

BRANTLEY CAPITAL CORP

Form 10-Q

May 17, 2004

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**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**Form 10-Q**

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

**FOR THE QUARTERLY PERIOD ENDED MARCH 31, 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: 814-00127

**BRANTLEY CAPITAL  
CORPORATION**

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

**Maryland**

**34-1838462**

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**(State or other Jurisdiction of  
Incorporation or Organization)**

**(I.R.S. Employer Identification Number)**

**3201 Enterprise Parkway, Suite 350, Cleveland, Ohio 44122**

**(Address of principal executive offices including zip code)**

**(216) 464-8400**

**(Registrant's telephone number including area code)**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period

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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 [ ].

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X].

The number of shares of common stock, \$.01 par value, outstanding as of March 31, 2004 was 3,810,535.

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BALANCE SHEETS**

	<b>March 31, 2004 (Unaudited)</b>	<b>December 31, 2003 (Audited)</b>
<b>ASSETS</b>		
Investments, at fair value		
Companies 5% to 25% owned	\$51,914,012	\$51,814,010
Companies less than 5% owned	8,971,392	8,576,394
Cash and cash equivalents	391,126	4,688,731
Restricted cash	6,000,000	6,000,000
Dividends and interest receivable	6,516,160	6,074,224
Other assets	1,020,249	700,000
<b>Total Assets</b>	<b>\$74,812,939</b>	<b>\$77,853,359</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Notes payable	\$ 7,500,000	\$ 7,500,000
Advisory fee payable	473,602	473,474
Accrued professional fees	503,341	343,023
Distributions payable		2,630,172
Other liabilities	787,587	816,025
<b>Total Liabilities</b>	<b>9,264,530</b>	<b>11,762,694</b>
<b>Stockholders Equity:</b>		
Common Stock, \$0.01 par value; 25,000,000 shares authorized and 3,810,535 shares issued and outstanding at March 31, 2004 and December 31, 2003, respectively	38,105	38,105
Additional paid in capital	34,506,838	34,506,838
Retained earnings	31,003,466	31,545,722
<b>Total Stockholders Equity</b>	<b>65,548,409</b>	<b>66,090,665</b>
<b>Total Liabilities and Stockholders Equity</b>	<b>\$74,812,939</b>	<b>\$77,853,359</b>
<b>Net Asset Value Per Share</b>	<b>\$ 17.20</b>	<b>\$ 17.34</b>

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

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**BRANTLEY CAPITAL CORPORATION**  
**STATEMENTS OF OPERATIONS**  
(Unaudited)

	<b>For the quarter ended March 31, 2004</b>	<b>For the quarter ended March 31, 2003</b>
<b>Investment Income (Loss):</b>		
Interest and Dividends		
Companies owned 5% to 25%	\$ 215,643	\$ 510,994
Companies less than 5% owned	227,079	
Write Off of Interest and Dividends Receivable		(517,886)
<b>Total investment income (loss)</b>	<b>442,722</b>	<b>(6,892)</b>
<b>Operating Expenses:</b>		
Advisory fees	473,602	466,122
Administration fees	18,699	18,493
Professional fees	191,942	38,218
Interest and other expense	299,948	217,519
<b>Total operating expenses</b>	<b>984,191</b>	<b>740,352</b>
<b>Investment Loss, net</b>	<b>(541,469)</b>	<b>(747,244)</b>
<b>Net Realized and Unrealized Gains (Losses) on Investments:</b>		
Net realized gains (losses) on investments		
Net unrealized gains (losses) on investments	(787)	4,863,407
<b>Net realized and unrealized gains (losses) on investment transactions</b>	<b>(787)</b>	<b>4,863,407</b>
<b>Net increase (decrease) in net assets resulting from operations</b>	<b>\$ (542,256)</b>	<b>\$4,116,163</b>
<b>Net increase (decrease) in net assets from operations per share, basic and diluted</b>	<b>\$ (0.14)</b>	<b>\$ 1.08</b>
<b>Weighted average number of shares outstanding, basic and diluted</b>	<b>3,810,535</b>	<b>3,810,535</b>

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

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**BRANTLEY CAPITAL CORPORATION**  
**STATEMENTS OF CHANGES IN NET ASSETS**  
(Unaudited)

	<b>Common Stock</b>	<b>Additional Paid in Capital</b>	<b>Retained Earnings</b>	<b>Total Stockholders Equity</b>
<b>Balance at December 31, 2001</b>	\$38,105	\$37,484,895	\$30,483,314	\$68,006,314
Net decrease in net assets from operations:				
Net investment income (loss)		(2,978,057)	819,660	(2,158,397)
Net realized loss			(402,012)	(402,012)
Net unrealized gain			454,423	454,423
<b>Balance at December 31, 2002</b>	\$38,105	\$34,506,838	\$31,355,385	\$65,900,328
Net increase in net assets from operations:				
Net investment income			2,656,555	2,656,555
Net realized loss			(3,204,104)	(3,204,104)
Net unrealized gain			3,368,058	3,368,058
Distributions from:				
Net investment income			(2,630,172)	(2,630,172)
<b>Balance at December 31, 2003</b>	\$38,105	\$34,506,838	\$31,545,722	\$66,090,665
Net decrease in net assets from operations:				
Net investment loss			(541,469)	(541,469)
Net realized gain (loss)				
Net unrealized loss			(787)	(787)
<b>Balance at March 31, 2004</b>	\$38,105	\$34,506,838	\$31,003,466	\$65,548,409

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

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**BRANTLEY CAPITAL CORPORATION**  
**STATEMENTS OF CASH FLOWS**  
**(unaudited)**

	<b>For the quarter ended March 31, 2004</b>	<b>For the quarter ended March 31, 2003</b>
	<hr/>	<hr/>
<b>Cash Flows from Operating Activities:</b>		
<b>Net change in net assets resulting from operations:</b>	\$ (542,256)	\$ 4,116,163
Adjustments to reconcile net change in net assets resulting from operations to net cash used for operations:		
Net unrealized gains on investments	787	(4,863,407)
Changes in assets and liabilities:		
Dividend and interest receivable	(441,936)	3,487
Other assets	(320,249)	(202,278)
Advisory fee payable	128	(16,803)
Accrued professional fees	160,318	38,218
Distributions payable	(2,630,172)	
Other liabilities	(28,438)	73,699
	<hr/>	<hr/>
<b>Net cash used for operating activities</b>	<b>(3,801,818)</b>	<b>(850,921)</b>
	<hr/>	<hr/>
<b>Cash Flows from Investing Activities:</b>		
Purchases of investment securities	(495,787)	(252,844)
	<hr/>	<hr/>
<b>Net cash used for investing activities</b>	<b>(495,787)</b>	<b>(252,844)</b>
	<hr/>	<hr/>
<b>Cash Flows from Financing Activities:</b>		
Note Payable		1,500,000
	<hr/>	<hr/>
<b>Net cash provided by financing activities</b>		<b>1,500,000</b>
	<hr/>	<hr/>
<b>Net change in cash and cash equivalents for the year</b>	<b>(4,297,605)</b>	<b>396,235</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>4,688,731</b>	<b>237,154</b>
	<hr/>	<hr/>
<b>Cash and cash equivalents, end of the year</b>	<b>\$ 391,126</b>	<b>\$ 633,389</b>
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The accompanying notes to the financial statements are an integral part of these statements.

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**Brantley Capital Corporation**  
**STATEMENT OF INVESTMENTS**  
**March 31, 2004**  
**(unaudited)**

Name of Issuer and Title of Issue	Shares/Par	Value
<b>Aviation</b>		
Flight Options International Inc. Preferred Stock and Warrants *#@	3,342,060	\$32,500,000
<b>Business Services</b>		
Disposable Products Company, LLC Subordinated Debt with Warrants #	4,260,992	3,504,332
The Holland Group, Inc. Convertible Preferred Stock #@	282,530	2,125,000
International Total Services, Inc. Common Stock	104,250	101
Prime Office Products, Inc. Convertible Preferred Stock #@	800,000	1,600,000
		7,229,433
<b>Drugs &amp; Health Care</b>		
Integrated Physician Solutions, Inc. Convertible Preferred Stock #	793,000	3,172,000
Integrated Physician Solutions, Subordinated Debt with Warrants#	697,448	692,348
Health Care Solutions, Subordinated Debt with Warrants #	1,701,782	1,602,611
National Rehabilitation Partners, Inc. Convertible Preferred Stock#@	2,218,375	1,454,285
National Rehabilitation Partners, Inc. Subordinated Debt #	27,228	27,228
		6,948,472
<b>Miscellaneous</b>		
Streamline Foods, Inc. Convertible Preferred Stock #@	897,572	699,725
Streamline Foods, Inc. Subordinated Debt with Warrants #	122,500	95,275
Value Creation Partners, Inc. Convertible Preferred Stock #@	304,989	2,225,960
Waterlink, Inc. Warrants	53,550	
		3,020,960
<b>Retail Trade</b>		
Fitness Quest, Inc. Convertible Preferred Stock *#@	788,961	8,091,876
Fitness Quest, Inc. Common Stock #@	120,766	1,238,621
Fitness Quest, Inc. Warrants #@	181,172	1,856,042
		11,186,539
<b>Total Investments (Cost \$25,677,154)</b>		<b>\$60,885,404</b>

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All investments are U.S. companies

\* Represents 5% or more of total stockholders equity.

# Represents privately held securities which are considered illiquid.

@ Represents more than 5% but less than 25% of the voting class of securities.

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

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**BRANTLEY CAPITAL CORPORATION**  
**NOTES TO THE FINANCIAL STATEMENTS (Unaudited)**

**1. Significant Accounting Policies**

The interim financial statements have been prepared by Brantley Capital Corporation ( the Company ) pursuant to the rules and regulations of the Securities and Exchange Commission applicable to quarterly reports on Form 10-Q. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although management believes that the disclosures are adequate to make the information presented not misleading. These financial statements should be read in conjunction with the audited financial statements and related notes and schedules included in the Company s 2003 Annual Report filed on Form 10-K dated December 31, 2003.

The unaudited financial statements reflect, in the opinion of management, all adjustments, all of which are of a normal recurring nature, necessary to present fairly the financial position of the Company as of March 31, 2004, the results of its operations for the quarters ended March 31, 2004 and 2003, and its cash flows for the quarters ended March 31, 2004 and 2003. Interim results are not necessarily indicative of results to be expected for a full fiscal year.

Privately placed securities are carried at fair value as determined in good faith by the Board of Directors. Generally, the fair value of each security will initially be based primarily upon its original cost to the Company. Cost will be the primary factor used to determine fair value on an ongoing basis until significant developments or other factors affecting the investment (such as results of the portfolio company s operations, changes in the general market conditions, subsequent financings or the availability of market quotations) provide a basis for value other than cost valuation.

Portfolio investments listed on an exchange or traded on NASDAQ National Market are valued at the closing price listed on their respective exchange or system on the date of valuation. Securities traded in the over-the-counter market will be valued on the average of the closing bid and asked prices on the day of valuation.

Debt securities with 60 days or less remaining to maturity will be valued at amortized cost.

**2. Investments, Cash and Cash Equivalents**

As of March 31, 2004 and December 31, 2003, the identified costs of investments for financial statement and tax reporting purposes were \$25,677,154, and \$25,182,154, respectively.

Cash equivalents consist of highly liquid investments with insignificant interest rate risk and original maturities of three months or less at acquisition date. Cash and cash equivalents consisted of the following:

	<b>March 31, 2004 (Unaudited)</b>	<b>December 31, 2003 (Audited)</b>
Cash	\$ 391,126	\$4,688,731
Restricted Cash	\$6,000,000	\$6,000,000
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**BRANTLEY CAPITAL CORPORATION**  
**NOTES TO THE FINANCIAL STATEMENTS (Unaudited) (Continued)**

**3. Investment Advisory Agreement**

The Company has entered into an investment advisory agreement (the Investment Advisory Agreement) with Brantley Capital Management, L.L.C. (the Investment Adviser) under which the Investment Adviser is entitled to an annual management fee of 2.85% of the Company's net assets, determined at the end of each calendar quarter, and payable quarterly in arrears throughout the term of the Investment Advisory Agreement. For the quarter ended March 31, 2004, the Investment Adviser earned \$473,602 under the Investment Advisory Agreement. Certain officers of the Company are also officers of the Investment Adviser. No officer of the Investment Adviser receives any compensation from the Company for serving as officer of the Company.

**4. Financial Highlights**

	<b>For the quarter ended March 31, 2004</b>	<b>For the quarter ended March 31, 2003</b>
	<u>                    </u>	<u>                    </u>
Net Asset Value, Beginning of the Period	\$ 17.34	\$ 17.29
	<u>                    </u>	<u>                    </u>
Income (loss) from investment operations:		
Net investment loss	(0.14)	(0.20)
Net realized and unrealized gain (loss) on investments	(0.00)	1.28
	<u>                    </u>	<u>                    </u>
Total from investment operations	(0.14)	1.08
	<u>                    </u>	<u>                    </u>
Net Asset Value, End of Period	\$ 17.20	\$ 18.37
	<u>                    </u>	<u>                    </u>
Market Value, End of Period	\$ 11.92	\$ 8.35
	<u>                    </u>	<u>                    </u>
Total return, at Market Value	16.86%(1)	8.44%(1)
	<u>                    </u>	<u>                    </u>
Total return, at Net Asset Value	(0.81)%(1)	6.25)%(1)
	<u>                    </u>	<u>                    </u>
Total Expenses/Average net assets	6.05%(2)	4.36%(2)

	_____	_____
Net Investment Income/Average net assets	(3.33)%(2)	4.40%(2)
	_____	_____

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(1) Not annualized.

(2) Annualized.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**General**

*Overview*

We are a non-diversified investment company that is regulated as a business development company under the Investment Company Act of 1940. We provide equity and long-term debt financing to small and medium-sized private companies in a variety of industries throughout the United States. Our investment objective is to achieve long-term capital appreciation in the value of our investments and to provide current income primarily from interest, dividends and fees paid by our portfolio companies.

Historically, we have focused our investing activities on private equity securities. We generally structure our private equity investments as participating preferred stock with an 8% to 10% dividend yield that accumulates and is paid upon a liquidity event. Our private equity investments typically range from \$1 million to \$5 million, and we generally expect these investments to achieve liquidity within three to five years. We typically do not receive a cash return on our private equity investments until a liquidity event occurs, but instead seek to achieve long-term capital appreciation in net asset value through such investments.

On March 19, 2003, we entered into a Memorandum of Understanding with Phillip Goldstein, a director of the Company, pursuant to which Mr. Goldstein agreed to dismiss the lawsuit he filed against us in September 2002, subject to compliance with the Investment Company Act of 1940. See Part II, Item 1. Legal Proceedings. The Court approved the proposed settlement on February 26, 2004.

On June 4, 2003, we filed an application for exemptive relief from certain provisions of the 1940 Act in order to effect the provisions of the Memorandum of Understanding. On June 18, 2003, we received comments on our application from the Staff (the Staff) of the Division of Investment Management of the Securities and Exchange Commission (the SEC). On August 14, 2003 we responded to those comments. With our response, we proposed a new Memorandum of Understanding that was submitted to the Staff. On November 12, 2003, we received comments regarding our August 14, 2003 response. We responded to such comments on December 18, 2003. On February 11, 2004, the staff of the Division of Investment Management requested a response from the Board of Directors, which the Board provided on February 15, 2004. The application for exemptive relief is still pending.

The Memorandum of Understanding is subject to approval by the stockholders, and the receipt of exemptive relief from the SEC. There can be no assurance that this exemptive relief will be granted.

Pursuant to the proposed Memorandum of Understanding, we would agree, among other things:

To cause there to be four (4) directors who are not interested persons as defined under the 1940 Act and cause the board to be exactly seven (7) directors in total;

If Mr. Goldstein or Gerald Hellerman is no longer director of the Company then whichever of Mr. Goldstein or Mr. Hellerman remains on the board shall have the right to select a nominee;

To not convert the Company from being an advised fund to an internally managed fund unless a majority of the independent directors agree;

To allow any independent director to request independent counsel, subject to approval of the board, which cannot be unreasonably withheld; and

To refrain from making defamatory remarks about any party to the agreement.

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In addition, the proposed Memorandum of Understanding provides that at the next Annual Meeting of Stockholders following SEC approval:

We would ask shareholders to approve a plan of orderly disposition of the assets of the Company or a sale of the assets with the goal of prompt cash distribution to shareholders;

We would ask shareholders to approve a new investment advisory agreement pursuant to which, prospectively:

The advisor's fees would be reduced from 2.85% to 2.5% of our net asset value;

All stock options would be forfeited and cancelled; and

The advisor would be entitled to receive a fee equal to 20% of the aggregate distributions made by the Company in excess of \$10.00 per share; however, none of the amount would be paid until aggregate distributions totaled \$12.50 per share.

The proposed Memorandum of Understanding also includes provisions that would require the parties to take all steps necessary to accomplish the goals of the Memorandum, including voting their shares in favor of the proposals. Under the proposed memorandum, we would also be required to reimburse Mr. Goldstein for certain expenses (not to exceed \$275,000) he incurred in connection with the proxy solicitation and litigation related to the Annual Meeting of Stockholders on September 17, 2002. Mr. Goldstein would also agree not to engage in, lead or fund a proxy contest while the agreement is in effect. The term of the new proposed Memorandum of Understanding would run until December 31, 2006.

If we receive all necessary government and stockholder approvals, the effect of the Memorandum of Understanding will be that we intend to make only follow-on investments, and any remaining proceeds we receive from liquidity events are intended to be distributed to stockholders.

*Critical Accounting Policies and Estimates*

Privately placed equity and mezzanine securities are carried at fair value as determined in good faith by our board of directors. Initially, the fair value of each such security is based upon its original cost. Cost is also the primary factor used to determine fair value on an ongoing basis until significant developments or other factors affecting the investment (such as results of subsequent financings, the availability of market quotations, the portfolio company's operations and changes in general market conditions) provide a basis for value other than cost.

Portfolio investments listed on a securities exchange or traded on the Nasdaq Stock Market are valued at the closing price listed on the relevant exchange or quotation system on the date of valuation. Securities traded in the over-the-counter market are valued based on the average of the closing bid and asked prices on the date of valuation. Interest income is recorded on mezzanine investments when the payment is contractually due unless a loan is more than 30 days past due. Interest is not accrued on any loans that are more than 30 days past due. Dividend income is recorded on cumulative preferred equity securities on an accrual basis to the extent that such amounts are expected to be collected and on common equity securities on the record date for private companies or on the ex-dividend date for publicly traded companies. Dividends and interest income receivables are typically collected upon a liquidity event. We assess the collectibility of dividends and interest income receivables in connection with our determination of the fair value of the related security. To the extent that there are adverse future developments, previously recognized dividend and interest income may not be realized.

We account for our operations utilizing accounting principles generally accepted in the United States for investment companies. On this basis, the principal measure of our financial performance is captioned Net increase

(decrease) in net assets resulting from operations, which is the sum of two elements. The first element is Investment income (loss), net, which is the difference between (1) our income from interest,

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dividends and fees, and (2) our operating expenses. The second element is Net realized and unrealized gains (losses) on investments, which is the sum of (1) the difference between the proceeds received from our dispositions of portfolio securities and their stated cost ( Net realized gain (loss) on investments ), and (2) the net change in the fair value of our investment portfolio ( Net unrealized gain (loss) on investments ). Net realized gain (loss) on investments and Net unrealized gain (loss) on investments are directly related. For example, in the period during which a security reflecting an unrealized gain is sold to realize a gain, net unrealized gain on investments decreases, and net realized gain on investments increases.

Historically, we have focused our investing activities on private equity securities. We began making such investments in 1997 and are now in a phase of the business plan which emphasizes positioning our more mature portfolio companies for appropriate liquidity events. As a result, we are continuously monitoring portfolio company results and evaluating opportunities to maximize the valuation of our investments. In that regard, we periodically evaluate potential acquisitions, financing transactions, initial public offerings, strategic alliances, and sale opportunities involving our portfolio companies. Any such transaction could have an impact on the valuation of our investments. These transactions and activities are generally not disclosed to our stockholders and the investing public until such time as the transactions are publicly announced or completed, as the case may be.

## **Results of Operations**

### *Dividend and Interest Income*

Dividend and interest income on investments for the three months ended March 31, 2004, and 2003 were \$442,722, and \$(6,892), respectively. The increase in interest and dividend income during the three months ended March 31, 2004 was primarily due to the 2003 write-off of our investment and related accrued dividend and interest receivable in Petroleum Partners, Inc. as more fully described below.

### *Operating Expenses*

Total operating expenses during the three months ended March 31, 2004, and 2003 were \$984,191 and \$740,352, respectively. Total operating expenses during the three months ended March 31, 2004 and 2003 included advisory fees of \$473,602 and \$466,122, respectively, professional fees of \$191,942 and \$38,218, respectively and interest and other expenses of \$299,948 and \$217,199, respectively. The increase in professional fees during 2004 was a result of costs associated with the settlement of outstanding litigation and the preparation of an exemptive order with the SEC as more fully described below. The increase in interest and other expenses during 2004 reflects the increased interest costs associated with the increased note payable balance and increased directors and officer liability insurance costs.

### *Net Realized and Unrealized Gains (Losses) on Investment Transactions*

During the three months ended March 31, 2004 and 2003, valuation of our equity and mezzanine investments resulted in net realized and unrealized gains (losses) on investments of \$(787) and \$4,863,407, respectively. At March 31, 2004 and December 31, 2003, we had investments in eleven privately-held companies which are subject to general stock market and business conditions. The unrealized gains during 2003 were primarily due to an increase in the valuation of Fitness Quest, Inc. resulting from Fitness Quest's increases in revenues, improvements in operating margins, and reductions in debt and a write-down in the valuation of Petroleum Partners, Inc. as more fully discussed below.

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

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At March 31, 2004 and December 31, 2003, we had \$391,126 and \$4,688,731, respectively, in cash and cash equivalents which were primarily invested in United States Treasury securities. Restricted cash is held under direction of the lender and is not readily available to fund investments or pay operating expenses.

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Our management generally believes that our cash and cash equivalents, together with proceeds from our investments, will provide us with the liquidity necessary to pay our operating expenses and make follow-on investments as necessary. However, because of the inherent uncertainty with respect to the timing of liquidity events, the Company entered into a \$1.5 million short-term note arrangement with Huntington National Bank in March 2003 for the purpose of paying operating expenses pending potential liquidity events. The note is unsecured and carries an interest rate of prime plus 1% (5.00% at March 31, 2004). As of March 31, 2004, \$1.5 million has been drawn down on the note.

At March 31, 2004 and December 31, 2003, we had stockholders' equity of \$65,548,409 and \$66,090,665, respectively, resulting in a net asset value per share of \$17.20 and \$17.34, respectively.

At March 31, 2004 and December 31, 2003, we had \$7,500,000 of outstanding indebtedness, respectively. For the three months ended March 31, 2004, the weighted average interest rate on this indebtedness was 4.07%.

Brantley Venture Partners II, L.P., Brantley Venture Partners III, L.P. and Brantley Partners IV, L.P. hold, in the aggregate, approximately \$152 million of private equity investments. These partnerships are related to our investment adviser in a manner that required the receipt, from the Securities and Exchange Commission, of an exemption from certain provisions of the Investment Company Act of 1940 in order to permit us, under certain circumstances, to invest in the same portfolio companies as the other private investment funds managed by our investment adviser.

We intend to use our cash to fund operations, make follow on investments in our existing portfolio companies, and distribute any remaining proceeds from liquidity events to stockholders (see Overview).

At March 31, 2004 and December 31, 2003, the aggregate cost of the investments held was \$25.7 million and \$25.2 million, respectively, and their aggregate market value was \$60.9 million and \$60.4 million, respectively, for an aggregate fair value appreciation of \$35.2 million and \$35.2 million, respectively.

We did not have material off-balance sheet arrangements, as defined in Item 303(a) of Regulation S-K under the Exchange Act for the three months ended March 31, 2004.

Our contractual obligations as of March 31, 2004 are:

Contractual Obligations	Total	Payment Due			
		Less than 1 year or on demand	1 to 3 years	3 to 5 years	More than 5 years
Debt Obligations	\$7,500,000	\$7,500,000	—	—	—
Total Contractual Obligations	\$7,500,000	\$7,500,000	—	—	—





**Table of Contents***Portfolio Company Investments*

The following is a list of companies in which we had an investment and the cost and fair value of such securities at March 31, 2004.

<b>Name of Company</b>	<b>Nature of its Principal Business</b>	<b>Cost</b>	<b>Fair Value</b>
Disposable Products Company, LLC	Non-Woven Paper Products Manufacturer	4,260,993	3,504,333
Fitness Quest, Inc.	Fitness Products Direct Marketer	2,225,620	11,186,539
Flight Options International, Inc.	Private Air Travel Services	5,562,500	32,500,000
Health Care Solutions, Inc.	Home Health Care Provider	1,573,210	1,602,611
The Holland Group, Inc.	Temporary Staffing	2,125,000	2,125,000
National Rehab Partners, Inc.	Rehabilitation Services	1,481,513	1,481,513
Integrated Physician Solutions, Inc.	Pediatric Physician Practice Management Group	3,839,448	3,864,348
Prime Office Products, Inc.	Office Products Distributor	1,600,000	1,600,000
Streamline Foods, Inc.	Food Products Manufacturer and Distributor	795,000	795,000
Value Creation Partners, Inc.	Food Products Manufacturer and Distributor	2,145,460	2,225,960
International Total Services, Inc.	Security	68,410	101
	<b>Total</b>	<b>\$25,677,154</b>	<b>\$60,885,404</b>

Our individually significant equity and mezzanine investments at March 31, 2004 are described below:

*Disposable Products Company, LLC*

On August 10, 1998, we entered into an investment led by Banc One Capital to provide \$1.0 million of a \$3.0 million subordinated debt facility with warrants for Disposable Products Company, LLC. Disposable Products is an acquisition strategy company in the business of manufacturing and converting paper and non-woven materials into wiping products for sale to commercial, institutional, industrial and government markets. In addition, Disposable Products is a converter and reseller of other safety and industrial/janitorial products. Proceeds of the transaction were used to complete Disposable Products' first acquisition. The terms of the debt facility call for a 12% interest rate per annum. We also received a detachable capital stock purchase warrant exercisable for 65% of the fully-diluted capital stock of Disposable Products at the time of exercise at a nominal exercise price. In addition, through March 31, 2004 we funded additional 12% promissory notes of \$3,260,993 from Disposable Products.

*Fitness Quest, Inc.*

On December 16, 1997, we funded a \$1.35 million commitment to invest with Brantley Venture Partners III, L.P. in a \$3.85 million preferred stock issue for Fitness Quest, Inc. As a result, we purchased approximately 788,961 shares of Fitness Quest Series A 10% Convertible Preferred Stock at \$1.71 per share. Fitness Quest is a direct marketing and

distribution company. The proceeds were used by Fitness Quest for a management buy-out of the company from its previous owner. The Time Warner Music Group, a 100% wholly owned subsidiary of Time Warner, Inc., and for other acquisitions. Fitness Quest has been

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in the fitness promotional products business since 1994. Fitness Quest operates in a highly competitive industry and is dependent on the management talent and efforts of key personnel for its success. We do not believe that Fitness Quest is dependent on a single or small number of customers, possesses significant intellectual property, or is operating in an unusually regulated industry.

During 1997, Fitness Quest increased its revenue and improved its operating margins and profits. After a complete evaluation, our board of directors re-valued our Fitness Quest investment to \$5,440,000, resulting in a 1997 unrealized gain of \$4,090,000. This evaluation was based on price to earnings ratios, cash flow multiples and other appropriate financial measurements of similar private companies. In addition to the above Series A 10% Convertible Preferred Stock, we funded \$1,751,300 to invest with Brantley Venture Partners III, L.P. in a \$3.5 million 10% senior subordinated debt investment in Fitness Quest in 2000. In addition, we received a warrant to purchase 181,172 shares of Fitness Quest common stock for \$0.01 per share. The proceeds of the most recent investment were used to fund Fitness Quest's working capital needs. During the fourth quarter of 2000, we exchanged the senior subordinated debt investment and related unpaid interest for 679,641 shares of Fitness Quest common stock.

Through March 31, 2003, Fitness Quest has continued to increase its revenues, improve its operating margins, and reduce its debt. As a result, the Board of Directors increased the value of the investment to \$15,000,000 resulting in an unrealized gain of \$6,341,959 for the quarter ending March 31, 2003.

On July 31, 2003, Fitness Quest successfully completed a recapitalization of the company. As a result of this transaction, we received a distribution from Fitness Quest of \$7.3 million, including special and ordinary dividends of \$5,234,338, of which \$567,000 was in repayment of previously accrued preferred stock dividends. Subsequent to this transaction, we maintain a 15.1% ownership interest in the company with an estimated fair market value of \$11.2 million.

*Flight Options International, Inc. (Formerly Corporate Wings, Inc.)*

On December 23, 1997, we funded \$2.1 million to invest with Brantley Venture Partners III, L.P. in a \$6.0 million preferred stock issue for Flight Options International, Inc. Our investment consists of approximately 2,576,000 shares of Flight Options Series A 8% Convertible Preferred Stock at \$0.8152 per share. Flight Options provides complete private air travel service through the sale of fractional interests in pre-owned jet aircraft. The proceeds of the transaction were used by Flight Options to continue to execute an acquisition strategy. We believe Flight Options is one of the top five providers of fractional interests in aircraft in the United States, a highly competitive industry and is dependent on the management talent and efforts of key personnel for its success. Flight Options is subject to certain regulations of the Federal Aviation Administration. We do not believe it is dependent on a single or small number of customers or possesses significant intellectual property.

On December 29, 1998, we completed a second private equity investment in Flight Options. In this investment, we purchased \$962,500 of a \$5.5 million preferred stock transaction led by The Provident Bank. Our purchase represents approximately 260,135 shares of Class A 8% Convertible Preferred Stock at \$3.70 per share. The proceeds were used by Flight Options to fund the expansion of its fractional ownership program and to continue to execute its acquisition strategy. During 1998, Flight Options completed the acquisition of Miller Aviation. Based upon the price of this subsequent financing and the operating performance of Flight Options during 1998, the fair value of our original investment was increased to \$9,531,760, resulting in an unrealized gain of \$7,431,760. This valuation was based on the \$3.70 per share price negotiated by The Provident Bank and was approved by our board of directors.

On August 31, 1999, Flight Options sold \$20 million of Series B 8% Preferred Stock to a third party private equity group at \$4.365 per share. Consistent with our investment valuation guidelines, this transaction resulted in a valuation increase on our Flight Options investment of \$1,886,030 or \$0.50 per share.



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On July 11, 2000, we guaranteed a portion of Flight Options' third-party borrowings. As a result, we were issued a warrant to purchase 36,000 shares of Flight Options common stock at a price of \$0.01 per share. This guarantee was terminated prior to December 12, 2000.

On December 12, 2000 we purchased 469,925 shares of Flight Options Class C 8% Preferred Stock at \$5.32 per share for a total investment of \$2.5 million. The proceeds of the transaction were used by Flight Options to fund the continued expansion of its fractional ownership program.

On June 30, 2001, Flight Options received offers from institutional investors to purchase convertible preferred stock or subordinated debt securities of Flight Options which support the valuation used to complete the December 12, 2000 Class C 8% Preferred Stock transaction described in the preceding paragraph. As a result, and consistent with our investment valuation guidelines, our board of directors approved a valuation increase on the Flight Options investment which resulted in our reporting an unrealized gain of \$2,742,889 or \$0.72 per share for the quarter ended June 30, 2001.

On December 21, 2001, Flight Options, Inc. and Raytheon Travel Air, a Wichita, Kansas-based unit of Raytheon Company, a Lexington, Mass, based defense contractor, agreed to combine operations into one fractional aircraft ownership program to be known as Flight Options. The transaction was completed during the quarter ended March 31, 2002. During the second quarter of 2003, Raytheon Company provided additional debt and equity financing to Flight Options.

As a result of the transactions described above, our board of directors has met each quarter to review the terms of the then current transactions. Consistent with our valuation guidelines, the board has used private market methods to value our investment in Flight Options, Inc. and approved increases in the value of our investment in Flight Options, Inc. to its current \$32.5 million. At March 31, 2004, the financial statement value of our investment in Flight Options represents an increase of more than 484% from its original purchase price.

*Health Care Solutions, Inc.*

On September 30, 1997, we funded a \$1.5 million convertible junior subordinated promissory note facility for Health Care Solutions, Inc. Health Care Solutions is an acquisition strategy company in the home healthcare services market with a strong presence in the Midwest and Great Lakes regions. The terms of the notes called for an 18% interest rate per annum during the first year and 12% per annum thereafter, with final maturity two years from the closing. After the first year, the notes were convertible into common stock at a price of \$3.50 per share. In connection with our commitment to provide this facility, we received warrants to purchase up to \$450,000 of common stock valued at an exercise price of 10% of an initial public offering price completed during the term of the notes, or at \$3.50 per share should the warrants be exercised other than in connection with an initial public offering. The warrants are currently exercisable. The proceeds of the notes were used by Health Care Solutions to help finance acquisitions.

In 2000, Health Care Solutions completed a re-capitalization plan, including a two-for-one reverse stock split. As a result, we agreed to exchange our convertible junior subordinated promissory note and accrued interest thereon for 246,994 shares of Series C 8% Convertible Preferred Stock at an exchange rate of \$7.50 per share. The warrants to purchase up to \$450,000 of common stock at an exercise price of 10% of an initial public offering price or at \$3.50 per share remain outstanding and have been adjusted to reflect the reverse stock split.

In addition to the above Series C 8% Convertible Preferred Stock, we funded \$500,000 and \$299,000 12% Convertible Subordinated Notes from Health Care Solutions in 2000. As part of this transaction, we received a warrant to purchase up to \$50,000 of Health Care Solutions common stock at an exercise price equal to the lower of the price determined by an initial public offering or \$7.50 per share. On March 7, 2001, we agreed to exchange the

\$500,000 Convertible Subordinated Note for 71,880 shares of Series D

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Convertible Preferred Stock. On January 29, 2002, we funded a \$1,250,000 12% Convertible Subordinated Note from Health Care Solutions.

On May 1, 2003, Health Care Solutions sold its respiratory division assets. Through July 31, 2003, Health Care Solutions sold its remaining operating assets. As a result of this transaction, we have received \$1,676,790 in proceeds through March 31, 2004. In addition we have received \$225,000 of proceeds subsequent to March 31, 2004 and expect to receive additional proceeds of approximately \$1.75 million over the next 18 months. The remaining corporate assets of Health Care Solutions are presently being marketed for a projected sale in 2004.

*The Holland Group, Inc.*

On July 13, 2000, we funded a \$2.1 million commitment to invest with Brantley Partners IV, L.P. in a \$8.5 million preferred stock issue of The Holland Group, Inc. The Holland Group is a provider of temporary staffing and human resource management services that currently operates 35 branches in five states. In this transaction, we purchased 282,530 shares of The Holland Group's Series A 8% Convertible Preferred Stock. In February 2002 we purchased a \$50,000 12% convertible subordinated note from The Holland Group which was repaid with interest in December 2002.

*National Rehab Partners, Inc.*

On August 10, 1999, we funded \$1.4 million of a \$1.5 million commitment to invest with Brantley Partners IV, L.P. and a third party equity group in a \$12.0 million preferred stock issue for National Rehab Partners, Inc. Pursuant to this commitment, we purchased 2.2 million shares of Class A 8% Convertible Preferred Stock. The proceeds of this transaction were used to complete the acquisition of a group of rehabilitation management service providers. The remainder of the commitment has been funded upon the successful closing of additional acquisitions. National Rehab Partners is a Brentwood, Tennessee rehabilitation management service company providing rehabilitation services through acute care hospitals and hospital systems throughout the United States. National Rehab Partners is the only national rehabilitation company focused exclusively on helping hospitals develop their outpatient rehabilitation services.

On January 10, 2001, we funded a \$26,126 10% promissory note from National Rehab Partners. On June 13, 2001, the \$26,126 note and the related accrued interest were cancelled and replaced with a \$27,228 10% promissory note.

*Integrated Physician Solutions, Inc. (Formerly Pediatric Physicians Alliance, Inc.)*

On January 28, 1999, we funded a \$3.2 million commitment to invest with Brantley Venture Partners III, L.P. in a \$7.9 million preferred stock issue for Integrated Physician Solutions, Inc. Pursuant to our commitment, we purchased 793,000 shares of Class A-2 10% Convertible Preferred Stock. Integrated Physician Solutions is a physician practice management systems provider. Their objective is to develop the leading integrated physician practice management system in the United States. Integrated Physician Solutions is dependent on the management talent and effort of key personnel for its success in this highly competitive industry. We do not believe it is dependent on a single or small number of customers, possesses significant intellectual property or that it is subject to significant regulations. The proceeds of the transaction were used to complete the acquisition of a number of physician practices.

In addition to the above Class A-2 10% Convertible Preferred Stock, in 2000 we funded \$267,448 and \$400,000 to invest in promissory notes, with detachable warrants, in Integrated Physician Solutions. The detachable warrants are for the purchase of 30,000 shares of Integrated Physician Solutions common stock at \$4.00 per share.





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Integrated Physician Solutions, Inc. has signed a definitive agreement to merge with SurgiCare, Inc. (AMEX: SRG) for stock in Surgicare, Inc. which will be renamed Orion HealthCorp, Inc. . As a result of this transaction, holders of Integrated Physician Solutions, Inc. stock and certain notes, will be exchanged for an aggregate number of shares of Orion Class A Common Shares equal to the number of such shares held by SurgiCare s equityholders immediately prior to the acquisition. Subsequent to the combination, Orion will execute a restructuring of its debt and an approximate \$7.3 million private equity offering of Orion Class B Common Shares. Closing of the transactions contemplated above are conditioned upon several factors, including: approval of SurgiCare s stockholders; approval of continued listing of Orion s stock on the American Stock Exchange; satisfactory completion of due diligence by certain of the parties; satisfactory resolution of outstanding issues with creditors; simultaneous closing of all transactions; and other conditions commonly found in similar transactions. We expect the proposed transaction to close in 2004.

*Petroleum Partners, Inc.*

On June 7, 2001, we entered into a \$2.7 million commitment to invest with Brantley Partners IV, L.P. in a \$15.0 million preferred stock and subordinated debt issue for Petroleum Partners, Inc. In connection with this commitment, we purchased 250,000 shares of Class A 8% Convertible Preferred Stock at \$1.00 per share, 600,000 shares of Class B 8% Convertible Preferred Stock at \$2.00 per share, and funded a \$1,250,000 10% Convertible Subordinated Note with a detachable warrant for the purchase of 78,125 shares of common stock at \$0.01 per share. Petroleum Partners, based in Cleveland, Ohio, is a provider of outsourced maintenance services to the petroleum industry s retailers and refineries. The proceeds from the transaction were used to acquire a company which is a leading provider of petroleum and petrochemical handling equipment and outsourced facilities maintenance services to providers of fuel delivery systems such as gasoline retailers and refineries. The equipment distributed by the company includes petroleum storage tanks, pumps, fuel dispensers, flexible piping, tank valves, leak detection gauges, canopies, air compressors and service station lighting equipment.

In addition to the above investment, we funded \$1,875,000 of 10% Convertible Subordinated Notes through December 31, 2002. The proceeds of the notes were used for operating purposes.

As a result of adverse operating performance, the Board of Directors approved a valuation reduction of our investment to \$1,874,219 thereby generating a \$1,450,781 unrealized loss for the quarter ended March 31, 2003. At that time, the Board of Directors also approved a write-off of all interest and dividends receivable relating to this investment of \$517,886. For the quarter ended June 30, 2003, the Board of Directors approved a second valuation reduction in our investment by \$1,874,219 thereby generating a year to date unrealized loss of \$3,325,000.

*Prime Office Products, Inc. (Formerly Business Essentials, Inc.)*

On April 22, 1999, we entered into a \$1.7 million commitment to invest with Brantley Partners IV, L.P. and Massey Burch Capital Corp. in a \$10.0 million preferred stock issue for Prime Office Products, Inc. Pursuant to our commitment, we purchased 510,000 shares of Class A 8% Convertible Preferred Stock at \$2.00 per share. Prime Office Products is an office products marketing and distribution company based in Nashville, Tennessee. The first part of the commitment was funded to launch an acquisition strategy focused on office distribution companies serving primarily commercial and industrial customers. The remainder of the commitment is being funded upon the closing of additional acquisitions. On January 8, 2002, we purchased an additional 200,000 shares of Class A 8% Convertible Preferred Stock at \$2.00 per share. On July 31, 2002, we purchased an additional 40,000 shares of Class A 8% Convertible Preferred Stock at \$2.00 per share to fund acquisitions. On January 24, 2004, we purchased an additional 50,000 shares of Class A 8% Convertible Preferred Stock at \$2.00 per share to fund acquisitions.



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*Streamline Foods, Inc.*

On February 7, 2002 we funded a \$795,000 commitment to invest with Brantley Partners IV, L.P. in a \$7,950,000 preferred stock and subordinated debt issue for Streamline Foods, Inc. Pursuant to our commitment we purchased approximately 898,000 shares of Series A 8% Convertible Preferred Stock at \$0.78 per share and a \$95,000 13% Convertible Subordinated Note with warrants to purchase 27,500 shares of common stock at \$0.01 per share. The proceeds were used by Streamline Foods for a buy-out of the company from its previous owner. Streamline Foods, Inc. sources, blends, packages and distributes high sugar content food products for branded multi-national food companies and private label manufacturers.

*Value Creation Partners, Inc.*

On June 14, 2000, we completed a \$2.1 million commitment to invest with Brantley Partners IV, L.P. and several other private equity investors in a \$23.8 million preferred stock issue for Value Creation Partners, Inc. Pursuant to this commitment, we purchased approximately 35,000 shares and 269,989 shares of 8% Convertible Preferred Stock at \$5.00 and \$7.30 per share, respectively. Value Creation Partners is an acquisition strategy company in the food industry. The proceeds of the transaction were used to complete the acquisition of Best Brands, Inc., one of the six largest manufacturers and distributors of a complete line of premium ingredients, mixes and products, including equipment, for all segments of the baking industry. Their products are sold primarily to retail bakeries, bakery distributors, supermarket in-store bakeries, food wholesalers and food service establishments.

**Impact of Inflation**

We do not believe that our business is materially affected by inflation, other than the impact that inflation may have on the securities markets, the valuations of business enterprises and the relationship of such valuations to underlying earnings, all of which will influence the value of our investments.

**Disclosure Regarding Forward-Looking Statements**

Information contained in this Quarterly Report on Form 10-Q may contain forward-looking statements which can be identified by the use of forward-looking terminology such as may, will, expect, intend, anticipate, estimate, continue or the negative thereof or other variations or similar words or phrases. The matters described throughout this Quarterly Report on Form 10-Q and in any exhibits of which this Quarterly Report is a part constitute cautionary statements identifying important factors with respect to any such forward-looking statements, including certain risks and uncertainties, that could cause actual results to differ materially from those in such forward-looking statements.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

We have invested in small and medium-sized companies, and our investments are considered speculative in nature. Our investments often include securities that are subject to legal or contractual restrictions on resale that adversely affect the liquidity and marketability of such securities. As a result, we are subject to risk of loss which may prevent our stockholders from achieving price appreciation and dividend distributions. The portion of our portfolio consisting of investments in private companies is also subject to valuation risk. We value our privately held investments based on a determination of their fair value made in good faith by our board of directors on a quarterly basis in accordance with our established guidelines. In the absence of a readily ascertainable market value, the estimated values of our investments may differ significantly from the values that would exist if a ready market for these securities existed. Any changes in valuation are recorded in our statements of operations as Net unrealized gain (loss) on investments.

We consider the management of equity price risk essential to conducting our business and maintaining our profitability. Our portfolio consists of investments in private companies. We anticipate no impact on

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these investments from modest changes in public market equity prices. However, should significant changes in market prices occur, there could be a long-term effect on valuations of private companies, which could affect the carrying value and the amount and timing of gains realized on these investments. This could also affect our ability to generate cash through the sale of private equity investments, since there may not be realistic initial public offering opportunities.

**Item 4. Controls and Procedures**

- (a) As of the end of the period covered by this quarterly report on Form 10-Q, the Company's chief executive officer and chief financial officer conducted an evaluation of the Company's disclosure controls and procedures (as defined in Rules 13a-15 and 15d-15 of the Securities Exchange Act of 1934). Based upon this evaluation, the Company's chief executive officer and chief financial officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them of any material information relating to the Company that is required to be disclosed by the Company in the reports it files or submits under the Securities Exchange Act of 1934.
- (b) There have not been any significant changes in the Company's internal control over financial reporting that occurred during our most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

On September 25, 2002, Phillip Goldstein, a director and shareholder of the Company filed a lawsuit in the District Court for the Northern District of Ohio against us, Robert Pinkas, James Oliver, Benjamin Bryan and IVS Associates, Inc. alleging, among other things, that the Company engaged in wrongdoing and that the individual defendants breached their fiduciary duties during the Annual Meeting of Stockholders held on September 17, 2002. Mr. Goldstein alleges that the Company's actions surrounding the closing of the polls disenfranchised certain shareholders. Mr. Goldstein sought to have votes for which he had proxies, which were submitted after the polls were closed, counted. He also sought an order declaring his nominees to be directors of the Company. The Company also asserted a counterclaim against Mr. Goldstein alleging violations of the proxy rules and the failure to disclose his participation in a group as required by Regulation 13D. Mr. Goldstein denied the allegations of the counterclaims. Mr. Goldstein's motion for a temporary restraining order was denied, and a hearing for a preliminary injunction was held on November 18-21, 2002. On December 18, 2002, Magistrate Jack B. Streepy issued a report and recommendation that Mr. Goldstein's motion for a preliminary injunction be granted. Both parties filed objections to the Magistrate's report. No order has been issued by the Court to date. On February 13, 2003, the judge set a trial date of March 19, 2003, and on March 19, 2003, the judge issued a stay of the proceeding. On February 26, 2004, the Court approved the proposed settlement of the lawsuit as more fully described below.

On March 19, 2003, we entered into a Memorandum of Understanding with Phillip Goldstein, a director of the Company, pursuant to which Mr. Goldstein agreed to dismiss the lawsuit he filed against us in September 2002, subject to compliance with the Investment Company Act of 1940. See Part II, Item 1. Legal Proceedings. The Court approved the proposed settlement on February 26, 2004.

On June 4, 2003, we filed an application for exemptive relief from certain provisions of the 1940 Act in order to effect the provisions of the Memorandum of Understanding. On June 18, 2003, we received



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comments on our application from the Staff. On August 14, 2003 we responded to those comments. With such response, we proposed a new Memorandum of Understanding that was submitted to the Staff. On November 12, 2003, we received comments regarding our August 14, 2003 response. We responded to such comments on December 18, 2003. On February 11, 2004, the staff of the Division of Investment Management requested a response from the Board of Directors, which the Board provided on February 15, 2004. The application for exemptive relief is still pending.

The Memorandum of Understanding is subject to approval by the stockholders, and the receipt of exemptive relief from the SEC. There can be no assurance that this exemptive relief will be granted.

Pursuant to the proposed Memorandum of Understanding, we would agree, among other things:

To cause there to be four (4) directors who are not interested persons as defined under the 1940 Act and cause the board to be exactly seven (7) directors in total;

If Mr. Goldstein or Gerald Hellerman is no longer director of the Company then whichever of Mr. Goldstein or Mr. Hellerman remains on the board shall have the right to select a nominee;

To not convert the Company from being an advised fund to an internally managed fund unless a majority of the independent directors agree;

To allow any independent director to request independent counsel, subject to approval of the board, which cannot be unreasonably withheld; and

To refrain from making defamatory remarks about any party to the agreement.

In addition, the proposed Memorandum of Understanding provides that at the next Annual Meeting of Stockholders following SEC approval:

We would ask shareholders to approve a plan of orderly disposition of the assets of the Company or a sale of the assets with the goal of prompt cash distribution to shareholders;

We would ask shareholders to approve a new investment advisory agreement pursuant to which, prospectively:

The advisor's fees would be reduced from 2.85% to 2.5% of our net asset value;

All stock options would be forfeited and cancelled; and

The advisor would be entitled to receive a fee equal to 20% of the aggregate distributions made by the Company in excess of \$10.00 per share; however, none of the amount would be paid until aggregate distributions totaled \$12.50 per share.

The proposed Memorandum of Understanding also includes provisions that would require the parties to take all steps necessary to accomplish the goals of the Memorandum, including voting their shares in favor of the proposals. Under the proposed memorandum, we would also be required to reimburse Mr. Goldstein for certain expenses (not to exceed \$275,000) he incurred in connection with the proxy solicitation and litigation related to the Annual Meeting of Stockholders on September 17, 2002. Mr. Goldstein would also agree not to engage in, lead or fund a proxy contest while the agreement is in effect. The term of the new proposed Memorandum of Understanding would run until December 31, 2006.

If we receive all necessary government and stockholder approvals, the effect of the Memorandum of Understanding will be that we intend to make only follow-on investments, and any remaining proceeds we receive

from liquidity events are intended to be distributed to stockholders.

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On October 8, 2002, Thomas Kornfeld and Robert Strougo filed a purported class action lawsuit against the Company, the directors of the Company excluding Phillip Goldstein, IVS Associates, Inc. and JMP Securities LLC, alleging a series of derivative and direct claims that the directors have breached their fiduciary duties and that the Company engaged in wrongdoing with respect to the Annual Meeting of Stockholders held on September 17, 2002. The factual allegations are substantially similar to the complaint filed by Mr. Goldstein and also include allegations of conversion of corporate funds. The complaint seeks, among other things, an order declaring Mr. Goldstein's nominees to be directors of the Company, an order declaring that the investment advisory agreement be terminated and damages for breach of fiduciary duty. On January 12, 2003, the plaintiffs filed a motion to consolidate this lawsuit with the lawsuit by Goldstein discussed above, which was subsequently denied. On April 5, 2004 the case was dismissed with prejudice and the court retained jurisdiction over the implementation and conservation of the settlement agreement between the parties.

On October 4, 2002, the Company received notice from the Midwest Regional Office ( MRO ) of the SEC that they were inquiring into activities involving the Annual Meeting. The Company has and will cooperate with the inquiry. The letter from the MRO states that the inquiry should not be construed as an indication by the staff of that office that any violation of law has occurred, or as a reflection upon any person or entity that may be involved. There has been no communication between the MRO and the Company since the fourth quarter of 2002.

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

At the 2003 Annual Meeting of Stockholders held on March 30, 2004, there were a total of 2,044,240 shares represented either in person or by proxy. The stockholders elected four directors to the Company's Board of Directors. The stockholders elected Phillip Goldstein, Robert P. Pinkas, and L. Patrick Bales to serve terms expiring in 2008. The stockholders also elected Gerald Hellerman to serve the remainder of a term expiring in 2007. The certified results of the voting for the election of directors of the Company Inc. were as follows:

	<u>In Favor</u>	<u>Withheld</u>
Phillip Goldstein	1,812,810	231,430
Robert P. Pinkas	1,493,003	551,237
L. Patrick Bales	1,801,610	242,630
Gerald Hellerman	1,810,710	233,530

In addition, the stockholders ratified the selection of KPMG LLP as the Company's independent public accountant for the fiscal year ending December 31, 2003. The results of voting for the ratification of the selection of KPMG LLP as the Company's independent public accountants were as follows:

For	1,817,687
Against	89,767
Abstain	136,786

**Item 6. Exhibits and Reports on Form 8-K**

a. Exhibits

Articles of Incorporation and By-laws

**Exhibit 3**

(1)

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- Articles of Amendment and Restatement of the Charter of the Company (Exhibit 3.1 to the Annual Report on Form 10-K filed on March 31, 1999, which exhibit is incorporated herein by reference)
- (2) Amended and Restated Bylaws of the Company (Exhibit 3.2 to the Annual Report on Form 10-K filed on March 31, 1999, which exhibit is incorporated herein by reference)
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- (3) Amendment to the Charter of the Company (Exhibit 3.3 to the Registration Statement filed on October 26, 2001, which exhibit is incorporated herein by reference)

**Exhibit 4** Form of Share Certificate (Exhibit 2.d to amendment No. 1 to the Registration Statement filed on October 31, 1996, which exhibit is incorporated herein by reference)

**Exhibit 10** Material Contracts

- (1) Dividend Reinvestment and Cash Purchase Plan (Exhibit 2.e to Amendment No. 3 to the Registration Statement filed on November 26, 1996, which exhibit is incorporated herein by reference)
- (2) Form of Investment Advisory Agreement between the Company and the Investment Adviser (Exhibit 2.g to Amendment No. 3 to the Registration Statement filed on November 26, 1996, which exhibit is incorporated herein by reference)
- (3) Stock Option Plan and Form of Option Grants (Exhibit 2.i. 1 to Amendment No. 2 to the Registration Statement filed on November 22, 1996, which exhibit is incorporated herein by reference)
- (4) Disinterested Director Option Plan and Form of Option Grants (Exhibit 2.i.2 to Amendment No. 2 to the Registration Statement filed on November 22, 1996, which exhibit is incorporated herein by reference)
- (5) Form of Custodian Contract (Exhibit 2.j to Amendment No. 2 to the Registration Statement filed on November 22, 1996, which exhibit is incorporated herein by reference)
- (6) Form of Registrar, Transfer Agency and Service Agreement (Exhibit 2.k.1 to Amendment No. 2 to the Registration Statement filed on November 22, 1996, which exhibit is incorporated herein by reference)
- (7) Form of Administration Agreement (Exhibit 2.k.2 to Amendment No. 2 to the Registration Statement filed on November 22, 1996, which exhibit is incorporated herein by reference)
- (8) Form of Indemnification Agreement for Directors and Officers (Exhibit 2.s to Amendment No. 2 to the Registration Statement filed on November 22, 1996, which exhibit is incorporated herein by reference)
- (9) Memorandum of Understanding dated March 19, 2003 (Exhibit 99.1 to Form 8-K filed March 20, 2003.)

**Exhibit 31**

- (1) Certification of Chief Executive Officer Pursuant to Rules 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934, as amended.
- (2) Certification of Chief Financial Officer Pursuant to Rules 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934, as amended.

**Exhibit 32** Other

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- (1) Certification Pursuant to 18 U.S.C. 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. Submitted herewith.
- (2) Certification Pursuant to 18 U.S.C. 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. Submitted herewith.

b. Reports on Form 8-K

A Form 8-K was filed on March 3, 2004 that announced the dismissal of the case of Goldstein v. Brantley Capital Corporation et. al. with the court retaining jurisdiction over the implementation of the Memorandum of Understanding.

A Form 8-K was filed on March 31, 2004 that announced the results of the Company's 2003 Annual Meeting of Stockholders.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**BRANTLEY CAPITAL CORPORATION**

Date: May 17, 2004

By: /s/ ROBERT P. PINKAS

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

Date: May 17, 2004

By: /s/ TAB A. KEPLINGER

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Tab A. Keplinger  
Vice President and  
Chief Financial Officer