Operator: Greetings. Welcome to the Rand Capital Corporation Second Quarter 2021 Financial Results Conference Call. [Operator Instructions]

Please note, this conference is being recorded. I will now turn the conference over to your host, Deborah Pawlowski, Investor Relations for Rand Capital. You may begin.

Deborah Pawlowski: Thank you, Shamali, and good afternoon, everyone. We appreciate your interest in Rand Capital and for joining us today for our Second Quarter 2021 Financial Results conference call. Here with me today are Pete Grum, our Chief Executive Officer, and Dan Penberthy, our Executive Vice President and Chief Financial Officer.

You should have a copy of the release that crossed the wires this morning as well as the slides that will accompany our conversation today. If not, they are available on our website at randcapital.com.

If you are following along on the slide deck and will turn to Slide 2, I would like to point out some important information. As you are likely aware, we may make some forward-looking statements during this presentation and 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. You can find a summary of these risks and uncertainties and other factors in the earnings release as well as in other documents filed by the company with the Securities and Exchange Commission. These documents can be found on our website or at sec.gov.

During today's call, we will also discuss some non-GAAP financial measures. We believe that these will be useful in evaluating our performance. You should not consider the presentation of this additional information in isolation or as a substitute for results in accordance with GAAP. We have provided reconciliations of non-GAAP measures with comparable GAAP measures in the tables that accompany today's release and in the slides.

So with that, if you would turn to **Slide 3**, I will hand the discussion over to Pete to begin. Pete?

Pete Grum: Thank you, Deb. Good afternoon, everyone. We continue to execute our strategy as we focus on evolving our portfolio from equity investments to income-producing investments, with the goal of driving investment income and ultimately delivering higher cash distributions. For the quarter, our total investment income grew 20% to $811 thousand. Net asset value per share of $22.51 was up 8% and 26% from the sequential first quarter and year-end period, respectively.

The sequential increase largely reflects unrealized appreciation of our investment in Open Exchange following their equity financing by new nonstrategic outside investors. The change from year-end reflects the increase in fair value of our investments in ACV Auctions, which completed their IPO at the end of March.

During the quarter, we sold our investment in GiveGab, a software company that we've owned since 2015. Our equity investment of $616 thousand netted us a recognized gain of $1.8 million. This is consistent with our strategy of transforming our portfolio from equity to debt.

During the quarter, we accrued $1.1 million in noncash expenses related to capital gains incentive fees, which were primarily a result of realized gains from the sale of GiveGab and the increase in unrealized appreciation mostly related to Open Exchange. The accrual will be adjusted on a quarterly basis. As a result, we reported a GAAP net investment loss of $0.31 per share. Absent this expense, adjusted net investment income was $0.10 per share.

We announced and paid our regular quarterly dividend distribution of $0.10 per share during the second quarter. And at the end of July, we announced our third quarter dividend distribution also at $0.10 per share. So far this year, we have declared $1.63 per share in dividends, including the $1.33 per share that was declared at the end of last year but was paid in 2021.

If you turn to **Slide 4**, we can discuss the progress we have made regarding the evolution of our investment portfolio to support our strategy. The 14% increase in fair value shown here reflects the impact of Open Exchange, which now has a fair value of $5.6 million, an increase of $4.9 million during the year. The fair value of all of our investments increased by $7.5 million. At quarter end, our portfolio was comprised of approximately 55% in equity investments, 36% in fixed-rate debt investments and 9% in dividend-paying publicly traded BDCs.

During the quarter, we made $4.6 million in new and follow-on investments and received $2.4 million from the one exit we discussed and the other loan repayments. These transactions are highlighted on **Slide 5**.

The largest investment during the quarter was for ITA Inc. and totaled $3.9 million, $3.4 million consisted of 12% term notes and $500,000 was in equity. ITA manufactures a broad variety of window covering components and finished wood treatments, including wood, faux wood, and fabric shades, shutters and blinds for residential and commercial applications.

The follow-on investment was provided to Mattison Avenue Holdings, LLC, a high-end salon suite business that provides customized fully furnished salon and spa studio space for lease and prime locations for individual stylists, barbers, massage therapists, nail technicians and estheticians. This works as well for other individualized services, such as acupuncture. Our $667 thousand follow-on investment consisted of a 14% promissory note. In total, we now have $1.8 million invested in Mattison at the end of the quarter.

The charts on **Slide 6** illustrate the diversity of our portfolio and the change in industry mix since 2020 year-end. With the investment we recently made, the impact of the investments and fair value changes, software and health care saw notable changes, while most of the other industries were within a point of that or so during that period. We like the diversity of our portfolio and believe it reduces our exposure to market risk.

Slide 7 lists our top 5 portfolio companies at quarter end. There are two new companies on the list. Open Exchange, which saw a measurable increase in its fair value, and ITA with the new investment. ACV's fair value came down about $1.7 million during the quarter, which followed the significant jump during the first quarter given their IPO. Their valuation on our portfolio represents 24% of net assets. Our ACV holdings consist of 147,645 Class A common stock and 442,935 of Class B common stock. The Class A shares are freely tradable, while the Class B are still restricted and nontradable through the September 20, 2021. We have discounted our valuation due to these current restrictions.

As a reminder, any proceeds for us above our $163,000 initial investment will be a capital gain and treated as such as it relates to any dividend or distribution.

With that, I'm going to turn it over to Dan to review our financials in greater depth.

Dan Penberthy: Thanks, Pete, and good afternoon all. **Slide 9** provides an overview of our financial summary and our operational highlights.

Total investment income for the quarter was $811,000, a 20% increase over last year and does reflect the shift in our portfolio profile to more interest-yielding assets. In total, 23 portfolio companies generated income compared with 13 in the prior year period. This quarter's total investment income also benefited from approximately $137,000 of dividend income, which was up 45% over last year's second quarter. This was primarily comprised of dividends received from our BDC investment portfolio.

Total expenses in the quarter were $1.6 million, up from $476,000 in last year's second quarter. The change was largely due to the addition of $1.1 million of accrued capital gains incentive fees during the quarter, which Pete had already discussed. This incentive fee accrual was a result of the sale of GiveGab and the unrealized appreciation on Open Exchange's portfolio value.

As a reminder, a capital gains incentive fee accrual under GAAP is calculated using the cumulative aggregate realized capital gains and losses and the aggregate net change in unrealized capital appreciation and depreciation at the close of the period.

Operating expenses in the quarter, of which a non-GAAP financial measure excludes the capital gains incentive fee accrual, increased $84,000, or 18%, mostly because of the increase in the base management fee payable to Rand's investment adviser, resulting from the increased portfolio asset values.

Net investment loss was $811,000 or $0.31 per share. Excluding the accrued capital gains incentive fees, adjusted net investment income per share was $0.10 compared with $0.08 per share in the prior year period. Even with the increase in expenses, net assets from operations increased $4.5 million or $1.74 per share.

Slide 10 provides a waterfall graph for the change in NAV for the quarter. The increase was primarily due to the change in the fair value of Rand's investment in Open Exchange, which was reflected in the $3.5 million net change in unrealized appreciation on the portfolio investments. Also contributing to the NAV increase was a net realized gain on the sale of GiveGab, which Pete had discussed. We also paid out approximately $260,000 of cash dividends.

Slide 11 highlights the strength of our balance sheet. We have approximately $16 million in liquidity for new investments. This does include $3 million of availability for borrowing under our SBIC debentures. The $10.8 million currently owed to the SBA matures over a long multiyear period; however, that begins next year in September when $3 million is due.

As required to maintain our RIC status, we will continue to distribute at least 90% of our calendar year qualified income to our shareholders in the form of dividends. Our annualized dividend rate of $0.40 is based off our initial conservative estimates of our 2021 net investment income and is reviewed quarterly based on our actual year-to-date GAAP and estimated tax results.

Later in the fourth quarter, we will then review all sources of GAAP and tax-based income, including those from short- and long-term capital gains, which may result in additional 2021 distributions over the previously distributed regular quarterly cash dividend estimates.

The final determination and calculation of our tax-based distributable income for each year is finalized in September of the following year in conjunction with our corporate tax return filings. This is commonly referred to as a spill back dividend. Our current share repurchase program authorizes the purchase of up to $1.5 million in stock and expires next year in April 2022. We did not repurchase any stock during the second quarter.

As we look forward, with the support of our strong liquidity position, we believe we can continue to execute our strategy to grow our portfolio, drive investment income and support a growing dividend.

That completes our prepared remarks. Operator, please open the lines for questions.

Operator: [Operator Instructions] Our first question is from Sam Rebotsky with SER Asset Management.

Sam Rebotsky: The ACVA, which is currently valued at $23.62, what was the value on June 30 that we used?

Pete Grum: We wrote it down $1.7 million. Some of that was due to changes in the market value and some of that was changes in the discounts that we used because of lack of sale-ability at the time.

Deborah Pawlowski: Sam, the Class A at June 30 was $24.85 and the Class B was $23.61.

Sam Rebotsky: So, of the $1.06 million capital gains that we paid, $3.6 million. How much is that attributable to the ACVA?

Pete Grum: Well, I don't think we've paid anything. We have accrued.

Sam Rebotsky: Accrued, right. Okay. What amount that we accrued would you say is attributable to the ACVA?

Dan Penberthy: Sam, I think you're maybe mixing up a couple of items here. The $1.6 million of the realized gains, those are primarily driven off GiveGab. There is a capital gains incentive fee, which was $1.06 million, which was accrued during the quarter, most of that is attributable to unrealized appreciation on Open Exchange and also some offset by the depreciation actually in ACV during the quarter, because if you remember, we had ACV valued at $26.79 at the end of the March 31 quarter, and that was adjusted downward based on the closing stock price at June 30 to the $24 numbers that Pete had mentioned.

Sam Rebotsky: Okay. And the $3.6 million?

Pete Grum: That is the total capital gains incentive fee if, in theory, the portfolio were to liquidate at its closing values at June 30 based on the realized gains and losses, unrealized activity.

Sam Rebotsky: Okay. Okay. Do we have another ACVA in our portfolio?

Pete Grum: Sure. Of course, we do, Sam.

Dan Penberthy: Sam, the portfolio is mark-to-market quarterly and those are the corporation's estimates of what the fair value is at that time period. We can't get out the crystal ball and tell you where things will end up September 30, 2021, much less where they're going to be 2, 3 or 5 years down the road.

Sam Rebotsky: Okay. When the stock ran up 26, 27, what was that attributable to?

Pete Grum: We were not responsible for that. We didn't have any news in there. It's happened periodically during my life here. You have a thinly traded stock and people start talking about it, but we don't have any idea. We talked to Nasdaq surveillance. There was no information that we put into the market, so I don't know, Sam, and I didn't get any calls prior to that or after that.

Sam Rebotsky: Yes. Okay. I heard somebody attributed you to be another Warren Buffett stock, Berkshire Hathaway. Did you hear those rumors?

Pete Grum: No.

Operator: And our next question is from Brett Davidson, who is a private investor.

Brett Davidson: Forget about whether you heard the rumors, are they true?

Pete Grum: You mean that I'm the next Warren Buffett.

Brett Davidson: There you go. That's the important answer I want to hear. Is it true? I have a couple of questions. I heard in the presentation and tried to take it all into account as far as adjusting the dividend; and so, it looks like, yearly, it's going to be done after the close of the year. Any adjustment would be done later, but subsequent year. How will that play into adjusting the quarterly dividend or are most of these adjustments going to be done on a onetime special sometime later in the subsequent year?

Pete Grum: I'll answer it as I thought I heard it. The quarterly dividend, we believe, is designed on a conservative basis to match our net investment income of what we see in the future, and we forecast out and look at that. The Board and the management company analyze that to make sure it's a sustainable dividend and the hope is that will grow over time. I'm going to turn it over to Dan to talk about the work that goes through on the capital gains, because that's also on a tax basis as most of this is, so there can be some differences and differences in timing.

Dan Penberthy: Yes. So, at the beginning of the year, we project out what we think is going to happen for the year based on our investment portfolio. Since we are in a debt portfolio, we do experience more debt repayment, which often happens unexpectedly and which does have a negative effect to deterioration of our income, obviously. And so, we monitor that quarterly and we prepare an analysis and determine where we think the year will end up. That is done each quarter.

And then, as we get to the fourth quarter, we'll tighten those numbers down as we prepare an initial tax estimate based on our actual projected results for the full calendar year 2021. As Pete mentioned, those will have 2 components. The first will be a capital gains component, which will be more kind of just a onetime type dividend annually, because that's based on net capital gains offset by losses, obviously, that we may have had. And then, we also look at operating income for the year, and we do an initial tax calculation with our third-party tax advisers trying to get as precise a tax model as you can on your income, because we strive to make sure we distribute out at least 90% of our income during the calendar year or in January, immediately following the conclusion of the year, and all that is attributable to 2021.

Then what happens is, when the final tax returns are done, hopefully, we've done our job well enough with our outside advisers, that there's minimal adjustment that's needed for 2021 on a tax basis based on our final tax return calculations. That work is being done currently with an expectation of our tax returns being filed typically in September. That is what I referred to as that spill back dividends. We would think that would be a minor amount, but we don't know until we're to the conclusion of the tax returns and that would be included as a onetime adjustment to this upcoming quarter's tax numbers. This is now the first time through all these RIC calculation processes on a tax basis, so some of this is still stuff that could change, but that is the fundamental thesis. We look at it quarterly, we tighten it down in December for the calendar year, and then, we go back and proof our numbers in August and September to see if there's a plus or minus adjustment that needs to happen for tax purposes.

Brett Davidson: My particular interest is in how that's going to be paid. So, capital gains, that's going to be a onetime thing. Say that the estimate for the income that was used to base that $0.10 quarterly dividend is wrong by a dime, is that going to result in a one-time $0.10 dividend or is that going to be spread over the subsequent years quarterly?

Pete Grum: I believe that it has to be paid during the year or else you lose your RIC status, so it would be paid, and it's not spread over the next years.

Dan Penberthy: Yes. I don't believe it will be spread; however, again, I will stress that this is in consultation with our third-party RIC tax advisers, so we need to take that into consideration, but I also believe it would be a onetime adjustment to the dividend. The Board at its election can determine whether that be a cash, stock, or other form of distribution.

Brett Davidson: Well, I would think it would need to be a cash, wouldn't it, if it requires the distribution of the earnings?

Pete Grum: You can do cash, or you can do a combination of cash and stock with some limitations.

Dan Penberthy: There are minimum cash requirements that have to go out, but that is also to be discussed at the Board level on a quarterly and annual basis.

Brett Davidson: All right. So, correct me if I'm wrong here. The dividend for the subsequent year will be set prior to that year, and it will result in an up or down adjustment in the quarterly dividend. And then, for the spill back and any capital gains, those would ordinarily result in one-time dividends.

Dan Penberthy: Yes, it would be an adjustment to the third quarter dividend, most likely.

Brett Davidson: Okay. So, it will be an adjustment to one quarter's dividend then. Got it.

Deborah Pawlowski: Yes. We'll make it very clear. This is the regular quarterly dividend.

Daniel Penberthy: Here's our $0.10 plus whatever the adjustment is, just as this is the $0.10, we just issued in July. Here's $0.10 plus the extra amount, where we have to offset the number, because the real number for last year was make up/subtract a penny. We don't know what the number is until the final tax calculations have occurred.

Brett Davidson: Yes. Understood. Next question I'm interested in. Is there any kind of exit strategy for ACV?

Pete Grum: Yes, and we look at that with our liquidity, upcoming needs, where we think the price will go… kind of our own little algorithm that we have. But yes, we are not in the business of owning public shares and I think, over time, as we have historically done, we will exit.

Brett Davidson: So, you said "over time." That means this isn't like an all or none operation here?

Pete Grum: Of course, you wouldn't want us to give you insider information. Would you?

Brett Davidson: No, no, no. I'm just talking about the character of the transactions. I'm not looking for specifics regarding timing.

Allen F. Grum: Yes. Our goal is to take equity investments like ours, liquefy them, convert that cash into interest paying debentures or loans or a variety of other things, so that we can increase our ongoing dividend, and part of that is changing equity into debt.

Brett Davidson: Yes. And so, from the all or none perspective, I mean, we decide we're going to exit ACV and it's going to happen over the course of a day or a couple of days. This could be a period that runs from beginning of one year to the end of the next. Is that a fair characterization?

Pete Grum: I'm uncomfortable characterizing it either way. We own 500,000 shares. It's a $4 billion company. It will be based on our alternatives to put the money out and where we think the price is compared to where we think it should be.

Brett Davidson: All right. Let me rephrase it. Is there a certain time period that this has to occur over or an end date that this has to occur by?

Pete Grum: No.

Brett Davidson: Okay. So, this could conceivably take place over a period of time and not necessarily once you decide to sell, it has to be completed within a week or whatever.

Pete Grum: Right.

Brett Davidson: Are you aware of any other investments that are currently looking to take advantage of the atmosphere in the public equity markets? Is there anybody that you've got feedback from that's looking to maybe do an IPO? Or is that something you wouldn't ordinarily be privy to?

Pete Grum: Well, we wouldn't disclose it in the conference call.

Brett Davidson: Got it. And my last one, can you give some clarity as to what the transaction was that precipitated the sale of the GiveGab position? Was it something that they did or were you just able to find a buyer for your investment?

Pete Grum: Well, the company sold in totality and that's our proportion that we received. As you can imagine, COVID hits each company a little bit differently. They were in the business of online fundraising, and they had been having a nice trajectory of growing anyway; but they were in a nice spot and had a number of opportunities and, to provide liquidity, they picked this one until the whole company was sold.

Brett Davidson: Is that information available online? Can you give some idea what that transaction involved? Was it private equity?

Dan Penberthy: It is all available online. If you just google GiveGab and do a search. This one is April 15 from the NonProfit Times, just google as you're on the phone. “EveryAction Continues Shopping, Acquirers GiveGab.” No transaction price was disclosed, but I'm sure, if you're affluent, you can find out a lot.

Operator: [Operator Instructions] Our next question is from Ross Haberman with RLH Investments.

Ross Haberman: I just have two follow-up questions about ACV. I got on a little late. If I understand right, you have about 353,000 of the B shares currently?

Pete Grum: I'm going to tell you exactly, not approximately. We have 147,645 shares of the Class A and 442,935 of the Class B.

Ross Haberman: When can you register the B to sale?

Pete Grum: I believe that the B sales will become freely tradable after September 20.

Ross Haberman: Okay. And if I understood it right, you marked the whole position of roughly, I don't know, $23.5 to $24 as of the end of the quarter. Is that correct?

Pete Grum*:* We mark them using the last 3 trading days of the quarter. The Class A, we don't have any discount, because it's freely tradable. The Class B, we have a 5% discount to reflect the restrictions.

Ross Haberman: I see what you're saying. And both those marks total your $14 million carrying value at the end of the quarter?

Dan Penberthy: Yes.

Pete Grum: Yes, sir.

Operator: We have reached the end of the question-and-answer session. I'll now turn the call over to Pete Grum for closing remarks.

Pete Grum: Thank you very much and thank you for joining us today and for your interest in Rand Capital. We look forward to updating all of you on our third quarter 2021 results in November. Have a great day.

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