

RAND CAPITAL CORP
Form 10-Q
May 15, 2007

Table of Contents

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

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

For the quarter ended March 31, 2007

**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: 001-08205

Rand Capital Corporation

(Exact Name of Registrant as specified in its Charter)

New York

(State or Other Jurisdiction of Incorporation
or organization)

16-0961359

(IRS Employer
Identification No.)

2200 Rand Building, Buffalo, NY

(Address of Principal executive offices)

14203

(Zip Code)

(716) 853-0802

(Registrant's Telephone No. 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 No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 under the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No
As of May 7, 2007 there were 5,718,934 shares of the registrant's common stock outstanding.

RAND CAPITAL CORPORATION
TABLE OF CONTENTS FOR FORM 10-Q

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements and Supplementary Data (Unaudited)

Consolidated Statements of Financial Position as of March 31, 2007 and December 31, 2006

Condensed Consolidated Statements of Operations for the Three Months Ended March 31, 2007 and 2006

Condensed Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2007 and 2006

Condensed Consolidated Statements of Changes in Net Assets for the Three Months Ended March 31, 2007 and 2006

Condensed Consolidated Schedule of Portfolio Investments as of March 31, 2007

Notes to the Consolidated Financial Statements

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

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Item 4. Controls and Procedures

PART II OTHER INFORMATION

Item 1. Legal Proceedings

Item 1A. Risk Factors

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Item 3. Defaults upon Senior Securities

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

Item 5. Other Information

Item 6. Exhibits

EX-31.1

EX-31.2

EX-32.1

EX-32.2

Table of Contents

PART I.
FINANCIAL INFORMATION

Item 1. Financial Statements and Supplementary Data

Rand Capital Corporation and Subsidiaries
Consolidated Statements of Financial Position
As of March 31, 2007 and December 31, 2006

	March 31, 2007 (Unaudited)	December 31, 2006
ASSETS		
Investments at fair value (identified cost: 3/31/07 - \$13,126,870; 12/31/06 - \$14,033,789)	\$ 22,852,516	\$ 23,649,814
Cash and cash equivalents	4,215,573	4,299,852
Interest receivable (net of allowance: 3/31/07 - \$122,000; 12/31/06 - \$122,000)	503,861	507,242
Other assets	1,314,801	1,007,036
Total assets	\$ 28,886,751	\$ 29,463,944
LIABILITIES AND STOCKHOLDERS EQUITY (NET ASSETS)		
Liabilities:		
Debentures guaranteed by the SBA	\$ 8,100,000	\$ 8,100,000
Deferred income taxes	3,412,000	3,808,000
Income tax payable	8,591	410,575
Accounts payable and accrued expenses	95,657	317,359
Deferred revenue	40,377	45,605
Total liabilities	11,656,625	12,681,539
Stockholders equity (net assets):		
Common stock, \$.10 par shares authorized 10,000,000; shares issued 5,763,034	576,304	576,304
Capital in excess of par value	6,973,454	6,973,454
Accumulated net investment (loss)	(6,162,940)	(6,253,128)
Undistributed net realized gain on investments	9,724,130	9,763,366
Net unrealized appreciation on investments	6,166,384	5,769,615
Treasury stock, at cost, 44,100 shares	(47,206)	(47,206)
Net assets (per share: 3/31/07-\$3.01 , 12/31/2006-\$2.93)	17,230,126	16,782,405
Total liabilities and stockholders equity (net assets)	\$ 28,886,751	\$ 29,463,944

See accompanying notes

Table of Contents

Rand Capital Corporation and Subsidiaries
Condensed Consolidated Statements of Operations
For the Three Months Ended March 31, 2007 and 2006
(Unaudited)

	Three months ended March 31, 2007	Three months ended March 31, 2006
Investment income:		
Interest from portfolio companies	\$ 199,717	\$ 172,020
Interest from other investments	46,047	5,143
Dividend and other investment income	229,420	13,135
Other income	5,228	10,947
	480,412	201,245
Operating expenses:		
Salaries	106,970	96,284
Employee benefits	42,313	31,926
Directors fees	12,250	13,500
Professional fees	31,678	26,536
Stockholders and office operating	32,413	26,228
Insurance	10,920	10,920
Corporate development	14,790	12,905
Other operating	2,479	2,622
	253,813	220,921
Interest on SBA obligations	125,766	106,924
Total expenses	379,579	327,845
Investment gain (loss) before income taxes	100,833	(126,600)
Current income tax expense	98,297	5,000
Deferred income tax (benefit) expense	(98,668)	11,089
Net investment gain (loss)	101,204	(142,689)
Realized and unrealized gain on investments:		
Net (loss) gain on sales and dispositions	(39,236)	187,953
Unrealized appreciation (depreciation) on investments:		
Beginning of period	9,616,025	(342,028)
End of period	9,725,646	(94,751)

Edgar Filing: RAND CAPITAL CORP - Form 10-Q

Change in unrealized appreciation (depreciation) before income taxes	109,621	247,277
Deferred income tax expense	40,121	98,911
Net change in unrealized appreciation (depreciation) on investments	69,500	148,366
Net realized and unrealized gain on investments	30,264	336,319
Net increase in net assets from operations	\$ 131,468	\$ 193,630
Weighted average shares outstanding	5,718,934	5,718,934
Basic and diluted net increase in net assets from operations per share	\$ 0.02	\$ 0.03
See accompanying notes		

Table of Contents

Rand Capital Corporation and Subsidiaries
Condensed Consolidated Statements of Cash Flows
For the Three Months Ended March 31, 2007 and 2006
(Unaudited)

	March 31, 2007	March 31, 2006
Cash flows from operating activities:		
Net increase in net assets from operations	\$ 131,468	\$ 193,630
Adjustments to reconcile net increase in net assets to net cash used in operating activities:		
Depreciation and amortization	8,496	7,708
Original issue discount amortization	(62,333)	
Increase in unrealized appreciation of investments	(109,621)	(247,277)
Deferred tax expense (benefit)	(58,547)	110,000
Net realized loss (gain) on portfolio investments	39,236	(187,953)
Non-cash conversion of debenture interest	(40,000)	(2,877)
Changes in operating assets and liabilities:		
Decrease (increase) in interest receivable	3,381	(31,344)
(Increase) decrease in other assets	(314,910)	30,986
Decrease in accounts payable and accrued liabilities	(644,886)	(95,922)
Decrease in deferred revenue	(5,228)	(3,948)
Total adjustments	(1,184,412)	(420,627)
Net cash used in operating activities	(1,052,944)	(226,997)
Cash flows from investing activities:		
Investments originated		(800,000)
Proceeds from sale of portfolio investments		581,396
Proceeds from loan repayments	970,015	26,544
Capital expenditures	(1,350)	
Net cash provided (used) by investing activities	968,665	(192,060)
Net decrease in cash and cash equivalents	(84,279)	(419,057)
Cash and cash equivalents:		
Beginning of period	4,299,852	1,209,839
End of period	\$ 4,215,573	\$ 790,782

See accompanying notes

Table of Contents

Rand Capital Corporation and Subsidiaries
Condensed Consolidated Statements of Changes in Net Assets
For the Three Months Ended March 31, 2007 and 2006
(Unaudited)

	Three months ended March 31, 2007	Three months ended March 31, 2006
Net assets at beginning of period	\$ 16,782,405	\$ 8,615,934
Cumulative effect adjustment for uncertain tax positions FIN 48	316,253	
Net investment gain (loss)	101,204	(142,689)
Net realized gain (loss) on investments	(39,236)	187,953
Net change in unrealized appreciation on investments	69,500	148,366
Net increase in net assets	447,721	193,630
Net assets at end of period	\$ 17,230,126	\$ 8,809,564

See accompanying notes

Table of Contents

Rand Capital Corporation and Subsidiaries
Condensed Consolidated Schedule of Portfolio Investments
March 31, 2007
(Unaudited)

Company and Business	Type of Investment	(b) Date	(c) Acquired Equity	Cost	(d) Value	Per Share of Rand
Adampluseve, Inc. (g) New York, NY. Luxury sports wear company for men and women. www.adampluseve.com	Warrants to purchase 1,715 Series A Convertible Preferred shares.	7/14/06	3%	\$ 68,000	\$ 133,341	.02
APF Group, Inc. (g)(h) Mount Vernon, NY. Manufacturer of museum quality picture frames and framed mirrors for museums, art galleries, retail frame shops, upscale designers and prominent collectors. www.apfgroup.com	\$584,328 Consolidated Senior Subordinated note at 12.74% due June 30, 2011. Warrants to purchase 10.2941 shares of common stock.	7/8/04	6%	570,960	570,960	.10
Carolina Skiff LLC (e)(g) Waycross, GA. Manufacturer of fresh water, ocean fishing and pleasure boats. www.carolinaskiff.com	\$985,000 Class A preferred membership interest at 11%. Redeemable January 31, 2010. 5% common membership interest.	1/30/04	5%	1,000,000	1,227,000	.21
Contract Staffing Buffalo, NY. PEO providing human resource administration for small businesses. www.contract-staffing.com	Preferred Stock Repurchase Agreement through March 31, 2010 at 5%.	11/8/99	10%	141,400	141,400	.02
EmergingMed.com, Inc. (g) New York, NY. Cancer clinical trial matching and referral service. www.emergingmed.com	\$500,000 Senior subordinated note at 10% due December 19, 2010.	12/19/05	5%	500,000	500,000	.09
Gemcor II, LLC (e)(g)(h) West Seneca, NY. Designs and sells automatic riveting machines used in the assembly of aircraft components.	\$250,000 Subordinated note at 8% due June 28, 2010 with warrant to purchase 6.25 membership units. 25	6/28/04	31%	708,989	708,989	.12

Edgar Filing: RAND CAPITAL CORP - Form 10-Q

www.gemcor.com	membership units.					
G-TEC Natural Gas Systems Buffalo, NY. Manufactures and distributes systems that allow natural gas to be used as an alternative fuel to gases. www.gas-tec.com	33.057% Class A membership interest. 8% cumulative dividend.	8/31/99	33%	400,000	198,000	.03
Innov-X Systems, Inc. (g) Woburn, MA. Manufactures portable x-ray fluorescence (XRF) analyzers used in metals/alloy analysis. www.innovxsys.com	2,642 Series A Convertible Preferred stock. Warrants for 21,596 common shares.	9/27/04	9%	1,000,000	8,761,700	1.53
Kionix, Inc. Ithaca, NY. Develops innovative MEMS based technology applications. www.kionix.com	30,241 shares Series B preferred stock. 696,296 shares Series C preferred stock. (g) 2,862,091 shares Series A preferred stock. 714,285 shares Series B preferred stock.	5/17/02	2%	1,506,044	1,221,568	.21
New Monarch Machine Tool, Inc. (e)(g)(h) Cortland, NY. Manufactures and services vertical/horizontal machining centers. www.monarchmt.com	\$527,877 note at 12% due January 13, 2009. \$300,000 note at 12% due January 13, 2009. Warrants for 22.84 shares of common stock.	9/24/03	11%	651,333	651,333	.11
Niagara Dispensing Technologies, Inc. (g) Tonawanda, NY. Beverage dispensing technology development and products manufacturer, specializing in beer dispensing systems. www.exactpour.com	\$500,000 Senior Subordinated note at 8% due March 7, 2011. Adjustable warrant for 4% of common stock.	3/8/06	4%	540,000	540,000	.09

Table of Contents

Rand Capital Corporation and Subsidiaries
Condensed Consolidated Schedule of Portfolio Investments
March 31, 2007 (Continued)
(Unaudited)

Company and Business	Type of Investment	(b) Date	(c) Equity	Cost	(d) Value	Per Share of Rand
Photonic Products Group, Inc (OTC:PHPG.OB) (i) Northvale, NJ. Develops and manufactures products for laser photonics industry. www.inrad.com	100 shares convertible Series B preferred stock, 10% dividend. (a) 22,000 shares common stock.	10/31/00	<1%	155,000	138,500	.02
RAMSCO (e)(g)(h) Albany, NY. Distributor of water, sanitary, storm sewer and specialty construction materials to the contractor, highway and municipal construction markets. www.ramsco.com	\$916,947.23 notes at 13% due November 18, 2007. Warrants to purchase 12.5% of common shares.	11/19/02	13%	793,644	793,644	.14
Rocket Broadband Networks, Inc. (g) Rochester, NY. Communications service provider of satellite TV, broadband internet and VoIP digital phone targeting multiple dwelling units. www.rocketbroadband.com	533,827 Series A-1 Preferred shares.	12/20/05	8%	400,000	400,000	.07
Somerset Gas Transmission Company, LLC Columbus, OH. Natural gas transportation company. www.somersetgas.com	26.5337 Units.	7/10/02	2%	719,097	786,748	.14
Synacor Inc. (e)(g) Buffalo, NY. Develops provisioning platforms for aggregation and delivery of content for broadband access providers. www.synacor.com	200,000 shares of Series B preferred stock. 78,186 Series A preferred shares. 80,126 Series C preferred shares. Warrants for 299,146 common shares.	11/18/02	4%	999,478	3,818,000	.67

Topps Meat Company LLC (e)(g) Elizabeth, NJ. Producer and supplier of premium branded frozen hamburgers and other portion controlled meat products. www.toppemeat.com	Preferred A and Class A common membership interest.	4/3/03	3%	595,000	927,000	.16
Ultra Scan Corporation Amherst, NY. Biometrics application developer of ultrasonic fingerprint technology. www.ultra-scan.com	536,596 common shares, 107,104 Series A-1 preferred shares. (g) 95,284 Series A-1 preferred shares.	12/11/92	4%	938,164	1,203,000	.21
Ustec, Inc. Victor, NY. Markets digital wiring systems for new home construction. www.ustecnet.com	\$100,000 note at 5% due February 1, 2007. 50,000 common shares. Warrants for 139,395 common shares.	6/26/98	<1%	100,500	0	.00
Wineisit.Com, Corp. (e) Amherst, NY. Marketing company specializing in customer loyalty programs supporting the wine and spirit industry. www.wineisit.com	\$20,000 note at 12% due April 26, 2007. (g) \$500,000 Senior Subordinated note at 10% due December 17, 2009. \$250,000 note at 10% due April 16, 2005. Warrants to purchase 100,000 shares Class B common stock.	12/18/02	2%	821,918	100,000	.02
Other Investments	Various			517,343	31,333	.02
	Total portfolio investments			\$ 13,126,870	\$ 22,852,516	

Table of Contents

Rand Capital Corporation and Subsidiaries
Condensed Consolidated Schedule of Portfolio Investments
March 31, 2007 (Continued)
(Unaudited)

Notes to Consolidated Schedule of Portfolio Investments

- (a) Unrestricted securities are freely marketable securities having readily available market quotations. All other securities are restricted securities, which are subject to one or more restrictions on resale and are not freely marketable. At March 31, 2007 restricted securities represented 99% of the value of the investment portfolio. Freed Maxick & Battaglia, CPA's PC has not examined the business descriptions of the portfolio companies.
- (b) The Date Acquired column indicates the year in which the Corporation acquired its first investment in the company or a predecessor company.
- (c) The equity percentages estimate the Corporation's ownership interest in the portfolio investment. The estimated ownership is calculated based on the percent of outstanding voting securities held by the Corporation or the potential percentage of voting securities held by the Corporation upon exercise of its warrants or conversion of debentures, or other available data. Freed Maxick & Battaglia, CPA's, PC has not audited the equity percentages of the portfolio companies. The symbol <1% indicates that the Corporation holds equity interest of less than one percent.
- (d) The Corporation has adopted the SBA's valuation guidelines for SBIC's which describes the policies and procedures used in valuing investments. Under the valuation policy of the Corporation, unrestricted securities are valued at the closing price for publicly held securities for the last three days of the month. Restricted securities, including securities of publicly-held companies that are subject to restrictions on resale, are valued at fair value as determined by the Board of Directors. Fair value is considered to be the amount which the Corporation may reasonably expect to receive for portfolio securities if it is sold on the valuation date. Valuations as of any particular date, however, are not necessarily indicative of amounts which may ultimately be realized as a result of future sales or other dispositions of securities and these favorable or unfavorable differences could be material. Among the factors considered by the Board of Directors in determining the fair value of restricted securities are the financial condition and operating results, projected operations, and other analytical data relating to the portfolio company. Also considered are the market prices for unrestricted securities of the same class (if applicable) and other matters which may have an impact on the value of the portfolio company.
- (e) These investments are income producing. All other investments are non-income producing. Income producing investments have generated cash payments of interest or dividends within the last twelve months.
- (f) Income Tax Information As of March 31, 2007, the aggregate cost of investment securities approximated \$13.1 million. Net unrealized appreciation was approximately \$9.7 million of which \$11.5 million related to appreciated investment securities and \$1.8 million related to depreciated investment securities
- (g) Rand Capital SBIC, L.P. investment.
- (h) Reduction in cost and value reflects current principal repayment.
- (i) Publicly owned company.
-

Table of Contents

Rand Capital Corporation and Subsidiaries
Notes to the Consolidated Financial Statements
For the Three Months Ended March 31, 2007 and 2006
(Unaudited)

Note 1. ORGANIZATION

Rand Capital Corporation (Rand or Corporation) was incorporated under the laws of the state of New York on February 24, 1969. Commencing in 1971, Rand operated as a publicly traded, closed-end, diversified management company that was registered under Section 8(b) of the Investment Company Act of 1940 (the 1940 Act). On August 16, 2001, Rand filed an election to be treated as a business development company (BDC) under the 1940 Act, which became effective on the date of filing. A BDC is a specialized type of investment company that is primarily engaged in the business of furnishing capital and managerial expertise to companies that do not have ready access to capital through conventional finance channels. There was no impact on the corporate structure as a result of the change to a BDC. Rand continues to operate as a publicly held venture capital company, listed on the NASDAQ Capital Market tier of the NASDAQ Stock Market under the symbol RAND.

Formation of SBIC Subsidiary

On January 16, 2002, Rand formed a wholly owned subsidiary, Rand Capital SBIC, L.P., (Rand SBIC) for the purpose of operating it as a small business investment company. At the same time, Rand organized another wholly owned subsidiary, Rand Capital Management, LLC (Rand Management), as a Delaware limited liability company, to act as the general partner of Rand SBIC. Rand transferred \$5 million in cash to Rand SBIC to serve as regulatory capital in January 2002, and on August 16, 2002 Rand received notification that its Small Business Investment Company (SBIC) application and license had been approved by the Small Business Administration (SBA). The approval allows Rand SBIC to obtain loans up to two times its initial \$5 million of regulatory capital from the SBA for purposes of making new investments in portfolio companies.

The following discussion includes Rand, Rand SBIC and Rand Management (collectively, the Corporation).

The Corporation paid \$100,000 to the SBA to reserve \$10,000,000 of its approved debenture leverage. The leverage commitment expires on September 30, 2008. This fee was 1% of the face amount of the leverage reserved under the commitment and represents a partial prepayment of the SBA's nonrefundable 3% leverage fee. As of March 31, 2007, Rand SBIC had drawn \$8,100,000 in leverage from the SBA.

SBA debentures are issued with 10-year maturities. Interest only is payable semi-annually until maturity. Ten-year SBA debentures may be prepaid with a penalty during the first 5 years, and then are pre-payable without penalty. Rand initially capitalized Rand SBIC with \$5 million in regulatory capital. Rand SBIC was approved to obtain SBA leverage at a 2:1 matching ratio, resulting in a total capital pool eligible for investment of \$15 million. The Corporation expects to use Rand SBIC as its primary investment vehicle.

The Corporation formed Rand SBIC as a subsidiary for the purpose of causing it to be licensed as a SBIC under the Small Business Investment Act of 1958 (the SBA Act) by the SBA, in order to have access to various forms of leverage provided by the SBA to SBIC's.

On May 28, 2002, the Corporation filed an Exemption Application with the SEC seeking an order under Sections 6(c), 12(d)(1)(J), 57(c), and 57(i) of, and Rule 17d-1 under, the 1940 Act for exemptions

Table of Contents

from the application of Sections 2(a)(3), 2(a)(19), 12(d)(1), 18(a), 21(b), 57(a)(1), (2), (3), and (4), and 61(a) of the 1940 Act to certain aspects of its operations. The application also seeks an order under Section 12(h) of the Securities Exchange Act of 1934 Act (the Exchange Act) for an exemption from separate reporting requirements for Rand SBIC under Section 13(a) of the Exchange Act. In general, the Corporation's applications seek orders that would permit:

a BDC (Rand) to operate a BDC/small business investment company (Rand SBIC) as its wholly owned subsidiary in limited partnership form;

Rand, Rand Management and Rand SBIC to engage in certain transactions that the Corporation would otherwise be permitted to engage in as a BDC if its component parts were organized as a single corporation;

Rand, as a BDC, and Rand SBIC, as its BDC/SBIC subsidiary, to meet asset coverage requirements for senior securities on a consolidated basis;

Rand SBIC, as a BDC/SBIC subsidiary of Rand as a BDC, to file Exchange Act reports on a consolidated basis as part of Rand's reports.

Since the filing of its original Application for Exemption, Rand has maintained discussions with the staff of the Division of Investment Management of the SEC concerning Rand's application. The principal substantive issue in these discussions has been the structure of Rand SBIC as a limited partnership. Rand SBIC must meet the requirements of the SBA for licensed SBICs, and at the same time Rand SBIC must meet the requirements of the SEC that apply to BDCs.

Rand formed Rand SBIC in 2002 as a limited partnership because that was the organizational form that the SBA strongly encouraged for all new entities seeking licenses as SBICs, and Rand formed Rand SBIC in a manner that was consistent with the SBA's model limited partnership forms for licensed SBICs. In that structure, the general partner of Rand SBIC is Rand Management, a limited liability company whose managers are the principal executive officers of Rand.

Under the rules and interpretations of the SEC applicable to BDCs, if a BDC is structured in limited partnership form, then it must have general partners who serve as a board of directors, or a general partner with very limited authority and a separate board of directors, and all of the persons who serve on the board of directors must be natural persons and a majority of them must not be interested persons of the BDC. Since the managers of Rand Management are the principal executive officers of Rand, and since both Rand Management and Rand SBIC are wholly owned by Rand, Rand believes that the Board of Directors of Rand is the functional equivalent of a board of directors for both Rand Management and Rand SBIC. Nevertheless, the staff of the Division of Investment Management of the SEC has expressed the view that if Rand SBIC is to be operated as a limited partnership BDC in compliance with the 1940 Act, then the organizational documents of Rand SBIC must specifically provide that it will have a