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MACC PRIVATE EQUITIES INC
Form 10-Q
May 17, 2004

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

(Mark One)

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

For the quarterly period ended March 31, 2004

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 0-24412

MACC Private Equities Inc.

(Exact name of registrant as specified in its charter)

Delaware 42-1421406
(State or other jurisdiction of incorporation (I.R.S. Employer
or organization) Identification No.)

101 Second Street SE, Suite 800, Cedar Rapids, Iowa 52401

(Address of principal executive offices)
(Zip Code)

(319) 363-8249

(Registrant's telephone number, including area code)

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

Please 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 []

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

At April 30, 2004, the registrant had issued and outstanding 2,329,255 shares of common stock.

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PART 1 -- FINANCIAL INFORMATION

Item 1. Financial Statements

MACC PRIVATE EQUITIES INC. AND SUBSIDIARY

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Condensed Consolidated Balance Sheets
(Unaudited)

	March 31, 2004	September 2003
	-----	-----
Assets		
Loans and investments in portfolio securities, at market or fair value:		
Unaffiliated companies (cost of \$11,490,011 and \$13,439,514)	\$ 9,733,065	12,803
Affiliated companies (cost of \$18,773,191 and \$20,949,721)	19,904,287	20,875
Controlled companies (cost of \$4,536,308 and \$4,490,502)	4,480,058	4,921
Cash and money market accounts	6,689,397	722
Other assets, net	1,083,679	1,909
	-----	-----
Total assets	\$ 41,890,486	41,233
	=====	=====
Liabilities and net assets		
Liabilities:		
Debentures payable, net of discount	\$ 27,940,000	27,940
Incentive fees payable	48,792	27
Accrued interest	187,839	185
Accounts payable and other liabilities	439,895	334
	-----	-----
Total liabilities	28,616,526	28,487
	-----	-----
Net assets:		
Common stock, \$.01 par value per share; authorized 10,000,000 shares and 4,000,000 shares in 2004 and 2003, respectively; issued and outstanding 2,329,255 shares	23,293	23
Additional paid-in-capital	13,932,767	13,001
Unrealized depreciation on investments	(682,100)	(278)
	-----	-----
Total net assets	13,273,960	12,745
	-----	-----
Total liabilities and net assets	\$ 41,890,486	41,233
	=====	=====
Net assets per share	\$ 5.70	
	=====	=====

See accompanying notes to unaudited condensed consolidated financial statements.

MACC PRIVATE EQUITIES INC. AND SUBSIDIARY
Condensed Consolidated Statements of Operations
(Unaudited)

For the three months ended	For the three months ended	For the six months ended
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	March 31, 2004	March 31, 2003	March 31, 2004
	-----	-----	-----
Investment income:			
Interest			
Unaffiliated companies	\$ 241,933	138,032	363,553
Affiliated companies	211,364	246,422	366,771
Controlled companies	68,298	60,238	137,769
Other	15,571	7,671	24,367
Dividends			
Unaffiliated companies	---	93,656	78,204
Affiliated companies	287,251	2,397	342,267
Controlled companies	---	7,871	---
Processing fees	---	9,435	---
Other	1,855	75,971	7,659
	-----	-----	-----
Total investment income	826,272	641,693	1,320,590
	-----	-----	-----
Operating expenses:			
Interest expenses	531,714	550,421	1,063,428
Management fees	259,264	280,017	519,798
Professional fees	262,020	230,810	453,846
Other	847,401	142,726	915,486
	-----	-----	-----
Total operating expenses before management fees waived	1,900,399	1,203,974	2,952,558
Management fees waived	(34,292)	(70,655)	(87,092)
	-----	-----	-----
Net operating expenses	1,866,107	1,133,319	2,865,466
Investment expense, net before tax expense	(1,039,835)	(491,626)	(1,544,876)
	-----	-----	-----
Income tax expense	---	(15,000)	---
	-----	-----	-----
Investment expense, net	(1,039,835)	(506,626)	(1,544,876)
	-----	-----	-----
Realized and unrealized gain (loss) on investments:			
Net realized gain (loss) on investments (net incentive fees of \$514,314 in 2004 and \$0 in 2003):			
Unaffiliated companies	9,681	(218,959)	1,948,163
Affiliated companies	579,727	---	61,310
Controlled companies	---	---	466,991
Net change in unrealized appreciation/ depreciation on investments	1,365,962	(575,371)	(403,540)
	-----	-----	-----
Net gain (loss) on investments	1,955,370	(794,330)	2,072,924
	-----	-----	-----
Net change in net assets from operations	\$ 915,535	(1,300,956)	528,048
	=====	=====	=====

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See accompanying notes to unaudited condensed consolidated financial statements.

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MACC PRIVATE EQUITIES INC. AND SUBSIDIARY Condensed Consolidated Statements of Cash Flows (Unaudited)

	For the six months ended March 31, 2004	For the months e March 200
	-----	-----
Cash flows from operating activities:		
Increase (decrease) in net assets from operations	\$ 528,048	(1,247
	-----	-----
Adjustments to reconcile increase (decrease) in net assets from operations to net cash provided by operating activities:		
Net realized and unrealized gain on investments	(2,072,924)	339
Net realized and unrealized loss on other assets	726,329	
Proceeds from disposition of and payments on loans and investments in portfolio securities	7,102,879	1,619
Payments of incentive fees to investment advisor	(493,050)	
Purchases of loans and investments in portfolio securities	(481,934)	(124
Change in accrued interest, accounts payable, and other liabilities	108,056	34
Other	549,302	21
	-----	-----
Total adjustments	5,438,658	1,890
	-----	-----
Net cash provided by operating activities	5,966,706	643
	-----	-----
Cash flows from financing activities:		
Payment of commitment fees	---	(65
	-----	-----
Net cash used in financing activities	---	(65
	-----	-----
Net increase in cash and cash equivalents	5,966,706	578
Cash and cash equivalents at beginning of period	722,691	1,802
	-----	-----
Cash and cash equivalents at end of period	\$ 6,689,397	2,380
	=====	=====
Supplemental disclosure of cash flow information -		
Cash paid during the period for interest	\$ 1,011,490	1,034

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Supplemental disclosure of noncash investing and financing information -		
Assets received in exchange of securities	\$ 476,074	194

See accompanying notes to unaudited condensed consolidated financial statements.

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MACC PRIVATE EQUITIES INC.

Notes to Unaudited Condensed Consolidated Financial Statements

(1) Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of MACC Private Equities Inc. (MACC) and its wholly owned subsidiary MorAmerica Capital Corporation (MorAmerica Capital) which have been prepared in accordance with accounting principles generally accepted in the United States of America for investment companies. All material intercompany accounts and transactions have been eliminated in consolidation.

The financial statements included herein have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and instructions to Form 10-Q and Article 6 of Regulation S-X. The financial statements should be read in conjunction with the consolidated financial statements and notes thereto of MACC Private Equities Inc. and its Subsidiary as of and for the year ended September 30, 2003. The information reflects all adjustments consisting of normal recurring adjustments which are, in the opinion of management, necessary for a fair presentation of the results of operations for the interim periods. The results of the interim period reported are not necessarily indicative of results to be expected for the year. The balance sheet information as of September 30, 2003 has been derived from the audited balance sheet as of that date.

(2) Critical Accounting Policy

Investments in securities traded on a national securities exchange (or reported on the NASDAQ national market) are stated at the average of the bid price on the three final trading days of the valuation period which is not materially different from the bid price on the final day of the period. Restricted and other securities for which quotations are not readily available are valued at fair value as determined by the Board of Directors. Among the factors considered in determining the fair value of investments are the cost of the investment; developments, including recent financing transactions, since the acquisition of the investment; financial condition and operating results of the investee; the long-term potential of the business of the investee; and other factors generally pertinent to the valuation of investments. However, because of the inherent uncertainty of valuation, those estimated values may differ significantly from the values that would have been used had a ready market for the securities existed, and the differences could be material.

In the valuation process, MorAmerica Capital uses financial information received monthly, quarterly, and annually from its portfolio companies which includes both audited and unaudited financial statements. This information is

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used to determine financial condition, performance, and valuation of the portfolio investments.

Realization of the carrying value of investments is subject to future developments. Investment transactions are recorded on the trade date and identified cost is used to determine realized gains and losses. Under the provisions of SOP 90-7, the fair value of loans and investments in portfolio securities on February 15, 1995, the fresh-start date, is considered the cost basis for financial statement purposes.

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(3) Loss Contingency

MorAmerica Capital is party to arbitration proceedings instituted by TransCore Holdings, Inc., a company (Buyer) seeking indemnification under the Stock Purchase Agreement (the Stock Purchase Agreement), pursuant to which MorAmerica Capital and certain other individuals and institutional investors (collectively, the Sellers) sold their interest in a former portfolio company investment (Portfolio Company). The arbitration proceedings are being administered by JAMS. Under the Stock Purchase Agreement, the Sellers agreed to indemnify Buyer for breaches of representations and warranties as to Portfolio Company made by the Sellers. Buyer claims that accounting irregularities at Portfolio Company resulted in a breach of the Sellers' representations and warranties. The Sellers have retained counsel and forensic accountants to defend the Sellers against Buyer's claim for indemnification. Following discovery, depositions and other preliminary proceedings, in June, 2003, the formal arbitration proceedings commenced and are being intensively contested by all parties. Based on the current schedule for the arbitration, a decision will not be rendered until at least August, 2004. Based on its evaluation of the Buyer's claim and discussions with external legal counsel, MACC believes that it is reasonably possible that a loss may have been incurred as a result of the indemnification claim, against which no accrual for loss has been made as of March 31, 2004, because the amount of the possible loss, and therefore its materiality to the financial statements, cannot be estimated. MorAmerica Capital intends to continue vigorously defending this arbitration. MorAmerica Capital received approximately \$939,000 of proceeds from the sale of the Portfolio Company. MorAmerica Capital owned debt securities of Buyer with a face value of \$508,761 and warrants with a cost of \$24,000 received as part of the sale. Buyer has defaulted on interest payments due on these debt securities. On March 31, 2003, MorAmerica Capital reduced the valuation of the debt securities by \$254,380 in light of the interest default and information regarding the related dispute as of that date. On June 30, 2003, MorAmerica Capital further reduced the valuation of these debt securities by \$254,380 to \$1 and reduced the valuation of the warrants to zero based upon the continuing interest default and additional information regarding the related dispute as of that date. Subsequent to December 31, 2003, Buyer refinanced certain of its obligations, including the debt securities held by MorAmerica Capital, and the principal amount of these debt securities and accrued interest has been deposited in an escrow account pending conclusion of the arbitration proceedings.

In a related development, MorAmerica Capital and another small business investment company, NDSBIC, L.P., which co-invested in Portfolio Company, filed suit on December 24, 2003 in the United States District Court for the Northern District of Texas against Patton Boggs LLP and Charles P. Miller, Esq., of Patton Boggs alleging legal malpractice and breach of fiduciary duty. Patton Boggs and Mr. Miller represented MorAmerica Capital and NDSBIC in connection

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with their investment in the Portfolio Company and the subsequent sale of the Portfolio Company to Buyer. MorAmerica Capital and NDSBIC are seeking monetary damages, in an amount that has not been determined.

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Item 2. **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

This section contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the "1995 Act"). Such statements are made in good faith by MACC pursuant to the safe-harbor provisions of the 1995 Act, and are identified as including terms such as "may," "will," "should," "expects," "anticipates," "estimates," "plans," or similar language. In connection with these safe-harbor provisions, MACC has identified in its Annual Report to Shareholders for the fiscal year ended September 30, 2003, important factors that could cause actual results to differ materially from those contained in any forward-looking statement made by or on behalf of MACC, including, without limitation, the high risk nature of MACC's portfolio investments, the effects of general economic conditions on MACC's portfolio companies, the effects of recent or future losses on the ability of MorAmerica Capital to comply with applicable regulations of the Small Business Administration and MorAmerica Capital's ability to obtain future funding, any failure to achieve annual investment level objectives, changes in prevailing market interest rates, contractions in the markets for corporate acquisitions and initial public offerings, and an adverse outcome on the pending arbitration proceedings against MorAmerica Capital. MACC further cautions that such factors are not exhaustive or exclusive. MACC does not undertake to update any forward-looking statement which may be made from time to time by or on behalf of MACC.

Results of Operations

MACC's investment income includes income from interest, dividends and fees. Investment expense, net represents total investment income minus total operating expenses. The main objective of portfolio company investments is to achieve capital appreciation and realized gains in the portfolio. These gains and losses are not included in investment expense, net. Another one of MACC's on-going goals is to achieve net investment income and increased earnings stability. In this regard, a significant proportion of new portfolio investments are structured so as to provide a current yield through interest or dividends. MACC also earns interest on short-term investments of cash.

Second Quarter Ended March 31, 2004 Compared to Second Quarter Ended March 31, 2003

	For the three months ended March 31,		
	2004	2003	Change
Investment income	\$ 826,272	641,693	184,579
Operating expenses	(1,866,107)	(1,148,319)	(717,788)
Investment expense, net	(1,039,835)	(506,626)	(533,209)

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Net realized gain (loss) on investments	589,408	(218,959)	808,367
Net change in unrealized appreciation/ depreciation on investments	1,365,962	(575,371)	1,941,333
	-----	-----	-----
Net gain on investments	1,955,370	(794,330)	2,749,700
	-----	-----	-----
 Net change in net assets from operations	 \$ 915,535	 (1,300,956)	 2,216,491
	=====	=====	=====
Net asset value:			
Beginning of period	\$ 5.31	6.74	
	=====	=====	
End of period	\$ 5.70	6.19	
	=====	=====	

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Investment Income

During the current year second quarter, total investment income was \$826,272, an increase of \$184,579, or 29%, from total investment income of \$641,693 for the prior year second quarter. In the current year second quarter as compared to the prior year second quarter, interest income increased \$84,803, or 19%, dividend income increased \$183,327, or 176%, processing fees decreased \$9,435, or 100%, and other income decreased \$74,116, or 98%. The increase in interest income is mainly due to one investment which converted all interest accrued and reserved to an equity investment in the current year second quarter which was on a non-accrual of interest status in the prior year second quarter. In the current year second quarter, MACC received dividends on five existing portfolio companies, as compared to dividend income received in the prior year second quarter on four existing portfolio companies. Processing fees decreased due to no fees received on the two follow-on portfolio company investments made in the current year second quarter, compared to one follow-on portfolio company investment in which MACC received a processing fee at closing in the prior year second quarter. The decrease in other income is due to advisory fees received from two portfolio companies in the prior year second quarter.

Operating Expenses

Total operating expenses for the second quarter of the current year were \$1,866,107, an increase of \$717,788, or 63%, as compared to total operating expenses for the prior year second quarter of \$1,148,319. Interest expense decreased \$18,707, or 3%, in the current year second quarter due to a reduction in the interest rate on \$2,150,000 of SBA-guaranteed debentures to 3.125% in the current year second quarter, from 6.12% in the prior year second quarter. Following the expiration of the terms of the investment advisory agreements between each of MACC and MorAmerica Capital and InvestAmerica Investment Advisors, Inc. ("InvestAmerica"), MACC and MorAmerica Capital each entered into an investment advisory agreement with Atlas Management Partners, LLC (the "Investment Advisor"). Contemporaneously with this change in investment advisor, MACC, MorAmerica Capital, the Investment Advisor and InvestAmerica entered into an agreement pursuant to which InvestAmerica will act as a subadvisor (the "Subadvisor") with respect to the companies' existing investment portfolio as of the transition date. Management fees increased \$15,610, or 7%, in the current year second quarter due to a voluntary reduction in management fees by InvestAmerica in the prior year second quarter which terminated on February 29, 2004. Professional fees increased \$31,210, or 14%, in the current year second

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quarter primarily due to increased legal expenses associated with the change in MACC's investment advisor which became effective on March 1, 2004 and various corporate governance changes. Professional fees are expected to be high in the next three to six months due to the item identified in Note 3 to the Unaudited Condensed Consolidated Financial Statements and legal advice in implementing the future direction of MACC. Other expenses increased \$704,675, or 494%, in the current year second quarter as compared to the prior year second quarter mainly due to the change in the other assets loss provision. The other assets loss provision increased because depreciated portfolio securities were reclassified as other assets in the current year second quarter, which required the unrealized depreciation on such assets in the amount of \$532,760 to be recorded as other assets loss provision, and because additional loss provision of \$197,727 was recorded in the current year second quarter with respect to other securities which had been classified as other assets in a prior period.

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Investment Expense, Net

For the current year second quarter, MACC recorded investment expense, net of \$1,039,835, as compared to investment expense, net of \$506,626 during the prior year second quarter.

Net Realized Gain (Loss) on Investments

During the current year second quarter, MACC recorded net realized gain on investments of \$589,408, as compared with net realized loss on investments of \$218,959 during the prior year second quarter. In the current year second quarter, MACC realized a gain of \$579,727 from the sale of one portfolio company of which \$611,340 was previously recorded as unrealized appreciation and \$9,681 of additional sale proceeds from the sale of an equity interest of one portfolio company which occurred in the current year first quarter. Management does not attempt to maintain a comparable level of realized gains quarter to quarter but instead attempts to maximize total investment portfolio appreciation through realizing gains in the disposition of securities and investing in new portfolio investments.

Net Change in Unrealized Appreciation/Depreciation of Investments

MACC recorded net change in unrealized appreciation/depreciation on investments of \$1,365,962 during the current year second quarter, as compared to (\$575,371) during the prior year second quarter. This net change in unrealized appreciation/depreciation on investments of \$1,365,962 is the net effect of increases in fair value of five portfolio companies totaling \$1,444,543, a decrease in fair value of one portfolio company totaling \$1, the reversal of \$611,340 of appreciation resulting from the sale of one portfolio investment and the reversal of \$532,760 of depreciation resulting from the restructure of one portfolio investment to other assets.

Net change in unrealized appreciation/depreciation on investments represents the change for the period in the unrealized appreciation net of unrealized depreciation on MACC's total investment portfolio. When MACC increases the fair value of a portfolio investment above its cost, the unrealized appreciation for the portfolio as a whole increases, and when MACC decreases the fair value of a portfolio investment below its cost, unrealized depreciation for the portfolio as a whole increases. When MACC sells an appreciated portfolio investment for a gain, unrealized appreciation for the

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portfolio as a whole decreases as the gain is realized. Similarly, when MACC sells or writes off a depreciated portfolio investment for a loss, unrealized depreciation for the portfolio as a whole decreases as the loss is realized.

Net Change in Net Assets from Operations

MACC experienced an increase of \$915,535 in net assets at the end of the second quarter of fiscal year 2004, and the resulting net asset value per share was \$5.70 as of March 31, 2004, as compared to \$5.47 as of September 30, 2003. General economic conditions have recently appeared to have a positive impact on the operating results and financial condition of a number of MACC's portfolio companies, and the majority of MACC's thirty-four operating portfolio companies continue to be valued at cost or above. MACC has fourteen portfolio

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investments valued at cost, has recorded unrealized appreciation on eight portfolio investments and has recorded unrealized depreciation on twelve portfolio investments.

To mitigate the effects of the current economic environment on MACC's operating performance, MACC has projected fewer investments and has projected no new borrowings under the SBIC leverage program in the current fiscal year 2004 budget. Recent years have been difficult years for the venture capital industry. With the recent improvement in the economy, MACC's overall portfolio is showing signs of increasing strength. If the economy continues to improve, management believes MACC's investment portfolio will benefit from improved operating performance at a number of portfolio companies and from a more robust merger and acquisition market.

Six Months Ended March 31, 2004 Compared to Six Months Ended March 31, 2003

	For the six months ended March 31,		
	2004	2003	Change
Investment income	\$ 1,320,590	1,250,251	70,339
Operating expenses	(2,865,466)	(2,158,375)	(707,091)
Investment expense, net	(1,544,876)	(908,124)	(636,752)
Net realized gain (loss) on investments	2,476,464	(2,792,282)	5,268,746
Net change in unrealized appreciation/ depreciation on investments	(403,540)	2,453,021	(2,856,561)
Net gain on investments	2,072,924	(339,261)	2,412,185
Net change in net assets from operations	\$ 528,048	(1,247,385)	1,775,433
Net asset value:			
Beginning of period	\$ 5.47	6.72	
End of period	\$ 5.70	6.19	

=====

Investment Income

During the current year six-month period, total investment income was \$1,320,590, an increase of \$70,339, or 6%, from total investment income of \$1,250,251 for the prior year six-month period. In the current year six-month period as compared to the prior year six-month period, interest income decreased \$16,682, or 2%, dividend income increased \$182,573, or 77%, processing fees decreased \$17,185, or 100%, and other income decreased \$78,367, or 91%. The decrease in interest income is the net result of only two follow-on investments made during the current year second quarter, one investment which converted all interest accrued and reserved to an equity investment, the placing of debt portfolio securities issued by three portfolio companies on non-accrual of interest status in the current year six-month period which were accruing interest in the prior year six-month period and the receipt of \$1,252,627 in principal payments on five portfolio investments. In the current year six-month period and in the prior year six-month period, MACC received dividends on seven existing portfolio companies, however dividend payments were greater in the current year six-month period. Processing fees decreased due to no fees received on the three follow-on investments made in the current year six-month period, compared to one follow-on investment and one existing portfolio company investment in which MACC received processing fees in the prior year six-month period. The period-over-period decrease in other income is due to a decrease in advisory fees received from two portfolio companies in the prior year six-month period.

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Operating Expenses

Total operating expenses for the six-month period of the current year were \$2,865,466, an increase of \$707,091, or 33%, as compared to total operating expenses for the prior year six-month period of \$2,158,375. Interest expense decreased \$37,413, or 3%, in the current year six-month period due to a reduction in the interest rate on \$2,150,000 of SBA-guaranteed debentures to 3.125% in the current year six-month period, from 6.12% in the prior year six-month period. Management fees decreased \$51,724, or 11%, in the current year six-month period due to InvestAmerica agreeing to a voluntary, temporary reduction in management fees to reduce the expenses of MACC. This voluntary, temporary reduction in management fees terminated at February 29, 2004. Professional fees increased \$123,579, or 37%, in the current year six-month period primarily due to increased legal expenses due to arbitration proceedings related to the sale of a former portfolio company and legal expenses associated with the change in MACC's investment advisor which became effective on March 1, 2004 and various corporate governance changes. Professional fees are expected to be high for at least the next three to six months as a result of the item identified in Note 3 to the Unaudited Condensed Consolidated Financial Statements and legal advice in implementing the future direction of MACC. Other expenses increased \$702,649, or 330%, in the current year second quarter as compared to the prior year six-month period mainly due to the change in the other assets loss provision. The other assets loss provision increased because depreciated portfolio securities were reclassified as other assets in the current year second quarter, which required the unrealized depreciation on such assets in the amount of \$532,760 to be recorded as other assets loss provision, and because additional loss provision of \$197,727 was recorded in the current year second quarter with respect to other securities which had been classified

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as other assets in a prior period.

Investment Expense, Net

For the current year six-month period, MACC recorded investment expense, net of \$1,544,876, as compared to investment expense, net of \$908,124 during the prior year six-month period.

Net Realized Gain (Loss) on Investments

During the current year six-month period, MACC recorded net realized gain on investments of \$2,476,464, as compared with net realized loss on investments of \$2,792,282 during the prior year six-month period. In the current year six-month period, MACC realized a gain of \$328,968 from the sale of warrants of one portfolio company, and \$2,994,881 from the sale of equity interests of three portfolio companies of which \$3,259,790 was previously recorded as unrealized appreciation. MACC also realized a loss of \$847,385 from the write-off of one portfolio company of which \$847,384 was previously recorded as unrealized depreciation. Management does not attempt to maintain a comparable level of realized gains quarter to quarter but instead attempts to maximize total investment portfolio appreciation by appropriately realizing gains in the disposition of securities and investing in new portfolio investments.

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Net Change in Unrealized Appreciation/Depreciation of Investments

MACC recorded net change in unrealized appreciation/depreciation on investments of (\$403,540) during the current year six-month period, as compared to \$2,453,021 during the prior year six-month period. This net change in unrealized appreciation/depreciation on investments of (\$403,540) is the net effect of increases in fair value of six portfolio companies totaling \$1,620,098, decreases in fair value of two portfolio companies totaling \$143,992, the reversal of \$3,259,790 of appreciation resulting from the sale of warrants of one portfolio investment and the sale of equity interests of three portfolio investments referenced above, the reversal of \$847,384 of depreciation resulting from the write-off of the investment in one portfolio investment, and the reversal of \$532,760 of depreciation resulting from the restructure of one portfolio investment to other assets.

Financial Condition, Liquidity and Capital Resources

To date, MACC has relied upon several sources to fund its investment activities, including MACC's cash and money market accounts and the Small Business Investment Company ("SBIC") leverage program operated by the Small Business Administration (the "SBA").

MACC, through its wholly-owned subsidiary, MorAmerica Capital, from time to time may seek to procure additional capital through the SBIC leverage program to fund a portion of its investment capital requirements. At present, committed leverage with a commitment period of up to four years is available through the SBIC leverage program and MACC anticipates that leverage may be available in future periods. MACC has not currently budgeted to borrow any funds through the SBIC leverage program during fiscal year 2004.

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As of March 31, 2004, MACC's cash and money market accounts totaled \$6,689,397. MACC has commitments for an additional \$3,500,000 and \$6,500,000 in SBA guaranteed debentures, which expire on September 30, 2005 and September 30, 2007, respectively. Subject to the risks and uncertainties described in this report on Form 10-Q, MACC believes that its existing cash and money market accounts, the \$10,000,000 of SBA commitments, and other anticipated cash flows, will provide adequate funds for MACC's anticipated budgeted cash requirements during the current fiscal year, including portfolio investment activities, principal and interest payments on outstanding debentures payable and administrative expenses. MACC's budgeted investment objective is to invest \$2,500,000 in new and follow-on investments during the current fiscal year, subject to further adjustment based upon current economic and operating conditions.

Debentures payable are composed of \$27,940,000 in principal amount of SBA-guaranteed debentures issued by MACC's subsidiary, MorAmerica Capital, which mature as follows: \$2,150,000 in fiscal year 2005, \$1,000,000 in fiscal year 2007, \$2,500,000 in fiscal year 2009, \$9,000,000 in fiscal year 2010, \$5,835,000 in fiscal year 2011, and \$7,455,000 in fiscal year 2012. Subject to the risks and uncertainties described in this report on Form 10-Q, it is anticipated MorAmerica Capital will be able to roll over these debentures with new ten-year debentures when they mature.

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MACC currently anticipates that it will rely primarily on its current cash and money market accounts and its cash flows from operations to fund its investment activities and other cash requirements during the remainder of fiscal year 2004. Although management believes these sources will provide sufficient funds for MACC to meet its fiscal 2004 investment level objective and other anticipated cash requirements, there can be no assurances that MACC's cash flows from operations will be as projected, or that MACC's cash requirements will be as projected. MACC's cash flow has been negatively affected by expenses associated with the pending arbitration proceedings described in Note 3 to the Unaudited Condensed Consolidated Financial Statements. An adverse outcome on such arbitration proceedings could further adversely affect MACC's cash flow.

As an SBIC, MorAmerica Capital is required to comply with the regulations of the SBA (the "SBA Regulations"). These regulations include the capital impairment rules, as defined by Regulation 107.1830 of the SBA Regulations. As of March 31, 2004, the capital of MorAmerica Capital was impaired less than the maximum impairment percentage permitted under SBA Regulations. No assurances can be given, however, that MorAmerica Capital will continue to be less than the maximum impairment percentage in future periods if MorAmerica Capital continues to experience negative operating results. If MorAmerica Capital would exceed the maximum impairment percentage in future periods, a number of events could occur which could have a material adverse effect on the financial position, results of operations, cash flow and liquidity of MACC and MorAmerica Capital.

MorAmerica Capital is currently limited by the SBA Regulations in the amount of distributions it may make to MACC. MACC historically has relied in large part on distributions from MorAmerica Capital to fund its operating expenses and other cash requirements. While the paragraphs above describe MACC's liquidity on a consolidated basis, due to current limitations on MorAmerica Capital's ability to make distributions to MACC, MACC has limited liquidity to pay its holding company operating expenses. During the second quarter of the current fiscal year, MACC entered into a loan agreement providing for advances

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of up to \$400,000 through a loan made by one of its directors. MACC obtained \$200,000 under this loan agreement in the second quarter of the current fiscal year and it is anticipated that additional drawings will be necessary in the third quarter of the current fiscal year. In addition to utilizing this loan facility, MACC is currently evaluating a number of alternatives to provide for its liquidity, including one or more of the capital transactions approved by shareholders at the 2004 annual meeting.

Portfolio Activity

MACC's primary business is investing in and lending to businesses through investments in subordinated debt (generally with detachable equity warrants), preferred stock and common stock. The total portfolio value of investments in publicly and non-publicly traded securities was \$34,117,410 at March 31, 2004 and \$38,601,177 at September 30, 2003. During the three months ended March 31, 2004, MACC invested \$245,126 in follow-on investments in two existing portfolio companies. Management views investment objectives for any given year as secondary in importance to MACC's overriding concern of investing in only those portfolio companies which satisfy MACC's investment criteria. MACC's budgeted investment objective for fiscal year 2004 is to invest \$2,500,000 in new and follow-on

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investments, subject to further adjustment based on current economic and operating conditions.

MACC has frequently co-invested with other funds managed by the Subadvisor. When it makes any co-investment with these related funds, MACC follows certain procedures consistent with orders of the Securities and Exchange Commission for related party co-investments to reduce or eliminate conflict of interest issues. Of the \$245,126 invested during the current year second quarter, \$245,126 represented co-investments with funds managed by the Subadvisor.

Critical Accounting Policy

Investments in securities traded on a national securities exchange (or reported on the NASDAQ national market) are stated at the average of the bid price on the three final trading days of the valuation period which is not materially different from the bid price on the final day of the period. Restricted and other securities for which quotations are not readily available are valued at fair value as determined by the Board of Directors. Among the factors considered in determining the fair value of investments are the cost of the investment; developments, including recent financing transactions, since the acquisition of the investment; the financial condition and operating results of the investee; the long-term potential of the business of the investee; and other factors generally pertinent to the valuation of investments. However, because of the inherent uncertainty of valuation, those estimated values may differ significantly from the values that would have been used had a ready market for the securities existed, and the differences could be material.

In the valuation process, MorAmerica Capital uses financial information received monthly, quarterly, and annually from its portfolio companies which includes both audited and unaudited financial statements. This information is used to determine financial condition, performance, and valuation of the

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portfolio investments.

Realization of the carrying value of investments is subject to future developments. Investment transactions are recorded on the trade date and identified cost is used to determine realized gains and losses. Under the provisions of SOP 90-7, the fair value of loans and investments in portfolio securities on February 15, 1995, the fresh-start date, is considered the cost basis for financial statement purposes.

Determination of Net Asset Value

The net asset value per share of MACC's outstanding common stock is determined quarterly, as soon as practicable after and as of the end of each calendar quarter, by dividing the value of total assets minus total liabilities by the total number of shares outstanding at the date as of which the determination is made.

Item 3. Quantitative and Qualitative Disclosure About Market Risk

MACC is exposed to market risk from changes in the market price of publicly traded equity securities held from time to time in the MACC consolidated investment portfolio. At

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March 31, 2004, MACC held only one publicly traded equity security in its consolidated investment portfolio, and the fair value of that portfolio investment was not material. Therefore, a hypothetical 10% adverse change in quoted market price of that portfolio investment would not be material.

MACC is also exposed to market risk from changes in market interest rates that affect the fair value of MorAmerica Capital's debentures payable determined in accordance with Statement of Financial Accounting Standards No. 107, *Disclosures About Fair Value of Financial Instruments*. The estimated fair value of MorAmerica Capital's outstanding debentures payable at March 31, 2004, was \$30,409,000, with a cost of \$27,940,000. Fair value of MorAmerica Capital's outstanding debentures payable is calculated by discounting cash flows through estimated maturity using the borrowing rate currently available to MorAmerica Capital for debt of similar original maturity. None of MorAmerica Capital's outstanding debentures payable are publicly traded. Market risk is estimated as the potential increase in fair value resulting from a hypothetical 0.5% decrease in interest rates. Actual results may differ.

March 31, 2004	
Fair Value of Debentures Payable	\$30,409,000
Amount Above Cost	\$2,469,000
Additional Market Risk	\$747,000

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Item 4. Controls and Procedures

In accordance with Item 307 of Regulation S-K promulgated under the Securities Act of 1933, as amended, and within 90 days of the date of this Quarterly Report on Form 10-Q, the Chief Executive Officer and Chief Financial Officer of MACC (the "Certifying Officers") have conducted evaluations of MACC's disclosure controls and procedures. As defined under Sections 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the term "disclosure controls and procedures" means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive officer or officers and principal financial officer or officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. The Certifying Officers have reviewed MACC's disclosure controls and procedures and have concluded that those disclosure controls and procedures are effective as of the date of this Quarterly Report on Form 10-Q. In

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compliance with Section 302 of the Sarbanes-Oxley Act of 2002, each of the Certifying Officers executed an Officer's Certification included in this Quarterly Report on Form 10-Q.

As of the date of this Quarterly Report on Form 10-Q, there have not been any significant changes in MACC's internal controls or other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

MorAmerica Capital is party to arbitration proceedings instituted by TransCore Holdings, Inc., a company (Buyer) seeking indemnification under the Stock Purchase Agreement (the Stock Purchase Agreement), pursuant to which MorAmerica Capital and certain other individuals and institutional investors (collectively, the Sellers) sold their interest in a former portfolio company investment (Portfolio Company). The arbitration proceedings are being administered by JAMS. Under the Stock Purchase Agreement, the Sellers agreed to indemnify Buyer for breaches of representations and warranties as to Portfolio Company made by the Sellers. Buyer claims that accounting irregularities at Portfolio Company resulted in a breach of the Sellers' representations

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and warranties. The Sellers have retained counsel and forensic accountants to defend the Sellers against Buyer's claim for indemnification. Following discovery, depositions and other preliminary proceedings, in June, 2003, the formal arbitration proceedings commenced and are being intensively contested by all parties. Based on the current schedule for the arbitration, a decision will not be rendered until at least August, 2004. Based on its evaluation of the Buyer's claim and discussions with external legal counsel, MACC believes that it is reasonably possible that a loss may have been incurred as a result of the indemnification claim, against which no accrual for loss has been made as of March 31, 2004, because the amount of the possible loss, and therefore its materiality to the financial statements, cannot be estimated. MorAmerica Capital intends to continue vigorously defending this arbitration. MorAmerica Capital received approximately \$939,000 of proceeds from the sale of the Portfolio Company. MorAmerica Capital owned debt securities of Buyer with a face value of \$508,761 and warrants with a cost of \$24,000 received as part of the sale. Buyer has defaulted on interest payments due on these debt securities. On March 31, 2003, MorAmerica Capital reduced the valuation of these debt securities by \$254,380 in light of the interest default and information regarding the related dispute as of that date. On June 30, 2003, MorAmerica Capital further reduced the valuation of these debt securities by \$254,380 to \$1 and reduced the valuation of the warrants to zero based upon the continuing interest default and additional information regarding the related dispute as of that date. Subsequent to December 31, 2003, Buyer refinanced certain of its obligations, including the debt securities held by MorAmerica Capital, and the principal amount of these debt securities and accrued interest has been deposited in an escrow account pending conclusion of the arbitration proceedings.

In a related development, MorAmerica Capital and another small business investment company, NDSBIC, L.P., which co-invested in Portfolio Company, filed suit on December 24, 2003 in the United States District Court for the Northern District of Texas against Patton Boggs LLP and Charles P. Miller, Esq., of Patton Boggs alleging legal malpractice and breach of fiduciary duty. Patton Boggs and Mr. Miller represented MorAmerica Capital and NDSBIC in connection with their investment in the Portfolio Company and the subsequent sale of the Portfolio Company to Buyer. MorAmerica Capital and NDSBIC are seeking monetary damages, in an amount that has not been determined.

BFS Diversified Products, LLC ("BFS") was a supplier to Water Creations, Inc. ("Water Creations"), a former portfolio company of MorAmerica Capital. Water

Creations went out of business in December, 2002, at which time BFS was owed approximately \$900,000 for products sold to Water Creations. On March 26, 2004, BFS filed suit in the Iowa District Court of Polk County, Iowa against board members of and investors in Water Creations, including MorAmerica Capital, David Schroder (Chief Financial Officer of MACC), and InvestAmerica Venture Group, Inc., an affiliate of the Subadvisor. BFS has sued the defendants for fraud, fraudulent transfer, breach of fiduciary duty, civil conspiracy, breach of contract, conversion, and alter ego/piercing corporate veil.

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The central allegation of the case is that the defendants knew that Water Creations was insolvent and owed a duty to BFS to protect it from selling to Water Creations under these circumstances. The defendants have hired counsel and intend to vigorously defend this litigation.

Item 2. Changes in Securities

There are no items to report.

Item 3. Defaults Upon Senior Securities

There are no items to report.

Item 4. Submission of Matters to a Vote of Security Holders

On February 24, 2004, MACC's 2004 Annual Meeting of Shareholders (the "Meeting") was held in Salt Lake City, Utah. A quorum of 1,396,582 shares, or approximately 59.96% of issued and outstanding shares as of December 31, 2003, were represented in person or by proxy at the Meeting. The shareholders considered eight proposals at the meeting.

With respect to the first proposal, the shareholders elected eight nominees to serve as directors until the 2005 Annual Meeting of Shareholders or until their respective successors shall be elected and qualified. One director, Paul M. Bass, Jr., was not elected at the Meeting because his current term as a director continues until the 2005 Annual Meeting of Shareholders. The eight directors elected at the Meeting, and the votes cast in favor of and withheld with respect to each, are as follows:

	<u>For</u>	<u>Withheld</u>
Michael W. Dunn	1,382,885	13,697
Benjamin Jiaravanon	1,385,185	11,397
Jasja Kotterman	1,381,466	15,116
Kent I. Madsen	1,382,452	14,130
Shane Robison	1,385,185	11,397
Gordon J. Roth	1,382,885	13,697

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	<u>For</u>	<u>Withheld</u>
Martin Walton	1,385,185	11,397
Geoffrey T. Woolley	1,385,485	11,097

With regard to the second proposal, the shareholders approved an Investment Advisory Agreement between the Corporation and Atlas Management Partners LLC by a vote of 1,352,936 in favor of approval and 22,435 against approval, with

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21,211 shares abstaining.

With regard to the third proposal, the shareholders approved an Investment Advisory Agreement between MorAmerica Capital Corporation and Atlas Management Partners LLC by a vote of 1,350,538 in favor of approval and 19,323 against approval, with 26,721 shares abstaining.

With regard to the fourth proposal, the shareholders approved an Investment Advisory Support Services Agreement among the Corporation, MorAmerica Capital Corporation, Atlas Management Partners LLC and InvestAmerica Investment Advisors, Inc. by a vote of 1,347,748 in favor of approval and 23,243 against approval, with 25,591 shares abstaining.

With regard to the fifth proposal, the shareholders approved amending the Corporation's Certificate of Incorporation to increase the number of authorized shares of Common Stock of the Corporation from 4,000,000 to 10,000,000 by a vote of 1,352,789 in favor of approval and 23,974 against approval, with 19,819 shares abstaining.

With regard to the sixth proposal, the shareholders authorized the Corporation to issue rights to acquire any authorized shares of Common Stock of the Corporation by a vote of 1,347,060 in favor of approval and 25,820 against approval, with 23,702 shares abstaining.

With regard to the seventh proposal, the shareholders authorized the Corporation to issue warrants, rights or options to purchase, or securities convertible into, shares of the Corporation's Common Stock by a vote of 1,349,373 in favor of approval and 23,375 against approval, with 23,834 shares abstaining.

With regard to the eighth proposal, the shareholders voted to ratify the appointment of KPMG LLP as independent auditors for MACC for fiscal year 2004 by a vote of 1,372,794 in favor of approval and 3,818 against approval, with 19,970 shares abstaining.

Item 5. Other Information

There are no items to report.

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits

The following exhibits are filed with this quarterly report on Form 10-Q:

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10.4 Investment Advisory Agreement dated as of March 1, 2004 between MACC Private Equities Inc. and Atlas Management Partners, LLC

10.5 Investment Advisory Agreement dated as of March 1, 2004 between MorAmerica Capital Corporation and Atlas Management Partners, LLC

10.6 Investment Advisory Support Services Agreement dated as of March 1, 2004 among MACC Private Equities Inc., MorAmerica Capital Corporation, Atlas Management Partners, LLC and InvestAmerica Investment Advisors, Inc.

10.7 Convertible Note and Security Agreement dated as of March 1, 2004

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between MACC Private Equities Inc. and Geoffrey T. Woolley

- 10.8 Letter Agreement Regarding Subsidiary Support dated as of March 1, 2004 between MorAmerica Capital Corporation and MACC Private Equities Inc.
- 10.9 Guaranty dated as of March 1, 2004 by Atlas Management Partners, LLC in favor of Geoffrey T. Woolley
- 10.10 Employment Agreement between David R. Schroder and MACC Private Equities Inc. dated as of March 1, 2004*
- 10.11 Employment Agreement between Robert A. Comey and MorAmerica Capital Corporation dated as of March 1, 2004*
- 31.1 Section 302 Certification of Kent I. Madsen (CEO)
- 31.2 Section 302 Certification of David R. Schroder (CFO)
- 32.1 Section 1350 Certification of Kent I. Madsen (CEO)
- 32.2 Section 1350 Certification of David R. Schroder (CFO)

*Indicates a management contract or compensatory plan or arrangement.

(b) Reports on Form 8-K

MACC filed no current reports on Form 8-K during the quarter ended March 31, 2004.

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.

MACC PRIVATE EQUITIES INC.

Date: 5/13/04

By: /s/ Kent I. Madsen

Kent I.Madsen, President

Date: 5/13/04

By: /s/ David R. Schroder

David R. Schroder, Chief
Financial Officer

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EXHIBIT INDEX

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