

Mill City Ventures III, Ltd
Form 10-Q
August 15, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2016 OR

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission File Number 814-00991

MILL CITY VENTURES III, LTD.

(Exact name of registrant as specified in its charter)

Minnesota 90-0316651
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

328 Barry Avenue South #210, Wayzata, MN 55391

(Address of Principal Executive Offices)

(952) 479-1923

Edgar Filing: Mill City Ventures III, Ltd - Form 10-Q

(Registrant's telephone number, including area code)

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

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

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

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

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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

As of August 15, 2016, there were 12,151,493 shares of the issuer's common stock, \$0.001 par value, outstanding.

Table of Contents

Index

	Page
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements</u>	1
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	18
<u>Item 4. Controls and Procedures</u>	26
<u>PART II. OTHER INFORMATION</u>	
<u>Item 6. Exhibits</u>	26
<u>SIGNATURES</u>	27

PART I – FINANCIAL INFORMATION**Item 1. Financial Statements**

Mill City Ventures III, Ltd.

Balance Sheets

	June 30, 2016 (unaudited)	December 31, 2015 (audited)
ASSETS		
Investments, at fair value		
Non-control / Non-affiliate investments (cost of \$6,875,137 and \$7,218,131, respectively)	\$5,685,735	\$5,747,808
Cash	2,579,366	2,980,659
Prepaid expenses	77,331	43,808
Interest and dividends receivable	13,389	23,840
Leasehold improvements, net	19,719	23,773
Property and equipment, net	11,851	14,222
Total Assets	\$8,387,391	\$8,834,110
LIABILITIES		
Current Liabilities		
Accounts payable	\$10,938	\$10,431
Payable for purchases of investments	-	65,622
Deferred interest income	-	5,645
Deferred rent	11,288	11,124
Total Current Liabilities	22,226	92,822
Total Liabilities	\$22,226	\$92,822
Commitments and Contingencies (Note 3)		
SHAREHOLDERS' EQUITY (NET ASSETS)		
Common Stock, par value \$0.001 per share (250,000,000 common shares authorized; 12,151,493 and 12,151,493 issued and outstanding)	\$12,151	\$12,151
Additional paid-in capital	11,857,660	11,857,660
Accumulated deficit	(1,159,665)	(1,159,665)
Accumulated undistributed investment loss	(1,223,690)	(1,099,927)
Accumulated undistributed net realized gains on investment transactions	68,111	601,392

Edgar Filing: Mill City Ventures III, Ltd - Form 10-Q

Net unrealized appreciation in value of investments	(1,189,402)	(1,470,323)
Total Shareholders' Equity (Net Assets)	\$8,365,165	\$8,741,288
Total Liabilities and Shareholders' Equity	\$8,387,391	\$8,834,110
Net Asset Value Per Common Share	\$0.69	\$0.72

See accompanying notes to financial statements.

Mill City Ventures III, Ltd.

Statements of Operations

(unaudited)

	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
Investment Income				
Interest income	\$56,119	117,796	\$126,160	\$256,322
Dividend income	23,609	29,285	39,891	54,603
Total Investment Income	79,728	147,081	166,051	310,925
Operating Expenses				
Professional fees	45,477	36,071	85,484	87,468
Payroll expense	40,549	40,481	81,958	81,955
Insurance expense	18,730	21,610	40,087	46,174
Occupancy	14,428	22,819	38,604	45,618
Directors' fees expense	15,000	15,000	28,956	30,000
Depreciation and amortization expense	3,212	3,212	6,424	6,424
Other general and administrative expenses	5,700	4,368	8,301	9,163
Total Operating Expenses	143,096	143,561	289,814	306,802
Net Investment Income (Loss)	(63,368)	3,520	(123,763)	4,123
Realized and Unrealized Gain (Loss) on Investments				
Net realized gain (loss) on investments	8,814	139,290	(533,281)	286,143
Net change in unrealized appreciation (depreciation) on investments	(300,729)	(683,368)	280,921	(677,645)
Net Realized and Unrealized Gain (Loss) on Investments	(291,915)	(544,078)	(252,360)	(391,502)
Net Decrease in Net Assets Resulting from Operations	\$(355,283)	(540,558)	\$(376,123)	\$(387,379)
Net Decrease in Net Assets Resulting from Operations per share:				
Basic and diluted	\$(0.03)	(0.04)	\$(0.03)	\$(0.03)
Weighted-average number of common shares outstanding	12,151,493	12,151,493	12,151,493	12,151,493

See accompanying notes to financial statements.

Mill City Ventures III, Ltd.

Statements of Changes in Net Assets

(unaudited)

	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
Net Assets at Beginning of Period	\$8,741,288	\$11,473,690
Net investment income (loss)	(123,763)	4,123
Net realized gain (loss) on investments	(533,281)	286,143
Net increase (decrease) in unrealized appreciation on investments	280,921	(677,645)
Net increase (decrease) in net assets resulting from operations	(376,123)	(387,379)
Total net decrease in net assets resulting from operations	(376,123)	(387,379)
Net Assets at End of Period	\$8,365,165	\$11,086,311
Accumulated undistributed net investment loss	\$(1,223,690)	\$(1,024,300)

Mill City Ventures III, Ltd.

Statements of Cash Flows

(unaudited)

	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
Cash flows from operating activities:		
Net decrease in net asset value resulting from operations	\$(376,123)	\$(387,379)
Adjustments to reconcile net decrease in net assets resulting from operations to net cash used in operating activities:		
Net change in unrealized appreciation (depreciation) on investments	(280,921)	677,645
Net realized (gain) loss on investments	533,281	(286,143)
Payments for purchases of investments	(1,221,666)	(1,841,399)
Proceeds from sales of investments	1,031,379	1,442,595
Depreciation and amortization expense	6,425	6,424
Changes in operating assets and liabilities:		
Prepaid expenses	(33,523)	(36,681)
Receivable from sale of investments	-	82,103
Interest and dividends receivable	10,451	(52,517)
Accounts payable	507	(23,457)
Deferred interest income	(5,645)	20,645
Deferred rent	164	564
Payable for investment purchase	(65,622)	-
Net cash used in operating activities	(401,293)	(397,600)
Cash flows from investing activities:		
Purchases of property and equipment	-	-
Purchases of leasehold improvements	-	-
Net cash used by investing activities	-	-
Net decrease in cash	(401,293)	(397,600)
Cash, beginning of the period	2,980,659	4,105,911
Cash, end of the period	\$2,579,366	\$3,708,311

See accompanying notes to financial statements.

Mill City Ventures III, Ltd.

Financial Highlights

(unaudited)

	Six Months Ended June 30, 2016		Six Months Ended June 30, 2015	
Per Share Data				
Net asset value at beginning of the period	\$0.72		\$0.94	
Net investment loss	(0.01)	0.00	
Net realized and unrealized losses	(0.02)	(0.03)
Net asset value at end of period	\$0.69		\$0.91	
Ratio / Supplemental Data				
Per share market value of investments at end of period	\$0.47		\$0.59	
Shares outstanding at end of period	12,151,493		12,151,493	
Average weighted shares outstanding for period	12,151,493		12,151,493	
Net assets at end of period	\$8,365,165		\$11,086,311	
Average net assets ⁽¹⁾	\$8,670,320		\$11,525,839	
Portfolio turnover rate ⁽²⁾	11.90	%	12.52	%
Ratio of operating expenses to average net assets ⁽²⁾	(6.63)%	(2.49)%
Ratio of net investment income to average net assets ⁽²⁾	(2.86)%	0.07	%
Ratio of realized gains to average net assets ⁽²⁾	(12.02)%	5.07	%

⁽¹⁾ Based on the monthly average of net assets as of the beginning and end of each period presented.

⁽²⁾ Ratios are annualized.

See accompanying notes to financial statements.

Mill City Ventures III, Ltd

Schedule of Investments

As of June 30, 2016

Investments (1)	Investment Type	Interest Rate (2)	Maturity Date	Principal Amount	Cost	Fair Value	Percentage of Net Assets	Gross Unrealized Appreciation (Depreciation)	Gross Unrealized Appreciation (Depreciation)	Net Unrealized Appreciation (Depreciation)
Debt										
Investments										
Advertising										
Creative Realities, Inc.	Secured Loan (3)	12% cash + 2% pik	4/15/2017	\$ 606,000	\$ 606,000	\$ 606,000	7.24 %	—	—	—
Consumer Mix 1 Life, Inc.	Secured Loan (4)	12%	2/6/2016	\$ 500,000	500,000	500,000		—	—	—
Mix 1 Life, Inc.	Secured Loan	12%	3/13/2016	\$ 250,000	250,000	250,000		—	—	—
					750,000	750,000	8.97 %	—	—	—
Financial										
Bravo Financial LLC	Secured Loan	12%	12/31/2015	\$ 500,000	500,000	500,000	5.98 %	—	—	—
Oil & Gas Dala Petroleum, Inc.	Secured Loan	12%	12/31/2015	\$ 25,000	25,000	0		—	25,000	(25,000)
	Secured Loan	12%	12/22/2016	\$ 35,195	35,195	0		—	35,195	(35,195)
					60,195	0	0.00 %	—	60,195	(60,195)
Total Debt Investments					\$ 1,916,195	\$ 1,856,000	22.19 %	—	\$ 60,195	\$(60,195)

Investments (1)	Investment Type (5)	Interest Rate (6)	Expiration Date (7)	Shares/Units	Cost	Fair Value	Percentage of Net Assets	Gross Unrealized Appreciation	Gross Unrealized Depreciation	
Equity Investments										
Advertising										
	Warrants (8)	n/a	12/28/2020	1,071,429	—	—		—	—	

Edgar Filing: Mill City Ventures III, Ltd - Form 10-Q

Creative Realities, Inc.									
Creative Realities, Inc.	Common Stock ⁽⁸⁾	n/a	n/a	975,000	—	170,527		170,527	—
					—	170,527	2.04 %	170,527	—
Bio-technology									
Bio Life Solutions, Inc.	Warrants ⁽⁸⁾	n/a	3/20/2021	100,000	—	—		—	—
Combimatrix Corporation	Warrants ⁽⁸⁾	n/a	5/6/2019	5,464	—	—		—	—
Combimatrix Corporation	Warrants ⁽⁸⁾	n/a	6/28/2019	5,464	—	—		—	—
Combimatrix Corporation	Warrants ⁽⁸⁾	n/a	12/19/2018	16,666	—	—		—	—
					—	—	0.00 %	—	—
Consumer									
Escalade Inc.	Common Stock	n/a	n/a	7,929	93,975	81,193		—	12,782
Mix 1 Life, Inc.	Common Stock ⁽⁸⁾	n/a	n/a	202,070	—	56,580		56,580	—
Tzfat Spirits of Israel, LLC	LLC Membership Units ⁽⁸⁾	n/a	n/a	55,000	101,019	25,000		—	76,019
					194,994	162,773	1.95 %	56,580	88,801
Education									
Nat'l Amer. Univ. Holdings, Inc.	Common Stock	n/a	n/a	38,005	77,053	77,530	0.93 %	521	44
Financial									
Comm. Sales & Leasing	Common Stock ⁽⁹⁾	n/a	n/a	2,000	65,620	57,800		—	7,820
OTC Markets Group Cl A	Common Stock	n/a	n/a	19,074	297,381	314,721		17,422	82
QC Holdings, Inc.	Common Stock ⁽⁸⁾	n/a	n/a	15,000	10,655	14,130		3,475	—
					373,656	386,651	4.62 %	20,897	7,902
Healthcare									
Sequenom Inc.	Common Stock ⁽⁸⁾	n/a	n/a	20,000	29,222	18,274		—	10,948
WaferGen Bio-Systems, Inc.	Common Stock ⁽⁸⁾	n/a	n/a	149,900	149,900	123,083		—	26,817
WaferGen Bio-Systems, Inc.	Warrants ⁽⁸⁾	n/a	10/21/2020	200,000	—	—		—	—
					179,122	141,357	1.69 %	—	37,765
Information Technology									
Insite Software Solutions, Inc	Warrants ⁽⁸⁾	n/a	12/30/2023	108,960	—	—		—	—
MAX 4G	Preferred Stock ⁽⁸⁾	n/a	n/a	300,000	150,000	300,000		150,000	—
Mitek Systems Inc.	Common Stock ⁽⁸⁾	n/a	n/a	7,772	50,540	55,259		4,719	—

Edgar Filing: Mill City Ventures III, Ltd - Form 10-Q

Simulations Plus, Inc.	Common Stock	n/a	n/a	18,639	173,310	140,907		—	32,402
					373,850	496,166	5.93 %	154,719	32,402
Investment Fund									
Calamos Conv. & High Inc. Fund	Common Stock ⁽⁹⁾	n/a	n/a	10,000	128,357	106,100		—	22,257
Solar Senior Capital Ltd.	Common Stock ⁽⁹⁾	n/a	n/a	6,047	91,983	97,417		5,434	—
					220,340	203,517	2.43 %	5,434	22,257
Leisure & Hospitality									
Bitesquad.com LLC	Preferred LLC Units ⁽⁴⁾ ⁽⁸⁾	n/a	n/a	60,000	780,000	780,000	9.32 %	—	—
Media									
Discovery Communications Inc.	Common Stock ⁽⁹⁾	n/a	n/a	5,000	149,609	126,150	1.51 %	—	23,459
Oil & Gas									
Dala Petroleum, Inc.	Preferred Stock ⁽⁸⁾	n/a	n/a	500	500,000	—		—	500,000
	Warrants ⁽⁸⁾	n/a	6/3/2017	714,286	—	—		—	—
Northern Capital Partners I, LP	Ltd Partnership Units ⁽⁸⁾	n/a	n/a	500,000	500,000	374,410		—	125,590
Southern Plains Resources, Inc.	Common Stock ⁽⁸⁾	n/a	n/a	600,000	730,000	—		—	730,000
					1,730,000	374,410	4.48 %	—	1,355,590
Publishing									
Educational Development Corp.	Common Stock	n/a	n/a	36,905	409,380	428,467	5.12 %	36,765	17,679
Telecommunications									
AT&T	Common Stock ⁽⁹⁾	n/a	n/a	5,000	175,260	216,050		40,790	—
CenturyLink, Inc.	Common Stock ⁽⁹⁾	n/a	n/a	5,000	157,360	145,050		—	12,310
MagicJack VocalTek Ltd.	Common Stock ⁽⁸⁾ ⁽⁹⁾	n/a	n/a	5,754	34,141	36,193		2,052	—
Tessco Technologies Inc.	Common Stock	n/a	n/a	5,000	83,090	69,450		—	13,640
Windstream Holdings Inc.	Common Stock ⁽⁹⁾	n/a	n/a	1,666	21,087	15,444		—	5,643
					470,938	482,187	5.76 %	42,842	31,593
Total Equity Investments					\$4,958,942	\$3,829,735	45.78 %	\$488,285	\$1,617,415
Total Cash, Restricted Cash and Cash Equivalents					\$2,579,366	\$2,579,366	30.83 %	—	—

Total Investments, Cash, Restricted Cash and Cash Equivalents	\$9,454,503	\$8,265,101	98.80%	\$488,285	\$1,677,
--	-------------	-------------	--------	-----------	----------

- (1) All investments and all cash, restricted cash and cash equivalents are “qualifying assets” under Section 55(a) of the Investment Company Act of 1940 unless indicated to the contrary in the table or by footnote.
- (2) Interest is presented on a per annum basis.
- (3) Investment is secured but payment and collateral are subordinated to the debt of another creditor by contract.
- (4) Investment is convertible into common equity of the issuer.
- (5) In the case of warrants, warrants provide for the right to purchase common equity of the issuer.
- (6) In the case of preferred stock, this represents the right to annual cumulative dividends calculated on a per annum basis.
- (7) In the case of warrants, purchase rights under the warrants will expire at the close of business on this date.
- (8) Investment is not an income-producing investment.
- (9) Investment is not a “qualifying asset” under Section 55(a) of the Investment Company Act of 1940,.

Mill City Ventures III, Ltd
Schedule of Investments
As of December 31, 2015

Investments (1)	Investment Type	Interest Rate ⁽²⁾	Maturity Date	Principal Amount	Cost	Fair Value	Percentage of Net Assets	Gross Unrealized Appreciation	Gross Unrealized Depreciation	Net Unrealized Appreciation (Depreciation)
Debt Investments										
Advertising Creative Realities, Inc.	Secured Loan ⁽³⁾	12% cash + 2% pik	4/15/2017	\$ 600,000	\$ 600,000	\$ 600,000	6.86 %	—	—	—
Consumer Mix 1 Life, Inc.	Secured Loan ⁽⁴⁾	12%	2/6/2016	\$ 500,000	500,000	500,000		—	—	—
Mix 1 Life, Inc.	Secured Loan	12%	3/13/2016	\$ 250,000	250,000	250,000		—	—	—
					750,000	750,000	8.58 %	—	—	—
Financial Bravo Financial LLC	Secured Loan	12%	12/31/2015	\$ 500,000	500,000	500,000	5.72 %	—	—	—
Leisure & Hospitality The Igloo LLC	Secured Loan	20%	12/31/2016	500,000	500,000	—	0.00 %	—	500,000	(500,000)
Oil & Gas Dala Petroleum, Inc.	Secured Loan	12%	12/22/2016	\$ 5,195	5,195	—		—	5,195	(5,195)
Pacific Oil & Gas LLC	Secured Loan	12%	12/31/2015	\$ 25,000	25,000	—		—	25,000	(25,000)
					30,195	—	0.00 %	—	30,195	(30,195)
Total Debt Investments					\$ 2,380,195	\$ 1,850,000	21.16 %	—	\$ 530,195	(\$ 530,195)

Investments ⁽¹⁾	Investment Type ⁽⁵⁾	Interest Rate ⁽⁶⁾	Expiration Date ⁽⁷⁾	Shares/Units	Cost	Fair Value	Percentage of Net Assets	Gross Unrealized Appreciation	Gross Unrealized Depreciation
-----------------------------------	---	---	---	---------------------	-------------	-------------------	---	--	--

Equity Investments

Edgar Filing: Mill City Ventures III, Ltd - Form 10-Q

Advertising Creative Realities, Inc.	Warrants ⁽⁸⁾	n/a	12/28/2020	1,071,429	—	—	—	—
Creative Realities, Inc.	Common Stock ⁽⁸⁾	n/a	n/a	975,000	—	243,750	243,750	—
					—	243,750	2.79 %	243,750
Bio-technology Bio Life Solutions, Inc.	Warrants ⁽⁸⁾	n/a	3/20/2021	100,000	—	—	—	—
Combimatrix Corporation	Warrants ⁽⁸⁾	n/a	5/6/2019	81,967	—	—	—	—
Combimatrix Corporation	Warrants ⁽⁸⁾	n/a	6/28/2019	81,967	—	—	—	—
Combimatrix Corporation	Warrants ⁽⁸⁾	n/a	12/19/2018	250,000	—	—	0.00 %	—
Consumer Mix 1 Life, Inc.	Common Stock ⁽⁸⁾	n/a	n/a	237,470	—	237,470	237,470	—
Tzfat Spirits of Israel, LLC	LLC Membership Units ⁽⁸⁾	n/a	n/a	55,000	101,019	25,000	—	76,019
					101,019	262,470	3.00 %	237,470
Financial Comm. Sales & Leasing Healthcare WaferGen Bio-Systems, Inc.	Common Stock ⁽⁹⁾	n/a	n/a	2,000	65,620	37,380	0.43 %	—
WaferGen Bio-Systems, Inc.	Common Stock ⁽⁸⁾	n/a	n/a	200,000	200,000	146,760	—	53,240
WaferGen Bio-Systems, Inc.	Warrants ⁽⁸⁾	n/a	10/21/2020	200,000	—	—	—	—
					200,000	146,760	1.68 %	53,240
Information Technology Insite Software Solutions, Inc	Warrants ⁽⁸⁾	n/a	12/30/2023	108,960	—	—	—	—
MAX 4G	Preferred Stock ⁽⁸⁾	n/a	n/a	300,000	150,000	300,000	150,000	—
Simulations Plus, Inc.	Common Stock	n/a	n/a	5,000	47,869	49,550	1,681	—
					197,869	349,550	4.00 %	151,681
Investment Fund Calamos Conv. & High Inc. Fund Powershares High Dividend Yield	Common Stock ⁽⁹⁾	n/a	n/a	10,000	128,357	105,100	—	23,257
Solar Senior Capital Ltd	Common Stock ⁽⁹⁾	n/a	n/a	10,000	253,510	210,000	—	43,510
				6,047	91,983	90,100	—	1,883
					473,850	405,200	4.64 %	68,650
Leisure & Hospitality								

Edgar Filing: Mill City Ventures III, Ltd - Form 10-Q

Bitesquad.com LLC	Preferred LLC Units ⁽⁴⁾	n/a	n/a	60,000	780,000	780,000	8.92 %	—	—
DBR Phase III US Investors, LLC	Limited Partnership Units ⁽⁸⁾	n/a	n/a	761,050	761,050	761,050	8.71 %	—	—
					1,541,050	1,541,050	17.63 %	—	—
Media Discovery Communications Inc.	Common Stock ⁽⁹⁾	n/a	n/a	5,000	149,609	133,400	1.53 %	—	16,200
Oil & Gas Dala Petroleum, Inc.	Preferred Stock ⁽⁸⁾	n/a	n/a	500	500,000	—	—	—	500,000
	Warrants ⁽⁸⁾	n/a	6/3/2017	714,286	—	—	—	—	—
Northern Capital Partners I, LP	Limited Partnership Units ⁽⁸⁾	n/a	n/a	500,000	500,000	444,208	—	—	55,792
Southern Plains Resources, Inc.	Common Stock ⁽⁸⁾	n/a	n/a	600,000	730,000	—	—	—	730,000
					1,730,000	444,208	5.08 %	—	1,285,792
Publishing Educational Development Corp.	Common Stock	n/a	n/a	2,300	25,212	25,461	0.29 %	249	—
Telecommunications AT&T	Common Stock ⁽⁹⁾	n/a	n/a	5,000	175,260	172,050	—	—	3,210
CenturyLink, Inc.	Common Stock ⁽⁹⁾	n/a	n/a	5,000	157,360	125,800	—	—	31,560
Windstream Holdings Inc.	Common Stock ⁽⁹⁾	n/a	n/a	1,666	21,087	10,729	—	—	10,358
					353,707	308,579	3.53 %	—	45,125
Total Equity Investments					\$4,837,936	\$3,897,808	44.59 %	\$633,150	\$1,573,278
Total Cash, Restricted Cash and Cash Equivalents					\$2,980,659	\$2,980,659	34.10 %	—	—
Total Investments, Cash, Restricted Cash and Cash Equivalents					\$10,198,790	\$8,728,467	99.85 %	\$633,150	\$2,103,278

Edgar Filing: Mill City Ventures III, Ltd - Form 10-Q

- (1) All investments and all cash, restricted cash and cash equivalents are “qualifying assets” under Section 55(a) of the Investment Company Act of 1940 unless indicated to the contrary in the table or by footnote.
- (2) Interest is presented on a per annum basis.
- (3) Investment is secured but payment and collateral are subordinated to the debt of another creditor by contract.
- (4) Investment is convertible into common equity of the issuer.
- (5) In the case of warrants, warrants provide for the right to purchase common equity of the issuer.
- (6) In the case of preferred stock, this represents the right to annual cumulative dividends calculated on a per annum basis.
- (7) In the case of warrants, purchase rights under the warrants will expire at the close of business on this date.
- (8) Investment is not an income-producing investment.
- (9) Investment is not a “qualifying asset” under Section 55(a) of the Investment Company Act of 1940.

Mill City Ventures III, Ltd.

Notes to Financial Statements

June 30, 2016

NOTE 1—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Operations and Basis of Presentation

Mill City Ventures III, Ltd. (the “Company”) is an investment company that was incorporated in the State of Minnesota on January 10, 2006.

We are regulated as a BDC and plan to be taxed as a regulated investment company, although we currently have not elected this tax status. As a BDC, we primarily focus on investing in or lending to privately held and publicly traded companies and making managerial assistance available to such companies. A BDC may provide shareholders with the ability to retain the liquidity of a publicly traded stock, while sharing in the possible benefits of investing in emerging-growth or expansion stage companies. Our future revenues will relate to the earnings we receive from the sale of securities, dividends and interest from our portfolio investments. Our objective is to obtain returns from investments in securities and other investment opportunities available to business development companies under the 1940 Act. We intend to invest capital in portfolio companies for purposes of financing acquisitions, recapitalizations, buyouts, organic growth and working capital. Buyouts generally include transactions that involve the acquisition of a controlling interest in an entity, either by management or other investors. Organic growth refers to growth through the internal operations of the company, through investments in marketing initiatives, capital expenditures or other internal growth initiatives, rather than growth by means of an acquisition. We plan to identify potential investments through multiple sources, including private equity sponsors, investment bankers, brokers, and owners and operators of businesses. We will base our investment decisions on analyses of potential customers’ business operations and asset valuations as well as financing structure, utilizing risk management methods, pricing tools, due diligence methodologies and data management processes designed to help us assess risk, establish appropriate pricing, and maximize our return on investment. Subject to regulations set forth in the 1940 Act and applicable to BDCs, we plan to invest in private companies, small-cap public stocks, notes and other forms of debt, investment contracts, and other investments commonly referred to as securities.

Interim Financial Information

The balance sheet as of December 31, 2015, which has been derived from audited financial statements, and the unaudited interim condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States and pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") for interim financial information. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been omitted pursuant to such rules and regulations. Operating results for the six months ended June 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016 or any other period. The accompanying financial statements and related notes should be read in conjunction with our audited financial statements and notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2015. The financial information furnished in this report is unaudited and reflects all adjustments which are normal recurring adjustments and, which in the opinion of management, are necessary to fairly present the results of the interim periods presented in order to make the financial statements not misleading.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management and our independent board members to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of expenses during the reporting period. Actual results could differ from those estimates.

Cash Deposits

The Company maintains its cash balances in financial institutions and with regulated financial investment brokers. Cash on deposit in excess of FDIC and similar coverage is subject to the usual banking risk of funds in excess of those limits.

Fair Value of Financial Instruments

The carrying amounts of certain of the Company's financial instruments, including cash, receivable from sale of investments, interest and dividends receivable, prepaid expenses, accounts payable and notes payable approximate fair value due to their relatively short maturities.

In the normal course of business, the Company may utilize derivative financial instruments (principally options) in connection with its trading activities. The Company records its derivative activities at fair value. Gains and losses from derivative financial instruments are included in net gain (loss) on investments in the statement of operations.

Investment Valuation

Investment transactions are recorded on the trade date. Realized gains or losses on investments are measured by the difference between the net proceeds from the repayment or sale and the amortized cost basis of the investment without regard to unrealized gains or losses on investments previously recognized, and include investments charged off during the period, net of recoveries. Unrealized gains or losses on investments primarily reflect the change in investment values, including the reversal of previously recorded unrealized gains or losses when gains or losses are realized.

Investments for which market quotations are readily available are typically valued at such market quotations. In order to validate market quotations, we look at a number of factors to determine if the quotations are representative of fair value, including the source and nature of the quotations. Debt and equity securities that are not publicly traded or whose market prices are not readily available are valued at fair value as determined in good faith by our Board of Directors or the Valuation Committee of the board, based on, among other things, the input of our executive management, audit committee and independent third-party valuation expert that may be engaged by management to assist in the valuation of our portfolio investments, but in all cases consistent with our written valuation policies and procedures.

Due to the inherent uncertainty of determining the fair value of investments that do not have a readily available market value, the fair value of our investments may fluctuate from period to period. Additionally, the fair value of our investments may differ significantly from the values that would have been used had a ready market existed for such investments and may differ materially from the values that we may ultimately realize. Further, such investments are generally less liquid than publicly traded securities. If we were required to liquidate a portfolio investment in a forced or liquidation sale, we could realize significantly less than the value at which we have recorded it.

In addition, changes in the market environment and other events that may occur over the life of the investments may cause the gains or losses ultimately realized on these investments to be different than the unrealized gains or losses reflected in the valuations currently assigned.

Allocation of Net Gains and Losses

All income, gains, losses, deductions and credits for any investment are allocated in a manner proportionate to the shares owned.

Income Taxes

The Company accounts for income taxes under the liability method. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized.

Realized Gains and Losses, Interest and Dividend Income Recognition

Realized gains or losses on the sale of investments are calculated using the specific investment method.

Interest income is recorded on an accrual basis and includes the accretion of discounts and amortization of premiums. Discounts from and premiums to par value on securities purchased are accreted/amortized into interest income over the life of the respective security using the effective yield method. The amortized cost of investments represents the original cost adjusted for the accretion of discounts and amortization of premiums, if any.

Loans are generally placed on non-accrual status when principal or interest payments are past due 30 days or more or when there is reasonable doubt that principal or interest will be collected in full. Accrued and unpaid interest is generally reversed when a loan is placed on non-accrual status. Interest payments received on non-accrual loans may be recognized as income or applied to principal depending upon management's judgment regarding collectability. Non-accrual loans are restored to accrual status when past due principal and interest is paid and, in management's judgment, are likely to remain current. The Company may make exceptions to this if the loan has sufficient collateral value and is in the process of collection.

Dividend income on preferred equity securities is recorded as dividend income on an accrual basis to the extent that such amounts are payable by the portfolio company and are expected to be collected. Dividend income on common equity securities is recorded on the record date for private portfolio companies or on the ex-dividend date for publicly traded portfolio companies.

Our investment portfolio investments at June 30, 2016 and December 31, 2015 were \$5,685,735 and \$5,747,808, respectively.

Management and Service Fees

We do not incur expenses related to management and service fees. Our executive management team manages the Company's investments as part of their employment responsibilities.

Recent Accounting Pronouncements

No other new accounting pronouncement issued or effective during the fiscal quarter has had or is expected to have a material impact on the condensed financial statements.

NOTE 2—NET LOSS PER COMMON SHARE

Basic net loss per common share is computed by dividing net loss by the weighted average number of vested common shares outstanding during the period. A reconciliation of the numerator and denominator used in the calculation of basic and diluted net gain (loss) per common share follows:

	For the Three Months Ended June 30,	
	2016	2015
Numerator: Net Decrease in Net Asset Value Resulting from Operations	\$(355,283)	\$(540,558)
Denominator: Weighted-average number of common shares outstanding	12,151,493	12,151,493
Basic and diluted net loss per common share	\$(0.03)	\$(0.04)

	For the Six Months Ended June 30,	
	2016	2015
Numerator: Net Decrease in Net Asset Value Resulting from Operations	\$(376,123)	\$(387,379)
Denominator: Weighted-average number of common shares outstanding	12,151,493	12,151,493
Basic and diluted net loss per common share	\$(0.03)	\$(0.03)

At June 30, 2016 and 2015, the Company did not have any options or warrants outstanding or any other dilutive common equivalent shares.

NOTE 3—COMMITMENTS AND CONTINGENCIES

We have an agreement to lease approximately 1,917 square feet of commercial space and two parking spots, for a period of 62 months. The 62-month lease term began October 1, 2013 and runs through November 30, 2018. The total rent expense for the three and six month periods ended June 30, 2016 was \$14,428 and \$38,604.

The following is a schedule of the required annual minimum lease payments.

Year	Amount
2016	\$23,655
2017	50,311
2018	46,988
TOTAL	\$120,954

NOTE 4—SHAREHOLDERS' EQUITY

Common stock

At June 30, 2016, a total of 12,151,493 shares of common stock were issued and outstanding.

NOTE 5—FAIR VALUE OF INVESTMENTS

Investment Risks

Our investments are subject to a variety of risks. Those risks include the following:

Market Risk

Market risk represents the potential loss that can be caused by a change in the fair value of the instrument.

Credit Risk

Credit risk represents the risk that the Company would incur if the counterparties failed to perform pursuant to the terms of their agreements with the Company.

Fair Value Hierarchy

The fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels is explained below:

Level 1

Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that we have the ability to access. Valuation adjustments are not applied to Level 1 securities. Because valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these securities does not entail a significant degree of judgment.

Level 2

Pricing inputs are other than used in Level 1, which include the closing bid price for unlisted marketable securities, which are available in active or inactive markets for identical investments or liabilities, other direct or indirect observable inputs that can be corroborated by market data or the use of models or other valuation methodologies as of the reporting date.

Level 3

Pricing inputs are unobservable for the investment and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require significant management judgment or estimation.

The tables below presents the balances of assets measured at fair value:

	As of June 30, 2016			Total
	Level 1	Level 2	Level 3	
AT&T	\$216,050	\$ -	\$-	\$216,050
Calamos Convertible & High Income Fund	106,100	-	-	106,100
CenturyLink, Inc.	145,050	-	-	145,050
Communication Sales & Leasing, Inc.	57,800	-	-	57,800
Discovery Communications Corporation	126,150	-	-	126,150
Educational Development Corp.	428,467	-	-	428,467
Escalade Inc.	81,193	-	-	81,193
Mix 1 Life, Inc.	56,580	-	-	56,580
MagicJack VocalTek Ltd.	36,193	-	-	36,193
Mitek Systems Inc.	55,259	-	-	55,259
National American University Holdings, Inc.	77,530	-	-	77,530
OTC Markets Group, Inc. Cl A	314,721	-	-	314,721
QC Holdings, Inc.	14,130	-	-	14,130
Sequenom Inc.	18,274	-	-	18,274
Simulations Plus Inc.	140,907	-	-	140,907
Solar Senior Capital Ltd	97,417	-	-	97,417
Tessco Technologies Inc.	69,450	-	-	69,450
WaferGen Bio-Systems	123,083	-	-	123,083
Windstream Holdings Inc.	15,444	-	-	15,444

Edgar Filing: Mill City Ventures III, Ltd - Form 10-Q

Bitesquad.com, LLC	-	-	780,000	780,000
Bravo Financial, LLC	-	-	500,000	500,000
Southern Plains Resources, Inc.	-	-	-	-
MAX 4G, Inc.	-	-	300,000	300,000
Tzfat Spirits of Israel, LLC	-	-	25,000	25,000
Mix 1 Life, Inc.	-	-	500,000	500,000
Mix 1 Life, Inc.	-	-	250,000	250,000
Dala Petroleum Inc.	-	-	-	-
Northern Capital Partners I, LP	-	-	374,410	374,410
Creative Realities, Inc.	170,527	-	-	170,527
Creative Realities, Inc.	-	-	606,000	606,000
Total	\$2,350,325	\$ -	\$3,335,410	\$5,685,735

The changes in Level 3 assets and liabilities measured at fair value on a recurring basis are summarized as follows:

Fair value, December 31, 2015	Fair Value
Total realized loss, net	\$4,160,258
Change in unrealized appreciation	(485,000)
Net realized and unrealized gain	400,202
Purchases of portfolio investments	(84,798)
Sale of portfolio investments	30,000
Payment in kind interest	(776,050)
Fair value, June 30, 2016	6,000
Net unrealized gains included in the net increase in net assets resulting from operations relating to assets held at June 30, 2016	\$3,335,410
	\$(84,798)

	As of June 30, 2015			
	Level 1	Level 2	Level 3	Total
AT&T	\$177,600	\$ -	\$-	\$177,600
Calamos Convertible & High Income Fund	132,900	-	-	132,900
CenturyLink, Inc.	146,900	-	-	146,900
Communication Sales & Leasing, Inc.	49,440	-	-	49,440
Discovery Communications Corp.	166,300	-	-	166,300
Hi Crush Partners, LP	153,450	-	-	153,450
Windstream Holdings, Inc.	10,629	-	-	10,629
Solar Senior Capital Ltd	95,361	-	-	95,361
Powershares High Yield Dividend Fund	241,500	-	-	241,500
Pacific Oil & Gas, Inc.	-	-	25,000	25,000
Southern Plains Resources, Inc.	-	-	150,000	150,000
Max 4G	-	-	150,000	150,000
Tzfat Spirits of Israel, LLC	-	-	25,000	25,000
DBR Phase III US Investors, LLC	-	-	1,000,000	1,000,000
Mix 1 Life, Inc. Convertible Note	-	-	500,000	500,000
Mix 1 Life, Inc. Promissory Note	-	-	250,000	250,000
Mix 1 Life, Inc. Common Stock	1,460,523	-	-	1,460,523
Dala Petroleum Inc.	-	-	500,000	500,000
The Igloo, LLC	-	-	500,000	500,000
Creative Realities, Inc.	-	-	1,000,000	1,000,000
Northern Capital Partners I, LP	-	-	444,208	444,208
Total	\$2,634,603	\$ -	\$4,544,208	\$7,178,811

The changes in Level 3 assets and liabilities measured at fair value on a recurring basis are summarized as follows:

	Fair Value
Fair value, December 31, 2014	\$4,225,000
Change in unrealized appreciation	(205,792)
Net realized and unrealized loss	(205,792)
Purchases of portfolio investments	1,275,000
Sales of portfolio investments	(750,000)
Fair value, June 30, 2015	\$4,544,208
Net unrealized losses included in the net increase in net assets resulting from operations relating to assets	\$(205,792)

Level 3 Valuation Information

The estimated fair value of our Level 3 investments is determined on a quarterly basis by the Valuation Committee of our Board of Directors, pursuant to our Valuation Policy and Procedures. These policies and procedures generally require that we value our Level 3 equity investments at cost plus any accrued interest unless circumstances warrant a different approach. Our Valuation Policy and Procedures provide examples of these circumstances, such as when a portfolio company has engaged in a subsequent financing of more than a *de minimis* size involving sophisticated investors (in which case we may use the price involved in that financing as a determinative input absent other known factors), or when a portfolio company is engaged in the process of a transaction that we determine is reasonably likely to occur (in which case we may use the price involved in the pending transaction as a determinative input absent other known factors). Other situations identified in our Valuation Policy and Procedures that may serve as input supporting a change in the valuation of our Level 3 equity investments include (i) a third-party valuation conducted by an independent and qualified professional, (ii) changes in the performance of long-term financial prospects of the portfolio company, (iii) a subsequent financing that changes the distribution rights associated with the equity security held by the Company, or (iv) sale transactions involving comparable companies but only if further supported by a third-party valuation conducted by an independent and qualified professional.

When valuing preferred equity investments, we generally view intrinsic value as a key input. Intrinsic value means the value of any conversion feature (if the preferred investment is convertible) or the value of any liquidation or other preference. Discounts to intrinsic value may be applied in cases where the issuer's financial condition is impaired or, in cases where intrinsic value relating to a conversion is determined to be a key input, for resale restrictions would apply to the securities issued upon conversion.

When valuing warrants, our Valuation Policy and Procedures indicate that value will generally be the difference between closing price of the underlying equity security and the exercise price, after applying an appropriate discount for restriction, if applicable, in situations where the underlying security is marketable. If the underlying security is not marketable, then intrinsic value will be considered consistent with the principles described above. Generally, “out-of-the-money” warrants will be valued at cost or zero.

For non-traded (Level 3) debt securities with a residual maturity less than or equal to 60 days, the value will generally be the straight-line amortized face value of the debt unless justification for impairment exists.

No changes have been made to our Valuation Policy and Procedures during the reporting period.

Portfolio Investments

At June 30, 2016, we held investments in 22 eligible portfolio investments, which had an amortized cost of \$6,051,720 and a fair value of \$4,885,531. At December 31, 2015, we held investments in 18 eligible portfolio investments, which had an amortized cost of \$6,175,345 and a fair value of \$4,863,249.

On March 6, 2013, we entered into a purchase and sale agreement with Mill City Ventures II, LP, wherein we purchased 400,000 shares of Southern Plains Resources, Inc. (“Southern Plains”) common stock from Mill City Ventures II, LP for \$420,000. On July 11, 2013, we entered into a subscription agreement with Southern Plains through a private placement of common stock to purchase an additional 200,000 shares of common stock at \$1.55 per share for \$310,000. Our cost of the Southern Plains investment at June 30, 2016 was \$730,000 and the fair value was \$0.

On May 3, 2013, we entered into a securities purchase agreement with CombiMatrix Corporation (“CombiMatrix”) to purchase Series C convertible preferred stock and warrants in two separate closings. In the May 6, 2013 closing, we purchased 200 shares of Series C preferred stock convertible into common stock at \$2.86 per share and warrants to purchase up to 81,967 common shares at an exercise price of \$3.77 per share. In the June 28, 2013 closing, we purchased 200 shares of Series C preferred stock convertible into common stock at \$2.86 per share and warrants to purchase up to 81,967 common shares at an exercise price of \$3.55 per share. On August 9, 2013, we converted 100 shares of the Series C preferred stock into 34,994 shares of CombiMatrix common stock at \$2.86 per share and an additional 207 shares of common stock were issued in lieu of accrued dividend on the converted principal amount. On November 21, 2013, we converted 300 shares of the series C preferred stock into 104,983 shares of CombiMatrix common stock at \$2.86 per share and an additional 3,710 shares of common stock were issued in lieu of accrued dividend on the converted principal balance. On December 18, 2013, we purchased 515 shares of Series D convertible

preferred stock of CombiMatrix for \$1,000 per share for a total purchase price of \$515,000 together with a warrant to purchase up to 250,000 shares of common stock at an exercise price of \$3.12 per share. Each Series D preferred share is convertible into common stock at \$2.06 per share. The warrant has an expiration date of December 18, 2018. On December 19, 2013, we converted all of our Series D preferred shares into 250,000 shares of common stock. During the quarter ended March 31, 2014, we sold 204,850 shares of the common stock for \$615,394, resulting in a realized gain of \$193,403. During the quarter ended September 30, 2014, we sold the remaining 45,150 shares of the common stock for \$61,252, resulting in a realized loss of \$31,756. On February 13, 2015, CombiMatrix decreased the exercise price of all the 81,967 warrants issued in connection with the Series C preferred to \$1.97 per share. The decrease was made in accordance with anti-dilution price-protection provisions in the warrants. On February 1, 2016 CombiMatrix affected a 1-for-15 share reverse split. On a post-split basis, our two warrants for 81,976 shares (issued in connection with the Series C preferred stock) each became warrants to purchase 5,464 shares at an exercise price of \$29.55 and the warrant for 250,000 shares (issued in connection with the Series D preferred stock) became a warrant to purchase 16,666 shares at an exercise price of \$46.80. At June 30, 2016, the cost and fair value of the warrants was \$0.

On May 29, 2013, we entered into a subscription and investment letter with MAX4G, Inc. ("MAX4G") to purchase 300,000 shares of MAX4G's Series B convertible preferred stock, at \$0.50 per share, for a total of \$150,000. At June 30, 2016, the cost of the MAX4G investment was \$150,000 and the fair value was \$300,000.

On October 14, 2013, we entered into subscription agreement with Tzfat Spirits of Israel, LLC (“Tzfat”), to purchase 55,000 Class A membership units at \$1.8367 per unit for a total of \$101,019. At June 30, 2016, the cost and fair value of the Tzfat investment was \$101,019 and \$25,000, respectively.

On December 30, 2013, we purchased a \$750,000 promissory note from Insite Software Solutions, Inc. (“Insite Software”) and received a warrant to purchase 108,960 shares of Insite common stock at \$0.01 per share. The warrant has a 10-year term expiring December 30, 2023. On April 27, 2015, we received the principal amount of \$750,000 plus \$5,825.34 in accrued interest in full payment of amounts owing under the promissory note. At June 30, 2016, the cost and fair value of the warrant was \$0.

On February 6, 2014, we purchased a \$500,000 senior secured convertible promissory note from Mix 1 Life, Inc. (“Mix 1 Life”) and received a five-year warrant to purchase up to 1,600,000 shares of Mix 1 common stock at \$0.50 per share. The note currently is convertible into shares of common stock at \$1.08 per share after giving effect to the 1-for-3 share reverse split effected September 11, 2014. On August 7, 2014, we elected to exercise, on a cashless basis, our warrants and convert them into 1,121,912 shares of common stock. On September 11, 2014, Mix 1 affected a 1-for-3 share reverse split on its common stock, reducing our holdings to 373,971 common shares. At June 30, 2016, the cost and fair value of the promissory note was \$500,000 and the cost and fair value of the common stock was \$0 and \$56,580, respectively. Our former director, Christopher Larson, is currently the Chief Financial Officer and a director of Mix 1 as well as a 5% shareholder of that company. Mr. Larson was appointed the Chief Financial Officer and a director of Mix 1 on June 24, 2014, after our initial investment in Mix 1. On March 13, 2015, we purchased a 12% senior secured promissory note from Mix 1 in the principal amount of \$250,000, with 12 months of interest prepaid by Mix 1. The note was due on March 13, 2016. At June 30, 2016, the cost and fair value of the note was \$250,000. We have agreed in principle to extend both notes (\$500,000 and \$250,000) owed by Mix 1. Thus far, Mix 1 is current on agreed-upon interest payments through June 30, 2016.

On February 7, 2014, we purchased a \$1,000,000 promissory note from DBR Phase III US Investors, LLC (“DBR Phase III”) and in connection therewith funded a first capital call of \$350,000. We funded a second capital call of \$350,000 on May 9, 2014 and a final capital call on October 21, 2014 in the amount of \$300,000. On December 3, 2015, we received a \$238,950 principal payment plus \$90,389 of accrued interest. On January 22, 2016, we received \$434,195 from DBR Phase III, representing a \$418,750 principal payment plus \$15,445 of accrued interest. On March 22, 2016, we received a final and full payment on the note from DBR Phase III for \$342,300 in principal and \$6,316 of accrued interest. The note and accrued interest have now been paid in full.

On June 3, 2014, we entered purchased 500 shares of Series A 6% convertible preferred stock from Dala Petroleum Corporation (“Dala”) at \$1,000 per share, for a total of \$500,000, and received a three-year warrant to purchase up to 714,286 shares of Dala common stock at an exercise price of \$1.35 per share. The preferred stock converts into common stock at \$0.70. On May 25, 2015, we entered into an agreement to defer the receipt of the quarterly dividend distribution on the preferred shares until October 1, 2015. Dala did not, however, make the prescribed payment and has subsequently notified us of its inability to make the payment. As a result, the deferred dividend of \$7,500 for each

of the quarters ended June 30, September 30, and December 31, 2015 was deemed uncollectible and removed from Dividend Income on the Statement of Operations as of December 31, 2015. At June 30, 2016, the cost and fair value of the preferred stock was \$500,000 and \$0, respectively, and the cost and fair value of the warrant was \$0. On March 18, 2016, we entered into an agreement with Dala Petroleum Corporation (“Dala”) whereby the original conversion price of the Series A convertible preferred stock was modified from \$0.70 to \$0.05.

On December 22, 2015 we purchased a \$5,195 promissory note with Dala Petroleum Corporation (“Dala”). The note bears interest at 12% and is due on December 22, 2016. On February 17, 2016, an additional \$30,000 promissory note was purchased, bearing 12% interest and due on February 17, 2017. At June 30, 2016 the cost and fair value of the note was \$35,195 and \$0.

On May 16, 2014, we entered into an agreement to purchase \$500,000 of limited partnership interests in Northern Capital Partners I, LP and in connection therewith funded a first capital call of \$50,000 on June 16, 2014, a second capital call of \$125,000 on August 26, 2014, a third capital call of \$200,000 on October 21, 2014, and the fourth and final capital call of \$125,000 on December 26, 2014. At June 30, 2016, the cost and fair value of the interests was \$500,000 and \$374,410 respectively.

On December 31, 2014, we purchased a \$500,000 promissory note from The Igloo, LLC (“The Igloo”). The Igloo no longer operates. On March 17, 2016, we entered into a Settlement and Forbearance Agreement involving Christopher M. Gnetz, Jr., the guarantor of the \$500,000 promissory note. The terms of the agreement provide that we forbear from commencing or continuing legal action to recover the debt until August 1, 2016, unless a forbearance event of defaults occurs under the agreement, and contemplates the assignment of our rights claims and interests against Mr. Gnetz and The Igloo to a third party in consideration for payments as follows: (i) \$15,000 by March 31, 2016 (ii) \$50,000 by May 1, 2016 and (iii) \$70,000 by August 1, 2016. On March 31, 2016, we received the \$15,000 first payment. The Company has recognized a \$485,000 realized loss on the settlement of this note. The settlement payments will be recorded upon receipt of cash, due to the uncertainty of receipt.

On February 19, 2015, we purchased a \$1,000,000 convertible note from Creative Realities, Inc. (“Creative Realities”). The note bears 12% annual interest paid monthly in arrears and is due August 18, 2016. The outstanding principal amount is convertible into common stock at \$0.33 per share. In connection with the financing, we received a five-year warrant to purchase up to 1,515,152 common shares at a conversion price of \$0.38 per share. On October 14, 2015, we received the principal amount of \$1,000,000 plus \$46,684.93 in accrued interest in full payment of amounts owing under the promissory note. On December 28, 2015, the warrants were exchanged for zero cost into 975,000 shares of common stock. At June 30, 2016, the cost and fair value of the common stock was \$0 and \$170,527, respectively.

On June 1, 2015, we purchased a 12% promissory note from Pacific Oil & Gas, LLC (“POG”) in principal amount of \$25,000. The note plus accrued interest was due on December 31, 2015. POG is a related entity to Dala Petroleum, another portfolio company. On May 6, 2016, the POG note was restated and became an obligation of Dala Petroleum, including all interest accrued to date. The restated note bears interest at 12% and is due on December 31, 2016. At June 30, 2016, the cost and fair value of the note was \$25,000 and \$0, respectively.

On August 31, 2015, we entered into an agreement with Bravo Financial, LLC (“Bravo”) to loan Bravo up to \$1,100,000 in principal amount. We funded a first advance in the amount of \$500,000 on September 1, 2015. The

associated promissory note bears 12% annual interest that is paid monthly in arrears and is due August 31, 2018. At June 30, 2016, the cost and fair value of the note was \$500,000.

On September 21, 2015, we purchased 60,000 shares of Series A convertible preferred stock from BiteSquad.com, LLC at \$13 per share, for a total of \$780,000. The preferred stock converts to common at \$13 per share. At June 30, 2016, the cost and fair value of the preferred stock was \$780,000.

On October 21, 2015, we purchased 200,000 shares of common stock of WaferGen Bio-Systems Inc. at \$1.00 per share, for a total of \$200,000. We also received a five-year warrant to purchase 200,000 common shares at \$1.44 per share. On March 8, 2016, we sold 100 shares of the common stock at a realized loss of \$40. On May 13, 2016 we sold 50,000 shares of the common stock at a realized loss of \$2,923. At June 30, 2016, the cost of the common stock was \$149,900 and fair value was \$123,083, and the cost and fair value of the warrant was \$0.

On December 24, 2015, we purchased 804 shares of common stock of Simulations Plus Inc. at \$9.25 per share, for a total of \$7,759. On December 29, 2015, we added 1,996 shares to our holdings at \$9.60 per share for a total of \$19,224. On December 30, 2015, we added 2,200 shares to our holdings at \$9.60 per share for a total of \$21,186. On January 22, 2016 we added 3,600 shares to our holdings at \$10.77 per share for a total of \$38,789. On February 5, 2016 we added 38,533 shares to our holdings through a dividend reinvestment option for a total of \$430 and on February 8, 2016 we added 10,000 shares to our holdings at \$8.62 per share for a total of \$86,222, bringing our total holdings to 18,639 shares as of June 30, 2016. At June 30, 2016, the cost and fair value of the common stock was \$173,310 and \$140,907, respectively.

On December 31, 2015, we owned 2,300 shares of common stock of Educational Development Corporation at a cost of \$10.93 per share, for a total of \$25,212. From January 1 through March 31, 2016, we purchased a total of 26,847 common shares through open-market purchases at an aggregate cost of \$282,669. From April 1 through June 30, 2016, we purchased a total of 7,758 common shares through open-market purchases at an aggregate cost of \$101,500. At June 30, 2016 our total holdings were 36,905 shares and the cost and fair value was \$409,380 and \$428,467, respectively.

On December 28, 2015, we purchased a \$600,000 promissory note from Creative Realities, Inc. The note bears 12% annual interest paid monthly in arrears plus 2% annual increase of principal at the maturity of the note. The note is due April 15, 2017. The outstanding principal amount is convertible into common stock at \$0.28 per share. In conjunction with the financing, we received a five-year warrant to purchase up to 1,071,429 common shares at an exercise price of \$0.28 per share. At June 30, 2016, the cost and fair value of the convertible note was \$606,000.

From January 1 through March 31, 2016, we purchased a total of 19,074 common shares of OTC Markets Group Cl A through open-market purchases at an aggregate cost of \$297,381. At June 30, 2016 the cost and fair value of these shares was \$297,381 and \$314,721, respectively.

On January 27, 2016, we purchased 5,000 shares of common stock of QC Holdings Inc. at \$0.72 per share, for a total of \$3,586. On January 28, 2016 we added 10,000 shares to our holdings for \$0.71 per share for a total of \$7,070, bringing our total holdings to 15,000 shares. At June 30, 2016 the cost and fair value of our total holdings was \$10,656 and \$14,130, respectively.

From April 1 through June 30, 2016, we purchased a total of 7,929 common shares of Escalade, Inc. through open-market purchases at an aggregate cost of \$93,975. At June 30, 2016 the cost and fair value of these shares was \$93,975 and \$81,193, respectively.

On April 7, 2016 we purchased 5,754 common shares of Magicjack Vocaltek Ltd at a cost of \$34,141. At June 30, 2016 the cost and fair value of these shares was \$34,141 and \$36,193, respectively.

On April 7, 2016 we purchased 7,772 common shares of Mitek Systems, Inc. at a cost of \$50,540. At June 30, 2016 the cost and fair value of these shares was \$50,540 and \$55,259, respectively.

From April 1 through June 30, 2016, we purchased a total of 38,005 common shares of National American University Holdings through open-market purchases at an aggregate cost of \$77,053. At June 30, 2016 the cost and fair value of these shares was \$77,053 and \$77,530, respectively.

On April 7, 2016, we purchased 20,000 common shares of Sequenom, Inc. at a cost of \$29,222. At June 30, 2016 the cost and fair value of these shares was \$29,222 and \$18,274, respectively.

From April 1 through June 30, 2016, we purchased a total of 5,000 common shares of Tessco Technologies Inc. through open-market purchases at an aggregate cost of \$83,090. At June 30, 2016 the cost and fair value of these shares was \$83,090 and \$69,450, respectively.

NOTE 6—MINIMUM ASSET COVERAGE

As a BDC, we are required to meet various regulatory tests. Among other things, these tests will require us to invest at least 70% of our total assets in private or small-cap public U.S.-based companies, and to maintain a coverage ratio of total assets (less all liabilities and indebtedness not represented by senior securities) to total indebtedness represented by senior securities of at least 200%. As of June 30, 2016, approximately 87% of our investments (by fair value at that date) were in private or small-cap public U.S.- based companies and our coverage ratio was 100%.

NOTE 7—INCOME TAXES

We plan to be taxed as a regulated investment company (“RIC”) and intend to comply with the requirements of the Internal Revenue Code, applicable to regulated investment companies. Currently, we have not elected to be treated as a RIC. Upon our election to be taxed as a RIC, we will be required to distribute at least 90% of our investment company taxable income and we intend at that time to distribute (or retain through a deemed distribution) all of our investment company taxable income and net capital gain to shareholders. Therefore, we have made no provision for income taxes. The characterization of income and gains that we will distribute is determined in accordance with income tax regulations that may differ from GAAP. Book and tax basis differences relating to shareholder dividends and distributions and other permanent book and tax differences are reclassified to paid-in capital.

NOTE 8—SUBSEQUENT EVENTS

On August 1, 2016, we purchased an additional \$50,000 of limited partnership interests in Northern Capital Partners I, LP.

On August 9, 2016, we purchased 40,000 Series A-2 Preferred Shares from Bitesquad.com, LLC for an aggregate purchase price of \$600,000.

On August 1, 2016 we were notified that Igloo, LLC and its guarantor, Christopher M. Gnetz, would not meet their obligation under the terms of the Forbearance and Settlement Agreement dated March 17, 2016. On May 1, 2016 we received \$15,000 under the Agreement. We intend to pursue the legal remedies available to us under the law.

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

Our Management's Discussion and Analysis of Financial Condition and Results of Operations set forth below should be read in conjunction with our audited financial statements, and notes thereto, contained in our Form 10-K filed with the SEC on March 31, 2016 related to our year ended December 31, 2015.

Forward-Looking Statements

Some of the statements made in this section of our report are forward-looking statements based on the current expectations of the management of our company. These expectations involve substantial risks and uncertainties which could cause actual results to differ materially from the results expressed in, or implied by, these forward-looking statements. Forward-looking statements relate to future events or our future financial performance. We generally identify forward-looking statements by terminology such as "may," "will," "should," "expects," "plans," "anticipates," "could," "intends," "targets," "projects," "contemplates," "believes," "estimates," "predicts," "potential" or "continue" or the negative of terms or other similar words. Important assumptions include our ability to originate new investments, achieve certain margins and levels of profitability, the availability of additional capital, and the ability to maintain certain debt-to-asset ratios. In light of these and other uncertainties, the inclusion of a projection or forward-looking statement in this report should not be regarded as a representation by us that our plans or objectives will be achieved.

Some of the forward-looking statements contained in this report include statements as to:

- our future operating results;
- our business prospects and the prospects of our portfolio companies;
- the outcome of a pending compliance inspection by the SEC Office of Compliance and Inspections;
- the impact of investments that we expect to make;
- our informal relationships with third parties;
- the dependence of our future success on the general economy and its impact on the industries in which we invest;

- the ability of our portfolio companies to achieve their objectives;
- our expected financings and investments;
- our regulatory structure and tax treatment;
- our ability to operate as a business development company and to be taxed as a regulated investment company;
- the adequacy of our cash resources and working capital; and
- the timing of cash flows, if any, from the operations of our portfolio companies.

The foregoing list is not exhaustive. In light of the foregoing, prospective investors are cautioned that the forward-looking statements included in this filing may ultimately prove to be inaccurate—even materially inaccurate. For a more complete summary of the risks and uncertainties facing our company and its business and relating to our forward-looking statements, please refer to our Annual Report on Form 10-K filed on March 31, 2016 (related to our year ended December 31, 2015) and in particular the section thereof entitled “Risk Factors.” Because of the significant uncertainties inherent in the forward-looking statements pertaining to our company, the inclusion of such information should not be regarded as a representation or warranty by us or any other person that our objectives, plans, expectations or projections that are contained in this filing will be achieved in any specified time frame, if ever. We undertake no obligation to update any forward-looking statement to reflect events or circumstances occurring after the date of this report. The forward-looking statements made in this report relate only to events as of the date on which the statements are made, and are excluded from the safe harbor protection provided by Section 21E of the Securities Exchange Act of 1934.

General Overview

Mill City Ventures III, Ltd. is a Minnesota corporation that was incorporated in January 2006. Until December 13, 2012, we were a development-stage company focused on promoting and placing a poker-based game online and into casinos and entertainment facilities nationwide. We are regulated as a business development company (a “BDC”) under the Investment Company Act of 1940 (the “1940 Act”), and we plan to be taxed as a regulated investment company (“RIC”) although we have not made an election to be taxed as a RIC at this time.

Business Model and Strategy

As a BDC, we primarily focus on investing in, lending to and making managerial assistance available to privately held and publicly traded companies. A BDC may provide shareholders with the ability to retain the liquidity of a publicly traded stock, while sharing in the possible benefits of investing in emerging- growth or expansion-stage companies.

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

We plan to identify potential investments through multiple sources, including private equity sponsors, investment bankers, brokers, our Board of Directors, owners and operators of businesses and other persons within our professional network. We will base our investment decisions primarily on analyses of potential growth prospects of business operations and asset valuations. Subject to applicable BDC regulations set forth in the 1940 Act, we plan to invest in private companies, small-cap public stocks, notes and other forms of debt, investment contracts, and other investments commonly referred to as securities.

Highlights for the Six Months Ended June 30, 2016

Investment Transactions

On January 22, 2016, we received \$434,195 from DBR Phase III US Investors, LLC. The payment represented a \$418,750 principal payment on a promissory note we purchased on February 7, 2014, plus \$15,445 of accrued interest. On March 22, 2016, we received a final principal payment from the portfolio company for \$342,300 in principal and \$6,316 of accrued interest. The note and accrued interest have now been paid.

From January 1 through June 30, 2016, we purchased a total of 34,605 shares of common stock of Educational Development Corporation through open-market purchases at an aggregate cost of \$384,168, bringing our total holdings to 36,905 common shares. At June 30, 2016 the cost and fair value of these shares was \$409,380 and \$428,467, respectively.

From January 1 through June 30, 2016, we purchased a total of 19,074 common shares of OTC Markets Group Cl A through open-market purchases at an aggregate cost of \$297,381. At June 30, 2016 the cost and fair value of these shares was \$297,381 and \$314,721, respectively.

On January 27, 2016, we purchased 5,000 shares of common stock of QC Holdings Inc. at \$0.72 per share, for a total of \$3,586. On January 28, 2016 we added 10,000 shares to our holdings at \$0.71 per share for a total of \$7,070, bringing our total holdings to 15,000 shares. At June 30, 2016 the cost and fair value was \$10,655 and \$14,130, respectively.

From April 1 through June 30, 2016, we purchased a total of 7,929 common shares of Escalade, Inc. through open-market purchases at an aggregate cost of \$93,975. At June 30, 2016 the cost and fair value of these shares was \$93,975 and \$81,193, respectively.

On April 7, 2016 we purchased 5,754 common shares of Magicjack Vocaltek Ltd at a cost of \$34,141. At June 30, 2016 the cost and fair value of these shares was \$34,141 and \$36,193, respectively.

On April 7, 2016 we purchased 7,772 common shares of Mitek Systems, Inc. at a cost of \$50,540. At June 30, 2016 the cost and fair value of these shares was \$50,540 and \$55,259, respectively.

From April 1 through June 30, 2016, we purchased a total of 38,005 common shares of National American University Holdings through open-market purchases at an aggregate cost of \$77,053. At June 30, 2016 the cost and fair value of these shares was \$77,053 and \$77,530, respectively.

Edgar Filing: Mill City Ventures III, Ltd - Form 10-Q

On April 7, 2016 we purchased 20,000 common shares of Sequenom, Inc. at a cost of \$29,222. At June 30, 2016 the cost and fair value of these shares was \$29,222 and \$18,274, respectively.

From January 1 through June 30, 2016, we purchased a total of 13,639 shares of common stock of Simulations Plus Inc. through open-market purchases at an aggregate cost of \$125,441, bringing our total holdings to 18,639 common shares. At June 30, 2016 the cost and fair value of these shares was \$173,310 and \$140,907, respectively.

From April 1 through June 30, 2016, we purchased a total of 5,000 common shares of Tessco Technologies Inc. through open-market purchases at an aggregate cost of \$83,090. At June 30, 2016 the cost and fair value of these shares was \$83,090 and \$69,450, respectively.

Material Changes in Assets and Liabilities

Our prepaid expenses as of June 30, 2016 were \$77,331 compared to \$43,808 for the year ended December 31, 2015. The increase relates to our annual insurance and fidelity bond premiums. These premiums will be amortized ratably over the covered period.

Our interest and dividends receivable at June 30, 2016 were \$13,389 compared to \$23,840 for the year ended December 31, 2015. The decrease relates to our investments in Insite Software Solutions, Inc, DBR Phase III US Investors, LLC, The Igloo LLC, Mix 1 Life Inc., and Creative Realities Inc.

Results of Operations for the Six Months Ended June 30, 2016 compared to the Six Months Ended June 30, 2015*Operating Expenses*

Item	For the Six-Month Period Ended June 30, 2016	For the Six-Month Period Ended June, 2015
Investment Income	\$ 166,051	310,925
Operating Expenses:		
Professional fees	85,484	87,468
Payroll expense	81,958	81,955
Occupancy expense	38,604	45,618
Insurance expense	40,087	46,174
Directors' fees expense	28,956	30,000
Depreciation and amortization	6,424	6,424
Other general and administrative	8,301	9,163
Net Investment Gain (Loss)	\$ (123,763)	4,123

As the table above demonstrates, we incurred operating expenses of \$289,814 and \$306,802 for the six-month periods ended June 30, 2016 and 2015, respectively. A discussion and analysis of the material components of our operating expenses appears below.

Professional fees. Our professional fees were \$85,484 for the six-month period ended June 30, 2016, compared to \$87,468 for the six-month period ended June 30, 2015. The decrease in professional fees is due to decreased legal fees associated with the preparation of the Company's filing requirements.

Insurance expense. During the six -month period ended June 30, 2016, we incurred \$40,087 in insurance expense compared to \$46,174 for the six -month period ended June 30, 2015. Insurance expense relates to our annual director and officer insurance, fidelity bond premiums and business insurance amortized ratably over the covered period.

Directors' fees expense. Our directors' fees expense for the six -month periods ended June 30, 2016 were \$28,956 compared to \$30,000 for the six -month period ended June 30, 2015. The decrease relates to the temporary vacancy in our third director position due to the resignation of Mr. Christopher Larson in December 2015.

Results of Operations for the Three Months Ended June 30, 2016 Compared to the Three Months Ended June 30, 2015

Operating Expenses

Item	For the Three-Month Period Ended June 30, 2016	For the Three-Month Period Ended June 30, 2015
Investment Income	\$ 79,728	147,081
Operating Expenses:		
Professional fees	45,477	36,071
Payroll expense	40,549	40,481
Occupancy expense	14,428	22,819
Insurance expense	18,730	21,610
Directors' fees expense	15,000	15,000
Depreciation and amortization	3,212	3,212
Other general and administrative	5,700	4,368
Net Investment Income (Loss)	\$ (63,368)	3,520

As the table above demonstrates, we incurred operating expenses of \$143,096 and \$143,561 for the three-month periods ended June 30, 2016 and 2015, respectively. A discussion and analysis of the material components of our operating expenses appears below.

Professional fees. Our professional fees were \$45,477 for the three-month period ended June 30, 2016, compared to \$36,071 for the three-month period ended June 30, 2015. The increase in professional fees is due to increased legal fees associated with the preparation of the Company's filing requirements.

Occupancy expense. During the three-month period ended June 30, 2016, we incurred \$14,428 in occupancy expense compared to \$22,819 incurred during the three-month period ended June 30, 2015. The decrease relates to a refund received on the Common Area Maintenance charges.

Insurance expense. During the three-month period ended June 30, 2016, we incurred \$18,730 in insurance expense compared to \$21,610 for the three-month period ended June 30, 2015. Insurance expense relates to our annual director and officer insurance, fidelity bond premiums and business insurance amortized ratably over the covered period.

Net Investment Income (Loss)

Net investment income (loss) represents the difference between investment income and operating expenses. Our net investment income (loss) for the six- month period ended June 30, 2016 and 2015 was (\$123,763) and \$4,123 respectively. The decrease was due to a reduction in our investment income due to our investments in Igloo, LLC, Insite Software Solutions, Inc. and DBR Phase III US Investors, LLC.

Net Realized Gains (Losses), Increase in Net Assets from Net Changes in Unrealized Appreciation

Net realized losses on investments for the six-month period ended June 30, 2016 was (\$533,281). This was primarily due to a net realized loss of \$485,000 due to our settlement of the note with Igloo, LLC.

The net increase in net assets from changes in unrealized appreciation was \$280,921. This was primarily due to the realization of our \$500,000 investment in Igloo, LLC which had a realized loss of \$485,000.

Summary cash flow data is as follows:

	Six Months Ended June	
	30,	
	2016	2015
Cash flows provided (used) by :		
Operating activities	\$(401,293)	\$(397,600)
Investing activities	-	-
Financing activities	-	-
Net decrease in cash	(401,293)	(397,600)
Cash, beginning of period	2,980,659	4,105,911
Cash, end of period	\$2,579,366	\$3,708,311

The cash provided in operating activities for the six-month period June 30, 2016 was primarily from our investment transactions, specifically our receipt of payment on the promissory note we purchased from DBR Phase III US Investors, LLC.

During the six months ending June 30, 2016, we used cash in operating activities for open-market purchases of common shares of Educational Development Corporation (aggregating to \$384,168 of total acquisition costs), common shares of OTC Markets Group CI A (aggregating to \$297,381 of total acquisition costs), common shares of QC Holdings, Inc. (aggregating to \$10,656 of total acquisition costs), common shares of Escalade (aggregating to \$93,975 of total acquisition costs), common shares of Magicjack Vocaltek Ltd. (aggregating to \$34,141 of total acquisition costs), common shares of Mitek Systems Inc. (aggregating to \$50,540 of total acquisition costs), common shares of National American University Holdings. (aggregating to \$77,053 of total acquisition costs), common shares of Sequenom Inc. (aggregating to \$29,222 of total acquisition costs), common shares of Simulations Plus Inc. (aggregating to \$125,441 of total acquisition costs), and common shares of Tessco Technologies Inc. (aggregating to

\$83,090 of total acquisition costs).

Regulation as a BDC

As a BDC, we are regulated by the 1940 Act. A BDC must be organized in the United States for the purpose of investing in or lending to primarily private companies, or certain small-cap public companies, and, with limited exceptions, making managerial assistance available to them. A BDC may use capital provided by public shareholders and from other sources to make long-term, private investments in businesses. A BDC may provide shareholders the ability to retain the liquidity of a publicly traded stock while sharing in the possible benefits, if any, of investing in primarily privately owned or small-cap public companies.

We may not change the nature of our business so as to cease to be, or withdraw our election as, a BDC unless authorized by vote of a majority of the outstanding voting securities, as required by the 1940 Act. A majority of the outstanding voting securities of a company is defined under the 1940 Act as the lesser of: (a) 67% or more of such company's voting securities present at a meeting if more than 50% of the outstanding voting securities of such company are present or represented by proxy; or (b) more than 50% of the outstanding voting securities of such company. We do not anticipate any substantial change in the nature of our business.

As with other companies regulated by the 1940 Act, a BDC must adhere to certain substantive regulatory requirements. A majority of our directors must be persons who are not "interested persons," as that term is defined in the 1940 Act. Additionally, we are required to provide and maintain a bond issued by a reputable fidelity insurance company to protect the BDC. Furthermore, as a BDC, we are prohibited from protecting any director or officer against any liability to us or our shareholders arising from willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of such person's office.

We are generally not able to sell our common stock at a price below net asset value per share. We may, however, sell our common stock at a price below net asset value per share (i) in connection with a rights offering to our existing shareholders, (ii) with the consent of shareholders holding a majority of our common stock, or (iii) under such other circumstances as the SEC may permit. For example, we may sell our common stock at a price below the then-current net asset value of our common stock if our Board of Directors determines that such sale is in our best interests and the best interests of our shareholders, and our shareholders approve our policy and practice of making such sales. In addition, we may generally issue new shares of our common stock at a price below net asset value in rights offerings to our existing shareholders, in payment of dividends and in certain other limited circumstances. No such offerings have occurred as of the date of this filing.

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

We are prohibited under the 1940 Act from knowingly participating in certain transactions with our affiliates without the prior approval of our directors who are not interested persons and, in some cases, prior approval by the SEC. Subject to certain exceptions, as a BDC, we are generally not permitted to invest in any portfolio company in which our affiliates currently have an investment or to make any co-investments with our affiliates without an exemptive order from the SEC.

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

Qualifying Assets

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

principal categories of qualifying assets relevant to our business are the following:

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

(a) is organized under the laws of, and has its principal place of business in, the United States;

(b) is not an investment company or a company that would be an investment company but for certain exclusions under the 1940 Act; and

(c) satisfies one of the following:

does not have outstanding any class of securities with respect to which a broker or dealer may extend margin credit (or, if a broker or dealer may in fact extend or maintain margin credit to a customer with respect to such securities, then at the time of purchase of the issuer’s securities (A) the BDC owns at least 50% of the greatest number of outstanding and issuable equity securities of such issuer (i.e., 50% determined on a fully diluted basis) and the greatest amount of debt securities of such issuer), (B) the BDC is one of the 20 largest holders of record of the issuer’s outstanding voting securities);

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

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

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

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

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

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

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

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

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

In addition to the foregoing description of “qualifying assets,” certain types of follow-on investments in issuers that no longer satisfy the definition of “eligible portfolio company” may nonetheless be “qualifying assets.”

Significant Managerial Assistance or Control

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

Temporary Investments

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

Capital Expenditures

We did not have and do not plan to have any material commitments for capital expenditures in 2014 or 2015. Given our business model and status as a BDC, we do not require material investments in capital resources.

Certain Potential Conflicts of Interest

Our Company maintains a Code of Ethics and certain other policies relating to conflicts of interest and related-party transactions, as well as policies and procedures relating to what applicable BDC regulations generally describe as “affiliate transaction.” Nevertheless, from time to time we may hold investments in portfolio companies in which certain members of our management are also directly or indirectly invested. Our Board of Directors has recently adopted a policy to require our disclosure of these instances in our periodic filings with the SEC.

Presently, each of Messrs. Geraci and Polinsky have direct and indirect interests in Southern Plains Resources, Inc. We invested in Southern Plains Resources in each of March and July 2013. In addition, our former director Christopher Larson had a direct interest in Mix 1 Life, Inc. and served as that company’s Chief Financial Officer at the time of our investment. We invested in Mix 1 Life in February 2014 and we exercised, on a cashless basis, a warrant for the purchase of Mix 1 Life common stock in September 2014. Subsequent to our initial investment, Mr. Larson became a director of Mix 1 Life. Mr. Larson is no longer a director of the Company.

In addition, Lantern Advisors, LLC, a limited liability company equally owned by Messrs. Geraci and Polinsky, owns a cashless warrant to purchase 153,846 shares of Creative Realities, Inc. which expires July 14, 2019 at a price of \$0.70 a share.

Critical Accounting Policies

Investment Valuation

Investment transactions are recorded on the trade date. Realized gains or losses are measured by the difference between the net proceeds from the repayment or sale and the amortized cost basis of the investment without regard to unrealized gains or losses previously recognized, and include investments charged off during the period, net of

recoveries. Unrealized gains or losses primarily reflect the change in investment values, including the reversal of previously recorded unrealized gains or losses when gains or losses are realized.

Investments for which market quotations are readily available are typically valued at such market quotations. In order to validate market quotations, we look at a number of factors to determine if the quotations are representative of fair value, including the source and nature of the quotations. Debt and equity securities that are not publicly traded or whose market prices are not readily available are valued at fair value as determined in good faith by our board of directors, based on, among other things, the input of our executive management, audit committee and independent third-party valuation expert that may be engaged by management to assist in the valuation of our portfolio investments.

Realized Gains and Losses, Interest and Dividend Income Recognition

Realized gains or losses on the sale of investments are calculated using the specific investment method.

Interest income is recorded on an accrual basis and includes the accretion of discounts and amortization of premiums. Discounts from and premiums to par value on securities purchased are accreted/amortized into interest income over the life of the respective security using the effective yield method. The amortized cost of investments represents the original cost adjusted for the accretion of discounts and amortization of premiums, if any.

Loans are generally placed on non-accrual status when principal or interest payments are past due 30 days or more or when there is reasonable doubt that principal or interest will be collected in full. Accrued and unpaid interest is generally reversed when a loan is placed on non-accrual status. Interest payments received on non-accrual loans may be recognized as income or applied to principal depending upon management's judgment regarding collectability. Non-accrual loans are restored to accrual status when past due principal and interest is paid and, in management's judgment, are likely to remain current. We may make exceptions to this if the loan has sufficient collateral value and is in the process of collection.

Dividend income on preferred equity securities is recorded as dividend income on an accrual basis to the extent that such amounts are payable by the portfolio company and are expected to be collected. Dividend income on common equity securities is recorded on the record date for private portfolio companies or on the ex-dividend date for publicly traded portfolio companies.

Further information on our critical accounting policies and use of estimates can be found in our financial statements and notes thereto included in this report and in our Annual Report on Form 10-K filed with the SEC on March 30, 2016. There have been no material changes to our critical accounting policies and estimates from those disclosed in our Annual Report on Form 10-K.

Off-Balance Sheet Arrangements

During the six months ended June 30, 2016, we did not engage in any off-balance sheet arrangements set forth in Item 303(a)(4) of Regulation S-K.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures designed to provide reasonable assurance that information required to be disclosed in our reports filed pursuant to the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer as appropriate, to allow timely decisions regarding required disclosure. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance the objectives of the control system are met.

As of June 30, 2016, our Chief Executive Officer and Chief Financial Officer carried out an evaluation of the effectiveness of our disclosure controls and procedures as such term is defined in Rule 13a-15(e) under the Securities and Exchange Act of 1934. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded our disclosure controls and procedures are effective as of June 30, 2016.

Changes in Internal Controls

There were no significant changes in our internal controls over financial reporting that occurred during the fiscal quarter covered by this report that materially affected, or were reasonably likely to materially affect such controls.

PART II – OTHER INFORMATION

Item 6. Exhibits

Exhibit No.	Description
31.1	Certification of Chief Executive Officer (filed herewith).
31.2	Certification of Chief Financial Officer (filed herewith).
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).

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.

MILL CITY VENTURES III, LTD.

/s/ Douglas Polinsky
Douglas Polinsky
Chief Executive Officer

Dated: August 15, 2016

/s/ Joseph A. Geraci, II
Joseph A. Geraci, II
Chief Financial Officer

Dated: August 15, 2016