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Hercules Capital, Inc.
Form 10-Q
May 03, 2018
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For The Quarterly Period Ended March 31, 2018

OR

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

Commission File Number: 814-00702

HERCULES CAPITAL, INC.

(Exact Name of Registrant as Specified in its Charter)

Maryland
(State or Jurisdiction of

Incorporation or Organization)

400 Hamilton Ave., Suite 310

Palo Alto, California

743113410
(IRS Employer

Identification No.)
94301

(Zip Code)

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(Address of Principal Executive Offices)

(650) 289-3060

(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 periods that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with a new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

On April 30, 2018, there were 85,899,098 shares outstanding of the Registrant's common stock, \$0.001 par value.

HERCULES CAPITAL, INC.

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PART I: FINANCIAL INFORMATION

In this Quarterly Report, the “Company,” “Hercules,” “we,” “us” and “our” refer to Hercules Capital, Inc. and its wholly owned subsidiaries and its affiliated securitization trusts on or after February 25, 2016 and “Hercules Technology Growth Capital, Inc.” and its wholly owned subsidiaries and its affiliated securitization trusts prior to February 25, 2016, unless the context otherwise requires.

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS
HERCULES CAPITAL, INC.

CONSOLIDATED STATEMENT OF ASSETS AND LIABILITIES

(unaudited)

(dollars in thousands, except per share data)

	March 31, 2018	December 31, 2017
Assets		
Investments:		
Non-control/Non-affiliate investments (cost of \$1,427,863 and \$1,506,454, respectively)	\$1,398,640	\$1,491,458
Control investments (cost of \$60,992 and \$25,419, respectively)	54,413	19,461
Affiliate investments (cost of \$87,423 and \$87,956, respectively)	30,525	31,295
Total investments in securities, at value (cost of \$1,576,278 and \$1,619,829, respectively)	1,483,578	1,542,214
Cash and cash equivalents	118,228	91,309
Restricted cash	3,632	3,686
Interest receivable	11,087	12,262
Other assets	3,187	5,244
Total assets	\$1,619,712	\$1,654,715
Liabilities		
Accounts payable and accrued liabilities	\$18,789	\$26,896
SBA Debentures, net (principal of \$190,200 and \$190,200, respectively) ⁽¹⁾	188,299	188,141
2022 Notes, net (principal of \$150,000 and \$150,000, respectively) ⁽¹⁾	147,698	147,572
2024 Notes, net (principal of \$183,510 and \$183,510, respectively) ⁽¹⁾	179,161	179,001
2021 Asset-Backed Notes, net (principal of \$33,575 and \$49,153, respectively) ⁽¹⁾	33,156	48,650
2022 Convertible Notes, net (principal of \$230,000 and \$230,000, respectively) ⁽¹⁾	223,878	223,488
Total liabilities	\$790,981	\$813,748
Net assets consist of:		
Common stock, par value	85	85
Capital in excess of par value	916,738	908,501
Unrealized depreciation on investments ⁽²⁾	(94,957)	(79,760)
Accumulated undistributed realized gains (losses) on investments	(25,294)	(20,374)
Undistributed net investment income	32,159	32,515

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Total net assets	\$828,731	\$840,967
Total liabilities and net assets	\$1,619,712	\$1,654,715
Shares of common stock outstanding (\$0.001 par value, 200,000,000 authorized)	85,239	84,424
Net asset value per share	\$9.72	\$9.96

(1) The Company's SBA Debentures, 2022 Notes, 2024 Notes, 2021 Asset-Backed Notes and 2022 Convertible Notes, as each term is defined herein, are presented net of the associated debt issuance costs for each instrument. See "Note 4 – Borrowings".

(2) Amounts include \$2.3 million and \$2.1 million in net unrealized depreciation on other assets and accrued liabilities, including escrow receivables, and estimated taxes payable as of March 31, 2018 and December 31, 2017, respectively.

See notes to consolidated financial statements.

The following table presents the assets and liabilities of our consolidated securitization trust for the 2021 Asset-Backed Notes (see Note 4), which is a variable interest entity (“VIE”). The assets of our securitization VIE can only be used to settle obligations of our consolidated securitization VIE, these liabilities are only the obligations of our consolidated securitization VIE, and the creditors (or beneficial interest holders) do not have recourse to our general credit. These assets and liabilities are included in the Consolidated Statement of Assets and Liabilities above.

(Dollars in thousands)	March 31, 2018	December 31, 2017
Assets		
Restricted Cash	\$3,632	\$3,686
Total investments in securities, at value (cost of \$117,441 and \$146,208, respectively)	112,826	144,513
Total assets	\$116,458	\$148,199
Liabilities		
2021 Asset-Backed Notes, net (principal of \$33,575 and \$49,153, respectively) ⁽¹⁾	\$33,156	\$48,650
Total liabilities	\$33,156	\$48,650

(1) The Company’s 2021 Asset-Backed Notes are presented net of the associated debt issuance costs. See “Note 4 – Borrowings”.

See notes to consolidated financial statements.

HERCULES CAPITAL, INC.

CONSOLIDATED STATEMENT OF OPERATIONS

(unaudited)

(in thousands, except per share data)

	Three Months Ended March 31,	
	2018	2017
Investment income:		
Interest income		
Non-control/Non-affiliate investments	\$41,834	\$42,345
Control investments	586	514
Affiliate investments	561	2
Total interest income	42,981	42,861
Fee income		
Commitment, facility and loan fee income:		
Non-control/Non-affiliate investments	2,440	2,934
Control investments	—	5
Affiliate investments	108	—
Total commitment, facility and loan fee income	2,548	2,939
One-time fee income:		
Non-control/Non-affiliate investments	3,171	565
Total one-time fee income	3,171	565
Total fee income	5,719	3,504
Total investment income	48,700	46,365
Operating expenses:		
Interest	9,386	9,607
Loan fees	1,175	2,838
General and administrative	4,009	4,064
Employee compensation:		
Compensation and benefits	5,758	5,345
Stock-based compensation	2,309	1,833
Total employee compensation	8,067	7,178
Total operating expenses	22,637	23,687
Net investment income	26,063	22,678
Net realized gain (loss) on investments		
Non-control/Non-affiliate investments	(3,512)	3,288
Control investments	(1,408)	(51)
Total net realized gain (loss) on investments	(4,920)	3,237
Net change in unrealized appreciation (depreciation) on investments		
Non-control/Non-affiliate investments	(14,340)	(32,155)
Control investments	(620)	213
Affiliate investments	(237)	439
Total net unrealized appreciation (depreciation) on investments	(15,197)	(31,503)

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Total net realized and unrealized gain (loss)	(20,117)	(28,266)
Net increase (decrease) in net assets resulting from operations	\$5,946	\$(5,588)
Net investment income before investment gains and losses per common share:		
Basic	\$0.31	\$0.28
Change in net assets resulting from operations per common share:		
Basic	\$0.07	\$(0.07)
Diluted	\$0.07	\$(0.07)
Weighted average shares outstanding		
Basic	84,596	81,420
Diluted	84,666	81,420
Distributions declared per common share:		
Basic	\$0.31	\$0.31

See notes to consolidated financial statements.

HERCULES CAPITAL, INC.

CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS

(unaudited)

(dollars and shares in thousands)

	Common Shares	Stock Par Value	Capital in excess of par value	Unrealized Appreciation (Depreciation) on Investments	Accumulated Undistributed Realized Gains (Losses) on Investments	Undistributed Net Investment Income	Net Assets
Balance at December 31, 2016	79,555	\$ 80	\$ 839,657	\$ (89,025)	\$ 14,314	\$ 22,918	\$ 787,944
Net increase (decrease) in net assets resulting from operations	—	—	—	(31,503)	3,237	22,678	(5,588)
Public offering, net of offering expenses	3,309	3	46,945	—	—	—	46,948
Issuance of common stock due to stock option exercises	24	—	181	—	—	—	181
Retired shares from net issuance	(16)	—	(140)	—	—	—	(140)
Issuance of common stock under restricted stock plan	4	—	—	—	—	—	—
Retired shares for restricted stock vesting	(101)	—	(1,433)	—	—	—	(1,433)
Distributions reinvested in common stock	26	—	388	—	—	—	388
Issuance of Convertible Notes	—	—	3,413	—	—	—	3,413
Distributions	—	—	—	—	—	(25,667)	(25,667)
Stock-based compensation ⁽¹⁾	—	—	1,850	—	—	—	1,850
Balance at March 31, 2017	82,801	\$ 83	\$ 890,861	\$ (120,528)	\$ 17,551	\$ 19,929	\$ 807,896
Balance at December 31, 2017	84,424	\$ 85	\$ 908,501	\$ (79,760)	\$ (20,374)	\$ 32,515	\$ 840,967
Net increase (decrease) in net assets resulting from operations	—	—	—	(15,197)	(4,920)	26,063	5,946
Public offering, net of offering expenses	478	—	5,952	—	—	—	5,952
Issuance of common stock due to stock option exercises	38	—	432	—	—	—	432
Retired shares from net issuance	(36)	—	(446)	—	—	—	(446)
Issuance of common stock under restricted stock plan	336	—	—	—	—	—	—
	(36)	—	(446)	—	—	—	(446)

Retired shares for restricted
stock vesting

Distributions reinvested in common stock	35	—	426	—	—	—	426
Distributions	—	—	—	—	—	(26,419)	(26,419)
Stock-based compensation ⁽¹⁾	—	—	2,319	—	—	—	2,319
Balance at March 31, 2018	85,239	\$ 85	\$ 916,738	\$ (94,957)	\$ (25,294)	\$ 32,159	\$ 828,731

(1) Stock-based compensation includes \$10 and \$17 of restricted stock and option expense related to director compensation for the three months ended March 31, 2018 and 2017, respectively.

See notes to consolidated financial statements.

HERCULES CAPITAL, INC.

CONSOLIDATED STATEMENT OF CASH FLOWS

(unaudited)

(dollars in thousands)

	For the Three Months Ended March 31,	
	2018	2017
Cash flows from operating activities:		
Net increase (decrease) in net assets resulting from operations	\$5,946	\$(5,588)
Adjustments to reconcile net increase in net assets resulting from operations to net cash provided by (used in) operating activities:		
Purchase of investments	(236,285)	(153,665)
Principal and fee payments received on investments	280,181	141,798
Proceeds from the sale of investments	1,582	11,995
Net unrealized depreciation (appreciation) on investments	15,197	31,503
Net realized loss (gain) on investments	4,920	(3,237)
Accretion of paid-in-kind principal	(2,507)	(2,199)
Accretion of loan discounts	(763)	(1,924)
Accretion of loan discount on Convertible Notes	168	112
Accretion of loan exit fees	(4,407)	(6,574)
Change in deferred loan origination revenue	631	284
Unearned fees related to unfunded commitments	321	976
Amortization of debt fees and issuance costs	840	2,508
Depreciation	46	52
Stock-based compensation and amortization of restricted stock grants ⁽¹⁾	2,319	1,850
Change in operating assets and liabilities:		
Interest and fees receivable	1,175	130
Prepaid expenses and other assets	1,870	(1,061)
Accounts payable	(194)	1
Accrued liabilities	(8,025)	(5,255)
Net cash provided by (used in) operating activities	63,015	11,706
Cash flows from investing activities:		
Purchases of capital equipment	(72)	(39)
Net cash provided by (used in) investing activities	(72)	(39)
Cash flows from financing activities:		
Issuance of common stock, net	5,952	46,948
Retirement of employee shares	(460)	(1,392)
Distributions paid	(25,993)	(25,279)
Issuance of 2022 Convertible Notes	—	230,000
Issuance of 2024 Notes	—	5,637

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Repayments of 2019 Notes	—	(110,365)
Repayments of 2021 Asset-Backed Notes	(15,577)	(7,794)
Borrowings of credit facilities	—	8,497
Repayments of credit facilities	—	(13,513)
Cash paid for debt issuance costs	—	(4,456)
Fees paid for credit facilities and debentures	—	(252)
Net cash provided by (used in) financing activities	(36,078)	128,031
Net increase (decrease) in cash, cash equivalents and restricted cash	26,865	139,698
Cash, cash equivalents and restricted cash at beginning of period	94,995	21,366
Cash, cash equivalents and restricted cash at end of period	\$ 121,860	\$ 161,064
Supplemental non-cash investing and financing activities:		
Distributions reinvested	426	388

(1) Stock-based compensation includes \$10 and \$17 of restricted stock and option expense related to director compensation for the three months ended March 31, 2018 and 2017, respectively.

See notes to consolidated financial statements.

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The following table presents a reconciliation of cash, cash equivalents and restricted cash reported within the Consolidated Statement of Assets and Liabilities that sum to the total of the same such amounts in the Consolidated Statement of Cash Flows:

(Dollars in thousands)	For the Three Months Ended March 31,	
	2018	2017
Cash and cash equivalents	\$118,228	\$148,140
Restricted cash	3,632	12,924
Total cash, cash equivalents and restricted cash presented in the Consolidated Statements of Cash Flows	\$121,860	\$161,064

See “Note 2 – Summary of Significant Accounting Policies” and “Note 11- Recent Accounting Pronouncements” for a description of restricted cash and cash equivalents.

See notes to consolidated financial statements.

HERCULES CAPITAL, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS

March 31, 2018

(unaudited)

(dollars in thousands)

Portfolio Company	Sub-Industry	Type of Investment ⁽¹⁾	Maturity Date	Interest Rate and Floor ⁽²⁾	Principal Amount	Cost ⁽³⁾	Value ⁽⁴⁾
Debt Investments							
Biotechnology Tools							
1-5 Years Maturity							
Excicure, Inc. ⁽¹²⁾	Biotechnology Tools	Senior Secured	September 2019	Interest rate PRIME + 6.45% or Floor rate of 9.95%, 3.85% Exit Fee	\$4,999	\$5,135	\$5,151
Subtotal: 1-5 Years Maturity						5,135	5,151
Subtotal: Biotechnology Tools (0.62%)*						5,135	5,151
Communications & Networking							
Under 1 Year Maturity							
OpenPeak, Inc. ⁽⁸⁾	Communications & Networking	Senior Secured	April 2018	Interest rate PRIME + 8.75% or Floor rate of 12.00%	\$11,464	8,228	—
Subtotal: Under 1 Year Maturity						8,228	—
Subtotal: Communications & Networking (0.00%)*						8,228	—
Consumer & Business Products							
Under 1 Year Maturity							
Gadget Guard (p.k.a. Antenna79) ⁽¹⁵⁾	Consumer & Business Products	Senior Secured	December 2018	Interest rate PRIME + 6.00% or Floor rate of 9.50%	\$1,000	1,000	1,000
Subtotal: Under 1 Year Maturity						1,000	1,000
1-5 Years Maturity							
Gadget Guard (p.k.a. Antenna79) ⁽¹⁵⁾	Consumer & Business Products	Senior Secured	December 2019	Interest rate PRIME + 7.45%	\$18,043	18,245	18,133

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	or Floor rate of 10.95%, 2.95% Exit Fee		
Subtotal: 1-5 Years Maturity		18,245	18,133
Subtotal: Consumer & Business Products (2.31%)*		19,245	19,133
Diversified Financial Services 1-5 Years Maturity			
Gibraltar Business Diversified Capital, LLC ⁽⁷⁾ Financial Services	Unsecured March 2023 Interest rate FIXED 14.50%	\$ 10,000	9,802
Subtotal: 1-5 Years Maturity		9,802	9,802
Subtotal: Diversified Financial Services (1.18%)*		9,802	9,802
Drug Delivery			