

BRANTLEY CAPITAL CORP

Form 10-Q

November 15, 2002

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**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**Form 10-Q**

**[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF**

**THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2002**

**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: 814-00127

**BRANTLEY CAPITAL CORPORATION**

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(Exact name of registrant as specified in its charter)

Maryland

34-1838462

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(State or other Jurisdiction of  
Incorporation or Organization)

(I.R.S. Employer Identification Number)

3201 Enterprise Parkway, Suite 350, Cleveland, Ohio 44122

(Address of principal executive offices including zip code)

(216) 464-8400

(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. Yes [X] No [ ].

The number of shares of common stock, \$.01 par value, outstanding as of September 30, 2002 was 3,810,535.

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****BRANTLEY CAPITAL CORPORATION****BALANCE SHEETS**

	<b>September 30, 2002 (Unaudited)</b>	<b>December 31, 2001 (Audited)</b>
<b>ASSETS</b>		
Investments at fair value		
Companies 5% to 25% owned	\$ 59,612,969	\$ 56,482,013
Companies less than 5% owned	2,935,496	3,829,094
Cash and cash equivalents	151,440	5,369,345
Restricted cash	6,000,000	6,000,000
Receivable for investments sold	318,709	
Dividends and interest receivable	4,844,649	3,493,059
Other assets	399,957	360,158
	<hr/>	<hr/>
<b>Total Assets</b>	<b>\$ 74,263,220</b>	<b>\$ 75,533,669</b>
	<hr/>	<hr/>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Note payable	\$ 6,000,000	\$ 6,000,000
Payable for investments purchased	285,853	200,000
Advisory fee payable	478,734	487,931
Accrued professional fees	463,138	53,163
Distributions payable		736,455
Other liabilities	99,196	49,806
	<hr/>	<hr/>
<b>Total Liabilities</b>	<b>7,326,921</b>	<b>7,527,355</b>
	<hr/>	<hr/>
<b>Stockholders Equity:</b>		
Common Stock, \$0.01 par value; 25,000,000 shares authorized and 3,810,535 shares issued and outstanding at September 30, 2002 and December 31, 2001, respectively	38,105	38,105
Additional paid in capital	37,484,895	37,484,895
Retained earnings	29,413,299	30,483,314
	<hr/>	<hr/>
<b>Total Stockholders Equity</b>	<b>66,936,299</b>	<b>68,006,314</b>
	<hr/>	<hr/>
<b>Total Liabilities and Stockholders Equity</b>	<b>\$ 74,263,220</b>	<b>\$ 75,533,669</b>
	<hr/>	<hr/>
<b>Net Asset Value Per Share</b>	<b>\$ 17.57</b>	<b>\$ 17.85</b>
	<hr/>	<hr/>

The accompanying notes to the financial statements are an integral part of these statements.

**Table of Contents****BRANTLEY CAPITAL CORPORATION****STATEMENTS OF OPERATIONS****(Unaudited)**

	<b>For the nine months ended September 30, 2002</b>	<b>For the nine months ended September 30, 2001</b>
<b>Investment Income:</b>		
Interest and Dividends		
Companies owned 5% to 25%	\$ 1,626,575	\$ 1,209,953
Companies less than 5% owned	61,327	34,962
	<u>1,687,902</u>	<u>1,244,915</u>
<b>Operating Expenses:</b>		
Advisory fees	1,419,601	1,124,410
Administration fees	56,096	55,891
Professional fees	666,437	287,358
Interest and other expenses	550,685	638,226
	<u>2,692,819</u>	<u>2,105,885</u>
<b>Investment Loss, net</b>	<b>(1,004,917)</b>	<b>(860,970)</b>
<b>Net Realized and Unrealized Gains (Losses) on Investments:</b>		
Net realized gains (losses)		
Companies less than 5% owned	(318,939)	998,050
Net unrealized gains on investments	253,841	1,625,803
	<u>(65,098)</u>	<u>2,623,853</u>
<b>Net realized and unrealized gains (losses) on investment transactions</b>	<b>(65,098)</b>	<b>2,623,853</b>
<b>Net increase (decrease) in net assets resulting from operations</b>	<b>\$(1,070,015)</b>	<b>\$1,762,883</b>
<b>Net increase (decrease) in net assets from operations per share, basic and diluted</b>	<b>\$ (0.28)</b>	<b>\$ 0.46</b>
<b>Weighted average number of shares outstanding, basic and diluted</b>	<b>3,810,535</b>	<b>3,810,535</b>

The accompanying notes to the financial statements are an integral part of these statements.



**Table of Contents****BRANTLEY CAPITAL CORPORATION****STATEMENTS OF CHANGES IN NET ASSETS****(Unaudited)**

	<u>Common Stock</u>	<u>Additional Paid in Capital</u>	<u>Retained Earnings</u>	<u>Total Stockholders Equity</u>
<b>Balance at December 31, 1999</b>	\$ 38,105	\$ 37,505,433	\$ 14,896,797	\$ 52,440,335
Net increase in net assets from operations:				
Net investment income			145,082	145,082
Net realized gain			1,564,206	1,564,206
Net unrealized gain			170,027	170,027
Distributions from:				
Net investment income		(20,538)	(112,831)	(133,369)
Net realized gain			(2,243,262)	(2,243,262)
<b>Balance at December 31, 2000</b>	\$ 38,105	\$ 37,484,895	\$ 14,420,019	\$ 51,943,019
Net increase in net assets from operations:				
Net investment loss			(1,207,676)	(1,207,676)
Net realized gain			1,155,843	1,155,843
Net unrealized gain			16,851,583	16,851,583
Distributions from:				
Net investment income				
Net realized gain			(736,455)	(736,455)
<b>Balance at December 31, 2001</b>	\$ 38,105	\$ 37,484,895	\$ 30,483,314	\$ 68,006,314
Net decrease in net assets from operations:				
Net investment loss			(1,004,917)	(1,004,917)
Net realized loss			(318,939)	(318,939)
Net unrealized gain			253,841	253,841
<b>Balance at September 30, 2002</b>	\$ 38,105	\$ 37,484,895	\$ 29,413,299	\$ 66,936,299

The accompanying notes to the financial statements are an integral part of these statements.



**Table of Contents****BRANTLEY CAPITAL CORPORATION****STATEMENTS OF CASH FLOWS****(Unaudited)**

	<b>For the nine months ended September 30, 2002</b>	<b>For the nine months ended September 30, 2001</b>
<b>Cash Flows from Operating Activities:</b>		
<b>Net change in net assets resulting from operations:</b>	\$ (1,070,015)	\$ 1,762,883
Adjustments to reconcile net change in net assets resulting from operations to net cash used for operations:		
Net realized gains (losses) from investments	318,939	(998,050)
Net unrealized gains on investments	(253,841)	(1,625,803)
Changes in assets and liabilities:		
Dividend and interest receivable	(1,351,590)	(1,053,933)
Receivable for investments sold	(318,709)	
Other assets	(39,799)	6,642
Payable for investments purchased	85,853	
Advisory fee payable	(9,197)	2,208
Accrued professional fees	409,975	26,337
Dividends payable	(736,455)	
Accrued interest		40,328
Other liabilities	49,390	(30,782)
<b>Net cash used for operating activities</b>	<b>(2,915,449)</b>	<b>(1,870,170)</b>
<b>Cash Flows from Investing Activities:</b>		
Purchases of investment securities	(9,117,416)	(5,441,940)
Sales/ Maturities of investment securities	6,814,960	3,404,077
Purchases of short-term investments		(514,412,500)
Sales/ Maturities of short-term investments		514,416,321
<b>Net cash used for investing activities</b>	<b>(2,302,456)</b>	<b>(2,034,042)</b>
<b>Net change in cash and cash equivalents for the period</b>	<b>(5,217,905)</b>	<b>(3,904,212)</b>
<b>Cash, cash equivalents and restricted cash, beginning of period</b>	<b>11,369,345</b>	<b>14,882,432</b>
<b>Cash, cash equivalents and restricted cash, end of the period</b>	<b>\$ 6,151,440</b>	<b>\$ 10,978,220</b>

The accompanying notes to the financial statements are an integral part of these statements.

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## BRANTLEY CAPITAL CORPORATION

## STATEMENT OF INVESTMENTS

September 30, 2002

(unaudited)

Name of Issuer and Title of Issue	Shares/Par	Value
<b>Avionics</b>		
Flight Options International Inc. Preferred Stock **@	3,342,060	\$ 32,500,000
<b>Business Services</b>		
Disposable Products Company, LLC Subordinated Debt with Warrants #	2,437,201	2,430,541
FactSet Research Systems, Inc. Common Stock	1,080	28,674
The Holland Group, Inc. Convertible Preferred Stock #@	282,530	2,125,001
The Holland Group, Inc. Subordinated Note #@	50,000	50,000
International Total Services, Inc. Common Stock	104,250	2,085
Prime Office Products, Inc. Convertible Preferred Stock #@	750,000	1,500,000
ScanSource, Inc. Common Stock	485	28,154
		<u>6,164,455</u>
<b>Drugs &amp; Health Care</b>		
Dynacq International, Inc. Common Stock	2,250	26,190
Health Care Solutions, Subordinated Debt with Warrants #@	3,677,572	3,549,000
Integrated Physician Solutions, Inc. Convertible Preferred Stock #@	823,000	3,196,900
Integrated Physician Solutions, Subordinated Debt with Warrants #@	267,448	267,448
KV Pharmaceutical, Inc. Common Stock	1,660	31,374
Medical Action Industries, Inc. Common Stock	2,470	29,297
Merit Medical Services, Inc. Common Stock	1,420	27,420
National Rehabilitation Partners, Inc. Convertible Preferred Stock #@	2,245,603	1,461,365
Orthodontic Centers of America, Inc. Common Stock	2,450	26,215
U.S. Physical Therapy, Inc. Common Stock	2,770	29,224
		<u>8,644,433</u>
<b>Miscellaneous</b>		
Action Performance Companies, Inc. Common Stock	1,160	29,812
American Woodmark Corporation Common Stock	575	29,176
Avocent Corporation Common Stock	1,357	18,157
Buca, Inc. Common Stock	3,430	27,440
Fossil, Inc. Common Stock	1,420	28,471
ITT Educational Services, Inc. Common Stock	1,620	30,407
K-Swiss, Inc. Common Stock	1,280	27,354
Streamline Foods, Inc. Convertible Preferred Stock #@	925,072	699,941
Streamline Foods, Inc. Subordinated Debt with Warrants #@	95,000	95,000
Triad Guarantee, Inc. Common Stock	880	30,642
Value Creation Partners, Inc. Convertible Preferred Stock #@	304,989	2,226,069
Waterlink, Inc. Warrants	53,550	

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		3,242,469
<hr/>		
<b>Oil</b>		
GulfMark International, Inc. Common Stock	1,600	27,680
Petroleum Partners, Inc. Convertible Preferred Stock #@	825,000	1,450,000
Petroleum Partners, Inc. Subordinated Debt with Warrants #@	1,953,125	1,875,781
		<hr/>
		3,353,461
<hr/>		
<b>Retail Trade</b>		
Fitness Quest, Inc. Convertible Preferred Stock *#@	1,468,602	\$ 7,369,722
Fitness Quest, Subordinated Debt with Warrants #@	181,172	1,246,742
Hibbett Sporting Goods, Inc. Common Stock	1,310	27,183
		<hr/>
		8,643,647
<hr/>		
<b>Total Investments (Cost \$30,988,583)</b>		<b>\$62,548,465</b>
		<hr/>

All investments are U.S. companies

\* Represents 5% or more of total stockholders equity

# Represents privately held securities which are considered illiquid.

@ Represents more than 5% but less than 25% of the voting class of securities.

The accompanying notes to the financial statements are an integral part of these statements.

**Table of Contents****BRANTLEY CAPITAL CORPORATION****NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)****1. Significant Accounting Policies**

The interim financial statements have been prepared by Brantley Capital Corporation ( the Company ) pursuant to the rules and regulations of the Securities and Exchange Commission applicable to quarterly reports on Form 10-Q. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although management believes that the disclosures are adequate to make the information presented not misleading. These financial statements should be read in conjunction with the audited financial statements and related notes and schedules included in the Company's 2001 Annual Report filed on Form 10-K dated December 31, 2001.

The unaudited financial statements reflect, in the opinion of management, all adjustments, all of which are of a normal recurring nature, necessary to present fairly the financial position of the Company as of September 30, 2002, the results of its operations for the quarter ended September 30, 2002, the results of its operations for the nine months ended September 30, 2002, and its cash flows for the nine months ended September 30, 2002. Interim results are not necessarily indicative of results to be expected for a full fiscal year.

Privately placed securities are carried at fair value as determined in good faith by or under the direction of the Board of Directors. Generally, the fair value of each security will initially be based primarily upon its original cost to the Company. Cost will be the primary factor used to determine fair value on an ongoing basis until significant developments or other factors affecting the investment (such as results of the portfolio company's operations, changes in the general market conditions, subsequent financings or the availability of market quotations) provide a basis for value other than cost valuation.

Portfolio investments listed on an exchange or traded on NASDAQ National Market are valued at the closing price listed on their respective exchange or system on the date of valuation. Securities traded in the over-the-counter market will be valued on the average of the closing bid and asked prices on the day of valuation.

Debt securities with 60 days or less remaining to maturity will be valued at amortized cost.

**2. Investments, Cash and Cash Equivalents**

As of September 30, 2002 and December 31, 2001, the identified costs of investments were \$30,988,583 and \$40,292,851, respectively.

Cash equivalents consist of highly liquid investments with insignificant interest rate risk and original maturities of three months or less at acquisition date. Cash and cash equivalents consisted of the following:

	<b>September 30, 2002 (Unaudited)</b>	<b>December 31, 2001 (Audited)</b>
Cash	\$ 151,440	\$5,369,345
Restricted Cash	\$6,000,000	\$6,000,000

For the nine months ended September 30, 2002, the Company made the following investments in portfolio companies owned more than 5%.

Prime Office Products, Inc.	\$ 480,000
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Health Care Solutions, Inc.	1,250,000
Streamline Foods, Inc.	795,000
Petroleum Partners, Inc.	625,000

**Table of Contents****BRANTLEY CAPITAL CORPORATION****NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED) (Continued)****3. Investment Advisory Agreement**

The Company has entered into an investment advisory agreement (the "Investment Advisory Agreement") with Brantley Capital Management, L.L.C. (the "Investment Adviser") under which the Investment Adviser is entitled to an annual management fee of 2.85% of the Company's net assets, determined at the end of each calendar quarter, and payable quarterly in arrears throughout the term of the Investment Advisory Agreement. For the three and nine months ended September 30, 2002, the Investment Adviser earned \$483,280 and \$1,419,601 respectively under the Investment Advisory Agreement. Certain officers of the Company are also officers of the Investment Adviser. No officer of the Investment Adviser receives any compensation from the Company for serving as officer of the Company.

**4. Financial Highlights**

	For the nine months ended September 30, 2002	For the nine months ended September 30, 2001
Net Asset Value, Beginning of the Period	\$ 17.85	\$ 13.63
Income from investment operations:		
Net investment loss	(0.26)	(0.23)
Net realized and unrealized gain (loss) on investments	(0.02)	0.69
Total from investment operations	(0.28)	0.46
Less Distributions:		
Distributions from net investment income		
Net Asset Value, End of Period	\$ 17.57	\$ 14.09
Market Value, End of Period	\$ 8.76	\$ 8.42
Total return, at Market Value	(19.56)%(1)	(2.37)%(1)
Total return, at Net Asset Value	(1.57)%(1)	3.37%(1)
Total Expenses/ Average net assets	5.32%(2)	5.37%(2)
Net Investment Income/ Average net assets	(1.49)%(2)	(2.20)%(2)

(1) Not annualized.

(2) Annualized.

**5. Recent Developments**

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On September 25, 2002, Phillip Goldstein, a director and shareholder of the Company filed a lawsuit in the District Court for the Northern District of Ohio against us, Robert Pinkas, James Oliver, Benjamin Bryan and IVS Associates, Inc. alleging, among other things, that the Company engaged in wrongdoing and that the individual defendants breached their fiduciary duties during the Annual Meeting of Stockholders held on September 17, 2002. Mr. Goldstein alleges that the Company's actions surrounding the closing of the polls disenfranchised certain shareholders. Mr. Goldstein is seeking to have votes for which he has proxies, which were submitted after the polls were closed, counted. He also seeks an order declaring his nominees to be directors of the Company. The Company has answered the complaint and denied any violations. The Company also asserted a counterclaim against Mr. Goldstein alleging violations of the proxy rules and the failure to disclose his participation in a group as required by Regulation 13D. Mr. Goldstein has denied the allegations of the counterclaims. Mr. Goldstein's motion for a temporary restraining order was denied, and there is a hearing for a preliminary injunction scheduled for November 18, 2002.

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**BRANTLEY CAPITAL CORPORATION**

**NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

On October 8, 2002, Thomas Kornfeld and Robert Strougo filed a purported class action lawsuit against the Company, the directors of the Company excluding Phillip Goldstein, IVS Associates, Inc. and JMP Securities LLC, alleging a series of derivative and direct claims that the directors have breached their fiduciary duties and that the Company engaged in wrongdoing with respect to the Annual Meeting of Stockholders held on September 17, 2002. The factual allegations are substantially similar to the complaint filed by Mr. Goldstein and also include allegations of conversion of corporate funds. The complaint seeks, among other things, an order declaring Mr. Goldstein's nominees to be directors of the Company, an order declaring that the investment advisory agreement be terminated and damages for breach of fiduciary duty.

We believe that both of these lawsuits are without merit, and we intend to defend the lawsuits vigorously. While we do not expect these matters to materially affect our financial condition or results of operations, there can be no assurance as to whether these matters will have a material adverse effect on our financial condition or results of operations in any future reporting period.

On October 4, 2002, the Company received notice from the Midwest Regional Office ( MRO ) of the SEC that they were inquiring into activities involving the Annual Meeting. The Company has and will cooperate with the inquiry. The letter from the MRO states that the inquiry should not be construed as an indication by the staff of that office that any violation of law has occurred, or as a reflection upon any person or entity that may be involved.



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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*General Overview*

We are a non-diversified investment company that is regulated as a business development company under the Investment Company Act of 1940. We provide equity and long-term debt financing to small and medium-sized private companies in a variety of industries throughout the United States. In addition, we invest a portion of our assets in small-capitalization public companies. Our investment objective is to achieve long-term capital appreciation in the value of our investments and to provide current income primarily from interest, dividends and fees paid by our portfolio companies.

Historically, we have focused our investing activities on private equity securities. We generally structure our private equity investments as participating preferred stock with an 8% to 10% dividend yield that accumulates and is paid upon a liquidity event. Our private equity investments typically range from \$1 million to \$5 million, and we generally expect these investments to achieve liquidity within four to seven years although there is no assurance they will do so. We typically do not receive a cash return on our private equity investments until a liquidity event occurs, but instead seek to achieve long-term capital appreciation in net asset value through such investments.

We have explored various strategic alternatives to enhance our growth and stockholders' value. We determined that operating at our current size or attempting to realize premature liquidity events within our portfolio would not enhance the market value of our common stock and would limit our ability to generate recurring income sought by the investment community and our stockholders. Specifically, we have been exploring the possibility of expanding our origination of mezzanine investments. Shares of business development companies that invest primarily in mezzanine investments tend to trade at a premium to net asset value per share due to the expectation of current income produced by such investments. There can be no assurance that our shares will trade at a premium to net asset value. We believe that current market conditions, influenced by more stringent credit standards of commercial banks and more conservative capital structures sought by entrepreneurs and equity sponsors, have created an increased demand for mezzanine investments.

Mezzanine investments would be expected to provide a current cash return to us in the form of interest and origination fees. We typically participate in any increase in the equity value of the companies to whom we provide mezzanine financing through warrants or other equity rights. We anticipate that mezzanine investments would provide less potential for appreciation in our net asset value than private equity investments, but would instead provide higher current income that may be distributed to our stockholders. In the future, we may also seek to further leverage our portfolio by utilizing additional borrowings to fund our investments.

In order to fund the origination of mezzanine investments, we are exploring various capital-raising alternatives. We intend to use the proceeds of such an event to make mezzanine investments. We can make no assurances that a capital raising effort will be undertaken or that any of our portfolio companies would experience a liquidity event. We can also make no assurances that our plan to expand our origination of mezzanine investments will be consummated or be successful.

On June 4, 2002 the Company announced that it had received board approval to pursue a preliminary plan to raise capital for the purpose of expanding its origination of mezzanine investments. As part of the plan, we intend to initiate a rights offering to stockholders where each stockholder will receive a right to purchase one new share of the Company's common stock for every three shares of common stock that a stockholder owns. The right would entitle the holder to purchase the share of common stock at a discount to the market price. Based on the current number of shares outstanding, the plan would increase the outstanding shares by up to 1.27 million shares. The subscription price and the record date for the distribution of the rights have not been determined. We anticipate that the rights will be transferable and will be admitted for trading on the Nasdaq National Market. There can be no assurance that a market for the rights will develop. We intend to file a registration statement with the Securities and Exchange Commission, which will be subject to review.

In addition to the rights offering, we have applied for inclusion in the Small Business Investment Company program of the Small Business Administration (the "SBA"). If granted, we would be eligible for debt financing from the SBA at an amount up to two times the equity financing expected from the rights offering. We have filed an application with the SBA, which will be subject to review. There can be no assurance that we will be able to obtain a license to operate an SBIC or that we will be able to obtain leverage from the SBA.

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*Certain Accounting Policies*

Privately placed equity and mezzanine securities are carried at fair value as determined in good faith by our board of directors. Initially, the fair value of each such security is based upon its original cost. Cost is also the primary factor used to determine fair value on an ongoing basis until significant developments or other factors affecting the investment (such as results of subsequent financings, the availability of market quotations, the portfolio company's operations and changes in general market conditions) provide a basis for value other than cost. Portfolio investments listed on a securities exchange or traded on the Nasdaq Stock Market are valued at the closing price listed on the relevant exchange or quotation system on the date of valuation. Securities traded in the over-the-counter market are valued based on the average of the closing bid and asked prices on the date of valuation.

Origination fees are recognized as income during the period in which they are received. Interest income is recorded on mezzanine investments when the payment is contractually due unless a loan is more than 30 days past due. Interest is not accrued on any loans that are more than 30 days past due.

We account for our operations utilizing accounting principles generally accepted in the United States for investment companies. On this basis, the principal measure of our financial performance is captioned Net change in net assets resulting from operations, which is the sum of two elements. The first element is Investment income (loss), net, which is the difference between (1) our income from interest, dividends and fees, and (2) our operating expenses. The second element is Net gain (loss) on investment transactions, which is the sum of (1) the difference between the proceeds received from our dispositions of portfolio securities and their stated cost ( Net realized gain (loss) on investments ), and (2) the net change in the fair value of our investment portfolio ( Net unrealized gain (loss) on investments ). Net realized gain (loss) on investments and Net unrealized gain (loss) on investments are directly related. For example, in the period during which a security is sold to realize a gain, net unrealized gain on investments decreases, and net realized gain on investments increases.

Historically, we have focused our investing activities on private equity securities. We began making such investments in 1997 and are now entering into a phase of the business plan which emphasizes positioning our more mature portfolio companies for appropriate liquidity events. As a result, we are continually monitoring portfolio company results and evaluating opportunities to maximize the valuation of our investments. In that regard, we periodically evaluate potential acquisitions, financing transactions, initial public offerings, strategic alliances, and sale opportunities involving our portfolio companies. Any such transaction could have an impact on the valuation of our investments. These transactions and activities are generally not disclosed to our stockholders and the investing public until such time as the transactions are publicly announced or completed, as the case may be.

**Results of Operations**

*Dividend and Interest Income*

Dividend and interest income on investments for the three months ended September 30, 2002 and 2001 was \$697,184 and \$391,034. Dividend and interest income on investments for the nine months ended September 30, 2002 and 2001 was \$1,687,902 and \$1,244,915, respectively. The increase in interest and dividend income during the three and nine months ended September 30, 2002 was primarily because of the ongoing increase in the private equity and mezzanine portfolio which generates higher dividend and interest income.

*Operating Expenses*

Total operating expenses during the three months ended September 30, 2002 and 2001 were \$1,252,666 and \$797,210 respectively. The significant components of total operating expenses were advisory fees of \$483,280 and \$401,335 earned by our investment adviser and professional fees of \$567,915 and \$135,859 during the three months ended September 30, 2002 and 2001, respectively. The increase in total operating expenses was primarily due to the increase of \$81,954 in the advisory fees resulting from the increase in net assets and the increase of \$432,056 in professional fees which is primarily related to contested matters involving the Annual Meeting of Stockholders, ongoing litigation challenging the certified results of the Annual Meeting of Stockholders, and counsel retained for the independent directors in connection with certain matters regarding the Advisor.

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Total operating expenses during the nine months ended September 30, 2002 and 2001 were \$2,692,819 and \$2,105,885, respectively. The significant components of total operating expenses were advisory fees of \$1,419,601 and \$1,124,410 earned by our investment adviser and professional fees of \$666,437 and \$287,358 during the nine months ended September 30, 2002 and 2001, respectively. The increase in total operating expenses was primarily due to the increase of \$295,191 in the advisory fees resulting from the increase in net assets and the increase of \$379,079 in professional fees which is primarily related to contested matters involving the Annual Meeting of Stockholders, ongoing litigation challenging the certified results of the Annual Meeting of Stockholders, and counsel retained for the independent directors in connection with certain matters regarding the Advisor.

*Net Realized and Unrealized Gains on Investment Transactions*

During the three months ended September 30, 2002 and 2001, valuation of our equity and mezzanine investments resulted in net realized and unrealized losses on investments of (\$272,956) and (\$1,316,867). During the nine months ended September 30, 2002 and 2001, valuation of our equity and mezzanine investments resulted in net realized and unrealized gains (losses) on investments of (\$65,098) and \$2,623,853, respectively. At September 30, 2002, and 2001, we had investments in eleven privately-held companies, as well as in various small-capitalization public stocks which are subject to general stock market and business conditions. The unrealized gains (losses) during such periods were significantly influenced by general stock market and business conditions as well as the June 30, 2001 financing transaction of Flight Options International, Inc. as more fully described under Financial Conditions, Liquidity and Capital Resources .

**Financial Condition, Liquidity and Capital Resources**

At September 30 2002 and December 31, 2001, we had \$151,440 and \$5,369,345, respectively, in cash and cash equivalents which were primarily invested in overnight securities. Restricted cash is held under direction of our lender and is not readily available to fund investments or pay operating expenses. Our management believes that proceeds from our investments will provide us with the liquidity necessary to pay our operating expenses. However, in order to execute our mezzanine investment plan, we will continue to seek opportunities to raise additional capital in the form of debt or equity.

At September 30, 2002 and December 31, 2001, we had stockholders' equity of \$67,323,299 and \$68,006,314, respectively, resulting in net asset values per share of \$17.67 and 17.85 respectively. At September 30, 2002, we had \$6,000,000 of outstanding indebtedness. For the nine months ended September 30, 2002, the weighted average interest rate on this indebtedness was 4.75%.

Brantley Venture Partners II, L.P., Brantley Venture Partners III, L.P. and Brantley Partners IV, L.P. hold, in the aggregate, approximately \$211 million of private equity investments. These partnerships are related to our investment adviser in a manner that required the receipt, from the Securities and Exchange Commission, of an exemption from certain provisions of the Investment Company Act of 1940 in order to permit us, under certain circumstances, to invest in the same portfolio companies as the other private investment funds managed by our investment adviser.

At September 30, 2002 and December 31, 2001, the aggregate cost of the investments we made to date was \$31.0 million and \$28.9 million, respectively, and their aggregate market value was \$62.5 million and \$60.3 million, respectively, for an aggregate fair value appreciation of 102% and 109%, respectively. Our management believes that our portfolio companies have significant potential for long-term growth in sales and earnings.

Since the completion of our initial public offering, our management has focused its investment activities on securing new investments for our portfolio. However, given the nature of our current portfolio and the fact that this portfolio as a whole is maturing, our management is seeking to position the more mature portfolio companies for appropriate liquidity events. We are continuously monitoring portfolio company results and evaluating opportunities to maximize the value of our investments. In that regard, we periodically evaluate potential acquisitions, financing transactions, initial public offerings, strategic alliances and sale opportunities involving our portfolio companies. These transactions and activities are generally not disclosed to our stockholders and the investing public until such time as the transactions are publicly announced or completed, as the case may be. Any such transaction could have an impact on the valuation of our investments. However, these revised valuations would generally not be adjusted until the transaction is publicly announced or completed.

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*Private Portfolio Company Investments*

Our individually significant equity and mezzanine investments at September 30, 2002 are described in more detail below:

*Disposable Products Company, LLC*

On August 10, 1998, we entered into an investment led by Banc One Capital to provide \$1.0 million of a \$3.0 million subordinated debt facility with warrants for Disposable Products Company, LLC. Disposable Products is an acquisition strategy company in the business of manufacturing and converting paper and non-woven materials into wiping products for sale to commercial, institutional, industrial and government markets. In addition, Disposable Products is a converter and reseller of other safety and industrial/janitorial products. Proceeds of the transaction were used to complete Disposable Products' first acquisition. The terms of the debt facility call for a 12% interest rate per annum with a final maturity in 2003. We also received a detachable capital stock purchase warrant exercisable for 5% of the fully-diluted capital stock of Disposable Products at the time of exercise at a nominal exercise price. On January 26, 2001, we funded a \$166,667 12% promissory note from Disposable Products. In addition, through September 30, 2002 we funded additional 12% promissory notes of \$1,270,534 from Disposable Products.

*Fitness Quest, Inc.*

On December 16, 1997, we funded a \$1.35 million commitment to invest with Brantley Venture Partners III, L.P. in a \$3.85 million preferred stock issue for Fitness Quest, Inc. As a result, we purchased approximately 788,961 shares of Fitness Quest Series A 10% Convertible Preferred Stock at \$1.71 per share. Fitness Quest is a direct marketing and distribution company. The proceeds were used by Fitness Quest for a management buy-out of the company from its previous owner, The Time Warner Music Group, a 100% wholly owned subsidiary of Time Warner, Inc., and for other acquisitions. Fitness Quest has been in the fitness promotional products business since 1994. Fitness Quest operates in a highly competitive industry and is dependent on the management talent and efforts of key personnel for its success. We do not believe that Fitness Quest is dependent on a single or small number of customers, possesses significant intellectual property, or is operating in an unusually regulated industry.

During 1997, Fitness Quest increased its revenue and improved its operating margins and profits. After a complete evaluation, our board of directors re-valued our Fitness Quest investment to \$5,440,000, resulting in a 1997 unrealized gain of \$4,090,000. This evaluation was based on price to earnings ratios, cash flow multiples and other appropriate financial measurements of similar private companies. In addition to the above Series A 10% Convertible Preferred Stock, we funded \$1,751,300 to invest with Brantley Venture Partners III, L.P. in a \$3.5 million 10% senior subordinated debt investment in Fitness Quest in 2000. In addition, we received a warrant to purchase 181,172 shares of Fitness Quest common stock for \$0.01 per share.

The proceeds of the most recent investment were used to fund Fitness Quest's working capital needs. During the fourth quarter of 2000, we exchanged the senior subordinated debt investment and related unpaid interest for 679,641 shares of Fitness Quest common stock.

*Flight Options International, Inc. (Formerly Corporate Wings, Inc.)*

On December 23, 1997, we funded \$2.1 million to invest with Brantley Venture Partners III, L.P. in a \$6.0 million preferred stock issue for Flight Options International, Inc. Our investment consists of approximately 2,576,000 shares of Flight Options Series A 8% Convertible Preferred Stock at \$0.8152 per share. Flight Options provides complete private air travel service through the sale of fractional interests in pre-owned jet aircraft. The proceeds of the transaction were used by Flight Options to continue to execute an acquisition strategy. We believe Flight Options is one of the top five providers of fractional interests in aircraft in the United States, a highly competitive industry and is dependent on the management talent and efforts of key personnel for its success. Flight Options is subject to certain regulations of the Federal Aviation Administration. We do not believe it is dependent on a single or small number of customers or possesses significant intellectual property.

On December 29, 1998, we completed a second private equity investment in Flight Options. In this investment, we purchased \$962,500 of a \$5.5 million preferred stock transaction led by The Provident Bank. Our

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purchase represents approximately 260,135 shares of Class A 8% Convertible Preferred Stock at \$3.70 per share. The proceeds were used by Flight Options to fund the expansion of its fractional ownership program and to continue to execute its acquisition strategy. During 1998, Flight Options completed the acquisition of Miller Aviation. Based upon the price of this subsequent financing and the operating performance of Flight Options during 1998, the fair value of our original investment was increased to \$9,531,760, resulting in an unrealized gain of \$7,431,760. This valuation was based on the \$3.70 per share price negotiated by The Provident Bank and was approved by our board of directors.

On August 31, 1999, Flight Options sold \$20 million of Series B 8% Preferred Stock to a third party private equity group at \$4.365 per share. Consistent with our investment valuation guidelines, this transaction resulted in a valuation increase on our Flight Options investment of \$1,886,030 or \$0.50 per share.

On July 11, 2000, we guaranteed a portion of Flight Options third-party borrowings. As a result, we were issued a warrant to purchase 36,000 shares of Flight Options common stock at a price of \$0.01 per share. This guarantee was terminated prior to December 12, 2000.

On December 12, 2000 we purchased 469,925 shares of Flight Options Class C 8% Preferred Stock at \$5.32 per share for a total investment of \$2.5 million. The proceeds of the transaction were used by Flight Options to fund the continued expansion of its fractional ownership program.

On June 30, 2001, Flight Options received offers from institutional investors to purchase convertible preferred stock or subordinated debt securities of Flight Options which support the valuation used to complete the December 12, 2000 Class C 8% Preferred Stock transaction described in the preceding paragraph. As a result, and consistent with our investment valuation guidelines, our board of directors approved a valuation increase on the Flight Options investment which resulted in our reporting an unrealized gain of \$2,742,889 or \$0.72 per share for the quarter ended June 30, 2001.

On December 21, 2001, Flight Options, Inc. and Raytheon Travel Air, a Wichita, Kansas-based unit of Raytheon Company, a Lexington, Mass. based defense contractor, agreed to combine operations into one fractional aircraft ownership program to be known as Flight Options. Under the terms of the transaction, Flight Options, Inc. holds 50.1% ownership of the new business with Raytheon holding 49.9%. The transaction was completed during the quarter ended March 31, 2002.

As a result of the transaction described above, our board of directors met to review the terms of the transaction including, among other things, a valuation review prepared by an investment banking firm working on the transaction. Consistent with our valuation guidelines, the board used a private market method to value our investment in Flight Options, Inc. and approved an increase in the value of our investment in Flight Options, Inc. to \$32.5 million. At September 30, 2002, the financial statement value of our investment in Flight Options represents an increase of more than 484% from its original purchase price. The commentary above reflects a four-for-one stock split executed in 2000. All share and per share amounts have been adjusted to reflect such stock split.

*Health Care Solutions, Inc.*

On September 30, 1997, we funded a \$1.5 million convertible junior subordinated promissory note facility for Health Care Solutions, Inc. Health Care Solutions is an acquisition strategy company in the home healthcare services market with a strong presence in the Midwest and Great Lakes regions. The terms of the notes called for an 18% interest rate per annum during the first year and 12% per annum thereafter, with final maturity two years from the closing. After the first year, the notes were convertible into common stock at a price of \$3.50 per share.

In connection with our commitment to provide this facility, we received warrants to purchase up to \$450,000 of common stock valued at an exercise price of 10% of an initial public offering price completed during the term of the notes, or at \$3.50 per share should the warrants be exercised other than in connection with an initial public offering. The warrants are currently exercisable. The proceeds of the notes were used by Health Care Solutions to help finance acquisitions.

In 2000, Health Care Solutions completed a re-capitalization plan, including a two-for-one reverse stock split. As a result, we agreed to exchange our convertible junior subordinated promissory note and accrued interest thereon for 246,994 shares of Series C 8% Convertible Preferred Stock at an exchange rate of \$7.50 per share.

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The warrants to purchase up to \$450,000 of common stock at an exercise price of 10% of an initial public offering price or at \$3.50 per share remain outstanding and have been adjusted to reflect the reverse stock split.

In addition to the above Series C 8% Convertible Preferred Stock, we funded \$500,000 and \$299,000 12% Convertible Subordinated Notes from Health Care Solutions in 2000. As part of this transaction, we received a warrant to purchase up to \$50,000 of Health Care Solutions common stock at an exercise price equal to the lower of the price determined by an initial public offering or \$7.50 per share. On March 7, 2001, we agreed to exchange the \$500,000 Convertible Subordinated Note for 71,880 shares of Series D Convertible Preferred Stock. On January 29, 2002, we funded a \$1,250,000 12% Convertible Subordinated Note from Health Care Solutions.

*The Holland Group, Inc.*

On July 13, 2000, we funded a \$2.1 million commitment to invest with Brantley Partners IV, L.P. in a \$8.5 million preferred stock issue of The Holland Group, Inc. The Holland Group is a provider of temporary staffing and human resource management services that currently operates 35 branches in five states. In this transaction, we purchased 282,530 shares of The Holland Group's Series A 8% Convertible Preferred Stock. In February 2002 we purchased a \$50,000 12% convertible subordinated note from The Holland Group.

*National Rehab Partners, Inc.*

On August 10, 1999, we funded \$1.4 million of a \$1.5 million commitment to invest with Brantley Partners IV, L.P. and a third party equity group in a \$12.0 million preferred stock issue for National Rehab Partners, Inc. Pursuant to this commitment, we purchased 2.2 million shares of Class A 8% Convertible Preferred Stock. The proceeds of this transaction were used to complete the acquisition of a group of rehabilitation management service providers. The remainder of the commitment is being funded upon the successful closing of additional acquisitions. National Rehab Partners is a Brentwood, Tennessee rehabilitation management service company providing rehabilitation services through acute care hospitals and hospital systems throughout the United States. National Rehab Partners is the only national rehabilitation company focused exclusively on helping hospitals develop their outpatient rehabilitation services.

On January 10, 2001, we funded a \$26,126 10% promissory note from National Rehab Partners. On June 13, 2001, the \$26,126 note and the related accrued interest were cancelled and replaced with a \$27,228 10% promissory note.

*Integrated Physician Solutions, Inc. (Formerly Pediatric Physicians Alliance, Inc.)*

On January 28, 1999, we funded a \$3.2 million commitment to invest with Brantley Venture Partners III, L.P. in a \$7.9 million preferred stock issue for Integrated Physician Solutions, Inc. Pursuant to our commitment, we purchased 793,000 shares of Class A-2 10% Convertible Preferred Stock. Integrated Physician Solutions is a physician practice management systems provider. Their objective is to develop the leading integrated physician practice management system in the United States. Integrated Physician Solutions is dependent on the management talent and effort of key personnel for its success in this highly competitive industry. We do not believe it is dependent on a single or small number of customers, possesses significant intellectual property or that it is subject to significant regulations. The proceeds of the transaction were used to complete the acquisition of a number of physician practices.

In addition to the above Class A-2 10% Convertible Preferred Stock, in 2000 we funded \$267,448 to invest with Brantley Venture Partners III, L.P. in \$668,619 of promissory notes, with detachable warrants, in Integrated Physician Solutions. The detachable warrants are for the purchase of 30,000 shares of Integrated Physician Solutions common stock at \$4.00 per share.

*Petroleum Partners, Inc.*

On June 7, 2001, we entered into a \$2.7 million commitment to invest with Brantley Partners IV, L.P. in a \$15.0 million preferred stock and subordinated debt issue for Petroleum Partners, Inc. In connection with this commitment, we purchased 250,000 shares of Class A 8% Convertible Preferred Stock at \$1.00 per share, 600,000 shares of Class B 8% Convertible Preferred Stock at \$2.00 per share, and funded a \$1,250,000 10% Convertible Subordinated Note with a detachable warrant for the purchase of 78,125 shares of common stock at

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\$0.01 per share. Petroleum Partners, based in Cleveland, Ohio, is a provider of outsourced maintenance services to the petroleum industry's retailers and refineries. The proceeds from the transaction were used to acquire a company which is a leading provider of petroleum and petrochemical handling equipment and outsourced facilities maintenance services to providers of fuel delivery systems such as gasoline retailers and refineries. The equipment distributed by the company includes petroleum storage tanks, pumps, fuel dispensers, flexible piping, tank valves, leak detection gauges, canopies, air compressors and service station lighting equipment.

In addition to the above investment, we funded \$1,875,000 of 10% Convertible Subordinated through September 30, 2002. The proceeds of the notes were used for operating purposes.

### *Prime Office Products, Inc. (Formerly Business Essentials, Inc.)*

On April 22, 1999, we entered into a \$1.7 million commitment to invest with Brantley Partners IV, L.P. and Massey Burch Capital Corp. in a \$10.0 million preferred stock issue for Prime Office Products, Inc. Pursuant to our commitment, we purchased 510,000 shares of Class A 8% Convertible Preferred Stock at \$2.00 per share. Prime Office Products is an office products marketing and distribution company based in Nashville, Tennessee. The first part of the commitment was funded to launch an acquisition strategy focused on office distribution companies serving primarily commercial and industrial customers. The remainder of the commitment is being funded upon the closing of additional acquisitions. On January 8, 2002, we purchased an additional 200,000 shares of Class A 8% Convertible Preferred Stock at \$2.00 per share. On July 31, 2002, we purchased an additional 40,000 shares of Class A 8% Convertible Preferred Stock at \$2.00 per share.

### *Streamline Foods, Inc.*

On February 7, 2002 we funded a \$795,000 commitment to invest with Brantley Partners IV, L.P. in a \$7,950,000 preferred stock and subordinated debt issue for Streamline Foods, Inc. Pursuant to our commitment we purchased approximately 898,000 shares of Series A 8% Convertible Preferred Stock at \$0.78 per share and a \$95,000 13% Convertible Subordinated Note with warrants to purchase 27,500 shares of common stock at \$0.01 per share. The proceeds were used by Streamline Foods for a buy-out of the Company from its previous owner. Streamline Foods, Inc. sources, blends, packages and distributes high sugar content food products for branded multi-national food companies and private label manufacturers.

### *Value Creation Partners, Inc.*

On June 14, 2000, we completed a \$2.1 million commitment to invest with Brantley Partners IV, L.P. and several other private equity investors in a \$23.8 million preferred stock issue for Value Creation Partners, Inc. Pursuant to this commitment, we purchased approximately 35,000 shares and 269,989 shares of 8% Convertible Preferred Stock at \$5.00 and \$7.30 per share, respectively. Value Creation Partners is an acquisition strategy company in the food industry. The proceeds of the transaction were used to complete the acquisition of Best Brands, Inc., one of the six largest manufacturers and distributors of a complete line of premium ingredients, mixes and products, including equipment, for all segments of the baking industry. Their products are sold primarily to retail bakeries, bakery distributors, supermarket in-store bakeries, food wholesalers and food service establishments.

## **Small-Capitalization Public Equity Investments**

The small-capitalization public companies in which we had an investment at September 30, 2002 are listed in the Statement of Investments. Subsequent to the end of the quarter we completed a process of liquidating the small-capitalization public equity portfolio.

## **Impact of Inflation**

We do not believe that our business is materially affected by inflation, other than the impact that inflation may have on the securities markets, the valuations of business enterprises and the relationship of such valuations to underlying earnings, all of which will influence the value of our investments.

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### **Recent Developments**

On September 25, 2002, Phillip Goldstein, a director and shareholder of the Company filed a lawsuit in the District Court for the Northern District of Ohio against us, Robert Pinkas, James Oliver, Benjamin Bryan and IVS Associates, Inc. alleging, among other things, that the Company engaged in wrongdoing and that the individual defendants breached their fiduciary duties during the Annual Meeting of Stockholders held on September 17, 2002. Mr. Goldstein alleges that the Company's actions surrounding the closing of the polls disenfranchised certain shareholders. Mr. Goldstein is seeking to have votes for which he has proxies, which were submitted after the polls were closed, counted. He also seeks an order declaring his nominees to be directors of the Company. The Company has answered the complaint and denied any violations. The Company also asserted a counterclaim against Mr. Goldstein alleging violations of the proxy rules and the failure to disclose his participation in a group as required by Regulation 13D. Mr. Goldstein has denied the allegations of the counterclaims. Mr. Goldstein's motion for a temporary restraining order was denied, and there is a hearing for a preliminary injunction scheduled for November 18, 2002.

On October 8, 2002, Thomas Kornfeld and Robert Strougo filed a purported class action lawsuit against the Company, the directors of the Company excluding Phillip Goldstein, IVS Associates, Inc. and JMP Securities LLC, alleging a series of derivative and direct claims that the directors have breached their fiduciary duties and that the Company engaged in wrongdoing with respect to the Annual Meeting of Stockholders held on September 17, 2002. The factual allegations are substantially similar to the complaint filed by Mr. Goldstein and also include allegations of conversion of corporate funds. The complaint seeks, among other things, an order declaring Mr. Goldstein's nominees to be directors of the Company, an order declaring that the investment advisory agreement be terminated and damages for breach of fiduciary duty.

We believe that both of these lawsuits are without merit, and we intend to defend the lawsuits vigorously. While we do not expect these matters to materially affect our financial condition or results of operations, there can be no assurance as to whether these matters will have a material adverse effect on our financial condition or results of operations in any future reporting period.

On October 4, 2002, the Company received notice from the Midwest Regional Office ( MRO ) of the SEC that they were inquiring into activities involving the Annual Meeting. The Company has and will cooperate with the inquiry. The letter from the MRO states that the inquiry should not be construed as an indication by the staff of that office that any violation of law has occurred, or as a reflection upon any person or entity that may be involved.

### **Disclosure Regarding Forward-Looking Statements**

Information contained in this Quarterly Report on Form 10-Q may contain forward-looking statements which can be identified by the use of forward-looking terminology such as may, will, expect, intend, anticipate, estimate or continue or the negative thereof or other variations of similar words or phrases. The matters described throughout this Quarterly Report on Form 10-Q and in any exhibits of which this Quarterly Report is a part constitute cautionary statements identifying important factors with respect to any such forward-looking statements, including certain risks and uncertainties, that could cause actual results to differ materially from those in such forward-looking statements.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

We invest in small and medium-sized companies, and our investments are considered speculative in nature. Our investments often include securities that are subject to legal or contractual restrictions on resale that adversely affect the liquidity and marketability of such securities. As a result, we are subject to risk of loss which may prevent our stockholders from achieving price appreciation and dividend distributions.

The portion of our portfolio consisting of investments in private companies is also subject to valuation risk. We value our privately held investments based on a determination of their fair value made in good faith by our board of directors on a quarterly basis in accordance with our established guidelines. In the absence of a readily ascertainable market value, the estimated values of our investments may differ significantly from the values that would exist if a ready market for these securities existed. Any changes in valuation are recorded in our consolidated statements of operations as Net unrealized gain (loss) on investments.



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We consider the management of equity price risk essential to conducting our business and maintaining our profitability. A portion of our portfolio consists of investments in private companies. We anticipate no impact on these investments from modest changes in public market equity prices. However, should significant changes in market prices occur, there could be a long-term effect on valuations of private companies, which could affect the carrying value and the amount and timing of gains realized on these investments. This could also affect our ability to generate cash through the sale of private equity investments, since there may not be realistic initial public offering opportunities. A portion of our investment portfolio also consists of shares of common stock of small-capitalization public companies. These investments are directly exposed to market price risk.

### **Item 4. Controls and Procedures**

(a) Within the 90-day period prior to the filing date of this quarterly report, the Company's chief executive officer and chief financial officer conducted an evaluation of the Company's disclosure controls and procedures (as defined in Rules 13a-14 and 15d-14 of the Securities Exchange Act of 1934). Based upon this evaluation, the Company's chief executive officer and chief financial officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them of any material information relating to the Company that is required to be disclosed by the Company in the reports it files or submits under the Securities Exchange Act of 1934.

(b) There have not been any significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

On September 25, 2002, Phillip Goldstein, a director and shareholder of the Company filed a lawsuit in the District Court for the Northern District of Ohio against us, Robert Pinkas, James Oliver, Benjamin Bryan and IVS Associates, Inc. alleging, among other things, that the Company engaged in wrongdoing and that the individual defendants breached their fiduciary duties during the Annual Meeting of Stockholders held on September 17, 2002. Mr. Goldstein alleges that the Company's actions surrounding the closing of the polls disenfranchised certain shareholders. Mr. Goldstein is seeking to have votes for which he has proxies, which were submitted after the polls were closed, counted. He also seeks an order declaring his nominees to be directors of the Company. The Company has answered the complaint and denied any violations. The Company also asserted a counterclaim against Mr. Goldstein alleging violations of the proxy rules and the failure to disclose his participation in a group as required by Regulation 13D. Mr. Goldstein has denied the allegations of the counterclaims. Mr. Goldstein's motion for a temporary restraining order was denied, and there is a hearing for a preliminary injunction scheduled for November 18, 2002.

On October 8, 2002, Thomas Kornfeld and Robert Strougo filed a purported class action lawsuit against the Company, the directors of the Company excluding Phillip Goldstein, IVS Associates, Inc. and JMP Securities LLC, alleging a series of derivative and direct claims that the directors have breached their fiduciary duties and that the Company engaged in wrongdoing with respect to the Annual Meeting of Stockholders held on September 17, 2002. The factual allegations are substantially similar to the complaint filed by Mr. Goldstein and also include allegations of conversion of corporate funds. The complaint seeks, among other things, an order declaring Mr. Goldstein's nominees to be directors of the Company, an order declaring that the investment advisory agreement be terminated and damages for breach of fiduciary duty.

We believe that both of these lawsuits are without merit, and we intend to defend the lawsuits vigorously. While we do not expect these matters to materially affect our financial condition or results of operations, there can be no assurance as to whether these matters will have a material adverse effect on our financial condition or results of operations in any future reporting period.

On October 4, 2002, the Company received notice from the Midwest Regional Office ( MRO ) of the SEC that they were inquiring into activities involving the Annual Meeting. The Company has and will cooperate with the inquiry. The letter from the MRO states that the inquiry should not be construed as an indication by the staff

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of that office that any violation of law has occurred, or as a reflection upon any person or entity that may be involved.

**Item 4. Submission of Matters to a Vote of Security Holders**

At the Annual Meeting of Stockholders held on September 17, 2002, there were a total of 2,854,144 shares represented either in person or by proxy. The stockholders elected two directors to the Company's Board of Directors. The stockholders elected James P. Oliver and Benjamin F. Bryan to serve terms expiring in 2007. The certified results of the voting for the election of directors of the Company as certified by IVS Associates Inc. were as follows:

	<u>In Favor</u>	<u>Withheld</u>
James P. Oliver	1,154,517	92,324
Benjamin F. Bryan	1,154,517	92,324
Andrew Dakos	6,000	0
Gerald Hellerman	6,000	0

In addition, the stockholders ratified the selection of KPMG LLP as the Company's independent public accountant for the fiscal year ending December 31, 2002. The results of voting for the ratification of the selection of KPMG LLP as the Company's independent public accountant as certified by IVS Associates Inc. were as follows:

For	1,088,161
Against	149,051
Abstain	15,628

The stockholders also voted down a proposal recommending that the board of directors take action to commence an orderly liquidation of the Company as soon as possible. The results of voting down the proposal as certified by IVS Associates Inc. were as follows:

For	159,929
Against	1,071,407
Abstain	23,071

Finally, the stockholders voted down a proposal to terminate the existing investment advisory agreement and to request the board negotiate a new advisory agreement at a reduced fee. The results of voting down the proposal as certified by IVS Associates Inc. were as follows:

For	217,151
Against	1,012,618
Abstain	23,071

The certified election results have been challenged in two lawsuits. See [Legal Proceedings](#) for a discussion of proceedings related to the Annual Meeting.

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**Item 6. Exhibits and Reports on Form 8-K**

a. Exhibits

**Exhibit 3** Articles of Incorporation and By-laws

- (1) Articles of Amendment and Restatement of the Charter of the Company (Exhibit 3.1 to the Annual Report on Form 10-K filed on March 31, 1999, which exhibit is incorporated herein by reference)
- (2) Amended and Restated Bylaws of the Company (Exhibit 3.2 to the Annual Report on Form 10-K filed on March 31, 1999, which exhibit is incorporated herein by reference)
- (3) Amendment to the Charter of the Company (Exhibit 3.3 to the Registration Statement filed on October 26, 2001, which exhibit is incorporated herein by reference)

**Exhibit 4** Form of Share Certificate (Exhibit 2.d to amendment No. 1 to the Registration Statement filed on October 31, 1996, which exhibit is incorporated herein by reference)

**Exhibit 10** Material Contracts

- (1) Dividend Reinvestment and Cash Purchase Plan (Exhibit 2.e to Amendment No. 3 to the Registration Statement filed on November 26, 1996, which exhibit is incorporated herein by reference)
- (2) Form of Investment Advisory Agreement between the Company and the Investment Adviser (Exhibit 2.g to Amendment No. 3 to the Registration Statement filed on November 26, 1996, which exhibit is incorporated herein by reference)
- (3) Stock Option Plan and Form of Option Grants (Exhibit 2.i.1 to Amendment No. 2 to the Registration Statement filed on November 22, 1996, which exhibit is incorporated herein by reference)
- (4) Disinterested Director Option Plan and Form of Option Grants (Exhibit 2.i.2 to Amendment No. 2 to the Registration Statement filed on November 22, 1996, which exhibit is incorporated herein by reference)
- (5) Form of Custodian Contract (Exhibit 2.j to Amendment No. 2 to the Registration Statement filed on November 22, 1996, which exhibit is incorporated herein by reference)
- (6) Form of Registrar, Transfer Agency and Service Agreement (Exhibit 2.k.1 to Amendment No. 2 to the Registration Statement filed on November 22, 1996, which exhibit is incorporated herein by reference)
- (7) Form of Administration Agreement (Exhibit 2.k.2 to Amendment No. 2 to the Registration Statement filed on November 22, 1996, which exhibit is incorporated herein by reference)
- (8) Form of Indemnification Agreement for Directors and Officers (Exhibit 2.s to Amendment No. 2 to the Registration Statement filed on November 22, 1996, which exhibit is incorporated herein by reference)

**Exhibit 99** Other

- (1) Certificaton Pursuant to 18 U.S.C. 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- (2) Certificaton Pursuant to 18 U.S.C. 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

b. Reports on Form 8-K

A Form 8-K was filed on October 22, 2002 which announced that Brantley Capital Management LLC, the Company's investment advisor (the Advisor) obtained an order from the Securities and Exchange Commission (SEC) declaring that its investment adviser registration had become effective.

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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.

BRANTLEY CAPITAL CORPORATION

Date: November 14, 2002

By: /s/ ROBERT P. PINKAS

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Robert P. Pinkas  
Chairman of the Board and  
Chief Executive Officer

Date: November 14, 2002

By: /s/ TAB A. KEPLINGER

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Tab A. Keplinger  
Vice President and  
Chief Financial Officer

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**CERTIFICATION OF CHIEF EXECUTIVE OFFICER**

I, Robert P. Pinkas, Chief Executive Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Brantley Capital Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: 11/14/02

/s/ ROBERT P. PINKAS

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Robert P. Pinkas  
Chief Executive Officer

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**CERTIFICATION OF CHIEF FINANCIAL OFFICER**

I, Tab A. Keplinger, Chief Financial Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Brantley Capital Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: 11/14/02

/s/ TAB A. KEPLINGER

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Tab A. Keplinger  
Chief Financial Officer