

BRANTLEY CAPITAL CORP

Form 10-Q

August 14, 2002

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF

**THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2002**

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: 000-21251

BRANTLEY CAPITAL CORPORATION

(Exact name of registrant as specified in its charter)

Maryland

34-1838462

(State or other Jurisdiction of
Incorporation or Organization)

(I.R.S. Employer Identification Number)

3201 Enterprise Parkway, Suite 350, Cleveland, Ohio 44122

(Address of principal executive offices including zip code)

(216) 464-8400

(Registrant's telephone number including area code)

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

The number of shares of common stock, \$.01 par value, outstanding as of June 30, 2002 was 3,810,535.

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	June 30, 2002 (Unaudited)	December 31, 2001 (Audited)
ASSETS		
Investments, at fair value	\$ 62,453,733	\$ 60,311,107
Cash and cash equivalents	1,021,221	5,369,345
Restricted cash	6,000,000	6,000,000
Dividends and interest receivable	4,420,616	3,493,059
Other assets	472,241	360,158
Total Assets	\$ 74,367,811	\$ 75,533,669
LIABILITIES AND STOCKHOLDERS' EQUITY		
Note payable	\$ 6,000,000	\$ 6,000,000
Payable for investments purchased		200,000
Advisory fee payable	448,198	487,931
Accrued professional fees	101,427	53,163
Distributions payable		736,455
Other liabilities	53,449	49,806
Total Liabilities	6,603,074	7,527,355
Stockholders' Equity:		
Common Stock, \$0.01 par value; 25,000,000 shares authorized and 3,810,535 shares issued and outstanding at June 30, 2002 and December 31, 2001, respectively	38,105	38,105
Additional paid in capital	37,484,895	37,484,895
Retained earnings	30,241,737	30,483,314
Total Stockholders' Equity	67,764,737	68,006,314
Total Liabilities and Stockholders' Equity	\$ 74,367,811	\$ 75,533,669
Net Asset Value Per Share	\$ 17.78	\$ 17.85

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

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BRANTLEY CAPITAL CORPORATION

STATEMENTS OF OPERATIONS

(Unaudited)

	For the six months ended June 30, 2002	For the six months ended June 30, 2001
Investment Income:		
Interest	\$ 332,954	\$ 293,138
Dividends	657,764	560,743
Total investment income	990,718	853,881
Operating Expenses:		
Advisory fees	936,321	723,075
Administration fees	37,192	36,986
Professional fees	98,522	151,499
Interest expense	242,875	228,656
Other	125,243	168,459
Total operating expenses	1,440,153	1,308,675
Investment Loss, net	(449,435)	(454,794)
Net Realized and Unrealized Gains (Losses) on Investments:		
Net realized gains (losses) on investments	(169,752)	433,135
Net unrealized gains on investments	377,610	3,507,585
Net realized and unrealized gains on investment transactions	207,858	3,940,720
Net increase (decrease) in net assets resulting from operations	\$ (241,577)	\$ 3,485,926
Net increase (decrease) in net assets from operations per share, basic and diluted	\$ (0.07)	\$ 0.92
Weighted average number of shares outstanding, basic and diluted	3,810,535	3,810,535

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

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BRANTLEY CAPITAL CORPORATION

STATEMENTS OF OPERATIONS

(Unaudited)

	For the quarter ended June 30, 2002	For the quarter ended June 30, 2001
Investment Income:		
Interest	\$ 150,315	\$ 124,633
Dividends	362,463	289,285
Total investment income	512,778	413,918
Operating Expenses:		
Advisory fees	448,197	371,504
Administration fees	18,699	18,698
Professional fees	52,906	52,389
Interest expense	88,799	93,575
Other	75,316	20,791
Total operating expenses	683,917	556,957
Investment Loss, net	(171,139)	(143,039)
Net Realized and Unrealized Gains (Losses) on Investments:		
Net realized gains on investments	271,482	26,039
Net unrealized gains (losses) on investments	(355,928)	3,439,067
Net realized and unrealized gains (losses) on investment transactions	(84,446)	3,465,106
Net increase (decrease) in net assets resulting from operations	\$ (255,585)	\$ 3,322,067
Net increase (decrease) in net assets from operations per share, basic and diluted	\$ (0.07)	\$ 0.88
Weighted average number of shares outstanding, basic and diluted	3,810,535	3,810,535

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

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BRANTLEY CAPITAL CORPORATION

STATEMENTS OF STOCKHOLDERS' EQUITY

(Unaudited)

	Common Stock	Additional Paid in Capital	Retained Earnings	Total Stockholders Equity
Balance at December 31, 1999	\$38,105	\$37,505,433	\$14,896,797	\$52,440,335
Net increase in net assets from operations			1,879,315	1,879,315
Distributions from:				
Net investment income		(20,538)	(112,831)	(133,369)
Net realized gains			(2,243,262)	(2,243,262)
Balance at December 31, 2000	\$38,105	\$37,484,895	\$14,420,019	\$51,943,019
Net increase in net assets from operations			16,799,750	16,799,750
Distributions from:				
Net investment income				
Net realized gains			(736,455)	(736,455)
Balance at December 31, 2001	\$38,105	\$37,484,895	\$30,483,314	\$68,006,314
Net decrease in net assets from operations			(241,577)	(241,577)
Balance at June 30, 2002	\$38,105	\$37,484,895	\$30,241,737	\$67,764,737

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

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BRANTLEY CAPITAL CORPORATION

STATEMENTS OF CASH FLOWS

(Unaudited)

	For the six months ended June 30, 2002	For the six months ended June 30, 2001
Cash Flows from Operating Activities:		
Net change in net assets resulting from operations:	\$ (241,577)	\$ 3,485,926
Adjustments to reconcile net change in net assets resulting from operations to net cash used for operations:		
Net realized (gains) losses from investments	169,752	(433,135)
Net unrealized gains on investments	(377,610)	(3,507,585)
Changes in assets and liabilities:		
Dividend and interest receivable	(927,557)	(689,319)
Other assets	(112,083)	4,404
Payable for investments purchased	(200,000)	
Advisory fee payable	(39,733)	(21,244)
Accrued professional fees	48,264	(54,862)
Dividends payable	(736,455)	
Accrued interest		65,117
Other liabilities	3,643	(38,586)
Net cash used for operating activities	(2,413,356)	(1,189,284)
Cash Flows from Investing Activities:		
Purchases of investment securities	(7,668,421)	(5,440,797)
Sales/ Maturities of investment securities	5,733,653	1,969,563
Purchases of short-term investments		(514,412,500)
Sales/ Maturities of short-term investments		514,416,813
Net cash used for investing activities	(1,934,768)	(3,466,921)
Net change in cash and cash equivalents for the period	(4,348,124)	(4,656,205)
Cash, cash equivalents and restricted cash, beginning of period	11,369,345	14,882,432
Cash, cash equivalents and restricted cash, end of the period	\$ 7,021,221	\$ 10,226,227

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

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The interim financial statements have been prepared by Brantley Capital Corporation (the Company) pursuant to the rules and regulations of the Securities and Exchange Commission applicable to quarterly reports on Form 10-Q. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although management believes that the disclosures are adequate to make the information presented not misleading. These financial statements should be read in conjunction with the audited financial statements and related notes and schedules included in the Company's 2001 Annual Report filed on Form 10-K dated December 31, 2001.

The unaudited financial statements reflect, in the opinion of management, all adjustments, all of which are of a normal recurring nature, necessary to present fairly the financial position of the Company as of June 30, 2002, the results of its operations for the quarter ended June 30, 2002, the results of its operations for the six months ended June 30, 2002, and its cash flows for the six months ended June 30, 2002. Interim results are not necessarily indicative of results to be expected for a full fiscal year.

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

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

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

2. Investments, Cash and Cash Equivalents

As of June 30, 2002 and December 31, 2001, the identified costs of investments, cash, and cash equivalents were \$30,770,082 and \$40,292,851, respectively.

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

	June 30, 2002 (Unaudited)	December 31, 2001 (Audited)
Cash	\$ 1,021,221	\$5,369,345
Non-restricted Cash	\$ 1,021,221	\$5,369,345
Restricted Cash	\$6,000,000	\$6,000,000

3. Investment Advisory Agreement

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The Company has entered into an investment advisory agreement (the "Investment Advisory Agreement") with Brantley Capital Management, L.L.C. (the "Investment Adviser") under which the Investment Adviser is entitled to an annual management fee of 2.85% of the Company's net assets, determined at the end of each calendar quarter, and payable quarterly in arrears throughout the term of the Investment Advisory Agreement. For the three and six months ended June 30, 2002, the Investment Adviser earned \$448,197 and \$936,321 respectively under the Investment Advisory Agreement. Certain officers of the Company are also

Table of Contents**BRANTLEY CAPITAL CORPORATION****NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

officers of the Investment Adviser. No officer of the Investment Adviser receives any compensation from the Company for serving as officer of the Company. See Note 7, Recent Developments .

4. Financial Highlights

	For the six months ended June 30, 2002	For the six months ended June 30, 2001
Net Asset Value, Beginning of the Period	\$ 17.85	\$ 13.63
Income from investment operations:		
Net investment loss	(0.12)	(0.12)
Net realized and unrealized gains on investments	0.05	1.04
Total from investment operations	(0.07)	0.92
Less Distributions:		
Distributions from net investment income		
Net Asset Value, End of Period	\$ 17.78	\$ 14.55
Market Value, End of Period	\$ 9.50	\$ 9.35
Total return, at Market Value	(12.76)%(1)	8.41%(1)
Total return, at Net Asset Value	27.09%(1)	6.75%(1)
Total Expenses/Average net assets	4.28%(2)	5.07%(2)
Net Investment Income/Average net assets	(1.34)%(2)	(1.76)%(2)

(1) Not annualized

(2) Annualized

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BRANTLEY CAPITAL CORPORATION

NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED) (Continued)

5. Schedule of Investments

Name of Issuer and Title of Issue	June 30, 2002	
	Shares/Par	Market Value
Avionics		
Flight Options International Inc. Preferred Stock *#@	3,342,060	32,500,001
Business Services		
Disposable Products Company, LLC Subordinated Debt with Warrants #@	2,054,667	2,048,008
The Holland Group, Inc. Preferred Stock #@	282,530	2,125,000
The Holland Group, Inc. Subordinated Note #@	50,000	50,000
International Total Services, Inc. Common Stock	104,250	3,128
NCO Group, Inc. Common Stock	3,675	80,042
Prime Office Products, Inc. Preferred Stock #@	710,000	1,420,000
		5,726,178
Drugs & Health Care		
Health Care Solutions, Subordinated Debt with Warrants #@	2,577,572	3,549,000
KV Pharmaceutical, Inc. Common Stock	2,900	78,300
Merit Medical Services, Inc. Common Stock	5,100	105,213
National Rehabilitation Partners, Inc. Preferred Stock #@	2,245,603	1,461,364
Pediatric Physicians Alliance, Inc. Preferred Stock #@	823,000	3,196,900
Pediatric Physicians Alliance, Subordinated Debt/ Warrants #@	267,448	267,448
		8,658,225
Electronics		
Catapult Communications Corporation Common Stock	5,700	124,665
Miscellaneous		
Action Performance Companies, Inc. Common Stock	2,400	75,840
Avocent Corporation Common Stock	1,357	21,603
Buca, Inc. Common Stock	4,900	93,345
Fossil, Inc. Common Stock	3,900	80,184
Streamline Foods, Inc. Preferred Stock #@	925,072	699,941
Streamline Foods, Inc. Subordinated Debt Warrants #@	95,000	95,000
Triad Guarantee, Inc. Common Stock	2,000	87,060
Value Creation Partners, Inc. Preferred Stock #@	304,989	2,226,142
Waterlink, Inc. Warrants	53,550	
		3,379,115
Oil		
Petroleum Partners, Inc. Preferred Stock #@	825,000	1,450,000

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Petroleum Partners, Inc. Subordinated Debt with Warrants #	1,978,125	1,875,781
		<u>3,325,781</u>
Retail Trade		
Fitness Quest, Inc. Preferred Stock *#@	1,468,602	7,409,206
Fitness Quest, Subordinated Debt with Warrants #@	181,172	1,246,742
Hibbett Sporting Goods, Inc. Common Stock	3,300	83,820
		<u>8,739,768</u>
Total Investments (Cost \$30,770,082)		<u>\$62,453,733</u>

All investments are U.S. companies

* Represents 5% or more of total stockholders equity

Represents privately held securities

@ Represents more than 5% but less than 25% of the voting class of securities, which under the Investment Company Act of 1940 makes the portfolio company meet the definition of an Affiliate.

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BRANTLEY CAPITAL CORPORATION

NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED) (Continued)

6. Income From Affiliates

For the quarter and six months ended June 30, 2002 and 2001 interest and dividend income was comprised of income from investments which represent more than 5% but less than 25% of the voting class of securities, which under the Investment Company Act of 1940 makes the portfolio company meet the definition of an Affiliate.

For the quarter and six months ended June 30, 2002 and 2001 net realized and unrealized gains on investments was comprised of gains (losses) from public investments that individually represented less than 5% of the voting class of securities except for a 2001 unrealized gain of \$2,742,889 from Flight Options, Inc.

7. Recent Developments

The Company received notice from the SEC Staff as part of a routine examination of the Company that Brantley Capital Management, LLC (BCM), the Company's investment adviser is not properly registered under the Investment Advisers Act of 1940. BCM inadvertently failed to maintain its registration as a registered investment adviser under the Investment Advisers Act of 1940. BCM has filed the documentation to register as an investment adviser, a process that generally takes 45 days or more. There can be no assurance that BCM can become registered as an investment adviser, or if it can, the timeframe for such registration, or the impact, if any, of its failure to have been registered.

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

Overview

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

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

In the past year we have explored various strategic alternatives to enhance our growth and stockholders' value. We determined that operating at our current size or attempting to realize premature liquidity events within our portfolio would not enhance the market value of our common stock and would limit our ability to generate recurring income sought by the investment community and our stockholders. Specifically, we have been exploring the possibility of expanding our origination of mezzanine investments. Shares of business development companies that invest primarily in mezzanine investments tend to trade at a premium to net asset value per share due to the expectation of current income produced by such investments. There can be no assurance that our shares will trade at a premium to net asset value. We believe that current market conditions, influenced by more stringent credit standards of commercial banks and more conservative capital structures sought by entrepreneurs and equity sponsors, have created an increased demand for mezzanine investments.

Mezzanine investments would be expected to provide a current cash return to us in the form of interest and origination fees. We typically participate in any increase in the equity value of the companies to whom we provide mezzanine financing through warrants or other equity rights. We anticipate that mezzanine investments would provide less potential for appreciation in our net asset value than private equity investments, but would instead provide higher current income that may be distributed to our stockholders. In the future, we may also seek to further leverage our portfolio by utilizing additional borrowings to fund our investments.

In order to fund the origination of mezzanine investments, we are exploring various capital-raising alternatives. We intend to use the proceeds of such an event to make mezzanine investments. We can make no assurances that a capital raising effort will be undertaken or that any of our portfolio companies would experience a liquidity event. We can also make no assurances that our plan to expand our origination of mezzanine investments will be consummated or be successful.

On June 4, 2002 the Company announced that it had received board approval to pursue a preliminary plan to raise capital for the purpose of expanding its origination of mezzanine investments. As part of the plan, we intend to initiate a rights offering to stockholders where each stockholder will receive a right to purchase one new share of the Company's common stock for every three shares of common stock that a stockholder owns. The right would entitle the holder to purchase the share of common stock at a discount to the market price. Based on the current number of shares outstanding, the plan would increase the outstanding shares by up to 1.27 million shares. The subscription price and the record date for the distribution of the rights have not been determined. We anticipate that the rights will be transferable and will be admitted for trading on the Nasdaq National Market. There can be no assurance that a market for the rights will develop.

In addition to the rights offering, we intend to apply for inclusion in the Small Business Investment Company program of the Small Business Administration (the "SBA"). If granted, we would be eligible for debt financing from the SBA at an amount up to two times the equity financing expected from the rights offering. We intend to file a registration statement with the Securities and Exchange Commission and an application with the SBA, which will be subject to review. There can be no assurance that we will be able to obtain a license to operate an SBIC or that we will be able to obtain leverage from the SBA.

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Certain Accounting Policies

Privately placed equity and mezzanine securities are carried at fair value as determined in good faith by our board of directors. Initially, the fair value of each such security is based upon its original cost. Cost is also the primary factor used to determine fair value on an ongoing basis until significant developments or other factors affecting the investment (such as results of subsequent financings, the availability of market quotations, the portfolio company's operations and changes in general market conditions) provide a basis for value other than cost. Portfolio investments listed on a securities exchange or traded on the Nasdaq Stock Market are valued at the closing price listed on the relevant exchange or quotation system on the date of valuation. Securities traded in the over-the-counter market are valued based on the average of the closing bid and asked prices on the date of valuation.

Origination fees are recognized as income during the period in which they are received. Interest income is recorded on mezzanine investments when the payment is contractually due unless a loan is more than 30 days past due. Interest is not accrued on any loans that are more than 30 days past due.

We account for our operations utilizing accounting principles generally accepted in the United States for investment companies. On this basis, the principal measure of our financial performance is captioned Net change in net assets resulting from operations, which is the sum of two elements. The first element is Investment income (loss), net, which is the difference between (1) our income from interest, dividends and fees, and (2) our operating expenses. The second element is Net gain (loss) on investment transactions, which is the sum of (1) the difference between the proceeds received from our dispositions of portfolio securities and their stated cost (Net realized gain (loss) on investments), and (2) the net change in the fair value of our investment portfolio (Net unrealized gain (loss) on investments). Net realized gain (loss) on investments and Net unrealized gain (loss) on investments are directly related. For example, in the period during which a security is sold to realize a gain, net unrealized gain on investments decreases, and net realized gain on investments increases.

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

Results of Operations

Dividend and Interest Income

Dividend and interest income on investments for the three months ended June 30, 2002 and 2001 was \$512,778 and \$413,918. Dividend and interest income on investments for the six months ended June 30, 2002 and 2001 was \$990,718 and \$853,881, respectively. The increase in interest and dividend income during the three and six months ended June 30, 2002 was primarily because of the ongoing increase in the private equity and mezzanine portfolio which generates dividend and interest income.

Operating Expenses

Total operating expenses during the three months ended June 30, 2002 and 2001 were \$683,917 and \$556,957 respectively. The significant component of total operating expenses was advisory fees of \$448,197 and \$371,504 earned by our investment adviser during the three months ended June 30, 2002 and 2001, respectively. The increase in total operating expenses was primarily due to the increase in the Advisory Fees resulting from the increase in net asset value and expenses related to contested matters to be voted on at the Annual Meeting of Stockholders.

Total operating expenses during the six months ended June 30, 2002 and 2001 were \$1,440,153 and \$1,308,675, respectively. The significant component of total operating expenses was advisory fees of \$936,321

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and \$723,075 earned by our investment adviser during the six months ended June 30, 2002 and 2001, respectively. The increase in total operating expenses was primarily due to the increase in advisory fees resulting from the increase in net asset value.

Net Realized and Unrealized Gains on Investment Transactions

During the three months ended June 30, 2002 and 2001, valuation of our equity and mezzanine investments resulted in net realized and unrealized gains on investments of (\$84,446) and \$3,465,106. During the six months ended June 30, 2002 and 2001, valuation of our equity and mezzanine investments resulted in net realized and unrealized gains on investments of \$207,858 and \$3,940,720, respectively. At June 30, 2002, and 2001, we had investments in eleven privately-held companies, as well as in various small-capitalization public stocks which are subject to general stock market and business conditions. The unrealized gains during such periods were significantly influenced by general stock market and business conditions as well as the June 30, 2001 financing transaction of Flight Options International, Inc. as more fully described under Financial Conditions, Liquidity and Capital Resources .

Financial Condition, Liquidity and Capital Resources

At June 30 2002 and December 31, 2001, we had \$1,021,221 and \$5,369,345, respectively, in cash and cash equivalents which were primarily invested in United States Treasury securities. Restricted cash is held under direction of our lender and is not readily available to fund investments or pay operating expenses. Our management believes that proceeds from our investments will provide us with the liquidity necessary to pay our operating expenses and make follow-on investments. However, in order to execute our mezzanine investment plan, we will continue to seek opportunities to raise additional capital.

At June 30, 2002 and December 31, 2001, we had stockholders' equity of \$67,764,737 and \$68,006,314, respectively, resulting in net asset values per share of \$17.78 and 17.85 respectively. At June 30, 2002, we had \$6,000,000 of outstanding indebtedness. For the six months ended June 30, 2002, the weighted average interest rate on this indebtedness was 4.75%.

Brantley Venture Partners II, L.P., Brantley Venture Partners III, L.P. and Brantley Partners IV, L.P. hold, in the aggregate, approximately \$211 million of private equity investments. These partnerships are related to our investment adviser in a manner that required the receipt, from the Securities and Exchange Commission, of an exemption from certain provisions of the Investment Company Act of 1940 in order to permit us, under certain circumstances, to invest in the same portfolio companies as the other private investment funds managed by our investment adviser. [see Recent Developments]

Consistent with our current long-term objectives, our board of directors has recently asked our investment adviser to consider ways to maximize stockholder value in the event that our net asset value has not appreciated by a minimum of 15% per annum for the seven-year period ending December 31, 2003. Such actions could include, but are not limited to, a possible recommendation to consider the sale of some or all of our investments. Our management has been pleased with the performance of our portfolio companies since inception and believes that liquidity opportunities that generally start presenting themselves several years into a portfolio of this nature may create gains for us over the next few years. Our portfolio is just beginning to enter a period of possible liquidity events. However, in light of the market price of our common stock relative to its net asset value, our management has reiterated our planned goals and objectives and has reassured our stockholders that our management intends to take action if those goals and objectives are not met. Nevertheless, our management expects to meet our net asset value appreciation target.

At June 30, 2002 and December 31, 2001, the aggregate cost of the investments we made to date was \$30.8 million and \$28.9 million, respectively, and their aggregate market value was \$62.5 million and \$60.3 million, respectively, for an aggregate fair value appreciation of 103% and 109%, respectively. Our management believes that our portfolio companies have significant potential for long-term growth in sales and earnings.

Since the completion of our initial public offering, our management has focused its investment activities on securing new investments for our portfolio. However, given the nature of our current portfolio and the fact that

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this portfolio as a whole is maturing, our management is seeking to position the more mature portfolio companies for appropriate liquidity events. We are continuously monitoring portfolio company results and evaluating opportunities to maximize the value of our investments. In that regard, we periodically evaluate potential acquisitions, financing transactions, initial public offerings, strategic alliances and sale opportunities involving our portfolio companies. These transactions and activities are generally not disclosed to our stockholders and the investing public until such time as the transactions are publicly announced or completed, as the case may be. Any such transaction could have an impact on the valuation of our investments. However, these revised valuations would generally not be adjusted until the transaction is publicly announced or completed.

Private Portfolio Company Investments

Our equity and mezzanine investments at June 30, 2002 are listed in Note 5 to the Financial Statements and are described below:

Disposable Products Company, LLC

On August 10, 1998, we entered into an investment led by Banc One Capital to provide \$1.0 million of a \$3.0 million subordinated debt facility with warrants for Disposable Products Company, LLC. Disposable Products is an acquisition strategy company in the business of manufacturing and converting paper and non-woven materials into wiping products for sale to commercial, institutional, industrial and government markets. In addition, Disposable Products is a converter and reseller of other safety and industrial/janitorial products. Proceeds of the transaction were used to complete Disposable Products' first acquisition. The terms of the debt facility call for a 12% interest rate per annum with a final maturity in 2003. We also received a detachable capital stock purchase warrant exercisable for 5% of the fully-diluted capital stock of Disposable Products at the time of exercise at a nominal exercise price. On January 26, 2001, we funded a \$166,667 12% promissory note from Disposable Products. In addition, through June 30, 2002 we funded additional 12% promissory notes of \$1,138,000 from Disposable Products.

Fitness Quest, Inc.

On December 16, 1997, we funded a \$1.35 million commitment to invest with Brantley Venture Partners III, L.P. in a \$3.85 million preferred stock issue for Fitness Quest, Inc. As a result, we purchased approximately 788,961 shares of Fitness Quest Series A 10% Convertible Preferred Stock at \$1.71 per share. Fitness Quest is a direct marketing and distribution company. The proceeds were used by Fitness Quest for a management buy-out of the company from its previous owner, The Time Warner Music Group, a 100% wholly owned subsidiary of Time Warner, Inc., and for other acquisitions. Fitness Quest has been in the fitness promotional products business since 1994. Fitness Quest operates in a highly competitive industry and is dependent on the management talent and efforts of key personnel for its success. We do not believe that Fitness Quest is dependent on a single or small number of customers, possesses significant intellectual property, or is operating in an unusually regulated industry.

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

The proceeds of the most recent investment were used to fund Fitness Quest's working capital needs. During the fourth quarter of 2000, we exchanged the senior subordinated debt investment and related unpaid interest for 679,641 shares of Fitness Quest common stock.

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

On December 23, 1997, we funded \$2.1 million to invest with Brantley Venture Partners III, L.P. in a \$6.0 million preferred stock issue for Flight Options International, Inc. Our investment consists of approximately 2,576,000 shares of Flight Options Series A 8% Convertible Preferred Stock at \$0.8152 per share. Flight Options

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provides complete private air travel service through the sale of fractional interests in pre-owned jet aircraft. The proceeds of the transaction were used by Flight Options to continue to execute an acquisition strategy. We believe Flight Options is one of the top five providers of fractional interests in aircraft in the United States, a highly competitive industry and is dependent on the management talent and efforts of key personnel for its success. Flight Options is subject to certain regulations of the Federal Aviation Administration. We do not believe it is dependent on a single or small number of customers or possesses significant intellectual property.

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

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

On July 11, 2000, we guaranteed a portion of Flight Options' third-party borrowings. As a result, we were issued a warrant to purchase 36,000 shares of Flight Options common stock at a price of \$0.01 per share. Our management believes, based on the current facts and circumstances and Flight Options' financial position, that the likelihood of a payment pursuant to such guarantee is remote. This guarantee was terminated prior to December 12, 2000.

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

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

On December 21, 2001, Flight Options, Inc. and Raytheon Travel Air, a Wichita, Kansas-based unit of Raytheon Company, a Lexington, Mass. based defense contractor, agreed to combine operations into one fractional aircraft ownership program to be known as Flight Options. Under the terms of the transaction, Flight Options, Inc. will hold 50.1% ownership of the new business with Raytheon holding 49.9%. The transaction was completed during the quarter ended March 31, 2002.

As a result of the transaction described above, our board of directors met to review the terms of the transaction including, among other things, a valuation review prepared by an investment banking firm working on the transaction. Consistent with our valuation guidelines, the board used a private market method to value our investment in Flight Options, Inc. and approved an increase in the value of our investment in Flight Options, Inc. to \$32.5 million. At June 30, 2002, the financial statement value of our investment in Flight Options represents an increase of more than 484% from its original purchase price. The commentary above reflects a four-for-one stock split executed in 2000. All share and per share amounts have been adjusted to reflect such stock split.

Health Care Solutions, Inc.

On September 30, 1997, we funded a \$1.5 million convertible junior subordinated promissory note facility for Health Care Solutions, Inc. Health Care Solutions is an acquisition strategy company in the home healthcare services market with a strong presence in the Midwest and Great Lakes regions. The terms of the notes called for an 18% interest rate per annum during the first year and 12% per annum thereafter, with final maturity two years from the closing. After the first year, the notes were convertible into common stock at a price of \$3.50 per share.

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In connection with our commitment to provide this facility, we received warrants to purchase up to \$450,000 of common stock valued at an exercise price of 10% of an initial public offering price completed during the term of the notes, or at \$3.50 per share should the warrants be exercised other than in connection with an initial public offering. The warrants are currently exercisable. The proceeds of the notes were used by Health Care Solutions to help finance acquisitions.

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

In addition to the above Series C 8% Convertible Preferred Stock, we funded \$500,000 and \$299,000 12% Convertible Subordinated Notes from Health Care Solutions in 2000. As part of this transaction, we received a warrant to purchase up to \$50,000 of Health Care Solutions common stock at an exercise price equal to the lower of the price determined by an initial public offering or \$7.50 per share. On March 7, 2001, we agreed to exchange the \$500,000 Convertible Subordinated Note for 71,880 shares of Series D Convertible Preferred Stock. On January 29, 2002, we funded a \$1,250,000 12% Convertible Subordinated Note from Health Care Solutions and On November 12, 2000 we funded a \$299,000 12% Convertible Subordinated Note from Health Care Solutions.

The Holland Group, Inc.

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

National Rehab Partners, Inc.

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

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

Pediatric Physicians Alliance, Inc.

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

In addition to the above Class A-2 10% Convertible Preferred Stock, in 2000 we funded \$267,448 to invest with Brantley Venture Partners III, L.P. in \$668,619 of promissory notes, with detachable warrants, in Pediatric

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Physicians Alliance. The detachable warrants are for the purchase of 30,000 shares of Pediatric Physicians Alliance common stock at \$4.00 per share.

Petroleum Partners, Inc.

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

In addition to the above investment, we funded \$1,875,000 of 10% Convertible Subordinated through June 30, 2002. The proceeds of the notes were used for operating purposes.

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

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

Streamline Foods, Inc.

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

Value Creation Partners, Inc.

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

Small-Capitalization Public Equity Investments

The small-capitalization public companies in which we had an investment at June 30, 2002 are listed in Note 5 to the Financial Statements.

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Impact of Inflation

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

Recent Developments

The Company received notice from the SEC Staff as part of a routine examination of the Company that Brantley Capital Management, LLC (BCM), the Company's investment adviser is not properly registered under the Investment Advisers Act of 1940. BCM inadvertently failed to maintain its registration as a registered investment adviser under the Investment Advisers Act of 1940. BCM has filed the documentation to register as an investment adviser, a process that generally takes 45 days or more. There can be no assurance that BCM can become registered as an investment adviser, or if it can, the timeframe for such registration, or the impact, if any, of its failure to have been registered.

Disclosure Regarding Forward-Looking Statements

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

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We invest in small and medium-sized companies, and our investments are considered speculative in nature. Our investments often include securities that are subject to legal or contractual restrictions on resale that adversely affect the liquidity and marketability of such securities. As a result, we are subject to risk of loss which may prevent our stockholders from achieving price appreciation and dividend distributions.

The portion of our portfolio consisting of investments in private companies is also subject to valuation risk. We value our privately held investments based on a determination of their fair value made in good faith by our board of directors on a quarterly basis in accordance with our established guidelines. In the absence of a readily ascertainable market value, the estimated values of our investments may differ significantly from the values that would exist if a ready market for these securities existed. Any changes in valuation are recorded in our consolidated statements of operations as Net unrealized gain (loss) on investments.

We consider the management of equity price risk essential to conducting our business and maintaining our profitability. A portion of our portfolio consists of investments in private companies. We anticipate no impact on these investments from modest changes in public market equity prices. However, should significant changes in market prices occur, there could be a long-term effect on valuations of private companies, which could affect the carrying value and the amount and timing of gains realized on these investments. This could also effect our ability to generate cash through the sale of private equity investments, since their may not be realistic initial public offering opportunities. A portion of our investment portfolio also consists of shares of common stock of small-capitalization public companies. These investments are directly exposed to market price risk.

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PART II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

a. Exhibits

- Exhibit 3** Articles of Incorporation and By-laws
 - (1) Articles of Amendment and Restatement of the Charter of the Company (Exhibit 3.1 to the Annual Report on Form 10-K filed on March 31, 1999, which exhibit is incorporated herein by reference)
 - (2) Amended and Restated Bylaws of the Company (Exhibit 3.2 to the Annual Report on Form 10-K filed on March 31, 1999, which exhibit is incorporated herein by reference)
 - (3) Amendment to the Charter of the Company (Exhibit 3.3 to the Registration Statement filed on October 26, 2001, which exhibit is incorporated herein by reference)
- Exhibit 4** Form of Share Certificate (Exhibit 2.d to amendment No. 1 to the Registration Statement filed on October 31, 1996, which exhibit is incorporated herein by reference)
- Exhibit 10** Material Contracts
 - (1) Dividend Reinvestment and Cash Purchase Plan (Exhibit 2.e to Amendment No. 3 to the Registration Statement filed on November 26, 1996, which exhibit is incorporated herein by reference)
 - (2) Form of Investment Advisory Agreement between the Company and the Investment Adviser (Exhibit 2.g to Amendment No. 3 to the Registration Statement filed on November 26, 1996, which exhibit is incorporated herein by reference)
 - (3) Stock Option Plan and Form of Option Grants (Exhibit 2.i.1 to Amendment No. 2 to the Registration Statement filed on November 22, 1996, which exhibit is incorporated herein by reference)
 - (4) Disinterested Director Option Plan and Form of Option Grants (Exhibit 2.i.2 to Amendment No. 2 to the Registration Statement filed on November 22, 1996, which exhibit is incorporated herein by reference)
 - (5) Form of Custodian Contract (Exhibit 2.j to Amendment No. 2 to the Registration Statement filed on November 22, 1996, which exhibit is incorporated herein by reference)
 - (6) Form of Registrar, Transfer Agency and Service Agreement (Exhibit 2.k.1 to Amendment No. 2 to the Registration Statement filed on November 22, 1996, which exhibit is incorporated herein by reference)
 - (7) Form of Administration Agreement (Exhibit 2.k.2 to Amendment No. 2 to the Registration Statement filed on November 22, 1996, which exhibit is incorporated herein by reference)
 - (8) Form of Indemnification Agreement for Directors and Officers (Exhibit 2.s to Amendment No. 2 to the Registration Statement filed on November 22, 1996, which exhibit is incorporated herein by reference)
- Exhibit 99** Other
 - (1) Certificaton Pursuant to 18 U.S.C. 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
 - (2) Certificaton Pursuant to 18 U.S.C. 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

b. Reports on Form 8-K

A Form 8-K was filed on June 11, 2002 which announced that it had selected KPMG LLP to replace Arthur Andersen LLP as the Company's independent accountants. We no longer engaged Arthur Andersen LLP as its independent accountants effective upon completion of the December 31, 2001 audit and the March 31, 2002 quarterly review. The decision to change accountants was approved by our Audit Committee and Board of Directors and will be submitted for ratification by our stockholders.

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SIGNATURES

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

BRANTLEY CAPITAL CORPORATION

Date: August 14, 2002

By: /s/ ROBERT P. PINKAS

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

Date: August 14, 2002

By: /s/ TAB A. KEPLINGER

Tab A. Keplinger
Vice President and
Chief Financial Officer