



**Operator:** Greetings and welcome to the Rand Capital Corporation Third Quarter 2019 Financial Results. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. If anyone should require Operator assistance during the conference, please press star, zero on your telephone keypad. As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host Deborah Pawlowski, Investor Relations. Please go ahead.

**Deborah Pawlowski:** Thanks, Hector, and good afternoon, everyone. We appreciate your time today for Rand's Third Quarter 2019 Financial Results Conference Call. On the line with me today are Pete Grum, our Chief Executive Officer, and Dan Penberthy, our Executive Vice President and CFO.

You should have a copy of the release that crossed the wire this morning, as well as the slides that will accompany our conversation today. If not, they are both available on our website at [randcapital.com](http://randcapital.com).

If you would turn to the slide deck, on Slide 2, I will point out some important information. As you are likely aware, we may make some forward-looking statements during this presentation and also during the question-and-answer session. These statements apply to future events that are subject to risks and uncertainties as well as other factors that could cause actual results to differ from where we are today. These risks and uncertainties and other factors are provided in the earnings release as well as in other documents filed by the Company with the Securities and Exchange Commission. You can find the information on our website or at [sec.gov](http://sec.gov).

With that, let me turn the call over to Pete, who is going to first give us an update on the status of the transaction with East Asset Management and then summarize the quarter. Dan will follow with more details regarding financials. Pete?

**Pete Grum:** Good afternoon, everyone. Thank you for your time today. We are happy to have this opportunity to update you on Rand's third quarter, including the status of the transaction with East Asset Management, which I will refer to as East.

If you could all turn to Slide 3 for the status of the transaction with East. I'm pleased to announce that we are planning to close on the transaction in November. The closing of this transformational transaction culminates practically two years of work.

We will issue approximately 8.3 million shares of Rand to East in exchange for \$25 million of assets. That amounts to \$3 per share, which represents a 33% premium over the stock price on January 24, the day before we announced these exciting transactions. The \$25 million, we now believe, will consist of approximately \$10 million of investments and about \$15 million in cash. However, we continue to finalize our legal due diligence on the portfolio of securities, which may affect the final amount of the cash and securities received. The total, however, will not change and it will be \$25 million. The investment assets that we will receive will be added to our portfolio and the cash will be used for investing and other corporate purposes. We will also receive the ongoing cash flow from the investments.

We have established Rand Capital Management, or RCM. The current employees of Rand will become employees of RCM and the new entity will serve as the external registered investment adviser to Rand. Upon the completion of these transactions and subject to Board approval, we will then proceed with the steps necessary to transform Rand into a regulated investment



company, or R-I-C, or RIC. Recall that one of the benefits of being a RIC is that our investment income and capital gains will no longer be subject to U.S. federal income tax.

To accomplish this, we will need to have a special dividend equivalent to our excess earnings and profits. The amount is based on a complex tax calculation and we currently estimate it to be approximately \$17 million. We plan to do this by paying a special dividend to our shareholders, which will be in the form of Rand stock and cash. We anticipate that this will occur in the first quarter of 2020. Going forward, subject to Board approval, we intend to establish an ongoing regular cash dividend policy. It is a transformational transaction for Rand. We appreciate your support during the journey to accomplish this and look forward to an exciting future.

If you could please turn to Slide 4, I will summarize the third quarter. At the end of the quarter, our net asset value, or NAV, decreased to \$4.39 per share from \$4.85 at the end of June. The decline was mostly due to unrealized depreciation we recorded on five of our investments, which amounted to \$0.45 on a per-share basis.

It is important to understand the complexity of investing in small and growing businesses which may include unrealized valuation adjustments and fees. While the current conditions warrant the changes in value, we believe over time the companies can fulfill their potential and we may see reversals of some of the unfavorable adjustments that were taken this quarter.

We also incurred additional expenses associated with the East transaction and more interest expense due to higher outstanding debt. Dan will go over the financial results later in this discussion.

Regarding investments, none were made during this first quarter. Our investment activity has been curtailed over the past 18 months as we completed the requirements of the East transaction. We expect to increase our investment activity once the East transactions have closed, utilizing the additional capital from East as well as our available cash.

Finally, at its recent meeting, our Board of Directors renewed and increased its share buyback authorization to 1 million additional shares. Having additional capital, this authorization gives us more flexibility to purchase our shares in the open market if conditions warrant it.

Please turn to Slide 5. It's a snapshot of our top five investments in our portfolio based on our fair value at the end of September. Our total portfolio is valued at \$26.8 million and includes 28 active companies. The value of our top five investments consistently comprises about half of our portfolio.

If you turn to Slide 6, as I do each quarter, I want to take the opportunity to feature a couple of the companies within our portfolio as a way to give you more insight into them. Let's start with ACV Auctions. Based in, Buffalo, New York, ACV Auctions has a mission to become the trusted source for auto dealers to purchase wholesale vehicles by utilizing their online marketplace.

They recently launched new tools and features on their app to further increase efficiency. These include a Run List, which conveniently provides dealers with access to auction information before it goes live. The app has also been enhanced with filters allowing users to identify dealers more easily and quickly. Third, a process for proxy bids has been enhanced. Finally, they added Virtual Lift, the industry's first mobile vehicle undercarriage imaging tool. This effectively allows users to view the undercarriage of a vehicle online in a virtual manner.

Their platform has been growing rapidly. Since its establishment in 2015, ACV now operates in 138 territories across the US and plans to add more. Rand's initial \$163,000 investment in 2016



has a fair market value of \$2.8 million at September 30, 2019, representing the second largest in our portfolio at that date.

Please turn to Slide 7 and let me tell you a little bit about Carolina Skiff, which is based in Waycross, Georgia. They are a leading manufacturer of high-quality versatile outboard boats, including the number one fiberglass outdoor brand within their size range. They recently launched an industry-leading 18 new models for their 2020 model year, representing a comprehensive refresh of the product line. Most boat manufacturers typically introduce just a few new models per year, so this is very significant for the industry. They developed a more linear series of boats with advanced features and functionality in response to evolving customer preferences.

Rand initially invested in Carolina Skiff in 2004 and its investment currently carries a cost of \$15,000. The company's strong financial performance has resulted in the investment carrying a fair market value of \$1.8 million in Rand's portfolio as of September 30, 2019.

Slide 8 provides an industry mix of our diverse portfolio. Year-over-year comparisons as of September 30 show an increase in software, professional services, and manufacturing. The increase in software was driven by ACV Auctions and the increase in professional services was driven by Tilson and the addition of Tech 2000.

Slide 9 depicts our investments as a mix of equity and debt. The debt investments provide the needed cash flow to fund operations, while equity provides future upside potential. Looking forward with the East investment in Rand, we anticipate a heavier focus on debt-related investments to support an ongoing dividend.

Now I'd like to turn it over to Dan Penberthy, our Executive Vice President and Chief Financial Officer, to cover the financial results.

**Dan Penberthy:** Thanks, Pete, and good afternoon, everyone. If you could please turn to Slide 11, I will start with the net asset value per share, or NAV. As Pete mentioned, we finished the quarter with net asset value at \$4.39 per share. As you can see in the chart, NAV decreased \$0.46 per share over the trailing quarter. This decrease primarily resulted from unrealized valuation adjustments which we recorded on five of our portfolio companies this quarter, which is in accordance with our valuation policy. You recall this sometimes results in appreciation or depreciation in fair value based on the operating performance, the trends of particular portfolio companies, or capital transactions that they may be involved with. During the quarter, we recognized net reductions in fair value amounting to about \$0.45 per share.

On Slide 12 is a summary of our operating performance for the third quarters of 2019 and 2018 and also for the year-to-date for both periods. Our third-quarter investment income of \$437,000 is down \$225,000 as compared with last year. This reduction is mostly due to \$233,000 of nonrecurring interest and a debt modification fee that we received in last year's third quarter. On a year-to-date basis, investment income is up \$301,000 or 21%.

Our third quarter expenses of \$531,000 were up \$83,000 over last year. The increase was primarily due to higher expenses related to the East transaction as well as interest expense on the higher outstanding debt.

As I mentioned in the prior slide, we recorded unrealized losses on certain investments in accordance with our valuation policy. This did include Rheonix, Genicon, Empire Genomics, KnowledgeVision, and SciAps, all of which were in the third quarter of this year. The net impact was about \$2.5 million more in the 2019 third quarter than the same period of last year and



\$2.3 million net, on a year-to-date basis. To summarize, the 2019 third quarter resulted in a decrease in net assets from operations of \$0.46 per share compared with a \$0.03 per share decrease in the 2018 third quarter.

As you can see on Slide 13, we continue to have a solid balance sheet. We have a historically high level of cash representing \$1.47 per share. Our portfolio investments are valued at \$4.24 per share at the end of the quarter and we had \$1.74 per share that we continue to owe to the SBA. This is consistent with the end of the last quarter. We also have \$0.42 per share of other assets, net of liabilities. This all comprises our NAV per share of \$4.39.

With that, Pete, shall we open up the line for questions?

**Pete Grum:** Yes, we are ready for questions.

**Operator:** Thank you. At this time, we will be conducting a question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment, please, while we poll for questions.

Your first question comes from the line of Sam Rebotsky with SER Asset Management. Please proceed with your question.

**Sam Rebotsky:** Good afternoon, Pete and Dan. The transaction scheduled with East, is that supposed to close in two weeks? The distribution, where it says requires distribution of accumulated excess profits of \$17 million subject to change, does that mean you will close on the transaction in November and distribute the cash, and is it cash and stock?

If it's stock, what is the price of the stock of the distribution? Could you put some color to how this transaction goes forward? You want the Company to be able to make money and make dividends to shareholders.

**Pete Grum:** Sure. We anticipate that the deal will close in November and that's what we are working toward. This is all subject to Board approval. To become a RIC, we have to distribute our excess profits. Right now I would estimate that is about \$17 million. It's an IRS election and that happens on the day that we make the election. I can't give you a number right now. We anticipate that the special dividend will be paid out, assuming everything goes like we are planning, in the first quarter.

**Sam Rebotsky:** That will be distributed in the March quarter?

**Pete Grum:** Right, the first quarter of 2020. Remember, I am using the word anticipate and intend. The real details of all of that and the percentage of cash and stock is in the proxy. I can certainly talk to you offline and go through it. It's going to be, I believe, 80% stock, 20% cash, and the stock is distributed with a value of the current book value at the time of the distribution.

**Sam Rebotsky:** In other words, instead of \$3 per share, you are using the book value, which will be higher than the \$3 per share, which is what the East company came in at?

**Pete Grum:** Yes. That is correct.

**Sam Rebotsky:** Okay. At this time, the \$17 million is equivalent to \$1.50? Or what is the number? If you did \$17 million, what is the number of shares outstanding and what is the cash?



**Pete Grum:** I don't have a calculator but it is less than that. Dan is going to do the math.

**Dan Penberthy:** Well, Sam, if you just want to do a back-of-the-envelope test, we have 6.3 million shares outstanding. We are adding 8.3 million shares, so that totals 14.6 million shares. Just back-of-the-envelope test and you can do the math from there.

**Sam Rebotsky:** Okay. That is the plan. You had indicated that the Board of Directors and various other insiders will take stock and not the cash. At this point, when you make that distribution you will have less equity per share. Has there been some thought about if you reduce the price and with the stock right now trading \$2.60, \$2.70, that would take about \$1.40 off the stock. Do you do a reverse split or what do you do?

**Pete Grum:** That's certainly something that the Board is evaluating. We have not come to a conclusion on that, but the Board has had robust discussions about that. As you can see, the Board also authorized repurchasing an additional 1 million shares. One of the gating factors of that in the past has been cash. We will have a significant amount of cash at the parent level able to do that. Now, I can't promise when and where and how, but the corporate governance surrounding repurchasing shares in a reverse split are under active discussion.

**Sam Rebotsky:** But you have approval from SBIC to buy shares in the open market where you didn't seem to have approval before. At least that's what I understood.

**Pete Grum:** The money to buy shares back has been and always will be with cash at the parent. The SBIC does not buy shares back. It is a wholly-owned subsidiary of the parent. The parent will now have a substantial amount of cash because of the East transaction. That is part of the reason the Board increased and reauthorized the share repurchase.

**Sam Rebotsky:** Okay. Further, the date of the dividend that will be paid in the first quarter, what's your expectation? Will you have the date of the entitlement also sometime in the first quarter? Or will this be in the current quarter?

**Pete Grum:** I want to make sure. Are you talking about when the dividend will be paid out?

**Sam Rebotsky:** No, you said the dividend will be paid out in the first quarter of the next year. What I am asking is the entitlement to the dividend, what date will be used for the entitlement to the dividend of the shareholders?

**Pete Grum:** Are you talking about what the record date would be?

**Sam Rebotsky:** Yes. Correct.

**Pete Grum:** We have not established that yet.

**Sam Rebotsky:** But do you expect it to be in the current year or the next year?

**Pete Grum:** I'm not able to answer that right now.

**Sam Rebotsky:** Okay, you haven't decided. But it won't be paid out until the first quarter of the next year. Would it be towards the beginning or the end or is there any thought there?

**Pete Grum:** We haven't gotten there. By the way, Sam, I want to make sure you understand, these are my expectations.

**Sam Rebotsky:** Right, right.

**Pete Grum:** As we go forward.



**Sam Rebotsky:** Okay. Well, I mean, it's a new ballgame and the question is it changes the rules, etc. I want to try to understand where we are going, etc. All right.

**Pete Grum:** No, I think your questions are right on. We are thrilled and excited. The last two years have not been all up and down but we have had some good days and we are at the end, Sam. You and I have talked for many years about changing Rand. This is truly transformational and I think it's going to be great for Rand going forward. It will be a much different company; the tone will be different.

**Sam Rebotsky:** I hope it does. But unfortunately, you have to compete against much larger vehicles in this kind of a structure. You have to sort of bulk up, and it's a different ballgame and hopefully you are successful. All right, I will give a chance to some other people to ask some questions. Thank you.

**Pete Grum:** Feel free to call me if you have any more questions.

**Sam Rebotsky:** Sure, thank you.

**Operator:** Your next question comes from the line of Robert McCabe, EWM Investments. Please proceed with your question.

**Robert McCabe:** What do you anticipate the cash dividend will be?

**Pete Grum:** It will be determined on the day that we do the tax election. As we said, it is right now a distribution of \$17 million and that is based on the end of this quarter. I can't predict what is going to happen on values between now and the end of the quarter, but as of now it's \$17 million. And I believe that 20% will be cash and 80% will be stock.

**Robert McCabe:** What will that work out to be per share?

**Deborah Pawlowski:** It's between \$1.15, \$1.20-ish with the current number of shares at \$17 million, and roughly 20% of that would be cash. If you just use the midpoint of let's just say \$1.15, so you are looking at \$0.25 per share.

**Pete Grum:** If you want to call me after the meeting, I will get my calculator out.

**Deborah Pawlowski:** But what you have to understand is this is all just estimates right now. It is subject to what the determination is of the accumulated earnings and profits at the time that the declaration to become a RIC is made. It is a moving target at this point right now, plus or minus.

**Robert McCabe:** Well, you are just dealing with approximations. But when do you expect this valuation to occur?

**Pete Grum:** It will occur when we do the tax filing. If I had to guess, and this is a guess and is subject to Board approval, the determination will be January 1.

**Robert McCabe:** Do you have to have stockholder approval?

**Pete Grum:** No.

**Dan Penberthy:** We do not. There are some complex tax regulations which we need to have our respective entities comply with. We are going through that now with a multitude of consultants and tax advisors, trying to make sure that these entities do satisfy the RIC, the regulated investment company, regulation. Because if they do not, then we have no ability to proceed down this path of future dividends and making the distribution.



The first thing we need to do is get the transaction closed with East. The next step will be to finalize all these tax elections and get the two respective entities, both Rand the parent and Rand the SBIC, separately qualified under RIC tax regulation, which we really need another 45 days to get done. Then that will start the ball rolling for all the other things that Pete has explained.

**Robert McCabe:** Thank you.

**Operator:** Ladies and gentlemen, we have reached the end of the question-and-answer session. I'd like to turn the call back to Management for closing remarks.

**Pete Grum:** Thank you. Thanks for the questions. We are always available if you want to give us a call if we didn't answer them sufficiently or if something comes up. I want to thank you for your time and attention this afternoon. I want to say again, on behalf of Management and the Board of Directors, we appreciate your support and we are very excited about moving forward following the closing of the East transaction. This is a transformational transaction. We look forward to updating you as we progress towards achieving RIC status and the anticipated special dividend and the ongoing dividends. Thanks again and have a great day.

**Operator:** This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.