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Hercules Capital, Inc.  
Form 10-Q  
November 01, 2018  
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For The Quarterly Period Ended September 30, 2018

OR

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

Commission File Number: 814-00702

HERCULES CAPITAL, INC.

(Exact Name of Registrant as Specified in its Charter)

Maryland  
(State or Jurisdiction of

Incorporation or Organization)

400 Hamilton Ave., Suite 310

Palo Alto, California

743113410  
(IRS Employer

Identification No.)  
94301

(Zip Code)

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(Address of Principal Executive Offices)

(650) 289-3060

(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 periods that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this Chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with a new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

On October 29, 2018, there were 96,731,791 shares outstanding of the Registrant's common stock, \$0.001 par value.

HERCULES CAPITAL, INC.

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Item 1.

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## PART I: FINANCIAL INFORMATION

In this Quarterly Report, the “Company,” “Hercules,” “we,” “us” and “our” refer to Hercules Capital, Inc. and its wholly owned subsidiaries and its affiliated securitization trusts on or after February 25, 2016 and “Hercules Technology Growth Capital, Inc.” and its wholly owned subsidiaries and its affiliated securitization trusts prior to February 25, 2016, unless the context otherwise requires.

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS  
HERCULES CAPITAL, INC.

## CONSOLIDATED STATEMENT OF ASSETS AND LIABILITIES

(unaudited)

(dollars in thousands, except per share data)

	September 30, 2018	December 31, 2017
<b>Assets</b>		
Investments:		
Non-control/Non-affiliate investments (cost of \$1,663,658 and \$1,506,454, respectively)	\$1,670,034	\$1,491,458
Control investments (cost of \$64,630 and \$25,419, respectively)	62,387	19,461
Affiliate investments (cost of \$84,821 and \$87,956, respectively)	28,095	31,295
Total investments in securities, at value (cost of \$1,813,109 and \$1,619,829, respectively)	1,760,516	1,542,214
Cash and cash equivalents	43,212	91,309
Restricted cash	2,429	3,686
Interest receivable	15,722	12,262
Other assets	1,175	5,244
<b>Total assets</b>	<b>\$1,823,054</b>	<b>\$1,654,715</b>
<b>Liabilities</b>		
Accounts payable and accrued liabilities	\$21,473	\$26,896
SBA Debentures, net (principal of \$149,000 and \$190,200, respectively) <sup>(1)</sup>	147,527	188,141
2022 Notes, net (principal of \$150,000 and \$150,000, respectively) <sup>(1)</sup>	147,859	147,572
2024 Notes, net (principal of \$83,510 and \$183,510, respectively) <sup>(1)</sup>	81,791	179,001
2025 Notes, net (principal of \$75,000 and \$0, respectively) <sup>(1)</sup>	72,495	—
2033 Notes, net (principal of \$40,000 and \$0, respectively) <sup>(1)</sup>	38,752	—
2021 Asset-Backed Notes, net (principal of \$3,515 and \$49,153, respectively) <sup>(1)</sup>	3,423	48,650
2022 Convertible Notes, net (principal of \$230,000 and \$230,000, respectively) <sup>(1)</sup>	224,660	223,488
Credit Facilities	80,894	—
<b>Total liabilities</b>	<b>\$818,874</b>	<b>\$813,748</b>
<b>Net assets consist of:</b>		
Common stock, par value	96	85
Capital in excess of par value	1,060,875	908,501

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Unrealized appreciation (depreciation) on investments <sup>(2)</sup>	(53,784 )	(79,760 )
Accumulated undistributed realized gains (losses) on investments	(30,855 )	(20,374 )
Undistributed net investment income	27,848	32,515
Total net assets	\$1,004,180	\$840,967
Total liabilities and net assets	\$1,823,054	\$1,654,715
Shares of common stock outstanding (\$0.001 par value, 200,000,000 authorized)	96,751	84,424
Net asset value per share	\$10.38	\$9.96

(1) The Company's SBA Debentures, 2022 Notes, 2024 Notes, 2025 Notes, 2033 Notes, 2021 Asset-Backed Notes and 2022 Convertible Notes, as each term is defined herein, are presented net of the associated debt issuance costs for each instrument. See "Note 4 – Borrowings".

(2) Amounts include \$1.2 million and \$2.1 million in net unrealized depreciation on other assets and accrued liabilities, including escrow receivables, and estimated taxes payable as of September 30, 2018 and December 31, 2017, respectively.

See notes to consolidated financial statements.

The following table presents the assets and liabilities of our consolidated securitization trust for the 2021 Asset-Backed Notes (see Note 4), which is a variable interest entity (“VIE”). The assets of our securitization VIE can only be used to settle obligations of our consolidated securitization VIE, these liabilities are only the obligations of our consolidated securitization VIE, and the creditors (or beneficial interest holders) do not have recourse to our general credit. These assets and liabilities are included in the Consolidated Statement of Assets and Liabilities above.

(Dollars in thousands)	September 30, 2018	December 31, 2017
<b>Assets</b>		
Restricted Cash	\$ 2,429	\$ 3,686
Total investments in securities, at value (cost of \$86,070 and \$146,208, respectively)	85,965	144,513
Total assets	\$ 88,394	\$ 148,199
<b>Liabilities</b>		
2021 Asset-Backed Notes, net (principal of \$3,515 and \$49,153, respectively) <sup>(1)</sup>	\$ 3,423	\$ 48,650
Total liabilities	\$ 3,423	\$ 48,650

(1) The Company’s 2021 Asset-Backed Notes are presented net of the associated debt issuance costs. See “Note 4 – Borrowings”.

See notes to consolidated financial statements.

## HERCULES CAPITAL, INC.

## CONSOLIDATED STATEMENT OF OPERATIONS

(unaudited)

(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Investment income:				
Interest income				
Non-control/Non-affiliate investments	\$47,662	\$41,725	\$134,031	\$124,049
Control investments	921	464	2,348	1,505
Affiliate investments	509	246	1,570	248
Total interest income	49,092	42,435	137,949	125,802
Fee income				
Commitment, facility and loan fee income:				
Non-control/Non-affiliate investments	1,858	2,239	6,228	7,613
Control investments	1	1	1	11
Affiliate investments	71	2	263	2
Total commitment, facility and loan fee income	1,930	2,242	6,492	7,626
One-time fee income:				
Non-control/Non-affiliate investments	1,580	1,188	6,423	7,254
Total one-time fee income	1,580	1,188	6,423	7,254
Total fee income	3,510	3,430	12,915	14,880
Total investment income	52,602	45,865	150,864	140,682
Operating expenses:				
Interest	9,451	9,185	28,715	28,046
Loan fees	1,502	1,314	6,039	5,500
General and administrative				
Legal Expenses	677	925	1,889	3,792
Other Expenses	3,044	2,623	9,515	8,570
Total general and administrative	3,721	3,548	11,404	12,362
Employee compensation:				
Compensation and benefits	5,294	6,014	18,069	17,276
Stock-based compensation	3,332	1,831	8,498	5,573
Total employee compensation	8,626	7,845	26,567	22,849
Total operating expenses	23,300	21,892	72,725	68,757
Net investment income	29,302	23,973	78,139	71,925
Net realized gain (loss) on investments				
Non-control/Non-affiliate investments	3,350	(8,911 )	(4,115 )	(10,940 )
Control investments	—	(15,543 )	(4,308 )	(15,989 )
Affiliate investments	—	—	(2,058 )	—
Total net realized gain (loss) on investments	3,350	(24,454 )	(10,481 )	(26,929 )

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Net change in unrealized appreciation (depreciation) on investments				
Non-control/Non-affiliate investments	3,967	11,320	22,327	45,420
Control investments	378	17,624	3,715	17,703
Affiliate investments	(1,368 )	4,609	(66 )	(47,486 )
Total net unrealized appreciation (depreciation) on investments	2,977	33,553	25,976	15,637
Total net realized and unrealized gain (loss)	6,327	9,099	15,495	(11,292 )
Net increase (decrease) in net assets resulting from operations	\$35,629	\$33,072	\$93,634	\$60,633
Net investment income before investment gains and losses per common share:				
Basic	\$0.31	\$0.29	\$0.87	\$0.87
Change in net assets resulting from operations per common share:				
Basic	\$0.37	\$0.40	\$1.04	\$0.73
Diluted	\$0.37	\$0.40	\$1.04	\$0.73
Weighted average shares outstanding				
Basic	95,460	82,496	89,100	82,073
Diluted	95,671	82,607	89,212	82,173
Distributions declared per common share:				
Basic	\$0.31	\$0.31	\$0.93	\$0.93

See notes to consolidated financial statements.

## HERCULES CAPITAL, INC.

## CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS

(unaudited)

(dollars and shares in thousands)

	Common Shares	Stock Par Value	Capital in excess of par value	Unrealized Appreciation (Depreciation) on Investment	Accumulated Undistributed Realized Gains (Losses) on Investment	Undistributed Net Investment Income	Net Assets
Balance at December 31, 2016	79,555	\$ 80	\$839,657	\$ (89,025 )	\$ 14,314	\$ 22,918	\$787,944
Net increase (decrease) in net assets resulting from operations	—	—	—	15,637	(26,929 )	71,925	60,633
Public offering, net of offering expenses	4,077	4	56,330	—	—	—	56,334
Issuance of common stock due to stock option exercises	46	—	213	—	—	—	213
Retired shares from net issuance	(18 )	—	(172 )	—	—	—	(172 )
Issuance of common stock under restricted stock plan	10	—	—	—	—	—	—
Retired shares for restricted stock vesting	(187 )	—	(2,483 )	—	—	—	(2,483 )
Distributions reinvested in common stock	132	—	1,780	—	—	—	1,780
Issuance of Convertible Notes	—	—	3,413	—	—	—	3,413
Distributions	—	—	—	—	(14,893 )	(62,104 )	(76,997 )
Stock-based compensation <sup>(1)</sup>	—	—	5,619	—	—	—	5,619
Balance at September 30, 2017	83,615	\$ 84	\$904,357	\$ (73,388 )	\$ (27,508 )	\$ 32,739	\$836,284
Balance at December 31, 2017	84,424	\$ 85	\$908,501	\$ (79,760 )	\$ (20,374 )	\$ 32,515	\$840,967
Net increase (decrease) in net assets resulting from operations	—	—	—	25,976	(10,481 )	78,139	93,634
Public offering, net of offering expenses	11,953	11	143,787	—	—	—	143,798
Issuance of common stock due to stock option exercises	63	—	704	—	—	—	704
	(57 )	—	(718 )	—	—	—	(718 )

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Retired shares from net issuance							
Issuance of common stock under restricted stock plan	336	—	—	—	—	—	—
Retired shares for restricted stock vesting	(76 )	—	(937 )	—	—	—	(937 )
Distributions reinvested in common stock	108	—	1,372	—	—	—	1,372
Distributions	—	—	—	—	—	(82,806 )	(82,806 )
Stock-based compensation <sup>(1)</sup>	—	—	8,166	—	—	—	8,166
Balance at September 30, 2018	96,751	\$ 96	\$1,060,875	\$ (53,784 )	\$ (30,855 )	\$ 27,848	\$1,004,180

(1) Stock-based compensation includes \$33 and \$46 of restricted stock and option expense related to director compensation for the nine months ended September 30, 2018 and 2017, respectively.

See notes to consolidated financial statements.

## HERCULES CAPITAL, INC.

## CONSOLIDATED STATEMENT OF CASH FLOWS

(unaudited)

(dollars in thousands)

	For the Nine Months Ended September 30,	
	2018	2017
Cash flows from operating activities:		
Net increase (decrease) in net assets resulting from operations	\$93,634	\$60,633
Adjustments to reconcile net increase in net assets resulting from operations to net cash provided by (used in) operating activities:		
Purchase of investments	(706,113)	(487,321)
Principal and fee payments received on investments	503,971	486,985
Proceeds from the sale of investments	17,521	21,945
Net unrealized depreciation (appreciation) on investments	(25,976 )	(15,637 )
Net realized loss (gain) on investments	10,481	26,929
Accretion of paid-in-kind principal	(7,040 )	(7,078 )
Accretion of loan discounts	(2,961 )	(5,242 )
Accretion of loan discount on Convertible Notes	504	448
Accretion of loan exit fees	(12,482 )	(14,413 )
Change in deferred loan origination revenue	3,472	1,083
Unearned fees related to unfunded commitments	1,908	441
Amortization of debt fees and issuance costs	5,197	4,534
Depreciation	147	153
Stock-based compensation and amortization of restricted stock grants <sup>(1)</sup>	8,166	5,619
Change in operating assets and liabilities:		
Interest and fees receivable	(3,460 )	1,107
Prepaid expenses and other assets	2,141	(1,100 )
Accounts payable	(187 )	—
Accrued liabilities	(4,282 )	(2,457 )
Net cash provided by (used in) operating activities	(115,359)	76,629
Cash flows from investing activities:		
Purchases of capital equipment	(325 )	(127 )
Net cash provided by (used in) investing activities	(325 )	(127 )
Cash flows from financing activities:		
Issuance of common stock, net	143,498	56,334
Retirement of employee shares	(651 )	(2,442 )
Distributions paid	(81,434 )	(75,217 )
Issuance of 2022 Convertible Notes	—	230,000
Issuance of 2024 Notes	—	5,637

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Issuance of 2025 Notes	75,000	—
Issuance of 2033 Notes	40,000	—
Repayments of 2019 Notes	—	(110,364)
Repayments of 2024 Notes	(100,000)	—
Repayments of 2021 Asset-Backed Notes	(45,637 )	(43,729 )
Repayments of Long-Term SBA Debentures	(41,200 )	—
Borrowings of credit facilities	216,109	8,497
Repayments of credit facilities	(135,216)	(13,513 )
Cash paid for debt issuance costs	(3,978 )	(4,662 )
Fees paid for credit facilities and debentures	(161 )	(28 )
Net cash provided by (used in) financing activities	66,330	50,513
Net increase (decrease) in cash, cash equivalents and restricted cash	(49,354 )	127,015
Cash, cash equivalents and restricted cash at beginning of period	94,995	21,366
Cash, cash equivalents and restricted cash at end of period	\$45,641	\$148,381
Supplemental non-cash investing and financing activities:		
Distributions reinvested	1,372	1,780

(1) Stock-based compensation includes \$33 and \$46 of restricted stock and option expense related to director compensation for the nine months ended September 30, 2018 and 2017, respectively.

See notes to consolidated financial statements.

The following table presents a reconciliation of cash, cash equivalents and restricted cash reported within the Consolidated Statement of Assets and Liabilities that sum to the total of the same such amounts in the Consolidated Statement of Cash Flows:

(Dollars in thousands)	For the Nine Months Ended September 30,	
	2018	2017
Cash and cash equivalents	\$43,212	\$140,568
Restricted cash	2,429	7,813
Total cash, cash equivalents and restricted cash presented in the Consolidated Statements of Cash Flows	\$45,641	\$148,381

See “Note 2 – Summary of Significant Accounting Policies” and “Note 11- Recent Accounting Pronouncements” for a description of restricted cash and cash equivalents.

See notes to consolidated financial statements.

## HERCULES CAPITAL, INC.

## CONSOLIDATED SCHEDULE OF INVESTMENTS

September 30, 2018

(unaudited)

(dollars in thousands)

Portfolio Company	Sub-Industry	Type of Investment <sup>(1)</sup>	Maturity Date	Interest Rate and Floor <sup>(2)</sup>	Principal Amount	Cost <sup>(3)</sup>	Value <sup>(4)</sup>
<b>Debt Investments</b>							
<b>Biotechnology Tools</b>							
<b>Under 1 Year Maturity</b>							
Excicure, Inc. <sup>(12)</sup>	Biotechnology Tools	Senior Secured	September 2019	Interest rate PRIME + 6.45% or Floor rate of 9.95%, 3.85% Exit Fee	\$4,999	\$5,171	\$5,171
<b>Subtotal: Under 1 Year Maturity</b>						5,171	5,171
<b>Subtotal: Biotechnology Tools (0.51%)*</b>						5,171	5,171
<b>Consumer &amp; Business Products</b>							
<b>1-5 Years Maturity</b>							
WHOOP, INC. <sup>(12)</sup>	Consumer & Business Products	Senior Secured	July 2021	Interest rate PRIME + 3.75% or Floor rate of 8.50%, 6.95% Exit Fee	\$6,000	5,970	5,970
<b>Subtotal: 1-5 Years Maturity</b>						5,970	5,970
<b>Subtotal: Consumer &amp; Business Products (0.59%)*</b>						5,970	5,970
<b>Diversified Financial Services</b>							
<b>1-5 Years Maturity</b>							
Gibraltar Business Capital, LLC <sup>(7)</sup>	Diversified Financial Services	Unsecured	March 2023	Interest rate FIXED 14.50%	\$15,000	14,718	14,865
<b>Subtotal: 1-5 Years Maturity</b>						14,718	14,865