VECTREN UTILITY HOLDINGS INC
Form 10-Q
May 10, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 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: 1-16739

VECTREN UTILITY HOLDINGS, INC.
(Exact name of registrant as specified in its charter)

INDIANA	35-2104850
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

One Vectren Square, Evansville, IN 47708
(Address of principal executive offices) (Zip Code)

812-491-4000
(Registrant's telephone number, including area code)

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. xYes 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
x Yes No

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 definitions 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 x (Do not check if a smaller reporting company) 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 xNo

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock- Without Par Value	10	April 30, 2012
Class	Number of Shares	Date

Access to Information

Vectren Corporation makes available all SEC filings and recent annual reports, including those of its wholly owned subsidiaries, free of charge through its website at www.vectren.com as soon as reasonably practicable after electronically filing or furnishing the reports to the SEC, or by request, directed to Investor Relations at the mailing address, phone number, or email address that follows:

Mailing Address:	Phone Number:	Investor Relations Contact:
One Vectren Square Evansville, Indiana 47708	(812) 491-4000	Robert L. Goocher Treasurer and Vice President, Investor Relations rgoocher@vectren.com

Definitions

AFUDC: allowance for funds used during construction	MMBTU: millions of British thermal units
EPA: United States Environmental Protection Agency	MW: megawatts
FASB: Financial Accounting Standards Board	MWh / GWh: megawatt hours / thousands of megawatt hours (gigawatt hours)
FERC: Federal Energy Regulatory Commission	OCC: Ohio Office of the Consumer Counselor
IDEM: Indiana Department of Environmental Management	OUCC: Indiana Office of the Utility Consumer Counselor

IURC: Indiana Utility Regulatory Commission

MCF / BCF: thousands / billions of cubic feet

MDth / MMDth: thousands / millions of dekatherms

MISO: Midwest Independent System Operator

PUCO: Public Utilities Commission of Ohio

Throughput: combined gas sales and gas transportation volumes

XBRL: eXtensible Business Reporting Language

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

VECTREN UTILITY HOLDINGS, INC. AND SUBSIDIARY COMPANIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited – In millions)

	March 31, 2012	December 31, 2011
ASSETS		
Current Assets		
Cash & cash equivalents	$5.5	$6.0
Accounts receivable - less reserves of $5.3 & $5.9, respectively	95.6	95.5
Receivables due from other Vectren companies	0.1	0.2
Accrued unbilled revenues	41.4	90.8
Inventories	107.7	132.5
Recoverable fuel & natural gas costs	9.5	12.4
Prepayments & other current assets	22.3	69.3
Total current assets	282.1	406.7
Utility Plant		
Original cost	5,033.8	4,979.9
Less: accumulated depreciation & amortization	1,975.9	1,947.3
Net utility plant	3,057.9	3,032.6
Investments in unconsolidated affiliates	0.2	0.2
Other investments	32.5	31.8
Nonutility plant - net	151.7	156.6
Goodwill - net	205.0	205.0
Regulatory assets	106.8	100.0
Other assets	39.8	41.6
TOTAL ASSETS	$3,876.0	$3,974.5

The accompanying notes are an integral part of these condensed consolidated financial statements.

-4-

VECTREN UTILITY HOLDINGS, INC. AND SUBSIDIARY COMPANIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited – In millions)

LIABILITIES & SHAREHOLDER'S EQUITY	March 31, 2012	December 31, 2011
Current Liabilities		
Accounts payable	$83.3	$112.9
Accounts payable to affiliated companies	19.3	36.8
Payables to other Vectren companies	14.6	30.1
Accrued liabilities	149.1	121.0
Short-term borrowings	49.7	142.8
Total current liabilities	316.0	443.6
Long-Term Debt	1,208.2	1,208.2
Deferred Income Taxes & Other Liabilities		
Deferred income taxes	533.3	537.5
Regulatory liabilities	350.5	345.2
Deferred credits & other liabilities	88.8	93.4
Total deferred credits & other liabilities	972.6	976.1
Commitments & Contingencies (Notes 8 - 11)		
Common Shareholder's Equity		
Common stock (no par value)	776.2	774.6
Retained earnings	603.0	572.0
Total common shareholder's equity	1,379.2	1,346.6
TOTAL LIABILITIES & SHAREHOLDER'S EQUITY	$3,876.0	$3,974.5

The accompanying notes are an integral part of these condensed consolidated financial statements.

VECTREN UTILITY HOLDINGS, INC. AND SUBSIDIARY COMPANIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited – In millions)

	Three Months Ended March 31,	
	2012	2011
OPERATING REVENUES		
Gas utility	$292.3	$356.7
Electric utility	139.4	146.4
Other	0.4	0.5
Total operating revenues	432.1	503.6
OPERATING EXPENSES		
Cost of gas sold	137.1	195.1
Cost of fuel & purchased power	44.7	59.5
Other operating	79.9	86.9
Depreciation & amortization	48.6	48.2
Taxes other than income taxes	15.9	18.0
Total operating expenses	326.2	407.7
OPERATING INCOME	105.9	95.9
Other income - net	2.2	1.7
Interest expense	17.7	20.4
INCOME BEFORE INCOME TAXES	90.4	77.2
Income taxes	34.4	28.6
NET INCOME	$56.0	$48.6

The accompanying notes are an integral part of these condensed consolidated financial statements.

VECTREN UTILITY HOLDINGS, INC. AND SUBSIDIARY COMPANIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited – In millions)

	Three Months Ended March 31, 2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$56.0	$48.6
Adjustments to reconcile net income to cash from operating activities:		
Depreciation & amortization	48.6	48.2
Deferred income taxes & investment tax credits	10.5	14.0
Expense portion of pension & postretirement periodic benefit cost	1.3	1.1
Provision for uncollectible accounts	2.3	5.9
Other non-cash expense - net	1.4	2.3
Changes in working capital accounts:		
Accounts receivable, including to Vectren companies & accrued unbilled revenue	47.1	38.7
Inventories	15.1	27.2
Recoverable/refundable fuel & natural gas costs	5.5	5.1
Prepayments & other current assets	34.7	43.3
Accounts payable, including to Vectren companies & affiliated companies	(59.0)	(108.5)
Accrued liabilities	25.4	34.4
Changes in noncurrent assets	2.7	7.0
Changes in noncurrent liabilities	(10.1)	(29.2)
Net cash flows from operating activities	181.5	138.1
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from:		
Long-term debt - net of issuance costs	99.5	-
Additional capital contribution	1.6	-
Requirements for:		
Dividends to parent	(25.1)	(22.9)
Retirement of long-term debt	-	(0.1)
Net change in short-term borrowings, including from other Vectren companies	(193.1)	(47.0)
Net cash flows from financing activities	(117.1)	(70.0)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from other investing activities	0.1	0.1
Requirements for:		
Capital expenditures, excluding AFUDC equity	(65.0)	(39.2)
Net cash flows from investing activities	(64.9)	(39.1)
Net change in cash & cash equivalents	(0.5)	29.0
Cash & cash equivalents at beginning of period	6.0	2.4
Cash & cash equivalents at end of period	$5.5	$31.4

The accompanying notes are an integral part of these condensed consolidated financial statements.

VECTREN UTILITY HOLDINGS, INC. AND SUBSIDIARY COMPANIES
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. Organization & Nature of Operations

Vectren Utility Holdings, Inc. (the Company or Utility Holdings), an Indiana corporation, was formed on March 31, 2000 to serve as the intermediate holding company for Vectren Corporation's (Vectren) three operating public utilities: Indiana Gas Company, Inc. (Indiana Gas or Vectren North), Southern Indiana Gas and Electric Company (SIGECO or Vectren South), and Vectren Energy Delivery of Ohio, Inc. (VEDO). Utility Holdings also has other assets that provide information technology and other services to the three utilities. Vectren, an Indiana corporation, is an energy holding company headquartered in Evansville, Indiana and was organized on June 10, 1999. Both Vectren and Utility Holdings are holding companies as defined by the Energy Policy Act of 2005 (Energy Act).

Indiana Gas provides energy delivery services to approximately 570,000– natural gas customers located in central and southern Indiana. SIGECO provides energy delivery services to approximately 142,000 electric customers and approximately 110,000 gas customers located near Evansville in southwestern Indiana. SIGECO also owns and operates electric generation assets to serve its electric customers and optimizes those assets in the wholesale power market. Indiana Gas and SIGECO generally do business as Vectren Energy Delivery of Indiana. VEDO provides energy delivery services to over 313,000 natural gas customers located near Dayton in west central Ohio.

2. Basis of Presentation

The interim condensed consolidated financial statements included in this report have been prepared by the Company, without audit, as provided in the rules and regulations of the Securities and Exchange Commission and include a review of subsequent events through the date the financial statements were issued. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been omitted as provided in such rules and regulations. The information in this report reflects all adjustments which are, in the opinion of management, necessary to fairly state the interim periods presented, inclusive of adjustments that are normal and recurring in nature. These condensed consolidated financial statements and related notes should be read in conjunction with the Company's audited annual consolidated financial statements for the year ended December 31, 2011, filed with the Securities and Exchange Commission on March 2, 2012, on Form 10-K. Because of the seasonal nature of the Company's utility operations, the results shown on a quarterly basis are not necessarily indicative of annual results.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

3. Subsidiary Guarantor and Consolidating Information

The Company's three operating utility companies, SIGECO, Indiana Gas, and VEDO are guarantors of Utility Holdings' $350 million in short-term credit facilities, of which approximately $50 million is outstanding at March 31, 2012, and Utility Holdings' has unsecured senior notes with a par value of $822 million outstanding at March 31, 2012. The guarantees are full and unconditional and joint and several, and Utility Holdings has no subsidiaries other than the subsidiary guarantors. However, Utility Holdings does have operations other than those of the subsidiary guarantors. Pursuant to Item 3-10 of Regulation S-X, disclosure of the results of operations and balance sheets of the subsidiary guarantors, which are 100 percent owned, separate from the parent company's operations is required. Following are consolidating financial statements including information on the combined operations of the subsidiary guarantors separate from the other operations of the parent company. Pursuant to a tax sharing agreement, consolidating tax effects, which are calculated on a separate return basis, are reflected at the parent level.

Condensed Consolidating Balance Sheet as of March 31, 2012 (in millions):

ASSETS	Subsidiary Guarantors	Parent Company	Eliminations & Reclassifications	Consolidated
Current Assets				
Cash & cash equivalents	$ 4.7	$ 0.8	$ -	$ 5.5
Accounts receivable - less reserves	95.6	-	-	95.6
Intercompany receivables	19.5	103.8	(123.3)	-
Receivables due from other Vectren companies	-	0.1	-	0.1
Accrued unbilled revenues	41.4	-	-	41.4
Inventories	107.7	-	-	107.7
Recoverable fuel & natural gas costs	9.5	-	-	9.5
Prepayments & other current assets	23.6	4.3	(5.6)	22.3
Total current assets	302.0	109.0	(128.9)	282.1
Utility Plant				
Original cost	5,033.8	-	-	5,033.8
Less: accumulated depreciation & amortization	1,975.9	-	-	1,975.9
Net utility plant	3,057.9	-	-	3,057.9
Investments in consolidated subsidiaries	-	1,303.5	(1,303.5)	-
Notes receivable from consolidated subsidiaries	-	679.7	(679.7)	-
Investments in unconsolidated affiliates	0.2	-	-	0.2
Other investments	27.6	4.9	-	32.5
Nonutility property - net	2.9	148.8	-	151.7
Goodwill - net	205.0	-	-	205.0
Regulatory assets	83.6	23.2	-	106.8
Other assets	43.1	3.5	(6.8)	39.8
TOTAL ASSETS	$ 3,722.3	$ 2,272.6	$ (2,118.9)	$ 3,876.0

LIABILITIES & SHAREHOLDER'S EQUITY	Subsidiary Guarantors	Parent Company	Eliminations & Reclassifications	Consolidated
Current Liabilities				
Accounts payable	$ 80.0	$ 3.3	$ -	$ 83.3
Accounts payable to affiliated companies	19.3	-	-	19.3
Intercompany payables	15.0	-	(15.0)	-
Payables to other Vectren companies	14.6	-	-	14.6
Accrued liabilities	137.1	17.6	(5.6)	149.1
Short-term borrowings	-	49.7	-	49.7
Intercompany short-term borrowings	88.8	19.5	(108.3)	-
Total current liabilities	354.8	90.1	(128.9)	316.0
Long-Term Debt				
Long-term debt - net of current maturities & debt subject to tender	387.2	821.0	-	1,208.2
Long-term debt due to VUHI	679.7	-	(679.7)	-
Total long-term debt - net	1,066.9	821.0	(679.7)	1,208.2
Deferred Income Taxes & Other Liabilities				
Deferred income taxes	555.0	(21.7)	-	533.3
Regulatory liabilities	348.1	2.4	-	350.5

Deferred credits & other liabilities		94.0		1.6			(6.8	)		88.8
Total deferred credits & other liabilities		997.1		(17.7	)		(6.8	)		972.6
Common Shareholder's Equity										
Common stock (no par value)		789.4		776.2			(789.4	)		776.2
Retained earnings		514.1		603.0			(514.1	)		603.0
Total common shareholder's equity		1,303.5		1,379.2			(1,303.5	)		1,379.2
TOTAL LIABILITIES & SHAREHOLDER'S EQUITY	$	3,722.3	$	2,272.6		$	(2,118.9	)	$	3,876.0

Condensed Consolidating Balance Sheet as of December 31, 2011 (in millions):

ASSETS	Subsidiary Guarantors	Parent Company	Eliminations & Reclassifications	Consolidated
Current Assets				
Cash & cash equivalents	$5.3	$0.7	$ -	$ 6.0
Accounts receivable - less reserves	94.8	0.7	-	95.5
Intercompany receivables	-	206.0	(206.0)	-
Receivables due from other Vectren companies	-	0.2	-	0.2
Accrued unbilled revenues	90.8	-	-	90.8
Inventories	132.5	-	-	132.5
Recoverable fuel & natural gas costs	12.4	-	-	12.4
Prepayments & other current assets	57.1	16.7	(4.5)	69.3
Total current assets	392.9	224.3	(210.5)	406.7
Utility Plant				
Original cost	4,979.9	-	-	4,979.9
Less: accumulated depreciation & amortization	1,947.3	-	-	1,947.3
Net utility plant	3,032.6	-	-	3,032.6
Investments in consolidated subsidiaries	-	1,272.2	(1,272.2)	-
Notes receivable from consolidated subsidiaries	-	679.7	(679.7)	-
Investments in unconsolidated affiliates	0.2	-	-	0.2
Other investments	26.8	5.0	-	31.8
Nonutility property - net	3.0	153.6	-	156.6
Goodwill - net	205.0	-	-	205.0
Regulatory assets	77.0	23.0	-	100.0
Other assets	44.2	4.0	(6.6)	41.6
TOTAL ASSETS	$3,781.7	$2,361.8	$ (2,169.0)	$ 3,974.5

LIABILITIES & SHAREHOLDER'S EQUITY	Subsidiary Guarantors	Parent Company	Eliminations & Reclassifications	Consolidated
Current Liabilities				
Accounts payable	$106.1	$6.8	$ -	$ 112.9
Accounts payable to affiliated companies	36.8	-	-	36.8
Intercompany payables	11.8	-	(11.8)	-
Payables to other Vectren companies	30.1	-	-	30.1
Accrued liabilities	112.9	12.6	(4.5)	121.0
Short-term borrowings	-	142.8	-	142.8
Intercompany short-term borrowings	158.5	35.7	(194.2)	-
Total current liabilities	456.2	197.9	(210.5)	443.6
Long-Term Debt				
Long-term debt - net of current maturities & debt subject to tender	387.2	821.0	-	1,208.2
Long-term debt due to VUHI	679.7	-	(679.7)	-
Total long-term debt - net	1,066.9	821.0	(679.7)	1,208.2
Deferred Income Taxes & Other Liabilities				
Deferred income taxes	545.2	(7.7)	-	537.5

Regulatory liabilities	342.6	2.6	-	345.2
Deferred credits & other liabilities	98.6	1.4	(6.6)	93.4
Total deferred credits & other liabilities	986.4	(3.7)	(6.6)	976.1
Common Shareholder's Equity				
Common stock (no par value)	787.8	774.6	(787.8)	774.6
Retained earnings	484.4	572.0	(484.4)	572.0
Total common shareholder's equity	1,272.2	1,346.6	(1,272.2)	1,346.6
TOTAL LIABILITIES & SHAREHOLDER'S EQUITY	$3,781.7	$2,361.8	$ (2,169.0)	$ 3,974.5

Condensed Consolidating Statement of Income for the three months ended March 31, 2012 (in millions):

	Subsidiary Guarantors	Parent Company	Eliminations & Reclassifications	Consolidated
OPERATING REVENUES				
Gas utility	$292.3	$-	$ -	$ 292.3
Electric utility	139.4	-	-	139.4
Other	-	9.9	(9.5)	0.4
Total operating revenues	431.7	9.9	(9.5)	432.1
OPERATING EXPENSES				
Cost of gas sold	137.1	-	-	137.1
Cost of fuel & purchased power	44.7	-	-	44.7
Other operating	89.6	-	(9.7)	79.9
Depreciation & amortization	41.7	6.8	0.1	48.6
Taxes other than income taxes	15.5	0.4	-	15.9
Total operating expenses	328.6	7.2	(9.6)	326.2
OPERATING INCOME	103.1	2.7	0.1	105.9
Other income (loss) - net	2.0	10.6	(10.4)	2.2
Interest expense	16.5	11.5	(10.3)	17.7
INCOME BEFORE INCOME TAXES	88.6	1.8	-	90.4
Income taxes	35.5	(1.1)	-	34.4
Equity in earnings of consolidated companies, net of tax	-	53.1	(53.1)	-
NET INCOME	$53.1	$56.0	$ (53.1)	$ 56.0

Condensed Consolidating Statement of Income for the three months ended March 31, 2011 (in millions):

	Subsidiary Guarantors	Parent Company	Eliminations & Reclassifications	Consolidated
OPERATING REVENUES				
Gas utility	$356.7	$-	$ -	$ 356.7
Electric utility	146.4	-	-	146.4
Other	-	11.0	(10.5)	0.5
Total operating revenues	503.1	11.0	(10.5)	503.6
OPERATING EXPENSES				
Cost of gas	195.1	-	-	195.1
Cost of fuel & purchased power	59.5	-	-	59.5
Other operating	97.4	-	(10.5)	86.9
Depreciation & amortization	41.4	6.7	0.1	48.2
Taxes other than income taxes	17.6	0.4	-	18.0
Total operating expenses	411.0	7.1	(10.4)	407.7
OPERATING INCOME	92.1	3.9	(0.1)	95.9

Other income - net	1.5	12.8		(12.6	)	1.7
Interest expense	18.9	14.2		(12.7	)	20.4
INCOME BEFORE INCOME TAXES	74.7	2.5		-		77.2
Income taxes	30.0	(1.4)		-		28.6
Equity in earnings of consolidated companies, net of tax	-	44.7		(44.7	)	-
NET INCOME	$44.7	$48.6	$	(44.7	)	$ 48.6

Condensed Consolidating Statement of Cash Flows for the three months ended March 31, 2012 (in millions):

	Subsidiary Guarantors	Parent Company	Eliminations	Consolidated
NET CASH FLOWS FROM OPERATING ACTIVITIES	$173.9	$7.6	$ -	$ 181.5
CASH FLOWS FROM FINANCING ACTIVITIES				
Proceeds from				
Additional capital contribution from parent	1.6	1.6	(1.6)	1.6
Long-term debt - net of issuance costs	-	99.5	-	99.5
Requirements for:				
Dividends to parent	(23.4)	(25.1)	23.4	(25.1)
Net change in intercompany short-term borrowings	(69.7)	19.5	50.2	-
Net change in short-term borrowings	-	(193.1)	-	(193.1)
Net cash flows from financing activities	(91.5)	(97.6)	72.0	(117.1)
CASH FLOWS FROM INVESTING ACTIVITIES				
Proceeds from				
Consolidated subsidiary distributions	-	23.4	(23.4)	-
Other investing activities	-	0.1	-	0.1
Requirements for:				
Capital expenditures, excluding AFUDC equity	(63.5)	(1.5)	-	(65.0)
Consolidated subsidiary investments	-	(1.6)	1.6	-
Net change in short-term intercompany notes receivable	(19.5)	69.7	(50.2)	-
Net cash flows from investing activities	(83.0)	90.1	(72.0)	(64.9)
Net change in cash & cash equivalents	(0.6)	0.1	-	(0.5)
Cash & cash equivalents at beginning of period	5.3	0.7	-	6.0
Cash & cash equivalents at end of period	$4.7	$0.8	$ -	$ 5.5

Condensed Consolidating Statement of Cash Flows for the three months ended March 31, 2011 (in millions):

	Subsidiary Guarantors	Parent Company	Eliminations	Consolidated
NET CASH FLOWS FROM OPERATING ACTIVITIES	$134.7	$3.4	$ -	$ 138.1

CASH FLOWS FROM FINANCING ACTIVITIES				
Requirements for:				
Dividends to parent	(21.1)	(22.9)	21.1	(22.9)
Retirement of long-term debt, including premiums paid	(0.1)	(0.1)	0.1	(0.1)
Net change in intercompany short-term borrowings	(82.3)	(15.6)	97.9	-
Net change in short-term borrowings	-	(47.0)	-	(47.0)
Net cash flows from financing activities	(103.5)	(85.6)	119.1	(70.0)
CASH FLOWS FROM INVESTING ACTIVITIES				
Proceeds from				
Consolidated subsidiary distributions	-	21.1	(21.1)	-
Other investing activities	-	0.1	-	0.1
Requirements for:				
Capital expenditures, excluding AFUDC equity	(38.2)	(1.0)	-	(39.2)
Net change in long-term intercompany notes receivable	-	0.1	(0.1)	-
Net change in short-term intercompany notes receivable	15.6	82.3	(97.9)	-
Net cash flows from investing activities	(22.6)	102.6	(119.1)	(39.1)
Net change in cash & cash equivalents	8.6	20.4	-	29.0
Cash & cash equivalents at beginning of period	2.0	0.4	-	2.4
Cash & cash equivalents at end of period	$10.6	$20.8	$ -	$ 31.4

4. Excise and Utility Receipts Taxes

Excise taxes and a portion of utility receipts taxes are included in rates charged to customers. Accordingly, the Company records these taxes received as a component of operating revenues, which totaled $9.3 million and $11.0 million in the three months ended March 31, 2012 and 2011 respectively. Expense associated with excise and utility receipts taxes are recorded as a component of Taxes other than income taxes.

5. Accruals for Utility & Nonutility Plant

As of March 31, 2012 and December 31, 2011, the Company has accruals related to utility and nonutility plant purchases totaling approximately $9.0 million and $9.2 million, respectively.

6. Transactions with Other Vectren Companies and Affiliates

Vectren Fuels, Inc.
Vectren Fuels, Inc., a wholly owned subsidiary of Vectren, owns coal mines from which SIGECO purchases coal used for electric generation. The price of coal that is charged by Vectren Fuels to SIGECO is priced consistent with contracts reviewed by the OUCC and on file with the IURC. Amounts purchased for the three months ended March 31, 2012 and 2011 totaled $24.9 million and $33.2 million, respectively. Amounts owed to Vectren Fuels at March 31, 2012 and December 31, 2011 are included in Payables to other Vectren companies.

Miller Pipeline, LLC
Miller Pipeline, LLC (Miller), a wholly owned subsidiary of Vectren, performs natural gas and water distribution, transmission, and construction repair and rehabilitation primarily in the Midwest and the repair and rehabilitation of gas, water, and wastewater facilities nationwide. Miller's customers include Utility Holdings' utilities. Fees incurred by Utility Holdings and its subsidiaries totaled $8.1 million and $4.9 million for the three months ended March 31, 2012 and 2011, respectively. Amounts owed to Miller at March 31, 2012 and December 31, 2011 are included in Payables to other Vectren companies.

ProLiance Holdings, LLC (ProLiance)
ProLiance, a nonutility energy marketing affiliate of Vectren and Citizens Energy Group (Citizens), provides services to a broad range of municipalities, utilities, industrial operations, schools, and healthcare institutions located throughout the Midwest and Southeast United States. ProLiance's customers include the Company's Indiana utilities as well as Citizens' utilities. ProLiance's primary businesses include gas marketing, gas portfolio optimization, and other portfolio and energy management services. Vectren received regulatory approval on April 25, 2006, from the IURC for ProLiance to provide natural gas supply services to the Company's Indiana utilities through March 2011. On March 17, 2011, an order was received by the IURC providing for ProLiance's continued provision of gas supply services to the Company's Indiana utilities and Citizens Energy Group through March 2016.

Purchases from ProLiance for resale and for injections into storage for the three months ended March 31, 2012 and 2011 totaled $79.5 million and $119.3 million, respectively. Amounts owed to ProLiance at March 31, 2012 and December 31, 2011 for those purchases were $19.3 million and $36.8 million, respectively, and are included in Accounts payable to affiliated companies in the Consolidated Balance Sheets. Amounts charged by ProLiance for gas supply services are established by supply agreements with each utility.

Support Services & Purchases
Vectren provides corporate and general and administrative services to the Company and allocates costs to the Company. These costs have been allocated using various allocators, including number of employees, number of customers and/or the level of payroll, revenue contribution and capital expenditures. Allocations are at cost. For the three months ended March 31, 2012 and 2011, Utility Holdings received corporate allocations totaling $12.5 million

and $13.8 million, respectively.

The Company does not have share-based compensation plans and pension and other postretirement plans separate from Vectren and allocated costs include participation in Vectren's plans. The allocation methodology for retirement costs is consistent with FASB guidance related to "multiemployer" benefit accounting.

7. Financing Activities

On February 1, 2012, the Company issued $100 million of senior unsecured notes at an interest rate of 5.00 percent per annum and with a maturity date of February 3, 2042. The notes were sold to various institutional investors pursuant to a private placement note purchase agreement executed in November 2011 with a delayed draw feature. These senior notes are unsecured and jointly and severally guaranteed by Utility Holdings' regulated utility subsidiaries, SIGECO, Indiana Gas, and VEDO. The proceeds from the sale of the notes, net of issuance costs, totaled approximately $99.5 million. These notes have no sinking fund requirements and interest payments are due semi-annually. These notes contain customary representations, warranties and covenants, including a leverage covenant consistent with leverage covenants contained in other Utility Holdings' borrowing arrangements. As of December 31, 2011, the Company had reclassified $100 million of short-term borrowings as long-term debt to reflect those borrowings were refinanced with the proceeds received.

8. Commitments & Contingencies

The Company is party to various legal proceedings, audits, and reviews by taxing authorities and other government agencies arising in the normal course of business. In the opinion of management, there are no legal proceedings or other regulatory reviews or audits pending against the Company that are likely to have a material adverse effect on its financial position, results of operations or cash flows.

9. Legislative Matters

Pipeline Safety Law
On January 3, 2012 the Pipeline Safety, Regulatory Certainty and Job Creation Act of 2011 was signed into law. This new law, which reauthorizes federal pipeline safety programs through fiscal year 2015, provides for enhanced safety, reliability and environmental protection in the transportation of energy products by pipeline. The new law increases federal enforcement authority, grants the federal government expanded authority over pipeline safety, provides for new safety regulations and standards, and authorizes or requires the completion of several pipeline safety-related studies. The DOT is required to promulgate a number of new regulatory requirements. The direction of those regulations will be based on the results of the studies and reports required or authorized by the new law and may eventually lead to further regulatory or statutory requirements.

The Company continues to study the impact of the new law and potential new regulations associated with its implementation. At this time, compliance costs and other effects associated with the increased pipeline safety regulations remain uncertain. However, the new law is expected to result in further investment in pipeline inspections, and where necessary, additional modernization of pipeline infrastructure; and therefore, result in both increased levels of operating expenses and capital expenditures associated with the Company's natural gas distribution businesses. Operating expenses associated with expanded compliance requirements may grow to approximately $9 million annually, with $6 million attributable to the Indiana operations. Related to the Indiana operations, the Company expects to seek recovery under Senate Bill 251 referenced below, or such costs may be recoverable through current tracking mechanisms. Capital investments, driven by the pipeline safety regulations, associated with the Company's Indiana gas utilities are expected to be approximately $80 million over the next five years, which would likely qualify as federally mandated regulatory requirements. In Ohio, capital investments are expected to be approximately $55 million over the next five years. The Company expects to seek recovery of capital investments associated with complying with these federal mandates in accordance with Senate Bill 251 in Indiana and House Bill 95 in Ohio (referenced below).

Indiana Senate Bill 251
In April 2011, Senate Bill 251 was signed into law. While the bill is broad in scope, it allows for cost recovery outside of a base rate proceeding for federal government mandated projects and provides for a voluntary clean energy

portfolio standard.

The law applies to both gas and electric utility operations and provides a framework to recover 80 percent of federally mandated costs through a periodic rate adjustment mechanism outside of a general rate case. Such costs include construction, depreciation, operating and other costs. The remaining 20 percent of those costs are to be deferred for recovery in the utility's next general rate case. The Company is currently evaluating the impact this law may have on its operations, including applicability to expenditures associated with the integrity, safety, and reliable operation of natural gas pipelines and facilities; ash disposal; water regulations; and air pollution control, including greenhouse gas emissions, among other federally mandated projects and potential projects.

Ohio House Bill 95

In June 2011, Ohio House Bill 95 was signed into law. The law adjusts, among other things, the manner in which gas utilities file for rate changes, including the implementation of base rate changes, alternative rate plans, and automatic rate adjustment mechanisms. Outside of a base rate proceeding, the legislation permits a natural gas company to apply for recovery of a capital expenditure program for infrastructure expansion, upgrade, or replacement; installation, upgrade, or replacement of information technology systems; or any program necessary to comply with government regulation. Once such application is approved, the legislation authorizes deferral of program costs, such as depreciation, property taxes, and debt-related carrying costs. On February 3, 2012, the Company initiated a filing under House Bill 95. This filing requests accounting authority to defer depreciation, debt-related post in service carrying costs and property taxes for its approximate $25 million fifteen month capital expenditure program ending on December 31, 2012. The capital expenditure program includes infrastructure expansion and improvements not covered by the Company's distribution replacement rider as well as expenditures necessary to comply with PUCO rules, regulations and orders. The Company's approach is consistent with approaches made by other Ohio utilities. A procedural schedule associated with the filing has been set and all respective responses have been submitted. It is anticipated the PUCO will act on the Company's filing and the flings of the other Ohio utilities later this year.

10. Environmental Matters

Air Quality

Cross-State Air Pollution Rule (Formerly Clean Air Interstate Rule (CAIR))

On July 7, 2011, EPA finalized the Cross-State Air Pollution Rule (CSAPR). CSPAR is the EPA's response to the US Court of Appeals for the District of Columbia's (the Court) remand of the Clean Air Interstate Rule (CAIR). CAIR was originally established in 2005 as an allowance cap and trade program that required reductions from coal-burning power plants for NOx emissions beginning January 1, 2009 and SO2 emissions beginning January 1, 2010, with a second phase of reductions in 2015.

In an effort to address the Court's finding that CAIR did not adequately ensure attainment of pollutants in certain downwind states due to unlimited trading of SO2and NOx allowances, CSPAR reduces the ability of facilities to meet emission reduction targets through allowance trading. Like CAIR, CSPAR sets individual state caps for SO2and NOx emissions. However, unlike CAIR in which states allocated allowances through state implementation plans, CSPAR allowances were allocated to individual units directly through the federal rule. As finalized, CSAPR requires a 71 percent reduction of SO2 emissions compared to 2005 national levels and a 52 percent reduction of NOx emissions compared to 2005 national levels and that such reductions are to be achieved with initial step reductions beginning January 1, 2012, with final compliance to be achieved in 2014. Multiple administrative and judicial challenges have been filed, including requests to stay CSPAR's implementation.

On December 30, 2011, the Court granted a stay of CSPAR and ordered expedited briefing schedules be submitted by January 18, 2012, which allowed for completion of briefing and a hearing in April 2012. Two primary issues are before the Court for review: (1) EPA's use of air modeling data (as opposed to exclusive reliance on actual monitoring data) to support state contribution levels, and (2) EPA's allocation of allowances directly through a federal implementation plan as opposed to setting state caps and providing states the opportunity to submit individual state implementation plans. In addition, there are initiatives in the Congress that, if adopted, would suspend CSPAR's implementation. A final ruling is expected later this year.

Utility Hazardous Air Pollutants (HAPs) Rule

On December 21, 2011, the EPA finalized the Utility HAPs rule. The HAPs Rule is the EPA's response to the US Court of Appeals for the District of Columbia vacating the Clean Air Mercury Rule (CAMR) in 2008. CAMR was originally established in 2005 as a nation-wide mercury emission allowance cap and trade system which sought to reduce utility emissions of mercury starting in 2010.

The HAPs rule sets emission limits for hazardous air pollutants for existing and new coal-fired power plants and identifies the following broad categories of hazardous air pollutants: mercury, non-mercury hazardous air pollutants (primarily arsenic, chromium, cobalt, and selenium) and acid gases (hydrogen cyanide, hydrogen chloride, and hydrogen fluoride). The rule imposes mercury emission limits for two sub-categories of coal, and proposed surrogate limits for non-mercury and acid gas hazardous air pollutants. The EPA did not grant blanket compliance extensions, but asserted that states have broad authority to grant one year extensions for individual units where potential reliability impacts have been demonstrated. Reductions are to be achieved within three years of publication of the final rule in the Federal register (April 2015). Initiatives to suspend CSPAR’s implementation by the Congress also apply to the implementation of the HAPs rule. The reviewing court has yet to rule on any requests to stay the implementation of the HAPs rule.

Conclusions Regarding Air Regulations

To comply with Indiana's implementation plan of the Clean Air Act, and other federal air quality standards, the Company obtained authority from the IURC to invest in clean coal technology. Using this authorization, the Company invested approximately $411 million starting in 2001 with the last equipment being placed into service on January 1, 2010. The pollution control equipment included Selective Catalytic Reduction (SCR) systems, fabric filters, and an SO2 scrubber at its generating facility that is jointly owned with ALCOA (the Company's portion is 150 MW). SCR technology is the most effective method of reducing NOx emissions where high removal efficiencies are required and fabric filters control particulate matter emissions. The unamortized portion of the $411 million clean coal technology investment was included in rate base for purposes of determining SIGECO's new electric base rates approved in the latest base rate order obtained April 27, 2011. SIGECO's coal fired generating fleet is 100 percent scrubbed for SO2 and 90 percent controlled for NOx.

Utilization of the Company's NOx and SO2 allowances can be impacted as these regulations are revised and implemented. Most of these allowances were granted to the Company at zero cost; therefore, any reduction in carrying value that could result from future changes in regulations would be immaterial.

The Company is currently reviewing the sufficiency of its existing pollution control equipment in relation to the requirements described in CSPAR and the Utility HAPs Rule. Based upon an initial review of the final rules, including minor revisions made to CSPAR in October 2011, the Company believes that it will be able to meet these requirements with its existing suite of pollution control equipment and the anticipated allotment of new emission allowances. However, it is possible some minor modifications to the control equipment and additional operating expenses could be required. The Company believes that such additional costs, if necessary, would be recoverable under Indiana Senate Bill 251 referenced above.

Notice of Violation Received

The Company received a notice of violation (NOV) from the EPA pertaining to its A.B. Brown power plant. The NOV asserts that when the power plant was equipped with SCRs the correct permits were not obtained or the best available control technology to control incidental sulfuric acid mist was not installed. Based on the Company's understanding of the New Source Review reform in effect when the equipment was installed, it is the Company's position that its SCR project was exempted from such requirements. At this time the Company is reviewing the potential impact this NOV could have on operating costs. To the extent costs to comply increase, they should be recoverable under Indiana law.

Water

Section 316(b) of the Clean Water Act requires that generating facilities use the "best technology available" to minimize adverse environmental impacts in a body of water. More specifically, Section 316(b) is concerned with impingement and entrainment of aquatic species in once-through cooling water intake structures used at electric generating facilities. In April 2009, the U.S. Supreme Court affirmed that the EPA could, but was not required to, consider costs and benefits in making the evaluation as to the best technology available for existing generating facilities. The regulation was remanded back to the EPA for further consideration. In March 2011, the EPA released its proposed Section 316(b) regulations. The EPA did not mandate the retrofitting of cooling towers in the proposed regulation, but if finalized the regulation will leave it to the state to determine whether cooling towers should be required on a case by case basis. A final rule is expected in 2012. Depending on the final rule and on the Company's facts and circumstances, capital investments could be in the $40 million range if new infrastructure, such as new cooling water towers, is required. Costs for compliance with these final regulations would likely qualify as federally mandated regulatory requirements under Indiana Senate Bill 251 referenced above.

Coal Ash Waste Disposal & Ash Ponds

In June 2010, the EPA issued proposed regulations affecting the management and disposal of coal combustion products, such as ash generated by the Company's coal-fired power plants. The proposed rules more stringently regulate these byproducts and would likely increase the cost of operating or expanding existing ash ponds and the development of new ash ponds. The alternatives include regulating coal combustion by-products that are not being beneficially reused as hazardous waste. The EPA did not offer a preferred alternative, but took public comment on multiple alternative regulations. Rules may not be finalized in 2012 given oversight hearings, congressional interest, and other factors.

At this time, the majority of the Company's ash is being beneficially reused. However, the alternatives proposed would require some retrofitting or closure of existing ash ponds. The Company estimates capital expenditures to comply could be as much as $30 million, and such expenditures could exceed $100 million if the most stringent of the alternatives is selected. Annual compliance costs could increase slightly or be impacted by as much as $5 million. Costs for compliance with these regulations would likely qualify as federally mandated regulatory requirements under Senate Bill 251 referenced above.

Climate Change
In April 2007, the US Supreme Court determined that greenhouse gases meet the definition of "air pollutant" under the Clean Air Act and ordered the EPA to determine whether greenhouse gas emissions from motor vehicles cause or contribute to air pollution that may reasonably be anticipated to endanger public health or welfare. In April 2009, the EPA published its proposed endangerment finding for public comment. The proposed endangerment finding concludes that carbon emissions from mobile sources pose an endangerment to public health and the environment. The endangerment finding was finalized in December 2009, and is the first step toward EPA regulating carbon emissions through the existing Clean Air Act in the absence of specific carbon legislation from Congress. The EPA has promulgated two greenhouse gas regulations that apply to the Company's generating facilities. In 2009, the EPA finalized a mandatory greenhouse gas emissions registry which requires the reporting of emissions. The EPA has also finalized a revision to the Prevention of Significant Deterioration (PSD) and Title V permitting rules which would require facilities that emit 75,000 tons or more of greenhouse gases a year to obtain a PSD permit for new construction or a significant modification of an existing facility. In April 2012, the USEPA issued its proposed new source performance standards for greenhouse gases applicable to new construction. This proposed rule does not apply to existing sources, such as Vectren's generating facilities. The USEPA has not indicated when it intends to propose standards for existing sources.

Numerous competing federal legislative proposals have also been introduced in recent years that involve carbon, energy efficiency, and renewable energy. Comprehensive energy legislation at the federal level continues to be debated, but there has been little progress to date. The progression of regional initiatives throughout the United States has also slowed.

Impact of Legislative Actions & Other Initiatives is Unknown
If regulations are enacted by the EPA or other agencies or if legislation requiring reductions in CO2 and other greenhouse gases or legislation mandating a renewable energy portfolio standard is adopted, such regulation could substantially affect both the costs and operating characteristics of the Company's fossil fuel generating plants and natural gas distribution businesses. At this time and in the absence of final legislation or rulemaking, compliance costs and other effects associated with reductions in greenhouse gas emissions or obtaining renewable energy sources remain uncertain. The Company has gathered preliminary estimates of the costs to control greenhouse gas emissions. A preliminary investigation demonstrated costs to comply would be significant, first with regard to operating expenses and later for capital expenditures as technology becomes available to control greenhouse gas emissions. However, these compliance cost estimates are based on highly uncertain assumptions, including allowance prices if a cap and trade approach were employed, and energy efficiency targets. Costs to purchase allowances that cap greenhouse gas emissions or expenditures made to control emissions should be considered a cost of providing electricity, and as such, the Company believes such costs and expenditures would be recoverable from customers through Senate Bill 251. Customer rates may also be impacted should decisions be made to reduce the level of sales to municipal and other wholesale customers in order to meet emission targets.

Manufactured Gas Plants
In the past, the Company operated facilities to manufacture natural gas. Given the availability of natural gas transported by pipelines, these facilities have not been operated for many years. Under current environmental laws and regulations, those that owned or operated these facilities may now be required to take remedial action if certain contaminants are found above the regulatory thresholds at these sites.

In the Indiana Gas service territory, the existence, location, and certain general characteristics of 26 gas manufacturing and storage sites have been identified for which the Company may have some remedial responsibility. A remedial investigation/feasibility study (RI/FS) was completed at one of the sites under an agreed order between Indiana Gas and the IDEM, and a Record of Decision was issued by the IDEM in January 2000. The remaining sites have been submitted to the IDEM's Voluntary Remediation Program (VRP). The Company has identified its involvement in five manufactured gas plants sites in SIGECO's service territory, all of which are currently enrolled in the IDEM's

VRP. The Company is currently conducting some level of remedial activities, including groundwater monitoring at certain sites.

The Company has accrued the estimated costs for further investigation, remediation, groundwater monitoring, and related costs for the sites. While the total costs that may be incurred in connection with addressing these sites cannot be determined at this time, the Company has recorded cumulative costs that it reasonably expects to incur totaling approximately $41.7 million ($23.2 million at Indiana Gas and $18.5 million at SIGECO). The estimated accrued costs are limited to the Company's share of the remediation efforts and are therefore net of exposures of other potentially responsible parties (PRP).

With respect to insurance coverage, Indiana Gas has received approximately $20.8 million from all known insurance carriers under insurance policies in effect when these plants were in operation. SIGECO filed a declaratory judgment action against its insurance carriers seeking a judgment finding its carriers liable under the policies for coverage of further investigation and any necessary remediation costs that SIGECO may accrue under the VRP program and/or another site subject to a lawsuit that has been settled. In November 2011, the Court ruled on two motions for summary judgment, finding for SIGECO and against certain insurers on indemnification and defense obligations in the policies at issue. SIGECO has settlement agreements with all known insurance carriers and has recorded approximately $15.2 million of expected insurance recoveries.

The costs the Company expects to incur are estimated by management using assumptions based on actual costs incurred, the timing of expected future payments, and inflation factors, among others. While the Company's utilities have recorded all costs which they presently expect to incur in connection with activities at these sites, it is possible that future events may require some level of additional remedial activities which are not presently foreseen and those costs may not be subject to PRP or insurance recovery. As of March 31, 2012 and December 31, 2011, respectively, approximately $4.7 million and $6.5 million of accrued, but not yet spent, costs are included in Other Liabilities related to both the Indiana Gas and SIGECO sites.

11. Rate & Regulatory Matters

Vectren South Electric Base Rate Filing

On December 11, 2009, Vectren South filed a request with the IURC to adjust its base electric rates. The requested increase in base rates addressed capital investments, a modified electric rate design that would facilitate a partnership between Vectren South and customers to pursue energy efficiency and conservation, and new energy efficiency programs to complement those currently offered for natural gas customers. The IURC issued an order in the case on April 27, 2011. The order provides for an approximate $28.6 million revenue increase to recover costs associated with approximately $325 million in system upgrades that were completed in the three years leading up to the December 2009 filing and modest increases in maintenance and operating expenses. The approved revenue increase is based on rate base of $1,295.6 million, return on equity of 10.4 percent and an overall rate of return of 7.29 percent. The new rates were effective May 3, 2011. The IURC, in its order, denied the Company's request for implementation of the decoupled rate design. (See disclosure below regarding the IURC's approval of demand side management programs and lost margin recovery.) Addressing issues raised in the case concerning coal supply contracts and related costs, the IURC found that current coal contracts remain effective and that a prospective review process of future procurement decisions would be initiated.

Coal Procurement Procedures

Vectren South submitted a request for proposal in April 2011 regarding coal purchases for a four year period beginning in 2012. After negotiations with bidders, Vectren South has reached an agreement in principle for multi-year purchases with two suppliers, one of which is Vectren Fuels, Inc. Consistent with the IURC direction in the electric rate case, a sub docket proceeding was established to review the Company's prospective coal procurement procedures, and the Company submitted evidence related to its recent request for proposal (RFP) and those coal procurement procedures to the IURC in September 2011. In March 2012, the IURC issued its order in the sub docket. The order concluded that Vectren South's 2011 RFP process resulted in prices at the lowest fuel cost reasonably possible. The IURC will continue to regularly monitor Vectren South's procurement process in future fuel adjustment proceedings.

Vectren South Electric Fuel Cost Reduction

In the spring of 2011, Vectren secured contracts for lower coal costs through a formal bidding process. This lower-priced coal is expected to start being delivered and used at Vectren's power plants by late 2012 to early 2013 and beyond. On December 5, 2011 within the quarterly FAC filing, Vectren South submitted a joint proposal with the OUCC to reduce its fuel costs by accelerating the impact of lower cost coal contracts to be effective after 2012. The agreement to accelerate savings into early 2012 means that the existing 2012 coal costs that are above the new, lower prices will be deferred to a regulatory asset and recovered over a six-year period without interest beginning in 2014. The IURC approved this proposal on January 25, 2012, with a positive impact to customer's rates effective February 1, 2012. Deferrals also include a reduction in the value of the coal inventory at December 31, 2011 of approximately $17.7 million to reflect existing coal inventory at the new, lower price. Deferrals related to coal purchases in 2012 have totaled approximately $9.7 million, bringing the total deferred balance as of March 2012 to $27.4 million.

Vectren South Electric Demand Side Management Program Filing

On August 16, 2010, Vectren South filed a petition with the IURC, seeking approval of its proposed electric Demand Side Management (DSM) Programs, recovery of the costs associated with these programs, recovery of lost margins as a result of implementing these programs for large customers, and recovery of performance incentives linked with specific measurement criteria on all programs. The DSM Programs proposed are consistent with a December 9, 2009 order issued by the IURC, which, among other actions, defined long-term conservation objectives and goals of DSM programs for all Indiana electric utilities under a consistent statewide approach. In order to meet these objectives, the IURC order divided the DSM programs into Core and Core Plus programs. Core programs are joint programs required to be offered by all Indiana electric utilities to all customers, and include some for large industrial customers. Core Plus programs are those programs not required specifically by the IURC, but defined by each utility to meet the overall energy savings targets defined by the IURC.

On August 31, 2011 the IURC issued an order approving an initial three year DSM plan in the Vectren South service territory that complies with the IURC's energy saving targets. Consistent with the Company's proposal, the order approved, among other items, the following: 1) recovery of costs associated with implementing the DSM Plan; 2) the recovery of a performance incentive mechanism based on measured savings related to certain DSM programs; 3) lost margin recovery associated with the implementation of DSM programs; and 4) deferral of lost margin up to $1 million in 2011 associated with small customer DSM programs for subsequent recovery under a tracking mechanism to be proposed by the Company. This mechanism is an alternative to the electric decoupling proposal that was denied by the IURC in the order received April 27, 2011. On January 26, 2012, the Company requested approval from the IURC of a recovery mechanism within the existing Demand Side Management Adjustment (DSMA) for lost margins resulting from small customer participation in the Company's DSM programs. The filing included a request for recovery of the $1 million deferred in 2011, and a request for continued deferral of lost margins in 2012 until such point as these lost margins are included in DSMA rates. The evidentiary hearing in this matter is scheduled for June 5, 2012.

Vectren South Electric Dense Pack Filing

On September 14, 2011, Vectren South filed a petition with the IURC seeking recovery of and return on the capital investment in dense pack technology to improve the efficiency of its A.B. Brown Generating Station. This investment is expected to be approximately $32 million over the next two years, of which approximately $22 million has been invested to date. This technology is expected to allow the A.B. Brown units to run at least 5 percent more efficient, thereby burning less fuel, and reducing fuel costs and emissions of pollutants. In the Company's base rate order issued in April 2011, the IURC authorized deferred accounting treatment associated with this investment. Indiana statute also provides for timely recovery of investments, with a return, in instances where the investment increases the efficiency of existing generating plants that are fueled by coal. Several parties have intervened in the case and are requesting that the IURC deny recovery of these project costs outside of a base rate proceeding. A hearing was held by the IURC in February 2012 and proposed orders were submitted by the parties in March 2012. An order on timely recovery is expected later in 2012.

Vectren North Reporting Location Consolidation Proceeding

Vectren North implemented a reporting location consolidation plan in 2011 and converted certain reporting locations into staging areas throughout the Vectren North territory. On May 26, 2011, the International Brotherhood of Electrical Workers Local 1393, United Steel Workers Locals 12213 and 7441 and others (the "Complainants") filed a formal complaint with the IURC claiming that implementation of the consolidation plan by Vectren North endangers public safety and impairs Vectren North's ability to provide adequate, safe and reliable service. The Complainants asked the IURC to require Vectren North to reopen previously consolidated reporting locations and maintain and staff those locations. A hearing in this case was held in February 2012. Complainants submitted a proposed order in March and Vectren North submitted a reply brief and a proposed order in April. The case will be fully briefed as of the first of May and the Company expects the IURC to issue a final order in this matter some time in 2012.

VEDO Continues the Process to Exit the Merchant Function

On August 20, 2008, the PUCO approved the results of an auction selecting qualified wholesale suppliers to provide the gas commodity to the Company for resale to its customers at auction-determined standard pricing. This standard pricing was comprised of the monthly NYMEX settlement price plus a fixed adder. This standard pricing, which was effective from October 1, 2008 through March 31, 2010, was the initial step in exiting the merchant function in the Company's Ohio service territory. The approach eliminated the need for monthly gas cost recovery (GCR) filings and prospective PUCO GCR audits.

The second phase of the exit process began on April 1, 2010. During this phase, the Company no longer sells natural gas directly to customers. Rather, state-certified Competitive Retail Natural Gas Suppliers, that are successful bidders in a similar regulatory-approved auction, sell the gas commodity to specific customers for a 12-month period at auction-determined standard pricing. During the second phase, VEDO conducted its third retail auction on January

31, 2012 to address the 12-month term beginning April 1, 2012. The results of that auction were approved by the PUCO on February 1, 2012. Consistent with current practice, customers continue to receive a single bill for the commodity as well as the delivery component of natural gas service from VEDO.

The PUCO provided for an Exit Transition Cost rider, which allows the Company to recover costs associated with the transition process. Exiting the merchant function has not had a material impact on earnings or financial condition.

12. Fair Value Measurements

The carrying values and estimated fair values using primarily Level 2 assumptions of the Company's other financial instruments follow:

(In millions)	March 31, 2012 Carrying Amount	March 31, 2012 Est. Fair Value	December 31, 2011 Carrying Amount	December 31, 2011 Est. Fair Value
Long-term debt	$1,208.2	$1,321.8	$1,208.2	$1,392.9
Short-term borrowings	49.7	49.7	142.8	142.8
Cash & cash equivalents	5.5	5.5	6.0	6.0

For the balance sheet dates presented in these financial statements, the Company had no material assets or liabilities recorded at fair value outstanding.

Certain methods and assumptions must be used to estimate the fair value of financial instruments. The fair value of the Company's long-term debt was estimated based on the quoted market prices for the same or similar issues or on the current rates offered to the Company for instruments with similar characteristics. Because of the maturity dates and variable interest rates of short-term borrowings and cash & cash equivalents, those carrying amounts approximate fair value. Because of the inherent difficulty of estimating interest rate and other market risks, the methods used to estimate fair value may not always be indicative of actual realizable value, and different methodologies could produce different fair value estimates at the reporting date.

Under current regulatory treatment, call premiums on reacquisition of long-term debt are generally recovered in customer rates over the life of the refunding issue or over a 15-year period. Accordingly, any reacquisition would not be expected to have a material effect on the Company's results of operations.

13. Impact of Recently Issued Accounting Principles

Other Comprehensive Income (OCI)
In 2011, the FASB issued new accounting guidance regarding the presentation of comprehensive income within financial statements. The new guidance requires entities to report components of comprehensive income in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements. The guidance does not change the items that must be reported in OCI. The new guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and retrospective application is required. The Company adopted this guidance, as amended for condensed quarterly reporting, for the quarterly reporting period ended March 31, 2012. During the periods presented comprehensive income and net income were equal.

Goodwill Testing
In September 2011, the FASB issued new accounting guidance regarding testing goodwill for impairment. The new guidance will allow the Company an option to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Using the new guidance, the Company no longer would be required to calculate the fair value of a reporting unit unless the Company determines, based on that qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. The Company considered this option during its quarterly reporting period ended March 31, 2012 and concluded the continuation of the use of a quantitative approach is appropriate.

Fair Value Measurement and Disclosure
In May 2011, the FASB issued accounting guidance to improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and International Financial

Reporting Standards (IFRS). The amendments are not intended to change the application of the current fair value requirements, but to clarify the application of existing requirements. The guidance does change particular principles or requirements for measuring fair value or disclosing information about fair value measurements. To improve consistency, language has been changed to ensure that U.S. GAAP and IFRS fair value measurement and disclosure requirements are described in the same way. The Company adopted this guidance for its quarterly reporting period ended March 31, 2012. The adoption of this guidance did not have a material impact on our financial position, results of operations or cash flows.

14. Segment Reporting

The Company's operations consist of regulated operations and other operations that provide information technology and other support services to those regulated operations. The Company segregates its regulated operations between Gas Utility Services and Electric Utility Services. Gas Utility Services provides natural gas distribution and transportation services to nearly two-thirds of Indiana and to west central Ohio. Electric Utility Services provides electric distribution services to southwestern Indiana, and includes the Company's power generating and wholesale power operations. Regulated operations supply natural gas and/or electricity to over one million customers. In total, the Company is comprised of three operating segments: Gas Utility Services, Electric Utility Services, and Other operations. Net income is the measure of profitability used by management for all operations.

Information related to the Company's business segments is summarized below:

	Three Months Ended March 31,	
(In millions)	2012	2011
Revenues		
Gas Utility Services	$292.3	$356.7
Electric Utility Services	139.4	146.4
Other Operations	9.9	11.0
Eliminations	(9.5)	(10.5)
Total revenues	$432.1	$503.6
Profitability Measure - Net Income		
Gas Utility Services	$37.5	$36.1
Electric Utility Services	15.6	8.6
Other Operations	2.9	3.9
Total net income	$56.0	$48.6

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

Description of the Business

Vectren Utility Holdings, Inc. (the Company or Utility Holdings), an Indiana corporation, was formed on March 31, 2000 to serve as the intermediate holding company for Vectren Corporation's (Vectren) three operating public utilities: Indiana Gas Company, Inc. (Indiana Gas or Vectren North), Southern Indiana Gas and Electric Company (SIGECO or Vectren South), and the Ohio operations (VEDO or Vectren Ohio). Utility Holdings also earns a return on shared assets that provide information technology and other services to the three utilities. Vectren, an Indiana corporation, is an energy holding company headquartered in Evansville, Indiana and was organized on June 10, 1999. Both Vectren and Utility Holdings are holding companies as defined by the Energy Policy Act of 2005 (Energy Act).

Indiana Gas provides energy delivery services to approximately 570,000– natural gas customers located in central and southern Indiana. SIGECO provides energy delivery services to approximately 142,000 electric customers and approximately 110,000 gas customers located near Evansville in southwestern Indiana. SIGECO also owns and operates electric generation assets to serve its electric customers and optimizes those assets in the wholesale power market. Indiana Gas and SIGECO generally do business as Vectren Energy Delivery of Indiana. VEDO provides energy delivery services to over 313,000 natural gas customers located near Dayton in west central Ohio.

Executive Summary of Consolidated Results of Operations

The following discussion and analysis should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto as well as the Company's 2011 annual report filed on Form 10-K.

In 2012, Utility Holdings' first quarter earnings were $56.0 million compared to $48.6 million in 2011, an increase of $7.4 million. The first quarter of 2012 has been positively impacted by new electric base rates implemented on May 3, 2011 and negatively impacted by extremely mild winter weather. Utility Holdings also was impacted by lower interest expense as a result of refinancing's occurring in the last quarter of 2011 and first quarter of 2012 and lower other operating costs.

Gas Utility Services
Gas utility services earned $37.5 million during the three months ended March 31, 2012, compared to earnings of $36.1 million in the first quarter of 2011. Results in 2012 have been impacted by lower uncollectible accounts expense driven primarily by lower gas costs and lower interest expense due to the recent refinancing activity. With rate designs that substantially limit the impact of weather on margin, heating degree days that were 71 percent of normal in Indiana and 82 percent of normal in Ohio had only a slightly negative impact on margin.

Electric utility services
The electric operations earned $15.6 million during the three months ended March 31, 2012, compared to $8.6 million in the prior year period. Factors impacting electric results were consistent with those impacting the overall Utility Group including increased base rates, mild weather, and lower other operating and interest costs.

Management estimates the impact of very mild weather on retail electric customer electric margin, compared to normal temperatures, to be approximately $3.6 million unfavorable in the first quarter of 2012. This compares to the first quarter of 2011, where management estimated a $0.2 million unfavorable impact on margin compared to normal.

Other utility operations

Year to date in 2012 earnings from other utility operations were $2.9 million compared to $3.9 million in 2011.

Operating Trends

Margin

Throughout this discussion, the terms Gas Utility margin and Electric Utility margin are used. Gas Utility margin is calculated as Gas utility revenues less the Cost of gas sold. Electric Utility margin is calculated as Electric utility revenues less Cost of fuel & purchased power. The Company believes Gas Utility and Electric Utility margins are better indicators of relative contribution than revenues since gas prices, fuel, and purchased power costs can be volatile and are generally collected on a dollar-for-dollar basis from customers. Following is a discussion and analysis of margin generated from regulated utility operations.

Gas Utility Margin (Gas utility revenues less Cost of gas sold)
Gas utility margin and throughput by customer type follows:

	Three Months Ended March 31,	
(In millions)	2012	2011
Gas utility revenues	$292.3	$356.7
Cost of gas sold	137.1	195.1
Total gas utility margin	$155.2	$161.6
Margin attributed to:		
Residential & commercial customers	$135.1	$139.7
Industrial customers	16.5	17.6
Other	3.6	4.3
Total gas utility margin	$155.2	$161.6
Sold & transported volumes in MMDth attributed to:		
Residential & commercial customers	40.8	52.8
Industrial customers	27.8	28.8
Total sold & transported volumes	68.6	81.6

For the three months ended March 31, 2012, gas utility margins were $155.2 million and compared to 2011 decreased $6.4 million. Approximately $5.4 million of this decrease results from the impact of low natural gas prices and mild weather on revenue taxes, late and reconnect fees, and volumetric pass through costs. Large customer margin, net of the impacts of regulatory initiatives and tracked costs, decreased by $0.9 million due primarily to lower volumes sold, largely due to warmer weather. Weather also had some impact on small customers, reducing margin $0.7 million quarter over quarter. Returns generated on investments in bare steel/ cast iron and distribution riser replacement in Ohio increased margins $0.7 million quarter over quarter.

Electric Utility Margin (Electric utility revenues less Cost of fuel & purchased power)
Electric utility margin and volumes sold by customer type follows:

(In millions)	Three Months Ended March 31, 2012	2011
Electric utility revenues	$139.4	$146.4
Cost of fuel & purchased power	44.7	59.5
Total electric utility margin	$94.7	$86.9
Margin attributed to:		
Residential & commercial customers	$58.7	$54.0
Industrial customers	25.3	23.4
Other customers	1.8	1.9
Subtotal: retail	$85.8	

	Services				
Preferred Equity 0.4%(7)					
SuttonPark Holdings, Inc.	Business	14.00%	2,000	2,000,000	1,505,602
Common Equity 0.0%(7)	Services				
SuttonPark Holdings, Inc.	Business		100	100	100
	Services				
Investments in Controlled, Affiliated Portfolio Companies				8,000,100	8,000,100
Total Investments 172.0%				656,708,503	664,724,406
Cash Equivalents 0.5%			1,814,451	1,814,451	1,814,451
Total Investments and Cash Equivalents 172.5%				$ 658,522,954	$ 666,538,857
Liabilities in Excess of Other Assets (72.5%)					(279,963,634)
Net Assets 100.0%					$ 386,575,223

(1) The provisions of the 1940 Act classify investments based on the level of control that we maintain in a particular portfolio company. As defined in the 1940 Act, a company is deemed as non-controlled when we own less than 25% of a portfolio company s voting securities and controlled when we own 25% or more of a portfolio company s voting securities.
(2) The provisions of the 1940 Act classify investments further based on the level of ownership that we maintain in a particular portfolio company. As defined in the 1940 Act, a company is deemed as non-affiliated when we own less than 5% of a portfolio company s voting securities and affiliated when we own 5% or more of a portfolio company s voting securities.
(3) Valued based on our accounting policy (see Note 2 to our consolidated financial statements).
(4) Represents floating rate instruments that accrue interest at a predetermined spread relative to an index, typically the applicable London Interbank Offer Rate (LIBOR or L) or Prime Rate (Prime or P).
(5) Security is exempt from registration under Rule 144A promulgated under the Securities Act of 1933. The security may be resold in transactions that are exempt from registration, normally to qualified institutional buyers.
(6) Coupon is payable in cash and/or in-kind (PIK).
(7) Non-income producing securities.
(8) Coupon is subject to a LIBOR or Prime rate floor.
(9) Represents the purchase of a security with delayed settlement (unfunded investment). This security does not have a basis point spread above an index.
(10) Non-U.S. company or principal place of business outside the United States.

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Table of Contents

PENNANTPARK INVESTMENT CORPORATION

SCHEDULE OF INVESTMENTS

SEPTEMBER 30, 2009

Issuer Name	Maturity	Industry	Current Coupon	Basis Point Spread Above Index[4]	Par / Shares	Cost	Fair Value[3]
Investments in Non-Controlled, Non-Affiliated Portfolio Companies 150.9%[1],[2]							
First Lien Secured Debt 50.1%							
1-800 Contacts, Inc.	03/04/2015	Distribution	7.70%	P+295[8]	$ 13,929,825	$ 11,941,660	$ 13,720,877
Burlington Coat Factory Warehouse Corp.	05/28/2013	Retail Store	2.57%	L+225	2,837,374	2,835,299	2,578,464
Ceva Group PLC[5]	10/01/2016	Logistics	11.63%		7,500,000	7,284,525	7,284,525
Chester Downs and Marina, LLC	07/31/2016	Hotels, Motels, Inns and Gaming	12.38%	L+988[8]	10,000,000	9,421,220	10,050,000
EnviroSolutions, Inc.	07/07/2012	Environmental Services	11.00%[6]	P+775[8]	14,175,260	13,391,908	12,715,207
Hanley-Wood, L.L.C.	03/08/2014	Other Media	2.49%	L+225	8,842,500	8,842,500	6,225,120
Hughes Network Systems, L.L.C.	04/15/2014	Telecommunications	2.88%	L+250	5,000,000	5,000,000	4,562,500
Jacuzzi Brands Corp.	02/07/2014	Home and Office Furnishings, Housewares and Durable Consumer Products	2.53%	L+225	9,817,568	9,817,568	4,810,608
Levlad, L.L.C.	03/08/2014	Consumer Products	7.75%	L+475	4,434,548	4,434,548	1,064,292
Lyondell Chemical Co.	12/15/2009	Chemicals, Plastics and Rubber	13.00%	L+1,000[8]	12,668,615	12,965,067	13,169,026
Lyondell Chemical Co.[9]	12/15/2009	Chemicals, Plastics and Rubber			6,331,385	6,458,897	6,581,474
Mattress Holding Corp.	01/18/2014	Home and Office Furnishings, Housewares and Durable Consumer Products	2.55%	L+225	3,910,200	3,910,200	3,022,585
Mitchell International, Inc.	03/28/2014	Business Services	2.31%	L+200	1,910,204	1,910,204	1,687,346
National Bedding Co., L.L.C.	02/28/2013	Home and Office Furnishings, Housewares and Durable Consumer Products	2.26%	L+200	6,825,000	6,829,243	6,142,500
Penton Media, Inc.	02/01/2013	Other Media	2.73%	L+225	4,875,000	4,875,000	3,568,500
Philosophy, Inc.	03/16/2014	Consumer Products	2.25%	L+200	1,426,506	1,426,506	1,148,337
Questex Media Group, Inc.	05/04/2014	Other Media	5.25%[7]	L+200	4,886,667	4,886,667	2,912,600
Rexair, L.L.C.	06/30/2010	Retail	4.50%	L+425	6,695,795	5,507,847	5,189,241
Rexnord, L.L.C.	07/19/2013	Manufacturing/ Basic Industry	2.50%	L+200	2,887,881	2,887,881	2,768,756
Sitel, L.L.C.	01/30/2014	Business Services	5.95%	L+550	2,682,328	2,682,328	2,226,332
Sugarhouse HSP Gaming Prop.	09/23/2014	Hotels, Motels, Inns and Gaming	11.25%	L+825[8]	20,000,000	19,203,528	19,600,000
U.S. Xpress Enterprises, Inc.	10/12/2014	Cargo Transportation	4.26%	L+400	14,966,254	10,315,732	10,887,950
World Color Press Inc.	07/21/2012	Printing	9.00%	P+500[8]	3,500,000	3,177,842	3,491,250
Yonkers Racing Corp.[5]	07/15/2016	Hotels, Motels, Inns and Gaming	11.38%		5,000,000	4,857,698	5,200,000

Total First Lien Secured Debt	164,863,868	150,607,490

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

78

PENNANTPARK INVESTMENT CORPORATION

SCHEDULE OF INVESTMENTS (Continued)

SEPTEMBER 30, 2009

Issuer Name	Maturity	Industry	Current Coupon	Basis Point Spread Above Index[4]	Par / Shares	Cost	Fair Value[3]
Second Lien Secured Debt 42.1%							
Brand Energy and Infrastructure Services, Inc.	02/07/2015	Energy/Utilities	6.36%	L+600	$ 13,600,000	$ 13,153,077	$ 12,416,800
Brand Energy and Infrastructure Services, Inc.	02/07/2015	Energy/Utilities	7.44%	L+700	12,000,000	11,735,965	11,364,000
Generics International (U.S.), Inc.	04/30/2015	Healthcare, Education and Childcare	7.78%	L+750	12,000,000	11,949,634	11,376,000
Greatwide Logistics Services, L.L.C.	03/01/2014	Cargo Transport	11.00%[6]	L+700[8]	2,309,343	2,309,344	2,309,344
Questex Media Group, Inc.	11/04/2014	Other Media	6.91%[7]	L+650	10,000,000	10,000,000	
Realogy Corp.	10/15/2017	Buildings and Real Estate	13.50%		10,000,000	10,000,000	10,387,500
Saint Acquisition Corp.[5]	05/15/2015	Transportation	8.19%	L+775	10,000,000	9,941,121	7,100,000
Saint Acquisition Corp.[5]	05/15/2017	Transportation	12.50%		19,000,000	16,890,972	14,250,000
Sheridan Holdings, Inc.	06/15/2015	Healthcare, Education and Childcare	6.00%[6]	L+575	21,500,000	18,855,728	19,414,500
Specialized Technology Resources, Inc.	12/15/2014	Chemical, Plastics and Rubber	7.25%[6]	L+700	22,500,000	22,488,166	22,500,000
TransFirst Holdings, Inc.	06/15/2015	Financial Services	7.04%[6]	L+675	16,792,105	16,247,489	15,264,023
Total Second Lien Secured Debt						143,571,496	126,382,167
Subordinated Debt/Corporate Notes 50.6%							
Affinion Group Holdings, Inc.	03/01/2012	Consumer Products	8.27%[6]	L+750	23,572,133	22,930,475	21,497,875
Consolidated Foundries, Inc.	04/17/2015	Aerospace and Defense	14.25%[6]		8,109,468	7,952,769	8,190,563
CT Technologies Intermediate Holdings, Inc.	03/22/2014	Business Services	14.00%[6]		20,311,603	19,875,880	20,463,940
Digicel Limited[5]	04/01/2014	Telecommunications	12.00%		1,000,000	995,610	1,115,000
i2 Holdings Ltd.	06/06/2014	Aerospace and Defense	14.75%[6]		22,653,857	22,279,800	22,880,395
IDQ Holdings, Inc.	05/20/2012	Auto Sector	13.75%		20,000,000	19,632,400	20,060,000
Learning Care Group, Inc.	12/28/2015	Education	13.50%[6]		10,324,976	10,190,682	10,324,976
Realogy Corp.	04/15/2015	Buildings and Real Estate	12.38%		10,000,000	8,921,187	5,525,000
Trizetto Group, Inc.	10/01/2016	Insurance	13.50%[6]		20,197,856	20,010,210	20,652,308
UP Acquisitions Sub Inc.	02/08/2015	Oil and Gas	13.50%		21,000,000	20,472,809	21,420,000
Total Subordinated Debt/Corporate Notes						153,261,822	152,130,057

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Table of Contents

PENNANTPARK INVESTMENT CORPORATION

SCHEDULE OF INVESTMENTS (Continued)

SEPTEMBER 30, 2009

Issuer Name	Maturity	Industry	Current Coupon	Basis Point Spread Above Index [4]	Par / Shares		Cost		Fair Value[3]
Preferred Equity/Partnership Interests(7) 3.6%									
CFHC Holdings, Inc., Class A (Consolidated Foundries, Inc.)		Aerospace and Defense	12.00%		797	$	797,288	$	949,648
i2 Holdings Ltd.		Aerospace and Defense	12.00%		4,137,240		4,137,240		4,793,729
TZ Holdings, L.P., Series A (Trizetto Group, Inc.) (TZ Merger Sub, Inc.)		Insurance			686		685,820		685,820
TZ Holdings, L.P., Series B (Trizetto Group, Inc.)		Insurance	6.50%		1,312		1,312,006		1,410,604
UP Holdings Inc., Class A-1 (UP Acquisitions Sub Inc.)		Oil and Gas	8.00%		91,608		2,499,067		3,094,252
VSS-AHC Holdings, LLC (Advanstar Inc.)		Other Media			319		318,896		
Total Preferred Equity/Partnership Interests							9,750,317		10,934,053
Common Equity/Warrants/Partnership Interests 4.5%(7)									
AHC Mezzanine (Advanstar Inc.)		Other Media			3,000		3,005,163		
CFHC Holdings, Inc. (Consolidated Foundries, Inc.)		Aerospace and Defense			1,627		16,271		215,547
CT Technologies Holdings, LLC		Business Services			5,556		3,200,000		6,696,281
i2 Holdings Ltd.		Aerospace and Defense			457,322		454,030		1,293,476
Transportation 100 Holdco, L.L.C.		Cargo Transport			106,299		1,779,455		2,391,463
TZ Holdings, L.P. (Trizetto Group, Inc.)		Insurance			2		6,467		1,337,451
UP Holdings Inc. (UP Acquisitions Sub Inc.)		Oil and Gas			91,608		916		1,656,350
VSS-AHC Holdings, Inc. (Advanstar, Inc.) (Warrant)	11/06/2018	Other Media			85				
Total Common Equity/Warrants/Partnership Interests							8,462,302		13,590,568
Investments in Non-Controlled, Non-Affiliated Portfolio Companies							479,909,805		453,644,335
Investments in Non-Controlled, Affiliated Portfolio Companies 5.4%(1),(2)									
Subordinated Debt/Corporate Notes 1.7%									
Performance Holdings, Inc.	07/02/2014	Leisure, Amusement,	14.25%[6]		$ 5,077,822		4,878,081		4,988,960
		Motion Pictures, Entertainment							
Second Lien Secured Debt 2.7%									
Performance, Inc.	07/02/2013	Leisure, Amusement,	6.24%	L+575	8,750,000		8,750,000		8,019,375

Motion Pictures,
Entertainment

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Table of Contents

PENNANTPARK INVESTMENT CORPORATION

SCHEDULE OF INVESTMENTS (Continued)

SEPTEMBER 30, 2009

Issuer Name	Maturity	Industry	Current Coupon	Basis Point Spread Above Index[4]	Par / Shares	Cost	Fair Value[3]
Common Equity/Partnership Interest 1.0%[7]							
NCP-Performance (Performance Holdings, Inc.)		Leisure, Amusement, Motion Pictures, Entertainment			37,500	$ 3,750,000	$ 3,107,403
Investments in Non-Controlled, Affiliated Portfolio Companies						17,378,081	16,115,738
Total Investments 156.3%						497,287,886	469,760,073
Cash Equivalents 11.1%					33,247,666	33,247,666	33,247,666
Total Investments and Cash Equivalents 167.4%						$ 530,535,552	$ 503,007,739
Liabilities in Excess of Other Assets (67.4%)							(202,427,471)
Net Assets 100.0%							**$ 300,580,268**

(1) The provisions of the 1940 Act classify investments based on the level of control that we maintain in a particular portfolio company. As defined in the 1940 Act, a company is deemed as non-controlled when we own less than 25% of a portfolio company s voting securities and controlled when we own 25% or more of a portfolio company s voting securities.
(2) The provisions of the 1940 Act classify investments further based on the level of ownership that we maintain in a particular portfolio company. As defined in the 1940 Act, a company is deemed as non-affiliated when we own less than 5% of a portfolio company s voting securities and affiliated when we own 5% or more of a portfolio company s voting securities.
(3) Valued based on our accounting policy (see Note 2 to our financial statements).
(4) Represents floating rate instruments that accrue interest at a predetermined spread relative to an index, typically the applicable London Interbank Offer Rate (LIBOR or L) or Prime Rate (Prime or P).
(5) Security is exempt from registration under Rule 144A promulgated under the Securities Act of 1933. The security may be resold in transactions that are exempt from registration, normally to qualified institutional buyers.
(6) Coupon is payable in cash and/or in-kind (PIK).
(7) Non-income producing securities.
(8) Coupon is subject to a LIBOR or Prime rate floor.
(9) Represents the purchase of a security with delayed settlement. This security does not have a basis point spread above an index.

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Table of Contents

PENNANTPARK INVESTMENT CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2010

Except where the context suggests otherwise, the terms we, us, our or PennantPark Investment refer to PennantPark Investment Corporation.

1. ORGANIZATION

PennantPark Investment Corporation was organized as a Maryland corporation on January 11, 2007. PennantPark Investment is a closed-end, externally managed, non-diversified investment company that has elected to be treated as a business development company (BDC), under the Investment Company Act of 1940 (the 1940 Act). PennantPark Investment s objective is to generate both current income and capital appreciation through debt and equity investments. PennantPark Investment invests primarily in U.S. middle-market companies in the form of senior secured loans, mezzanine debt and equity investments.

On April 24, 2007, PennantPark Investment closed its initial public offering and its common stock trades on the NASDAQ Global Select Market under the symbol PNNT . We are externally managed by PennantPark Investment Advisers, LLC (the Investment Adviser or PennantPark Investment Advisers). PennantPark Investment Administration, LLC (the Administrator or PennantPark Investment Administration) provides the administrative services necessary for us to operate.

PennantPark SBIC LP (the SBIC LP or our SBIC) and its general partner, PennantPark SBIC GP, LLC (the SBIC GP), were organized in Delaware as a limited partnership and a limited liability company, respectively, on May 7, 2010 and began operations on June 11, 2010. SBIC LP received a license from the Small Business Administration (SBA) to operate as a Small Business Investment Company (SBIC) effective July 30, 2010 under Section 301(c) of the Small Business Investment Act of 1958 (the 1958 Act). Both SBIC LP and SBIC GP (the Subsidiaries) are consolidated wholly owned subsidiaries of PennantPark Investment. The 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. See Note 13 for subsequent events regarding SBIC LP.

PennantPark Investment completed its initial public offering of common stock in 2007 and issued 21.0 million shares raising $294.1 million in net proceeds. For the year ended September 30, 2009, we sold 4.3 million shares of common stock through a follow-on public offering at a price less than the then current net asset value, resulting in net proceeds of $32.5 million. For the year ended September 30, 2010, we sold 10.8 million shares of common stock through follow-on public offerings at a price less than the then current net asset value, resulting in net proceeds of $101.7 million.

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 PennantPark Investment s and its Subsidiaries 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. Certain prior period amounts have been reclassified to conform to current period presentation. All intercompany balances and transactions have been eliminated. References to the Accounting Standards Codification (ASC), serve as a single source of accounting literature and are not intended to change accounting literature. Subsequent events are evaluated and disclosed as appropriate for events occurring subsequently through the date the consolidated financial statements are issued.

Table of Contents

PENNANTPARK INVESTMENT CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

SEPTEMBER 30, 2010

The consolidated financial statements are prepared in accordance with GAAP and pursuant to the requirements for reporting on Form 10-K 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 Consolidated Statement of Changes in Net Assets in lieu of a Consolidated Statement of Changes in Stockholders Equity.

The significant accounting policies consistently followed by PennantPark Investment and its Subsidiaries are:

(a) Investment Valuations

Our board of directors generally uses market quotations to assess the value of our investments for which market quotations are readily available. We obtain these market values from independent pricing services or at the bid prices obtained from at least two broker/dealers if available, otherwise by a principal market maker or a primary market dealer. If the board of directors has a bona fide reason to believe any such market quote does not reflect the fair value of an investment, it may independently value such investments by using the valuation procedure that it uses with respect to assets for which market quotations are not readily available. First lien secured debt, subordinated debt and other debt investments with maturities greater than 60 days generally are valued by an independent pricing service or at the bid prices from at least two broker/dealers (if available, otherwise by a principal market maker or a primary market dealer). Investments, of sufficient credit quality, purchased within 60 days of maturity are valued at cost plus accreted discount, or minus amortized premium, which approximates value. We expect that there will not be readily available market values for most, if not all, of the investments which are or will be in our portfolio, and we value such investments at fair value as determined in good faith by or under the direction of our board of directors using a documented valuation policy, described herein, and a consistently applied valuation process. With respect to investments for which there is no readily available market value, valuation methods include, but are not limited to, comparisons of financial ratios of the portfolio companies that issued such private 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 or revise our valuation. 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. See Note 5 to the consolidated financial statements.

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

(1) 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;

(2) Preliminary valuation conclusions are then documented and discussed with the management of our Investment Adviser;

(3) Our board of directors also engages independent valuation firms to conduct independent appraisals of our investments for which market quotations are not readily available or are readily available but deemed not reflective of the fair value of the investment. The independent valuation firms review management s preliminary valuations in light of their own independent assessment and also in light of any market quotations obtained from an independent pricing service, broker, dealer or market maker.

Table of Contents

PENNANTPARK INVESTMENT CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

SEPTEMBER 30, 2010

(4) The audit committee of our board of directors reviews the preliminary valuations of the Investment Adviser and that of the independent valuation firms and responds and supplements the valuation recommendations of the independent valuation firms to reflect any comments; and

(5) The board of directors discusses these 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.

The 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.

(b) Security Transactions, Revenue Recognition, and Realized/Unrealized Gains or Losses

Security transactions are recorded on a trade-date basis. 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 and credit facility values during the reporting period, including any reversal of previously recorded unrealized appreciation or depreciation, when gains or losses are realized.

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

Loans are placed on non-accrual status when principal or interest payments are past due 30 days or more and/or when there is reasonable doubt that principal or interest will be collected. Accrued interest is generally reversed when a loan is placed on non-accrual status. Interest payments received on non-accrual loans may be recognized as income or applied to principal depending upon management s judgment. Non-accrual loans are restored to accrual status when past due principal and interest is paid and, in management s judgment, are likely to remain current.

(c) Income Taxes

Since May 1, 2007, PennantPark Investment has complied with the requirements of Subchapter M of the Internal Revenue Code of 1986, as amended, (the Code) and expects to be subject to tax as a regulated investment company (RIC). As a RIC, PennantPark Investment accounts for income taxes using the asset liability method prescribed by ASC 740, 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

PENNANTPARK INVESTMENT CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

SEPTEMBER 30, 2010

financial statement carrying amounts and the tax bases of existing assets and liabilities. Based upon PennantPark Investment s qualification and election to be subject to tax as a RIC, we do not anticipate paying any material level of taxes in the future. Although we are subject to tax as a RIC, we have elected to retain a portion of our calendar year income and pay an excise tax of $0.1 million for the fiscal year ended September 30, 2010. PennantPark Investment recognizes in its consolidated 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. We did not have any uncertain tax positions that met the recognition or measurement criteria of ASC 740-10-25 nor did we have any unrecognized tax benefits as of the periods presented herein. Although we file federal and state tax returns, our major tax jurisdiction is federal. Our inception-to-date federal tax years remain subject to examination by the Internal Revenue Service.

Book and tax basis differences relating to permanent book and tax differences are reclassified among PennantPark Investment s capital accounts, as appropriate. Additionally, the character of income and gain distributions are determined in accordance with income tax regulations that may differ from U.S. generally accepted accounting principles. See Note 8 to the consolidated financial statements.

(d) Dividends, Distributions, and Capital Transactions

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.

Capital transactions, in connection with our dividend reinvestment plan or through offerings of our common stock, are recorded when issued and offering costs are charged as a reduction of capital upon issuance of our common stock.

(e) Consolidation

As permitted under Regulation S-X and the AICPA Audit and Accounting Guide for Investment Companies, PennantPark Investment will generally not consolidate its investment in a company other than an investment company subsidiary or a controlled operating company whose business consists of providing services to us. Accordingly, we have consolidated the results of the Subsidiaries in our consolidated financial statements.

(f) New Accounting Pronouncements and Accounting Standards Updates (ASU)

In January 2010, the FASB issued ASU 2010-06, Fair Value Measurements and Disclosures, to clarify and amend ASC 820-10. In particular, it requires additional disclosures with regards to transfers into and out of Levels 1 and 2. It also requires that entities disclose on a gross basis purchases, sales, issuances, and settlements within the Level 3 fair value roll-forward. ASU 2010-06 also clarifies existing fair value disclosures about the level of disaggregation as well as inputs and valuation techniques for both recurring and nonrecurring fair value measurements that fall into Level 2 or 3. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales and settlements in the roll-forward of activity in Level 3 fair value measurements, which are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of the additional disclosure requirements of ASU 2010-06 did not materially impact our consolidated financial statements. The disclosures regarding the disaggregation of purchases, sales and settlements in the roll-forward of activity in Level 3 fair value measurements is not expected to have a material impact on our consolidated financial statements.

Table of Contents

PENNANTPARK INVESTMENT CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

SEPTEMBER 30, 2010

3. AGREEMENTS

PennantPark Investment has entered into an Investment Management Agreement with the Investment Adviser, which was re-approved by our board of directors, including a majority of our directors who are not interested persons of PennantPark Investment in February 2010. Under this agreement 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. PennantPark Investment, through the Investment Adviser, manages day-to-day operations of and provides investment advisory services to SBIC LP under its investment management agreement. The SBIC LP investment management agreement does not affect the management or incentive fees of 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 (net of U.S. Treasury Bills and/or temporary draws on the credit facility or average adjusted gross assets , if any, see Note 11). Although the base management fee is 2.00% of our average adjusted gross assets, the Investment Adviser agreed to waive a portion of the base management fee such that the base management fee equaled 1.50% from the consummation of the initial public offering through September 30, 2007 and 1.75% from October 1, 2007 through March 31, 2008. The base management fee has been 2.00% since March 31, 2008 and is payable quarterly in arrears. The base management fee is calculated based on the average value of adjusted 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. For the fiscal years ended September 30, 2010, 2009 and 2008, the Investment Adviser earned a net base management fee of $11.6 million, $7.7 million and $6.7 million, respectively, from us.

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 PIK 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 of 1.75%,(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.

PENNANTPARK INVESTMENT CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

SEPTEMBER 30, 2010

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 amount of any previously paid capital gain incentive fees. However, the incentive fee determined as of December 31, 2007 was 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. For the fiscal years ended September 30, 2010, 2009 and 2008, the Investment Adviser received an incentive fee of $8.0 million, $5.7 million and $3.8 million, respectively, from us.

PennantPark Investment has also entered into an Administration Agreement with the Administrator, which was reapproved by our board of directors including a majority of our directors who are not interested persons of PennantPark Investment in February 2010. Under this agreement PennantPark Investment Administration provides administrative services for PennantPark Investment. PennantPark Investment, through the Administrator, provides similar services to SBIC LP under its administration agreement with us. 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, technology systems, insurance 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 offers on PennantPark Investment s behalf managerial assistance to portfolio companies to which PennantPark Investment is required to offer such assistance. Reimbursement for certain of these costs is included in administrative services expenses in the statement of operations. For the fiscal years ended September 30, 2010, 2009 and 2008, the Investment Adviser and Administrator, collectively, were reimbursed $2.1 million, $1.7 million and $2.0 million, respectively, from us, including expenses it incurred on behalf of the Administrator, for services described above.

PennantPark Investment entered into an administration agreement with its controlled affiliate, SuttonPark Holdings, Inc. and its subsidiaries (SPH). Under the administration with SPH, or the SPH Administration Agreement, PennantPark Investment through the Administrator furnishes SPH with office facilities, equipment and clerical, bookkeeping and record keeping services at such facilities. Additionally, the Administrator performs, or oversees the performance of, SPH s required administrative services, which include, among other things, maintaining financial records, preparing financial reports and filing of tax returns. Payments under the SPH Administration Agreement are equal to an amount based upon SPH s allocable portion of the Administrator s overhead in performing its obligations under the SPH Administration Agreement, including rent and allocable portion of the cost of compensation and related expenses of our chief financial officer and their respective staffs. For the fiscal year ended September 30, 2010, the PennantPark Investment was reimbursed $0.1 million, for the services described above.

4. INVESTMENTS

Purchases of long-term investments including PIK for the fiscal years ended September 30, 2010, 2009 and 2008 totaled $315.8 million, $117.4 million and $209.2 million, respectively. Sales and repayments of long-term investments for the fiscal years ended September 30, 2010, 2009 and 2008 totaled $145.2 million, $28.0 million and $70.1 million, respectively.

Table of Contents

PENNANTPARK INVESTMENT CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

SEPTEMBER 30, 2010

Investments and cash equivalents consisted of the following:

	September 30, 2010		September 30, 2009	
	Cost	Fair Value	Cost	Fair Value
First lien	$ 236,707,418	$ 234,595,683	$ 164,863,868	$ 150,607,490
Second lien	159,611,934	156,671,151	152,321,496	134,401,542
Subordinated debt / corporate notes	220,149,211	223,969,304	158,139,903	157,119,017
Preferred equity	11,894,692	9,271,682	9,750,317	10,934,053
Common equity	28,345,248	40,216,586	12,212,302	16,697,971
Cash equivalents	1,814,451	1,814,451	33,247,666	33,247,666
Total	$ 658,522,954	$ 666,538,857	$ 530,535,552	$ 503,007,739

The table below describes investments by industry classification and enumerates the percentage, by market value, of the total portfolio assets (excluding cash equivalents) in such industries as of September 30, 2010 and September 30, 2009.

	September 30,	
Industry Classification	2010	2009
Business Services	15%	7%
Healthcare, Education and Childcare	8	7
Hotels, Motels, Inns and Gaming	7	7
Aerospace and Defense	6	8
Chemicals, Plastic and Rubber	6	9
Home and Office Furnishings, Housewares, and Durable Consumer Products	6	3
Education	5	2
Communications	4	
Insurance	4	5
Oil and Gas	4	6
Printing and Publishing	4	
Transportation	4	5
Buildings and Real Estate	3	3
Diversified/Conglomerate Services	3	
Energy / Utilities	3	5
Environmental Services	3	3
Telecommunications	3	
Financial Services	2	3
Grocery	2	
Leisure, Amusement, Motion Picture, Entertainment	2	3
Other Media	2	3
Cargo Transport	1	3
Consumer Products	1	5
Logistics	1	2

Auto Sector		4
Distribution		3
Other	1	4
Total	100%	100%

88

PENNANTPARK INVESTMENT CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

SEPTEMBER 30, 2010

5. FAIR VALUE OF FINANCIAL INSTRUMENTS

Effective October 1, 2008, we adopted ASC 820, Fair Value Measurements for all financial instruments. We realized no gain or loss as a result of the adoption of ASC 820. Fair value, as defined under ASC 820, is the price that we would receive upon selling an investment or pay to transfer a liability in an orderly transaction to a market participant in the principal or most advantageous market for the investment or liability. ASC 820 emphasizes that valuation techniques maximize the use of observable market inputs and minimize the use of unobservable inputs. Inputs refer broadly to the assumptions that market participants would use in pricing an asset or liability, including assumptions about risk. Inputs may be observable or unobservable. Observable inputs are inputs that reflect the assumptions market participants would use in pricing an asset or liability developed based on market data obtained from sources independent of PennantPark Investment. Unobservable inputs are inputs that reflect the assumptions market participants would use in pricing an asset or liability developed based on the best information available in the circumstances.

ASC 820 classifies the inputs used to measure these fair values into the following hierarchies:

Level 1: Inputs that are quoted prices (unadjusted) in active markets for identical assets or liabilities, accessible by us at the measurement date.

Level 2: Inputs that are quoted prices for similar assets or liabilities in active markets, or that are quoted prices for identical or similar assets or liabilities in markets that are not active and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term, if applicable, of the financial instrument.

Level 3: Inputs that are unobservable for an asset or liability because they are based on our own assumptions about how market participants would price the asset or liability.

A financial instrument s categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Generally, most of our investments and long-term credit facility are classified as Level 3.

The inputs into the determination of fair value may require significant management judgment or estimation. Even if observable market data is available, such information may be the result of consensus pricing information or broker quotes which include a disclaimer that the broker would not be held to such a price in an actual transaction. The non-binding nature of consensus pricing and/or quotes accompanied by disclaimer would result in classification as Level 3 information, assuming no additional corroborating evidence was available.

In addition to using the above inputs in cash and cash equivalents, investments and long-term credit facility valuations, PennantPark Investment employs the valuation policy approved by its board of directors that is consistent with ASC 820 (See Note 2). Consistent with our valuation policy, PennantPark Investment evaluates the source of inputs, including any markets in which its investments are trading, in determining fair value.

Our investments are generally structured as debt and equity investments in the form of senior secured loans, mezzanine debt and equity co-investments. The transaction price, excluding transaction costs, is typically the best estimate of fair value at inception. When evidence supports a subsequent change to the carrying value from the original transaction price, adjustments are made to reflect the expected exit values. Ongoing reviews by our Investment Adviser and independent valuation firms are based on an assessment of each underlying investment, incorporating valuations that consider the evaluation of financing and sale transactions with third parties, expected cash flows and market-based information, including comparable transactions and performance multiples, among other factors. These nonpublic investments are included in Level 3 of the fair value hierarchy.

89

Table of Contents

PENNANTPARK INVESTMENT CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

SEPTEMBER 30, 2010

At September 30, 2010 and 2009, our cash and cash equivalents, investments and our long-term credit facility were categorized as listed below in the fair value hierarchy for ASC 820 purposes. Please refer to the paragraphs preceding this sentence for information regarding Levels 1 through 3 within the fair value hierarchy.

		Fair Value Measurements using at September 30, 2010		
Description	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Loan and debt investments	$ 615,236,138	$	$	$ 615,236,138
Equity investments	49,488,268	4,350,440		45,137,828
Total Investments	664,724,406	4,350,440		660,373,966
Cash Equivalents	1,814,451	1,814,451		
Total Investments and cash equivalents	666,538,857	6,164,891		660,373,966
Long-Term Credit Facility	$ (213,941,125)	$	$	$ (213,941,125)

		Fair Value Measurements using at September 30, 2009		
Description	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Loan and debt investments	$ 442,128,049	$	$	$ 442,128,049
Equity investments	27,632,024			27,632,024
Total Investments	469,760,073			469,760,073
Cash Equivalents	33,247,666	33,247,666		
Total Investments and cash equivalents	503,007,739	33,247,666		469,760,073
Long-Term Credit Facility	$ (168,475,380)	$	$	$ (168,475,380)

The following tables show a reconciliation of the beginning and ending balances for fair valued investments measured using significant unobservable inputs (Level 3) for the years ended September 30, 2010 and 2009:

	Year ended September 30, 2010		
Description	**Loan and debt investments**	**Equity investments**	**Totals**
Beginning Balance, September 30, 2009	$ 442,128,049	$ 27,632,024	$ 469,760,073
Realized (losses)	(12,411,934)	(3,005,163)	(15,417,097)
Unrealized appreciation	31,964,795	1,693,480	33,658,275
Purchases, PIK and net discount accretion	304,625,814	12,984,260	317,610,074

Sales / repayments	(138,765,449)	(6,922)	(138,772,371)
Non-cash exchanges, including settled delayed draws	(12,305,137)	5,840,149	(6,464,988)
Transfers in and /or out of Level 3			
Ending Balance, September 30, 2010	$ 615,236,138	45,137,828	660,373,966
Net change in unrealized appreciation (depreciation) for the period above within the net change in unrealized appreciation on investments in our consolidated statement of operations attributable to our Level 3 assets still held at the reporting date:	$ 15,408,002	(1,311,683)	14,096,319

90

Table of Contents

PENNANTPARK INVESTMENT CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

SEPTEMBER 30, 2010

	Year ended September 30, 2009		
Description	**Loan and debt investments**	**Equity investments**	**Totals**
Beginning Balance, September 30, 2008	$ 349,260,104	$ 22,887,716	$ 372,147,820
Realized (losses)	(39,243,879)		(39,243,879)
Unrealized (depreciation)	42,008,505	2,489,868	44,498,373
Purchases, PIK and net discount accretion	118,059,327	2,254,440	120,313,767
Sales / repayments	(27,956,008)		(27,956,008)
Transfers in and /or out of Level 3			
Ending Balance, September 30, 2009	$ 442,128,049	$ 27,632,024	$ 469,760,073
Net change in unrealized depreciation for the period above within the net change in unrealized depreciation on investments in our statement of operations attributable to our Level 3 assets still held at the reporting date:	$ 30,141,081	$ 2,489,868	$ 32,630,949

The following tables show a reconciliation of the beginning and ending balances for fair valued liabilities measured using significant unobservable inputs (Level 3) for the fiscal years ended September 30, 2010 and 2009.

Fiscal Year Ended September 30, 2010

Long-Term Credit Facility	**Carrying / Fair Value**
Beginning balance, September 30, 2009 (Cost $218,100,000)	$ 168,475,380
Total unrealized appreciation included in earnings	35,665,745
Borrowings	177,700,000
Repayments	(167,900,000)
Transfers in and/or out of Level 3	
Ending balance of long-term credit facility at fair value, (Cost $227,900,000)	213,941,125
Temporary draw outstanding, at cost	5,200,000
Total credit facility, September 30, 2010 (Cost $233,100,000)	219,141,125

Fiscal Year Ended September 30, 2009

Long-Term Credit Facility

	Carrying / Fair Value
Beginning balance, September 30, 2008 (Cost $162,000,000)	$ 162,000,000
Cumulative effect of adoption of fair value option	(41,796,000)
Total unrealized (depreciation) included in earnings	(7,828,620)
Borrowings	108,200,000
Repayments	(52,100,000)
Transfers in and/or out of Level 3	
Ending balance of long-term credit facility at fair value, (Cost $218,100,000)	$ 168,475,380
Temporary draw outstanding, at cost	7,000,000
Total credit facility, September 30, 2009 (Cost $225,100,000)	$ 175,475,380

91

Table of Contents

PENNANTPARK INVESTMENT CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

SEPTEMBER 30, 2010

The carrying value of PennantPark Investment s financial liabilities approximates fair value. Effective October 1, 2008, we adopted ASC 825-10, which provides companies with an option to report selected financial assets and liabilities at fair value, and made an irrevocable election to apply ASC 825-10 to its long-term credit facility. PennantPark Investment elected to use the fair value option for its credit facility to align the measurement attributes of both our assets and liabilities while mitigating volatility in earnings from using different measurement attributes. ASC 825-10 establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities and to more easily understand the effect of a company s choice to use fair value on its earnings. ASC 825-10 also requires entities to display the fair value of the selected assets and liabilities on the face of the balance sheet and changes in fair value of the credit facility are recorded in the statement of operations. We elected not to apply ASC 825-10 to any other financial assets or liabilities including the SBA debentures. For the years ended September 30, 2010 and 2009, our credit facility had a net change in unrealized (appreciation) depreciation of $(35.7) million and $7.8 million, respectively. As of September 30, 2010 and 2009, net unrealized depreciation on our long-term credit facility totaled $13.9 million and $49.6 million, respectively, which included the cumulative effect of adoption of ASC 825-10 on our credit facility of $41.8 million. PennantPark Investment uses a nationally recognized independent valuation services to measure the fair value of its credit facility in a manner consistent with the valuation process that the board of directors uses to value investments.

6. TRANSACTIONS WITH AFFILIATED COMPANIES

An affiliated company is a company in which the PennantPark Investment has ownership of 5% or more of the portfolio company s voting securities. Advances to and distributions from affiliates are included in the consolidated statement of cash flows purchases and sales. Transactions with affiliates were as follows:

Name of Investment	Fair Value at September 30, 2009	Advances to affiliates	Distributions from affiliates	Income Received	Fair Value at September 30, 2010
Controlled Affiliates					
SuttonPark Holdings, Inc.	$	$ 8,000,100	$	$ 210,000	$ 8,000,100
Non-Controlled Affiliates					
Performance Holdings, Inc.	16,115,738		750,000	1,313,772	15,433,680
Total Controlled and Non-Controlled Affiliates	$ 16,115,738	$ 8,000,100	$ 750,000	$ 1,523,772	$ 23,433,780

7. CHANGE IN NET ASSETS FROM OPERATIONS PER COMMON SHARE

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

Class and Year	Years ended September 30, 2010	2009	2008
Numerator for net increase (decrease) in net assets resulting from operations	$ 16,535,491	$ 35,802,029	$ (40,702,939)

Denominator for basic and diluted weighted average shares	29,546,772	21,092,334 *	21,068,772
Basic and diluted net increase (decrease) in net assets per share resulting from operations	$ 0.56	$ 1.70	$ (1.93)

* Denominator for diluted weighted average shares is 21,094,745 based the overallotment exercised subsequent to September 30, 2009.

92

Table of Contents

PENNANTPARK INVESTMENT CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

SEPTEMBER 30, 2010

8. TAXES AND DISTRIBUTIONS

Dividends from net investment income and distributions from net realized capital gains are determined in accordance with U.S. federal tax regulations, which may differ from amounts determined in accordance with GAAP and these book-to-tax adjustments could be material. These book-to-tax differences are either temporary or permanent in nature. To the extent these differences are permanent, they are reclassified to undistributed net investment income, accumulated net realized loss or paid-in-capital, as appropriate in the period that the difference arises. The following differences were reclassified for tax purposes for the years ended September 30, 2010 and 2009:

	2010	2009
Decrease in paid-in capital	$ (98,294)	$ (1,536)
(Increase) in accumulated net realized loss	$	$ (87,991)
Increase in undistributed net investment income	$ 98,294	$ 89,527

As of September 30, 2010 and 2009, the cost of investments for federal income tax purposes was $659.4 million and $497.3 million, respectively, resulting in a gross unrealized appreciation of $28.8 million and $19.4 million, respectively, and depreciation of $23.5 million and $46.9 million, respectively.

The following reconciles net increase in net assets resulting from operations to taxable income:

	Years ended September 30,	
	2010	2009
Net increase in net assets resulting from operations	$ 16,535,491	$ 35,802,029
Net realized loss on investments not taxable	15,417,097	39,243,879
Net unrealized appreciation / (depreciation) on investments and credit facility	122,029	(52,326,993)
Other temporary book-to-tax differences	(305,849)	841,335
Other deductible expenses	(15,956)	(13,808)
Taxable income before deductions for distributions	$ 31,752,812	$ 23,546,442

The components of accumulated losses on tax basis and reconciliation to accumulated losses on a book basis are as follows:

	Years ended September 30,	
	2010	2009
Undistributed ordinary income	$ 11,451,782	$ 7,618,230
Undistributed long-term net capital gains		
Total undistributed net earnings	11,451,782	7,618,230
Capital loss carry forwards[1]	(54,591,911)	(11,250,568)
Post-October capital losses[2]	(8,645,354)	(39,331,872)

Dividends payable and other temporary differences	(9,651,137)	(5,638,469)
Net unrealized appreciation (depreciation) of investments and credit facility	19,300,499	22,096,807
Total accumulated deficit	$ (42,136,121)	$ (26,505,872)

(1) As of September 30, 2010, the capital loss carry forward of $54.6 million expires, if not utilized against future capital gains, as follows: $0.2 million in 2016, $11.0 million in 2017 and $43.3 million expires in 2018.

Table of Contents

PENNANTPARK INVESTMENT CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

SEPTEMBER 30, 2010

(2) Under federal tax law, capital losses realized after October 31 may be deferred and treated as having arisen on the first day of the following fiscal year.

The tax characteristics of dividends during the fiscal years ended September 30, 2010 and 2009 were solely from ordinary income, and totaled $32.3 million or $1.09 per share, and $20.2 million or $0.96 per share, respectively.

9. CASH EQUIVALENTS

Cash equivalents represents cash pending investment in longer-term portfolio holdings, PennantPark Investment may invest temporarily in U.S. Treasury Bills (of varying maturities), repurchase agreements, money market funds or repo-like treasury securities. These temporary investments with maturities of 90 days or less are deemed cash equivalents and are included in the Schedule of Investments. At the end of each fiscal quarter, PennantPark Investment could take proactive steps to preserve investment flexibility for 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, temporarily drawing down on its credit facility, or utilizing repurchase agreements or other balance sheet transactions as are deemed appropriate for this purpose. These amounts are excluded from adjusted gross assets for purposes of computing management fee. 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. As of September 30, 2010, cash equivalents consisted of $1.8 million in money market funds.

Table of Contents

PENNANTPARK INVESTMENT CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

SEPTEMBER 30, 2010

10. FINANCIAL HIGHLIGHTS

Below are the financial highlights for the respective periods:

	Year ended September 30, 2010	Year ended September 30, 2009	Year ended September 30, 2008	Period from January 11, 2007 (inception) through September 30, 2007
Per Share Data:				
Net asset value, beginning of period	$ 11.85	$ 10.00	$ 12.83	$
Cumulative effect of adoption of fair value option[1]		1.99		
Adjusted net asset value, beginning of period	11.85	11.99	12.83	
Net investment income[2]	1.09	1.08	0.88	0.35
Net realized and unrealized losses[2]	(0.53)	0.62	(2.81)	(1.15)
Net increase (decrease) in net assets resulting from operations[2]	0.56	1.70	(1.93)	(0.80)
Dividends and distributions to stockholders[2],[3]	(1.09)	(0.96)	(0.90)	(0.36)
Initial issuance of common stock				15.00
Offering Costs[2]	(0.20)	(0.09)		(1.01)
Dilutive effect of common stock issuance[2]	(0.43)	(0.79)		
Net asset value, end of period	$ 10.69	$ 11.85	$ 10.00	$ 12.83
Per share market value, end of period	$ 10.61	$ 8.11	$ 7.41	$ 13.40
Total return[4]*	44.79%	30.39%	(38.58)%	(8.29)%[7]
Shares outstanding at end of period	36,158,772	25,368,772	21,068,772	21,068,772
Ratio/Supplemental Data:				
Ratio of operating expenses to average net assets[5]	7.16%	7.42%	6.30%	3.76%[7]
Ratio of credit facility related expenses to average net assets	1.08%	1.93%	2.66%	1.50%[7]
Total expenses to average net assets[6]	8.24%	9.35%	8.96%	5.26%[7]
Ratio of net investment income to average net assets	9.45%	9.49%	7.82%	5.96%[7]
Net assets at end of period	$ 386,575,223	$ 300,580,268	$ 210,728,260	$ 270,393,094
Weighted average debt outstanding[8]	$ 246,216,548	$ 182,490,685	$ 119,472,732	$ 817,610[7]
Weighted average debt per share[8]	$ 8.33	$ 8.65	$ 5.67	$ 0.04[7]
Portfolio turnover ratio	25.97%	7.47%	20.10%	62.20%

* Not annualized for a period of less than a year.

(1) On October 1, 2008, PennantPark Investment adopted ASC 825 and made an irrevocable election to apply the fair value option to our long-term credit facility. Upon our adoption Net Asset Value increased $41.8 million, or $1.99 per share, due to the fair value adjustment related to our credit facility.

(2) Per share data are calculated based on the weighted average shares outstanding for the respective periods.

(3) Determined based on taxable income calculated in accordance with income tax regulations and may differ from amounts determined under U.S. generally accepted accounting principles.

PENNANTPARK INVESTMENT CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

SEPTEMBER 30, 2010

(4) Based on the change in market price per share during the periods and takes into account dividends and distributions, if any, reinvested in accordance with our dividend reinvestment plan.

(5) Before adoption of ASC 825 for the fiscal years ended September 30, 2010 and 2009, the ratios were 7.95% and 9.32%, respectively. The ratios before management fee waiver were 6.47% and 4.28% for the fiscal year ended September 30, 2008 and for the period from April 24, 2007 (initial public offering) through September 30, 2007, respectively.

(6) Before adoption of ASC 825 for the fiscal years ended September 30, 2010 and 2009, the ratios were 9.15% and 11.75%. The ratios before management fee waiver to average net assets were 9.13% and 5.78% for the fiscal year ended September 30, 2008 and for the period from April 24, 2007 (initial public offering) through September 30, 2007, respectively.

(7) Since initial public offering on April 24, 2007.

(8) Include the SBA debentures outstanding.

11. CREDIT FACILITY AND SBA DEBENTURES

Credit Facility

On June 25, 2007, we entered into a senior secured revolving credit agreement, or our credit facility, 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 JPMorgan Chase (Chase Lincoln First Commercial successor interest of Bear Stearns Corporate Lending Inc.) acted as joint lead arranger and syndication agent. As of September 30, 2010 and 2009, there was $233.1 million and $225.1 million in outstanding borrowings under the credit facility (including a $5.2 million and a $7.0 million temporary draw), with a weighted average interest rate at the time of 1.34% and 1.31% exclusive of the fee on undrawn commitment of 0.20%, respectively.

Under the credit facility, the lenders agreed to extend credit to PennantPark Investment in an initial aggregate principal or face amount not exceeding $300.0 million at any one time outstanding. The credit facility is a five-year revolving facility (with a stated maturity date of June 25, 2012) and pricing is set at 100 basis points over LIBOR. The credit facility contains customary affirmative and negative covenants, including the maintenance of a minimum stockholders equity, the maintenance of a ratio not less than 200% of total assets (less total liabilities other than indebtedness) to total indebtedness, and restrictions on certain payments and issuance of debt. For a complete list of such covenants, see our report on Form 8-K, filed June 28, 2007 and on Form 10-Q, filed May 5, 2010. As of September 30, 2010, we were in compliance with our covenants relating to our credit facility.

SBA Debentures

SBIC LP is able to borrow funds from the SBA against regulatory capital that is paid-in, subject to customary regulatory requirements including but not limited to an examination by the SBA. As of September 30, 2010, we have committed $50.0 million to SBIC LP, funded it with equity capital of $14.5 million and had SBA debentures outstanding of $14.5 million. SBA debentures are non-recourse to us, have a 10-year maturity, and may be prepaid at any time without penalty. The interest rate of SBA debentures is fixed at the time of issuance, often referred to as pooling, at a market-driven spread over 10-year U.S. Treasury Notes. SBA current regulations limit the amount that SBIC LP may borrow to a maximum of $150 million, which is up to twice its potential regulatory capital. This means that SBIC LP may access the maximum borrowing if it has $75 million in regulatory capital.

On August 5, 2010, SBIC LP received a SBA debenture commitment of $33.5 million. As of September 30, 2010, $14.5 million of the $33.5 million debt commitment was drawn with a weighted average interest rate of

PENNANTPARK INVESTMENT CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

SEPTEMBER 30, 2010

0.93% exclusive of the 3.43% in upfront fees. Of the $14.5 million of SBA debentures outstanding, $0.5 million is fixed for 10-years with a rate of 3.50% (inclusive of the SBA annual fee) and $14.0 million is temporary financing currently bearing a rate of 0.84% that will reset to a market-driven rate in March 2011.

Under SBA regulations, SBIC LP is subject to regulatory requirements including making investments in SBA eligible businesses, investing at least 25% of regulatory capital in eligible smaller businesses, as defined under the 1958 Act, placing certain limitations on the financing terms of investments, prohibiting investing in certain industries, required capitalization thresholds and is subject to periodic audits and examinations. If our SBIC subsidiary fails to comply with applicable SBA regulations, the SBA could, depending on the severity of the violation, limit or prohibit its use of debentures, declare outstanding debentures immediately due and payable, and/or limit it from making new investments. In addition, the SBA can revoke or suspend a license for willful or repeated violation of, or willful or repeated failure to observe, any provision of the Small Business Investment Act of 1958 or any rule or regulation promulgated thereunder. These actions by the SBA would, in turn, negatively affect us because our SBIC subsidiary is our wholly owned subsidiary. As of September 30, 2010, SBIC LP was in compliance with our requirements relating to our SBA debentures.

In connection with the filing of its SBA license application, PennantPark Investment applied for exemptive relief from the SEC to permit us to exclude the debt of SBIC LP from our consolidated asset coverage ratio. There can be no assurance that we will be able to capitalize SBIC LP with sufficient regulatory capital to access the maximum borrowing amount available or that we will receive an exemptive relief from the SEC with respect to the SBA-guaranteed debentures.

If we are granted exemptive relief, our ratio of total assets on a consolidated basis to outstanding to indebtedness may be greater than 200%, which while providing increased investment flexibility, would also increase our exposure to risks associated with leverage. See Note 13 for subsequent events.

Our net asset value may decline as a result of economic conditions in the United States. Our continued compliance with the covenants under our credit facility and SBA debentures depend on many factors, some of which are beyond our control. Material net asset devaluation could have a material adverse effect on our operations and could require us to reduce our borrowings under our credit facility and SBA debentures in order to comply with certain of the covenants we made when we entered into, including the ratio of total assets to total indebtedness.

12. COMMITMENTS AND CONTINGENCIES

From time to time, PennantPark Investment, the Investment Adviser or the Administrator may be a party to 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 statement of assets and liabilities represent unfunded delayed draws on investments in first lien secured debt and subordinated debt investments.

13. SUBSEQUENT EVENTS

On November 4, 2010, SBIC LP received a debt commitment from the SBA for an additional $66.5 million bringing its total debt commitment from the SBA to $100.0 million. Subsequent to September 30, 2010, SBIC LP completed its SBA examination in order to gain access to the full SBA commitment subject to customary regulatory requirements.

Table of Contents

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure
None

Item 9A. Controls and Procedures
(a) Evaluation of Disclosure Controls and Procedures

As of September 30, 2010, 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) of the 1934 Act). Based on that evaluation, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective and provided reasonable assurance that information required to be disclosed in our periodic SEC filings is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. 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 such possible controls and procedures.

(b) Management s Report on Internal Control Over Financial Reporting

Management s Report on Internal Control Over Financial Reporting, which appears on page 67 of this Form 10-K, is incorporated by reference herein.

(c) Changes in Internal Controls Over Financial Reporting.

There have been no material changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during our most recently completed fiscal quarter, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information
None

Table of Contents

PART III

We will file a definitive Proxy Statement for our 2011 Annual Meeting of Stockholders with the SEC, pursuant to Regulation 14A, not later than 120 days after the end of our fiscal year. Accordingly, certain information required by Part III has been omitted under General Instruction G(3) to Form 10-K. Only those sections of our definitive Proxy Statement that specifically address the items set forth herein are incorporated by reference.

Item 10. Directors, Executive Officers and Corporate Governance

The information required by Item 10 is hereby incorporated by reference from our definitive Proxy Statement relating to our 2011 Annual Meeting of Stockholders, to be filed with the Securities and Exchange Commission within 120 days following the end of our fiscal year.

Item 11. Executive Compensation

The information required by Item 11 is hereby incorporated by reference from our definitive Proxy Statement relating to our 2011 Annual Meeting of Stockholders, to be filed with the Securities and Exchange Commission within 120 days following the end of our fiscal year.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by Item 12 is hereby incorporated by reference from our definitive Proxy Statement relating to our 2011 Annual Meeting of Stockholders, to be filed with the Securities and Exchange Commission within 120 days following the end of our fiscal year.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by Item 13 is hereby incorporated by reference from our definitive Proxy Statement relating to our 2011 Annual Meeting of Stockholders, to be filed with the Securities and Exchange Commission within 120 days following the end of our fiscal year.

Item 14. Principal Accountant Fees and Services

The information required by Item 14 is hereby incorporated by reference from our definitive Proxy Statement relating to our 2011 Annual Meeting of Stockholders, to be filed with the Securities and Exchange Commission within 120 days following the end of our fiscal year.

PART IV

Item 15. Exhibits and Financial Statement Schedules

The following documents are filed as part of this Annual Report:

(1) Financial Statements Refer to Item 8 starting on page 44.

(2) Financial Statement Schedules None.

(3) Exhibits

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/A (File No. 333-140092), filed on March 5, 2007).
3.2	Amended and Restated Bylaws of the Registrant (Incorporated by reference to Exhibit 3.2 to the Registrant s Annual Report on Form 10-K (File No. 814-00736), filed on December 13, 2007).
4.1	Form of Share Certificate (Incorporated by reference to Exhibit 99(d)(1) to the Registrant s Registration Statement on Form N-2 (File No. 333-150033), filed on April 2, 2008).
10.1	Form of Investment Management Agreement between the Registrant and PennantPark Investment Advisers, LLC (Incorporated by reference to Exhibit 99(g) to the Registrant s Registration Statement on Form N-2 (File No. 333-150033), filed on April 2, 2008).
10.2	Form of Custodian Agreement between the Registrant and PFPC Trust Company (Incorporated by reference to Exhibit 99(j)(1) to the Registrant s Registration Statement on Form N-2 (File No. 333-150033), filed on April 2, 2008).
10.3	Form of Administration Agreement between the Registrant and various lenders (Incorporated by reference to Exhibit 99(k)(1) to the Registrant s Registration Statement on Form N-2 (File No. 333-150033), filed on April 2, 2008).
10.4	Dividend Reinvestment Plan (Incorporated by reference to Exhibit 99(e) to the Registrant s Registration Statement on Form N-2 (File No. 333-150033), filed on April 2, 2008).
10.5	Senior Secured Revolving Credit Agreement between Registrant and various lenders (Incorporated by reference to the Report on Form 8-K. Exhibit 99.2 (File No. 814-00736), filed on June 28, 2007 and May 5, 2010, as amended).
11	Computation of Per Share Earnings (included in the notes to the audited financial statements contained in this Report).
14.1*	Joint Code of Ethics of the Registrant.
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.
99.1	Privacy Policy of the Registrant (Incorporated by reference to Exhibit 99.1 to the Registrant s Annual Report on Form 10-K (File No. 814-00736), filed on December 13, 2007).

* Filed herewith

Table of Contents

SIGNATURES

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

By: /s/ ARTHUR H. PENN
Name: **Arthur H. Penn**
Title: **Chief Executive Officer and Chairman of the Board**

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ ARTHUR H. PENN **Arthur H. Penn**	Chairman of the Board of Directors and Chief Executive Officer (Principal Executive Officer)	November 17, 2010
/s/ AVIV EFRAT **Aviv Efrat**	Chief Financial Officer and Treasurer (Principal Financial and Accounting Officer)	November 17, 2010
/s/ ADAM K. BERNSTEIN **Adam K. Bernstein**	Director	November 17, 2010
/s/ JEFFREY FLUG **Jeffrey Flug**	Director	November 17, 2010
/s/ MARSHALL BROZOST **Marshall Brozost**	Director	November 17, 2010
/s/ SAMUEL L. KATZ **Samuel L. Katz**	Director	November 17, 2010