

CAPITAL SOUTHWEST CORP

Form 10-Q

November 08, 2016

Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2016

OR

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

For the transition period fromto

Commission File Number: 814-00061

CAPITAL SOUTHWEST CORPORATION

(Exact name of registrant as specified in its charter)

Edgar Filing: CAPITAL SOUTHWEST CORP - Form 10-Q

Texas	75-1072796
	(I.R.S.
(State or other jurisdiction of incorporation	Employer
or organization)	Identification
	No.)

5400 Lyndon B Johnson Freeway, Suite 1300, Dallas, Texas	75240
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (214) 238-5700

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such filings). Yes No

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

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

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

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

15,812,607 shares of Common Stock, \$0.25 value per share, as of November 4, 2016.

Table of Contents

TABLE OF CONTENTS

	Page
<u>PART I</u>	<u>FINANCIAL INFORMATION</u>
<u>Item 1.</u>	<u>Consolidated Financial Statements</u>
	3
	<u>Consolidated Statements of Assets and Liabilities as of September 30, 2016 (Unaudited) and March 31, 2016</u>
	3
	<u>Consolidated Statements of Operations (Unaudited) for the three and six months ended September 30, 2016 and 2015</u>
	4
	<u>Consolidated Statements of Changes in Net Assets (Unaudited) for the six months ended September 30, 2016 and 2015</u>
	5
	<u>Consolidated Statements of Cash Flows (Unaudited) for the six months ended September 30, 2016 and 2015</u>
	6
	<u>Consolidated Schedule of Investments as of September 30, 2016 (Unaudited) and March 31, 2016</u>
	7
	<u>Notes to Consolidated Financial Statements (Unaudited)</u>
	12
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>
	41
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>
	50
<u>Item 4.</u>	<u>Controls and Procedures</u>
	50
<u>PART II</u>	<u>OTHER INFORMATION</u>
<u>Item 1.</u>	<u>Legal Proceedings</u>
	51
<u>Item 1A.</u>	<u>Risk Factors</u>
	51
<u>Item 6.</u>	<u>Exhibits</u>
	53
<u>Signatures</u>	54

Table of Contents

PART I – FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES

(In thousands, except shares and per share data)

	September 30, 2016 (Unaudited)	March 31, 2016
Assets		
Investments at fair value:		
Non-control/Non-affiliate investments (Cost: September 30, 2016 - \$145,184, March 31, 2016 - \$101,538)	\$ 144,720	\$ 99,279
Affiliate investments (Cost: September 30, 2016 - \$5,919, March 31, 2016 - \$6,356)	7,454	10,618
Control investments (Cost: September 30, 2016 - \$54,215, March 31, 2016 - \$42,215)	86,145	68,539
Total investments (Cost: September 30, 2016 - \$205,318, March 31, 2016 - \$150,110)	238,319	178,436
Cash and cash equivalents	57,840	95,969
Receivables:		
Dividends and interest	1,738	1,752
Escrow	1,758	3,424
Other	104	219
Income tax receivable	696	1,010
Deferred tax asset	1,940	2,342
Debt issuance costs (net of accumulated amortization of \$52 and \$ - as of September 30, 2016 and March 31, 2016, respectively)	2,443	-
Other assets	2,437	1,341
Total assets	\$ 307,275	\$ 284,493
Liabilities		
Other liabilities	\$ 6,087	\$ 5,713
Payable for unsettled transactions	19,361	3,940
Income tax payable	211	-
Accrued restoration plan liability	2,165	2,205

Edgar Filing: CAPITAL SOUTHWEST CORP - Form 10-Q

Deferred income taxes	522	-
Total liabilities	28,346	11,858
Net Assets		
Common stock, \$0.25 par value: authorized, 25,000,000 shares; issued, 18,066,138 shares at September 30, 2016 and 18,065,518 shares at March 31, 2016	4,517	4,516
Additional capital	261,880	262,539
Accumulated net investment loss	(1,234)	(307)
Accumulated net realized gain	5,224	1,498
Unrealized appreciation of investments, net of income taxes	32,479	28,326
Treasury stock - at cost, 2,339,512 shares	(23,937)	(23,937)
Total net assets	278,929	272,635
Total liabilities and net assets	\$ 307,275	\$ 284,493
Net asset value per share (15,726,626 shares outstanding at September 30, 2016 and 15,726,006 shares outstanding at March 31, 2016)	\$ 17.74	\$ 17.34

The accompanying Notes are an integral part of these Consolidated Financial Statements.

Table of Contents

CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except shares and per share data)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2016	2015	2016	2015
Investment income:				
Interest and dividends				
Non-control/Non-affiliate investments	\$ 2,433	\$ 842	\$ 4,515	\$ 1,245
Affiliate investments	141	-	280	-
Control investments	1,995	-	3,765	300
Interest income from cash and cash equivalents	56	103	126	159
Fees and other income	101	133	197	338
Total investment income	4,726	1,078	8,883	2,042
Operating expenses:				
Compensation	1,404	3,411	2,889	4,623
Spin-off compensation plan	172	-	345	-
Share-based compensation	255	370	494	729
Interest	103	-	103	-
Net pension expense (benefit)	43	(105)	86	(175)
Spin-off professional fees	-	5,474	-	6,712
General and administrative	972	1,175	2,271	2,200
Total operating expenses	2,949	10,325	6,188	14,089
Income (loss) before income taxes	1,777	(9,247)	2,695	(12,047)
Income tax expense	412	88	958	118
Net investment income (loss)	\$ 1,365	\$ (9,335)	\$ 1,737	\$ (12,165)
Realized gain (loss)				
Non-control/Non-affiliate investments	\$ (459)	\$ (3,396)	\$ (260)	\$ (3,332)
Affiliate investments	3,986	-	3,986	684
Control investments	-	-	-	-
Total net realized gain (loss) on investments before income tax	3,527	(3,396)	3,726	(2,648)
Unrealized appreciation of investments				
Portfolio company investments	2,026	3,783	4,675	8,028
Income tax provision	-	-	(522)	-
Total net increase (decrease) in unrealized appreciation of investments	2,026	3,783	4,153	8,028

Edgar Filing: CAPITAL SOUTHWEST CORP - Form 10-Q

Net realized and unrealized gain on investments	\$ 5,553	\$ 387	\$ 7,879	\$ 5,380
Net increase (decrease) in net assets from operations	\$ 6,918	\$ (8,948)	\$ 9,616	\$ (6,785)
Pre-tax net investment income (loss) per share - basic and diluted	\$ 0.11	\$ (0.59)	\$ 0.17	\$ (0.77)
Net investment income (loss) per share – basic and diluted	\$ 0.09	\$ (0.60)	\$ 0.11	\$ (0.78)
Net increase (decrease) in net assets from operations – basic and diluted	\$ 0.44	\$ (0.57)	\$ 0.61	\$ (0.43)
Weighted average shares outstanding – basic	15,726,419	15,583,332	15,728,476	15,578,339
Weighted average shares outstanding – diluted	15,805,577	15,671,664	15,801,535	15,678,379

The accompanying Notes are an integral part of these Consolidated Financial Statements.

Table of Contents

CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS

(Unaudited)

(In thousands)

	Six Months Ended September 30,	
	2016	2015
Operations:		
Net investment income (loss)	\$ 1,737	\$ (12,165)
Net realized gain (loss) on investments	3,726	(2,648)
Net increase (decrease) in unrealized appreciation of investments	4,153	8,028
Net increase (decrease) in net assets from operations	9,616	(6,785)
Distributions from:		
Undistributed net investment income	(2,664)	(1,542)
Distributions of CSW Industrials, Inc.		
Decrease in unrealized appreciation related to spin-off investments	-	(458,338)
Distribution from additional capital	-	(26,278)
Spin-Off Compensation Plan distribution, net of tax of \$346 and \$ - for the six months ended September 30, 2016 and 2015, respectively	(1,175)	-
Capital share transactions:		
Change in pension plan funded status	23	-
Exercise of employee stock options	-	387
Share-based compensation expense	494	729
Increase (decrease) in net assets	6,294	(491,827)
Net assets, beginning of period	272,635	767,418
Net assets, end of period	\$ 278,929	\$ 275,591

The accompanying Notes are an integral part of these Consolidated Financial Statements.

Table of Contents

CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Six Months Ended September 30,	
	2016	2015
Cash flows from operating activities		
Net increase (decrease) in net assets from operations	\$ 9,616	\$ (6,785)
Adjustments to reconcile net increase (decrease) in net assets from operations to net cash used in operating activities:		
Purchases and originations of investments	(67,520)	(34,114)
Net proceeds from disposition of and return of capital on investments	4,442	16,395
Principal repayments on debt investments	12,045	-
Payment of accreted original issue discounts	220	-
Depreciation and amortization	98	36
Net pension benefit	(16)	(284)
Realized (gain) loss on investments before income tax	(3,726)	2,648
Net increase in unrealized appreciation of investments	(4,675)	(8,028)
Accretion of discounts on investments	(176)	(22)
Stock option and restricted awards expense	494	729
Deferred income tax expense	1,480	-
Changes in other assets and liabilities:		
Decrease (increase) in dividend and interest receivable	14	(219)
Decrease in escrow receivables	1,173	183
Decrease (increase) in other receivables	115	(1,263)
Decrease (increase) in tax receivable	314	(212)
(Increase) decrease in other assets	(1,141)	167
(Decrease) increase in other liabilities	(1,523)	2,907
Increase in payable for unsettled transaction	15,421	-
Increase in deferred income taxes	-	331
Net cash used in operating activities	(33,345)	(27,531)
Cash flows from financing activities		
Distributions from undistributed net investment income	(940)	(1,542)
Proceeds from exercise of employee stock options	-	387
Debt issuance costs paid	(2,495)	-
Spin-off Compensation Plan distribution	(1,349)	(13,000)
Net cash used in financing activities	(4,784)	(14,155)
Net decrease in cash and cash equivalents	(38,129)	(41,686)
Cash and cash equivalents at beginning of period	95,969	225,797

Edgar Filing: CAPITAL SOUTHWEST CORP - Form 10-Q

Cash and cash equivalents at end of period	\$ 57,840	\$ 184,111
Supplemental disclosure of noncash financing activities:		
Dividend declared, not yet paid	\$ 1,724	\$ -
Noncash adjustment to realized gain for escrow receivable	493	-
Cost of Investments spun-off ¹	-	6,981
Decrease in unrealized appreciation due to spin-off of CSWI ¹	-	458,338
Net pension assets ¹	-	9,687
Change in deferred tax liabilities ¹	-	3,391
Spin-off Compensation Plan distribution accrued, not yet paid	172	-

¹ These non-cash items are related to the spin-off of CSW Industrials, Inc. at September 30, 2015.

The accompanying Notes are an integral part of these Consolidated Financial Statements.

Table of Contents

CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED SCHEDULE OF INVESTMENTS

(Unaudited)

September 30, 2016

Portfolio Company ¹ Non-control/Non-affiliate Investments ⁴	Type of Investment ³	Industry	Current Interest Rate ²	Maturity	Principal	Cost
360 HOLDINGS III CORP.	Senior secured debt	Consumer products & retail	L+9.00% (Floor 1.00%)	10/1/2021	\$ 6,930,000	\$ 6,680,000
AG KINGS HOLDINGS ¹⁰	Senior secured debt	Food, agriculture & beverage	L+9.00% (Floor 1.00%)	8/8/2021	10,000,000	9,802,000
AMERICAN TELECONFERENCING	Senior secured debt	Telecommunications	L+6.50% (Floor 1.00%)	12/8/2021	6,911,168	6,721,000
AMWARE FULFILLMENT	Senior secured debt	Distribution	L+9.50% (Floor 1.00%)	5/21/2019	13,400,000	13,140,000
ARGON MEDICAL DEVICES	Senior secured debt	Healthcare products	L+9.50% (Floor 1.00%)	6/23/2022	5,000,000	4,863,000
CALIFORNIA PIZZA KITCHEN	Senior secured debt	Restaurants	L+6.00% (Floor 1.00%)	8/23/2022	5,000,000	4,950,000
CAST AND CREW PAYROLL, LLC	Senior secured debt	Media, marketing & entertainment	L+7.75% (Floor 1.00%)	8/12/2023	5,000,000	4,971,000
DEEPWATER CORROSION SERVICES, INC.	127,004 shares of Series A convertible preferred stock	Energy services (upstream)	-	-	-	8,000,000
DIGITAL RIVER, INC.	Senior secured debt	Software & IT services	L+6.50% (Floor 1.00%)	2/12/2021	7,032,285	6,998,000
DUNN PAPER, INC.	Senior secured debt	Paper & forest products	L+8.75% (Floor 1.00%)	8/26/2023	3,000,000	2,940,000

Edgar Filing: CAPITAL SOUTHWEST CORP - Form 10-Q

HYGEA HOLDINGS	Senior secured debt Warrants	Healthcare services	L+9.25% -	2/22/2019 -	7,875,000 -	7,199,000 546,000 7,745,000
IMAGINE! PRINT SOLUTIONS, INC.	Senior secured debt	Media, marketing & entertainment	L+6.00% (Floor 1.00%) L+5.50%	3/30/2022	4,877,744	4,820,000
INFOGROUP INC.	Senior secured debt	Software & IT services	(Floor 1.50%) L+9.25%	5/26/2018	4,921,044	4,819,000
LTI HOLDINGS, INC.	Senior secured debt	Industrial products	(Floor 1.00%) L+9.00%	4/17/2023	7,000,000	6,845,000
PREPAID LEGAL SERVICES, INC.	Senior secured debt	Consumer services	(Floor 1.25%) L+7.50%	7/1/2020	5,000,000	4,949,000
REDBOX AUTOMATED RETAIL	Senior secured debt	Gaming & leisure	(Floor 1.00%) L+8.75%	9/27/2021	10,000,000	9,700,000
RESEARCH NOW GROUP, INC.	Senior secured debt	Business services	(Floor 1.00%) L+7.50%	3/18/2022	7,000,000	6,911,000
ROYAL HOLDINGS, INC.	Senior secured debt	Specialty chemicals	(Floor 1.00%) L+6.00%	6/19/2023	1,000,000	993,300
TAXACT, INC.7	Senior secured debt	Financial services	(Floor 1.00%)	12/31/2022	3,687,500	3,614,000

Table of Contents

Portfolio Company 1	Type of Investment 13	Industry	Current Interest Rate 2	Maturity	Principal	Cost
TITANLINER, INC.11	Senior subordinated debt 339,277 shares of Series A convertible preferred stock	Energy services (upstream)	8.50%	6/30/2017	2,667,223	2,667,223
TRAX DATA REFINERY, INC.	Common stock	Software & IT services	-	-	-	3,200,000
VIVID SEATS	Senior secured debt	Media, marketing & entertainment	L+6.00% (Floor 1.00%)	3/1/2022	6,912,500	6,912,500
WATER PIK, INC.	Senior secured debt	Consumer products & retail	L+8.75% (Floor 1.00%)	1/8/2021	4,692,982	4,692,982
WINZER CORPORATION	Senior subordinated debt	Distribution	11.00%	5/31/2021	8,100,000	7,900,000
Total Non-control/Non-affiliate Investments						\$ 14,000,000
Affiliate Investments5						
CHANDLER SIGNS, LP	Senior subordinated debt 1,500,000 units of Class A-1 common stock	Business services	12.00%	7/4/2021	\$ 4,500,000	\$ 4,500,000
			-			