INTERGROUP CORP
Form 10-Q
November 04, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2016

or

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

For the transition period from _______ to_________

Commission File Number 1-10324

THE INTERGROUP CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE	13-3293645
(State or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No.)

10940 Wilshire Blvd., Suite 2150, Los Angeles, California 90024

(Address of principal executive offices) (Zip Code)

(310) 889-2500

(Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

x 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 (Section 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).

x 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.

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨	Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act):

¨ Yes x No

The number of shares outstanding of registrant’s Common Stock, as of October 21, 2016 was 2,381,726.

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PART I

FINANCIAL INFORMATION

Item 1 - Condensed Consolidated Financial Statements

THE INTERGROUP CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

As of	September 30, 2016 (Unaudited)	June 30, 2016
ASSETS		
Investment in Hotel, net	$ 44,338,000	$44,821,000
Investment in real estate, net	56,285,000	56,356,000
Investment in marketable securities	19,310,000	14,282,000
Other investments, net	1,009,000	1,029,000
Cash and cash equivalents	4,057,000	5,404,000
Restricted cash - mortgage impounds	3,968,000	3,221,000
Other assets, net	5,683,000	6,172,000
Deferred income taxes	2,933,000	3,985,000
Total assets	$ 137,583,000	$135,270,000
LIABILITIES AND SHAREHOLDERS' DEFICIT		
Liabilities:		
Accounts payable and other liabilities	$ 3,714,000	$3,717,000
Accounts payable and other liabilities - Hotel	12,597,000	14,783,000
Due to securities broker	3,037,000	1,493,000
Obligations for securities sold	1,107,000	163,000
Other notes payable	6,476,000	6,996,000
Mortgage notes payable - Hotel, net	116,188,000	116,160,000
Mortgage notes payable - real estate	66,044,000	65,205,000
Total liabilities	209,163,000	208,517,000
Commitments and contingencies		
Shareholders' deficit:		
Preferred stock, $.01 par value, 100,000 shares authorized; none issued]	-	-
Common stock, $.01 par value, 4,000,000 shares authorized;		

3,395,616 issued; 2,381,726 outstanding	33,000	33,000
Additional paid-in capital	10,435,000	10,363,000
Accumulated deficit	(42,454,000)	(43,645,000)
Treasury stock, at cost, 1,013,890 shares	(12,082,000)	(12,082,000)
Total InterGroup shareholders' deficit	(44,068,000)	(45,331,000)
Noncontrolling interest	(27,512,000)	(27,916,000)
Total shareholders' deficit	(71,580,000)	(73,247,000)
Total liabilities and shareholders' equity	$ 137,583,000	$ 135,270,000

The accompanying notes are an integral part of these condensed consolidated financial statements.

THE INTERGROUP CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

For the three months ended September 30,	2016	2015
Revenues:		
Hotel	$14,605,000	$15,138,000
Real estate	3,649,000	3,582,000
Total revenues	18,254,000	18,720,000
Costs and operating expenses:		
Hotel operating expenses	(10,256,000)	(11,193,000)
Real estate operating expenses	(1,807,000)	(1,736,000)
Depreciation and amortization expense	(1,268,000)	(1,236,000)
General and administrative expense	(728,000)	(809,000)
Total costs and operating expenses	(14,059,000)	(14,974,000)
Income from operations	4,195,000	3,746,000
Other income (expense):		
Interest expense - mortgages	(2,462,000)	(2,464,000)
Net loss on disposal of assets	-	(30,000)
Net gain on marketable securities	1,154,000	380,000
Net unrealized loss on other investments	-	(74,000)
Impairment loss on other investments	(20,000)	-
Dividend and interest income	42,000	13,000
Trading and margin interest expense	(262,000)	(240,000)
Other expense, net	(1,548,000)	(2,415,000)
Income before income taxes	2,647,000	1,331,000
Income tax expense	(1,052,000)	(618,000)
Net income	1,595,000	713,000
Less: Net income attributable to the noncontrolling interest	(404,000)	(244,000)
Net income attributable to InterGroup	$1,191,000	$469,000
Net income per share		
Basic	$0.67	$0.30
Diluted	$0.65	$0.29
Net income per share attributable to InterGroup		
Basic	$0.50	$0.20
Diluted	$0.48	$0.19

Weighted average number of basic common shares outstanding	2,381,726	2,387,296
Weighted average number of diluted common shares outstanding	2,469,295	2,485,584

The accompanying notes are an integral part of these condensed consolidated financial statements.

THE INTERGROUP CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

For the three months ended September 30,	2016	2015
Cash flows from operating activities:		
Net income	$1,595,000	$713,000
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	1,268,000	1,236,000
Net loss on disposal of assets	-	30,000
Net unrealized gain on marketable securities	(735,000)	(440,000)
Unrealized loss on other investments	-	74,000
Impairment loss on other investments	20,000	-
Stock compensation expense	72,000	211,000
Changes in assets and liabilities:		
Investment in marketable securities	(4,293,000)	1,764,000
Other assets	558,000	4,399,000
Accounts payable and other liabilities	(2,189,000)	(3,832,000)
Due to securities broker	1,544,000	(345,000)
Obligations for securities sold	944,000	(22,000)
Deferred taxes	1,052,000	443,000
Net cash (used in) provided by operating activities	(164,000)	4,231,000
Cash flows from investing activities:		
Investment in hotel, net	(272,000)	(1,291,000)
Investment in real estate, net	(483,000)	(2,243,000)
Investment in Santa Fe	-	(120,000)
Net cash used in investing activities	(755,000)	(3,654,000)
Cash flows from financing activities:		
Restricted cash - withdrawal of mortgage impounds	(747,000)	(175,000)
Net proceeds from (payments of) mortgage and other notes payable	319,000	(465,000)
Purchase of treasury stock	-	(122,000)
Net cash used in financing activities	(428,000)	(762,000)
Net decrease in cash and cash equivalents	(1,347,000)	(185,000)
Cash and cash equivalents at the beginning of the period	5,404,000	8,529,000
Cash and cash equivalents at the end of the period	$4,057,000	$8,344,000
Supplemental information:		
Interest paid	$2,606,000	$2,563,000
Non-cash transaction:		
Conversion of other investments to marketable securities	$-	$13,231,000

The accompanying notes are an integral part of these condensed consolidated financial statements.

THE INTERGROUP CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

The condensed consolidated financial statements included herein have been prepared by The InterGroup Corporation (“InterGroup” or the “Company”), without audit, according to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in the condensed consolidated financial statements prepared in accordance with generally accepted accounting principles (U.S. GAAP) have been condensed or omitted pursuant to such rules and regulations, although the Company believes the disclosures that are made are adequate to make the information presented not misleading. Further, the condensed consolidated financial statements reflect, in the opinion of management, all adjustments (which included only normal recurring adjustments) necessary for a fair statement of the financial position, cash flows and results of operations as of and for the periods indicated. It is suggested that these financial statements be read in conjunction with the audited financial statements of InterGroup and the notes therein included in the Company's Annual Report on Form 10-K for the year ended June 30, 2016. The June 30, 2016 Condensed Consolidated Balance Sheet was derived from the Company’s Form 10-K for the year ended June 30, 2016.

The results of operations for the three months ended September 30, 2016 are not necessarily indicative of results to be expected for the full fiscal year ending June 30, 2017.

Basic and diluted loss per share is computed by dividing net loss available to common stockholders by the weighted average number of common shares outstanding. The computation of diluted income per share is similar to the computation of basic earnings per share except that the weighted-average number of common shares is increased to include the number of additional common shares that would have been outstanding if potential dilutive common shares had been issued. The Company's only potentially dilutive common shares are stock options.

As of September 30, 2016, the Company had the power to vote 85.6% of the voting shares of Santa Fe Financial Corporation (“Santa Fe”), a public company (OTCBB: SFEF). This percentage includes the power to vote an approximately 4% interest in the common stock in Santa Fe owned by the Company’s Chairman and President pursuant to a voting trust agreement entered into on June 30, 1998.

Santa Fe's primary business is conducted through the management of its 68.8% owned subsidiary, Portsmouth Square, Inc. ("Portsmouth"), a public company (OTCBB: PRSI). Portsmouth has a 93% limited partnership interest in Justice and is the sole general partner. InterGroup also directly owns approximately 13.3% of the common stock of Portsmouth.

Justice, through its subsidiaries Justice Holdings Company, LLC ("Holdings"), a Delaware Limited Liability Company, Justice Operating Company, LLC ("Operating") and Justice Mezzanine Company, LLC ("Mezzanine"), owns a 543-room hotel property located at 750 Kearny Street, San Francisco California, known as the Hilton San Francisco Financial District (the "Hotel") and related facilities including a five level underground parking garage. Holdings and Mezzanine are both wholly-owned subsidiaries of the Partnership; Operating is a wholly-owned subsidiary of Mezzanine. Mezzanine is the borrower under certain mezzanine indebtedness of Justice, and in December 2013, the Partnership conveyed ownership of the Hotel to Operating. The Hotel is operated by the partnership as a full service Hilton brand hotel pursuant to a Franchise License Agreement with HLT Franchise Holding LLC (Hilton). Justice has a management agreement with Prism Hospitality L.P. ("Prism") to perform certain management functions for the Hotel. The management agreement with Prism had an original term of ten years, subject to the Partnership's right to terminate at any time with or without cause. Effective January 2014, the management agreement with Prism was amended by the Partnership to change the nature of the services provided by Prism and the compensation payable to Prism, among other things. Effective December 1, 2013, GMP Management, Inc. ("GMP"), a company owned by a Justice limited partner and a related party, also provided management services for the Partnership pursuant to a management services agreement, with a three year term, subject to the Partnership's right to terminate earlier for cause. In June 2016, GMP resigned and the Company is currently interviewing several national third party hotel management companies to replace GMP.

The parking garage that is part of the Hotel property was managed by Ace Parking pursuant to a contract with the Partnership. The contract was terminated with an effective termination date of October 4, 2016. The Company began managing the parking garage in-house after the termination of Ace Parking.

Management believes that the revenues expected to be generated from the operations of the hotel, garage and leases will be sufficient to meet all of the Partnership's current and future obligations and financial requirements.

In addition to the operations of the Hotel, the Company also generates income from the ownership of real estate. Properties include apartment complexes, commercial real estate, and three single-family houses as strategic investments. The properties are located throughout the United States, but are concentrated in Texas and Southern California. The Company also has investments in unimproved real property. All of the Company's residential rental properties are managed in-house.

Recently Issued Accounting Pronouncements

On June 16, 2016, the FASB issued ASU 2016-13, "*Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*." This ASU modifies the impairment model to utilize an expected loss methodology in place of the currently used incurred loss methodology, which will result in the more timely recognition of losses. ASU No. 2016-13 will be effective for us as of January 1, 2020. The Company is currently reviewing the effect of ASU No. 2016-13.

On August 26, 2016, the FASB issued ASU 2016-15, "*Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments (Topic230)*." This ASU is intended to reduce the diversity in practice around how certain transactions are classified within the statement of cash flows. The Company adopted ASU No. 2016-15 in the first quarter of 2017 with no material impact to our financial statements.

In April 2015, the FASB issued ASU 2015-03, *Simplifying the Presentation of Debt Issuance Costs*, which requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. ASU 2015-03 is effective for annual and interim periods within these annual periods beginning after December 15, 2015 and early application is permitted. This standard did not have material impact on the Company's consolidated financial statements. The Company adopted this standard during the quarter and reclassified the debt issuance costs on the June 30, 2016 consolidated balance sheet.

NOTE 2 – INVESTMENT IN HOTEL, NET

Investment in hotel consisted of the following as of:

September 30, 2016	Cost	Accumulated Depreciation	Net Book Value
Land	$2,738,000	$-	$2,738,000
Furniture and equipment	29,070,000	(23,444,000)	5,626,000
Building and improvements	62,926,000	(26,952,000)	35,974,000
	$94,734,000	$(50,396,000)	$44,338,000

June 30, 2016	Cost	Accumulated Depreciation	Net Book Value
Land	$2,738,000	$-	$2,738,000
Furniture and equipment	28,857,000	(23,096,000)	5,761,000
Building and improvements	62,908,000	(26,586,000)	36,322,000
	$94,503,000	$(49,682,000)	$44,821,000

NOTE 3 – INVESTMENT IN REAL ESTATE

Investment in real estate consisted of the following:

As of	September 30, 2016	June 30, 2016
Land	$ 25,033,000	$25,033,000
Buildings, improvements and equipment	66,412,000	65,929,000
Accumulated depreciation	(35,160,000)	(34,606,000)
Investment in real estate, net	$ 56,285,000	$56,356,000

In July 2015, the Company purchased residential house in Los Angeles, California as a strategic asset for $1,975,000 in cash. In August 2016, the Company obtained a mortgage note payable on the house in the amount of $1,000,000. The note has an adjustable interest rate of 4.5% as of September 30, 2016 and requires interest only payments for the first twenty three months with a balloon payment at maturity in August 2018.

NOTE 4 – INVESTMENT IN MARKETABLE SECURITIES

The Company's investment in marketable securities consists primarily of corporate equities. The Company has also periodically invested in corporate bonds and income producing securities, which may include interests in real estate based companies and REITs, where financial benefit could transfer to its shareholders through income and/or capital gain.

At September 30, 2016 and June 30, 2016, all of the Company's marketable securities are classified as trading securities. The change in the unrealized gains and losses on these investments are included in earnings. Trading securities are summarized as follows:

Investment	Cost	Gross Unrealized Gain	Gross Unrealized Loss	Net Unrealized Loss	Fair Value
As of September 30, 2016					
Corporate Equities	$26,752,000	$1,500,000	$(8,942,000)	$(7,442,000)	$19,310,000

As of June 30, 2016					
Corporate Equities	$22,500,000	$1,161,000	$(9,379,000)	$(8,218,000)	$14,282,000

As of September 30, 2016 and June 30, 2016, approximately 51% and 65%, respectively, of the investment marketable securities balance above is comprised of the common stock of Comstock Mining, Inc.

As of September 30, 2016 and June 30, 2016, the Company had unrealized losses of $3,846,000 and $3,620,000, respectively, related to securities held for over one year.

Net loss on marketable securities on the statement of operations is comprised of realized and unrealized gains (losses). Below is the composition of the two components for the respective periods:

For the three months ended September 30,	2016	2015
Realized income (loss) on marketable securities	$419,000	$(60,000)
Unrealized loss on marketable securities	735,000	440,000
Net gain on marketable securities	$1,154,000	$380,000

NOTE 5 – OTHER INVESTMENTS, NET

The Company may also invest, with the approval of the Securities Investment Committee and other Company guidelines, in private investment equity funds and other unlisted securities, such as convertible notes through private placements. Those investments in non-marketable securities are carried at cost on the Company’s balance sheet as part of other investments, net of other than temporary impairment losses. Other investments also include non-marketable warrants carried at fair value.

Other investments, net consist of the following:

Type	September 30, 2016	June 30, 2016
Private equity hedge fund, at cost	$ 916,000	$916,000
Other preferred stock, at cost	93,000	113,000
	$ 1,009,000	$1,029,000

NOTE 6 - FAIR VALUE MEASUREMENTS

The carrying values of the Company’s financial instruments not required to be carried at fair value on a recurring basis approximate fair value due to their short maturities (i.e., accounts receivable, other assets, accounts payable and other liabilities and obligations for securities sold) or the nature and terms of the obligation (i.e., other notes payable and mortgage notes payable).

The assets measured at fair value on a recurring basis are as follows:

As of September 30, 2016	Total
Assets:	Level 1
Investment in marketable securities:	
Basic materials	$9,824,000
Consumer goods	2,013,000
Energy	1,601,000
Financial services	1,485,000
Corporate bonds	1,217,000
Other	3,170,000

	$19,310,000

As of June 30, 2016	Total
Assets:	Level 1
Investment in marketable securities:	
Basic materials	$9,273,000
Energy	1,907,000
Financial services	1,021,000
Other	2,081,000
	$14,282,000

The fair values of investments in marketable securities are determined by the most recently traded price of each security at the balance sheet date.

Financial assets that are measured at fair value on a non-recurring basis and are not included in the tables above include “Other investments in non-marketable securities,” that were initially measured at cost and have been written down to fair value as a result of impairment or adjusted to record the fair value of new instruments received (i.e., preferred shares) in exchange for old instruments (i.e., debt instruments). The following table shows the fair value hierarchy for these assets measured at fair value on a non-recurring basis as follows:

Assets	Level 3	September 30, 2016	Net loss for the three months ended September 30, 2016
Other non-marketable investments	$1,009,000	$ 1,009,000	$ (20,000)

Assets	Level 3	June 30, 2016	Net loss for the three months ended September 30, 2015
Other non-marketable investments	$1,029,000	$ 1,029,000	$ -

Other investments in non-marketable securities are carried at cost net of any impairment loss. The Company has no significant influence or control over the entities that issue these investments and holds less than 20% ownership in each of the investments. These investments are reviewed on a periodic basis for other-than-temporary impairment. The Company reviews several factors to determine whether a loss is other-than-temporary. These factors include but are not limited to: (i) the length of time an investment is in an unrealized loss position, (ii) the extent to which fair value is less than cost, (iii) the financial condition and near term prospects of the issuer and (iv) our ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in fair value.

NOTE 7 – STOCK BASED COMPENSATION PLANS

The Company follows Accounting Standard Codification (ASC) Topic 718 “Compensation – Stock Compensation”, which addresses accounting for equity-based compensation arrangements, including employee stock options and restricted stock units.

Please refer to Note 16 – Stock Based Compensation Plans in the Company's Form 10-K for the year ended June 30, 2016 for more detail information on the Company’s stock-based compensation plans.

During the three months ended September 30, 2016 and 2015, the Company recorded stock option compensation cost of $72,000 and $123,000, respectively, related to stock options that were previously issued. As of September 30, 2016, there was a total of $287,000 of unamortized compensation related to stock options which is expected to be recognized over the weighted-average period of 2.25 years.

Option-pricing models require the input of various subjective assumptions, including the option’s expected life and the price volatility of the underlying stock. The expected stock price volatility is based on analysis of the Company’s stock price history. The Company has selected to use the simplified method for estimating the expected term. The risk-free interest rate is based on the U.S. Treasury interest rates whose term is consistent with the expected life of the stock options. No dividend yield is included as the Company has not issued any dividends and does not anticipate issuing any dividends in the future.

The following table summarizes the stock options activity from July 1, 2015 through September 30, 2016:

		Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Life	Aggregate Intrinsic Value
Oustanding at	July 1, 2015	350,000	$ 16.70	6.95 years	$939,000
Granted		-	-		
Exercised		-	-		
Forfeited		-	-		
Exchanged		-	-		
Oustanding at	June 30, 2016	350,000	$ 16.70	5.95 years	$3,082,000
Exercisable at	June 30, 2016	236,000	$ 15.54	5.33 years	$2,351,000
Vested and Expected to vest at	June 30, 2016	350,000	$ 16.70	5.95 years	$3,082,000
Oustanding at	July 1, 2016	350,000	$ 16.70	5.95 years	$3,082,000
Granted		-	-		
Exercised		-	-		
Forfeited		-	-		
Exchanged		-	-		
Oustanding at	September 30, 2016	350,000	$ 16.70	5.69 years	$2,662,000
Exercisable at	September 30, 2016	236,000	$ 15.54	5.08 years	$2,068,000
Vested and Expected to vest at	September 30, 2016	350,000	$ 16.70	5.69 years	$2,662,000

NOTE 8 – SEGMENT INFORMATION

The Company operates in four reportable segments, the operation of the hotel (“Hotel Operations”), the operation of its multi-family residential properties (“Real Estate Operations”) and the investment of its cash in marketable securities and other investments (“Investment Transactions”). These four operating segments, as presented in the financial statements, reflect how management internally reviews each segment’s performance. Management also makes operational and strategic decisions based on this information.

Information below represents reported segments for the three months ended September 30, 2016 and 2015. Operating income (loss) from hotel operations consist of the operation of the hotel and operation of the garage. Operating income for rental properties consist of rental income. Operating income (loss) for investment transactions consist of net investment gain (loss), impairment loss on other investments, net unrealized gain (loss) on other investments, dividend and interest income and trading and margin interest expense. The other segment consists of corporate general and administrative expenses and the income tax expense for the entire Company.

As of and for the three months ended September 30, 2016	Hotel Operations	Real Estate Operations	Investment Transactions	Other	Total
Revenues	$14,605,000	$3,649,000	$-	$-	$18,254,000
Segment operating expenses	(10,256,000)	(1,807,000)	-	(728,000)	(12,791,000)
Segment income (loss) from operations	4,349,000	1,842,000	-	(728,000)	5,463,000
Interest expense - mortgage	(1,829,000)	(633,000)	-	-	(2,462,000)
Depreciation and amortization expense	(713,000)	(555,000)	-	-	(1,268,000)
Income from investments	-	-	914,000	-	914,000
Income tax expense	-	-	-	(1,052,000)	(1,052,000)
Net income (loss)	$1,807,000	$654,000	$914,000	$(1,780,000)	$1,595,000
Total assets	$50,985,000	$56,285,000	$20,319,000	$9,994,000	$137,583,000

As of and for the three months ended September 30, 2015	Hotel Operations	Real Estate Operations	Investment Transactions	Other	Total
Revenues	$15,138,000	$3,582,000	$-	$-	$18,720,000
Segment operating expenses	(11,193,000)	(1,736,000)	-	(809,000)	(13,738,000)
Segment income (loss) from operations	3,945,000	1,846,000	-	(809,000)	4,982,000
Interest expense - mortgage	(1,814,000)	(650,000)	-	-	(2,464,000)
Loss on disposal of assets	(30,000)	-	-	-	(30,000)
Depreciation and amortization expense	(762,000)	(474,000)	-	-	(1,236,000)
Income from investments	-	-	79,000	-	79,000
Income tax expense	-	-	-	(618,000)	(618,000)
Net income (loss)	$1,339,000	$722,000	$79,000	$(1,427,000)	$713,000
Total assets	$50,525,000	$57,537,000	$19,511,000	$12,307,000	$139,880,000

NOTE 9 – RELATED PARTY TRANSACTIONS

Four of the Portsmouth directors serve as directors of InterGroup. Three of those directors also serve as directors of Santa Fe. The three Santa Fe directors also serve as directors of InterGroup.

John V. Winfield serves as Chief Executive Officer and Chairman of the Company, Portsmouth and Santa Fe. Depending on certain market conditions and various risk factors, the Chief Executive Officer, Portsmouth and Santa Fe may, at times, invest in the same companies in which the Company invests. The Company encourages such investments because it places personal resources of the Chief Executive Officer and the resources of Portsmouth and Santa Fe, at risk in connection with investment decisions made on behalf of the Company.

Item 1 – LEGAL PROCEEDINGS

We are involved from time to time in legal proceedings of types regarded as common in our business, including administrative or judicial proceedings, such as employment or labor disputes, breach of contract liability and premises liability litigation. Where appropriate, we may establish financial reserves for such proceedings. We also maintain insurance to mitigate certain of such risks.

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