PMC CAPITAL INC
Form 10-K
March 31, 2003

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the Fiscal Year Ended December 31, 2002

o 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: 1-09589

PMC CAPITAL, INC.

(Exact name of registrant as specified in its charter)

Florida	**59-2338539**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
18111 Preston Road, Suite 600, Dallas, TX 75252	**(972) 349-3200**
(Address of principal executive offices)	(Registrant s telephone number)

Securities registered pursuant to Section 12(b) of the Act:
Common stock, $.01 par value

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). YES o NO x

The aggregate market value of the voting stock held by non-affiliates of the Registrant, based upon the closing sale price of the Common Stock on June 28, 2002 as reported on the American Stock Exchange, was approximately $63 million. Common Stock held by each officer and director and by each person who owns 10% or more of the outstanding Common Stock has been excluded because such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of March 21, 2003, the Registrant had 11,853,516 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the Registrant s Proxy Statement to be filed with the Securities and Exchange Commission within 120 days after the year covered by this Form 10-K with respect to the Annual Meeting of Shareholders are incorporated by reference into Part III.

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PART I

Item 1. BUSINESS

INTRODUCTION

PMC Capital, Inc., a Florida corporation, is a diversified, closed-end management investment company that has elected to operate as a business development company (BDC) under the Investment Company Act of 1940, as amended (the 1940 Act). PMC Capital, Inc. (PMC Capital or PMC, and together with its consolidated subsidiaries, the Company, we or our) is a national lender to small businesses either direct or through our three 1940 Act subsidiaries. These subsidiaries are 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. PMC Capital s common stock (the Common Stock) is traded on the American Stock Exchange under the symbol PMC. Our investment objective is to achieve current income that is available to pay out to shareholders in the form of quarterly dividends. PMC Capital has elected to be taxed as a regulated investment company under the Internal Revenue Code of 1986, as amended (the Code) and thus distributes substantially all of its taxable income as dividends to its shareholders, thereby incurring no Federal income tax liability on such income.

Our operations are centralized in Dallas, Texas and include originating, servicing and selling commercial loans. We also have business development offices in Georgia, Arizona and Missouri. We operate under several licenses from the Small Business Administration (the SBA). First Western is licensed as a small business lending company (SBLC) that originates loans through the SBA s 7(a) Guaranteed Loan Program. PMCIC is a licensed specialized small business investment company (SSBIC) under the Small Business Investment Act of 1958, as amended (SBIA). PMCIC uses long-term funds provided by the SBA, together with its own capital, to provide long-term collateralized loans to eligible small businesses owned by disadvantaged persons, as defined under SBA regulations. Western Financial is a licensed small business investment company (SBIC) under the SBIA that provides loans to borrowers whether or not they qualify as disadvantaged.

PMC Capital is either directly or indirectly the sole shareholder or a partner of several non-investment company subsidiaries: PMC Advisers, Ltd. and its subsidiary (PMC Advisers); PMC Funding Corp. and its subsidiary (PMC Funding); and several special purpose entities (the SPEs) established to facilitate structured loan transactions. Our consolidated financial statements include the accounts of PMC Capital and its wholly-owned regulated investment company subsidiaries. The accounts of PMC Advisers and PMC Funding are accounted for using the equity method of accounting in conformity with the requirements of Federal securities laws. Our interests in the SPEs are accounted for as retained interests in transferred assets.

In addition to our lending operations, we earn income through PMC Advisers which evaluates and services loans receivable and other investments pursuant to fee arrangements (the Investment Management Agreements) with PMC Commercial Trust (PMC Commercial), a real estate investment trust (REIT) affiliated with us through common management.

PMC Commercial provides loans to entities whose borrowing needs and/or strength and stability exceed the limitations set by the SBA for our SBA approved loan programs. As a result, we generally pursue different prospective borrowers than PMC Commercial. In order to further mitigate the potential for conflicts of interest, PMC Capital, PMC Commercial and PMC Advisers have entered into a loan origination agreement (the Loan Origination Agreement). Pursuant to the Loan Origination Agreement, loans that are greater than $1.3 million that meet PMC Commercial s underwriting criteria are first presented to PMC Commercial for funding. If PMC Commercial does not have available funds, we may originate those lending opportunities as long as they meet our lending criteria.

As of December 31, 2002 and 2001, our total assets were approximately $140.3 million and $162.7 million, respectively. During the years ended December 31, 2002 and 2001, our total investment income was approximately $16.7 million and $20.8 million, respectively and our net increase in net assets resulting from operations (hereinafter referred to as net income) was approximately $6.0 million and $10.6 million, respectively.

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LENDING ACTIVITIES

Overview

The fair value of our loans receivable was $87.2 million and $107.4 million at December 31, 2002 and 2001, respectively. As of December 31, 2002, we have $71.3 million (82%) of variable-rate loans receivable and $15.9 million (18%) of fixed-rate loans receivable and the weighted average interest rate on our loans receivable was 7.1%.

We primarily originate loans to small business concerns in the limited service sector of the hospitality industry. We have a fundamental policy with respect to loan concentration that requires us to have at least 25% of our total assets invested in the hospitality industry, and at December 31, 2002 our concentration was approximately 81%. We also emphasize lending to the convenience store and gas station, restaurant, service, retail and commercial real estate industries. We are a national lender that primarily lends to businesses in the southeast and southwest regions of the United States.

Limited Service Hospitality Industry

Our loans in the hospitality industry are generally collateralized by first liens on limited service hospitality properties and are generally made to owner-operated facilities operating under national franchises. We believe that franchise operations offer attractive lending opportunities because such businesses generally employ proven business concepts, have national reservation systems, have consistent product quality, are screened and monitored by franchisors and generally have a higher rate of success when compared to other independently operated hospitality businesses.

Reductions in business and discretionary travel have caused a moderation in demand for hotel rooms and a slowdown in construction of hospitality properties (including limited service hospitality properties). However, the limited service segment of the hospitality industry has been less impacted and has continued to outperform the luxury and upscale sectors which experienced the weakest performance. Another factor which affects the limited service sector of the hospitality industry is a significant rise in gasoline prices within a short period of time. Most of the limited service hospitality properties collateralizing our loans receivable are located on interstate highways. As seen in the past, when gas prices sharply increase, occupancy rates for properties located on interstate highways decrease.

Loan Originations and Underwriting

We originate mortgage loans to small businesses primarily collateralized by commercial real estate. We believe that we successfully compete in the commercial real estate finance market due to our understanding of our borrowers businesses, the flexible loan terms that we offer and our responsive customer service. Our approach to assessing new commercial mortgage loans requires an analysis of the replacement cost of the collateral, its liquidation value and an analysis of local market conditions. We also consider the underlying cash flow of the tenant or owner-occupant as well as more traditional real estate loan underwriting criteria.

Our variable-rate loans receivable require payments of principal and interest, reset on a quarterly basis, to amortize the principal over ten to 20 years. Our fixed interest rate loans receivable primarily require level payments of principal and interest calculated to amortize the principal over ten to 25 years.

We have business development offices in Texas, Georgia, Arizona and Missouri and we solicit loan applications from potential borrowers through personal contacts and public appearances, direct mailings, advertisements in trade publications and other marketing vehicles. In addition, a significant percentage of new loans is generated through referrals from existing borrowers, lawyers, accountants, real estate brokers and loan brokers. In certain cases, we make referral payments to persons who assist in generating loan applications. Such referral payments generally are in amounts not exceeding 1% of the principal amount of the related loan. Our loan committee, comprised primarily of senior management, makes the final determination on whether or not to approve each loan application.

Upon receipt of a completed loan application, our credit department conducts: (i) a detailed analysis of the loan, which typically includes an appraisal and a valuation by the credit department of the property that will

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collateralize the loan to assure compliance with loan-to-value percentages, (ii) a site inspection for real estate collateralized loans, (iii) a review of the borrower s business experience, (iv) a review of the borrower s credit history, and (v) an analysis of the borrower s debt-service-coverage and debt-to-equity ratios. All appraisals must be performed by an approved licensed third party appraiser and based on the market value, replacement cost and cash flow value approaches. We generally utilize nationwide independent appraisal firms and seek local market economic information to the extent available.

Our typical loan is distinguished from those of some of our competitors by the following characteristics:

Substantial down payments are required. We usually require an initial down payment of not less than 20% of the value of the property which is collateral for the loan at the time of such loan. Our experience has shown that the likelihood of full repayment of a loan increases if the owner/operator is required to make an initial and substantial financial commitment to the property which is collateral for the loan.

Cash outs are typically not permitted. Generally, we will not make a loan in an amount greater than either the cost or the current appraised value of the property which is collateral for the loan. For example, a hotel property may have been originally constructed for a cost of $2,000,000, with the owner/operator borrowing $1,600,000 of that amount. At the time of the borrower s loan refinancing request, the property which is collateral for the loan is appraised at $4,000,000. Some of our competitors might loan from 70% to 90% or more of the new appraised value of the property and permit the owner/operator to receive a cash distribution from the proceeds. Generally, we would not permit this type of cash-out distribution.

The obligor is personally liable for the loan. We generally require the principals of the borrower to guarantee the loan.

Loan Activity

The following table details our loan activity for the years indicated:

	Years Ended December 31,				
	2002	2001	2000	1999	1998
			(In thousands)		
Loans receivable beginning of year	$107,392	$100,353	$106,325	$116,711	$127,240
Loans originated	46,138	65,977	44,158	84,264	66,450
Principal collections (1)	(13,891)	(10,063)	(11,233)	(15,431)	(23,538)
Structured loan sales (2)	(43,218)	(49,194)	(28,046)	(60,481)	(43,144)
Loans sold (3)	(6,146)	(7,778)	(9,584)	(19,152)	(9,978)
Loans transferred to AAL (4)	(2,629)	(314)			
Loans assumed by affiliate (5)	(885)				
Loans purchased (6)	1,176	8,634			
Other adjustments (7)	(692)	(223)	(1,267)	414	(319)
Loans receivable end of year	$ 87,245	$107,392	$100,353	$106,325	$116,711

(1) Includes scheduled payments and prepayments.

(2) We sold loans receivable as part of structured loan sale transactions.

(3) First Western sells the guaranteed portion of its loans receivable through private placements to either dealers in government guaranteed loans or institutional investors.

(4) During 2001 and 2002, we transferred loans to assets acquired in liquidation (AAL).

(5) During 2002, PMC Funding acquired assets and assumed notes payable to PMC Capital and First Western.

(6) Represents the value of loans purchased through our exercise of optional redemption provisions from affiliated special purpose entities.

(7) Includes the change in unrealized appreciation (depreciation) in loans receivable, loans written-off and discounts.

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Quarterly Loan Originations

The following table is a breakdown of loans originated on a quarterly basis during the years indicated:

	Years Ended December 31,				
	2002	2001	2000	1999	1998
	(In thousands)				
First Quarter	$11,772	$15,628	$13,190	$17,231	$10,937
Second Quarter	7,696	32,850	10,943	16,534	11,739
Third Quarter	8,226	9,903	10,453	27,687	16,887
Fourth Quarter	18,444	7,596	9,572	22,812	26,887
Total	$46,138	$65,977	$44,158	$84,264	$66,450

Loan Portfolio Statistics

Information on our loans receivable, and combined with loans receivable which have been sold and which we service and have retained interests (the Serviced Loan Portfolio) was as follows, broken down by division:

	December 31,					
	2002			2001		
	Total	SBA 7(a)	Commercial Loans	Total	SBA 7(a)	Commercial Loans
	(Dollars in thousands, except footnotes)					
Principal balance:						
Loans receivable (1)	$ 88,476	$15,220	$ 73,256	$108,357	$17,510	$ 90,847
Sold loans of SPEs	176,296	3,590	172,706	158,002	4,907	153,095
Sold SBA 7(a) guaranteed loans	48,181	48,181		55,409	55,409	
Serviced Loan Portfolio	$312,953	$66,991	$245,962	$321,768	$77,826	$243,942
Weighted average interest rate:						
Loans receivable	7.1%	6.6%	7.2%	9.0%	7.9%	9.2%
Sold loans of SPEs	9.0%	7.1%	9.1%	9.1%	8.4%	9.1%
Sold SBA 7(a) guaranteed loans	6.8%	6.8%		8.0%	8.0%	
Serviced Loan Portfolio	8.2%	6.7%	8.6%	8.9%	8.1%	9.2%

(1) Balances represent the principal outstanding on our loans receivable before discounts aggregating $520,000 and $552,000 and unrealized depreciation of $711,000 and $443,000 at December 31, 2002 and 2001, respectively.

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Problem Loans

Our policy with respect to loans receivable which are in arrears as to interest payments for a period in excess of 60 days is generally to discontinue the accrual of interest income and reverse previously recorded interest income which is deemed uncollectible. We will deliver a default notice and begin foreclosure and liquidation proceedings when we determine that pursuit of these remedies is the most appropriate course of action.

Senior management closely monitors our problem loans which are classified into two categories: Impaired Loans and Special Mention Loans (together, Problem Loans). Our Impaired Loans are loans which are not complying with their contractual terms, the collection of the balance of the principal is considered impaired and on which its fair value is less than the remaining unamortized principal balance. Our Special Mention Loans are those loans receivable that are not complying with their contractual terms but we expect a full recovery of the principal balance through either collection efforts or liquidation of collateral.

Information on our Problem Loans was as follows, broken down by division:

	December 31,					
	2002			2001		
	Total	SBA 7(a)	Commercial Loans	Total	SBA 7(a)	Commercial Loans
	(Dollars in thousands, except footnotes)					
Impaired Loans (1):						
Loans receivable (2)	$5,728	$772	$4,956	$6,152	$1,308	$ 4,844
Sold loans of SPEs	2,343		2,343	1,799	125	1,674
	$8,071	$772	$7,299	$7,951	$1,433	$ 6,518
Special Mention Loans (1):						
Loans receivable	$3,248	$553	$2,695	$1,549	$ 60	$1,4890
Sold loans of SPEs	5,226	1	5,225	6,456	202	6,254
	$8,474	$554	$7,920	$8,005	$ 262	$ 7,743
Percentage Impaired Loans (3):						
Loans receivable	6.5%	5.1%	6.8%	5.7%	7.5%	5.3%
Sold loans of SPEs	1.3%		1.4%	1.1%	2.5%	1.1%
Loans receivable and sold loans of SPEs	3.0%	4.1%	3.0%	3.0%	6.4%	2.7%
Percentage Special Mention Loans (3):						
Loans receivable	3.7%	3.6%	3.7%	1.4%	0.3%	1.6%
Sold loans of SPEs	3.0%		3.0%	4.1%	4.1%	4.1%
Loans receivable and sold loans of SPEs	3.2%	2.9%	3.2%	3.0%	1.2%	3.2%

(1) Since the sold SBA 7(a) guaranteed loans are secured by a government guarantee, we do not have exposure to loss. Accordingly, impaired and special mention loan statistics for our SBA 7(a) guaranteed loans have not been presented.

(2) As of December 31, 2002 the balance included a loan collateralized by a golf facility that we repurchased from an SPE during December 2002 and was acquired through foreclosure during the first quarter of 2003 by one of our non-investment company subsidiaries. The fair value of the loan receivable was estimated to be $1.2 million. As of December 31, 2001 the balance included two limited service hospitality properties we acquired through foreclosure during the first quarter of 2002. The fair value of the loans receivable was estimated to be $2.1 million.

(3) The denominator does not include our SBA 7(a) guaranteed loans that have been sold.

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Industry Information on our Loan Portfolio

The distribution of our loans receivable and our serviced loan portfolio by industry were as follows at December 31, 2002:

	Loans Receivable				
	Number of Loans	Value	%	Cost	%
		(Dollars in thousands)			
Hotels and motels	104	$74,098	84.9%	$74,603	84.8%
Services	28	2,732	3.1%	2,773	3.2%
Restaurants	21	1,259	1.4%	1,274	1.5%
Retail, other	21	4,147	4.8%	4,176	4.7