asset value per share</b>	<b>\$ 13.74</b>

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

<sup>1</sup> None of our portfolio companies is controlled by, or affiliated with, PennantPark Investment Corporation as defined by the Investment Company Act of 1940, as amended (the "1940 Act").

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**PENNANTPARK INVESTMENT CORPORATION**  
**CONSOLIDATED STATEMENT OF OPERATIONS**  
**(UNAUDITED)**

	<b>For the Quarter Ended June 30, 2007</b>	<b>Period from January 11, 2007 (inception) through June 30, 2007</b>
<b>Investment Income:</b>		
Interest	\$ 5,425,279	\$ 6,198,262
<b>Total Investment income</b>	<b>5,425,279</b>	<b>6,198,262</b>
<b>Expenses:</b>		
Management fees	1,048,503	1,048,503
Interest and other credit facility expenses	862,433	1,603,408
Administrative services expenses	192,584	192,584
Organizational expenses		207,126
Directors fees	124,375	124,375
Other general and administrative expenses	151,791	227,893
<b>Total expenses</b>	<b>2,379,686</b>	<b>3,403,889</b>
Net investment income before management fee waiver and income tax	3,045,593	2,794,373
Management fee waiver	262,126	262,126
Income tax expense	(100,000)	(100,000)
<b>Net investment income</b>	<b>3,207,719</b>	<b>2,956,499</b>
<b>Realized and unrealized loss on investments:</b>		
Net realized loss on investments	(34,726)	(15,351)
Change in net unrealized depreciation on investments	(5,117,039)	(5,118,740)
<b>Net realized and unrealized loss from investments</b>	<b>(5,151,765)</b>	<b>(5,134,091)</b>
<b>Net decrease in net assets resulting from operations</b>	<b>\$ (1,944,046)</b>	<b>\$ (2,177,592)</b>
<b>Earnings per common share</b>	<b>\$ (.09)</b>	<b>\$ (.10)</b>

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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**PENNANTPARK INVESTMENT CORPORATION**  
**CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS**  
**(UNAUDITED)**

	<b>Period from January 11, 2007</b>	<b>(inception) through June 30, 2007</b>
<b>Increase in net assets from operations:</b>		
Net investment income	\$ 2,956,499	
Net realized loss on investments		(15,351)
Net change in unrealized depreciation on investments		(5,118,740)
<b>Net decrease in net assets resulting from operations</b>		<b>(2,177,592)</b>
<b>Dividends and distributions to shareholders:</b>		<b>(2,943,500)</b>
<b>Capital share transactions:</b>		
Issuance of shares of common stock		315,375,000
Less: Offering costs related to public share offerings		(21,309,375)
Reinvestment of dividends		307,229
<b>Net increase in net assets resulting from capital share transactions</b>		<b>294,372,854</b>
<b>Total increase in net assets</b>		<b>289,251,762</b>
<b>Net Assets:</b>		
Beginning of Period		
End of Period		\$ 289,251,762

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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**PENNANTPARK INVESTMENT CORPORATION**  
**CONSOLIDATED STATEMENT OF CASH FLOWS**  
**(UNAUDITED)**

	<b>Period from January 11, 2007</b>
	<b>(inception) through</b>
	<b>June 30, 2007</b>
<b>Cash flows from operating activities:</b>	
Net decrease in net assets resulting from operations	\$ (2,177,592)
Adjustments to reconcile net decrease in net assets derived from operations:	
Change in net unrealized depreciation on investments	5,118,740
Net realized loss on investments	15,351
Purchase of investments	(372,854,779)
Proceeds from disposition of investments	92,676,996
Increase in receivable for investments sold	(13,574,352)
Increase in interest receivable	(3,030,837)
Increase in prepaid expenses and other assets	(297,430)
Increase in payables for cash equivalents purchased	281,783,538
Increase in unfunded investments	8,591,972
Increase in accrued expenses	1,595,812
Net cash used by operating activities	(2,152,580)
<b>Cash flows from financing activities:</b>	
Issuance of shares of common stock	315,682,229
Offering costs	(21,309,375)
Capitalized borrowing costs	(1,171,824)
Borrowings under credit facilities	241,913,786
Repayments under credit facilities	(241,913,786)
Distributions to shareholders	(2,943,500)
Net cash provided by financing activities	290,257,530
<b>Net increase in cash and cash equivalents</b>	<b>288,104,949</b>
<b>Cash and cash equivalents, beginning of period</b>	
<b>Cash and cash equivalents, end of period</b>	<b>\$ 288,104,949</b>

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS



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**PENNANTPARK INVESTMENT CORPORATION**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS**

**JUNE 30, 2007**

**(UNAUDITED)**

Issuer name(1)	Maturity	Industry	Current Coupon	Basis Point Spread Above Index(3)	Par	Cost	Value(2)
<b><u>SUBORDINATED DEBT/ CORPORATE NOTES</u></b>							
<b>14.6%</b>							
ADVANSTAR COMMUNICATIONS, INC.	11/30/2015	OTHER MEDIA	12.32%*	L+700	14,138,942	14,138,942	14,138,942
AFFINION GROUP, INC.	10/17/2012	CONSUMER PRODUCTS	11.66%*	L+625	10,000,000	10,040,851	9,900,000
REALOGY CORP.	4/15/2015	BUILDINGS & REAL ESTATE	12.38%		20,000,000	20,047,225	18,237,500
<b>TOTAL SUBORDINATED DEBT/CORPORATE NOTES</b>					44,138,942	44,227,018	42,276,442
<b>COMMON EQUITY 1.0%</b>							
<b>Shares</b>							
VSS-AHC HOLDINGS, L.L.C.		OTHER MEDIA			3,000	3,000,000	3,000,000
<b>TOTAL COMMON EQUITY</b>					3,000	3,000,000	3,000,000
<b>2<sup>nd</sup> Lien Secured Debt 18.8%</b>							
<b>Par</b>							
QUESTEX MEDIA GROUP	11/04/2014	OTHER MEDIA	11.86%	L+650	10,000,000	10,000,000	10,012,500
SAINT ACQUISITION CORP.	5/15/2015	TRANSPORTATION	13.11%	L+775	10,000,000	9,927,611	9,412,500
SAINT ACQUISITION CORP.	5/15/2017	TRANSPORTATION	12.50%		10,000,000	10,000,000	9,475,000
SPECIALIZED TECHNOLOGY RESOURCES, INC.	11/23/2014	CHEMICAL, PLASTICS & RUBBER	12.32%	L+700	15,000,000	15,000,000	15,000,000
TRANSFIRST HOLDINGS, INC.	6/15/2015	BUSINESS SERVICES	11.30%*	L+600	10,500,000	10,500,000	10,500,000
<b>TOTAL 2<sup>ND</sup> LIEN SECURED DEBT</b>					55,500,000	55,427,611	54,400,000
<b>1<sup>st</sup> Lien Secured Debt 60.6%</b>							
BERRY PLASTICS HOLDING CORP.	4/03/2014	CONTAINERS, PACKAGING & GLASS	7.36%	L+200	7,481,250	7,481,250	7,383,059
BURLINGTON COAT FACTORY WAREHOUSE, INC.	5/28/2013	RETAIL STORE	7.61%	L+225	8,000,000	7,990,544	7,860,000

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**PENNANTPARK INVESTMENT CORPORATION**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS**

**JUNE 30, 2007**

**(UNAUDITED)**

Issuer name(1)	Maturity	Industry	Current Coupon	Basis Point Spread Above Index(3)	Par	Cost	Value(2)
CHARTER COMMUNICATIONS OPERATING, L.L.C.	3/6/2014	CABLE TELEVISION	7.35%	L+200	15,000,000	14,992,594	14,803,125
COHR HOLDINGS, INC.	1/31/2013	HEALTHCARE, EDUCATION & CHILDCARE	7.86%	L+250	2,992,500	2,992,500	2,977,537
FR BRAND HOLDINGS, CORP.	2/7/2014	ENERGY & Utilities	7.63%	L+225	1,995,000	1,995,000	1,990,012
GATEHOUSE MEDIA OPERATION, INC.	8/28/2014	MEDIA	7.36%	L+200	7,000,000	7,000,000	6,934,375
GENERAL NUTRITION CENTERS, INC.	3/16/2014	RETAIL STORE	7.60%	L+225	6,500,000	6,504,328	6,390,313
GREATWIDE LOGISTICS SERVICES, INC.	12/19/2013	CARGO TRANSPORT	8.85%	L+350	6,965,000	6,965,000	6,816,994
HANLEY WOOD, L.L.C.	3/8/2014	OTHER MEDIA	7.59%	L+225	9,000,000	9,000,000	8,786,250
HAWKER BEECHCRAFT, INC.	3/28/2014	AEROSPACE / DEFENCE	7.36%	L+200	1,995,390	1,995,390	1,985,413
HEALTH MANAGEMENT ASSOCIATES, INC.	2/28/2014	HEALTHCARE, EDUCATION & CHILDCARE	7.11%	L+175	9,975,000	9,975,000	9,962,531
HUGHES NETWORK SYSTEMS, L.L.C.	4/15/2014	TELE-	7.88%	L+250	5,000,000	5,000,000	4,975,000
JACUZZI BRANDS, INC.	2/15/2014	COMMUNICATIONS HOME & OFFICE FURNISHINGS, HOUSEWARES, & DURABLES	7.58%	L+225	10,000,000	10,000,000	9,600,000
LEVEL 3 FINANCING, INC.	3/13/2014	TELE-	7.61%	L+225	2,000,000	2,000,000	1,995,000
LEVLAD, L.L.C.	3/8/2014	COMMUNICATIONS CONSUMER PRODUCTS	7.60%	L+225	4,855,088	4,855,088	4,618,403
LONGVIEW POWER, L.L.C.	2/28/2014	UTILITIES	7.63%	L+225	2,666,667	2,666,667	2,666,667
LONGVIEW POWER, L.L.C.(4)	2/28/2014	UTILITIES			2,333,333	2,333,333	2,333,333
MACH GEN, L.L.C.	2/22/2013- 2/22/2014	UTILITIES	7.36%	L+200	3,981,875	3,980,556	3,971,920
MATTRESS HOLDING CORP.	1/18/2014	HOME & OFFICE FURNISHINGS, HOUSEWARES, & DURABLES	7.61%	L+225	4,000,000	4,000,000	3,985,000
McJUNKIN CORP.	1/31/2014	OIL & GAS	7.59%	L+225	2,985,000	2,985,000	2,986,866
MITCHELL INTERNATIONAL, INC.	3/28/2014	BUSINESS SERVICES	7.38%	L+200	4,000,000	4,000,000	3,992,500
NATIONAL BEDDING Co., L.L.C.	8/31/2011	HOME & OFFICE FURNISHINGS, HOUSEWARES, & DURABLES	7.36%	L+200	6,982,500	6,989,926	6,960,680
PENTON MEDIA, INC.	1/31/2014	OTHER MEDIA	7.60%	L+225	5,000,000	5,000,000	4,993,750
PHILOSOPHY, INC.	3/23/2014	CONSUMER PRODUCTS	7.36%	L+200	1,493,333	1,493,333	1,482,133

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**PENNANTPARK INVESTMENT CORPORATION**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS, CONTINUED**

**JUNE 30, 2007**

**(UNAUDITED)**

Issuer name(1)	Maturity	Industry	Current Coupon	Basis Point Spread Above Index(3)	Par	Cost	Value(2)
<b>1<sup>st</sup> Lien Secured Debt (Continued)</b>							
PROQUEST CSA, L.L.C.	2/9/2014	EDUCATION	8.33%	L+300	997,500	997,500	995,006
QUESTEX MEDIA GROUP	11/04/2014	OTHER MEDIA	8.36%	L+300	3,508,334	3,508,333	3,512,719
QUESTEX MEDIA GROUP(4)	11/04/2014	OTHER MEDIA			1,480,834	1,480,833	1,482,684
READERS DIGEST ASSOCIATION, INC.	3/2/2014	PRINTING & PUBLISHING	7.36%	L+200	1,000,000	1,000,000	996,875
REXNORD CORP.	2/27/2014	MANUFACTURING/ BASIC INDUSTRIES	7.58%	L+225	4,937,500	4,937,500	4,949,844
SITEL, L.L.C.	1/30/2014	BUSINESS SERVICES	7.82%	L+250	4,867,302	4,867,302	4,867,302
UNIVISION COMMUNICATIONS, INC.	9/29/2014	BROADCASTING & ENTERTAINMENT	7.61%	L+225	14,093,960	14,093,960	13,785,654
UNIVISION COMMUNICATIONS, INC.(4)	9/29/2014	BROADCASTING & ENTERTAINMENT			906,040	906,040	886,221
VALASSIS COMMUNICATIONS, INC.	3/2/2014	PRINTING & PUBLISHING	7.10%	L+175	7,410,030	7,410,030	7,354,455
VALASSIS COMMUNICATIONS, INC (4)	3/2/2014	PRINTING & PUBLISHING			2,103,908	2,103,908	2,088,129
WESTERN REFINING, INC.	6/25/2010	OIL & GAS	7.10%	L+175	2,232,143	2,232,143	2,230,748
WESTERN REFINING, INC. (4)	6/25/2010	OIL & GAS			1,767,857	1,767,857	1,766,752
<b>TOTAL 1<sup>st</sup> LIEN SECURED DEBT</b>					<b>177,507,344</b>	<b>177,500,915</b>	<b>175,367,250</b>
<b>TOTAL INVESTMENTS</b>						<b>\$ 280,155,544</b>	<b>\$ 275,043,692</b>
<b>Cash Equivalents 99.5%</b>							
U.S. TREASURY BILL	9/27/2007		4.67%		\$ 285,000,000	\$ 281,783,538	\$ 281,776,650
MONEY MARKET MUTUAL FUNDS					6,328,299	6,328,299	6,328,299
<b>TOTAL CASH EQUIVALENTS 99.5%</b>					<b>291,328,299</b>	<b>288,111,837</b>	<b>288,104,949</b>
<b>TOTAL INVESTMENTS AND CASH EQUIVALENTS</b>							
<b>194.5%</b>					<b>\$ 568,477,585</b>	<b>\$ 568,267,381</b>	<b>\$ 563,148,641</b>
<b>Liabilities in Excess of Other Assets</b>							
<b>(94.5)%</b>							<b>(273,896,879)</b>
<b>Net assets 100.0%</b>							<b>\$ 289,251,762</b>



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- (1) We do not control and are not an affiliate of any of our portfolio companies, each as defined in the 1940 Act. In general, under the 1940 Act, we would be presumed to control a portfolio company if we owned 25% or more of its voting securities and would be deemed to be an affiliate of a portfolio company if we owned 5% or more of its voting securities.
  - (2) Valued based on accounting policy of the Company. (See Note 2)
  - (3) Represents floating rate instruments that accrue interest at a predetermined spread relative to an index, typically the applicable LIBOR (London Interbank Offer Rate) ( L ).
  - (4) Represents purchases of securities with delayed draws. These securities do not have a basis point spread above index.
- \* Coupon payable in cash or Payment In Kind.

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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**PENNANTPARK INVESTMENT CORPORATION**

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2007**

**(UNAUDITED)**

**1. ORGANIZATION**

PennantPark Investment Corporation ( PennantPark Investment or Company ) was organized as a Maryland corporation on January 11, 2007. PennantPark Investment's objective is to generate both current income and capital appreciation through debt and equity investments. PennantPark Investment invests primarily in middle market companies in the form of mezzanine loans, senior secured loans and equity securities. As of June 30, 2007 PennantPark Investment had sold and issued 21,046,883 shares of its common stock, with proceeds of \$315.7 million. Before the completion of its initial public offering on April 24, 2007, PennantPark Investment had limited operations other than the sale and issuance of 80,000 shares of common stock at an aggregate purchase price of \$1,200,000 to PennantPark Investment Advisers, LLC and the purchase of senior secured and mezzanine loans.

On April 24, 2007 Pennant Park closed its initial public offering, resulting in net proceeds of approximately \$279.6 million. Also on April 24, PennantPark closed a private placement of common stock pursuant to Regulation D under the Securities Act of 1933. This private placement of 320,000 shares was made to officers, directors, the investment adviser and managers of the investment adviser, for \$15 per share, resulting in net proceeds of approximately \$4.8 million. On May 21, the underwriters of the initial public offering exercised their over-allotment option to them under the Underwriting Agreement. The Underwriters elected to purchase 625,000 shares of our common stock, resulting in net proceeds of \$8.8 million.

The consolidated financial statements include the accounts of PennantPark Investment and its wholly owned special purpose subsidiary, Pennant SPV Company, LLC ( Pennant SPV ) a Delaware corporation. On April 24, 2007, Pennant SPV transferred all of its assets to PennantPark Investment. On May 31, 2007, the board of directors approved a resolution to set September 30th as the fiscal year end of PennantPark Investment. The Company's first fiscal year will end on September 30, 2007.

**2. SIGNIFICANT ACCOUNTING POLICIES**

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles ( GAAP ) requires management to make estimates and assumptions that affect the reported amount of assets and liabilities at the date of the consolidated financial statements and the reported amounts of income and expenses during the reported period. Actual results could differ from these estimates.

Interim financial statements are prepared in accordance with GAAP for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 6 or 10 of Regulation S-X, as appropriate. In accordance with Article 6-09 of Regulation S-X under the Exchange Act, we are providing a Statement of Changes in Net Assets in lieu of a Statement of Changes in Stockholders' Equity.

The significant accounting policies consistently followed by PennantPark Investment are:

- (a) Security transactions are recorded on a trade-date basis. Investments for which market quotations are readily available are valued at such market quotations. Debt and equity securities that are not publicly traded or whose market prices are not readily available are valued at fair value as determined in good faith by or under the direction of the board of directors. Subordinated debt, senior secured debt and other debt securities with maturities greater than 60 days are valued by an independent pricing service or at the bid prices from at least two brokers or dealers (if available, otherwise by a principal market maker or a primary market dealer). With respect to private equity securities for which there is no readily available market value, each investment is valued by independent third party valuation firms using methods that may, among other measures and as applicable, include comparisons of financial ratios of the portfolio companies that issued such private equity securities to peer companies that are public. When an external event such as a purchase transaction, public offering or subsequent equity sale occurs, we consider the pricing indicated by the external event to corroborate our private equity valuation. Because we expect that there will not be readily available market values for many of the investments which are or will be in our portfolio, we expect to value such investments at fair value as determined in good

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faith by or under the direction of our board of directors using a documented valuation policy and a consistently applied valuation process. Due to the inherent uncertainty of determining the fair value of investments that do not have a readily available market value, the fair value of our investments may differ significantly from the values that would have been used had a readily available market value existed for such investments, and the differences could be material.

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With respect to investments for which market quotations are not readily available, the board of directors undertakes a multi-step valuation process each quarter, as described below:

- (1) PennantPark Investment's quarterly valuation process begins with each portfolio company or investment being initially valued by the investment professionals responsible for the portfolio investment;
- (2) preliminary valuation conclusions are then documented and discussed with senior management;
- (3) independent valuation firms engaged by the board of directors conduct independent appraisals and review management's preliminary valuations and their own independent assessment;
- (4) the audit committee of the board of directors reviews the preliminary valuation of the PennantPark Investment Advisers, LLC and that of the independent valuation firms and responds and supplements the valuation recommendation of the independent valuation firm to reflect any comments; and
- (5) the board of directors discusses valuations and determines the fair value of each investment in the portfolio in good faith based on the input of PennantPark Investment Advisers, LLC, the respective independent valuation firms and the audit committee.

The types of factors that the board of directors may take into account in pricing our investments at fair value include, as relevant, the nature and realizable value of any collateral, the portfolio company's ability to make payments and its earnings and discounted cash flow, the markets in which the portfolio company does business, comparison to publicly traded securities and other relevant factors.

Determination of fair values involves subjective judgments and estimates. Accordingly, these notes to the consolidated financial statements express the uncertainty with respect to the possible effect of such valuations, and any change in such valuations, on the consolidated financial statements.

- (b) Investments purchased within 60 days of maturity are valued at cost plus accreted discount, or minus amortized premium, which approximates value.
- (c) Realized gains or losses on the sale of investments are calculated using the specific identification method.
- (d) Interest income, adjusted for amortization of premium and accretion of discount, is recorded on an accrual basis. Origination, closing and/or commitment fees which will be associated with investments in portfolio companies are accreted into interest income over the respective terms of the applicable loans. Upon the prepayment of a loan or debt security, any prepayment penalties and unamortized loan origination, closing and commitment fees are recorded as interest income. Dividend income is recognized and recorded on the ex-dividend date.
- (e) Before May 1, 2007 PennantPark Investment was taxed as a corporation under Subchapter C of the Internal Revenue Code of 1986, as amended (the Code), and subject to corporate-level federal, state and local taxes. Starting May 1, 2007 PennantPark Investment intends to comply with the requirements of Subchapter M of the Code, and expects to be subject to tax as a regulated investment company, or "RIC". As a corporation, PennantPark Investment accounted for income taxes using the asset liability method prescribed by FASB Statement No. 109, Accounting for Income Taxes. Under this method, income taxes were provided for amounts currently payable and for amounts deferred as tax assets and liabilities based on differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. Federal, state and local taxes of \$100,000 were accrued and included in PennantPark Investment's statement of



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operations. Based upon PennantPark Investment's qualification and election to be subject to tax as RIC as of its next taxable year-end, we do not anticipate any taxes in the future. There is no expected future benefit of net operating losses created by PennantPark Investments generated during the period May 1, 2007 through June 30, 2007. The Company shall recognize in its financial statements the effect of a tax position when it is more likely than not, based on the technical merits, that the position will be sustained upon examination.

- (f) Dividends and distributions to common stockholders are recorded on the ex-dividend date. The amount, if any, to be paid as a dividend is determined by the board of directors each quarter and is generally based upon the earnings estimated by management. Net realized capital gains, if any, are distributed at least annually.
  
- (g) In September 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards ( SFAS ) 157, Fair Value Measurements, which clarifies the definition of fair value and requires companies to expand their disclosure about the use of fair value to measure assets and liabilities in interim and annual periods subsequent to initial recognition. Adoption of SFAS 157 requires the use of the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. At this time, PennantPark Investment is in the process of reviewing this standard against its valuation policies to determine future applicability.

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**Table of Contents****3. AGREEMENTS**

PennantPark Investment has entered into an Investment Management Agreement with the PennantPark Investment Advisers, LLC (the Investment Adviser or PennantPark Investment Adviser ) under which the Investment Adviser, subject to the overall supervision of PennantPark Investment's board of directors, manages the day-to-day operations of and provides investment advisory services to, PennantPark Investment. For providing these services, the Investment Adviser receives a fee from PennantPark Investment, consisting of two components a base management fee and an incentive fee (collectively, Management Fees ).

The base management fee is calculated at an annual rate of 2.00% on PennantPark Investment's gross assets (See Note 9). Although the base management fee is 2.00% of gross assets, the Investment Adviser has agreed to waive a portion of the base management fee such that the base management fee will equal 1.50% from the consummation of the initial public offering through September 30, 2007; 1.75 percent from October 1, 2007 through March 31, 2008; and 2.00% thereafter. For the period from the commencement of operations to the consummation of the initial public offering there were no management fees. For services rendered under the Investment Management Agreement during the period commencing from the closing of the initial public offering through and including the first six months of operations, the base management fee is payable monthly in arrears. For services rendered under the Investment Management Agreement after that time, the base management fee will be payable quarterly in arrears. For the first quarter of operations, the base management fee was calculated based on the initial value of gross assets. Subsequently, the base management fee is calculated based on the average value of gross assets at the end of the two most recently completed calendar quarters, and appropriately adjusted for any share issuances or repurchases during the current calendar quarter. Base investment advisory fees for any partial month or quarter are appropriately pro rated.

For the period from the consummation of the initial public offering to June 30, 2007, the Investment Adviser received \$786,377 in base management fee.

The incentive fee has two parts, as follows:

One part is calculated and payable quarterly in arrears based on PennantPark Investment's Pre-Incentive Fee Net Investment Income for the immediately preceding calendar quarter. For this purpose, Pre-Incentive Fee Net Investment Income means interest income, distribution income and any other income (including any other fees (other than fees for providing managerial assistance), such as commitment, origination, structuring, diligence and consulting fees or other fees received from portfolio companies) accrued during the calendar quarter, minus PennantPark Investment's operating expenses for the quarter (including the base management fee, any expenses payable under the Administration Agreement, and any interest expense and distribution paid on any issued and outstanding preferred stock, but excluding the incentive fee). Pre-Incentive Fee Net Investment Income includes, in the case of investments with deferred interest feature (such as original issue discount, debt instruments with pay in kind interest and zero coupon securities), accrued income not yet received in cash. Pre-Incentive Fee Net Investment Income does not include any realized capital gains, realized capital losses or unrealized capital appreciation or depreciation. Pre-Incentive Fee Net Investment Income, expressed as a rate of return on the value of PennantPark Investment's net assets at the end of the immediately preceding calendar quarter, is compared to the hurdle rate of 1.75% per quarter (7.00% annualized). PennantPark Investment pays the Investment Adviser an incentive fee with respect to PennantPark Investment's Pre-Incentive Fee Net Investment Income in each calendar quarter as follows: (1) no incentive fee in any calendar quarter in which PennantPark Investment's Pre-Incentive Fee Net Investment Income does not exceed the hurdle rate; (2) 100% of PennantPark Investment's Pre-Incentive Fee Net Investment Income with respect to that portion of such Pre-Incentive Fee Net Investment Income, if any, that exceeds the hurdle rate but is less than 2.1875% in any calendar quarter (8.75% annualized); and (3) 20% of the amount of PennantPark Investment's Pre-Incentive Fee Net Investment Income, if any, that exceeds 2.1875% in any calendar quarter. These calculations are pro rated for any period of less than three months and adjusted for any share issuances or repurchases during the current quarter.

The second part of the incentive fee is determined and payable in arrears as of the end of each calendar year (or upon termination of the Investment Management Agreement, as of the termination date), commencing on December 31, 2007, and equals 20.0% of PennantPark Investment's realized capital gains, if any, on a cumulative basis from inception through the end of each calendar year, computed net of all realized capital losses and unrealized capital depreciation on a cumulative basis, less the aggregate

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amount of any previously paid capital gain incentive fees. However, the incentive fee determined as of December 31, 2007 will be calculated for a period of shorter than twelve calendar months to take into account any realized capital gains computed net of all realized capital losses and unrealized capital depreciation from inception.

PennantPark Investment has also entered into an Administration Agreement with PennantPark Investment Administration, LLC (the Administrator or PennantPark Investment Administration ) under which PennantPark Investment Administration provides administrative services for PennantPark Investment. For providing these services, facilities and personnel, PennantPark Investment reimburses the Administrator for PennantPark Investment's allocable portion of overhead and other expenses incurred by the Administrator in performing its obligations under the Administration Agreement, including rent and PennantPark Investment's allocable portion of the costs of the compensation and related expenses for its chief compliance officer, chief financial officer and their respective staffs. The Administrator also provides on PennantPark Investment's behalf managerial assistance to portfolio companies to which PennantPark Investment is required to provide such assistance. Reimbursement for certain of these costs is included in other expenses in the consolidated statement of operations.

**4. ORGANIZATIONAL AND OFFERING EXPENSES**

A portion of the net proceeds of the Company's initial public offering was used for organizational, offering and other expenses. Organizational expenses were treated as expenses incurred. Offering costs of \$21,309,375 were charged to net assets after the completion of the initial public offering on April 24, 2007.

**5. NET ASSET VALUE PER SHARE**

On June 30, 2007, PennantPark Investment's total net assets and net asset value per share were \$289,251,762 and \$13.74, respectively.

**6. EARNINGS PER SHARE**

The following information sets forth the computation of basic and diluted per share net decrease in net assets resulting from operations:

	<b>Quarter Ended</b>	<b>Period from</b>
	<b>June 30, 2007</b>	<b>January 11,</b>
		<b>2007 (inception)</b>
	<b>through June</b>	
	<b>June 30, 2007</b>	<b>30, 2007</b>
Numerator for net (decrease) in net assets per share resulting from operations:	\$ (1,944,046)	\$ (2,177,592)
Denominator for basic and diluted weighted average shares:	21,046,883	21,046,883
Basic and diluted net (decrease) in net assets per share resulting from operations:	\$ (0.09)	\$ (0.10)

**Table of Contents****7. INVESTMENTS**

Investments consisted of 1<sup>st</sup> lien secured debt, 2<sup>nd</sup> lien secured debt, subordinated debt, and common equity as of June 30, 2007. The table below describes investments by industry classification and enumerates the percentage, by market value, of the total investments in such industries as of June 30, 2007.

<b>Industry Classification</b>	<b>Percentage at Market Value</b>
Other Media	17%
Buildings & Real Estate	7%
Business Services	7%
Home & Office Furnishings, Housewares, & Durable Consumer Products	7%
Transportation	7%
Consumer Products	6%
Broadcasting & Entertainment	5%
Cable Television	5%
Chemical, Plastics & Rubber	5%
Healthcare, Education & Childcare	5%
Retail Store	5%
Printing & Publishing	4%
Containers, Packaging & Glass	3%
Media	3%
Telecommunications	3%
Utilities	3%
Cargo Transport	2%
Manufacturing / Basic Industries	2%
Oil & Gas	2%
Aerospace / Defense	1%
Energy / Utilities	1%
Education	Less than 1%
<b>Total Investments</b>	<b>100%</b>

**8. TAXES**

For the period from inception through April 30, 2007, the Company was taxed as a corporation, as such, federal, state and local taxes of \$100,000 were accrued and included in PennantPark Investment's statement of operations. Based upon PennantPark Investment's expected qualification and election to be subject to tax as RIC as of its next taxable year-end, we do not anticipate any taxes in the future. There is no expected future benefit of net operating losses created by PennantPark Investments generated during the period May 1, 2007 through June 30, 2007.

**9. CASH EQUIVALENTS**

Pending investment in longer-term portfolio holdings, PennantPark Investment may invest temporarily in U.S. Treasury bills (of varying maturities), repurchase agreements and money markets. These temporary investments with maturities of 90 days or less will be deemed cash equivalents and are included in the Schedule of Investments. At the end of each fiscal quarter, PennantPark Investment typically takes proactive steps to preserve investment flexibility in the next quarter, which is dependent upon the composition of its total assets at quarter end. PennantPark Investment may accomplish this in several ways, including purchasing U.S. Treasury bills and closing out its positions on a net cash basis after quarter-end or by utilizing repurchase agreements or other balance sheet transactions as it deems appropriate for this purpose. These amounts are excluded from total assets for purposes of computing the asset base upon which the management fee is determined. U.S. Treasury bills with maturities greater than 60 days from the time of purchase are marked-to-market consistent with PennantPark Investment's valuation policy.



**Table of Contents****10. REPURCHASE AGREEMENTS**

PennantPark Investment may enter into repurchase agreements as part of its investment program. In these transactions, PennantPark Investment's custodian takes possession of collateral pledged by the counterparty. The collateral is marked-to-market daily to ensure that the value, plus accrued interest, is at least equal to the repurchase price. In the event of default of the obligor to repurchase, PennantPark Investment will have the right to liquidate the collateral and apply the proceeds in satisfaction of the obligation. Under certain circumstances, in the event of default or bankruptcy by the counterparty to the agreement, realization and/or retention of the collateral or proceeds may be subject to legal proceedings. There were no repurchase agreements outstanding at June 30, 2007.

**11. FINANCIAL HIGHLIGHTS**

The following is an unaudited schedule of financial highlights for the period from January 11, 2007 (inception) through June 30, 2007:

<b>Per Share Data:</b>	
Net asset value, beginning of period	\$ 0.00
Net investment income	0.14
Net realized and unrealized gain	(0.24)
Net decrease in net assets resulting from operations	(0.10)
Distributions to shareholders(1)	(0.14)
Offering costs related to public offerings	(1.02)
Issuance of common stock	15.00
Net asset value, end of period	\$ 13.74
Per share market value at end of period	\$ 14.04
Total return(2)*	(5.47)%
Shares outstanding at end of period	21,046,883
<b>Ratio/Supplemental Data:</b>	
Net assets at end of period	\$ 289,251,762
Ratio of net investment income to average net assets*	1.02%
Ratio of operating expenses before management fee waiver to average net assets*	0.65%
Ratio of operating expenses after management fee waiver to average net assets*	0.57%
Ratio of credit facility related expenses to average net assets*	0.55%
Ratio of total expenses to average net assets*	1.12%
Average debt outstanding (3)	\$ 447,761
Average debt per share (3)	\$ 0.02
Portfolio turnover ratio*	47.3%

\* Percentages have not been annualized.

- (1) Dividends and distributions are determined based on taxable income calculated in accordance with income tax regulations which may differ from amounts determined under accounting principles generally accepted in the United States of America.
- (2) Total return is based on the change in market price per share during the respective reporting periods based on stock issuance price of \$15.00. It also takes into account distributions, if any, reinvested in accordance with the Company's dividend reinvestment plan.
- (3) Since completion of initial public offering on April 24, 2007.

**12. CREDIT FACILITY**

On June 25, 2007, PennantPark Investment entered into a Senior Secured Revolving Credit Agreement (the "Credit Agreement") among PennantPark Investment, various lenders and SunTrust Bank, as administrative agent for the lenders. SunTrust Robinson Humphrey Capital Markets acted as the joint lead arranger and book-runner, and Bear Stearns Corporate Lending Inc. acted as joint lead arranger and syndication agent. As of June 30, we did not have any outstanding borrowing under the Credit Agreement.

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Under the Credit Agreement, the lenders agreed to extend credit to PennantPark Investment in an initial aggregate principal or face amount not exceeding \$300,000,000 at any one time outstanding. The Credit Agreement is a five-year revolving facility (with a stated maturity date of June 25, 2012) and is secured by substantially all of the assets in PennantPark Investment's portfolio. Pricing is set at 100 basis points over LIBOR.

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The Credit Agreement contains affirmative and restrictive covenants, including: (a) periodic financial reporting requirements, (b) maintenance of a minimum shareholders' equity of the greater of (i) 40% of the total assets of PennantPark Investment and its subsidiaries as at the last day of any fiscal quarter and (ii) the sum of (A) \$120,000,000 plus (B) 25% of the net proceeds from the sale of equity interests in PennantPark and its subsidiaries after the closing date of the Credit Agreement, (c) maintenance of a ratio of total assets (less total liabilities other than indebtedness) to total indebtedness, in each case of PennantPark Investment, of not less than 2.0:1.0, (d) maintenance of minimum liquidity standards, (e) limitations on the incurrence of additional indebtedness, (f) limitations on liens, (g) limitations on fundamental corporate changes, (h) limitations on investments (other than PennantPark Investment's portfolio investments and certain other ordinary course investments), (i) limitations on payments and distributions (other than distributions to PennantPark Investment's shareholders as contemplated to maintain Regulated Investment Company status), (j) limitations on transactions with affiliates, (k) limitations on engaging in business not contemplated by PennantPark Investment's investment objectives, and (l) limitations on the creation or existence of agreements that prohibit liens on properties of PennantPark Investment and its subsidiaries. In addition to the asset coverage ratio described in clause (c) of the preceding sentence, borrowings under the Credit Agreement (and the incurrence of certain other permitted debt) will be subject to compliance with a borrowing base that will apply different advance rates to different types of assets in PennantPark Investment's portfolio. See our Credit Agreement, Exhibit 10.5, to this Report (incorporated by reference), for the definitions of capitalized terms used by us relating to the Credit Agreement but not defined in this note. The Credit Agreement will be used to supplement our equity capital to make additional portfolio investments and for other general corporate purposes.

Separately, Pennant SPV entered into a senior secured credit facility on February 6, 2007 with Bear Stearns Investment Products Inc., as lender. Under the terms of this credit agreement, as amended on March 26, 2007, Bear Stearns Investment Products Inc. agreed to extend credit to Pennant SPV in an aggregate principal of up to \$250 million at any one time outstanding. Borrowings under this credit agreement were used to finance investments made by PennantPark Investment prior to the closing of the initial public offering. By its terms this credit agreement matured on the closing date of the initial public offering on April 24, 2007, and accordingly PennantPark Investment caused Pennant SPV to repay the credit facility with Bear Stearns Investment Products Inc. in full.

### **13. COMMITMENTS AND CONTINGENCIES**

From time to time, we, the Investment Adviser or Administrator, may be a party to certain legal proceedings in the ordinary course of business, including proceedings relating to the enforcement of our rights under contracts with our portfolio companies. While the outcome of these legal proceedings cannot be predicted with certainty, we do not expect that these proceedings will have a material effect upon our financial condition or results of operations.

Unfunded debt investments described in the consolidated statement of assets and liabilities represent unfunded delayed draws on investments in 1<sup>st</sup> lien secured debt.



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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareholders of

PennantPark Investment Corporation

We have reviewed the accompanying consolidated statement of assets and liabilities of PennantPark Investment Corporation (the Company) as of June 30, 2007, including the consolidated schedule of investments and the related consolidated statements of operations, changes in net assets and cash flows for the quarter ended June 30, 2007 and for the period from January 11, 2007 (inception) through June 30, 2007. These consolidated financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the consolidated financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying consolidated financial statements for them to be in conformity with U.S. generally accepted accounting principles.

/s/ KPMG LLP

New York, New York

August 1, 2007

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**FORWARD-LOOKING STATEMENTS**

This Report, including the Management's Discussion and Analysis of Financial Condition and Results of Operations, contains statements that constitute forward-looking statements, which relate to future events or our future performance or financial condition. These forward-looking statements are not historical facts, but rather are based on current expectations, estimates and projections about our industry, our beliefs and our assumptions. The forward-looking statements contained in this Report involve risks and uncertainties, including without limitation statements as to:

our future operating results;

our business prospects and the prospects of our prospective portfolio companies;

the impact of investments that we expect to make;

our contractual arrangements and relationships with third parties;

the dependence of our future success on the general economy and its impact on the industries in which we invest;

the ability of our prospective portfolio companies to achieve their objectives;

our expected financings and investments;

the adequacy of our cash resources and working capital; and

the timing of cash flows, if any, from the operations of our prospective portfolio companies.

We use words such as anticipates, believes, expects, intends, seeks and similar expressions to identify forward-looking statements. Undue influence should not be placed on the forward looking statements as our actual results could differ materially from those projected in the forward-looking statements for any reason, including the factors set forth in our preliminary prospectus entitled Risk Factors and elsewhere.

We have based the forward-looking statements included in this Report on information available to us on the date of this Report, and we assume no obligation to update any such forward-looking statements. Although we undertake no obligation to revise or update any forward-looking statements in this Report, whether as a result of new information, future events or otherwise, you are advised to consult any additional disclosures that we may make directly to you or through reports that we in the future may file with the SEC, including annual reports on Form 10-K, Reports on Form 10-Q and current reports on Form 8-K.

The following analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the related notes thereto contained elsewhere in this Form 10-Q.

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**OVERVIEW**

PennantPark Investment was incorporated under the Maryland General Corporation Law in January 2007. We are an externally managed, closed-end, non-diversified management investment company that has elected to be treated as a business development company under 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 private or thinly traded public U.S. companies, cash, cash equivalents, U.S. government securities and high-quality debt investments that mature in one year or less.

Our investment objective is to generate both current income and capital appreciation through debt and equity investments. From time to time, we may also invest in public companies that are thinly traded. We anticipate that our portfolio will be comprised of investments in subordinated loans, referred to as mezzanine loans, and senior secured loans made to private U.S. middle market companies. We expect that the companies in which we invest will typically be highly leveraged, often as a result of leveraged buy-outs or other recapitalization transactions, and, in most cases, will not be rated by national rating agencies. If such companies were rated, we believe 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 the debt securities of such companies to range in maturity from three to ten years.

We may also invest in equity securities, such as preferred stock, common stock, warrants or options received in connection with our debt investments or through direct investments. We expect that our investments in mezzanine loans, senior secured loans and other investments will range between \$10 million and \$50 million each, although this investment size will vary proportionately with the size of our capital base. While we have invested substantially all of the proceeds of our initial public offering, we anticipate that it may take us up to 12 to 18 months from the closing date of our initial public offering to invest a substantial portion of the net proceeds in accordance with our investment objectives and up to two years to invest all of the net proceeds in accordance with our investment objectives, in part because privately negotiated investments in illiquid securities or private middle market companies require substantial due diligence and structuring. Until we are able to invest in accordance with our investment objectives, we plan to hold senior secured loans of between \$3 and \$10 million each. During that period, we expect to have lower interest income and capital gains than we will have after we become fully invested according to our investment objectives.

While our primary focus will be to generate current income and capital appreciation through debt and equity investments in thinly traded or private U.S. companies, we may invest up to 30% of the portfolio in opportunistic investments in order to seek to enhance returns to stockholders. Such investments may include investments in high-yield bonds, distressed debt, private equity or securities of public companies that are not thinly traded and securities of middle market companies located outside of the United States. We expect that these public companies generally will have debt securities that are non-investment grade.

***Revenues***

We generate revenue in the form of interest income on the debt securities that we own and capital gains and distributions, if any, on the warrants or other equity interests that we may acquire in portfolio companies. Our debt investments, whether in the form of mezzanine loans or senior secured loans, typically have a term of five to ten years and bear interest at a fixed or floating rate. Interest on debt securities is generally payable quarterly or semiannually, with the amortization of principal generally being deferred for several years from the date of the initial investment. In some cases, we also defer payments of interest for the first few years after our investment. The principal amount of the debt securities and any accrued but unpaid interest generally becomes due at the maturity date. In addition, we generate revenue in the form of commitment, origination, structuring or diligence fees, fees for providing managerial assistance and possibly consulting fees. Loan origination fees, original issue discount and market discount are capitalized, and we amortize such amounts as interest income. Upon the prepayment of a loan or debt security, we record any unamortized loan origination fees as interest income. We record prepayment premiums on loans and debt securities as interest income when we receive such amounts.

***Expenses***

Our primary operating expenses include the payment of investment advisory fees to our Investment Adviser, our allocable portion of overhead under the Administration Agreement and other operating costs as detailed below. Our investment advisory fee compensates our investment adviser for its work in identifying, evaluating, negotiating, consummating and monitoring our investments. Additionally, we pay interest expense on the outstanding debt we accrue under our credit facility. We will bear all other costs and expenses of our operations and transactions, including (without limitation):

the cost of calculating our net asset value, including the cost of any third-party valuation services;

the cost of effecting sales and repurchases of shares of our common stock and other securities;

fees payable to third parties relating to, or associated with, making investments, including fees and expenses associated with performing due diligence reviews of prospective investments and investment advisory fees;

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transfer agent and custodial fees;

fees and expenses associated with marketing efforts;

federal and state registration fees and any stock exchange listing fees;

federal, state and local taxes;

independent directors' fees and expenses;

brokerage commissions;

fidelity bond, directors and officers/errors and omissions liability insurance and other insurance premiums;

direct costs such as printing, mailing, long distance telephone and staff;

fees and expenses associated with independent audits and outside legal costs;

costs associated with our reporting and compliance obligations under the 1940 Act and applicable federal and state securities laws; and

all other expenses incurred by either the Administrator or us in connection with administering our business, including payments under the Administration Agreement that will be based upon our allocable portion of overhead, and other expenses incurred by the Administrator in performing its obligations under the 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.

***Distribution Policy***

Our board of directors determines the timing and amount, if any, of our distributions. We intend to pay distributions on a quarterly basis. In order to avoid corporate-level tax on the income we distribute as a regulated investment company, or RIC, we must distribute to our stockholders at least 90% of our ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, on an annual basis out of the assets legally available for such distributions. In addition, we also intend to distribute any realized net capital gains (i.e., realized net long-term capital gains in excess of realized net short-term capital losses) at least annually out of the assets legally available for such distributions.

**CONTRACTUAL OBLIGATIONS**

We have entered into certain contracts under which we have material future commitments. We and PennantPark Investment Advisers entered into an Interim Management Agreement, dated January 18, 2007, pursuant to which PennantPark Investment Advisers provided investment management services to us prior to our initial public offering. Under the Interim Management Agreement, PennantPark Investment Advisers was reimbursed for expenses and did not receive a management or incentive fee. On April 17, 2007 we entered into an Investment Management Agreement with PennantPark Investment Advisers in accordance with the 1940 Act, effective as of the completion of our initial public offering. PennantPark Investment Advisers now serves as our investment adviser in accordance with the terms of the Investment Management Agreement. Payments under the Investment Management Agreement in each reporting period is equal to (1) a management fee equal to a

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percentage of the value of our gross assets and (2) an incentive fee based on our performance. See Note 3 within our financial statements for more information.

Pursuant to an Administration Agreement, dated April 17, 2007, the PennantPark Investment Administration furnishes us with office facilities and administrative services necessary to conduct our day-to-day operations. If requested to provide managerial assistance to our portfolio companies, PennantPark Investment Administration will be paid an additional amount based on the services provided, which amount will not in any case exceed the amount we receive from the portfolio companies for such services. Payment under the Administration Agreement is based upon our allocable portion of the Administrator's overhead in performing its obligations under the Administration Agreement, including rent, technology systems, insurance and our allocable portion of the costs of our chief compliance officer, chief financial officer and their respective staff.

If any of our contractual obligations discussed above is 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.

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### **Credit Facility**

On June 25, 2007, we entered into a Senior Secured Revolving Credit Agreement (the "Credit Agreement") among us, various lenders and SunTrust Bank, as administrative agent for the lenders. SunTrust Robinson Humphrey Capital Markets acted as the joint lead arranger and book-runner, and Bear Stearns Corporate Lending Inc. acted as joint lead arranger and syndication agent. As of June 30, we did not borrow under the Credit Agreement.

Under the Credit Agreement, the lenders agreed to extend us credit in an initial aggregate principal or face amount not exceeding \$300,000,000 at any one time outstanding. The Credit Agreement is a five-year revolving facility (with a stated maturity date of June 25, 2012) and is secured by substantially all of our investment portfolio assets. Pricing is set at 100 basis points over LIBOR.

The Credit Agreement contains affirmative and restrictive covenants, including: (a) periodic financial reporting requirements, (b) maintenance of a minimum shareholders' equity, (c) maintenance of a ratio of our total assets (less total liabilities other than indebtedness) to our total indebtedness, (d) maintenance of minimum liquidity standards, (e) limitations on the incurrence of additional indebtedness, (f) limitations on liens, (g) limitations on fundamental corporate changes, (h) limitations on investments (other than our portfolio investments and certain other ordinary course investments), (i) limitations on payments and distributions (other than distributions to our shareholders as contemplated to maintain Regulated Investment Company status), (j) limitations on transactions with affiliates, (k) limitations on engaging in business not contemplated by our investment objectives, and (l) limitations on the creation or existence of agreements that prohibit liens on our properties and our subsidiaries. In addition to the asset coverage ratio described in clause (c) of the preceding sentence, borrowings under the Credit Agreement (and the incurrence of certain other permitted debt) are subject to compliance with a borrowing base that will apply different advance rates to different types of assets in our portfolio. The Credit Agreement will be used to supplement our equity capital to make additional portfolio investments and for other corporate purposes.

Separately, Pennant SPV entered into a senior secured credit facility on February 6, 2007 with Bear Stearns Investment Products Inc., as lender. Under the terms of this credit agreement, as amended on March 26, 2007, Bear Stearns Investment Products Inc. agreed to extend credit to Pennant SPV in an aggregate principal of up to \$250 million at any one time outstanding. Borrowings under this credit agreement were used to finance investments made by PennantPark Investment prior to the closing of the initial public offering. By its terms this credit agreement matured on the closing date of the initial public offering on April 24, 2007, and accordingly PennantPark Investment caused Pennant SPV to repay the credit facility with Bear Stearns Investment Products Inc. in full.

### **PORTFOLIO AND INVESTMENT ACTIVITY**

Since the closing of our initial public offering on April 24, 2007, we completed our first quarter of operations on June 30, 2007 with our portfolio invested \$42.2 million in subordinated debt, \$54.4 million in 2<sup>nd</sup> lien secured debt, \$3.0 million in common equity and \$175.4 million in 1<sup>st</sup> lien secured debt. Our core portfolio of subordinated debt, 2<sup>nd</sup> lien secured debt and common equity totals \$99.7 million and consists of investments in seven different companies with an average investment size of \$14 million per company. The weighted average yield on our subordinated debt and 2<sup>nd</sup> lien secured portfolio was 12.2%. Our 1<sup>st</sup> lien secured portfolio totals \$175.4 million and consists of 30 different companies with an average investment size of \$6 million. The weighted average yield on the 1<sup>st</sup> lien investments was 7.6%. The portfolio had unrealized depreciation of \$5.1 million due to softness in the overall leveraged finance credit market.

We anticipate that our level of investment activity will vary substantially from period to period depending 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. We believe there is a large pool of un-invested private equity capital likely to seek mezzanine capital to support private investments. We believe that, when proposing a private investment, private equity funds generally seek to package their equity investments together with senior secured and/or mezzanine loans, which should provide opportunities for us to partner with such funds.

### **CRITICAL ACCOUNTING POLICIES**

Our discussion of our financial condition and results of operation is based upon our consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles, or GAAP. The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Changes in the economic environment, financial markets and any other parameters used in determining such estimates could cause actual results to differ. In addition to the discussion below, we describe our critical accounting policies in the notes to our financial statements.





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### **Valuation of Portfolio Investments**

As a business development company, we generally invest in illiquid securities including debt and equity securities of middle market companies. Under procedures established by our board of directors, we intend to value investments for which market quotations are readily available at such market quotations. We obtain these market values from an independent pricing service or at the bid prices obtained from at least two brokers or dealers (if available, otherwise by a principal market maker or a primary market dealer). Debt and equity securities that are not publicly traded or whose market prices are not readily available are valued at fair value as determined in good faith by our board of directors. Such determination of fair values involves subjective judgments and estimates. Investments purchased within 60 days of maturity will be valued at cost plus accreted discount, or minus amortized premium, which approximates value. With respect to unquoted securities, our board of directors, together with our independent valuation advisers, values each investment considering, among other measures, discounted cash flow models, comparisons of financial ratios of peer companies that are public and other factors.

When an external event such as a purchase transaction, public offering or subsequent equity sale occurs, our board uses the pricing indicated by the external event to corroborate and/or assist us in our valuation. Because there are not always readily available markets for many of the investments in our portfolio, we value certain of our portfolio investments at fair value as determined in good faith by our board of directors using a documented valuation policy and a consistently applied valuation process. Due to the inherent uncertainty of determining the fair value of investments that do not have a readily available market value, the fair value of our investments may differ significantly from the values that would have been used had a readily available market value existed for such investments, and the differences could be material.

With respect to investments for which market quotations are not readily available, our board of directors undertakes a multi-step valuation process each quarter, as described below:

Our quarterly valuation process begins with each portfolio company or investment being initially valued by the investment professionals of our investment adviser responsible for the portfolio investment;

Preliminary valuation conclusions are then documented and discussed with the management of our investment adviser;

Independent valuation firms engaged by our board of directors conduct independent appraisals and review management's preliminary valuations and their own independent assessment;

The audit committee of our board of directors reviews the preliminary valuation of our investment adviser and that of the independent valuation firms and responds and supplements the valuation recommendation of the independent valuation firms to reflect any comments; and

The board of directors then discusses valuations and determines the fair value of each investment in our portfolio in good faith, based on the input of our investment adviser, the respective independent valuation firms and the audit committee.

### **Revenue Recognition**

We record interest income on an accrual basis to the extent that we expect to collect such amounts. For loans and debt securities with contractual payment-in-kind, or PIK, interest, which represents contractual interest accrued and added to the loan balance that generally becomes due at maturity, we do not accrue PIK interest if the portfolio company valuation indicates that such PIK interest is not collectible. We do not accrue as a receivable interest on loans and debt securities if we have reason to doubt our ability to collect such interest. Loan origination fees, original issue discount and market discount or premium are capitalized, and we then accrete or amortize such amounts using the effective interest method as interest income. Upon the prepayment of a loan or debt security, any unamortized loan origination is recorded as interest income. We record prepayment premiums on loans and debt securities as interest income. Dividend income, if any, is recognized on the ex-dividend date.

### **Net Realized Gains or Losses and Net Change in Unrealized Appreciation or Depreciation**

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We measure realized gains or losses by the difference between the net proceeds from the repayment or sale and the amortized cost basis of the investment, using the specific identification method, without regard to unrealized appreciation or depreciation previously recognized, but considering unamortized upfront fees and prepayment penalties. Net change in unrealized appreciation or depreciation reflects the change in portfolio investment values during the reporting period, including any reversal of previously recorded unrealized appreciation or depreciation, when gains or losses are realized.

### **RESULTS OF OPERATIONS**

Set forth below are the results of operations for this quarter and from our organization on January 11, 2007.

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### **Investment Income**

Gross investment income totaled \$5,425,279 and \$6,198,262 for the three months ended June 30, 2007 and for the period January 11, 2007 (inception) through June 30, 2007, respectively. The investment income was generated primarily from 1<sup>st</sup> lien secured debt investments which had stated interest rates between 7.1% and 8.9%, and weighted average yield of 7.6%. Our 2<sup>nd</sup> lien secured debt investments had stated interest rates between 11.3% and 13.1% and weighted average yield of 12.2%. Our corporate notes/subordinated debt investments had stated interest rates between 11.7% and 12.4% and weighted average yield of 12.2%. Our total portfolio had a weighted average yield on debt investments of 9.3%.

### **Expenses**

Net expenses (including income tax) totaled \$2,217,560 and \$3,241,763 for the three months ended June 30, 2007 and for the period January 11, 2007 (inception) through June 30, 2007, respectively. Of these totals \$862,433 and \$1,603,408 were for interest and other credit facility expenses for the three months ended June 30, 2007 and for the period January 11, 2007 (inception) through June 30, 2007, respectively. In addition, of these totals \$23,898 and \$307,126 were for non-recurring, primarily legal and corporate tax expenses for the three months ended June 30, 2007 and for the period January 11, 2007 (inception) through June 30, 2007, respectively. Expenses net of management fee, interest and other credit facility and non-recurring expenses totaled \$544,852 for the three months ended June 30, 2007 and for the period January 11, 2007 (inception) through June 30, 2007.

### **Net Investment Income**

The Company's net investment income totaled \$3,207,719 and \$2,956,499 or \$0.15 and \$0.14 cents per share, for the three months ended June 30, 2007 and for the period January 11, 2007 (inception) through June 30, 2007, respectively.

### **Net Realized Gains/Losses on Investments**

The Company had long-term investment sales totaling \$84,608,537 and \$92,676,996 for the three months ended June 30, 2007 and for the period January 11, 2007 (inception) through June 30, 2007, respectively. Net realized losses totaled \$34,726 and \$15,351 for the three months ended June 30, 2007 and for the period January 11, 2007 (inception) through June 30, 2007, respectively.

### **Net Unrealized Depreciation on Investments**

On June 30, 2007 unrealized depreciation totaled \$5,118,740 due to softness in the overall leveraged finance credit market.

### **Net Increase in Net Assets From Operations**

The Company's net decrease in net assets resulting from operations totaled \$1,944,046 and \$2,177,592 for the three months ended June 30, 2007 and for the period January 11, 2007 (inception) through June 30, 2007, respectively, or \$0.09 and \$0.10 cents per share, respectively.

## **LIQUIDITY AND CAPITAL RESOURCES**

During the period from January 11, 2007 (inception) through June 30, 2007, cash and cash equivalents increased from \$0 to \$288,104,949. Cash and cash equivalents were provided through the issuance of 21,046,883 shares of common stock, investment sales and interest on investments and cash equivalents. Cash and cash equivalents were used for investment purchases, distribution to shareholders and other general corporate purposes.

### ***Off-Balance Sheet Arrangements***

We currently engage in no off-balance sheet arrangements, including any risk management of commodity pricing or other hedging practices.

### ***Distributions***

In order to qualify as a regulated investment company and to avoid corporate level tax on income, we will be required, under Subchapter M of the U.S. Internal Revenue Code, to distribute at least 90% of our ordinary income and short-term capital gains to our stockholders on an annual basis. Additionally, we must distribute at least 98% of our income (both ordinary income and net capital gains) to avoid an excise tax. On

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June 29, 2007 we made our first shareholder distribution of \$0.14 per share, for a total dividend of \$2,943,500. Tax characteristics of all distributions will be reported to shareholders on Form 1099 after the end of the calendar year.

Of the amount distributed on June 29, 2007, \$307,229 was reinvested under our dividend reinvestment plan.

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### **RECENT DEVELOPMENTS**

#### **Unregistered Sale of Equity Securities**

We completed a private placement of our common stock pursuant to Regulation D under the Securities Act of 1933. This private placement of 320,000 shares was made to our officers, directors, investment adviser and managers of our investment adviser, for \$15 per share. The private placement was subscribed for on April 16, 2007 and closed on April 24, 2007. No sales load accompanied this offering. Estimated fees for this private placement totaled \$28,000, and the total adjusted gross proceeds to us from this offering, therefore, were approximately \$4,772,000. We used the proceeds for working capital.

#### **Completion of Initial Public Offering**

On April 19, 2007 we elected to be treated as a business development company under the 1940 Act. Also on April 19, 2007, our registration statement became effective, and we sold 20,000,000 shares of common stock to the underwriters pursuant to an underwriting agreement.

On April 24, 2007 we closed our initial public offering, resulting in net proceeds to us of approximately \$279,628,000 after deducting the underwriters' discount (sales load) of \$19,500,000 and offering expenses of approximately \$1,172,000.

#### **Credit Agreement / Credit Facility / Use of Proceeds**

On June 25, 2007 we entered into a Credit Agreement among us, various lenders and SunTrust Bank, as administrative agent for the lenders. SunTrust Robinson Humphrey Capital Markets acted as the joint lead arranger and book-runner, and Bear Stearns Corporate Lending Inc. acted as joint lead arranger and syndication agent. As of June 30, we did not borrow under the Credit Agreement. Under the Credit Agreement, the lenders agreed to extend us credit in an initial aggregate principal or face amount not exceeding \$300,000,000 at any one time outstanding. We intend to use the borrowings under the Credit Agreement to supplement our equity capital to make additional portfolio investments on a cost effective basis.

By its terms, our credit facility of February 6, 2007 with Bear Stearns Investment Products, Inc. matured on April 24, 2007, the closing date of our initial public offering. We used a portion of the proceeds of our initial public offering to repay the current credit facility. Accordingly, we contributed to Pennant SPV Company and Pennant SPV Company delivered to the Lender \$221,913,786 (including \$1,583,621 for interest) on April 24, 2007 in full satisfaction of its obligations under the credit facility. We expect to use the remainder of the proceeds of our initial public offering for investments in portfolio companies.

#### **Underwriters Exercised Over-Allotment Option**

On May 21, the underwriters of our initial public offering exercised their over-allotment option provided to them under the Underwriting Agreement. The underwriters elected to purchase 625,000 shares of our common stock, par value \$.001, for \$8,765,625, after deducting the underwriters' discount of \$609,375.

Including the shares sold in the initial public offering, the unregistered sale of equity securities discussed above, the underwriters' over-allotment purchase and our original capitalization, our net proceeds were approximately \$294,065,625.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are subject to financial market risks, including changes in interest rates. As of June 30, 2007, we were invested in 1<sup>st</sup> lien secured debt, 2<sup>nd</sup> lien secured debt, subordinated debt, PIK bonds, common equity and cash equivalents.

We may in the future hedge against interest rate fluctuations by using standard hedging instruments such as futures, options and forward contracts. While hedging activities may insulate us against adverse changes in interest rates, they may also limit our ability to participate in the benefits of lower interest rates with respect to the investments in our portfolio with fixed interest rates.

### **ITEM 4. CONTROLS AND PROCEDURES.**

As of June 30, 2007, we, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based on that

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evaluation, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective in timely alerting management, including the Chief Executive Officer and Chief Financial Officer, of material information about us required to be included in periodic SEC filings. However, in evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

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There have been no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) that occurred during the period ended June 30, 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS.**

None of our Investment Adviser, our Administrator or us is currently subject to any material legal proceedings, nor, to our knowledge, is any material legal proceeding threatened against us, or against our Investment Adviser or Administrator. On January 30, 2007, we received a letter from a company objecting to our use of the name Pennant Investment Corporation. We subsequently changed our name to PennantPark Investment Corporation in order to avoid any confusion with that company. In subsequent correspondence with the counsel to that company, we understand that it has continuing concerns regarding our name. We are working to resolve these concerns amicably and, while we can offer no assurance in this regard, do not believe that this issue will have a material adverse effect on our business or financial condition. From time to time, we, our Investment Adviser or Administrator, may be a party to certain legal proceedings in the ordinary course of business, including proceedings relating to the enforcement of our rights under contracts with our portfolio companies. While the outcome of these legal proceedings cannot be predicted with certainty, we do not expect that these proceedings will have a material effect upon our financial condition of results of operations.

### **ITEM 1A. RISK FACTORS**

As of June 30, 2007, the Risk Factors included in our registration statement on Form N-2 remain substantially unchanged from the disclosure included in our preliminary prospectus released on March 29, 2007.

### **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.**

See Recent Developments in the Management Discussion and Analysis of Financial Condition and Results of Operations for a discussion of unregistered sales of equity securities and use of proceeds.

### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES.**

Not applicable.

### **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.**

None.

### **ITEM 5. OTHER INFORMATION.**

This Report is not a prospectus and is not intended to be used as a prospectus. We refer you to the Securities and Exchange Commission, or SEC, website, where you may find a copy of the registration statement on Form N-2 that we used in connection with our initial public offering of common stock.

### **ITEM 6. EXHIBITS.**

#### **(a) EXHIBITS**

Unless specifically indicated otherwise, the following exhibits are incorporated by reference to exhibits previously filed with the SEC:

- 3.1 Articles of Incorporation (Incorporated by reference to the Registrant's Pre-Effective Amendment No. 1 to the Registration Statement on Form N-2 (File No. 333-140092), filed on March 5, 2007).

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- 3.2 Amended and Restated Bylaws (Incorporated by reference to the Registrant's Pre-Effective Amendment No. 1 to the Registration Statement on Form N-2 (File No. 333-140092), filed on March 5, 2007).
- 4.1 Form of Share Certificate (Incorporated by reference to the Registrant's Exhibit Filing as Pre-Effective Amendment No. 3 to the Registration Statement on Form N-2 (File No. 333-140092), filed on April 5, 2007).
- 10.1 Form of Investment Management Agreement between the Registrant and PennantPark Investment Advisers, LLC (Incorporated by reference to the Registrant's Pre-Effective Amendment No. 1 to the Registration Statement on Form N-2 (File No. 333-140092), filed on March 5, 2007).
- 10.2 Form of Custodian Agreement between the Registrant and LaSalle Bank National Association (Incorporated by reference to the Registrant's Pre-Effective Amendment No. 1 to the Registration Statement on Form N-2 (File No. 333-140092), filed on March 5, 2007).



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- 10.3 Form of Administration Agreement between the Registrant and various lenders (Incorporated by reference to the Registrant's Form 8-K Exhibit 99-2 (File No. 814-00736)), filed on June 28, 2007).
- 10.4 Dividend Reinvestment Plan (Incorporated by reference to the Registrant's Pre-Effective Amendment No. 1 to the Registration Statement on Form N-2 (File No. 333-140092), filed on March 5, 2007).
- 10.5 Senior Secured Revolving Credit Agreement between Registrant and various lenders (Incorporated by reference to the Report on Form 8-K. Exhibits 99.2 (File No. 814-00736), filed on June 28, 2007).
- 11 Computation of Per Share Earnings (included in the notes to the unaudited financial statements contained in this Report).
- 31.1 \* Certification of Chief Executive Officer pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as amended.
- 31.2 \* Certification of Chief Financial Officer pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as amended.
- 32.1 \* Certification of Chief Executive Officer pursuant to section 906 of The Sarbanes-Oxley Act of 2002.
- 32.2 \* Certification of Chief Financial Officer pursuant to section 906 of The Sarbanes-Oxley Act of 2002.

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\* Filed herewith.

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**SIGNATURES**

Pursuant to the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Report on Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized.

PENNANTPARK INVESTMENT CORPORATION

Date: August 9, 2007

By: */s/ Arthur H. Penn*  
**Arthur H. Penn**

**Chief Executive Officer**

Date: August 9, 2007

By: */s/ Aviv Efrat*  
**Aviv Efrat**

**Chief Financial Officer**

**(Principal Accounting and Financial Officer)**