

Edgar Filing: MACC PRIVATE EQUITIES INC - Form 10-Q

MACC PRIVATE EQUITIES INC

Form 10-Q

February 14, 2002

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

(Mark One)

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

For the quarterly period ended December 31, 2001

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 0-24412

MACC Private Equities Inc.

(Exact name of registrant as specified in its charter)

Delaware

42-1421406

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

101 Second Street SE, Suite 800, Cedar Rapids, Iowa 52401

(Address of principal executive offices) (Zip Code)

(319) 363-8249

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Please indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

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At January 31, 2002, the registrant had issued and outstanding 2,329,255 shares of common stock.

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PART 1 -- FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MACC PRIVATE EQUITIES INC. AND SUBSIDIARY CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

December 31,
2001

Sept
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Assets		
Loans and investments in portfolio securities, at market or fair value:		
Unaffiliated companies (cost of \$17,292,684 and \$17,375,283)	\$ 15,777,325	16,66
Affiliated companies (cost of \$20,237,472 and \$22,002,764)	18,238,870	17,68
Controlled companies (cost of \$4,974,251 and \$3,005,000)	5,592,251	3,62
Cash and money market accounts	1,602,221	79
Certificates of deposit	800,626	68
Other assets, net	2,049,835	1,94
	-----	-----
Total assets	\$ 44,061,128	41,39
	=====	=====
Liabilities and net assets		
Liabilities:		
Debentures payable, net of discount	\$ 23,974,099	20,97
Incentive fees payable	124,539	10
Accrued interest	498,954	11
Accounts payable and other liabilities	49,455	16
	-----	-----
Total liabilities	24,647,047	21,35
	-----	-----
Net assets:		
Common stock, \$.01 par value per share;		
authorized 4,000,000 shares;		
issued and outstanding 2,329,255 shares	23,293	2
Additional paid-in-capital	21,978,599	24,32
Unrealized depreciation on investments	(2,587,811)	(4,30)
	-----	-----
Total net assets	19,414,081	20,04
	-----	-----
Total liabilities and net assets	\$ 44,061,128	41,39
	=====	=====
Net assets per share	\$ 8.33	
	=====	=====

See accompanying notes to unaudited condensed consolidated financial statements.

MACC PRIVATE EQUITIES INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

For the three months ended December 31, For the three months ended December 31,

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	2001	2000
	-----	-----
Investment income:		
Interest		
Unaffiliated companies	\$ 218,505	238,560
Affiliated companies	213,530	214,507
Controlled companies	73,093	80,970
Other	18,709	67,830
Dividends		
Unaffiliated companies	55,256	84,012
Affiliated companies	80,575	117,686
Processing fees	29,260	3,864
Other	17,432	1,000
	-----	-----
Total income	706,360	808,429
	-----	-----
Operating expenses:		
Interest	449,224	444,703
Management fees	268,951	266,143
Professional fees	42,409	25,105
Other	78,903	62,357
	-----	-----
Total operating expenses	839,487	798,308
	-----	-----
Investment (expense) income, net	(133,127)	10,121
	-----	-----
Realized and unrealized gain (loss) on investments:		
Net realized gain (loss) on investments		
Unaffiliated companies	23,953	1,427,435
Affiliated companies	(2,239,403)	---
Net change in unrealized appreciation/ depreciation on investments	1,719,687	(3,416,178)
	-----	-----
Net loss on investments	(495,763)	(1,988,743)
	-----	-----
Net change in net assets from operations	\$ (628,890)	(1,978,622)
	=====	=====

See accompanying notes to unaudited condensed consolidated financial statements.

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	For the three months ended December 31, 2001 -----
Cash flows from operating activities:	
Decrease in net assets from operations	\$ (628,890) -----
Adjustments to reconcile decrease in net assets from operations to net cash provided by operating activities:	
Net realized and unrealized loss on investments	495,763
Change in accrued interest, incentive fees payable, accounts payable and other liabilities	268,511
Other	98,795 -----
Total adjustments	863,069 -----
Net cash provided by operating activities	234,179 -----
Cash flows from investing activities:	
Proceeds from disposition of and payments on loans and investments in portfolio securities	130,466
Purchases of loans and investments in portfolio securities	(2,369,251)
Purchases of short-term investments	(113,767) -----
Net cash (used in) provided by investing activities	(2,352,552) -----
Cash flows from financing activities:	
Proceeds from debt issuance, net of commitment fees	2,925,000 -----
Net cash provided by financing activities	2,925,000 -----
Net increase in cash and cash equivalents	806,627
Cash and cash equivalents at beginning of period	795,594 -----
Cash and cash equivalents at end of period	\$ 1,602,221 =====
Supplemental disclosure of cash flow information -	
Cash paid during the period for interest	\$ 37,853 =====
Supplemental disclosure of noncash investing and financing information -	
Debt issuance costs financed with debentures payable	\$ 75,000
Assets received in exchange of securities	84,709 =====

See accompanying notes to unaudited condensed consolidated financial statements.

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MACC PRIVATE EQUITIES INC.

Notes to Unaudited Condensed Consolidated Financial Statements

(1) Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of MACC Private Equities Inc. (Equities) and its wholly-owned subsidiary MorAmerica Capital Corporation (MACC) which have been prepared in accordance with accounting principles generally accepted in the United States of America for investment companies. All material intercompany accounts and transactions have been eliminated in consolidation.

The financial statements included herein have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and instructions to Form 10-Q and Article 6 of Regulation S-X. The financial statements should be read in conjunction with the consolidated financial statements and notes thereto of MACC Private Equities Inc. and its Subsidiary as of and for the year ended September 30, 2001. The information reflects all adjustments consisting of normal recurring adjustments which are, in the opinion of management, necessary for a fair presentation of the results of operations for the interim periods. The results of the interim period reported are not necessarily indicative of results to be expected for the year. The balance sheet information as of September 30, 2001 has been derived from the audited balance sheet as of that date.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This section contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the "1995 Act"). Such statements are made in good faith by MACC pursuant to the safe-harbor provisions of the 1995 Act, and are identified as including terms such as "may," "will," "should," "expects," "anticipates," "estimates," "plans," or similar language. In connection with these safe-harbor provisions, MACC has identified in its Annual Report to Shareholders for the fiscal year ended September 30, 2001, important factors that could cause actual results to differ materially from those contained in any forward-looking statement made by or on behalf of MACC, including, without limitation, the high risk nature of MACC's portfolio investments, any failure to achieve annual investment level objectives, changes in prevailing market interest rates, and contractions in the markets for corporate acquisitions and initial public offerings. MACC further cautions that such factors are not exhaustive or exclusive. MACC does not undertake to update any forward-looking statement which may be made from time to time by or on behalf of MACC.

RESULTS OF OPERATIONS

Three Months Ended December 31, 2001, Compared to Three Months Ended December 31, 2000

MACC's investment income includes income from interest, dividends and fees. Net investment income/expense represents total investment income minus operating and interest expenses, net of applicable income taxes. The main objective of portfolio company investments is to achieve capital appreciation

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and realized gains in the portfolio. These are not included in net investment income/expense. However, another one of MACC's on-going goals is to achieve net investment income and increased earnings stability. In this regard, a significant proportion of new portfolio investments are structured so as to provide a current yield through interest or dividends. MACC also earns interest on short-term investments of cash.

During the current year first quarter total investment income of \$706,360 was approximately 13% lower than total investment income of \$808,429 for the prior year first quarter. In the current year first quarter as compared to the prior year first quarter, interest income decreased \$78,030, dividend income decreased \$65,867, processing fees increased \$25,396 and other income increased \$16,432. The decrease in interest income is due to an increase in the number of investments which are on non-accrual of interest status, the decreased cash on hand held in interest earning investments and the lower interest rate earned on these investments. The receipt of dividend income is based primarily on the performance of the limited liability companies in MACC's portfolio and the timing of when these companies make distributions. In the current year first quarter dividends were received on four portfolio companies as compared to dividends received on six portfolio companies in the prior year first quarter. Processing fees increased due to one new portfolio company investment made in the current year first quarter in which MACC received processing fees at the closing compared to only one small follow-on portfolio investment in the prior year first quarter in which MACC received a processing fee at closing. The increase in other income is due to the receipt of advisory fees from one portfolio company and the reimbursement of legal fees expensed in the prior fiscal year.

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Total operating expenses for the first quarter of the current year total \$839,487, an increase of approximately 5% as compared to total operating expenses for the prior year first quarter of \$798,308. Interest expense increased to \$449,224 due to additional borrowings of SBA-guaranteed debentures. Management fees increased to \$268,951 in the current year first quarter as compared \$266,143 in the prior year first quarter. Professional fees increased to \$42,409 in the current year first quarter from \$25,105 in the prior year first quarter. Other expenses increased to \$78,903 from \$62,357 in the current year first quarter as compared to the prior year first quarter mainly due to increased administrative expenses.

For the current year first quarter, MACC recorded a net investment expense of \$133,127 as compared to net investment income of \$10,121 during the prior year first quarter.

During the current year first quarter, MACC recorded net realized loss on investments of \$2,215,450 as compared with net realized gain on investments of \$1,427,435 during the prior year first quarter. The net realized loss is the net result of \$34,550 of gains from two portfolio companies and a write-off of \$2,250,000 from one portfolio company of which \$2,249,999 was previously recorded as unrealized depreciation. MACC has several portfolio investment companies that are seeking to sell or buyout MACC's position, however, it is uncertain at this time whether any of these dispositions will occur or the prices at which such transactions may occur. Management does not attempt to maintain a comparable level of realized gains from year to year or quarter to quarter but instead attempts to maximize total investment portfolio appreciation through realizing gains in the disposition of securities and investing in new

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portfolio investments.

MACC recorded net change in unrealized appreciation/depreciation on investments of \$1,719,687 during the current year first quarter, as compared to (\$3,416,178) during the prior year period. The net change in unrealized appreciation/depreciation on investments of \$1,719,687 is the net effect of increases in fair value of five portfolio companies totaling \$547,630, decreases in fair value of three portfolio companies totaling \$1,077,942 and the reversal of \$2,249,999 of depreciation on the write-off of the investment in one portfolio company referenced above.

Net change in unrealized appreciation/depreciation on investments represents the change for the period in the unrealized appreciation on MACC's total investment portfolio net of unrealized depreciation on MACC's total investment portfolio. Generally, when MACC increases the fair value of a portfolio investment above its cost, the unrealized appreciation item for the portfolio as a whole increases, and when MACC decreases the fair value of a portfolio investment below its cost, the unrealized depreciation item for the portfolio as a whole increases. When MACC sells an appreciated portfolio investment for a gain, unrealized appreciation for the portfolio as a whole decreases as the gain is realized. Similarly, when MACC sells a depreciated portfolio investment for a loss, unrealized depreciation for the portfolio as a whole decreases as the loss is realized.

MACC experienced a decrease of \$628,890 in net assets during the first quarter of fiscal year 2002, the resulting net asset value per share was \$8.33 as of December 31, 2001, as compared to \$8.60 as of September 30, 2001. During the first quarter of the current year, MACC's operating results were adversely affected by challenging economic conditions. These economic factors have adversely impacted the operating performance and financial condition of a number of companies in MACC's investment portfolio. For example, several

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of MACC's portfolio companies are in the aerospace and travel industries, both of which have been adversely affected following the events of September 11. In addition, management believes that current economic conditions, coupled with market uncertainty regarding hostilities involving the United States, have resulted in a contraction in the availability of capital generally, and from senior lenders in particular. The contraction in the availability of senior credit was a primary factor involving one portfolio investment that experienced a decrease in fair value during the first quarter of fiscal year 2002. These challenging economic conditions have resulted in fewer projected liquidity events for MACC's investment portfolio during fiscal year 2002, and potentially lower prices generally on those liquidity events that are projected to occur during fiscal year 2002.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

To date, MACC has relied upon several sources to fund its investment activities, including MACC's cash equivalents and cash, and the Small Business Investment Company ("SBIC") capital program operated by the Small Business Administration (the "SBA").

MACC, through its wholly-owned subsidiary, MorAmerica Capital, from time to time may seek to procure additional capital through the SBIC capital program to provide a portion of its future investment capital requirements. At present, it appears that there is availability of capital for the next five

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years through the SBIC capital program.

As of December 31, 2001, MACC's cash totaled \$1,602,221. MACC has a commitment for an additional \$7,455,000 in SBA guaranteed debentures, which expires September 30, 2005. MACC believes that its existing cash, together with a \$7,455,000 SBA commitment which expires September 30, 2005, additional commitments anticipated through the SBIC capital program and other anticipated cash flows, will provide adequate funds for MACC's anticipated cash requirements during the current fiscal year, including portfolio investment activities, interest payments on outstanding debentures payable and administrative expenses. MACC's investment objective has been revised to invest \$8,500,000 in new and follow-on investments during the current fiscal year.

Liquidity for the next several years will be impacted by principal payments on MACC's debentures payable. Debentures payable are composed of \$23,985,000 in principal amount of SBA-guaranteed debentures issued by MACC's subsidiary, MorAmerica Capital, which mature as follows: \$2,150,000 in 2003, \$1,000,000 in 2007, \$2,500,000 in 2009, \$9,000,000 in 2010, \$6,335,000 in 2011, and \$3,000,000 in 2012. It is anticipated MorAmerica Capital will be able to roll over these debenture with new ten year debentures when they mature. As indicated above, the total amount of MorAmerica Capital's commitment from the SBA is \$7,455,000.

During the current year first quarter, MACC adopted a stock repurchase program to repurchase up to \$100,000 of common stock on the open market, depending on market conditions and other factors. The stock repurchase program will run through April 15, 2002, unless extended. To date, MACC has not repurchased any shares of stock due to the lack of consistent trading activity.

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MACC anticipates that it will rely primarily on the SBIC capital program and its cash flows from operations to fund its investment activities during fiscal year 2002. Although management believes these sources will provide sufficient funds for MACC to meet its revised fiscal 2002 investment level objective and other anticipated cash requirements, there can be no assurances that the SBIC capital program will continue to be available to MACC or that MACC's cash flows from operations will be as projected. If MACC's liquidity is materially adversely affected by any of these factors, MACC may be required to further reduce its investment level objectives for fiscal year 2002, which could adversely affect its cash flows from operations and ability to realize gains in future periods. Currently MACC has a \$7,455,000 SBA commitment and plans to draw \$3,000,000 of this commitment in 2002 to fund investment activities.

PORTFOLIO ACTIVITY

During the three months ended December 31, 2001, MACC invested \$2,369,251 in three portfolio companies, consisting of \$1,463,000 invested in one new portfolio company and \$906,251 invested in follow-on investments in two existing portfolio companies. MACC frequently co-invests with other funds managed by MACC's investment advisor and with funds affiliated with MACC's largest shareholder, Zions First National Bank. When it makes any co-investment with these related funds, MACC follows certain procedures consistent with orders of the Securities and Exchange Commission for related party co-investments to reduce or eliminate conflict of interest issues. Of the \$2,369,251 invested during the three months ended December 31, 2001, \$2,369,251 represented co-investments with funds managed by MACC's investment advisor and \$400,000 represented co-investments with funds affiliated with Zions First National Bank.

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MACC's revised investment level objectives for fiscal year 2002 call for total new and follow-on investments of \$8,500,000. The timing of new and follow-on portfolio investments is somewhat uncertain and given current economic conditions, MACC may not meet its investment level objectives for the current fiscal year. However, management views investment level objectives for any given year as secondary in importance to MACC's overriding concern of investing in only those portfolio companies which satisfy MACC's investment criteria.

DETERMINATION OF NET ASSET VALUE

The net asset value per share of MACC's outstanding common stock is determined quarterly, as soon as practicable after and as of the end of each calendar quarter, by dividing the value of total assets minus total liabilities by the total number of shares outstanding at the date as of which the determination is made.

In calculating the value of total assets, securities that are traded in the over-the-counter market or on a stock exchange are valued in accordance with the current valuation policies of the Small Business Administration ("SBA"). Under SBA regulations, publicly traded equity securities are valued by taking the average of the close (or bid price in the case of over-the-counter equity securities) for the valuation date and the preceding two days. This policy differs from the Securities and Exchange Commission's guidelines which utilize only a one day price measurement. MACC's use of SBA valuation procedures on three publicly traded portfolio companies did not result in a material variance of December 31, 2001, from valuations using the Securities and Exchange Commission's guidelines.

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All other investments are valued at fair value as determined in good faith by the Board of Directors. The Board of Directors has determined that all other investments will be valued initially at cost, but such valuation will be subject to quarterly adjustments and on such other periods as are justified by material portfolio company events if the Board of Directors determines in good faith that cost no longer represents fair value.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

MACC is exposed to market risk from changes in market prices of publicly traded equity securities held in the MACC consolidated investment portfolio. At December 31, 2001, publicly traded equity securities in the MACC consolidated investment portfolio were recorded at a fair value of \$2,316,801. In accordance with MACC's valuation policies and SBA regulations, the fair value of publicly traded equity securities is determined based upon the average of the closing prices (or bid price in the case of over-the-counter equity securities) for the valuation date and the preceding two days. The publicly traded equity securities in the MACC consolidated investment portfolio thus have exposure to price risk, which is estimated as the potential loss in fair value due to a hypothetical 10% adverse change in quoted market prices, and would amount to a decrease in the recorded value of such publicly traded equity securities of approximately \$231,680. Actual results may differ.

MACC is also exposed to market risk from changes in market interest rates that affect the fair value of MorAmerica Capital's debentures payable determined in accordance with Statement of Financial Accounting Standards No. 107, Disclosures About Fair Value of Financial Instruments. The estimated fair value of MorAmerica Capital's outstanding debentures payable at December 31,

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2001, was \$25,016,000, with a cost of \$23,985,000. Fair value of MorAmerica Capital's outstanding debentures payable is calculated by discounting cash flows through estimated maturity using the borrowing rate currently available to MorAmerica Capital for debt of similar original maturity. None of MorAmerica Capital's outstanding debentures payable are publicly traded. Market risk is estimated as the potential increase in fair value resulting from a hypothetical 0.5% decrease in interest rates. Actual results may differ.

	2002
Fair Value of Debentures Payable	\$25,016,000
Amount Above Cost	\$ 1,031,000
Additional Market Risk	\$ 601,000

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

There are no items to report.

ITEM 2. CHANGES IN SECURITIES

There are no items to report.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

There are no items to report.

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

There are no items to report.

ITEM 5. OTHER INFORMATION

There are no items to report.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibits

No exhibits are applicable.

(b) Reports on Form 8-K

MACC filed a current report on Form 8-K on October 24, 2001 disclosing under Item 5 the adoption of its common stock repurchase program.

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SIGNATURES

Pursuant to the requirements 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.

MACC PRIVATE EQUITIES INC.

Date: 2/13/02

By: /s/ David Schroder

David Schroder, President

Date: 2/13/02

By: /s/ Robert A. Comey

Robert A. Comey, Treasurer