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MACC PRIVATE EQUITIES INC

Form 10-Q

February 14, 2001

1

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, 2000

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 ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

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Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes  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.

At January 31, 2001, the registrant had issued and outstanding 1,941,879 shares of common stock.

2

## INDEX

### PART I. FINANCIAL INFORMATION

Item		Page
		----
Item 1.	Financial Statements	
	Condensed Consolidated Balance Sheets at December 31, 2000 (Unaudited), and September 30, 2000.....	3
	Condensed Consolidated Statements of Operations (Unaudited) for the three months ended December 31, 2000, and the three months ended December 31, 1999.....	4
	Condensed Consolidated Statements of Cash Flows (Unaudited) for the three months ended December 31, 2000, and the three months ended December 31, 1999.....	5
	Notes to Condensed Consolidated Financial Statements.....	6
Item 2.	Management's Discussion and Analysis of Financial Condition and Results Of Operations.....	7
Item 3.	Quantitative and Qualitative Disclosure About Market Risk.....	10
PART II. OTHER INFORMATION.....		12
	Signatures.....	13

2

3

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### PART 1 -- FINANCIAL INFORMATION

#### ITEM 1. FINANCIAL STATEMENTS

#### MACC PRIVATE EQUITIES INC. AND SUBSIDIARY CONDENSED CONSOLIDATED BALANCE SHEETS

	December 31, 2000 (Unaudited)	September 30, 2000
	-----	-----
Assets		
Loans and investments in portfolio securities at market or fair value, cost of \$37,870,164 and \$36,965,143	\$38,520,960	41,032,116
Cash and money market accounts	4,329,901	3,767,188
Certificates of deposit	234,375	399,999
Other assets, net	1,452,420	1,408,163
	-----	-----
Total assets	\$44,537,656	46,607,466
	=====	=====
Liabilities and stockholders' equity		
Liabilities:		
Debtures payable, net of discount	\$20,322,558	20,320,922
Incentive fees payable	135,417	118,164
Accrued interest	366,268	242,424
Accounts payable and other liabilities	46,466	280,387
	-----	-----
Total liabilities	20,870,709	20,961,897
	-----	-----
Net assets:		
Common stock, \$.01 par value per share; authorized 4,000,000 shares; issued and outstanding 1,941,879 shares	19,419	19,419
Additional paid-in-capital	16,510,381	16,510,381
Net investment income	426,010	415,889
Net realized gain on investments	5,957,626	4,530,191
Unrealized appreciation on investments	753,511	4,169,689
	-----	-----
Total net assets	23,666,947	25,645,569
	-----	-----
Total liabilities and net assets	\$44,537,656	46,607,466
	=====	=====
Net assets per share	\$ 12.19	13.21
	=====	=====

See accompanying notes to unaudited condensed consolidated financial statements.

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3

4

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

	For the three months ended December 31, 2000	For the three months ended December 31, 1999
	-----	-----
Investment income:		
Interest	\$ 601,867	503,677
Dividends	201,698	39,082
Processing fees	3,864	51,873
Other	1,000	1,942
	-----	-----
Total income	808,429	596,574
	-----	-----
Operating expenses:		
Interest expenses	444,703	306,076
Management fees	266,143	235,220
Professional fees	25,105	30,302
Other	62,357	56,590
	-----	-----
Total operating expenses	798,308	628,188
	-----	-----
Investment income (expense)	10,121	(31,614)
	-----	-----
Realized and unrealized (loss) gain on investments:		
Net realized gain on investments	1,427,435	173,489
Net change in unrealized appreciation on investments	(3,416,178)	(90,725)
	-----	-----
Net (loss) gain on investments	(1,988,743)	82,764
	-----	-----
Net change in net assets from operations	\$ (1,978,622)	51,150
	=====	=====

See accompanying notes to unaudited condensed consolidated financial statements.

4

5

MACC PRIVATE EQUITIES INC. AND SUBSIDIARY  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

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	For the three months ended December 31, 2000 -----
Cash flows from operating activities:	
(Decrease) increase in net assets from operations	\$ (1,978,622) -----
Adjustments to reconcile (decrease) increase in net assets from operations to net cash provided by (used in) operating activities:	
Net realized and unrealized loss (gain) on investments	1,988,743
Change in accrued interest, incentive fees payable, accounts payable and other liabilities	84,927
Other	(52,634) -----
Total adjustments	2,021,036 -----
Net cash provided by (used in) operating activities	42,414 -----
Cash flows from investing activities:	
Proceeds from disposition of and payments on loans and investments in portfolio securities	894,601
Purchases of loans and investments in portfolio securities	(539,926)
Proceeds from disposition of short-term investments	--
Purchases of short-term investments	-- -----
Net cash provided by (used in) investing activities	354,675 -----
Net increase (decrease) in cash and cash equivalents	397,089
Cash and cash equivalents at beginning of period	4,167,187 -----
Cash and cash equivalents at end of period	\$ 4,564,276 =====
Supplemental disclosure of cash flow information -	
Cash paid during the period for interest	\$ 296,887 =====
Supplemental disclosure of noncash investing and financing information -	
Assets received in exchange of securities	\$ 1,887,179 =====

See accompanying notes to unaudited condensed consolidated financial statements.

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### (1) Basis of Presentation

The accompanying unaudited 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, 2000. 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, 2000 has been derived from the audited balance sheet as of that date.

6

7

### 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, 2000, 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, 2000, Compared to Three Months Ended December 31, 1999

MACC's investment income includes income from interest, dividends and fees. Net investment income 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 and realized gains in the portfolio. These are not included in net investment income. However, another one of MACC's on-going goals is to achieve net investment

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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 \$808,429 was approximately 36% higher than total investment income of \$596,574 for the prior year first quarter. In the current year first quarter as compared to the prior year first quarter, interest income increased \$98,190, dividend income increased \$162,616, processing fees decreased \$48,009 and other income decreased \$942. The increase in interest income is primarily due to a \$6,830,456, or 44% increase in MACC's interest-earning portfolio investments that are structured as subordinated debentures during the prior fiscal year. 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 six portfolio companies as compared to dividends received on two portfolio companies in the prior year first quarter. Processing fees decreased due to only one follow-on portfolio company investment made in the current year first quarter in which MACC received processing fees at the closing compared to two new portfolio company investments in the prior year first quarter in which MACC received a processing fee at closing.

7

8

Total operating expenses for the first quarter of the current year total \$798,308, an increase of approximately 27% as compared to total operating expenses for the prior year first quarter of \$628,188. Interest expense increased by \$138,627 due to additional borrowings of SBA-guaranteed debentures. Management fees increased by \$30,923 in the current year first quarter as compared to the prior year first quarter due to the increase in assets under management. Professional fees and other expenses, which include administrative expenses associated with being a public corporation, were substantially unchanged in the current year first quarter as compared to the prior year first quarter.

For the current year first quarter, MACC recorded net investment income of \$10,121 as compared to net investment expense of (\$31,614) during the prior year first quarter.

During the current year first quarter, MACC recorded net realized gain on investments of \$1,427,435 as compared with net realized gain on investments of \$173,489 during the prior year first quarter. In the current year first quarter, MACC realized a non-cash gain of \$1,251,101 from one portfolio investment in which shares of a privately held company were exchanged for shares in a publicly traded company. 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 portfolio investments.

MACC recorded net change in unrealized appreciation/depreciation on investments of (\$3,416,178) during the current year first quarter, as compared to (\$90,725) during the prior year period. The current year net change in unrealized appreciation/depreciation on investments is the net effect of a reversal of appreciation of \$1,444,689 in one portfolio investment, in which shares in a privately held company were exchanged for shares in a publicly traded company for a realized non-cash gain and decreases in the fair value of three portfolio investments totaling \$1,971,489 in the MACC consolidated

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investment portfolio, calculated in accordance with MACC's valuation policies. Of the three portfolio investments that experienced decreases in the fair value during the current year first quarter, \$1,085,653 is attributable to decreases in the current market price of the publicly traded common stock of two portfolio companies and \$885,836 is attributable to a decrease in fair value of the securities of one portfolio company, which the Board of Directors determined was appropriate due to continued operating losses, adverse changes in the portfolio company's access to funding, and financial condition. Although management believes that the market prices of MACC's publicly traded portfolio securities may increase over the course of this year, any or all of these three portfolio investment may experience additional decreases in fair value in future periods.

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.

8

9

At the end of the current year first quarter, MACC's net asset value per share was \$12.19 as compared to the net asset value per share on September 30, 2000 of \$13.21.

### 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, there is availability of capital through the SBIC capital program and MACC anticipates that there will be capital available in future periods.

As of December 31, 2000, MACC's certificates of deposit and cash totaled \$4,564,276. MACC has commitments for \$6,790,000 and \$10,000,000 in SBA guaranteed debentures which expire September 30, 2002 and September 30, 2005, respectively. MACC believes that its existing certificates of deposit and cash, together with the \$16,790,000 SBA commitment, and other anticipated cash flows, will provide adequate funds for MACC's anticipated cash requirements during the current fiscal year, including portfolio investment activities, principal and interest payments on outstanding debentures payable and administrative expenses. MACC's investment objective is to invest \$13,000,000 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 \$20,340,000 in principal amount of SBA-guaranteed debentures issued by MACC's subsidiary, MorAmerica Capital, which mature as follows: \$5,690,000 in 2001, \$2,150,000 in



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2003, \$1,000,000 in 2007, \$2,500,000 in 2009, and \$9,000,000 in 2010. It is anticipated MorAmerica Capital would be able to roll over these debentures with new ten year debentures when they mature. As indicated above, the total amount of MorAmerica Capital's commitment from the SBA is \$16,790,000.

Management believes that current economic conditions in the U.S. are less favorable to MACC than those experienced in fiscal year 2000. The general increase in fuel and energy costs over the past several months may adversely affect the operations or financial condition of MACC's portfolio companies, particularly those involved in manufacturing. In addition, the recent declines in market capitalization of many companies in the technology industry may have the effect of reducing the availability of capital to technology companies in MACC's investment portfolio. These and other factors may have an adverse effect on the fair value of MACC's portfolio investments and the markets for corporate acquisitions and initial public offerings generally, and, as a result, may adversely affect the rate of growth, if any, in MACC's net asset value over the next twelve months. However, management does not anticipate that these factors will have a significant adverse effect on MACC's liquidity over the next twelve months.

9

10

### PORTFOLIO ACTIVITY

During the three months ended December 31, 2000, MACC invested \$344,921 in follow-on investments in two existing portfolio companies. MACC's investment level objectives for fiscal year 2001 call for total new and follow-on investments of \$13,000,000. With the timing of new and follow-on portfolio investments being somewhat uncertain and a current slowing of the economy which may restrict the supply of good investment opportunities, MACC anticipates that it 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 did not result in a material variance as of December 31, 2000, from valuations using the Securities and Exchange Commission's guidelines.

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 semi-annual adjustments and on such other interim periods as are justified by

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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, 2000, publicly traded equity securities in the MACC consolidated investment portfolio were recorded at a fair value of \$1,058,653. 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 \$105,865. Actual results may differ.

10

11

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, 2000, was \$20,117,000, with a cost of \$20,340,000. 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.

	2001
Fair Value of Debentures Payable	\$20,117,000
Amount Below Cost	\$223,000
Additional Market Risk	\$434,000

### EFFECT OF NEW ACCOUNTING STANDARDS

The company adopted SFAS 133, as amended by SFAS 137 and SFAS 138, on October 1, 2000 as required. Adoption of this pronouncement had no material effect on the financial statements of the company.

11

12

### PART II. OTHER INFORMATION

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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 no reports on Form 8-K during the three months ended December 31, 2000.

12

13

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: 2/13/01

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By: /s/ DAVID SCHRODER

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David Schroder, President

Date: 2/13/01

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By: /s/ ROBERT A. COMEY

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Robert A. Comey, Treasurer

13