

**Item 1 - Cover Page**

The following brochure prepared as of **March 31, 2012**, is offered by:

**Penn Capital Management Company, Inc.**  
**Navy Yard Corporate Center**  
**Three Crescent Drive, Suite 400**  
**Philadelphia, PA 19112**  
**215-302-1500**  
**[www.penncapital.com](http://www.penncapital.com)**

This brochure provides information about the qualifications and business practices of PENN Capital Management Company, Inc. If you have any questions about the contents of this brochure, please contact us at (215) 302-1500. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority.

Additional Information about PENN Capital Management Company, Inc., is also available at [www.advisorinfo.sec.gov](http://www.advisorinfo.sec.gov).

**Item 2 - Material Changes**

**Changes made as of September 1, 2011:**

PENN amended its response to Item 10, "Other Financial Industry Activities and Affiliations" to read:

We have no other financial industry activities or affiliations.

Certain PENN owners and employees have formed a private entity, TH Partners LLC ("TH"), for the purpose of making joint personal investments. There are no PENN clients invested in TH, nor has TH invested in any issuer of securities held by clients of PENN.

**Changes made as of March 31, 2012:**

PENN amended its fee schedules to reflect the following strategies:

Tactical Equity

1.00% of Account Assets

Focused Credit

1.00% of Account Assets

Short Duration

0.55%- Up to \$10 million

0.45%- \$10 million and above

Double B Rated

0.65%- Up to \$10 million

0.55%- \$10 million and above

Ultra Equity High Yield

0.75% of Account Assets; plus 20% of profit over a preferred rate of return

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**Item 4- Advisory Business**

PENN Capital Management Company, Inc. (“PENN” or “we”), is an independent, 100% employee owned investment management firm founded in 1987. Our principal owner is Richard A. Hocker, Founder and Chief Investment Officer. During the first quarter of 2011, PENN formed PENN Capital Funds, LLC, which may act as General Partner for certain private investment funds.

As of December 31, 2011, we managed approximately \$5.39 billion on a discretionary basis and \$519 million on a non-discretionary basis.

We provide advice regarding primarily equity and fixed income securities. PENN evaluates its product offerings on a regular basis and makes changes based on market conditions. We describe our primary product offerings as follows:

- Micro Cap Equity
- Micro to Small Cap Equity
- Micro to Mid Cap Equity
- Small Cap Equity
- Small to Mid Cap Equity
- Mid Cap Equity
- Defensive High Yield Fixed Income
- Opportunistic High Yield Fixed Income
- Short Duration High Yield Fixed Income
- Double B High Yield Fixed Income
- Focused Credit
- Distressed Total Return Fixed Income
- Convertible Securities
- Capital Structure Opportunities
- Financial Services

Our products are marketed through the following product channels: separately managed accounts, private investment funds, and as sub-advisor to various advisory programs and mutual funds.

Separately managed accounts (“SMA”) are primarily marketed to high net-worth individuals, , foundations, endowments, insurance companies, corporate and union pension funds, as well as, public pension plans. The minimum account size is \$1 million for equity portfolios and \$10 million for bond portfolios. However, we reserve the right to waive the account size minimum. Separately managed account management is modified based on individual client directives. Clients may impose restrictions or limits to certain individual securities or types of securities by written notice at any time.

We are the general partner and investment advisor for thirteen private investment funds which are organized as limited partnerships of which six primarily invest in high yield bonds, one primarily invests in small cap equities, two primarily invest in mid cap equities, one primarily invests in small to mid-cap equity securities, one primarily invests in convertible securities, one primarily invests in micro-cap equities and one primarily invests in the financial services industry. These limited partnerships are available to accredited or qualified investors, and other persons as

allowable by SEC Rule. The minimum size of a limited partnership interest varies as noted in the below chart, PENN reserves the right to waive these minimums:

Capital Structure Opportunities Fund, L.P.	\$ 100,000
Capital Structure Opportunities Fund Offshore, L.P.	\$ 100,000
PENN Convertible Fund, L.P.	\$1,000,000
PENN Core High Yield Bond Fund, L.P.	\$ 100,000
PENN Core High Yield Bond Fund II, L.P.	\$1,000,000
PENN Core Opportunistic High Yield Bond Fund, L.P.	\$ 250,000
PENN Distressed Fund, L.P.	\$ 100,000
PENN Diversified Micro Cap Equity Fund, L.P.	\$ 500,000
PENN Financial Services Fund, L.P.	\$1,000,000
PENN Focused Mid Cap Equity Fund, L.P.	\$1,000,000
PENN Mid Cap Equity Fund, L.P.	\$ 100,000
PENN Small Capitalization Fund, L.P.	\$ 100,000
PENN Small to Mid Cap Equity Fund, L.P.	\$ 100,000

We are the investment advisor for the following private investment fund, organized as a limited partnership, in which our subsidiary acts as general partner:

PENN Short Duration High Yield Fund, L.P.	\$1,000,000
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We are the investment advisor, but not the general partner, for the Oppenheimer Capital Structure Opportunities Fund, L.P., a private investment fund organized as a limited partnership.

We serve as an investment sub-advisor to several broker/dealer-sponsored advisory programs, including WRAP or unified management accounts (“UMA”) through either a contract with the sponsor or contracts with both the sponsor and client. The broker-dealer sponsors of these programs are as follows: Brinker Capital, Charles Schwab, Concord Wealth, DA Davidson, J.P. Morgan Securities, Inc. (formerly Bear Stearns & Co.), Lockwood Advisors, Inc., LPL Financial, Merrill Lynch, MorganStanley SmithBarney, Oppenheimer & Co., Robert W. Baird & Co., Stifel Nicolaus, UBS Financial Services, and Wells Fargo.

We manage WRAP accounts in a similar manner to other separately managed accounts in the same investment strategy. We receive a portion of the WRAP sponsor’s fee for managing the WRAP account assets. We make no determination of the suitability of the sponsor’s WRAP product for such sponsor’s clients. We are responsible for managing the WRAP accounts in the specified investment strategy. On a limited basis, we allow WRAP clients to impose restrictions or limits on certain individual securities or types of securities.

We provide UMA sponsors with a model portfolio for each applicable investment strategy. PENN does not assume responsibility for executing trades or managing any aspect of the sponsors’ platform. The sponsor may or may not elect to execute the purchase or sale transactions suggested by our revision in the model portfolio. We do not enter trades, perform recordkeeping, or have access to performance data or any client reporting for such accounts. Our role in relation to UMA programs is to provide the sponsor with a regularly up-to-date model portfolio for each selected investment strategy.

We also act as sub-advisor to registered mutual funds, including the Dunham High-Yield Bond N fund (DNHYX), the Consulting Group High Yield Fund (THYUX), the Russell U.S. Small Cap Equity Fund (RLACX) and the American Beacon High Yield Fund (ABHAX). We do not perform any sales, custodial, or administrative functions on behalf of the registered mutual funds. Our role is to manage the assets held by the Funds in the investment strategy stated in their prospectus.

## **Item 5- Fees and Compensation**

Different fee schedules may apply to accounts with special mandates or service needs or accounts that do not meet the minimum account size. A lower fee schedule may apply to certain longstanding clients or larger accounts. Generally, separately managed account fees are calculated and paid quarterly in arrears and are prorated, if necessary, based on the period the assets were under management, including adjustments for significant additions or partial withdrawals. We typically invoice clients on a quarterly basis and do not require pre-payment of fees.

Generally, fees are based upon the market value of the account at the end of each calendar quarter, calculated on a 360-day year; although clients may request other arrangements. If the account uses margin (borrowed assets), the fee is charged on the total assets.

The below SMA fee schedules are the maximum charged for the stated investment strategy. Separately managed account fees are negotiable based upon the size of the account and other factors:

### **Equity Strategies**

Micro Cap Equity	1.10% of Account Assets
Tactical Equity	1.00% of Account Assets
Small Cap Equity	1.00% of Account Assets
Small to Mid Cap Equity	0.95% of Account Assets
Mid Cap Equity	0.90% of Account Assets

### **High Yield Fixed Income Strategies**

#### **Short Duration**

- 0.55%- Up to \$10 million
- 0.45%- \$10 million and above

#### **Double B Rated**

- 0.65%- Up to \$10 million
- 0.55%- \$10 million and above

#### **Defensive**

- 0.75%- Up to \$10 million, and
- 0.60%- \$10 million to \$50 million, and
- 0.50%- \$50 million and above

#### **Opportunistic**

- 0.85%- Up to \$10 million, and
- 0.70%- \$10 million to \$50 million, and
- 0.55%- \$50 million and above

Distressed Total Return	1.25% of Account Assets
Focused Credit	1.00% of Account Assets
Convertible Securities	0.85% of Account Assets
Ultra Equity High Yield	0.75% of Account Assets; plus 20% of profit over a preferred rate of return

Fees are deducted from private investment funds on a monthly basis. The fee is based upon the market value of the private investment fund at the end of each month. We do not require the prepayment of fees.

The below fee schedule is the maximum annual fee for our private investment funds which do not charge a performance-based fee. For private investment funds for which we charge a performance-based fee, please refer to Item 6 below. Private investment fund fees are negotiable based upon size of investment and other factors:

PENN Small to Mid Cap Equity Fund, L.P.	1.60% of the gross market value
PENN Small Capitalization Fund, L.P.	1.50% of the gross market value
PENN Core High Yield Bond Fund, L.P.	1.25% of the gross market value
PENN Core High Yield Bond Fund II, L.P.	1.25% of the gross market value
PENN Core Opportunistic High Yield Bond Fund, L.P.	1.50% of the gross market value
PENN Mid Cap Equity Fund, L.P.	1.25% of the gross market value
PENN Convertible Fund, L.P.	1.50% of the gross market value
PENN Financial Services Fund, L.P.	1.25% of the gross market value
PENN Diversified Micro Cap Equity Fund, L.P.	2.00% of the gross market value
PENN Focused Mid Cap Equity Fund, L.P.	1.25% of the gross market value
PENN Short Duration High Yield Fund, L.P.	1.50% of the gross market value

A separate fee schedule is available for registered mutual funds. We do not determine the fee which investors pay to WRAP program sponsors or mutual funds. We negotiate a fee with the WRAP program sponsors or investment adviser for our sub-advisory services. We generally receive a portion of the fees charged by the program sponsor or investment adviser.

In the normal course of having assets managed, our clients incur costs, including custodian, administrative and brokerage or transaction fees for the services provided by providers other than us. For more information regarding our brokerage practices and related costs, please refer to Item 12 below.

On a limited basis, PENN may invest in exchange traded funds or closed-end investment companies on behalf of clients. Our management fee is in addition to, and does not include, internal management, operating, or distribution fees or other expenses incurred by these products.

#### **Item 6- Performance Fees & Side-by-Side Management**

We have entered into performance fee arrangements with certain private investment funds and qualified clients. Performance fees are subject to individualized negotiation with each affected

client. We will structure a performance or incentive fee arrangement in accordance with applicable laws and related exemptions.

The base fee is based upon the market value of the account at the end of each month, while the incentive fees are paid annually, or upon a client's liquidation. The fee schedule below is the maximum annual fee for accounts in our private investment funds that charge a performance based fee. Our account fees are negotiable:

**Capital Structure Opportunities Fund, L.P.** - 1.50% of the total market value; plus 20% of the Fund's total profit subject to high watermark.

**Capital Structure Opportunities Fund Offshore, L.P.** - 1.50% of the total market value; plus 20% of the Fund's total profit subject to high watermark.

**PENN Distressed Fund, L.P.** - 1.00% of the total market value; plus 20% of the Fund's total profit subject to high watermark.

Performance based fee arrangements may create an incentive for us to recommend investments which may be riskier or more speculative than those which would be recommended under a different fee arrangement. Performance based fee arrangements may also create an incentive to favor accounts paying higher fees over other accounts in the allocation of investment opportunities. We have implemented portfolio management policies and procedures that are designed to assure that each client is treated fairly and equitably, as well as assure that the conflict of interest does not influence the allocation of investment opportunities among clients. We will not consider an account's fee structure in the investment process at any time. Investment opportunities are allocated on either a pro rata basis or rotation across the clients in each respective trading strategy.

## **Item 7 - Types of Clients**

We provide portfolio management services to individuals, high net worth individuals, corporate pension and profit-sharing plans, Taft-Hartley plans, insurance companies, charitable institutions, foundations, endowments, municipalities, registered mutual funds, private investment funds, foreign funds, and other U.S. and international institutions.

## **Item 8 - Methods of Analysis, Investment Strategies and Risk of Loss**

### **Equity Analysis Process**

Our goal is to find companies with price growth potential over a particular period. We also look for companies creating equity value through traditional and non-traditional sources. We follow a multi-step process to approve an equity security which is considered for purchase. Steps may include:

#### **Economic Analysis**

All Portfolio Managers combine expertise (credit & equity) to develop and apply a macro view

#### **Step 1: Fundamental Financial Analysis**

Analyst/PM screen for companies with improving financial metrics to determine relative value



**Step 2: Qualitative Research**

Analyst/PM performs qualitative research to confirm relative value

**Step 3: Liquidity Outlook/Covenant Analysis**

Analyst/PM screens for liquidity issues and performs covenant analysis, bank loan availability & asset value analysis

**Step 4: Recommendation**

Primary & secondary Analyst/PM present best new idea(s) to entire team for evaluation and consideration

**Step 5: Decision**

Approval by Portfolio Manager, Director of Research & Chief Investment Officer

**Step 6: Portfolio Construction**

Equity Strategy committee meets weekly to discuss macro-view & to determine sector allocations

As members of the investment team, the primary and secondary analysts propose a new idea to the investment team. All investment team members have the opportunity to contribute their opinions on the proposed idea. Approval by the Portfolio Manager, Director of Research and Chief Investment Officer is required for a final acceptance. This is also where discussions occur on the appropriate target weight, and the initial positioning.

Individual security weightings are determined as part of daily investment team meetings. As members of the investment team, the primary and secondary analysts have a high level of influence in the position size at initial purchase and throughout the holding period. The analysts recommend any adjustments to the current weighting based on discussions with company management, underlying fundamentals, and relative value. The portfolio manager considers the analyst's recommendations and directs trades within the portfolio.

We do not manage our investment styles to mirror indices and we may overweight, underweight, or choose to strategically avoid a sector or a security, at any time. Sector weightings are residual to the security selection process and are typically determined by relative value.

**Fixed Income Analysis Process**

We generally look for U.S. dollar-denominated, non-investment grade corporate debt securities in which we identify relative value. We follow a multi-step process to approve a fixed income security for purchase. Steps may include:

Economic Outlook – The team determines sectors/industries that may offer relative value. The team will review and evaluate: The economic cycle; Business environment; Industry/sector analysis; Interest rates.

Quantitative Screen – Analysts or Portfolio Managers screen industries for companies with a higher spread to US Treasury debt relative to comparable companies, industry averages and historical averages.

**Other Proprietary Sources** – Analysts or Portfolio Managers identify prospective investments from leveraging our equity market exposure and relationships (Equity conferences, IPO intelligence, management meetings and road shows, industry experts and ex-Government officials).

**Improving Fundamentals** – Analysts or Portfolio Managers further screen the identified companies with improving financial metrics. This process includes an analysis of the financial health of the company throughout the market cycle and the relative strength of the bonds.

**Liquidity Outlook** – Analysts or Portfolio Managers screen for liquidity issues and performs covenant analysis, bank loan availability and asset value analysis. This process determines the degree of flexibility the company has to achieve its goals and our internal projections.

**Qualitative Research** – Analysts or Portfolio Managers perform qualitative research on company management (strong fundamentals, positive catalysts, suppliers, customers, competitors, industry experts). This process assesses the strength of management and the sustainability of the business model.

**PENN Risk Rating** – Analysts and Portfolio Managers assign the proprietary PENN risk rating using a forward looking estimate of credit quality, quantitative factors, qualitative factors, and rating agency analyses based on static and backward looking assessments.

**Team Review** - The Investment team meets daily and is the primary forum for analyst and portfolio manager discussion. A consensus at a team level is required prior to moving to Credit Strategy Committee.

**Credit Strategy Committee Approval** – The Credit Strategy Committee reviews investment prospects approved by the investment team and considers the impact on portfolio construction. Final buy decisions are made by the Credit Strategy Committee. This committee serves as the ultimate decision making authority on adding approved credits to the portfolio. The portfolio manager works closely with the analysts and is ultimately responsible for adds, trims, and sells on current positions. The portfolio manager is also responsible for monitoring the portfolio daily and recommending actions to analysts based on new information in addition to leading the style discussions through the Credit Strategy Committee process.

### **Risks of Investing**

Investing in securities involves risk. Clients are responsible for investing based on their risk tolerance. The following principal risks may pertain to the investment strategies managed by PENN:

High yield bonds are generally considered to have more risk than investment grade bonds. The total return and yield of high yield bonds can be expected to fluctuate more than the total return and yield of higher-quality bonds. High yield bonds are regarded as predominantly speculative with respect to the issuer's continuing ability to meet principal and interest payments. Successful investment in high yield bonds involves greater investment risk and is highly dependent on the investment adviser's credit analysis and market analysis. A real or perceived economic downturn or higher interest rates could cause a decline in high yield bond prices by lessening the ability of

bond issuers to make principal and interest payments. High yield bonds are often thinly traded and can be more difficult to sell and value accurately than investment grade bonds.

Credit risk relates to the continuing ability of the issuer of a bond to pay the stated interest and ultimately to repay principal upon maturity. Concern over a company's ability to pay their interest expense can create volatility in a bond's price. Discontinuation of such payments can adversely affect the market price of the bond.

Interest rate risk relates to the impact that changing interest rates have on the value of an investment. As the general level of interest rates increase, the market price of fixed income securities tends to decline. Changes in interest rates will affect the value of longer-term fixed income securities more than shorter-term securities; in addition, such interest rate changes affect lower quality securities more than higher quality securities.

Market Risk relates to the risk that the market value of an investment will fluctuate as the securities markets fluctuate. Market risk may affect a single issuer, industry or section of the economy or it may affect the securities market as a whole. Securities markets in general are subject to substantial – and, at times, extreme - volatility and uncertainty.

Prepayment Risk relates to the risk that issuers will prepay fixed rate obligations when interest rates fall, forcing an investor to re-invest in obligations with lower interest rates than the original obligation.

Short selling risk involves selling securities which may or may not be owned and instead borrowing the same securities for delivery to the counterparty, with an obligation to replace the borrowed securities at a later date. Short selling allows the investor to profit from declines in market prices to the extent such declines exceed the transaction costs, and the costs of borrowing the securities and the cost of replacing the securities sold. A short sale creates the risk of an unlimited loss, in that the price of the underlying security could theoretically increase without limit.

Leverage risk involves margin buying of securities utilizing borrowed funds. There is a risk that the initial cash portion of the purchase price for investments purchased on margin will be insufficient due to fluctuations in the market price of the investments and that the investor will be required to contribute additional cash to meet margin requirements which may, in turn, require the investor to liquidate part of their portfolio at an inopportune time or to borrow additional cash.

Liquidity risk involves the securities of companies which may prove to be illiquid and difficult to sell on short notice, especially if there are negative developments in the company's fundamentals. The securities of smaller companies are often subject to wider and more abrupt fluctuations in market price and may not trade as readily as securities of large capitalization companies.

Economic risk involves the less certain prospects of smaller companies which are also more sensitive to changing economic conditions than large capitalization companies. Smaller companies may lack the financial resources, product diversification and competitive strengths of large capitalization companies.

**Item 9 - Disciplinary Information**

We are required to disclose any material facts regarding legal or disciplinary events that would be material to your evaluation of us or our integrity. We have no disciplinary information or events to disclose which are applicable.

**Item 10 - Other Financial Industry Activities and Affiliations**

We have no other financial industry activities or affiliations.

Certain PENN owners and employees have formed a private entity, TH Partners LLC ("TH"), for the purpose of making joint personal investments. There are no PENN clients invested in TH, nor has TH invested in any issuer of securities held by clients of PENN.

**Item 11 - Code of Ethics, Participation or Interest in Client Transactions and Personal Trading**

We have adopted a Code of Ethics pursuant to applicable regulations. The code contains procedures reasonably necessary to prevent our employees from engaging in any conduct prohibited by such rules and regulations. Our Code of Ethics is available upon request.

We may recommend that clients purchase or sell interests in private investment funds (or limited partnerships) described in Item 4, in which we have a financial interest. As with all investments, we select investments for clients primarily based on the aforementioned investment analysis process and agreed upon investment style and client-specific guidelines, if applicable. In addition, our financial interest in each such private investment fund is disclosed in the offering materials of such fund.

Also, we may purchase securities of an issuer which has retained us as its financial advisor. These purchases are solely based on the investment merits of the security and our relationship will have no impact on the investment decision. PENN does not invest in the securities of an issuer for the issuer's account, but may buy it for other accounts.

Our employees must obtain written approval prior to placing a transaction in certain securities for any personal transactions by them or their immediate family members. A transaction in an open-ended investment company does not require pre-authorization. Transactions are approved by an "Authorizing Person" by submission of an authorization form before the transactions occur. The personal transaction will be approved if: 1) A personal trade and a client portfolio trade will not occur within 7 days of each other; and 2) If a security is held in an employee's account and in a client account, the employee may not sell any portion of the position within 60 days of its purchase. If the entire position is sold for all clients, the 60-day rule no longer applies.

Our clients can request a copy of our full "Code of Ethics" by writing to us at:

Director of Client Services  
PENN Capital Management Company, Inc.  
Navy Yard Corporate Center  
Three Crescent Drive, Suite 400  
Philadelphia, PA 19112

## Item 12 - Brokerage Practices

We provide investment advisory services to clients with full discretionary authority, subject to overall review by the client or named fiduciaries of the client. This authority is subject to specific investment restrictions and requirements of the various accounts. While we generally have full discretion to place orders, some clients may direct us to use specific brokers. Client direction requests must be in writing and indicate that the request is properly authorized. We may not be able to obtain best execution when clients direct their account's brokerage.

In certain separately managed accounts, we are directed to place trades with specified brokers. When we combine orders for several accounts with the directed broker, only the portion of the commission generated for the client-directed account is credited.

In many instances, we may step out orders to selected brokers. The cost of step-out trades are netted into the trade, so that large blocks of shares may be traded at what we believe will be the lowest possible cost, while seeking best execution across multiple product lines. The additional step-out commission is remuneration to the broker for costs incurred in effecting the transaction. A step-out trade commission is in addition to fees or payments made by WRAP program clients or other programs which include a brokerage component.

We select broker/dealers to execute transactions based upon their professional capability to provide the service. Our primary consideration is to seek best execution. Best execution refers to favorable price, commissions, promptness and reliability of execution, confidentiality and placement accorded the trade order. We consider the following factors in reviewing brokers for best execution: the broker's capability to execute the order, the broker's financial responsibility, the broker's responsiveness to us, the value of research provided, the bid/ask spreads, the market price impact, and low transaction opportunity cost. Our determination of what is a reasonable commission rate is based upon our Trading Department's professional knowledge regarding competitive rates paid and charged for similar transactions.

Where possible, multiple orders are combined to achieve lower transaction costs. In some instances, clients may pay a higher transaction cost based upon the degree of difficulty of execution and whether brokers provide either a capital commitment to complete the trade, research or other services. We seek to limit brokerage commissions to no more than six cents per share on equity transactions. Under certain circumstances, an account may pay in excess of six cents per share due to special situations. Fixed income trades are made on a net basis. There is no separate commission charged on a fixed income trade, but there is a bid/ask spread which operates as the equivalent of a commission.

We may place a combined order for multiple accounts for the same security if, in our judgment, the execution is in the best interest of each participant and is expected to result in best execution. Transactions involving combined orders are allocated in a manner deemed equitable to each account.

We may place trades with broker/dealers who provide brokerage and research services to us. We receive an economic benefit because we do not have to produce or pay for the research or other services. The commissions generated by these transactions may be used to acquire research or brokerage services for the benefit of all our clients. These services, which will conform to the safe harbor established under Section 28(e) of the Securities Exchange Act of 1934, as amended,

may include, but not be limited to, advice, either directly or through publications or writings, as to the value of securities, the advisability of investing in, purchasing or selling securities, and the availability of securities or purchasers or sellers of securities, furnishing of analysis and reports concerning issuers, securities or industries, providing information on economic factors and trends, and assistance in determining portfolio strategy. Research services used by us in connection with our investment decision-making process are not used exclusively for the account generating the brokerage. Although we send orders to broker/dealers who provide brokerage and research services, we believe that the commissions (or their equivalent) paid to such broker/dealers are reasonable in relation to the value of the services received.

We may decide to participate in equity IPOs for client accounts when we believe that it presents a valuable investment opportunity. We have adopted procedures designed to ensure fairness in the allocation of those IPO opportunities among our clients.

We may, on occasion, cross bonds from one client account to another, utilizing an unaffiliated broker. "Cross Trade" transactions are usually made for the following reasons: (1) Account liquidation; (2) Account needed to raise funds; (3) Account is overweight the bond due to withdrawal of funds; or (4) Security holding is no longer appropriate for account's strategy. Cross trades where we have discretion on both sides of the transaction are prohibited transactions under ERISA. PENN will not engage in cross transactions with ERISA accounts.

#### **Item 13 - Review of Accounts**

Investment decisions are discussed at daily meetings attended by portfolio managers, research analysis and the senior investment officers ("Portfolio Team"). The daily meetings provide a format to discuss investment decisions and the reason(s) for such action(s).

Securities owned are reviewed numerous times a month by the Portfolio Team. At these meetings, earnings projections are reviewed, risk/reward parameters are reviewed and revised, if necessary, and recent research information is highlighted.

In addition, the Equity Strategy and Credit Committees meet weekly to review top-down strategy positioning such as sector and industry concentrations in the portfolios, both on an absolute basis and relative to the applicable benchmark.

Account Performance is computed monthly and is reviewed by the Performance Committee.

Written client reports are provided by PENN at least quarterly, and should be reconciled with the records provided by the client's custodian.

#### **Item 14 - Client Referrals and Other Compensation**

In accordance with applicable law and regulations, we may enter into written arrangements to pay certain persons who introduce client accounts to us. Such arrangements will not be undertaken with any person who is a fiduciary of the client and will be undertaken only after full disclosure of payments in writing to the client. PENN has the following referral arrangements with non-affiliated firms:

- |    |                           |                                                                        |
|----|---------------------------|------------------------------------------------------------------------|
| A. | Name of Solicitor:        | Esprit Communication Corporation                                       |
|    | Date of Engagement:       | November 15, 2005                                                      |
|    | Compensation Arrangement: | Solicitor shall receive 25% of the first year client fee and 15% after |
|    |                           |                                                                        |
| B. | Name of Solicitor:        | Christenson Investment Partners                                        |
|    | Date of Engagement:       | September 26, 2006                                                     |
|    | Compensation Arrangement: | Solicitor shall receive 20% of client fee                              |

#### **Item 15 - Custody**

We do not select or recommend custodians for our client's separately managed account holdings. While we may provide performance and transaction information to clients on a monthly or quarterly basis, this information should be cross referenced with the custodian to ensure accuracy. Our statements may vary from custodial statements based on accounting procedures, reporting dates, or valuation methodologies of certain securities.

As General Partner of the private funds referenced in Item 4 above, PENN is considered to have custody. Limited Partners will receive monthly statements. Each fund is audited on an annual basis. We urge you to carefully review the audited financial reports.

As sub-advisor for unaffiliated broker's investment programs or mutual funds, PENN does not have custody of these client assets. Clients should refer to the prospectus or documentation provided to them by their program sponsor.

#### **Item 16 - Investment Discretion**

In most instances, we receive full discretionary authority from the client at the beginning of the advisory relationship to select the amount of securities to be bought or sold. However, such discretion is exercised in a manner consistent with the stated investment objectives for the particular client account.

When selecting securities and determining amounts, we observe the investment policies, limitations and restrictions of each client for which we advise. Investment guidelines and restrictions must be provided to us in writing.

We have a limited number of institutional and investment program relationships for which we provide non-discretionary or "model portfolio" services. This service provides the client with a model portfolio and our ongoing changes to the model. We do not execute brokerage transactions on behalf of non-discretionary accounts, nor are we responsible for any non-discretionary account reconciliations.

#### **Item 17 - Voting Client Securities**

For clients that authorize us to vote proxies on their behalf, we have the ability to tailor voting. We vote proxies based on a client's instruction or a client's legal structure, such as an ERISA-covered pension plan. Absent legal structure considerations or specific instructions, clients' proxies are voted in accordance with what we believe is the best interest of the shareholders, in

consultation with our proxy research provider, as described below. Additionally, some clients contractually reserve the right to vote their own proxies or contractually direct us to vote their proxies in a certain manner.

We contract with the research firm of Glass Lewis & Co. to provide proxy research and voting recommendations. Recommendations are based on objective analysis and voting recommendations of proposals contained in thousands of proxies from companies around the world.

We currently use the services of the Proxy Edge automated voting system provided by Broadridge to vote ballots electronically. Broadridge also maintains records on proxy votes for each client, or group of clients. The Proxy Edge system is updated nightly.

Additionally, we will manually vote proxies in certain situations.

Our clients can request a copy of our full “Proxy Voting Policy” by writing to us at:

Director of Client Services  
PENN Capital Management Company, Inc.  
Navy Yard Corporate Center  
Three Crescent Drive, Suite 400  
Philadelphia, PA 19112

#### **Item 18 - Financial Information**

We have no financial commitment that impairs our ability to meet the contractual and fiduciary commitments we have made to clients.