

BRANTLEY CAPITAL CORP

Form 10-Q

May 15, 2002

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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 QUARTERLY PERIOD ENDED MARCH 31, 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

(Exact name of registrant as specified in its charter)

Maryland

34-1838462

(State or other Jurisdiction of
Incorporation or Organization)

(I.R.S. Employer Identification Number)

20600 Chagrin Boulevard, Suite 1150, Cleveland, Ohio 44122

(Address of principal executive offices including zip code)

(216) 283-4800

(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 No .

The number of shares of common stock, \$.01 par value, outstanding as of March 31, 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**

| | March 31, 2002 (Unaudited) | December 31, 2001 (Audited) |
|--|---|--|
| ASSETS | | |
| Investments, at market | \$64,733,175 | \$60,311,107 |
| Cash and cash equivalents | | 5,369,345 |
| Restricted cash | 6,000,000 | 6,000,000 |
| Dividends and interest receivable | 3,949,633 | 3,493,059 |
| Other assets | 357,969 | 360,158 |
| | <u> </u> | <u> </u> |
| Total Assets | \$75,040,777 | \$75,533,669 |
| | <u> </u> | <u> </u> |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Note payable | \$ 6,000,000 | \$ 6,000,000 |
| Payable for investments purchased | | 200,000 |
| Advisory fee payable | 591,124 | 487,931 |
| Accrued professional fees | 121,819 | 53,163 |
| Distributions payable | | 736,455 |
| Other liabilities | 307,512 | 49,806 |
| | <u> </u> | <u> </u> |
| Total Liabilities | 7,020,455 | 7,527,355 |
| | <u> </u> | <u> </u> |
| Stockholders Equity: | | |
| Common Stock, \$0.01 par value; 25,000,000 shares authorized and 3,810,535 shares issued and outstanding at March 31, 2002 and December 31, 2001, respectively | 38,105 | 38,105 |
| Additional paid in capital | 37,484,895 | 37,484,895 |
| Retained earnings | 30,497,322 | 30,483,314 |
| | <u> </u> | <u> </u> |
| Total Stockholders Equity | 68,020,322 | 68,006,314 |
| | <u> </u> | <u> </u> |
| Total Liabilities and Stockholders Equity | \$75,040,777 | \$75,533,669 |
| | <u> </u> | <u> </u> |
| Net Asset Value Per Share | \$ 17.85 | \$ 17.85 |
| | <u> </u> | <u> </u> |

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

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BRANTLEY CAPITAL CORPORATION

STATEMENTS OF OPERATIONS

(Unaudited)

| | For the quarter ended March 31, 2002 | For the quarter ended March 31, 2001 |
|--|---|---|
| Investment Income: | | |
| Interest | \$ 182,639 | \$ 168,505 |
| Dividends | 295,301 | 271,458 |
| | <u>477,940</u> | <u>439,963</u> |
| Operating Expenses: | | |
| Advisory fees | 488,124 | 351,571 |
| Administration fees | 18,493 | 18,288 |
| Professional fees | 45,616 | 99,110 |
| Interest expense | 154,076 | 135,081 |
| Other | 49,927 | 147,668 |
| | <u>756,236</u> | <u>751,718</u> |
| Total operating expenses | 756,236 | 751,718 |
| Investment Income (Loss), net | (278,296) | (311,755) |
| Net Realized and Unrealized Gains (Losses) on Investments: | | |
| Net realized gains (losses) on investments | (441,234) | 407,096 |
| Net unrealized gains on investments | 733,538 | 68,518 |
| | <u>292,304</u> | <u>475,614</u> |
| Net realized and unrealized gains on investment transactions | 292,304 | 475,614 |
| | <u>\$ 14,008</u> | <u>\$ 163,859</u> |
| Net increase in net assets resulting from operations | \$ 14,008 | \$ 163,859 |
| | <u>\$ 0.00</u> | <u>\$ 0.04</u> |
| Net increase in net assets from operations per share, primary and fully diluted | \$ 0.00 | \$ 0.04 |
| | <u>3,810,535</u> | <u>3,810,535</u> |
| Weighted average number of shares outstanding, primary and fully diluted | 3,810,535 | 3,810,535 |

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

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BRANTLEY CAPITAL CORPORATION

STATEMENTS OF STOCKHOLDERS EQUITY

(Unaudited)

| | Common Stock | Additional Paid in Capital | Retained Earnings | Total Stockholders Equity |
|--|-------------------|----------------------------------|----------------------|---------------------------------|
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Balance at December 31, 1999 | \$ 38,105 | \$ 37,505,433 | \$ 14,896,797 | \$ 52,440,335 |
| Net increase in net assets from operations | | | 1,879,315 | 1,879,315 |
| Distributions from: | | | | |
| Net investment income | | (20,538) | (112,831) | (133,369) |
| Net realized gains | | | (2,243,262) | (2,243,262) |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Balance at December 31, 2000 | \$ 38,105 | \$ 37,484,895 | \$ 14,420,019 | \$ 51,943,019 |
| Net increase in net assets from operations | | | 16,799,750 | 16,799,750 |
| Distributions from: | | | | |
| Net investment income | | | | |
| Net realized gains | | | (736,455) | (736,455) |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Balance at December 31, 2001 | \$ 38,105 | \$ 37,484,895 | \$ 30,483,314 | \$ 68,006,314 |
| Net increase in net assets from operations | | | 14,008 | 14,008 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Balance at March 31, 2002 | \$ 38,105 | \$ 37,484,895 | \$ 30,497,322 | \$ 68,020,322 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

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

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BRANTLEY CAPITAL CORPORATION

STATEMENTS OF CASH FLOWS

(Unaudited)

| | For the quarter ended March 31, 2002 | For the quarter ended March 31, 2001 |
|--|--|--|
| Cash Flows from Operating Activities: | | |
| Net change in net assets resulting from operations: | \$ 14,008 | \$ 163,859 |
| Adjustments to reconcile net change in net assets resulting from operations to net cash used for operations: | | |
| Net realized (gains) losses from investments | 441,234 | 407,096 |
| Net unrealized gains on investments | (733,538) | (68,518) |
| Changes in assets and liabilities: | | |
| Dividend and interest receivable | (456,574) | (297,710) |
| Other assets | 2,189 | 2,189 |
| Advisory fee payable | 103,193 | (19,812) |
| Accrued professional fees | 68,656 | (49,758) |
| Dividends payable | (736,455) | |
| Other liabilities | 57,706 | 192,546 |
| Net cash used for operating activities | (1,239,581) | (484,300) |
| Cash Flows from Investing Activities: | | |
| Purchases of investment securities | (5,945,482) | (722,225) |
| Sales/Maturities of investment securities | 1,815,718 | 1,123,297 |
| Purchases of short-term investments | | (514,416,928) |
| Sales/Maturities of short-term investments | | 514,416,321 |
| Net cash used for investing activities | (4,129,764) | 400,465 |
| Net change in cash and cash equivalents for the period | (5,369,345) | (83,835) |
| Cash, cash equivalents and restricted cash, beginning of period | 11,369,345 | 14,882,432 |
| Cash, cash equivalents and restricted cash, end of the period | \$ 6,000,000 | \$ 14,798,597 |

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 generally accepted accounting principles 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 March 31, 2002, the results of its operations for the quarter ended March 31, 2002, and its cash flows for the quarter ended March 31, 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 March 31, 2002 and December 31, 2001, the identified costs of investments, cash, cash equivalents and restricted cash were \$38,591,708 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:

| | March 31, 2002 (Unaudited) | December 31, 2001 (Audited) |
|---------------------|---|--|
| Cash | \$ | \$5,369,345 |
| Non-restricted Cash | \$ | \$5,369,345 |
| Restricted Cash | \$6,000,000 | \$6,000,000 |

3. Investment Advisory Agreement

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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 quarter ended March 31, 2002, the Investment Adviser earned \$488,124 under the Investment Advisory Agreement. Certain officers of the Company are also officers of the Investment Adviser.

Table of Contents**BRANTLEY CAPITAL CORPORATION****NOTES TO FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

No officer of the Investment Adviser receives any compensation from the Company for serving as officer of the Company.

4. Financial Highlights

| | For the quarter ended March 31, 2002 | For the quarter ended March 31, 2001 |
|---|--|--|
| Net Asset Value, Beginning of the Period | \$ 17.85 | \$ 13.63 |
| Income from investment operations: | | |
| Net investment income/(loss) | (0.07) | (0.08) |
| Net realized and unrealized gain on investments | 0.07 | 0.12 |
| Total from investment operations | 0.00 | 0.04 |
| Net Asset Value, End of Period | \$ 17.85 | \$ 13.67 |
| Market Value, End of Period | \$ 10.34 | \$ 8.00 |
| Total return, at Market Value | (5.05)% ⁽¹⁾ | (7.25)% ⁽¹⁾ |
| Total return, at Net Asset Value | 0.00% ⁽¹⁾ | 0.29% ⁽¹⁾ |

(1) Not annualized

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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 three to five years. 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.

In the past year 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. 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.

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.

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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 continuously 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 March 31, 2002 and 2001 was \$477,940 and \$439,963, respectively. The increase in interest and dividend income during the three months ended March 31, 2002 was primarily due to the ongoing increase in the private equity and mezzanine portfolio which generates dividend and interest income.

Operating Expenses

Total operating expenses during the three months ended March 31, 2002 and 2001 were \$756,236 and \$751,718, respectively. The significant component of total operating expenses was advisory fees of \$488,124 and \$351,571 earned by our investment adviser during the three months ended March 31, 2002 and 2001, respectively.

Net Realized and Unrealized Gains on Investment Transactions

During the three months ended March 31, 2002 and 2001, valuation of our equity and mezzanine investments resulted in net realized and unrealized gains on investments of \$292,304 and \$475,614, respectively. At March 31, 2002, and 2001, we had investments in twelve and ten privately-held companies, respectively, as well as in various small-capitalization public stocks which are subject to general stock market and business conditions. The unrealized gains during such periods were significantly influenced by general stock market and business conditions.

Financial Condition, Liquidity and Capital Resources

At March 31, 2002 and December 31, 2001, we had \$0 and \$5,369,345, respectively, in cash and cash equivalents which were primarily invested in United States Treasury 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 and make follow-on investments. However, in order to execute our mezzanine investment plan, we will continue to seek opportunities to raise additional capital.

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At March 31, 2002 and December 31, 2001, we had stockholders' equity of \$68,020,322 and \$68,006,314, respectively, resulting in a net asset value per share of \$17.85. At March 31, 2002, we had \$6,000,000 of outstanding indebtedness. For the three months ended March 31, 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.

Consistent with our current long-term objectives, our board of directors has recently asked our investment adviser to consider ways to maximize stockholder value in the event that our net asset value has not appreciated by a minimum of 15% per annum for the seven-year period ending December 31, 2003. Such actions could include, but are not limited to, a possible recommendation to consider the sale of some or all of our investments. Our management has been pleased with the performance of our portfolio companies since inception and believes that liquidity opportunities that generally start presenting themselves several years into a portfolio of this nature may create gains for us over the next few years. Our portfolio is just beginning to enter a period of possible liquidity events. However, in light of the market price of our common stock relative to its net asset value, our management has reiterated our planned goals and objectives and has reassured our stockholders that our management intends to take action if those goals and objectives are not met. Nevertheless, our management expects to meet our net asset value appreciation target.

At March 31, 2002 and December 31, 2001, the aggregate cost of the investments we made to date was \$32.6 million and \$28.9 million, respectively, and their aggregate market value was \$64.7 million and \$60.3 million, respectively, for an aggregate fair value appreciation of 99% 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.

Table of Contents*Private Portfolio Company Investments*

The following is a list of the private companies in which we had an investment and the cost and fair value of such securities at March 31, 2002.

| Name of Company | Nature of its Principal Business | Cost | Fair Value |
|-------------------------------------|---|--------------|--------------|
| Disposable Products Company, LLC | Non-Woven Paper Products Manufacturer | 1,779,667 | 1,773,000 |
| Fitness Quest, Inc. | Fitness Products Direct Marketer | 3,846,358 | 8,658,041 |
| Flight Options International, Inc. | Private Air Travel Services | 5,562,500 | 32,500,000 |
| Health Care Solutions, Inc. | Home Health Care Provider | 3,549,000 | 3,578,401 |
| The Holland Group, Inc. | Temporary Staffing | 2,175,000 | 2,175,000 |
| National Rehab Partners, Inc. | Rehabilitation Services | 1,481,513 | 1,481,513 |
| Pediatric Physicians Alliance, Inc. | Pediatric Physician Practice Management Group | 3,439,448 | 3,464,348 |
| Petroleum Partners, Inc. | Petroleum Distribution Maintenance Services | 3,325,000 | 3,325,000 |
| Streamline Foods, Inc. | Food Processing and Distribution Services | 795,000 | 795,000 |
| Prime Office Products, Inc. | Office Products Distributor | 1,420,000 | 1,420,000 |
| Value Creation Partners, Inc. | Food Products Manufacturer and Distributor | 2,145,460 | 2,225,960 |
| Waterlink, Inc.(1) | Water and Waste-Water Management | | |
| | Total | \$29,518,946 | \$61,396,263 |

- (1) We hold a warrant to purchase common stock with an exercise price in excess of the market price of the common stock at March 31, 2002. Our individually significant equity and mezzanine investments at March 31, 2002 are described 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 \$169,667 12% promissory note from Disposable Products. In addition, through March 31, 2002 we funded additional 12% promissory notes of \$610,000 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

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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 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. Our management believes, based on the current facts and circumstances and Flight Options' financial position, that the likelihood of a payment pursuant to such guarantee is remote.

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

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fractional aircraft ownership program to be known as Flight Options. Under the terms of the transaction, Flight Options, Inc. will hold 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. See Determination of Net Asset Value. 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 \$32,500,000 from its September 30, 2001 valuation of \$17,779,379, resulting in a \$14,720,621 or \$3.86 per share unrealized gain reported in the fourth quarter of 2001. At March 31, 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. 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 will be 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.

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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.

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 Pediatric Physicians Alliance, Inc. Pursuant to our commitment, we purchased 793,000 shares of Class A-2 10% Convertible Preferred Stock. Pediatric Physicians Alliance is a physician practice management company that develops integrated pediatric networks of care. Their objective is to develop the leading physician-based integrated pediatric organization in the United States. Pediatric Physicians Alliance 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 Pediatric Physicians Alliance. The detachable warrants are for the purchase of 30,000 shares of Pediatric Physicians Alliance 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 \$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 \$625,000 of 10% Convertible Subordinated Notes during the three months ended March 31, 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 will be 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.

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. 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.

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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 following is a list of the small-capitalization public companies in which we had an investment at March 31, 2002 and the cost and market value of such securities at March 31, 2002.

| Name of Company | Cost | Market Value |
|------------------------------------|--------------------|--------------------|
| Buca, Inc. | \$ 347,236 | \$ 417,910 |
| ICU Medical Industries | 363,245 | 409,500 |
| International Total Services, Inc. | 68,409 | 5,213 |
| KV Pharmaceutical, Inc. | 348,487 | 378,300 |
| NCO Group, Inc. | 397,150 | 326,180 |
| Rent-A-Center, Inc. | 256,671 | 475,137 |
| Renaissasnce Learning, Inc. | 354,250 | 425,100 |
| Regeneration Technologies, Inc. | 214,450 | 132,675 |
| Triad Guaranty, Inc. | 352,648 | 391,230 |
| Trendwest Resorts, Inc. | 370,216 | 375,667 |
| Totals | <u>\$3,072,762</u> | <u>\$3,336,912</u> |

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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.

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.

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. 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.

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PART II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

a. Exhibits

Reference is made to the Exhibit Index that is found on page 19 of this Form 10-Q.

b. Reports on Form 8-K

During the quarter ended March 31, 2002, the Company filed no reports on Form 8-K.

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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: May 15, 2002

By: /s/ ROBERT P. PINKAS

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

Date: May 15, 2002

By: /s/ TAB A. KEPLINGER

Tab A. Keplinger
Vice President and
Chief Financial Officer

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EXHIBIT INDEX

The following exhibits are filed with this report or are incorporated herein by reference to a prior filing, in accordance with Rule 12b-32 under the Securities Exchange Act of 1934. (Asterisk denotes exhibits filed with this report.)

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)