

Mill City Ventures III, Ltd  
Form 10-K  
March 31, 2015

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

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

**For the fiscal year ended December 31, 2014**

**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 814-00991

**MILL CITY VENTURES III, LTD.**

(Exact name of registrant as specified in its charter)

**Minnesota**                      **90-0316651**  
(State of incorporation) (I.R.S. Employer Identification No.)

**328 Barry Ave. S. #210**  
**Wayzata, Minnesota**                      **55391**  
(Address of principal executive offices) (Zip Code)

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

Registrant's telephone number, including area code: (952) 479-1923

**Securities registered pursuant to Section 12(b) of the Act:**

**Title of Each Class Name of Each Exchange on which Registered**

**Securities registered pursuant to Section 12(g) of the Act:**

Common stock, \$0.001 par value per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 the filing requirements for the past 90 days.  Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, 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 files).  Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements

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incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. "

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer," "non-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  x

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

The aggregate market value of the voting stock held by persons other than officers, directors and more than 5% shareholders of the registrant as of December 31, 2014 was approximately \$2,605,358 based on the closing sales price of \$1.00 per share as reported on the OTCBB. As of March 31, 2015, there were 12,151,493 shares of the registrant's common stock, \$0.001 par value, outstanding.

**DOCUMENTS INCORPORATED IN PART BY REFERENCE**

None.

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## **PART I**

### **ITEM 1 BUSINESS**

#### **Overview**

Mill City Ventures III, Ltd., formerly known as Poker Magic, Inc. (the “Company” or “we”), is a Minnesota corporation that was incorporated in January 2006. Until December 13, 2012, we were a development-stage company that previously focused on promoting and placing our Winner’s Pot Poker game online and into casinos and entertainment facilities nationwide, including those located in Native American tribal lands. On December 13, 2012, we filed a Form N-8A with the Securities and Exchange Commission (“SEC”), notifying the SEC of our intent to register as an internally managed, non-diversified, closed-end investment company under the Investment Company Act of 1940 (the “1940 Act”). On February 7, 2013, we filed Form N54A, Notification of Election to be Subject to Sections 55 through 65 of the Investment Company Act of 1940. We are regulated as a business development company (“BDC”) and intend to be taxed as a regulated investment company.

#### **Business Model and Strategy**

As a BDC, we primarily focus on investing in or lending to private and small-capitalization public companies and making managerial assistance available to such companies. A BDC generally provides shareholders with the ability to retain the liquidity of a publicly traded stock, while sharing in the possible benefits of investing in emerging-growth or expansion-stage companies that are privately or publicly owned.

Our revenues relate to the earnings we receive from our portfolio investments. Our objective is to obtain superior returns from investments in securities and other investment opportunities available to BDCs under the 1940 Act. We intend to invest capital in portfolio companies for purposes of financing acquisitions, organic growth, recapitalizations, buyouts and working capital. In this regard, buyouts generally include transactions that involve the acquisition of a controlling interest in an entity, either by management or other investors. Organic growth refers to growth through the internal operations of the company, whether through investments in marketing initiatives, capital expenditures or other internal growth initiatives, rather than growth by means of acquisitions.

We plan to identify potential investments through multiple sources, including without limitation private equity sponsors, investment bankers, brokers and owners and operators of businesses. We expect to base our investment decisions on our analyses of actual and potential business operations, asset valuations and viable exit strategies to establish appropriate pricing and maximize our return on investment. Subject to regulations set forth in the 1940 Act

and applicable to BDCs, we plan to invest in private companies, small-cap public stocks, notes and other forms of debt, investment contracts, and other investments commonly referred to as securities.

## Competition

As a BDC, we compete with strategic buyers, private equity funds, subordinated debt funds and other buyers and financing sources, including traditional financial services companies such as finance companies, commercial banks, investment banks and other equity and non-equity based investment funds. Some of our competitors will be substantially larger and have considerably greater financial resources than we do. Competitors may have a lower cost of funds and many have access to funding sources that are not available to us. In addition, certain of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more relationships and build their market shares. Competitive pressures may have a material adverse effect on our results of operations. In addition, as a result of this competition, we may be unable to take advantage of attractive investment opportunities and meet our investment goals.

## Competitive Advantages

We believe that we are well positioned to secure appropriate investments in target companies for the following reasons:

*Management Expertise.* We believe that our management's strong combination of experience and contacts in the investment sector, including the experience and contacts of non-management members of our Board of Directors, should attract suitable prospective portfolio companies. Since 1994, Douglas M. Polinsky, our Chief Executive Officer, has been the Chief Executive Officer of Great North Capital Consultants, Inc., a financial advisory company that he founded. Great North Capital Consultants advises corporate clients on matters regarding corporate and governance structures, public company acquisitions of private companies and other transaction-related matters, and also makes direct investments into public and private companies. Our Chief Financial Officer, Joseph A. Geraci, II, has been managing member of Isles Capital, LLC, an advisory and consulting firm that assists small businesses, both public and private, in business development. Mr. Geraci also managed Mill City Advisors, LLC, a Minnesota limited liability company that formerly served as the general partner of Mill City Ventures II, LP, a Minnesota limited partnership investment fund that previously invested directly into both private and public companies. Mr. Geraci previously served as a stockbroker and Vice President of Oak Ridge Financial Services, Inc. from June 2000 to December 2004. While at Oak Ridge Financial Services, Mr. Geraci's business was focused on structuring and negotiating debt and equity private placements with both private and publicly held companies. We believe that our management team's extensive experience in researching, analyzing, advising and investing in private and publicly held companies will afford us a relative competitive advantage in structuring investments in potential portfolio companies. See "Directors, Executive Officers and Corporate Governance" for a more detailed description of our management team. Although we believe our management provides valuable investment experience to the Company, none of our management team has been involved in the operation of a company subject to the BDC requirements and regulations set forth in the 1940 Act. Please see, however, "*Risk Factors — Risks Related to Our Business — We recently changed our business, and our management team has no experience managing a BDC*" for more information.



*Flexible Investment Options.* We will have significant relative flexibility in selecting and structuring our investments. We will not be subject to many of the regulatory limitations that govern traditional lending institutions. Also, we will have fairly broad latitude as to the term and nature of our investments. We intend to calculate rates of return on invested capital based on a combination of up-front commitment fees, current and deferred interest rates and residual values, which may take the form of common stock, warrants or future contract payments. We believe that this flexible approach to structuring investments will facilitate positive, long-term relationships with our portfolio companies and enable us to become a preferred source of capital to them after our initial investments.

*Longer Investment Horizons.* We will not be subject to periodic capital-return requirements that are typical for most private equity and venture capital funds. These requirements typically require that such funds return to investors the initial capital investment after a certain period of time, together with any capital gains on such capital investment. These provisions often force such funds to seek the return of their investments in portfolio companies through mergers, public equity offerings or other liquidity events more quickly than they otherwise might, which can result in a lower overall return to investors and adversely affect the ultimate viability of the affected portfolio companies. Because we may invest in the same portfolio companies as these funds, we are subject to these risks if these funds demand an early return on their investments in the portfolio companies. We believe that our flexibility to take a longer-term view should help us to maximize returns on our invested capital while still meeting the needs of our portfolio companies.

*Investing Across Industries.* We expect to seek to obtain and maintain a portfolio of investments that is appropriately balanced among various companies, industries, geographic regions and end markets. We believe that maintaining a balanced portfolio will mitigate the potential effects of negative economic events for particular companies, regions and industries.

## **Investment Process**

### ***Prospective Portfolio Company Characteristics***

We have identified several criteria that we believe will prove important in achieving our investment objectives with respect to target portfolio companies. These criteria will provide general guidelines for our investment decisions. Nevertheless, not all of these criteria will be met by each prospective portfolio company in which we choose to invest.

*Experienced Management.* We will seek portfolio companies that have an experienced and knowledgeable management team or Board of Directors. We will also seek portfolio companies that have in place proper incentives to induce management to succeed and to act in concert with our interests as investors, including having significant equity interests.



*Existing Significant Financial or Strategic Sponsor.* We may invest in target companies in which established private equity or venture capital funds or other financial or strategic sponsors have previously invested and make an ongoing contribution to the management of the business. We believe that having an established financial or strategic sponsor that has a meaningful commitment to the business diversifies the capital sources of the target portfolio company, making it more likely to succeed in the longer term.

*Competitive Position.* We will seek to invest in portfolio companies that have developed, or appear poised to develop, a strong competitive position within their respective sector or niche.

*Cash Flow Companies.* We will seek to invest in portfolio companies that are profitable or nearly profitable on an operating cash flow basis. We may, however, invest in start-up companies without any revenues.

*Future Growth.* We will seek out target portfolio companies that demonstrate an ability to increase revenues in addition to operating cash flow over time. The anticipated growth rate of a prospective target company will be an important factor in determining the value that we ascribe to any warrants or other equity securities that we may acquire in connection with an investment.

*Exit Strategy.* Prior to making an investment, we will analyze the potential for that company to increase the liquidity of its equity securities through a future event that would enable us to realize appreciation, if any, in the value of our equity interest. Liquidity events may include an initial public offering, a private sale of our equity interest to a third party, a merger or an acquisition of the company or a purchase of our equity interest by the company or one of its shareholders.

*Asset Liquidation Value.* Although we do not intend to operate as an asset-based lender, the prospective liquidation value of the assets, if any, collateralizing any debt securities we hold will be an important factor in our credit analysis of potential portfolio companies. In assessing creditworthiness and asset liquidation value, we expect to consider both tangible assets (such as accounts receivable, inventory and equipment) and intangible assets (such as intellectual property, customer lists, networks and databases).

### ***Due Diligence***

If we believe a target portfolio company generally meets the characteristics described above or if we believe that certain of the most important characteristics for that particular target portfolio company or the industry in which it operates are met, or if we have other reasons to believe in the potential profitability of an investment in a target portfolio company, we may perform initial due diligence on such company. Our due-diligence examination for each target portfolio company will differ based on a number of factors but is generally likely to include our:

assessment of the market in which the company operates, including any special risks (regulatory or otherwise) that apply,

assessment of the competitive landscape in that market,

familiarity with or evaluation of management,

review and assessment of the company's financing history, as well as the likely need for additional financings,

risk analysis relating to the terms of the investment and the transaction size, and

assessment of the investment pricing and structure.

The assessments delineated above provide our general approach for our investment decisions, although not all of such activities will be followed in each instance, or some may be stressed more so than others depending on facts and circumstances. Upon successful completion of this preliminary evaluation, we will decide whether to move forward towards negotiating a letter of intent and, thereafter, definitive documentation for our investment. Depending on timing, we may not use a letter of intent and will instead proceed directly to definitive documentation.

## **Types of Investments**

We expect to engage in various investment strategies in order to achieve our overall investment objectives. The particular type of investment strategy we select will depend, among other things, upon market opportunities, the skills and experience of our management and Board of Directors and our overall portfolio composition. Our strategies generally seek to provide (i) in the case of debt, current cash yields and favorable loan-to-value ratios, or other financial guarantees or credit enhancements with respect to loan collateral, and (ii) in the case of equity, favorable long-term growth and income potential together with viable exit or liquidity strategies.

### ***Debt Investments***

We intend to tailor the terms of each debt investment we make to the facts and circumstances of the transaction and prospective portfolio company, negotiating a structure that seeks to protect our rights and manage our risk while creating incentives for the portfolio company to achieve its business plan. Our expected primary source of return on debt investments is the monthly cash interest we collect on those investments. The particular types of debt investments we may make include, but are not limited to, the following:

First lien loans

Second lien loans

Unsecured loans

### ***Equity Investments***

Like debt investments, we intend to tailor the terms of each equity investment we make to the facts and circumstances of the transaction and prospective portfolio company, negotiating a structure that seeks to protect our rights and manage our risk while creating incentives for the portfolio company to achieve its business plan. As an equity holder, the rights we will generally seek to protect or obtain include minority rights, event-driven rights to “put” or sell our equity back to the portfolio company or certain affiliates or sponsors, and registration rights in connection such as “demand” or “piggyback” registration rights.. We may invest in common stock and preferred stock, and may receive warrants in connection with our investments. When we make a debt investment, we may also be granted equity participation in the form of warrants to purchase common equity in the company in the same class of security that the owners or equity sponsors receive upon funding.

### **Ongoing Relationships with Portfolio Companies**

#### ***Monitoring***

We will monitor our portfolio companies in order to determine whether they are meeting our financing criteria and their respective business plans. We may decline to make additional investments in portfolio companies that do not continue to meet our financing criteria or that fail to successfully execute their business plans. Of course, we may choose to make additional investments in portfolio companies that do not do so, but that we believe will nevertheless perform well in the future.

We expect to monitor the financial trends of each portfolio company and their respective industries to assess the appropriate course of action for each company and to evaluate our overall portfolio quality. In this regard, our management team will monitor the status and performance of each individual company on at least a quarterly and, in some cases, a monthly basis.

We have several methods of evaluating and monitoring the performance and fair value of our debt and equity positions, including but not limited to the following:

- Consider the amortized value of our debt securities;

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Assess the business development success, including product development, financings, profitability and the portfolio company's overall adherence to its business plan;

Contact portfolio company management regularly to discuss financial position, requirements and accomplishments;

Interview portfolio company management regularly and, if appropriate, other financial or strategic sponsors of that portfolio company;

Attend and participate in board meetings of portfolio companies; and

Review monthly and quarterly financial statements and financial projections of our portfolio companies.

We expect that the current financial statements of all portfolio companies will be available to us to assist us in our fair value reporting obligations under the 1940 Act.

### *Managerial Assistance*

As a BDC, we offer, and in many cases may provide, significant managerial assistance to those of our portfolio companies intended to qualify as "eligible portfolio companies" under the 1940 Act. We expect that this assistance, if any, will typically involve monitoring the operations of our portfolio companies, participating in their board and management meetings, consulting with and advising their officers and providing other organizational, financial, strategic and transactional guidance.

### **Our 2014 Portfolio**

At December 31, 2014, we held investments in eleven eligible portfolio investments, which had an aggregate amortized cost of \$4,946,019 and a fair value of \$6,265,399 and our non-eligible portfolio holdings had an aggregate cost of \$851,499 and a fair market value of \$906,110. At December 31, 2013, we held five eligible portfolio investments, which had an aggregate amortized cost of \$2,246,019 and a fair value of \$2,767,319. Our eligible portfolio investments at December 31, 2014 were as follows:

600,000 shares of common stock of Southern Plains Resources, Inc. Our aggregate cost for this holding at December 31, 2014 was \$730,000, and the fair value was \$300,000.

Warrants to purchase 413,934 shares of common stock of CombiMatrix Corporation. Our aggregate cost and fair value for these holdings at December 31, 2014 was \$0.

300,000 shares of Series B Convertible Preferred Stock of MAX4G, Inc. At December 31, 2014, our cost and fair value for this holding was \$150,000.

55,000 Class A Membership Units of Tzfat Spirits of Israel, LLC. At December 31, 2014, our cost for this holding was \$101,019 and our fair value was \$25,000.

a \$750,000 in principal amount of promissory note issued by Insite Software Solutions, Inc. and a warrant to purchase 108,960 shares of common stock of Insite Software Solutions. At December 31, 2014, our aggregate cost and fair value for this holding was \$750,000.

50,000 shares of common stock of Bio Life Solutions, Inc. and a warrant to purchase 100,000 shares of common stock of Bio Life Solutions, Inc. At December 31, 2014, our aggregate cost for this holding was \$215,000 and our fair value was \$82,000.

a \$500,000 in principal amount of a Senior Secured Convertible promissory note issued by Mix 1 Life, Inc. (convertible at \$1.08 per share) and 352,230 shares of common stock of Mix Life, Inc. At December 31, 2014, our aggregate cost for this holding was \$500,000 and our fair value was \$2,458,399.

A \$1,000,000 limited liability membership interest issued by DBR Phase III US Investors, LLC. At December 31, 2014, our aggregate cost and fair value for this holding was \$1,000,000.

500 shares of Series A 6% Convertible Preferred Stock of Dala Petroleum, Inc. and a warrant to purchase 714,286 shares of common stock of Dala Petroleum, Inc. At December 31, 2014, our aggregate cost and fair value for this holding was \$500,000.

500,000 Membership Units of Northern Capital Partners I, LP. At December 31, 2014, our aggregate cost and fair value for this holding was \$500,000.

a \$500,000 in principal amount of promissory note issued by The Igloo, LLC. At December 31, 2014, our aggregate cost and fair value for this holding was \$500,000.

## **BDC Regulation**

The following discussion is a general summary of some of the material prohibitions and restrictions governing BDCs generally. It does not purport to be a complete description of all the laws and regulations affecting BDCs.

The 1940 Act contains prohibitions and restrictions relating to transactions between BDCs and their directors and officers and principal underwriters and certain other related persons, and requires that a majority of the directors be persons other than “interested persons,” as that term is defined in the 1940 Act. In addition, the 1940 Act provides that we may not change the nature of our business so as to cease to be, or to withdraw our election as, a BDC unless approved by a majority of our outstanding voting securities. A majority of the outstanding voting securities of a company is defined under the 1940 Act as the lesser of (i) 67% or more of such company’s shares present at a meeting or represented by proxy if more than 50% of the outstanding shares of such company are present or represented by proxy or (ii) more than 50% of the outstanding shares of such company.

*Qualifying Assets*

Under the 1940 Act, a BDC may not acquire any asset other than “qualifying assets” listed in Section 55(a) of the 1940 Act unless, at the time the acquisition is made, qualifying assets represent at least 70% of the BDC’s total assets. The principal categories of qualifying assets relevant to our business are the following:

Securities of an “*eligible portfolio company*” purchased from the issuer of such securities or from a person who is, or who was within the prior 13 months of the date of purchase, an affiliate of the issuer or from any other person (subject to limitation by SEC rules), in any case in transactions not involving any public offering. The 1940 Act defines an “eligible portfolio company” as any issuer which:

- (a) is organized under the laws of, and has its principal place of business in, the United States;
- (b) is not an investment company or a company that would be an investment company but for certain exclusions under the 1940 Act; and
- (c) satisfies one of the following:
  - (i) does not have outstanding any class of securities with respect to which a broker or dealer may extend margin credit (or, if a broker or dealer may in fact extend or maintain margin credit to a customer with respect to such securities, then at the time of purchase of the issuer’s securities (A) the BDC owns at least 50% of the greatest number of outstanding and issuable equity securities of such issuer (i.e., 50% determined on a fully diluted basis) and the greatest amount of debt securities of such issuer), (B) the BDC is one of the 20 largest holders of record of the issuer’s outstanding voting securities);



is controlled by a BDC or a group of companies acting together that includes a BDC, the BDC does in fact exercise (ii) a controlling influence over the management or policies of the issuer, and, as a result of such control, the BDC has an affiliated person serving as a director of the eligible portfolio company;

(iii) is a small and solvent company having total assets of not more than \$4 million and capital and surplus of not less than \$2 million, subject to adjustment by SEC rules;

by virtue of SEC Rule 2a-46, (A) does not have any class of securities listed on a national securities exchange, or (iv) (B) has a class of securities listed on a national securities exchange but an aggregate market value (as computed under such rule) of outstanding voting and non-voting common equity of less than \$250 million.

Securities of any eligible portfolio company (as defined above) that we control through having a person serving on the board of directors of the issuer;

Securities purchased from an issuer, or from a person who is, or was in the prior 13 months of the date of purchase, an affiliate of the issuer, which issuer is organized under the laws of, and has its principal place of business in, the United States and is not an investment company (or a company that would be an investment company but for certain exclusions under the 1940 Act), and which is in bankruptcy and subject to reorganization (or where the issuance of securities is consummated pursuant to or in consummation of a bankruptcy or reorganization plan or arrangement);

Securities of an eligible portfolio company (as defined above) purchase from any person in a transaction not involving a public offering, if there is no ready market for such securities and if immediately prior to such purchase the BDC owns at least 60% of the outstanding equity securities of such issuer, as determined on a fully diluted basis;

Securities received in exchange for or distributed on or with respect to securities described above, or pursuant to the conversion of warrants or rights relating to such securities;

Cash, cash equivalents, U.S. government securities or high-quality debt securities maturing in one year or less from the time of investment; and

Office furniture and equipment, interests in real estate and leasehold improvement and facilities maintained to conduct the business operations of the BDC, deferred organization and operating expenses, and other non-investment assets necessary and appropriate to its operations as a BDC, including notes of indebtedness of directors, officers, employees and general partners held by the BDC as payment for securities of such company issued in connection with an executive compensation plan described in Section 57(j) of the 1940 Act.

*Significant Managerial Assistance*

A BDC must have been organized and have its principal place of business in the United States and must be operated for the purpose of making investments in the types of securities described above. However, to count portfolio securities as qualifying assets for the purpose of the foregoing 70% test, the BDC must either control the issuer of the securities or offer to make available to the issuer of the securities (other than small and solvent companies described above) significant managerial assistance; except that, where the BDC purchases such securities in conjunction with one or more other persons acting together, one of the other persons in the group may make available such managerial assistance. Making available significant managerial assistance means, among other things, any arrangement whereby the BDC, whether through its directors, officers or employees, offers to provide, and, if accepted, does in fact so provide, significant guidance and counsel concerning the management, operations or business objectives and policies of a portfolio company through monitoring of portfolio company operations, selective participation in board and management meetings, consulting with and advising a portfolio company's officers or other organizational or financial guidance.

*Temporary Investments*

Pending investment in other types of qualifying assets, as described above, our investments may consist of cash, cash equivalents, U.S. government securities or high quality debt securities maturing in one year or less from the time of investment, which we refer to, collectively, as temporary investments, so that at least 70% of our assets are qualifying assets. We plan to invest in U.S. treasury bills or in repurchase agreements, provided that such agreements are fully collateralized by cash or securities issued by the U.S. government or its agencies. A repurchase agreement involves the purchase by an investor, such as us, of a specified security and the simultaneous agreement by the seller to repurchase it at an agreed upon future date and at a price which is greater than the purchase price by an amount that reflects an agreed-upon interest rate. There is no percentage restriction on the proportion of our assets that may be invested in such repurchase agreements. However, if more than 25% of our total assets constitute repurchase agreements from a single counterparty, we would not meet the diversification tests imposed on us by the Internal Revenue Code (the "Code") to qualify for tax treatment as a Regulated Investment Company ("RIC") for federal income tax purposes. Thus, we do not intend to enter into repurchase agreements with a single counterparty in excess of this limit. We will monitor the creditworthiness of the counterparties with which we enter into repurchase agreement transactions.

*Senior Securities; Coverage Ratio*

We will be permitted, under specified conditions, to issue multiple classes of indebtedness and one class of stock senior to our common stock, but only if our “asset coverage,” as defined in the 1940 Act, is at least equal to 200% immediately after each such issuance. In addition, while any senior securities remain outstanding, we must not make any dividend distribution to our shareholders or repurchase securities unless we meet the applicable asset-coverage ratios at the time of the dividend distribution or repurchase. We may also borrow amounts up to 5% of the value of our total assets for temporary or emergency purposes.

*Other*

We will be periodically examined by the SEC for compliance with the 1940 Act, the rules and regulations thereunder, and good governance practices. We will not “concentrate” our investments (i.e., invest 25% or more of our assets in any particular industry, determined at the time of investment). We will be required to provide and maintain a bond issued by a reputable fidelity insurance company to protect us against larceny and embezzlement. Furthermore, as a BDC, we are prohibited from indemnifying any director or officer against any liability to our shareholders arising from willful malfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of such person’s office. We are required to adopt and implement written policies and procedures reasonably designed to prevent violation of the federal securities laws, review these policies and procedures annually for their adequacy and the effectiveness of their implementation.

**Dividend Reinvestment Plan**

We plan to adopt a dividend reinvestment plan (DRIP) that provides for reinvestment of our distributions on behalf of our shareholders, unless a shareholder elects to receive cash as provided below. For some time, we have been negotiating the final fee structure of our proposed DRIP with our transfer agent and, upon the conclusion of this process, we expect that the DRIP will be adopted and effected so long as we obtain the pricing structure we seek. As a result, if our Board of Directors authorizes, and we declare, a cash dividend, then our shareholders who have not “opted out” of our DRIP will have their cash dividends automatically reinvested in additional shares of our common stock, rather than receiving the cash dividends.

If and when adopted, no action will be required on the part of a registered shareholder to have their cash dividend reinvested in shares of our common stock. A registered shareholder will be able to elect to receive an entire dividend in cash by notifying the plan administrator and our transfer agent and registrar, in writing, so that such notice is

received by the plan administrator no later than the record date for dividends to shareholders. The plan administrator will set up an account for shares acquired through the plan for each shareholder who has not elected to receive dividends in cash and hold such shares in non-certificated form. Upon request by a shareholder participating in the DRIP, received in writing not less than ten days prior to the record date, the plan administrator will, instead of crediting shares to the participant's account, issue a certificate registered in the participant's name for the number of whole shares of our common stock and a check for any fractional share.

Those shareholders whose shares are held by a broker or other financial intermediary will be able to receive dividends in cash by notifying their broker or other financial intermediary of their election.

We intend to use primarily newly issued shares to implement the plan, whether our shares are trading at a premium or at a discount to net asset value. However, we reserve the right to purchase shares in the open market in connection with our implementation of the plan. The number of shares to be issued to a shareholder will be determined by dividing the total dollar amount of the dividend payable to such shareholder by the market price per share of our common stock at the close of regular trading on the over-the-counter bulletin board on the dividend payment date. Market price per share on that date will be the closing price for such shares on the over-the-counter bulletin board or, if no sale is reported for such day, at the average of their reported bid and asked prices. The number of shares of our common stock to be outstanding after giving effect to payment of the dividend will not be established until the value per share at which additional shares will be issued has been determined and elections of our shareholders are tabulated.

There will be no brokerage charges or other charges to shareholders who participate in the DRIP. We expect that we will pay the plan administrator's fees under the DRIP. If a participant elects by written notice to the plan administrator to have the plan administrator sell part or all of the shares held by the plan administrator in the participant's account and remit the proceeds to the participant, the plan administrator will be authorized to deduct a transaction fee plus a brokerage commission from the proceeds.

Participants will be able to terminate their accounts under the plan by notifying the plan administrator. We will also be able to terminate the plan upon notice in writing mailed to each participant at least 30 days prior to any record date for the payment of any dividend. Notwithstanding the above, we are presently uncertain about exactly when we will be in a position to adopt and effect the DRIP, if ever.

## **Management**

Currently, Mr. Douglas M. Polinsky, the Chief Executive Officer and Chairman of our Board of Directors, and Joseph A. Geraci, II, our Chief Financial Officer and a director of the Company, both serve as our senior management team. Our ability to achieve our investment objective will depend on our senior management team's ability to identify, evaluate, finance and invest in suitable companies that meet our investment goals. Accomplishing this result in a cost-effective manner will largely be a function of our management of the due-diligence and investment process, our ability to efficiently monitor investments we make and, in some cases, our access to financing sources on acceptable terms.

## ITEM 1A RISK FACTORS

*You should consider the following risk factors, in addition to the other information presented or incorporated by reference into this Annual Report on Form 10-K, in evaluating our business and any investment decision relating to our securities.*

### **Risks Related to our Business**

***We changed our business to a BDC, and our management team has no experience managing a BDC.***

On December 13, 2012, we changed our business to become an internally managed, closed-end investment company and subsequently elected to be treated as a BDC under the 1940 Act. We have limited experience in this regard, which may affect our ability to successfully manage and grow our business.

The 1940 Act imposes numerous constraints on the operations of BDCs. For example, BDCs are required to invest at least 70% of their total assets in specified types of securities, primarily in private companies or small-cap traded U.S. public companies, cash, cash equivalents, U.S. government securities and other high quality debt investments that mature in one year or less. Our management team's lack of experience in managing a portfolio of assets under such regulatory constraints may hinder our ability to take advantage of attractive investment opportunities and, as a result, achieve our investment objective. Furthermore, our failure to comply with the complex BDC requirements could cause the SEC to bring an enforcement action against us, expose us to private claims and/or cause us to lose our status as a BDC.

We intend to obtain and maintain tax treatment as a RIC under the Code. To maintain that status, we must meet specified source-of-income and asset diversification requirements and distribute annually at least 90% of the sum of our net ordinary income plus the excess, if any, of realized net short-term capital gains over realized net long-term capital losses. Failure to meet these requirements would subject us to excise taxes, which would reduce your return on investment.

***We are dependent upon senior management personnel for our future success. If we are unable to retain our senior management team, our ability to achieve our investment objectives could be significantly harmed.***

We expect to critically depend on our senior management, particularly our Chief Executive Officer, Douglas M. Polinsky, and our Chief Financial Officer, Joseph A. Geraci, II, for the identification, final selection, structuring, closing and monitoring of our investments. These employees have critical experience and relationships that we intend to rely on in the course of implementing our business plan. Thus, our future success and viability as a BDC will depend on the continued service of these persons. Their departure could have a material adverse effect on our ability to achieve our investment objective.

***In the near term, we expect a pending compliance inspection by the SEC's Office of Compliance and Inspections to result in the conclusion that, shortly after our election to become a BDC, we failed to sufficiently comply with certain operational and governance-related requirements applicable to BDCs under the 1940 Act. Despite the fact that we cooperated with the compliance inspection and quickly undertook, and continue to undertake and implement, remedial measures to redress our known compliance deficiencies, this conclusion may result in enforcement proceedings against the Company, and we may be required to pay a fine.***

We are the subject of an ongoing compliance inspection by the SEC's Office of Compliance and Inspections originally initiated after we elected in February 2013 to be treated as a BDC under the 1940 Act. We fully cooperated with the requests of the Office of Compliance and Inspections. Importantly, we have taken many measures to address our known compliance deficiencies since the beginning of the inspection, including the adoption of written valuation policies and procedures, the establishment of a Valuation Committee of our Board of Directors, the adoption of a written Affiliate Transaction Policy and the preparation of written procedures for the implementation of that policy, the adoption of a written Board Meeting Policy, the adoption of a written Conflict of Interest and Related Party Transaction Policy, the retention of a Chief Compliance Officer who is not a member of management, the preparation of written procedures for the implementation of the earlier-adopted Code of Ethics (the text of which we believe was and remains consistent with the requirements of the 1940 Act), and the preparation of a compliance calendar to facilitate the implementation of the various new compliance procedures by our Chief Compliance Officer, our Board of Directors and the professionals retained to assist their compliance efforts. Despite these remedial actions, it is possible that the Office of Compliance and Inspections may refer some or all of our compliance deficiencies to the SEC's Enforcement Division for enforcement proceedings. If this were to occur, we can reasonably expect to stipulate to a cease-and-desist order and we may also be required to pay a fine, which could be significant.

***We will operate in a highly competitive market for portfolio investment opportunities.***

We expect that many entities will compete with us to make the types of investments we plan to make in prospective portfolio companies. We will compete with private equity firms as well as other BDCs, investment funds, investment banks and other sources of financing, including traditional financial services companies such as commercial banks and finance companies. Many of our competitors are substantially larger and have considerably greater financial, technical, marketing and other resources than we do. For example, some competitors may have a lower cost of funds and access to funding sources not available to us. These resources may enable our competitors to offer terms that we cannot match. We may lose prospective portfolio investments if we do not match our competitors' pricing, terms and structure. If, on the other hand, we do match our competitors' pricing, terms or structure, we may experience decreased net interest income and increased risk of credit losses. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments, establish more relationships and build their market shares. Importantly, many of our potential competitors have greater experience operating under, or are not subject to, the regulatory restrictions that the 1940 Act does impose on us as a BDC. If we are not able to compete effectively, our business and financial condition and results of operations will be adversely affected.

***We may be unable to make distributions, which failure could materially and adversely affect your investment.***

Although we intend to make periodic distributions to our shareholders, we may be unable to achieve operating results that will allow us to make such distributions. For example, the BDC asset-coverage requirements may limit our ability to make distributions. In addition, restrictions and provisions in any future credit facilities may limit our ability to make distributions. Although we intend to elect RIC taxation under the Code, if we fail to meet certain annual income-distribution requirements, we could lose our RIC status and be subject to corporate-level income tax. Any failure to make distributions or any loss of our RIC status could materially and adversely affect your investment.

***Any unrealized losses we experience may be an indication of future realized losses, which could reduce our income available for distribution.***

As a BDC, we are required to carry our investments at market value or, if no market value is ascertainable, at the fair value as determined in good faith by our Board of Directors. Decreases in the market values or fair values of our investments will be recorded as unrealized depreciation on our statement of operations. Any unrealized losses in our portfolio could be an indication of a portfolio company's inability to meet its repayment obligations to us (if a loan), or of its diminishing value (if equity). This could result in future realized losses and, ultimately, in reductions of our income available for distribution in future periods.



***Many of our portfolio investments will be recorded at fair value as determined in good faith by our Board of Directors. As a result, there may be uncertainty as to the ultimate value of our investments.***

Our investments are expected to consist primarily of securities issued by privately held companies, the fair value of which is not readily determinable. In addition, we will not be permitted to maintain a general reserve for anticipated loan losses. Instead, we will be required by the 1940 Act to specifically value each investment and record an unrealized gain or loss for any asset that we believe has increased or decreased in value. Our Board of Directors will value these securities at fair value as they determine in good faith and consistent with the written policies and procedures that we have adopted for this purpose. Where appropriate, our board may utilize the services of an independent valuation firm to assist in the determination of fair value. Because valuations, and particularly valuations of private investments, are inherently uncertain and may be based on estimates, our fair value determinations may differ materially from those that would be assessed if a liquid market for these securities existed. Our net asset value could be adversely affected if the fair value determinations of our investments were materially higher than the values we ultimately realize from them.

***If we are unable to source investments effectively, we may be unable to achieve our investment objectives.***

Our ability to achieve our investment objective will depend on our senior management team's ability to identify, evaluate, finance and invest in suitable companies that meet our investment criteria. Accomplishing this result in a cost-effective manner will largely be a function of our management of the investment process, our ability to provide efficient services and our access to financing sources on acceptable terms. In addition to monitoring the performance of our investments, our management team must offer managerial assistance to our portfolio companies. These demands on their time may distract them, slowing the rate of overall investment. To grow, we expect that we will need to hire, train, supervise and manage new employees and to implement computer and other systems capable of effectively accommodating our growth. Our failure to effectively manage our future growth could materially and adversely affect our business, financial condition and results of operations.

***We will be exposed to risks associated with changes in interest rates.***

General interest rate fluctuations may have a substantial and negative impact on our investments, the value of our common stock and our rate of return on invested capital. A reduction in interest spreads on new investments could also have an adverse impact on our net interest income. An increase in interest rates could decrease the value of any investments we hold which earn fixed interest rates. Also, an increase in interest rates could make investment in our common stock less attractive if we are unable to increase our dividend rate, which could reduce the value of our common stock.

***We may have difficulty paying our required distributions if we recognize income before or without receiving cash representing such income.***

Once we become a BDC subject to RIC taxation, we may be required to include in our taxable income certain amounts that we have not yet received in cash. Any of these amounts will increase the amounts we are required to distribute to qualify under the RIC rules. In any such event, we would need to obtain cash from other sources to satisfy our RIC-related distribution requirements. If we are unable to so obtain cash, we may fail to qualify for tax treatment as a RIC, and thus could become subject to a corporate-level income tax on all of our income. Accordingly, we may have to sell some of our assets, raise additional debt or equity capital or reduce new investment originations to meet these distribution requirements and avoid a corporate-level income tax.

***If we incur additional debt, it could increase the risk of investing in our Company.***

We expect, in the future, that we may borrow from, and issue senior debt securities to, banks, insurance companies and other lenders. Lenders will have fixed-dollar claims on our assets that are superior to the claims of our shareholders, and we may grant a security interest in our assets in connection with our borrowings. In the case of a liquidation event, those lenders would receive proceeds before our shareholders. In addition, borrowings generally magnify the potential for gain or loss on amounts invested and, therefore, increase the risks associated with investing in our securities. Leverage is generally considered a speculative investment technique. If the value of our assets increases, then leveraging would cause the net asset value attributable to our common stock to increase more than it otherwise would have had we not leveraged. Conversely, if the value of our assets decreases, leveraging would cause the net asset value attributable to our common stock to decline more than it otherwise would have had we not leveraged. Similarly, any increase in our revenue in excess of interest expense on our borrowed funds would cause our net income to increase more than it would without the leverage; and any decrease in our revenue would cause our net income to decline more than it would have had we not borrowed funds, and could negatively affect our ability to make distributions on our common stock. Our ability to service any debt that we incur will depend largely on our financial performance and will be subject to prevailing economic conditions and competitive pressures.

As a BDC, we will be required to meet an asset-coverage ratio (total assets to total borrowings and other senior securities, including any preferred stock) of at least 200%. If this ratio declines below 200%, we will be unable to incur additional debt and may need to sell a portion of our investments to repay debt when it is otherwise disadvantageous to do so, and we may be unable to make distributions.

***Because we intend to distribute substantially all of our income and net realized capital gains to our shareholders, we will likely need additional capital to finance our growth.***

To qualify for RIC taxation and avoid payment of excise taxes and minimize or avoid payment of income taxes, we intend to distribute to our shareholders substantially all of our net ordinary income and realized net capital gains except for certain net long-term capital gains (which we may retain, pay applicable income taxes with respect thereto, and elect to treat as deemed distributions to our shareholders). As described elsewhere, as a BDC we will be required to meet a 200% asset-coverage ratio limiting the amount that we may borrow. Because we will continue to need capital to grow our investment portfolio, this limitation may require us to raise additional equity at a time when it may be disadvantageous to do so. While we expect to be able to borrow and issue additional debt and equity securities, debt and equity financing may not be available to us on favorable terms, if at all. In addition, as a BDC, we will generally not be permitted to issue equity securities below net asset value without shareholder approval. If additional funds are not available to us, we could be forced to curtail or cease new investment activities, and our net asset value could decline.

***Our Board of Directors may change our investment objective, operating policies and strategies without prior notice or shareholder approval.***

Our Board of Directors has the authority from time to time to modify or waive certain of our operating policies and strategies without prior notice (except as required by the 1940 Act) and without shareholder approval. Under Section 58 of the 1940 Act, our Board of Directors may not, however, choose to withdraw our status as a BDC, or change its operations so as to cease to be a BDC, without the prior approval of our shareholders. The effects of any such exercise of authority may adversely affect our business and the value of your investment.

***Failure to achieve and maintain effective internal controls could limit our ability to detect and prevent fraud and thereby adversely affect our business and stock price.***

Effective internal controls are necessary for us to provide reliable financial reports. Nevertheless, all internal control systems, no matter how well designed, have inherent limitations. Even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Our most recent evaluation of our internal controls resulted in our conclusion that our disclosure controls and procedures were effective. Our inability to maintain an effective control environment may cause investors to lose confidence in our reported financial information, which could in turn have a material adverse effect on our stock price.

***We are highly dependent on the services provided by certain executives and key personnel.***

Our success depends in significant part upon the continued service of certain senior management and other key personnel. In particular, the Company is materially dependent upon the services of Douglas M. Polinsky, our Chief Executive Officer and Chairman and Joseph A. Geraci, II, our Chief Financial Officer and a director of the Company. Although we have employment agreements with these individuals, we may nonetheless lose their services if they were to die or become disabled, or if they were to voluntarily terminate their association with our Company. We do not have any key-man insurance in place with respect to Messrs. Geraci and Polinsky.

***Our articles of incorporation grant our Board of Directors the power to designate and issue additional shares of common and/or preferred stock.***

Our authorized capital consists of 250,000,000 shares of capital stock. Unless otherwise specifically so designated upon issuance, all shares of capital issued we issue will be common stock. Pursuant to authority granted by our articles of incorporation, our Board of Directors, without any action by our shareholders, may designate and issue shares in such classes or series (including other classes or series of preferred stock) as it deems appropriate and establish the rights, preferences and privileges of such shares, including dividends, liquidation and voting rights. The rights of holders of other classes or series of stock that may be issued could be superior to the rights of holders of our common shares. The designation and issuance of shares of capital stock having preferential rights could adversely affect other rights appurtenant to shares of our common stock. Furthermore, any issuances of additional stock (common or preferred) will dilute the percentage of ownership interest of then-current holders of our capital stock and may dilute our book value per share.

***Our stock is thinly traded, which may make it difficult to sell shares of our common stock.***

Our