

PMC CAPITAL INC
Form 10-Q
May 15, 2001
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FORM 10 Q
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

(Mark One)

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

For the quarterly period ended **March 31, 2001**

OR

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

For the transition period from _____ to _____.

Commission File Number 811-3780

PMC CAPITAL, INC

(Exact name of registrant as specified in its charter)

FLORIDA

(State or other jurisdiction
of incorporation or organization)

59-2338439

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

18111 Preston Road, Suite 600, Dallas, TX 75252

(Address of principal executive offices)

(972) 349-3200

(Registrant's telephone number)

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

As of May 14, 2001, Registrant had outstanding 11,853,516 shares of Common Stock, par value \$.01 per share.

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PART I

Financial Information

ITEM 1.

Financial Statements

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PMC CAPITAL, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)

| | March 31, 2001 | December 31, 2000 |
|---|-------------------|-------------------------|
| ASSETS | | |
| Investments at value: Loans receivable, net \$112,830 | \$100,353 | |
| Retained interests in transferred assets 32,169 | 32,341 | |
| Cash equivalents 8,653 | 21,655 | |
| Mortgage-backed security of affiliate 1,828 | 1,841 | |
| Restricted investments 540 | 177 | |
| Investment in unconsolidated subsidiaries 239 | 148 | |
| Assets acquired in liquidation 217 | | |
| | | |
| Total investments at value 156,476 | 156,515 | |
| | | |
| Other assets: Due from unconsolidated subsidiaries 1,802 | 2,278 | |
| Deferred charges, deposits and other assets 947 | 938 | |
| Receivable for loans sold 737 | 750 | |
| Accrued interest receivable 577 | 579 | |
| Cash and equipment, net 178 | 164 | |
| | | |
| Total other assets 3,948 | 4,963 | |
| | | |
| Total assets \$160,424 | \$161,478 | |
| | | |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| Liabilities: Notes and debentures payable \$72,977 | \$72,977 | |
| Dividends payable 3,025 | 3,026 | |
| Borrower advances 1,662 | 1,549 | |
| Accrued interest payable 887 | 1,284 | |
| Accounts payable 1,347 | 1,088 | |
| Due to | | |

unconsolidated
 subsidiaries 5,556,670
 Other liabilities 869,122

Total liabilities 81,322,811

Commitments and contingencies
Cumulative preferred stock of subsidiary 7,000,000

Shareholders

equity: Common stock, authorized 30,000,000 shares of \$.01 par value, 11,853,516 shares issued and outstanding at March 31, 2001 and December 31, 2000 11,911,919
 Additional paid-in capital 71,508,715
 Undistributed (dividends in excess of) net operating income (744,238)
 Net unrealized appreciation on investments 1,219,802

72,102,667

Total liabilities and shareholders equity \$160,424,811 \$161,478,000

Net asset value per common share \$6.08 \$6.13

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

**PMC CAPITAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)**

**Three Months
Ended
March 31,**

2001 2000

(Unaudited)

Investment income:

Interest \$3,154 \$3,232 Income
from retained interests in
transferred
assets 1,265 1,054 Premium
income 110 119 Other
investment income,
net 163 127

Total investment
income 4,692 4,532 Other
income, net 471 499 Equity
in income of unconsolidated
subsidiaries, net 90 130

Total income 5,253 5,161

Expenses: Interest 1,380 1,264 Salaries
and related
benefits 1,068 987 General
and
administrative 214 194 Rent 81 75 Profit
sharing plan 51 38 Legal and
accounting 86 89 Small
Business Administration
fees 32 26 Directors and
shareholders expense 8 10

Total expenses 2,920 2,683

Net operating
income 2,332 2,478

**Realized and unrealized
gain (loss) on**

investments: Investments
written-off (290) (5) Change
in unrealized appreciation
(depreciation) on

| | | |
|--|----------------|----------------|
| investments | 417 | 143 |
| <hr/> | | |
| <hr/> | | |
| Total realized and unrealized gain (loss) on investments | 127 | 138 |
| <hr/> | | |
| <hr/> | | |
| Net operating income and realized and unrealized gain (loss) on investments | \$2,460 | \$2,616 |
| <hr/> | | |
| <hr/> | | |
| <i>Preferred dividends</i> | <i>\$62</i> | <i>\$62</i> |
| <hr/> | | |
| <hr/> | | |
| <i>Basic weighted average common shares outstanding</i> | <i>11,853</i> | <i>11,829</i> |
| <hr/> | | |
| <hr/> | | |
| <i>Diluted weighted average common shares outstanding</i> | <i>11,857</i> | <i>11,829</i> |
| <hr/> | | |
| <hr/> | | |
| <i>Basic and diluted earnings per common share</i> | <i>\$0.20</i> | <i>\$0.22</i> |
| <hr/> | | |
| <hr/> | | |

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

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**PMC CAPITAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)**

| Three Months Ended March 31, | |
|---|-------------|
| 2001 | 2000 |
| <hr/> | <hr/> |

*(Unaudited)***Cash flows from operating activities:**

Net operating income and realized and unrealized gain (loss) on investments \$2,460 \$2,616 Adjustments to reconcile net operating income and realized and unrealized gain (loss) on investments to net cash provided by operating activities: Loans funded, held for sale (727) (2,298) Proceeds from sale of guaranteed loans 2,264 1,211 Change in unrealized depreciation on investments and investments written-off (127) (138) Unrealized premium income, net (8) (44) Depreciation and amortization 44 221 Accretion of loan discount and deferred fees (27) (297) Deferred fees collected 18 Equity in income of unconsolidated subsidiaries, net (90) (130) Net change in operating assets and liabilities: Accrued interest receivable (2) (52) Other assets (34) 35 Accrued interest payable (398) (398) Borrower advances 115 (701) Other liabilities (82) (803)

Net cash provided by (used in) operating activities 3,388 (760)

Cash flows from investing activities: Loans funded (14,901) (10,892) Principal collected 1,297 2,597 Proceeds from retained interests in transferred assets 385 801 Purchase of property and equipment and other assets (32) (8) Proceeds from mortgage-backed security of affiliate 115 6 Release of (investment in) restricted cash (370) 512 Advances

from unconsolidated
affiliates, net 3632,422

**Net cash used in
investing
activities** (13,247) (4,512)

**Cash flows from
financing
activities:** Payment of
dividends on common
stock (2,963) (3,135) Payment
of dividends on preferred
stock (63) (62) Payment of
SBA debentures (4,000)

**Net cash used in
financing
activities** (3,026) (7,197)

**Net decrease in cash and
cash
equivalents** (12,885) (12,469) **Cash
and cash equivalents,
beginning of
year** 21,909 23,193

**Cash and cash
equivalents, end of
period** \$9,024 \$10,724

**Supplemental
disclosure:** Interest
paid \$1,779 \$1,662

Reclassification from
loans receivable to real
property owned \$217

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

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PMC CAPITAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. Interim Financial Statements:

The accompanying consolidated balance sheet of PMC Capital, Inc. (PMC Capital) and its wholly-owned regulated investment company subsidiaries (collectively, we , us or our) as of March 31, 2001 and the consolidated statements of income and cash flows for the three months ended March 31, 2001 and 2000 have not been audited by independent accountants. In the opinion of our management, the financial statements reflect all adjustments necessary to present fairly the financial position at March 31, 2001 and the results of operations for the three months ended March 31, 2001 and 2000. These adjustments are of a normal recurring nature.

Certain notes and other information have been omitted from the interim financial statements presented in this Quarterly Report on Form 10-Q. Therefore, these financial statements should be read in conjunction with our 2000 Annual Report on Form 10-K.

The preparation of financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The results for the three months ended March 31, 2001 are not necessarily indicative of future financial results.

Note 2. Reclassifications:

Certain prior period amounts have been reclassified to conform to the current year presentation.

Note 3. Business and Consolidation:

Business

PMC Capital is a diversified closed-end management investment company that operates as a business development company (BDC) under the Investment Company Act of 1940, as amended (the 1940 Act). Our common stock (the Common Stock) is traded on the American Stock Exchange under the symbol PMC.

We are engaged in the business of originating loans to small businesses either directly or through our three principal subsidiaries: First Western SBLC, Inc. (First Western), PMC Investment Corporation (PMCIC) and Western Financial Capital Corporation (Western Financial).

First Western, PMCIC and Western Financial are registered under the 1940 Act as diversified closed-end management investment companies. In addition, PMC Capital is either directly or indirectly the sole shareholder or partner of several non-investment company act subsidiaries.

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**PMC CAPITAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

These are: PMC Advisers, Ltd. and its subsidiary (PMC Advisers); PMC Funding Corp. and its subsidiary (PMC Funding); PMC Capital Limited Partnership (the 1996 Partnership); PMC Capital, L.P. 1998-1 (the 1998 Partnership) and PMC Capital, L.P. 1999-1 (the 1999 Partnership).

Additionally, PMC Capital owns approximately 33% of PMC Joint Venture, L.P. 2000 (the 2000 Joint Venture), and together with the 1996 Partnership, the 1998 Partnership and the 1999 Partnership, the Limited Partnerships).

Principles of Consolidation

The consolidated financial statements include the accounts of PMC Capital and its wholly-owned regulated investment company subsidiaries, First Western, PMCIC and Western Financial. Intercompany transactions have been eliminated in consolidation.

The accounts of our wholly-owned non-investment company act subsidiaries (other than the Limited Partnerships), PMC Advisers and PMC Funding are accounted for by the equity method of accounting in conformity with Federal securities laws. Our interests in the Limited Partnerships are accounted for as retained interests in transferred assets.

Note 4. Retained Interests in Transferred Assets:

Upon securitization and sale of our loan pools, we value the Retained Interest in accordance with SFAS No. 125 since our securitizations meet the definition of a transfer under SFAS No. 125. Our retained interests in transferred assets (the Retained Interests) are comprised of three separate assets: (1) the Reserve Fund, and the interest earned thereon, which consists of the cash required to be kept in a liquid cash account pursuant to the securitization documents, (2) the subordinated portion of the sold loans (commonly referred to as the B piece or the over-collateralized or OC portions of the loans), and (3) the excess cash flow that is to be received by us in the future after (a) payment of all interest and principal amount due to the purchaser of the loans or the Noteholders, (b) payment of all principal and interest on the B piece, (c) the repayment of the corpus of the Reserve Fund and (d) ongoing costs of the transaction. This excess cash flow is the interest-only strip receivable or the IO Receivable.

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**PMC CAPITAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

Our Retained Interests are comprised of the following as of March 31, 2001 and December 31, 2000, respectively:

| March 31, 2001 | | | |
|----------------|-------------|-----------------|------------------|
| Total | OC Piece | Reserve Fund | IO Receivable |
| | | | |

PMC Capital L.P. 1999-1. On June 3, 1999, the 1999 Partnership (a special purpose affiliate of PMC Capital) completed a private placement of approximately \$55.6 million of its Loan-Backed Fixed Rate Notes, Series 1999-1.

PMC Joint Venture, LP 2000. On December 18, 2000, the 2000 Joint Venture (a special purpose affiliate of PMC Capital and our affiliate, PMC Commercial Trust) completed a private placement of

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**PMC CAPITAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

approximately \$74.5 million of its Loan-Backed Fixed Rate Notes, Series 2000 (the 2000 Notes). PMC Capital owns approximately 33% of the 2000 Joint Venture as of March 31, 2001 and December 31, 2000. Accordingly, at inception PMC Capital s share of the 2000 Notes amounted to approximately \$24.9 million (the 2000 PMC Notes). At March 31, 2001, the aggregate remaining principal balance of PMC Capital s loans sold to the 2000 Joint Venture was \$27.9 million and the outstanding balance on the 2000 PMC Notes was \$24.9 million. During the three months ended March 31, 2001, our limited partnership share of the net income of the 2000 Joint Venture was approximately \$203,000.

Valuation of Retained Interests. As there is no quoted market value of Retained Interests, the fair value is based on management s estimate of the fair market value. This value may or may not vary significantly from what a willing buyer would pay for these assets. In determining the fair value of the Retained Interests related to our securitization and sale transactions, we utilize certain assumptions which include:

| | SBA 7(a) Transactions | Non-SBA 7(a) Transactions |
|---|-----------------------------------|--------------------------------------|
| Prepayment rate (a) | Minimum 17% CPR | Minimum 7% CPR |
| Loss rate (b) Range from 0.4% to 0.7% per annum | Range from 0.3% to 0.6% per annum | |
| Discount rate (c) Range from 10.5% to 13.5% | | Range from 8.0% to 13.5% |

- (a) The prepayment rate is based on current performance of the respective loan pools, adjusted for anticipated principal payments considering the current loan pools and similar loans. The minimum rates are for the twelve month period ending March 31, 2002.
- (b) Credit exposure exists to the extent of possible default on the underlying collateral requiring payment from anticipated future residual interests. We believe that a range of 0.3% to 0.7% loss rate covers this inherent risk. For SBA 7(a) guaranteed loan sales, there are no assumed losses since all principal losses are the responsibility of the SBA.
- (c) The discount rates are as of March 31, 2001 and are based upon our estimate of comparable rates which would be used by potential purchasers of similar assets. The discount rates (1) range from 8.0% to 8.8% for our B Pieces, (2) are 10.5% for our Reserve Fund and (3) are 13.5% for our IO Receivables.

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PMC CAPITAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

The following information summarizes the financial position at March 31, 2001 and December 31, 2000 and the results of operations for the three month periods ended March 31, 2001 and 2000 of the Limited Partnerships created in connection with our securitization transactions:

Summary of financial position:

| | PMC Capital Limited Partnership | | PMC Capital, L. P. 1998-1 | | PMC Capital, L. P. 1999-1 | | PMC Joint Venture L.P. 2000 (1) | |
|-----------------------|---------------------------------|---------|---------------------------|---------|---------------------------|---------|---------------------------------|---------|
| | 2001 | 2000 | 2001 | 2000 | 2001 | 2000 | 2001 | 2000 |
| | <i>(In millions)</i> | | | | | | | |
| Loans Receivable, Net | \$ 11.8 | \$ 12.0 | \$ 33.0 | \$ 34.9 | \$ 54.8 | \$ 55.3 | \$ 81.9 | \$ 83.6 |
| Total Assets | \$ 13.1 | \$ 12.9 | \$ 38.3 | \$ 38.5 | \$ 59.2 | \$ 59.8 | \$ 87.0 | \$ 87.4 |
| Notes Payable | \$ 6.3 | \$ 6.4 | \$ 33.0 | \$ 33.3 | \$ 50.7 | \$ 51.1 | \$ 73.1 | \$ 74.5 |
| Total Liabilities | \$ 6.8 | \$ 6.5 | \$ 33.8 | \$ 34.0 | \$ 51.6 | \$ 52.2 | \$ 73.5 | \$ 74.7 |
| Partners' Capital | \$ 6.3 | \$ 6.4 | \$ 4.5 | \$ 4.5 | \$ 7.6 | \$ 7.6 | \$ 13.5 | \$ 12.7 |

(1) Balances represent PMC Capital's and PMC Commercial's limited partnership interests in PMC Joint Venture, L.P. 2000.

Summary of Operations:

| | PMC Capital Limited Partnership | | PMC Capital, L. P. 1998-1 | | PMC Capital, L. P. 1999-1 | | PMC Joint Venture L.P. 2000 |
|------------------|---------------------------------|--------|---------------------------|----------|---------------------------|----------|-----------------------------|
| | 2001 | 2000 | 2001 | 2000 | 2001 | 2000 | 2001(1) |
| | <i>(In thousands)</i> | | | | | | |
| Interest Income | \$ 348 | \$ 421 | \$ 960 | \$ 1,032 | \$ 1,375 | \$ 1,424 | \$ 2,028 |
| Total Revenues | \$ 351 | \$ 422 | \$ 1,019 | \$ 1,112 | \$ 1,416 | \$ 1,430 | \$ 2,185 |
| Interest Expense | \$ 108 | \$ 145 | \$ 704 | \$ 701 | \$ 838 | \$ 873 | \$ 1,345 |

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| | | | | | | | |
|----------------|--------|--------|--------|--------|--------|--------|---------|
| Total Expenses | \$ 111 | \$ 170 | \$ 734 | \$ 735 | \$ 884 | \$ 920 | \$1,399 |
| | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| Net Income | \$ 240 | \$ 252 | \$ 285 | \$ 377 | \$ 532 | \$ 510 | \$ 786 |
| | ■ | ■ | ■ | ■ | ■ | ■ | ■ |

(1) The balances represent PMC Capital s and PMC Commercial s limited partnership interests in PMC Joint Venture, L.P. 2000.

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**PMC CAPITAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

In accordance with FASB No. 140, management has performed a sensitivity analysis of our Retained Interests to highlight the volatility that results when prepayments, losses and discount rates are different than management s original assumptions.

The following summarizes the results of the sensitivity analysis as of March 31, 2001:

| <u>Changed Assumption</u> | <u>Pro-Forma Value</u> | <u>Asset Reduction</u> |
|---|------------------------|------------------------|
| Losses increase by 50 basis points per annum | \$ 29,441,000 | \$ 2,728,000 |
| Losses increase by 100 basis points per annum | \$ 26,844,000 | \$ 5,325,000 |
| Prepayments increase by 5% per annum | \$ 31,011,000 | \$ 1,158,000 |
| Prepayments increase by 10% per annum | \$ 30,138,000 | \$ 2,031,000 |
| Discount rates increase by 1% | \$ 30,884,000 | \$ 1,285,000 |
| Discount rates increase by 2% | \$ 29,718,000 | \$ 2,451,000 |

Note 5. Dividends Paid and Declared:

In January 2001, we paid a quarterly dividend of \$0.25 per share of common stock to shareholders of record on December 31, 2000. On March 14, 2001, the Board declared a dividend of \$0.25 per share to shareholders of record on March 31, 2001, which was paid in April 2001. In the absence of unforeseen events, the Board has determined that the present level of quarterly dividends will be adjusted commencing with the dividend payable in July 2001. We anticipate that the quarterly dividend at that time will be reduced to a range between \$0.18 per share and \$0.22 per share.

Note 6. Net Unrealized Appreciation on Investments and Realized and Unrealized Gain (Loss) on Investments:

Net unrealized appreciation on investments is comprised of the following at March 31, 2001 and December 31, 2000:

| | |
|-------------------------------|----------------------------------|
| March 31, 2001 | December 31, 2000 |
| ■ | ■ |

(In thousands)

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| | | | |
|--|-------|---------|----------|
| Loans receivable | | \$(417) | \$ (659) |
| Retained interests in transferred assets | 1,556 | 1,379 | Other |
| investments | 808 | 2 | |

\$1,219\$802

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**PMC CAPITAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

Activity in our investments written-off and change in unrealized appreci