

Edgar Filing: MACC PRIVATE EQUITIES INC - Form 10-Q

MACC PRIVATE EQUITIES INC  
Form 10-Q  
February 14, 2005

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 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 December 31, 2004  
-----

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 0-24412  
-----

MACC Private Equities Inc.

-----  
(Exact name of registrant as specified in its charter)

Delaware

42-1421406

-----  
(State or other jurisdiction of incorporation  
or organization)

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

101 Second Street SE, Suite 800, Cedar Rapids, Iowa 52401  
-----

(Address of principal executive offices)  
(Zip Code)

(319) 363-8249

-----  
(Registrant's telephone number, including area code)

-----  
(Former name, former address and former fiscal year,  
if changed since last report)

Please 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   
-----

Please indicate by check mark whether the registrant is an accelerated

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filer (as defined in Rule 12b-2 of the Exchange Act).

Yes            No    X  
-----    -----

## APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

At January 31, 2005, the registrant had issued and outstanding 2,329,255 shares of common stock.

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**PART 1 -- FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**MACC PRIVATE EQUITIES INC. AND SUBSIDIARY  
Condensed Consolidated Balance Sheets  
(Unaudited)**

	December 31, 2004	September 30, 2004
	-----	-----
Assets		
Loans and investments in portfolio securities, at fair value:		
Unaffiliated companies (cost of \$7,603,743 and \$10,367,898)	\$ 6,331,206	7,352,409
Affiliated companies (cost of \$18,955,014 and \$19,100,024)	21,991,431	21,266,781
Controlled companies (cost of \$4,536,309 and \$4,536,309)	4,968,058	4,598,894
Cash and cash equivalents	5,427,926	4,774,771
Interest receivable	257,060	221,844
Other assets	645,939	729,417
	-----	-----
Total assets	\$ 39,621,620	38,944,116
	=====	=====
Liabilities and net assets		
Liabilities:		
Debentures payable	\$ 25,790,000	25,790,000
Litigation settlement payable	1,713,174	1,713,174
Note payable-related party	305,000	270,000
Deferred incentive fees payable	18,353	18,353
Accrued interest	632,320	180,138
Accounts payable and other liabilities	260,306	234,230
	-----	-----
Total liabilities	28,719,153	28,205,895
	-----	-----
Net assets:		
Common stock, \$.01 par value per share; authorized 4,000,000 shares; issued and outstanding 2,329,255 shares	23,293	23,293
Additional paid-in-capital	8,683,545	11,501,075
Unrealized appreciation (depreciation) on investments	2,195,629	(786,147)
	-----	-----
Total net assets	10,902,467	10,738,221
	-----	-----
Total liabilities and net assets	\$ 39,621,620	38,944,116

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	=====	=====
Net assets per share	\$ 4.68	4.61
	=====	=====

See accompanying notes to unaudited condensed consolidated financial statements.

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**MACC PRIVATE EQUITIES INC. AND SUBSIDIARY**  
**Condensed Consolidated Statements of Operations**  
**(Unaudited)**

	For the three months ended December 31, 2004	For the three months ended December 31, 2003
	-----	-----
Investment income:		
Interest		
Unaffiliated companies	\$ 50,100	121,620
Affiliated companies	219,467	155,407
Controlled companies	208,047	69,471
Other	18,984	8,796
Dividends		
Unaffiliated companies	---	78,204
Affiliated companies	194,152	55,016
Processing fees	7,700	---
Other	1,000	3,000
	-----	-----
Total investment income	699,450	491,514
	-----	-----
Operating expenses:		
Interest expenses	521,068	531,714
Management fees	244,439	260,534
Incentive fees	---	423,112
Professional fees	176,783	191,826
Other	82,622	68,085
	-----	-----
Total operating expenses before management fees waived	1,024,912	1,475,271
Management fees waived	---	(52,800)
	-----	-----
Net operating expenses	1,024,912	1,422,471
Investment expense, net	(325,462)	(930,957)
	-----	-----
Realized and unrealized gain on investments and other assets:		

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Net realized (loss) gain on investments:		
Unaffiliated companies	(2,467,409)	2,238,432
Affiliated companies	---	(467,514)
Controlled companies	---	539,250
Net change in unrealized appreciation/ depreciation on investments	2,981,776	(1,769,502)
Net change in unrealized (loss) gain on other assets	(24,659)	2,804
	-----	-----
Net gain on investments	489,708	543,470
	-----	-----
Net change in net assets from operations	\$ 164,246	(387,487)
	=====	=====

See accompanying notes to unaudited condensed consolidated financial statements.

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**MACC PRIVATE EQUITIES INC. AND SUBSIDIARY**  
**Condensed Consolidated Statements of Cash Flows**  
**(Unaudited)**

	For the three months ended December 31, 2004	For the three months ended December 31, 2003
	-----	-----
Cash flows from operating activities:		
Increase (decrease) in net assets from operations	\$ 164,246	(387,487)
	-----	-----
Adjustments to reconcile increase (decrease) in net assets from operations to net cash provided by operating activities:		
Net realized and unrealized gain on investments	(514,367)	(117,554)
Net realized and unrealized loss (gain) on other assets	24,659	(2,804)
Proceeds from disposition of and payments on loans and investments in portfolio securities	850,992	5,320,981
Payments of incentive fees to investment advisor	---	(423,112)
Purchases of loans and investments in portfolio securities	(385,000)	(236,808)
Change in interest receivable	(59,452)	(85,047)
Change in other assets	58,819	650,412
Change in accrued interest, deferred		

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incentive fees payable, accounts payable and other liabilities	478,258	430,695
Other	---	38,000
	-----	-----
Total adjustments	453,909	5,574,763
	-----	-----
Net cash provided by operating activities	618,155	5,187,276
	-----	-----
Cash flows from financing activities:		
Proceeds from issuance of note payable-related party	35,000	---
	-----	-----
Net cash provided by financing activities	35,000	---
	-----	-----
Net increase in cash and cash equivalents	653,155	5,187,276
Cash and cash equivalents at beginning of period	4,774,771	722,691
	-----	-----
Cash and cash equivalents at end of period	\$ 5,427,926	5,909,967
	=====	=====
Supplemental disclosure of cash flow information - Cash paid during the period for interest	\$ 37,853	37,853
	=====	=====
Supplemental disclosure of noncash investing and financing information - Assets received in exchange of securities	\$ 24,236	153,016
	=====	=====

See accompanying notes to unaudited condensed consolidated financial statements.

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**MACC PRIVATE EQUITIES INC.**

Notes to Unaudited Condensed Consolidated Financial Statements

(1) Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of MACC Private Equities Inc. (MACC) and its wholly owned subsidiary MorAmerica Capital Corporation (MorAmerica Capital) which have been prepared in accordance with accounting principles generally accepted in the

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United States of America for investment companies. All material intercompany accounts and transactions have been eliminated in consolidation.

The financial statements included herein have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and instructions to Form 10-Q and Article 6 of Regulation S-X. The financial statements should be read in conjunction with the consolidated financial statements and notes thereto of MACC Private Equities Inc. and its Subsidiary as of and for the year ended September 30, 2004. The information reflects all adjustments consisting of normal recurring adjustments which are, in the opinion of management, necessary for a fair presentation of the results of operations for the interim periods. The results of the interim period reported are not necessarily indicative of results to be expected for the year. The balance sheet information as of September 30, 2004 has been derived from the audited balance sheet as of that date.

Certain reclassifications have been made to prior period consolidated financial statements to conform to the December 31, 2004 presentation.

### (2) Critical Accounting Policy

Investments in securities traded on a national securities exchange (or reported on the NASDAQ national market) are stated at the average of the bid price on the three final trading days of the valuation period which is not materially different from the bid price on the final day of the period. Restricted and other securities for which quotations are not readily available are valued at fair value as determined by the Board of Directors. Among the factors considered in determining the fair value of investments are the cost of the investment; developments, including recent financing transactions, since the acquisition of the investment; financial condition and operating results of the investee; the long-term potential of the business of the investee; market interest rates for similar debt securities; and other factors generally pertinent to the valuation of investments. However, because of the inherent uncertainty of valuation, those estimated values may differ significantly from the values that would have been used had a ready market for the securities existed, and the differences could be material.

In the valuation process, MorAmerica Capital uses financial information received monthly, quarterly, and annually from its portfolio companies which includes both audited and unaudited financial statements. This information is used to determine financial condition, performance, and valuation of the portfolio investments.

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Realization of the carrying value of investments is subject to future developments. Investment transactions are recorded on the trade date and identified cost is used to determine realized gains and losses. Under the provisions of SOP 90-7, the fair value of loans and investments in portfolio securities on February 15, 1995, the fresh-start date, is considered the cost basis for financial statement purposes.

### (3) Litigation Settlement

At December 31, 2004, MorAmerica Capital was a party to arbitration proceedings instituted by TransCore Holdings, Inc., a company (Buyer) seeking indemnification under the Stock Purchase Agreement (the Stock Purchase

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Agreement) by which MorAmerica Capital and certain other individuals and institutional investors (collectively, the Sellers) sold their interest in a former portfolio company investment (Portfolio Company). Under the Stock Purchase Agreement, the Sellers agreed to indemnify Buyer for breaches of representations and warranties as to Portfolio Company made by the Sellers. Buyer claims that accounting irregularities by management at Portfolio Company resulted in a breach of the Sellers' representations and warranties.

Following the sale transaction, MorAmerica Capital owned debt securities (cost of \$508,761) and warrants (cost of \$24,000) of Buyer, issued as part of the sale transaction. During the arbitration, buyer refinanced certain of its obligations, including the debt securities held by MorAmerica Capital, and the principal amount of these debt securities and accrued interest, as well as an amount representing the agreed value of the warrants, has been deposited in an escrow account pending conclusion of the arbitration proceedings.

The arbitrator found all of the Sellers to be jointly and severally liable to Buyer. However, MorAmerica Capital is a party to a Contribution Agreement executed at the time of sale among the institutional investors and two individuals.

On January 4, 2005, the Sellers reached a settlement agreement with Buyer of approximately \$20 million. MorAmerica Capital's share of the settlement is \$2,245,935. The Company recorded the effects of the settlement in its September 30, 2004 consolidated financial statements which included the recording of a "Litigation settlement payable" in the amount of \$1,713,174. This amount is outstanding at December 31, 2004 and represents the Company's portion of the settlement (\$2,245,935) less the amount in escrow (\$532,761) the Company can use to offset its payment. The amount in escrow had been valued at \$1. On January 5, 2005, the Company paid its portion of the settlement (\$1,713,174) to satisfy its obligation.

#### (4) Commitments and Contingencies

As an SBIC, MorAmerica Capital is required to comply with the regulations of the SBA (the "SBA Regulations"). These regulations include the capital impairment rules, as defined by Regulation 107.1830 of the SBA Regulations. As of December 31, 2004, the capital of MorAmerica Capital was impaired by approximately 54.71%, which exceeded the 50% maximum impairment percentage permitted under the SBA Regulations. Accordingly, the SBA currently has the discretion not to extend additional financing to MorAmerica Capital, as well as the right to declare a default on MorAmerica Capital's outstanding SBA-guaranteed debentures, to accelerate MorAmerica Capital's payment obligations thereunder

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and to seek appointment of the SBA as receiver for MorAmerica Capital. If the SBA were to exercise its right to accelerate MorAmerica Capital's payment obligations under the outstanding SBA-guaranteed debentures, MorAmerica Capital may be required to liquidate some or all of its portfolio investments. Because most of its portfolio investments are not publicly traded, MorAmerica Capital may receive less than the carrying value for its portfolio investments in connection with such a forced sale. Therefore, the exercise by the SBA of any of these rights could have a material adverse effect on the financial position, results of operations, cash flow and liquidity of MACC and MorAmerica Capital and raises substantial doubt about the Company's ability to continue as a going

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concern.

(5) Financial Highlights

	For the three months ended December 31, 2004 -----	For the three months ended December 31, 2003 -----
Per Share Operating Performance		
(For a share of capital stock outstanding throughout the period (1):		
Net asset value, beginning of period	\$ 4.61 -----	5.47 -----
Income from investment operations:		
Investment expense, net	(0.14)	(0.21)
Net realized and unrealized (loss) gain on investment transactions	0.21	0.05
Total from investment operations	----- 0.07 -----	----- (0.16) -----
Net asset value, end of period	\$ 4.68 =====	5.31 =====
Closing market price	\$ 3.15 =====	2.75 =====
	For the three months ended December 31, 2004 -----	For the three months ended December 31, 2003 -----
Total return		
Net asset value basis (1)	1.53 %	(3.04)
Market price basis	(8.70) %	9.13
Net asset value, end of period (in thousands)	\$ 10,902	12,358
Ratio to average net assets:		
Investment (expense) income, net (1)	(3.13) %	(7.11)
Operating and income tax expense (1)	9.84 %	10.86

---

(1) MACC's investment advisor agreed to a voluntary, temporary reduction in management fees from January 1, 2003 through February 29, 2004. Due to the agreement, the investment advisor voluntarily waived \$0 and \$52,800 of management fees for the three months ended December 31, 2004 and 2003, respectively. Excluding the effects of the waiver for the three months ended December 31, 2004 and 2003, total return on a net assets value basis would be 1.53% and (3.45)%, respectively; the investment (expense) income,

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net ratio would be (3.13)% and (7.53)%, respectively; and the operating and income expense ratio would be 9.84% and 11.29%, respectively.

The ratios of investment (expense) income, net to average net assets, of operating and income tax expenses to average net assets and total return are calculated for common stockholders as a class. Total return, which reflects the annual change in net assets, was calculated using the change in net assets between the beginning and end of the year. An individual common stockholders' return may vary from these returns.

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MACC PRIVATE EQUITIES INC. AND SUBSIDIARY  
 CONSOLIDATED SCHEDULE OF INVESTMENTS  
 DECEMBER 31, 2004

Manufacturing:

Company	Security	Percent Net ass
<hr style="border-top: 1px dotted black;"/>		
Architectural Art Manufacturing, Inc. (a) Wichita, Kansas Manufacturer of industrial and commercial boilers and shower doors, frames and enclosures	12% debt security, due March 31, 2007 (c) Warrant to purchase 11,143 common shares (c) 10% debt security, due March 31, 2007 (c) 121,457 common shares (c)	
Aviation Manufacturing Group, LLC (a) Yankton, South Dakota Manufacturer of flight critical parts for aircraft	14% debt security, due October 1, 2007 154,000 units preferred Membership interest	
Central Fiber Corporation Wellsville, Kansas Recycles and manufactures cellulose fiber products	12% debt security, due December 31, 2005 12% debt security, due December 31, 2005 Warrant to purchase 490.67 common shares (c)	
Detroit Tool Metal Products Co. (a) Lebanon, Missouri Metal stamping	14% debt security, due February 29, 2008 19,853.94 shares Series A preferred (c)	
Handy Industries, LLC (a) Marshalltown, Iowa Manufacturer of lifts for motorcycles, trucks and	12.5% debt security, due January 8, 2007 167,171 units Class B preferred (c) Membership interest	

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industrial metal products

Hicklin Engineering, L.C. (a) Des Moines, Iowa Manufacturer of auto and truck transmission and brake dynamometers	10% debt security, due June 30, 2007 Membership interest
Humane Manufacturing, LLC (b) Baraboo, Wisconsin Manufacturer of rubber mats for anti-fatigue, agricultural, exercise and roofing markets	12% debt security, due January 31, 2005 12% promissory note, due December 31, 2004 Membership interest (c)
Industrial Tooling & Fabrication, LLC (a) Fort Madison, Iowa Metal stamping	10% debt security, due November 18, 2009 12% debt security, due November 18, 2009

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MACC PRIVATE EQUITIES INC. AND SUBSIDIARY  
 CONSOLIDATED SCHEDULE OF INVESTMENTS CONTINUED...  
 DECEMBER 31, 2004

Manufacturing Continued:

Company	Security	Percent Net ass
.....		
KW Products, Inc. (a) Marion, Iowa Manufacturer of automobile aftermarket engine and brake repair machinery	11% debt security, due June 15, 2005 (c) 11% debt security, due June 15, 2005 (c) 29,340 common shares (c) Warrant to purchase 8,879 common shares (c)	
Linton Truss Corporation Delray Beach, Florida Manufacturer of residential roof and floor truss systems	542.8 common shares (c) 400 shares Series 1 preferred (c) Warrants to purchase common shares (c)	
M.A. Gedney Company (a) Chaska, Minnesota Pickle processor	536,003 shares preferred (c) Warrant to purchase 34,223 preferred shares (c)	

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Magnum Systems, Inc. (a) Parsons, Kansas Manufacturer of industrial bagging equipment	12% debt security, due July 31, 2006 48,038 common shares (c) 292,800 shares preferred (c) Warrant to purchase 56,529 common shares (c)
Metal Tooling Holdings, Inc. (a) Lebanon, Missouri Metal stamping	6,652.98 common shares 1,234.19 common shares
Penn Wheeling Acquisition Company, LLC (a) Glen Dale, West Virginia Metal closure manufacturer	13% debt security, due March 10, 2007 62 units Class B membership interest (c) 35 units Class C membership interest (c)
Pratt-Read Corporation (a) Bridgeport, Connecticut Manufacturer of screwdriver shafts and handles and other hand tools	13,889 shares Series A Preferred 7,718 shares Series A preferred 13% debt security, due July 26, 2006 Warrants to purchase common shares (c)
Simoniz USA, Inc. Bolton, Connecticut Producer of cleaning and wax products under both the Simoniz brand and private label brand names	12% debt security, due April 1, 2008

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MACC PRIVATE EQUITIES INC. AND SUBSIDIARY  
 CONSOLIDATED SCHEDULE OF INVESTMENTS CONTINUED...  
 DECEMBER 31, 2004

Manufacturing Continued:

Company	Security	Percent Net ass
.....		
Spectrum Products, LLC (b) Missoula, Montana Manufacturer of equipment for the swimming pool industry	13% debt security, due October 9, 2006 385,000 units Series A preferred Membership interest	

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Total manufacturing		155.64
		=====
Service:		
Concentrix Corporation (a)	3,758,750 shares Series A preferred (c)	
Pittsford, New York	130,539 shares Series C preferred (c)	
Provides marketing outsourcing solutions including telemarketing, fulfillment and web communications	328,485 shares Series D preferred (c)	
Direct Mail Holding, LLC (a)	Membership interest	
Mt. Pleasant, Iowa		
Provider of turnkey services for non-profit fund raising		
FreightPro, Inc.	16.50% debt security, due February 21, 2007 (c)	
Overland Park, Kansas	16.50% debt security, due February 15, 2007 (c)	
Internet based outsource provider of freight logistics	Warrant to purchase 366,177.80 common shares (c)	
JHT Holdings, Inc.	1,238 shares Class A common (c)	
Joplin, Missouri		
Provider of truck drive-away, internet based auction and related services to the commercial truck industry		
Lee Mathews Equipment, Inc.	12% debt security, due March 10, 2005	
Kansas City, Missouri	Warrant to purchase 153,654 common shares (c)	
Distributor of industrial pump systems	12% debt security, due March 10, 2005	
Monitronics International, Inc.	73,214 common shares (c)	
Dallas, Texas		
Provides home security systems monitoring services		

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MACC PRIVATE EQUITIES INC. AND SUBSIDIARY  
CONSOLIDATED SCHEDULE OF INVESTMENTS CONTINUED...  
DECEMBER 31, 2004

Service Continued:

Company	Security	Percent
.....	.....	Net ass

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Morgan Ohare, Inc. (b)	0% debt security, due January 1, 2007 (c)
Addison, Illinois	10% debt security, due January 1, 2007
Fastener plating and heat treating	57 common shares (c)
	10% debt security, due January 1, 2007
	10% debt security, due January 1, 2007
	10% debt security, due January 1, 2007
	10% debt security, due January 1, 2007

Organized Living, Inc.	545,204 shares Series A preferred (c)
Westerville, Ohio	215,593 shares Series B preferred (c)
Retail specialty stores for storage and organizational products	174,964.5714 shares Series C preferred (c)
	138,889 shares Series D preferred (c)
	800,000 shares Series F preferred (c)

SMWC Acquisition Co., Inc. (a)	10% debt security, due on demand
Kansas City, Missouri	13% debt security due May 19, 2007
Steel warehouse distribution and processing	1,320 shares common (c)
	Warrant to purchase 2,200 common shares (c)
	176,550 shares Series A preferred (c)

Warren Family Funeral Homes, Inc.	12% debt security, due June 29, 2006
Topeka, Kansas	12% debt security, due June 29, 2006
Provider of value priced funeral services	Warrant to purchase 346.5 common shares (c)

Total service

103.54  
=====

Technology and Communications:

Feed Management Systems, Inc. (a)	540,551 common shares (c)
Brooklyn Center, Minnesota	674,309 shares Series A preferred (c)
Batch feed software and systems and B2B internet services	12% debt security, due May 20, 2008
	12% debt security, due August 21, 2008
	Warrants to purchase 166,500 Series A preferred (c)

MainStream Data, Inc. (a)	322,763 shares Series A preferred (c)
Salt Lake City, Utah	
Content delivery solutions provider	

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MACC PRIVATE EQUITIES INC. AND SUBSIDIARY  
 CONSOLIDATED SCHEDULE OF INVESTMENTS CONTINUED...  
 DECEMBER 31, 2004

Technology and Communications Continued:

Company	Security	Percent Net ass
Miles Media Group, Inc. (a) Sarasota, Florida Tourist magazine publisher	1,000 common shares (c) 100 common options (c) 12% debt security, due September 24, 2007 (c) 150 shares Series A preferred (c) 12% debt security, due September 24, 2007 (c) 50 shares Series A preferred (c) 12% debt security, due June 30, 2008 (c) Warrants to purchase 1,423 shares common (c)	
Phonex Broadband Corporation Midvale, Utah Power line communications	1,855,302 shares Series A preferred (c)	
Portrait Displays, Inc. Pleasanton, California Designs and markets pivot enabling software for LCD computer monitors	12% debt security, due April 1, 2005 8% debt security, due April 1, 2009 (c) 8% debt security, due April 1, 2012 (c) Warrant to purchase 39,400 common shares (c)	
SnapNames.com, Inc. Portland, Oregon Domain name management	10% debt security, due March 15, 2007 Warrant to purchase 465,000 common shares (c)	
Total technology and communications		46.17% =====

- (a) Affiliated company.
- (b) Controlled company.
- (c) Non-income producing.
- (d) For all debt securities presented, the cost is equal to the principal balance.

**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

This section contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the "1995 Act"). Such statements are made in good faith by MACC pursuant to the safe-harbor provisions of the 1995 Act, and are identified as including terms such as "may," "will," "should," "expects," "anticipates," "estimates," "plans," or similar language. In connection with these safe-harbor provisions, MACC has identified in its Annual Report to Shareholders for the fiscal year ended September 30, 2004, important factors that could cause actual results to differ materially from those contained in any forward-looking statement made by or on behalf of MACC, including, without limitation, the high risk nature of MACC's portfolio investments, the effects of general economic conditions on MACC's portfolio companies, the effects of recent or future losses on the ability of MorAmerica Capital to comply with applicable regulations of the Small Business Administration and MorAmerica Capital's ability to obtain future funding, any actions taken by the SBA with respect to MorAmerica Capital's impairment, any failure to achieve annual investment level objectives, changes in prevailing market interest rates, and contractions in the markets for corporate acquisitions and initial public offerings. MACC further cautions that such factors are not exhaustive or exclusive. MACC does not undertake to update any forward-looking statement which may be made from time to time by or on behalf of MACC.

**Results of Operations**

MACC's investment income includes income from interest, dividends and fees. Investment expense, net represents total investment income minus net operating expenses after management fees waived. The main objective of portfolio company investments is to achieve capital appreciation and realized gains in the portfolio. These gains and losses are not included in investment expense, net. However, another one of MACC's on-going goals is to achieve net investment income and increased earnings stability. In this regard, a significant proportion of new portfolio investments are structured so as to provide a current yield through interest or dividends. MACC also earns interest on short-term investments of cash.

First Quarter Ended December 31, 2004 Compared to First Quarter Ended December 31, 2003

	For the three months ----- ended December 31, -----		
Change	2004	2003	Change
	-----		
Total investment income	\$ 699,450	491,514	207,936
Net operating expenses	(1,024,912)	(1,422,471)	(397,559)
	-----		
Investment expense, net	(325,462)	(930,957)	605,495
	-----		

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Net realized (loss) gain on investments	(2,467,409)	2,310,168	(4,777,577)
Net change in unrealized appreciation/ depreciation on investments	2,981,776	(1,769,502)	4,751,278
Net change in unrealized (loss) gain on other assets	(24,659)	2,804	(27,463)
	-----	-----	-----
Net gain on investments	489,708	543,470	(53,762)
	-----	-----	-----
Net change in net assets from operations	\$ 164,246	(387,487)	551,733
	=====	=====	=====
Net asset value:			
Beginning of period		\$ 4.61	5.47
End of period		\$ 4.68	5.31
		=====	=====

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Total Investment Income

During the current year first quarter, total investment income was \$699,450, an increase of \$207,936, or 42%, from total investment income of \$491,514 for the prior year first quarter. In the current year first quarter as compared to the prior year first quarter, interest income increased \$141,304, or 40%, dividend income increased \$60,932, or 46%, processing fees increased \$7,700, or 100%, and other income decreased \$2,000, or 67%. The increase in interest income is due to interest received in the current year first quarter on one follow-on investment made during the current year first quarter and on debt portfolio securities issued by two portfolio companies which were on non-accrual of interest status in the prior year first quarter. In the current year first quarter, MACC received dividends on three existing portfolio companies, one of which was a distribution from a limited liability company, as compared to dividend income received in the prior year first quarter from three existing portfolio companies, all of which were distributions from limited liability companies. Processing fees increased due to fees received on the follow-on investment made in the current year first quarter, compared to no new portfolio company investments in which MACC received a processing fee at closing in the prior year first quarter. The decrease in other income is due to the collection on an account charge off in the prior year first quarter.

Net Operating Expenses

Total net operating expenses for the first quarter of the current year were \$1,024,912, a decrease of \$397,559, or 28%, as compared to total operating expenses for the prior year first quarter of \$1,422,471. Interest expense decreased \$10,646, or 2%, in the current year first quarter due to the repayment in the fourth quarter of fiscal year 2004 of \$2,150,000 of borrowings from the Small Business Administration. Management fees (after management fees waived in the prior year first quarter) increased \$36,705, or 18%, in the current year first quarter due to the termination during the second quarter of 2004 of the agreement with MACC's investment advisor to a voluntary, temporary reduction in management fees to reduce the expenses of MACC. Incentive fees decreased \$423,112, or 100%, in the current year first quarter due to no net capital gains realized. Professional fees decreased \$15,043, or 8%, in the current year first quarter primarily due a decrease in legal expenses from the arbitration proceedings related to the sale of a former portfolio company. Other expenses increased \$14,537, or 21%, in the current year first quarter as compared to the prior year first quarter mainly due to the increase in directors and officers insurance.

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### Investment Expense, Net

For the current year first quarter, MACC recorded investment expense, net of \$325,462, as compared to investment expense, net of \$930,957 during the prior year first quarter.

### Net Realized (Loss) Gain on Investments

During the current year first quarter, MACC recorded net realized loss on investments of \$2,467,409, as compared with net realized gain on investments of \$2,310,168 during the prior year first quarter. In the current year first quarter, MACC realized a loss of \$635,251 from the sale of one portfolio company and \$1,832,158 from the write-off of one portfolio company of which \$1,832,071 was previously recorded as unrealized depreciation.

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Management does not attempt to maintain a comparable level of realized gains quarter to quarter but instead attempts to maximize total investment portfolio appreciation through realizing gains in the disposition of securities and investing in new portfolio investments. MACC's investment advisor is entitled to be paid an incentive fee which is calculated as a percentage of the excess of MACC's realized gains in a particular period, over the sum of net realized losses and unrealized depreciation during the same period. As a result, the timing of realized gains, realized losses and unrealized depreciation can have an effect on the amount of the incentive fee payable to the investment advisor.

### Net Change in Unrealized Appreciation/Depreciation of Investments and Other Assets

MACC recorded net change in unrealized appreciation/depreciation on investments of \$2,981,776 during the current year first quarter, as compared to (\$1,769,502) during the prior year first quarter. This net change in unrealized appreciation/depreciation on investments of \$2,981,776 is the net effect of increases in fair value of five portfolio companies totaling \$1,657,310, decreases in fair value of five portfolio companies totaling \$1,107,604, the reversal of \$2,432,070 of depreciation resulting from the sale of one portfolio investment and the write-off of the investment in one portfolio investment.

Net change in unrealized appreciation/depreciation on investments represents the change for the period in the unrealized appreciation net of unrealized depreciation on MACC's total investment portfolio. When MACC increases the fair value of a portfolio investment above its cost, the unrealized appreciation for the portfolio as a whole increases, and when MACC decreases the fair value of a portfolio investment below its cost, unrealized depreciation for the portfolio as a whole increases. When MACC sells an appreciated portfolio investment for a gain, unrealized appreciation for the portfolio as a whole decreases as the gain is realized. Similarly, when MACC sells or writes off a depreciated portfolio investment for a loss, unrealized depreciation for the portfolio as a whole decreases as the loss is realized.

Net change in unrealized loss on other assets had an additional loss provision of \$24,659 during the current year first quarter recorded with respect to other securities which are classified as other assets, as compared to a net change in unrealized gain on other assets of \$2,804 during the prior year first quarter.

### Net Change in Net Assets from Operations

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MACC experienced an increase of \$164,246 in net assets at the end of the first quarter of fiscal year 2005, and the resulting net asset value per share was \$4.68 as of December 31, 2004, as compared to \$4.61 as of September 30, 2004. Although general economic conditions continue to have an adverse impact on the operating results and financial condition of a number of MACC's portfolio companies, the majority of MACC's thirty-one portfolio companies continue to be valued at cost or above. MACC has nine portfolio investments valued at cost, has recorded unrealized appreciation on ten portfolio investments and has recorded unrealized depreciation on twelve portfolio investments.

MACC has projected fewer investments and has projected no new borrowings under the SBIC leverage program in the fiscal year 2005 budget. Recent years have been difficult years for the venture capital industry. With the recent improvement in the economy, MACC's

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overall portfolio is showing signs of increasing strength. However, manufacturing and some market niches are lagging the overall improvement in the economy. If the economy continues to improve, management believes MACC's investment portfolio will benefit from improved operating performance at a number of portfolio companies and from a more robust market for corporate acquisitions and investments.

### **Financial Condition, Liquidity and Capital Resources**

To date, MACC has relied upon several sources to fund its investment activities, including MACC's cash and money market accounts and the Small Business Investment Company ("SBIC") leverage program operated by the Small Business Administration (the "SBA").

As an SBIC, MorAmerica Capital is required to comply with the regulations of the SBA (the "SBA Regulations"). These regulations include the capital impairment rules, as defined by Regulation 107.1830 of the SBA Regulations. As of December 31, 2004, the capital of MorAmerica Capital was impaired by approximately 54.71%, which exceeded the 50% maximum impairment percentage permitted under SBA Regulations. Accordingly, the SBA currently has the discretion not to extend additional financing to MorAmerica Capital, as well as the right to declare a default on MorAmerica Capital's outstanding SBA-guaranteed debentures, to accelerate MorAmerica Capital's payment obligations thereunder and to seek appointment of the SBA as receiver for MorAmerica Capital. The exercise by the SBA of any of these rights could have a material adverse effect on the financial position, results of operations, cash flow and liquidity of MACC and MorAmerica Capital. If the SBA were to exercise its right to accelerate MorAmerica Capital's payment obligations under the outstanding SBA-guaranteed debentures, MorAmerica Capital may be required to liquidate some or all of its portfolio investments. Because most of its portfolio investments are not publicly traded, MorAmerica Capital may receive less than the carrying value for its portfolio investments in connection with such a forced sale. Therefore, the exercise by the SBA of any of these rights could have a material adverse effect on the financial position, results of operations, cash flow and liquidity of MACC and MorAmerica Capital and raises substantial doubt about the Company's ability to continue as a going concern. MorAmerica Capital is also currently limited by the SBA Regulations in the amount of distributions it may make to MACC. Because MACC historically has relied in large part on distributions from MorAmerica Capital to fund its operating expenses and other cash requirements, MACC is currently evaluating a

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number of alternatives to seek to provide sufficient liquidity at the parent-company level.

As of December 31, 2004, MACC's cash and cash equivalents totaled \$5,427,926. MACC has commitments for an additional \$3,500,000 and \$6,500,000 in SBA guaranteed debentures, which expire on September 30, 2005 and September 30, 2007, respectively. Due to MorAmerica Capital's capital impairment described above as well as an agreement entered into by MorAmerica Capital and three other SBIC's in connection with an arbitration settlement, MACC does not believe that MorAmerica Capital will have access to the SBIC capital program for the foreseeable future. Nevertheless, if SBA does not accelerate MorAmerica Capital's obligations under its outstanding SBA-guaranteed debentures and subject to the other risks and uncertainties described in this report on Form 10-Q, MACC believes that its existing cash and cash equivalents and other anticipated cash flows will

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provide adequate funds for MACC's anticipated cash requirements during the current fiscal year, including portfolio investment activities, interest payments on outstanding debentures, administrative expenses, and payment of the arbitration settlement amounts described in note 3 to the unaudited condensed consolidated financial statements. MACC's investment objective is to invest \$885,000 in follow-on investments during the current fiscal year, subject to further adjustment based upon current economic and operating conditions.

Debentures payable are composed of \$25,790,000 in principal amount of SBA-guaranteed debentures issued by MACC's subsidiary, MorAmerica Capital, which mature as follows: \$1,000,000 in fiscal year 2007, \$2,500,000 in fiscal year 2009, \$9,000,000 in fiscal year 2010, \$5,835,000 in fiscal year 2011, and \$7,455,000 in fiscal year 2012. As noted above, due to MorAmerica Capital's capital impairment, SBA currently has the ability to accelerate MorAmerica Capital's obligations under the SBA-guaranteed debentures. MACC anticipates that MorAmerica Capital will not be able to refinance these debentures through the SBIC capital program when they mature. The following table shows our significant contractual obligations for the repayment of debt and other contractual obligations as of December 31, 2004:

### Payments due by period

#### Contractual Obligations

	Total -----	Less Than 1 Year -----	1-3 Years -----	3-5 Years -----	More than 5 Years -----
SBA Debentures	\$ 25,790,000	---	---	3,500,000	22,290,000
Loan Agreement <sup>1</sup>	\$ 305,000	228,750	76,250	---	----
Settlement Agreement <sup>2</sup>	\$ 1,713,174	1,713,174	---	---	----

MACC currently anticipates that it will rely primarily on its current cash and cash equivalents and its cash flows from operations to fund its investment activities and other cash requirements during fiscal year 2005. Although management believes these sources will provide sufficient funds for

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MACC to meet its fiscal 2005 investment level objective and other anticipated cash requirements, there can be no assurances that MACC's cash flows from operations will be as projected, or that MACC's cash requirements will be as projected. MACC's cash flow will be negatively affected in fiscal year 2005 by the payment of the arbitration settlement amount described in note 3 to the unaudited condensed consolidated financial statements.

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<sup>1</sup>During the second quarter of fiscal year 2004, MACC entered into a loan agreement with one of its directors, Geoffrey T. Woolley, providing for advances of up to \$400,000 on a revolving credit basis through February 28, 2005. The outstanding principal amount of the loan as of March 1, 2005 will be due and payable in four equal installments on the first day of June, September, December, and March, commencing June 1, 2005 and concluding March 1, 2006. The payment obligations in the table set forth above are based on the amount outstanding under the loan agreement as of December 31, 2004. The entire unpaid amount of the loan is convertible into shares of MACC's common stock at the option of the lender.

<sup>2</sup>As discussed in note 3 to the unaudited condensed consolidated financial statements, MorAmerica Capital's portion of the arbitration settlement was \$2,245,935, of which \$532,761 represents MorAmerica Capital's interest in an escrow balance which was used to partially offset its payment obligation. The remaining \$1,713,174 was paid on January 5, 2005.

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### Portfolio Activity

MACC's primary business is investing in and lending to businesses through investments in subordinated debt (generally with detachable equity warrants), preferred stock and common stock. The total portfolio value of investments in publicly and non-publicly traded securities was \$33,290,695 at December 31, 2004 and \$33,218,084 at September 30, 2004. During the three months ended December 31, 2004, MACC invested \$385,000 in a follow-on investment in one existing portfolio company. Management views investment objectives for any given year as secondary in importance to MACC's overriding concern of investing in only those portfolio companies which satisfy MACC's investment criteria. MACC's investment objective for fiscal year 2005 is to invest \$885,000 in follow-on investments, subject to further adjustment based on current economic and operating conditions.

MACC frequently co-invests with other funds managed by MACC's investment advisor. When it makes any co-investment with these related funds, MACC follows certain procedures consistent with orders of the Securities and Exchange Commission for related party co-investments to reduce or eliminate conflict of interest issues. Of the \$385,000 invested during the current year first quarter, no funds represented co-investments with funds managed by MACC's investment advisor.

### Critical Accounting Policy

Investments in securities traded on a national securities exchange (or reported on the NASDAQ national market) are stated at the average of the bid price on the three final trading days of the valuation period which is not materially different from the bid price on the final day of the period. Restricted and other securities for which quotations are not readily available are valued at fair value as determined by the Board of Directors. Among the

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factors considered in determining the fair value of investments are the cost of the investment; developments, including recent financing transactions, since the acquisition of the investment; the financial condition and operating results of the investee; the long-term potential of the business of the investee; market interest rates on similar debt securities; and other factors generally pertinent to the valuation of investments. However, because of the inherent uncertainty of valuation, those estimated values may differ significantly from the values that would have been used had a ready market for the securities existed, and the differences could be material.

In the valuation process, MorAmerica Capital uses financial information received monthly, quarterly, and annually from its portfolio companies which includes both audited and unaudited financial statements. This information is used to determine financial condition, performance, and valuation of the portfolio investments.

Realization of the carrying value of investments is subject to future developments. Investment transactions are recorded on the trade date and identified cost is used to determine realized gains and losses. Under the provisions of SOP 90-7, the fair value of loans and investments in portfolio securities on February 15, 1995, the fresh-start date, is considered the cost basis for financial statement purposes.

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### Determination of Net Asset Value

The net asset value per share of MACC's outstanding common stock is determined quarterly, as soon as practicable after and as of the end of each calendar quarter, by dividing the value of total assets minus total liabilities by the total number of shares outstanding at the date as of which the determination is made.

### Item 3. Quantitative and Qualitative Disclosure About Market Risk

MACC is exposed to market risk from changes in market interest rates that affect the fair value of MorAmerica Capital's debentures payable determined in accordance with Statement of Financial Accounting Standards No. 107, *Disclosures About Fair Value of Financial Instruments*. The estimated fair value of MorAmerica Capital's outstanding debentures payable at December 31, 2004, was \$28,324,000, with a cost of \$25,790,000. Fair value of MorAmerica Capital's outstanding debentures payable is calculated by discounting cash flows through estimated maturity using a SBA borrowing rate currently available (5.54% at December 31, 2004) for debt of similar original maturity. None of MorAmerica Capital's outstanding debentures payable are publicly traded. Market risk is estimated as the potential increase in fair value resulting from a hypothetical 0.5% decrease in interest rates. Actual results may differ.

December 31, 2004	
Fair Value of Debentures Payable	\$ 28,324,000
Amount Above Cost	\$ 2,534,000
Additional Market Risk	\$ 672,000

**Item 4. Controls and Procedures**

As of the end of the period covered by this report, in accordance with Item 307 of Regulation S-K promulgated under the Securities Act of 1933, as amended, the Chief Executive Officer and Chief Financial Officer of MACC (the "Certifying Officers") have conducted evaluations of MACC's disclosure controls and procedures. As defined under Sections 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the term "disclosure controls and procedures" means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive officer or officers and principal financial officer or officers, or persons performing similar functions, as appropriate to allow

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timely decisions regarding required disclosure. The Certifying Officers have reviewed MACC's disclosure controls and procedures and have concluded that those disclosure controls and procedures are effective as of the date of this Quarterly Report on Form 10-Q. In compliance with Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350), each of the Certifying Officers executed an Officer's Certification included in this Quarterly Report on Form 10-Q.

As of the date of this Quarterly Report on Form 10-Q, there have not been any significant changes in MACC's internal controls or other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

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**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings.**

BFS Diversified Products, LLC ("BFS") was a supplier to Water Creations, Inc. ("Water Creations"), a former portfolio company of MorAmerica Capital. Water Creations went out of business in December, 2002, at which time BFS was owed approximately \$900,000 for products sold to Water Creations. On March 26, 2004, BFS filed suit in the Iowa District Court of Polk County, Iowa against board members of and investors in Water Creations, including MorAmerica Capital, David Schroder (Chief Financial Officer of the Corporation), and InvestAmerica Venture Group, Inc., an affiliate of InvestAmerica Investment Advisors, Inc., the subadviser to the Corporation. BFS has sued the defendants for fraud, fraudulent transfer, breach of fiduciary duty, civil conspiracy, breach of contract, conversion, and alter ego/piercing corporate veil. The

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central allegation of the case is that the defendants knew that Water Creations was insolvent and owed a duty to BFS to protect it from selling to Water Creations under these circumstances. The defendants have hired counsel and intend to vigorously defend this litigation.

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

There are no items to report.

### **Item 3. Defaults Upon Senior Securities**

There are no items to report.

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

There are no items to report.

### **Item 5. Other Information**

In anticipation of changes to the Board of Directors of the MACC and MorAmerica Capital and a change in investment advisors, starting in July, 2003, Atlas Management Partners, LLC (Atlas), MACC's investment advisor since March 1, 2004, periodically notified the SBA of the proposed changes and, as required by the SBA regulations, submitted the Atlas/MorAmerica Capital Investment Advisory Agreement to the SBA for approval on January 29, 2004. At the same time, MACC, MorAmerica Capital and Atlas entered into the Investment Advisory Support Services Agreement (Subadvisory Agreement) with InvestAmerica Investment Advisors, Inc. (InvestAmerica). Prior to March 1, 2004, InvestAmerica was the sole investment advisor to MACC and MorAmerica Capital. Under the Subadvisory Agreement, InvestAmerica is retained to monitor and manage portfolio company investments in existence as of the date of the Subadvisory Agreement, including exits, preparation of valuations, follow-on investment analysis and recommendations and other portfolio management matters. InvestAmerica also currently provides certain accounting and financial services for the Corporation. These two agreements and an additional

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investment advisory agreement with Atlas for MACC were approved by MACC's shareholders in February, 2004.

As previously disclosed, most recently in MACC's Form 10-K filed on January 13, 2005, while SBA has previously notified MorAmerica Capital in writing that four of the five principals of Atlas have SBA's approval as managers of MorAmerica Capital, SBA notified MorAmerica Capital in late December that SBA will not grant approval of Atlas as investment advisor of MorAmerica Capital. Atlas and MorAmerica Capital have subsequently met with SBA and SBA has indicated it would approve the reinstatement of InvestAmerica as the sole investment advisor to MorAmerica Capital. MorAmerica Capital has submitted the form of investment advisory agreement previously in place for Atlas to SBA for approval, with InvestAmerica as the advisor. If SBA approves this form, the new MorAmerica Capital agreement will be submitted to MACC's shareholders for approval at the upcoming annual meeting. MACC anticipates holding the annual meeting as soon as practical following SBA's approval of the new contract.

### **Item 6. Exhibits**

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(a) Exhibits

The following exhibits are filed with this quarterly report on Form 10-Q:

- 31.1 Section 302 Certification of Kent I. Madsen (CEO)
- 31.2 Section 302 Certification of David R. Schroder (CFO)
- 32.1 Section 1350 Certification of Kent I. Madsen (CEO)
- 32.2 Section 1350 Certification of David R. Schroder (CFO)

(b) Reports on Form 8-K

MACC filed a current report on Form 8-K on December 3, 2003 with regard to items 8.01 and 9.01 thereof during the quarter ended December 31, 2004.

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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.

MACC PRIVATE EQUITIES INC.

Date: 2/10/05  
-----

By: /s/Kent I. Madsen  
-----

Kent I. Madsen, President

Date: 2/10/05  
-----

By: /s/David R. Schroder  
-----

David R. Schroder, Chief Financial Officer

### EXHIBIT INDEX

Exhibit -----	Description -----	Page ----
31.1	Section 302 Certification of Kent I. Madsen (CEO)	26
31.2	Section 302 Certification of David R. Schroder (CFO)	28
32.1	Section 1350 Certification of Kent I. Madsen (CEO)	30
32.2	Section 1350 Certification of David R. Schroder (CFO)	32

