MEMSIC Inc
Form 10-Q
November 14, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2012

or

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

For the transition period from to

Commission File No. 001-33813

MEMSIC, Inc.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	04-3457049 (I.R.S. Employer Identification No.)
One Tech Drive, Suite 325 Andover, Massachusetts (Address of principal executive offices)	01810 (Zip Code)

(978) 738-0900
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during

the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

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

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

The number of shares of common stock, par value $0.00001 per share, of the registrant outstanding as of November 12, 2012 was 24,199,585.

MEMSIC, Inc.

FORM 10-Q, September 30, 2012

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

MEMSIC, Inc.
CONSOLIDATED BALANCE SHEETS
(Unaudited)

	September 30, 2012	December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$25,347,187	$51,914,128
Restricted cash	2,706,830	3,791,189
Short-term investments	33,640,012	6,814,728
Accounts receivable, net of allowance for doubtful accounts of $41,815 and $6,441, respectively, as of September 30, 2012 and December 31, 2011	6,833,143	6,068,904
Inventories	9,775,070	11,459,153
Other current assets	2,751,586	2,050,787
Total current assets	81,053,828	82,098,889
Property and equipment, net	29,488,751	30,998,489
Long-term investments	2,600,000	2,600,000
Goodwill	612,578	606,976
Intangible assets, net	10,133,406	11,091,532
Other assets	141,610	136,633
Total assets	$124,030,173	$127,532,519
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$4,332,101	$8,439,605
Accrued expenses	3,199,371	2,630,966
Advance research funding	2,706,830	3,791,189
Current portion of note payable to bank	1,000,000	500,000
Total current liabilities	11,238,302	15,361,760
Note payable to bank, net of current portion	16,430,000	17,430,000
Building liability	8,064,310	8,161,288
Other liabilities	97,105	124,180
Total other liabilities	24,591,415	25,715,468
Stockholders’ equity:		
Common stock, $0.00001 par value; authorized, 45,000,000 shares; 24,199,585 and 23,983,813 shares issued and outstanding at September 30, 2012 and December 31, 2011, respectively	242	240
Additional paid-in capital	102,556,701	101,266,272
Accumulated other comprehensive income	4,423,913	4,363,930
Accumulated deficit	(19,487,200)	(19,908,135)

MEMSIC, Inc. stockholders' equity	87,493,656	85,722,307
Non-controlling interest related to joint ventures	706,800	732,984
Total stockholders' equity	88,200,456	86,455,291
Total liabilities and stockholders' equity	$124,030,173	$127,532,519

See notes to consolidated financial statements (unaudited)

MEMSIC, Inc.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Net sales	$15,188,705	$18,357,300	$49,620,995	$46,684,854
Cost of goods sold	9,878,008	12,155,533	31,108,812	30,543,197
Gross profit	5,310,697	6,201,767	18,512,183	16,141,657
Operating expenses:				
Research and development	1,440,336	2,200,240	4,912,696	6,610,213
Sales and marketing	1,276,933	1,881,240	3,937,640	4,875,893
General and administrative	2,332,925	2,397,618	6,968,920	6,374,497
Depreciation	358,277	401,815	1,175,572	1,199,166
Amortization	338,879	403,835	1,148,887	1,212,001
Total operating expenses	5,747,350	7,284,748	18,143,715	20,271,770
Operating (loss) income	(436,653)	(1,082,981)	368,468	(4,130,113)
Other income:				
Interest and dividend income	4,378	153,227	237,412	335,082
Foreign exchange gain (loss)	209,628	328,639	(15,825)	848,114
Other, net	19,583	323,587	58,225	406,007
Total other income	233,589	805,453	279,812	1,589,203
(Loss) profit before income taxes	(203,064)	(277,528)	648,280	(2,540,910)
Provision for income taxes	96,462	58,343	194,400	172,653
Net (loss) income	(299,526)	(335,871)	453,880	(2,713,563)
Less: net income attributable to non-controlling interests	18,629	32,895	32,945	91,685
Net (loss) income attributable to MEMSIC, Inc.	$(318,155)	$(368,766)	$420,935	$(2,805,248)
Net (loss) income per common share attributable to MEMSIC, Inc.:				
Basic	$(0.01)	$(0.02)	$0.02	$(0.12)
Diluted	$(0.01)	$(0.02)	$0.02	$(0.12)
Weighted average shares outstanding used in calculating net (loss) income per common share:				
Basic	24,024,725	23,825,134	23,985,453	23,822,587
Diluted	24,024,725	23,825,134	24,414,565	23,822,587

See notes to consolidated financial statements (unaudited)

MEMSIC, Inc.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited)

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
Net (loss) income	$(299,526)	$(335,871)	$453,880	$(2,713,563)
Other comprehensive income (loss):				
Unrealized gain on investments	1,068	(199,759)	12	(200,570)
Foreign currency translation adjustments	387,628	398,169	59,972	943,809
Comprehensive income (loss)	89,170	(137,461)	513,863	(1,970,324)
Less: income attributable to noncontrolling interest	18,629	32,895	32,945	91,685
Foreign currency translation adjustment	-	-	-	(3,025)
Comprehensive income attributable to noncontrolling interests	18,629	32,895	32,945	88,660
Comprehensive income (loss) attibutable to MEMSIC, Inc.	$70,541	$(170,356)	$480,918	$(2,058,984)

See notes to consolidated financial statements (unaudited)

MEMSIC, Inc.
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(Unaudited)

	Common Stock		Additional Paid-In	Accumulated Other Comprehensive	Accumulated	MEMSIC, Inc. Stockholders'	Non-controlling	Total
	Shares	Par Value	Capital	Income	Deficit	Equity	Interest	Equity
Balance at December 31, 2011	23,983,813	$240	$101,266,272	$4,363,930	$(19,908,135)	$85,722,307	$732,984	$86,455,291
Net income				-	420,935	420,935	32,945	453,880
Foreign currency translation adjustment				59,972	-	59,972	-	59,972
Unrealized loss on short-term investment				12	-	12	-	12
Comprehensive income				59,983	420,935	480,918	32,945	513,863
Exercise of options to purchase common stock	106,468	1	193,537			193,538		193,538
Issuance of restricted stock award	109,304	1	(7,224)			(7,223)		(7,223)
Stock compensation expense			1,104,116			1,104,116		1,104,116
Dividend paid to Japan non-controlling interest							(59,129)	(59,129)
Balance at September 30, 2012	24,199,585	$242	$102,556,701	$4,423,913	$(19,487,200)	$87,493,656	$706,800	$88,200,456

See notes to consolidated financial statements (unaudited)

MEMSIC, Inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine months ended September 30,	
	2012	2011
Cash flows from operating activities:		
Net income (loss)	$453,880	$(2,713,563)
Adjustments to reconcile net income (loss) to cash used in operating activities:		
Depreciation	2,626,577	2,293,162
Amortization	1,164,783	1,240,241
Stock compensation expense	1,104,116	1,259,202
Deferred rent	(27,075)	42,421
Deferred income taxes	(14,252)	46,483
Changes in operating assets and liabilities:		
Restricted cash	1,086,261	(773,318)
Accounts receivable	(765,348)	(3,711,949)
Inventories	1,691,000	(338,568)
Other assets	(814,422)	(104,043)
Advance research funding	(1,086,261)	773,318
Accounts payable and accrued expenses	(3,560,466)	3,212,975
Net cash provided by operating activities	1,858,793	1,226,361
Cash flows from investing activities:		
Purchase of short-term investments	(26,825,076)	(1,414,578)
Proceeds from sale of long-term investments	-	200,000
Purchase of property and equipment	(1,089,522)	(2,502,862)
Net cash used in investing activities	(27,914,598)	(3,717,440)
Cash flows from financing activities:		
Cash dividend paid to non-controlling interest	(59,129)	(115,389)
Proceeds from exercise of options to purchase common stock	186,315	55,662
Payment on note payable to bank	(500,000)	-
Net cash used in financing activities	(372,814)	(59,727)
Effect of exchange rate changes on cash and cash equivalents	(138,322)	(616,780)
Net decrease in cash and cash equivalents	(26,566,941)	(3,167,586)
Cash and cash equivalents —beginning of period	51,914,128	55,694,205
Cash and cash equivalents —end of period	$25,347,187	$52,526,619

See notes to consolidated financial statements (unaudited)

MEMSIC, Inc.

Notes to Unaudited Consolidated Financial Statements

1. NATURE OF THE BUSINESS AND OPERATIONS

MEMSIC, Inc. (the Company) was incorporated on March 3, 1999 as a Delaware corporation. The Company is a leading provider of semiconductor sensor systems solutions based on micro electromechanical systems (MEMS) technology and advanced integrated circuit design. The Company's sensor and solution products have a wide range of applications for consumer electronics, mobile phones, automotive (airbags, rollover detection, electronic stability control and navigation systems), as well as business, industrial and medical applications.

MEMSIC, Inc. maintains its corporate headquarters in Massachusetts. All manufacturing operations are provided by its wholly-owned subsidiary, MEMSIC Semiconductor (Wuxi) Company Limited (MEMSIC Semiconductor) and its indirect wholly owned subsidiary, MEMSIC Transducer Systems Company Limited (MTS), which are located in the People's Republic of China (PRC). The Company also has a majority (51%) owned and controlled joint venture, Crossbow Japan Limited (Crossbow Japan) and an indirect majority (67%) owned and controlled joint venture, MEMSIC Wuxi Wireless Sensor Network Technology Company Limited (Wuxi WSN) in the PRC.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The accompanying unaudited consolidated financial statements include the accounts of the Company, MEMSIC Semiconductor, MTS, Crossbow Japan and Wuxi WSN. The Company presents all of Crossbow Japan's and Wuxi WSN's assets, liabilities, revenue and expenses, as well as the non-controlling interests in joint ventures in its consolidated financial statements. All significant intercompany balances and transactions have been eliminated in consolidation.

Unaudited Interim Financial Information

The accompanying interim consolidated financial statements are unaudited. These financial statements and notes should be read in conjunction with the audited consolidated financial statements and related notes, together with management's discussion and analysis of financial condition and results of operations, contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2011, which is on file with the Securities and Exchange Commission (SEC).

The accompanying unaudited interim consolidated financial statements have been prepared pursuant to the rules and regulations of the SEC. Certain information and footnote disclosures normally included in financial statements that have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) have been condensed or omitted pursuant to such SEC rules and regulations. In the opinion of management, the unaudited interim consolidated financial statements and notes have been prepared on the same basis as the audited consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2011, and include all adjustments (consisting of normal, recurring adjustments) necessary for the fair presentation of the Company's financial position at September 30, 2012, results of operations for the three and nine months ended September 30, 2012 and 2011 and cash flows for the nine months ended September 30, 2012 and 2011. The interim periods are not necessarily indicative of results to be expected for any other interim periods or for the full year.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires the Company to make estimates and assumptions that affect at the date of the financial statements the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses. Actual results could differ from these estimates.

Cash Equivalents

The Company considers all highly liquid instruments with an original maturity of three months or less to be cash equivalents.

Restricted Cash

The Company has presented cash on hand associated with advance research funding received from the Chinese government as restricted cash since the cash must be maintained in a separate bank account and used only for specified research projects.

Advance Research Funding

Advance research funding represents research funding granted by the Chinese government for specific research and development projects the Company is taking on. The amount received is initially recorded as a liability and subsequently recognized as a credit to research and development expenses in the statements of operations or to the carrying value of equipment purchased for the projects as the Company performs the projects and has complied with the conditions or performance obligations attached to the related government grants. There are no conditions under which amounts utilized are required to be refunded under the terms of the grants.

Advance research funding activities for the nine months ended September 30, 2012 are as follows:

		Advanced Research Funding	
Balance at January 1, 2012	$	3,791,189	
Funds received		445,519	
Research and development activities		(669,946	)
Property and equipment expenditures		(865,421	)
Foreign exchange rate impact		5,489	
Balance at September 30, 2012	$	2,706,830	

Short-term Investments

Short-term investments consist primarily of bank certificate deposits, government and municipal bonds with maturities of one year or less. The Company classifies its short-term investments as “held-to-maturity”, which are carried at amortized cost.

Foreign Currency

The Company’s manufacturing operations and certain other operations are conducted by MEMSIC Semiconductor, MTS and Wuxi WSN. The functional currency of MEMSIC Semiconductor, MTS and Wuxi WSN is the Renminbi. Financial transactions between the Company and MEMSIC Semiconductor and MTS are conducted in United States dollars. At September 30, 2012 and December 31, 2011, the underlying currency for approximately 53.1% and 56.4% of consolidated assets, respectively, was the Renminbi. The functional currency of the acquired joint venture Crossbow Japan is the Japanese Yen. Financial transactions between the Company and Crossbow Japan are conducted in United States dollars. At September 30, 2012 and December 31, 2011, the underlying currency for approximately 1.5% and 1.2% of consolidated assets, respectively, was the Japanese Yen. The Company does not believe that it is

subject to significant foreign exchange risk and, accordingly, has not utilized hedging strategies with respect to such foreign exchange exposure.

The financial statements of MEMSIC Semiconductor, MTS, Wuxi WSN and Crossbow Japan are translated into United States dollars in accordance with GAAP, utilizing the following method: assets and liabilities are translated at the exchange rate in effect at the end of the period, and revenues and expenses are translated at the weighted average exchange rate during the year. Cumulative translation gains and losses are included as a separate component of stockholders' equity and reported as a part of comprehensive income. Transaction gains and losses are included in the consolidated statements of operations as incurred.

Net Income (Loss) per Common Share

Basic net income (loss) per share is calculated by dividing net income (loss) by the weighted-average common shares outstanding during the period. Diluted net income (loss) per share is calculated by dividing net income (loss) by the weighted-average common shares and potentially dilutive securities outstanding during the period using the treasury stock method.

Income Taxes

Deferred tax assets and liabilities relate to temporary differences between the financial reporting basis and the tax basis of assets and liabilities, the carryforward tax losses and available tax credits. Such assets and liabilities are measured using tax rates and laws expected to be in effect at the time of their reversal or utilization. Valuation allowances are established, when necessary, to reduce the net deferred tax asset to an amount more likely than not to be realized. For interim reporting periods, the Company uses the estimated annual effective tax rate except with respect to discrete items, whose impact is recognized in the interim period in which the discrete item occurred.

Inventories

Inventories are stated at the lower of cost (weighted average FIFO) or market. The Company evaluates its inventory for potential excess and obsolete inventories based on forecasted demands and records a provision for such amounts as necessary.

Revenue Recognition

The Company recognizes revenue from the sale of its products to its customers when all of the following conditions have been met: (i) evidence exists of an arrangement with the customer, typically consisting of a purchase order or contract; (ii) the Company's products have been shipped and risk of loss has passed to the customer; (iii) the Company has completed all of the necessary terms of the purchase order or contract; (iv) the amount of revenue to which the Company is entitled is fixed or determinable; and (v) the Company believes it is probable that it will be able to collect the amount due from the customer based upon an evaluation of the customer's creditworthiness. To the extent that one or more of these conditions has not been satisfied, the Company defers recognition of revenue. An allowance for estimated future product returns and sales price allowances is established at the date of revenue recognition. An allowance for uncollectible receivables is established by a charge to operations when, in the opinion of the Company, it is probable that the amount due to the Company will not be collected.

The Company sells its products to distributors as well as to end customers. Sales to distributors are made pursuant to distributor agreements, which allow for the return of goods under certain limited circumstances. Accordingly, the Company follows the following criteria for recognition of sales to distributors: (i) the selling price to the distributor is fixed or determinable at the date of shipment; (ii) the distributor's obligation to pay the selling price is not contingent on resale of the product; (iii) the Company's product has been shipped and risk of loss has passed to the distributor; (iv) it is probable that the amount due from the distributor will be collected; (v) the Company does not have significant future obligations to directly assist in the distributor's resale of the product; and (vi) the amount of future

returns can be reasonably estimated. Once these criteria are met, the Company recognizes revenue upon shipment to the distributor and estimates returns based on historical sales returns.

Stock-Based Compensation

The Company accounts for share-based payments to employees based on requirements that all share-based payments to employees, including grants of employee stock options, shall be recognized in the financial statements based on their fair values. The cost of equity-based service awards is based on the grant-date fair value of the award and is recognized over the period during which the employee is required to provide service in exchange for the award (vesting period). Stock-based compensation arrangements with non-employees are accounted for utilizing the fair value method or, if a more reliable measurement, the value of the services or consideration received. The resulting compensation expense is recognized for financial reporting purposes over the term of performance or vesting.

Recent Accounting Pronouncements

In July 2012, the FASB issued ASU No. 2012-02, Intangibles — Goodwill and Other (ASC Topic 350), Testing Indefinite-Lived Intangible Assets for Impairment, which adds an optional qualitative assessment for determining whether an indefinite-lived intangible asset is impaired, similar to the goodwill guidance issued in ASU 2011-08. Companies have the option to first perform a qualitative assessment to determine whether it is more likely than not (a likelihood of more than 50%) that an indefinite-lived intangible asset is impaired. If a company determines that it is more likely than not that the fair value of such an asset exceeds its carrying amount, it would not need to calculate the fair value of the asset in that year. However, if a company concludes otherwise, it must calculate the fair value of the asset, compare that value with its carrying amount and record an impairment charge, if any. The guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The adoption of ASU No. 2012-02 did not have a material effect on the Company’s financial position, results of operations or cash flows.

In September 2011, the FASB amended ASC Topic 350, Intangibles — Goodwill and Other. This amendment is intended to reduce the cost and complexity of the annual goodwill impairment test by providing entities an option to perform a qualitative assessment to determine whether further impairment testing is necessary. The amended provisions are effective for reporting periods beginning on or after December 15, 2011. This amendment impacts testing steps only and, therefore, adoption will not have an impact on the Company’s consolidated financial position, results of operations or cash flows.

In June 2011, the FASB issued ASU 2011-05, which amended ASC Topic 220, Comprehensive Income. This amendment was issued to enhance comparability between entities that report under GAAP and International Financial Reporting Standards (IFRS) and to provide a more consistent method of presenting non-owner transactions that affect an entity’s equity. The amendment requires companies to present the components of net income and other comprehensive income either as one continuous statement or as two separate but consecutive statements. It eliminates the option to report other comprehensive income and its components as part of the statement of changes in shareholders’ equity. Furthermore, regardless of the presentation methodology elected, the issuer will be required to present on the face of the financial statements a reclassification adjustment for items that are reclassified from other comprehensive income to net income. The methodology for the computation and presentation of earnings per share remains the same. The pronouncement is effective for fiscal years beginning after December 15, 2011 and is to be applied retrospectively. As this pronouncement relates to disclosure only, the adoption did not have an impact on the Company’s consolidated financial position, results of operations or cash flows.

In December 2011, the FASB issued ASU 2011-12, deferring a requirement in ASU 2011-05 that companies present reclassification adjustments for each component of accumulated other comprehensive income (AOCI) in both net income and other comprehensive income (OCI) on the face of the financial statements. Companies continue to be required to present amounts reclassified out of AOCI on the face of the financial statement in which the components of OCI are presented or to disclose those amounts in the notes to the financial statements. The FASB is reconsidering

the presentation requirements for reclassification adjustments.

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement (ASC Topic 820), Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS (ASU No. 2011-04). The amendments in this update apply to all reporting entities that are required or permitted to measure or disclose the fair value of an asset, a liability, or an instrument classified in a reporting entity's shareholders' equity in the financial statements. ASU No. 2011-04 does not extend the use of fair value accounting, but provides guidance on how it should be applied where its use is already required or permitted by other standards within U.S. GAAP or IFRS. ASU No. 2011-04 changes the wording used to describe many requirements in GAAP for measuring fair value and for disclosing information about fair value measurements. Additionally, ASU No. 2011-04 clarifies the FASB's intent about the application of existing fair value measurements. The amendments in this update are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. The adoption of ASU No. 2011-04 did not have a material effect on the Company's financial position, results of operations or cash flows.

3. LONG-TERM INVESTMENTS

Investments held by the Company at September 30, 2012 and December 31, 2011 consisted primarily of auction rate securities, or ARS, and are considered available for sale. These securities reset the interest or dividend rates by auctions held at intervals of 7, 28, 35 or 49 days, and at such dates the Company has the option to sell such securities. The auction rate securities held by the Company have a contractual maturity of greater than 10 years.

These investments are carried at fair value, with the unrealized gains and losses, if any, net of tax, reported in other comprehensive income. The cost of securities sold is based on the specific identification method. Interest and dividends on securities are included in interest and dividend income. Quarterly, management reviews the valuation of investments and considers whether any decline in value is deemed to be other than a temporary decline.

At September 30, 2012, the Company held one ARS investment: Illinois Educational Facilities Authority Select Auction Variable Rate Securities having a value at par of $3.0 million with a maturity date in 2028. The carrying value of this investment at September 30, 2012 was $2.6 million, net of a $0.4 million temporary unrealized impairment loss. The Company has classified this investment as a long-term asset due to liquidity issues experienced in global credit and capital markets as well as failed auctions since the first quarter of 2008. A failed auction means that the amount of securities submitted for sale at auction exceeded the amount of purchase orders. If an auction fails, the issuer becomes obligated to pay interest at penalty rates, and all of the auction rate securities the Company holds continue to pay interest in accordance with their stated terms. However, the failed auctions create uncertainty as to the liquidity of these securities.

Based on the Company's expected operating cash flows, and other sources of cash, the Company does not expect the potential lack of liquidity in these investments to affect its ability to execute its current business plan in the near term.

4. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company's financial instruments consist primarily of cash equivalents, restricted cash, short-term investments, accounts receivable, long-term investments, accounts payable, notes payable, accrued expenses and long-term debt. The carrying amounts of the Company's financial instruments, which include cash equivalents, restricted cash, short-term investments, accounts receivable, accounts payable, notes payable and accrued expenses, approximate their fair values due to the short-term nature of the instruments. Long-term investments are measured at fair value on a recurring basis. The Company's long-term debt consists of a five-year project loan from Agricultural Bank of China and reflects currently available terms and conditions. Consequently, the carrying value of the Company's long-term debt approximates fair value.

Fair Value Measurement

The Company accounts for assets and liabilities recognized or disclosed in the financial statements at fair value on a recurring basis in accordance with the provisions of ASC Topic 820.

ASC Topic 820 provides that fair value is an exit price, representing the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants based on the highest and best use of the asset or liability. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. ASC Topic 820 requires the Company to use valuation techniques to measure fair value that maximize the use of observable inputs and minimize the use of unobservable inputs. These inputs are prioritized as follows:

Level 1: Observable inputs such as quoted prices for identical assets or liabilities in active markets

Level 2: Other inputs that are observable directly or indirectly, such as quoted prices for similar assets or liabilities or market-corroborated inputs

Level 3: Unobservable inputs for which there is little or no market data and which require the Company to develop its own assumptions about how market participants would price the assets or liabilities

The valuation techniques that may be used to measure fair value are as follows:

A. Market approach - Uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities
B. Income approach - Uses valuation techniques to convert future amounts to a single present amount based on current market expectations about those future amounts, including present value techniques, option-pricing models and excess earnings method
C. Cost approach - Based on the amount that currently would be required to replace the service capacity of an asset (replacement cost)

The following table sets forth the Company's financial instruments that are measured at fair value on a recurring basis and presents them within the fair value hierarchy using the lowest level of input that is significant to the fair value measurement at September 30, 2012 (in thousands):

	Carrying amount as of September 30, 2012	Quoted prices in active markets available (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Valuation Technique
Cash equivalents	$ 25,347	$ 25,347	$ -	$ -	(A)
Restricted cash	2,707	2,707	-	-	(A)
Short-term investments	33,640	33,640	-	-	(A)
Long-term investments	2,600 50,000				
Convertible Senior Notes(2)	75,000	70,082			
SBA Debenture(3)	225,000	188,750	225,000	170,000	
Total	$ 395,000	$ 258,832	$ 295,000	$ 170,000	

(1) Except for the Convertible Senior Notes (as defined below), all carrying values are the same as the principal amount outstanding.

(2) Represents the aggregate principal amount outstanding of the Convertible Senior Notes (as defined below) less the unaccreted discount initially recorded upon issuance of the Convertible Notes. The total unaccreted discount for the Convertible Senior Notes was $4,918 at September 30, 2011.

(3) The Company has the ability to borrow an additional $36.3 million subject to SBA approval and compliance with SBIC regulations.

On September 27, 2006, HT II received a license and on May 26, 2010 HT III received a license to operate as SBICs under the SBIC program and are able to borrow funds from the SBA against eligible investments. As of September 30, 2011, all required contributed capital from the Company has been invested into HT II and HT III. The Company is the sole limited partner of HT II and HT III and HTM is the general partner. HTM is a wholly-owned subsidiary of the Company. If HT II or HT III fails to comply with applicable SBA regulations, the SBA could, depending on the severity of the violation, limit or prohibit HT II s or HT III s use of debentures, declare

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outstanding debentures immediately due and payable, and/or limit HT II or HT III from making new investments. In addition, HT II or HT III may also be limited in their ability to make distributions to us if they do not have sufficient capital in accordance with SBA regulations. Such actions by the SBA would, in turn, negatively affect us because HT II and HT III are our wholly owned subsidiaries. HT II and HT III were in compliance with the terms of the SBIC s leverage as of September 30, 2011 as a result of having sufficient capital as defined under the SBA regulations.

In aggregate, HT II and HT III hold approximately $334.9 million in assets, and accounted for approximately 35.5% of our total assets prior to consolidation at September 30, 2011.

With our net investment of $75.0 million in HT II as of September 30, 2011, HT II has the capacity to issue a total of $125.0 million of SBA guaranteed debentures, of which $125.0 million was outstanding at September 30, 2011. As of September 30, 2011, the maximum statutory limit on the dollar amount of outstanding SBA guaranteed debentures issued by a single SBIC is $150.0 million, subject to periodic adjustments by the SBA. As of September 30, 2011, we held investments in HT II in 84 companies with a fair value of approximately $180.8 million, accounting for approximately 31.4% of our total portfolio at September 30, 2011.

As of September 30, 2011, the maximum statutory limit on the dollar amount of combined outstanding SBA guaranteed debentures is $225.0 million, subject to periodic adjustments by the SBA. As of September 30, 2011, HT III had the potential to borrow up to $100.0 million of SBA-guaranteed debentures under the SBIC program. With our net investment of $50.0 million in HT III as of September 30, 2011, HT III has the capacity to issue a total of $100.0 million of SBA guaranteed debentures, subject to SBA approval, of which $63.75 million was outstanding at September 30, 2011. As of September 30, 2011, HT III has paid the SBA commitment fees of approximately $750,000. As of September 30, 2011, we held investments in HT III in 20 companies with a fair value of approximately $92.4 million accounting for approximately 16.0% of our total portfolio at September 30, 2011.

(in thousands)

Issuance/Pooling Date	Maturity Date	Interest Rate[1]	September 30, 2011	December 31, 2010
SBA Debentures:				
September 26, 2007	September 1, 2017	6.43%	$ 12,000	$ 12,000
March 26, 2008	March 1, 2018	6.38%	$ 58,050	$ 58,050
September 24, 2008	September 1, 2018	6.63%	$ 13,750	$ 38,750
March 25, 2009	March 1, 2019	5.53%	$ 18,400	$ 18,400
September 23, 2009	September 1, 2019	4.64%	$ 3,400	$ 3,400
September 22, 2010	September 1, 2020	3.62%	$ 6,500	$ 6,500
September 22, 2010	September 1, 2020	3.50%	$ 22,900	$ 32,900
March 29, 2011	March 1, 2021	4.37%	$ 28,750	$
September 21, 2011	September 1, 2021	3.16%	$ 25,000	$
Total SBA Debentures			**$ 188,750**	**$ 170,000**

(1) Interest rate includes annual charge

Current Market Conditions

Beginning in the fall of 2008, the global economy entered a financial crisis and recession. Volatile capital and credit markets, declining business and consumer confidence and increased unemployment precipitated a continuing economic slowdown. Although there have been signs of recovery in many regions, economic weakness could continue or worsen. For example, the current U.S. debt ceiling and budget deficit concerns, together with signs of deteriorating sovereign debt conditions in Europe, have increased the possibility of credit-rating downgrades and economic slowdowns. Although U.S. lawmakers passed legislation to raise the federal debt ceiling, Standard & Poor s Ratings Services lowered its long-term sovereign credit rating on the United States from AAA to AA+ on August 5, 2011. The impact of this or any further downgrades to the U.S. government s sovereign credit rating, or its perceived creditworthiness, and the impact of the current crisis in

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Europe with respect to the ability of certain European Union countries to continue to service their sovereign debt obligations is inherently unpredictable and could adversely effect the U.S. and global financial markets and economic conditions. There can be no assurance that governmental or other measures to aid economic recovery will be effective. We anticipate that there may be yield compression as 2011 comes to an end, however, given our level of liquidity and pipeline, we believe that we are well positioned despite the uncertainty in the market. Continued adverse economic conditions could have a material adverse effect on our business, financial condition and results of operations.

We may acquire a portfolio of investments or sell a portion of our portfolio on an opportunistic basis. We, from time to time, engage in discussions with counterparties in respect of various potential transactions. Some of these transactions could be material to our business. Consummation of any such transaction will be subject to completion of due diligence finalization of key business and financial terms (including price) and negotiation of final definitive documentation as well as a number of other factors and conditions including, without limitation, the approval of our Board of Directors and required third party consents and, in certain cases, the approval of our stockholders. Accordingly, there can be no assurance that any such transaction would be consummated.

We periodically review and assess investment portfolio acquisition opportunities of target companies that would be accretive to us. In the future, we may determine to acquire such portfolios which could affect our liquidity position and necessitate our need to raise additional capital to fund our growth.

Commitments

In the normal course of business, we are party to financial instruments with off-balance sheet risk. These consist primarily of unfunded commitments to extend credit, in the form of loans, to our portfolio companies. Unfunded commitments to provide funds to portfolio companies are not reflected on our balance sheet. Our origination activity unfunded commitments may be significant from time to time. As of September 30, 2011, we had unfunded commitments of approximately $148.2 million. These commitments will be subject to the same underwriting and ongoing portfolio maintenance as are the on-balance sheet financial instruments that we hold. Since these commitments may expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. Closed commitments generally fund 70-80% of the committed amount in aggregate over the life of the commitment. We intend to use cash flow from normal and early principal repayments, SBA debentures, our Wells Facility, our Union Bank Facility and proceeds from Senior Secured Notes to fund these commitments. However, there can be no assurance that we will have sufficient capital available to fund these commitments as they come due.

In addition, we had approximately $136.0 million of non-binding term sheets outstanding with nine companies, which generally convert to contractual commitments within approximately 45 to 60 days of signing. Non-binding outstanding term from prior release are subject to completion of our due diligence and final approval process, as well as the negotiation of definitive documentation with the prospective portfolio companies. Not all non-binding term sheets are expected to close and do not necessarily represent future cash requirements.

Contractual Obligations

The following table shows our contractual obligations as of September 30, 2011:

		Payments due by period (in thousands)			
Contractual Obligations[1][2]	**Total**	**Less than 1 year**	**1 - 3 years**	**3 - 5 years[3]**	**After 5 years[4]**
Borrowings	$ 258,832	$	$	$ 70,082	$ 188,750
Operating Lease Obligations[5]	2,488	1,242	1,245		
Total	$ 261,320	$ 1,242	$ 1,245	$ 70,082	$ 188,750

(1) Excludes commitments to extend credit to our portfolio companies.
(2) We also have warrant participation obligation with Citigroup. See Borrowings.
(3) Represents the aggregate principal amount outstanding of the Convertible Senior Notes (as defined below) less the unaccreted discount initially recorded upon issuance of the Convertible Notes. The total unaccreted discount for the Convertible Senior Notes was $4,918 at September 30, 2011.
(4) Borrowings under the SBA debentures
(5) Long-term facility leases

Hercules and its executives and directors are covered by Directors and Officers Insurance, with the directors and officers being indemnified by Hercules to the maximum extent permitted by Maryland law subject to the restrictions in the 1940 Act.

Borrowings

Long-term SBA Debentures

On September 27, 2006, HT II received a license to operate as a SBIC under the SBIC program and is able to borrow funds from the SBA against eligible investments and regulatory capital. Under the Small Business Investment Company Act and current SBA policy applicable to SBICs, a SBIC can have outstanding at any time SBA guaranteed debentures up to twice the amount of its regulatory capital. As of September 30, 2011, the maximum statutory limit on the dollar amount of outstanding SBA guaranteed debentures issued by a single SBIC is $150.0 million, subject to periodic adjustments by the SBA. HT II has a total of $125.0 million of SBA guaranteed debentures outstanding as of September 30, 2011 and has paid the SBA commitment fees of approximately $1.5 million. As of September 30, 2011, the Company held investments in HT II in 84 companies with a fair value of approximately $180.8 million, accounting for approximately 31.4% of our total portfolio at September 30, 2011.

On May 26, 2010, HT III received a license to operate as a SBIC under the SBIC program and is able to borrow funds from the SBA against eligible investments and additional contributions to regulatory capital. With the Company s net investment of $50.0 million in HT III as of September 30, 2011, HT III has the capacity to issue a total of $100.0 million of SBA guaranteed debentures, subject to SBA approval, of which $63.75 million was outstanding as of September 30, 2011. As of September 30, 2011, HT III has paid commitment fees of approximately $750,000. As of September 30, 2011, the Company held investments in HT III in 20 companies with a fair value of approximately $92.4 million accounting for approximately 16.0% of our total portfolio at September 30, 2011.

There is no assurance that HT II or HT III will be able to draw up to the maximum limit available under the SBIC program.

SBICs are designed to stimulate the flow of private equity capital to eligible small businesses. Under present SBA regulations, eligible small businesses include businesses that have a tangible net worth not exceeding $18 million and have average annual fully taxed net income not exceeding $6.0 million for the two most recent fiscal years. In addition, SBICs must devote 25.0% of its investment activity to smaller concerns as defined by the SBA. A smaller concern is one that has a tangible net worth not exceeding $6.0 million and has average annual fully taxed net income not exceeding $2.0 million for the two most recent fiscal years. SBA regulations also provide alternative size standard criteria to determine eligibility, which depend on the industry in which the business is engaged and are based on such factors as the number of employees and gross sales. According to SBA regulations, SBICs may make long-term loans to small businesses, invest in the equity securities of such businesses and provide them with consulting and advisory services. Through its wholly-owned subsidiaries HT II and HT III, the Company plans to provide long-term loans to qualifying small businesses, and in connection therewith, make equity investments.

HT II and HT III are periodically examined and audited by the SBA s staff to determine their compliance with SBA regulations. If HT II or HT III fails to comply with applicable SBA regulations, the SBA could, depending on the severity of the violation, limit or prohibit HT II s or HT III s use of debentures, declare outstanding debentures immediately due and payable, and/or limit HT II or HT III from making new investments. In addition, HT II or HT III may also be limited in their ability to make distributions to the Company if they do not have sufficient capital in accordance with SBA regulations. Such actions by the SBA would, in turn, negatively affect the Company because HT II and III are the Company s wholly owned subsidiaries. HT II and HT III were in compliance with the terms of the SBIC s leverage as of September 30, 2011 as a result of having sufficient capital as defined under the SBA regulations. As of September 30, 2011, HT III could draw up to $36.25 million, respectively, of additional leverage from SBA.

The rates of borrowings under various draws from the SBA beginning in April 2007 are set semiannually in March and September and range from 2.88% to 5.73%. Interest payments on SBA debentures are payable semi-annually. There are no principal payments required on these issues prior to maturity and no prepayment penalties. Debentures under the SBA generally mature ten years after being borrowed. Based on the initial draw down date of April 2007, the initial maturity of SBA debentures will occur in April 2017. In addition, the SBA charges a fee that is set annually, depending on the Federal fiscal year the leverage commitment was delegated by the SBA, regardless of the date that the leverage was drawn by the SBIC. The annual fees related to HT II debentures that pooled on September 22, 2010 were 0.406% and 0.285%, depending upon the year the underlying commitment was closed in. The annual fee related to HT III debentures that pooled on September 21, 2011 was 0.285%. The annual fees on other debentures have been set at 0.906%. The average amount of debentures outstanding for the quarter ended September 30, 2011 for HT II was approximately $125.0 million with an average interest rate of approximately 5.0%. The average amount of debentures outstanding for the quarter ended September 30, 2011 for HT III was approximately $63.75 million with an average interest rate of approximately 3.5%.

Wells Facility

On August 25, 2008, Hercules, through a special purpose wholly-owned subsidiary, Hercules Funding II, LLC, entered into a two-year revolving senior secured credit facility with an optional one-year extension with total commitments of $50.0 million, with Wells Fargo Capital Finance as a lender and as an arranger and administrative agent (the Wells Facility). The Wells Facility has the capacity to increase to $300.0 million if additional lenders are added to the syndicate. The Wells Facility expired in August 2011.

Borrowings under the Wells Facility will generally bear interest at a rate per annum equal to LIBOR plus 3.25% or PRIME plus 2.0%, but not less than 5.0%. The Wells Facility is collateralized by debt investments in our portfolio companies, and includes an advance rate equal to 50% of eligible loans placed in the collateral pool. The Wells Facility generally requires payment of interest on a monthly basis. All outstanding principal is due upon maturity. We have paid a total of $1.1 million in structuring fees in connection with the Wells Facility which has been amortized through August 2011.

The Wells Facility includes various financial and operating covenants applicable to the Company and its subsidiaries, in addition to those applicable to Hercules Funding II, LLC. These covenants require us to maintain certain financial ratios and a minimum tangible net worth in an amount, when added to outstanding Subordinated Indebtedness, that is in excess of $314.0 million plus 90% of the cumulative amount of equity raised after March 31, 2011. In addition, the tangible net worth covenant will increase by 90 cents on the dollar for every dollar of equity capital subsequently raised by the Company. The Wells Facility provides for customary events of default, including, but not limited to, payment defaults, breach of representations or covenants, bankruptcy events and change of control. We were in compliance with all covenants at September 30, 2011.

On June 20, 2011, we renewed the Wells Facility. Under this three-year senior secured facility, Wells Fargo Capital Finance has made commitments of $75.0 million. Borrowings under the facility will generally bear interest at a rate per annum equal to LIBOR plus 3.50%, with a floor of 5.00% and an advance rate of 50% against eligible loans. The facility will be secured by loans in the borrowing base. The Wells Facility requires the

monthly payment of a non-use fee of 0.3% for each payment date on or before September 1, 2011. The monthly payment of a non-use fee thereafter shall depend on the average balance that was outstanding on a scale between 0.0% and 0.75%. From September 1, 2011 through September 30, 2011, this non-use fee was 0.75%. The facility contains an accordion feature, in which we can increase the credit line up to an aggregate of $300.0 million, funded by additional lenders and with the agreement of Wells Fargo Capital Finance and subject to other customary conditions. We expect to continue discussions with various other potential lenders to join the new facility; however, there can be no assurances that additional lenders will join the new credit facility. This new arrangement replaced the previous $300.0 million Wells Facility under which Wells Fargo Capital Finance had committed $50.0 million in capital. On June 20, 2011 we paid an additional $1.1 million in structuring fees in connection with the Wells Facility which is being amortized through June 2014. There was no outstanding debt under the Wells Facility at September 30, 2011.

We anticipate incurring a non-use fee expense of approximately $200,000 or $0.005 per share per quarter until we borrow under the Wells Facility. In total, we expect the expense from the Convertible Senior Notes and facility fees to negatively impact earnings in the near term by approximately $1.5 million or $0.04 per quarter until any of the capital is deployed.

Union Bank Facility

On February 10, 2010, we entered a $20.0 million one-year revolving senior secured credit facility with Union Bank (the Union Bank Facility). Borrowings under the Union Bank Facility will generally bear interest at a rate per annum equal to LIBOR plus 2.25% with a floor of 4.0%, an advance rate of 50% against eligible loans, and secured by loans in the borrowing base. The Union Bank Facility required the payment of a non-use fee of 0.25% annually. The Union Bank Facility is collateralized by debt investments in our portfolio companies, and includes an advance rate equal to 50.0% of eligible loans placed in the collateral pool. The Union Bank Facility generally requires payment of interest on a monthly basis. All outstanding principal is due upon maturity. In February 2011, the maturity date of the facility was extended from May 1, 2011 to July 31, 2011. Union Bank Facility provides for customary events of default, including, but not limited to, payment defaults, breach of representations or covenants, bankruptcy events and change of control. We were in compliance with all covenants at September 30, 2011.

On June 7, 2011, we entered into an amendment to the Union Bank Facility which extended the borrowing termination date to September 30, 2011. The amendment to the Union Bank Facility also amends the maturity date of Union Bank s $20.0 million commitment to mean the earliest of: (a) December 31, 2011; (b) the date on which Union Bank s obligation to make loans is terminated and the obligations are declared to be due and payable or the commitment is terminated; or (c) the date of prepayment in full by the Company. There was no outstanding debt under the Union Bank Facility at September 30, 2011.

On November 2, 2011, we renewed and amended the Union Bank Facility. Union Bank and RBC Capital Markets have made commitments of $30.0 million and $25.0 million, respectively. The Union Bank Facility requires various financial and operating covenants. These covenants require us to maintain certain financial ratios and a minimum tangible net worth in an amount, when added to outstanding Subordinated Indebtedness, that is in excess of $314.0 million plus 90% of the amount of net cash proceeds received from the sale of common stock after March 31, 2011. The Union Bank Facility will mature on November 2, 2014, approximately three years from the date of issuance, revolving through the first 24 months with a term out provision for the remaining 12 months. The Union Bank Facility requires the payment of a non-use fee of 0.50% annually. The other terms of the Union Bank Facility generally remain unchanged, including the stated interest rate. The Union Bank Facility contains an accordion feature, in which we can increase the credit line up to an aggregate of $150.0 million, funded by additional lenders and with the agreement of Union Bank and subject to other customary conditions.

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Convertible Senior Notes

In April 2011, we issued $75.0 million in aggregate principle amount of 6.00% convertible senior notes (the Convertible Senior Notes) due 2016. As of September 30, 2011, the carrying value of the Convertible Senior Notes, comprised of the aggregate principal amount outstanding less the unaccreted discount initially recorded upon issuance of the Convertible Senior Notes, is approximately $70.1 million.

The Convertible Senior Notes mature on April 15, 2016 (the Maturity Date), unless previously converted or repurchased in accordance with their terms. The Convertible Senior Notes bear interest at a rate of 6.00% per year payable semiannually in arrears on April 15 and October 15 of each year, commencing on October 15, 2011. The Convertible Senior Notes are our senior unsecured obligations and rank senior in right of payment to our existing and future indebtedness that is expressly subordinated in right of payment to the Convertible Senior Notes; equal in right of payment to our existing and future unsecured indebtedness that is not so subordinated; effectively junior in right of payment to any of our secured indebtedness (including unsecured indebtedness that we later secure) to the extent of the value of the assets securing such indebtedness; and structurally junior to all existing and future indebtedness (including trade payables) incurred by our subsidiaries, financing vehicles or similar facilities.

Prior to the close of business on the business day immediately preceding October 15, 2015, holders may convert their Convertible Senior Notes only under certain circumstances set forth in the Indenture. On or after October 15, 2015 until the close of business on the scheduled trading day immediately preceding the Maturity Date, holders may convert their Convertible Senior Notes at any time. Upon conversion, we will pay or deliver, as the case may be, at our election, cash, shares of its common stock or a combination of cash and shares of its common stock. The conversion rate will initially be 84.0972 shares of common stock per $1,000 principal amount of Convertible Senior Notes (equivalent to an initial conversion price of approximately $11.89 per share of common stock). The conversion rate will be subject to adjustment in some events but will not be adjusted for any accrued and unpaid interest. In addition, if certain corporate events occur prior to the Maturity Date, the conversion rate will be increased for converting holders.

We may not redeem the Convertible Senior Notes prior to maturity. No sinking fund is provided for the Convertible Senior Notes. In addition, if certain corporate events occur, holders of the Convertible Senior Notes may require us to repurchase for cash all or part of their Convertible Senior Notes at a repurchase price equal to 100% of the principal amount of the Convertible Senior Notes to be repurchased, plus accrued and unpaid interest through, but excluding, the required repurchase date.

In accounting for the Convertible Senior Notes, we estimated that the values of the debt and the embedded conversion feature of the Convertible Senior Notes were approximately 92.8% and 7.2%, respectively. The original issue discount of 7.2% attributable to the conversion feature of the Convertible Senior Notes has initially be recorded in capital in excess of par value in the consolidated statement of assets and liabilities. As a result, we record interest expense comprised of both stated interest expense as well as accretion of the original issue discount resulting in an estimated effective interest rate of approximately 7.9%.

As of September 30, 2011, the components of the carrying value of the Convertible Senior Notes were as follows:

(in thousands)	**As of September 30, 2011**
Principal amount of debt	$ 75,000
Original issue discount, net of accretion	(4,918)
Carrying value of debt	$ 70,082

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For the three and nine months ended September 30, 2011, the components of interest expense and cash paid for interest expense for the Convertible Senior Notes were as follows:

(in thousands)	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
Stated interest expense	$ 1,125	$ 2,062
Accretion of original issue discount	270	496
Amortization of debt issuance cost	144	264
Total interest expense	$ 1,539	$ 2,822
Cash paid for interest expense	$	$

As of September 30, 2011, we are in compliance with the terms of the indentures governing the Convertible Senior Notes. See Note 4 to our consolidated financial statements for the three and nine months ended September 30, 2011 for more detail on the Convertible Senior Notes.

Citibank Credit Facility

We, through Hercules Funding Trust I, an affiliated statutory trust, had a securitized credit facility (the Citibank Credit Facility) with Citigroup Global Markets Realty Corp. During the first quarter of 2009, we paid off all remaining principal and interest owed under the Citibank Credit Facility. Citigroup has an equity participation right through a warrant participation agreement on the pool of loans and warrants collateralized under the Citibank Credit Facility. Pursuant to the warrant participation agreement, we granted to Citigroup a 10% participation in all warrants held as collateral. However, no additional warrants were included in collateral subsequent to the facility amendment on May 2, 2007. As a result, Citigroup is entitled to 10% of the realized gains on the warrants until the realized gains paid to Citigroup pursuant to the agreement equal $3,750,000 (the Maximum Participation Limit). The obligations under the warrant participation agreement continue even after the Citibank Credit Facility is terminated until the Maximum Participation Limit has been reached. The value of their participation right on unrealized gains in the related equity investments was approximately $727,000 as of September 30, 2011 and is included in accrued liabilities. There can be no assurances that the unrealized appreciation of the warrants will not be higher or lower in future periods due to fluctuations in the value of the warrants, thereby increasing or reducing the effect on the cost of borrowing. Since inception of the agreement, we have paid Citigroup approximately $1.1 million under the warrant participation agreement thereby reducing its realized gains by this amount. We will continue to pay Citigroup under the warrant participation agreement until the Maximum Participation Limit is reached or the warrants expire.

Outstanding Borrowings

At September 30, 2011 and December 31, 2010, we had the following borrowing capacity and outstanding borrowings:

	September 30, 2011		December 31, 2010	
	Total Available	Carrying Value[(1)]	Total Available	Carrying Value[(1)]
Union Bank Facility	$ 20,000	$	$ 20,000	$
Wells Facility	75,000		50,000	
Convertible Senior Notes[(2)]	75,000	70,082		
SBA Debenture[(3)]	225,000	188,750	225,000	170,000
Total	$ 395,000	$ 258,832	$ 295,000	$ 170,000

(1) Except for the Convertible Senior Notes (as defined above), all carrying values are the same as the principal amount outstanding.

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(2) Represents the aggregate principal amount outstanding of the Convertible Senior Notes (as defined above) less the unaccreted discount initially recorded upon issuance of the Convertible Notes. The total unaccreted discount for the Convertible Senior Notes was $4,918 at September 30, 2011.

(3) The Company has the ability to borrow an additional $36.3 million subject to SBA approval and compliance with SBIC regulations for which they have received a commitment.

Dividends

The following table summarizes our dividends declared and paid or to be paid on all shares, including restricted stock, to date:

Date Declared	Record Date	Payment Date	Amount Per Share
October 27, 2005	November 1, 2005	November 17, 2005	$ 0.025
December 9, 2005	January 6, 2006	January 27, 2006	0.300
April 3, 2006	April 10, 2006	May 5, 2006	0.300
July 19, 2006	July 31, 2006	August 28, 2006	0.300
October 16, 2006	November 6, 2006	December 1, 2006	0.300
February 7, 2007	February 19, 2007	March 19, 2007	0.300
May 3, 2007	May 16, 2007	June 18, 2007	0.300
August 2, 2007	August 16, 2007	September 17, 2007	0.300
November 1, 2007	November 16, 2007	December 17, 2007	0.300
February 7, 2008	February 15, 2008	March 17, 2008	0.300
May 8, 2008	May 16, 2008	June 16, 2008	0.340
August 7, 2008	August 15, 2008	September 19, 2008	0.340
November 6, 2008	November 14, 2008	December 15, 2008	0.340
February 12, 2009	February 23, 2009	March 30, 2009	0.320*
May 7, 2009	May 15, 2009	June 15, 2009	0.300
August 6, 2009	August 14, 2009	September 14, 2009	0.300
October 15, 2009	October 20, 2009	November 23, 2009	0.300
December 16, 2009	December 24, 2009	December 30, 2009	0.040
February 11, 2010	February 19, 2010	March 19, 2010	0.200
May 3, 2010	May 12, 2010	June 18, 2010	0.200
August 2, 2010	August 12, 2010	September 17, 2010	0.200
November 4, 2010	November 10, 2010	December 17, 2010	0.200
March 1, 2011	March 10, 2011	March 24, 2011	0.220
May 5, 2011	May 11, 2011	June 23, 2011	0.220
August 4, 2011	August 15, 2011	September 15, 2011	0.220
November 3, 2011	November 14, 2011	November 29, 2011	0.220
			$ 6.685

* Dividend paid in cash and stock.

On November 3, 2011, the Board of Directors announced a cash dividend of $0.22 per share to be paid on November 29, 2011 to shareholders of record as of November 14, 2011. This dividend is the Company s twenty-fifth consecutive quarterly dividend declaration since its initial public offering, and will bring the total cumulative dividend declared to date to $6.69 per share.

Our Board of Directors maintains a variable dividend policy with the objective of distributing four quarterly distributions in an amount that approximates 90 - 100% of our taxable quarterly income or potential annual income for a particular year. In addition, at the end of the year, we may also pay an additional special dividend or fifth dividend, such that we may distribute approximately all of our annual taxable income in the year it was earned, while maintaining the option to spill over our excess taxable income.

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Distributions in excess of our current and accumulated earnings and profits would generally be treated first as a return of capital to the extent of the stockholder s tax basis, and any remaining distributions would be treated as a capital gain. The determination of the tax attributes of our distributions is made annually as of the end of our fiscal year based upon our taxable income for the full year and distributions paid for the full year, therefore a determination made on a quarterly basis may not be representative of the tax attributes of our 2011 distributions to stockholders. If we had determined the tax attributes of our distributions year-to-date as of September 30, 2011, approximately 97% would be from ordinary income and spillover earnings from 2010, and 3% would be a return of capital.

We intend to distribute quarterly dividends to our stockholders. In order to avoid certain excise taxes imposed on RICs, we currently intend to distribute during each calendar year an amount at least equal to the sum of (1) 98% of our ordinary income for the calendar year, (2) 98.2% of our capital gains in excess of capital losses for the one year period ending on October 31 of the calendar year, and (3) any ordinary income and net capital gains for the preceding year that were not distributed during such year. We will not be subject to excise taxes on amounts on which we are required to pay corporate income tax (such as retained net capital gains). In order to obtain the tax benefits applicable to RICs, we will be required to distribute to our stockholders with respect to each taxable year at least 90% of our ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses.

We can offer no assurance that we will achieve results that will permit the payment of any cash distributions and, if we issue senior securities, we will be prohibited from making distributions if doing so causes us to fail to maintain the asset coverage ratios stipulated by the 1940 Act or if distributions are limited by the terms of any of our borrowings. See Regulation in the accompanying prospectus.

We maintain an opt-out dividend reinvestment plan for our common stockholders. As a result, if we declare a dividend, cash dividends will be automatically reinvested in additional shares of our common stock unless the stockholder specifically opts out of the dividend reinvestment plan and chooses to receive cash dividends. See Dividend Reinvestment Plan in the accompanying prospectus.

Our ability to make distributions will be limited by the asset coverage requirements under the 1940 Act.

Critical Accounting Policies

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and revenues and expenses during the period reported. On an ongoing basis, our management evaluates its estimates and assumptions, which are based on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results could differ from those estimates. Changes in our estimates and assumptions could materially impact our results of operations and financial condition.

Valuation of Portfolio Investments. The most significant estimate inherent in the preparation of our consolidated financial statements is the valuation of investments and the related amounts of unrealized appreciation and depreciation of investments recorded.

Our investments are carried at fair value in accordance with the 1940 Act and Accounting Standards Codification (ASC) topic 820 Fair Value Measurements and Disclosures, (formerly known as SFAS No. 157, Fair Value Measurements). At September 30, 2011, approximately 83.7% of the Company s total assets represented investments in portfolio companies that are valued at fair value by the Board of Directors. Value, as defined in Section 2(a)(41) of the 1940 Act, is (i) the market price for those securities for which a market quotation is readily available and (ii) for all other securities and assets, fair value is as determined in good faith

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by the Board of Directors. Our debt securities are primarily invested in equity sponsored technology-related companies including life science, clean technology and select lower middle market technology companies. Given the nature of lending to these types of businesses, our investments in these portfolio companies are generally considered Level 3 assets under ASC 820 because there is no known or accessible market or market indexes for these investment securities to be traded or exchanged. As such, it values substantially all of its investments at fair value as determined in good faith pursuant to a consistent valuation policy and our Board of Directors in accordance with the provisions of ASC 820 and the 1940 Act. Due to the inherent uncertainty in determining the fair value of investments that do not have a readily available market value, the fair value of our investments determined in good faith by our Board may differ significantly from the value that would have been used had a readily available market existed for such investments, and the differences could be material.

Our Board of Directors may from time to time engage an independent valuation firm to provide us with valuation assistance with respect to certain of our portfolio investments on a quarterly basis. We intend to continue to engage an independent valuation firm to provide us with assistance regarding our determination of the fair value of selected portfolio investments each quarter unless directed by the Board of Directors to cancel such valuation services. The scope of the services rendered by an independent valuation firm is at the discretion of the Board of Directors. Our Board of Directors is ultimately and solely responsible for determining the fair value of our investments in good faith.

With respect to investments for which market quotations are not readily available or when such market quotations are deemed not to represent fair value, our Board of Directors has approved a multi-step valuation process each quarter, as described below:

(1) our quarterly valuation process begins with each portfolio company or investment being initially valued by the investment professionals responsible for the portfolio investment;

(2) preliminary valuation conclusions are then documented and discussed with our investment committee;

(3) the valuation committee of the Board of Directors reviews the preliminary valuation of the investment committee and that of the independent valuation firm and responds to the valuation recommendation of the independent valuation firm to reflect any comments, if any, and

(4) the Board of Directors discusses valuations and determines the fair value of each investment in our portfolio in good faith based on the input of, where applicable, the respective independent valuation firm and the valuation committee.

We adopted ASC 820 on January 1, 2008. ASC 820 establishes a framework for measuring the fair value of the assets and liabilities and outlines a fair value hierarchy which prioritizes the inputs used to measure fair value and the effect of fair value measures on earnings. ASC 820 also enhances disclosure requirements for fair value measurements based on the level within the hierarchy of the information used in the valuation. ASC 820 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

We have categorized all investments recorded at fair value in accordance with ASC 820 based upon the level of judgment associated with the inputs used to measure their fair value. Hierarchical levels, defined by ASC 820 and directly related to the amount of subjectivity associated with the inputs to fair valuation of these assets and liabilities, are as follows:

Level 1 Inputs are unadjusted, quoted prices in active markets for identical assets at the measurement date. The types of assets carried at Level 1 fair value generally are equities listed in active markets.

Level 2 Inputs (other than quoted prices included in Level 1) are either directly or indirectly observable for the asset in connection with market data at the measurement date and for the extent of the instrument s

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anticipated life. Fair valued assets that are generally included in this category are warrants held in a public company.

Level 3 Inputs reflect management s best estimate of what market participants would use in pricing the asset at the measurement date. It includes prices or valuations that require inputs that are both significant to the fair value measurement and unobservable. Generally, assets carried at fair value and included in this category are the debt investments and warrants and equities held in a private company.

Debt Investments

We follow the guidance set forth in ASC 820 which establishes a framework for measuring the fair value of assets and liabilities and outlines a fair value hierarchy which prioritizes the inputs used to measure fair value and the effect of fair value measures on earnings. Our debt securities are primarily invested in equity sponsored technology, life science and clean technology companies. Given the nature of lending to these types of businesses, our investments in these portfolio companies are considered Level 3 assets under ASC 820 because there is no known or accessible market or market indexes for these investment securities to be traded or exchanged.

We apply a procedure that assumes a sale of investment in a hypothetical market to a hypothetical market participant where buyers and sellers are willing participants. The hypothetical market does not include scenarios where the underlying security was simply repaid or extinguished, but includes an exit concept. Under this process, we also evaluate the collateral for recoverability of the debt investments as well as apply all of its historical fair value analysis. We use pricing on recently issued comparable debt securities to determine the baseline hypothetical market yields as of the measurement date. We consider each portfolio company s credit rating, security liens and other characteristics of the investment to adjust the baseline yield to derive a hypothetical yield for each investment as of the measurement date. The anticipated future cash flows from each investment are then discounted at the hypothetical yield to estimate each investment s fair value as of the measurement date.

Our process includes, among other things, the underlying investment performance, the current portfolio company s financial condition and market changing events that impact valuation, estimated remaining life, current market yield and interest rate spreads of similar securities as of the measurement date. If there is a significant deterioration of the credit quality of a debt investment, we may consider other factors than those a hypothetical market participant would use to estimate fair value, including the proceeds that would be received in a liquidation analysis.

We record unrealized depreciation on investments when it believes that an investment has decreased in value, including where collection of a loan is doubtful or if under the in exchange premise when the value of a debt security were to be less than amortized cost of the investment. Conversely, where appropriate, we record unrealized appreciation if we believe that the underlying portfolio company has appreciated in value and, therefore, that our investment has also appreciated in value or if under the in exchange premise the value of a debt security were to be greater than amortized cost.

When originating a debt instrument, we generally receive warrants or other equity-related securities from the borrower. We determine the cost basis of the warrants or other equity-related securities received based upon their respective fair values on the date of receipt in proportion to the total fair value of the debt and warrants or other equity-related securities received. Any resulting discount on the loan from recordation of the warrant or other equity instruments is accreted into interest income over the life of the loan.

Equity-Related Securities and Warrants

Securities that are traded in the over-the-counter markets or on a stock exchange will be valued at the prevailing bid price at period end. We have a limited number of equity securities in public companies. In

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accordance with the 1940 Act, unrestricted publicly traded securities for which market quotations are readily available are valued at the closing market quote on the valuation date.

We estimate the fair value of warrants using a Black Scholes pricing model. At each reporting date, privately held warrant and equity related securities are valued based on an analysis of various factors including, but not limited to, the portfolio company s operating performance and financial condition and general market conditions, price to enterprise value or price to equity ratios, discounted cash flow, valuation comparisons to comparable public companies or other industry benchmarks. When an external event occurs, such as a purchase transaction, public offering, or subsequent equity sale, the pricing indicated by that external event is utilized to corroborate our valuation of the warrant and equity related. We periodically review the valuation of our portfolio companies that have not been involved in a qualifying external event to determine if the enterprise value of the portfolio company may have increased or decreased since the last valuation measurement date.

Income Recognition.

We record interest income on the accrual basis and we recognize it as earned in accordance with the contractual terms of the loan agreement to the extent that such amounts are expected to be collected. Original Issue Discount (OID) initially represents the value of detachable equity warrants obtained in conjunction with the acquisition of debt securities and is accreted into interest income over the term of the loan as a yield enhancement. When a loan becomes 90 days or more past due, or if management otherwise does not expect the portfolio company to be able to service its debt and other obligations, we will generally place the loan on non-accrual status and cease recognizing interest income on that loan until all principal has been paid. Any uncollected interest related to prior periods is reversed from income in the period that collection of the interest receivable is determined to be doubtful. However, we may make exceptions to this policy if the investment has sufficient collateral value and is in the process of collection. As of September 30, 2011, we had one portfolio company on non-accrual status with a fair value of zero. There were two loans on non-accrual status with a fair value of approximately $4.0 million as of December 31, 2010. During the three months ended March 31, 2011 we wrote off our warrant, equity and debt investments in one of these portfolio companies for a realized loss of approximately $5.2 million.

Paid-In-Kind and End of Term Income.

Contractual paid-in-kind (PIK) interest, which represents contractually deferred interest added to the loan balance that is generally due at the end of the loan term, is generally recorded on the accrual basis to the extent such amounts are expected to be collected. We will generally cease accruing PIK interest if there is insufficient value to support the accrual or we do not expect the portfolio company to be able to pay all principal and interest due. In addition, we may also be entitled to an end-of-term payment that we amortize into income over the life of the loan. To maintain our status as a RIC, PIK and end-of-term income must be paid out to stockholders in the form of dividends even though we have not yet collected the cash. Amounts necessary to pay these dividends may come from available cash or the liquidation of certain investments. The Company recorded approximately $285,000 and $1.4 million in PIK income in the three and nine-month periods ended September 30, 2011, respectively. The Company recorded approximately $552,000 and $1.7 million in the same periods ended September 30, 2010, respectively.

Fee Income.

Fee income, generally collected in advance, includes loan commitment and facility fees for due diligence and structuring, as well as fees for transaction services and management services rendered by us to portfolio companies and other third parties. Loan and commitment fees are amortized into income over the contractual life of the loan. Management fees are generally recognized as income when the services are rendered. Loan origination fees are capitalized and then amortized into interest income using the effective interest rate method. In certain loan arrangements, warrants or other equity interests are received from the borrower as additional origination fees.

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We recognize nonrecurring fees amortized over the remaining term of the loan commencing in the quarter relating to specific loan modifications. Certain fees may still be recognized as one-time fees, including prepayment penalties, fees related to select covenant default waiver fees and acceleration of previously deferred loan fees and original issue discount (OID) related to early loan pay-off or material modification of the specific debt outstanding.

Equity Offering Expenses

Our offering costs, excluding underwriter s fees, are charged against the proceeds from equity offerings when received.

Debt Issuance Costs

Debt issuance costs are being amortized over the life of the related debt instrument using the straight line method, which closely approximates the effective yield method.

Stock-Based Compensation.

We have issued and may, from time to time, issue additional stock options and restricted stock to employees under our 2004 Equity Incentive Plan and Board members under our 2006 Equity Incentive Plan. We follow ASC 718, formally known as FAS 123R *Share-Based Payments* to account for stock options granted. Under ASC 718, compensation expense associated with stock-based compensation is measured at the grant date based on the fair value of the award and is recognized.

Federal Income Taxes.

We intend to operate so as to qualify to be taxed as a RIC under Subchapter M of the Code and, as such, will not be subject to federal income tax on the portion of our taxable income and gains distributed to stockholders. To qualify as a RIC, we are required to distribute at least 90% of our investment company taxable income, as defined by the Code. We are subject to a non-deductible federal excise tax if we do not distribute at least 98% of our taxable income and 98.2% of our capital gain net income for each one year period ending on October 31. At December 31, 2010 and 2009, no excise tax was recorded. At December 31, 2008, we recorded a liability for excise tax of approximately $203,000 on income and capital gains of approximately $5.0 million which was distributed in 2009. Because federal income tax regulations differ from accounting principles generally accepted in the United States, distributions in accordance with tax regulations may differ from net investment income and realized gains recognized for financial reporting purposes. Differences may be permanent or temporary. Permanent differences are reclassified among capital accounts in the financial statement to reflect their tax character. Temporary differences arise when certain items of income, expense, gain or loss are recognized at some time in the future. Differences in classification may also result from the treatment of short-term gains as ordinary income for tax purposes.

Recent Accounting Pronouncements

In January 2010, the FASB issued ASU No. 2010-06, *Fair Value Measurements and Disclosures* (ASU 2010-06), which amends ASC 820 and requires additional disclosure related to recurring and nonrecurring fair value measurements with respect to transfers in and out of Levels 1 and 2 and activity in Level 3 fair value measurements. The update also clarifies existing disclosure requirements related to the level of disaggregation and disclosure about inputs and valuation techniques. ASU 2010-06 is effective for interim and annual periods beginning after December 15, 2009 except for disclosures related to activity in Level 3 fair value measurements which are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The Company adopted the requirements of ASU-2010-06 in the fourth quarter of 2009 and its adoption did not have a material effect on our consolidated financial statements.

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In May 2011, the FASB issued *Accounting Standards Update No. 2011-04 Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS*, or ASU 2011-04. ASU 2011-04 clarifies the application of existing fair value measurement and disclosure requirements, changes the application of some requirements for measuring fair value and requires additional disclosure for fair value measurements. The highest and best use valuation premise is only applicable to non-financial assets. In addition, the disclosure requirements are expanded to include for fair value measurements categorized in Level 3 of the fair value hierarchy: (1) a quantitative disclosure of the unobservable inputs and assumptions used in the measurement; (2) a description of the valuation processes in place; and (3) a narrative description of the sensitivity of the fair value to changes in unobservable inputs and interrelationships between those inputs. ASU 2011-04 is effective for interim and annual periods beginning after December 15, 2011, for public entities. We are evaluating the impact that our adoption of this update may have on our financial position or results of operations.

Subsequent Events

Closed and Pending Commitments

As of November 3, 2011, we have closed commitments of approximately $45.0 million to new and existing portfolio companies, and funded approximately $30.0 million since the close of the third quarter. In addition, we have pending commitments (signed term sheets) of approximately $129.0 million.

The table below summarizes our year-to-date closed and pending commitments as follows:

2011 Closed Commitments and Pending Commitments (in millions)	
January 1 September 30 Closed Commitments	$ 465.0
Q4-11 Closed Commitments (as of November 3, 2011)	$ 45.0
Total year to date 2011 Closed Commitments[a]	**$ 510.0**
Pending Commitments (as November 3, 2011)[b]	$ 129.0
Total year to date	**$ 639.0**

A. Not all Closed Commitments result in future cash requirements. Commitments generally fund over the two succeeding quarters from close.
B. Not all Pending Commitments (signed non-binding term sheets) are expected to close and do not necessarily represent any future cash requirements.

Portfolio Company Developments

In October 2011, Hercules portfolio company LaboPharm, Inc. was acquired by Paladin Labs resulting in the full repayment of Hercules debt of approximately $12.0 million and the cancellation of the remaining warrants.

Company Developments

In October 2011, Hercules announced the opening of its new office in McLean, Virginia, thereby expanding to the Mid-Atlantic and South-Atlantic regions where the Company was previously under represented.

On November 2, 2011, the Company renewed and amended the Union Bank Facility. The Union Bank Facility will mature on November 2, 2014, revolving through the first 24 months with a term out provision for the remaining 12 months. The Union Bank Facility requires the payment of a non-use fee of 0.50% annually. The other terms of the Union Bank Facility generally remain unchanged, including the stated interest rate.

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Disclosure Controls and Procedures

As of the end of the quarter ended September 30, 2011, the Company carried out an evaluation, under the supervision and with the participation of its management, including its Chief Executive Officer (principal executive officer) and Chief Financial Officer (principal financial officer), of the effectiveness of the design and operation of these disclosure controls and procedures, as such term is defined in Exchange Act Rules 13a-15(e) and 15d-15(e). Based on this evaluation, the Chief Executive Officer (principal executive officer) and Chief Financial Officer (principal financial officer) have concluded our current disclosure controls and procedures were not effective in timely alerting them of material information relating to the Company that is required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934 as of September 30, 2011 because of the continuing remediation efforts discussed below.

Changes in Internal Control Over Financial Reporting

As described in the accompanying prospectus, management identified remedial steps that were implemented with respect to disclosed material weaknesses. In light of these material weaknesses, the Company refined its procedures to ensure its financial statements were prepared in accordance with generally accepted accounting principles. The status of the remediation efforts, as discussed below, was regularly reviewed with management and the Company s Audit Committee of the Board of Directors. The Audit Committee was advised of issues encountered and key decisions reached by management relating to the remediation efforts. Accordingly, management believes that the financial statements included in this prospectus present fairly in all material respects the Company s financial condition, results of operations and cash flows for the periods presented.

During the three month period ended December 31, 2010, and in connection with the year-end audit process, the Company corrected the valuation process to refine its application of ASC 820. The Company applied a new procedure that assumes a sale of an investment in a hypothetical market to a hypothetical market participant where buyers and sellers are willing participants. The hypothetical market does not include scenarios where the underlying security was simply repaid or extinguished, but includes an exit concept. Under the new process, the Company has continued to evaluate the collateral for recoverability of the debt investments as well as apply all of its historical fair value analysis. The Company uses pricing on recently issued comparable debt securities to determine the baseline hypothetical market yields as of the measurement date. The Company considers each portfolio company s credit rating, security liens and other characteristics of the investment to adjust the baseline yield to derive a hypothetical yield for each investment. The anticipated future cash flows from each investment are then discounted at the hypothetical yield to estimate each investment s fair value as of the measurement date. The Company has completed its evaluation and testing of these additional processes. During the three months ended March 31, 2011, management evaluated the remedial action, assessed the operating effectiveness of the remediated controls and concluded that it has remediated the material weakness described above.

In connection with the preparation of the Company s Consolidated Financial Statements for the three-month period ended March 31, 2011, the Company identified a material weakness in its internal control over financial reporting. A material weakness is a deficiency, or combination of control deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the registrant s annual or interim financial statements will not be prevented or detected on a timely basis. In particular, management became aware of matters where existing controls did not operate effectively to detect manual input errors in calculations used to derive the fair value of some investment portfolio holdings as of the measurement date, thereby impacting reported amounts with respect to investments and net increase (decrease) in unrealized appreciation on investments. This control deficiency could result in misstatements of the aforementioned accounts and disclosures that would result in a material misstatement of the consolidated financial statements that would not be prevented or detected. Because of this material weakness, management concluded that the Company did not maintain effective control over financial reporting as of March 31, 2011. The Company designed and implemented its remediation efforts, as outlined below, to address the material weakness identified

as of March 31, 2011 and to strengthen its internal control over financial reporting. Beginning in the second quarter of 2011, the Company has implemented the following remediation steps to address the material weakness as it relates to manual input errors in calculations used and to improve its internal control over financial reporting:

- adding additional layers of review to ensure accuracy, existence and completeness of the number of equity security holdings as of the measurement date;

- adding additional review steps, particularly surrounding any manually input data, in the calculations used to support the fair value of investments as of the measurement date; and

- seeking to recruit additional experienced professionals to augment and upgrade its financial staff to address issues of timeliness and completeness in financial reporting.

As of September 30, 2011, management believes it has placed in operation controls to address the material weakness, however given the timing of certain remediation activities there was not sufficient evidence to conclude upon their sustained effectiveness. As a result, during 2011, management continued to monitor and test the controls that have been implemented to ensure sustained effectiveness and will further remediate should any evidence of ineffectiveness be found.

The Audit Committee has directed management to monitor and test the controls implemented and develop additional controls should any of these new controls require further enhancement. In addition, under the direction of the Audit Committee, management will continue to review and make necessary changes to the overall design of the Company s internal control environment, as well as policies and procedures to improve the overall effectiveness of internal control over financial reporting.

Management believes the measures described above and others that will be implemented as necessary will remediate the control deficiencies the Company has identified and strengthen its internal control over financial reporting. Management is committed to continuous improvement of the Company s internal control processes and will continue to diligently review the Company s financial reporting controls and procedures. As management continues to evaluate and work to improve internal control over financial reporting, the Company may determine to take additional measures to address control deficiencies or to determine to modify, or in appropriate circumstances not to complete, certain of the remediation measures described above.

Quantitative and Qualitative Disclosures About Market Risk

We are subject to financial market risks, including changes in interest rates. Interest rate risk is defined as the sensitivity of our current and future earnings to interest rate volatility, variability of spread relationships, the difference in re-pricing intervals between our assets and liabilities and the effect that interest rates may have on our cash flows. Changes in the general level of interest rates can affect our net investment income, which is the difference between the interest income earned on interest earning assets and our interest expense incurred in connection with our interest bearing debt and liabilities. Changes in interest rates can also affect, among other things, our ability to acquire and originate loans and securities and the value of our investment portfolio.

As of September 30, 2011, approximately 91.1% of our portfolio loans were at variable rates or variable rates with a floor and 8.9% of our loans were at fixed rates. Over time additional investments may be at variable rates. We do not currently engage in any hedging activities. However, we may, in the future, hedge against interest rate fluctuations by using standard hedging instruments such as futures, options, and forward contracts. While hedging activities may insulate us against changes in interest rates, they may also limit our ability to participate in the benefits of lower interest rates with respect to our borrowed funds and higher interest rates with respect to our portfolio of investments. Interest rates on our borrowings are based primarily on LIBOR. Borrowings under our SBA program are fixed at the ten year treasury rate every March and September for borrowings of the preceding six months. Borrowings under the program are charged interest based on ten year treasury rates plus a spread and the rates are generally set for a pool of debentures issued by the SBA in

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six-month periods. The rates of borrowings under the various draws from the SBA beginning in April 2007 and set semiannually in March and September range from 2.88% to 5.73%. In addition, the SBA charges a fee that is set annually, depending on the Federal fiscal year the leverage commitment was delegated by the SBA, regardless of the date that the leverage was drawn by the SBIC. The annual fee related to HT III debentures that pooled on September 21, 2011 was 0.285%. The annual fees related to HT II debentures that pooled on September 22, 2010 were 0.406% and 0.285%, depending upon the year the underlying commitment was closed in. The annual fees on other debentures have been set at 0.906%. The average amount of debentures outstanding for the quarter ended September 30, 2011 for HT II was approximately $125.0 million with an average interest rate of approximately 5.0%, and for HT III was approximately $63.75 million with an average interest rate of approximately 3.5%. Interest is payable semiannually and there are no principal payments required on these issues prior to maturity. Debentures under the SBA generally mature ten years after being borrowed. Based on the initial draw down date of April 2007, the initial maturity of SBA debentures will occur in April 2017.

Borrowings under the Wells Facility will generally bear interest at a rate per annum equal to LIBOR plus 3.50% with a floor of 5.0%. The Wells Facility is collateralized by debt investment in our portfolio companies, and includes an advance rate equal to 50% of eligible loans placed in the collateral pool. The Wells Facility generally requires payment of interest on a monthly basis. The Wells Facility requires the monthly payment of a non-use fee of 0.3% for each payment date on or before September 1, 2011. From September 1, 2011 through September 30, 2011, this non-use fee was 0.75%. The monthly payment of a non-use fee thereafter shall depend on the average balance that was outstanding on a scale between 0.0% and 0.75%**.** All outstanding principal is due upon maturity. There were no borrowings outstanding under this facility at September 30, 2011. The facility expires in June 2014.

Borrowings under the Union Bank Facility will generally bear interest at a rate per annum equal to LIBOR plus 2.25% with a floor of 4.0%. The Union Bank Facility required the payment of an unused fee of 0.25% annually. The Union Bank Facility is collateralized by debt investments in our portfolio companies, and includes an advance rate equal to 50% of eligible loans placed in the collateral pool. The Union Bank Facility generally requires payment of interest on a monthly basis. All outstanding principal is due upon maturity. There were no outstanding borrowings under this facility at September 30, 2011. In June 2011, the maturity date under the credit facility was extended from July 31, 2011 to December 31, 2011, subject to the same terms and conditions. On November 2, 2011, we renewed and amended the Union Bank Facility. The Union Bank Facility requires the payment of a non-use fee of 0.50% annually. The other terms of the Union Bank Facility generally remain unchanged, including the stated interest rate. The Union Bank Facility will mature on November 2, 2014, revolving through the first 24 months with a term out provision for the remaining 12 months.

Borrowings under the Convertible Senior Notes mature on April 15, 2016 (the Maturity Date), unless previously converted or repurchased in accordance with their terms. The Convertible Senior Notes bear interest at a rate of 6.00% per year payable semiannually in arrears on April 15 and October 15 of each year, commencing on October 15, 2011. The Convertible Senior Notes are our senior unsecured obligations and rank senior in right of payment to the our existing and future indebtedness that is expressly subordinated in right of payment to the Convertible Senior Notes; equal in right of payment to our existing and future unsecured indebtedness that is not so subordinated; effectively junior in right of payment to any of our secured indebtedness (including unsecured indebtedness that we later secure) to the extent of the value of the assets securing such indebtedness; and structurally junior to all existing and future indebtedness (including trade payables) incurred by our subsidiaries, financing vehicles or similar facilities.

Because we currently borrow, and plan to borrow in the future, money to make investments, our net investment income is dependent upon the difference between the rate at which we borrow funds and the rate at which we invest the funds borrowed. Accordingly, there can be no assurance that a significant change in market interest rates will not have a material adverse effect on our net investment income. In periods of rising interest rates, our cost of funds would increase, which could reduce our net investment income if there is not a corresponding increase in interest income generated by variable rate assets in our investment portfolio.

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UNDERWRITING

Under the terms and subject to the conditions contained in an underwriting agreement dated January 19, 2012, we have agreed to sell to Citigroup Global Markets Inc., the sole underwriter, and Citigroup Global Markets Inc. has agreed to purchase 5,000,000 shares of common stock at a price of $9.61 per share.

The underwriting agreement provides that the underwriter is obligated to purchase all of the shares of common stock in the offering if any are purchased, other than those shares covered by the over-allotment option described below subject to certain conditions precedent.

The underwriter proposes to offer the shares of common stock offered hereby from time to time for sale in one or more transactions on the Nasdaq Global Select Market, in the over-the-counter-market, through negotiated transactions or otherwise at market prices prevailing at the time of sale, at prices related to prevailing market prices or at negotiated prices, subject to receipt and acceptance by the underwriter and subject to the underwriter s right to reject any order in whole or in part. The underwriter may effect such transactions by selling the shares of common stock to or through dealers and such dealers may receive compensation in the form of discounts, concessions or commissions from the underwriter and/or purchasers of shares of common stock for whom they may act as agents or to whom they may sell as principal. The difference between the price at which the underwriter purchases shares and the price at which the underwriter resells such shares, which may include a commission equivalent of up to $0.05 per share, may be deemed underwriting compensation.

We have granted to the underwriter a 30-day option to purchase on a pro rata basis up to 750,000 additional shares at a price of $9.61 per share. The option may be exercised only to cover any over allotments of common stock.

We expect that our expenses for this offering will be approximately $300,000.

We have agreed to indemnify the underwriter against certain liabilities, including liabilities under the Securities Act of 1933, or contribute to payments that the underwriter may be required to make in that respect.

We have agreed that we will not directly or indirectly sell, offer to sell, enter into any agreement to sell, or otherwise dispose of, any equity or equity related securities of the Company or securities convertible into such securities, without the prior written consent of Citigroup Global Markets Inc. for a period of 45 days after the date of this prospectus, except issuances of common stock pursuant to any employee or director compensation, dividend reinvestment, savings, or benefit plan, or distributions to the Company s directors upon that individual s election to receive shares of the company s common stock in lieu of a cash retainer. However, in the event that either (1) during the last 17 days of the lock-up period, we release earnings results or material news or a material event relating to us occurs or (2) prior to the expiration of the lock-up period, we announce that we will release earnings results during the 16-day period beginning on the last day of the lock-up period, then in either case the expiration of the lock-up will be extended until the expiration of the 18-day period beginning on the date of the release of the earnings results or the occurrence of the material news or event, as applicable.

Our directors and senior executive officers have agreed that during the 45 days after the date of this prospectus supplement, subject to certain exceptions, they will not, without the prior written consent of Citigroup Global Markets Inc., offer to sell, contract to sell, or otherwise sell, dispose of, loan, pledge or grant any rights with respect to (collectively, a Disposition), any shares of our common stock, any options or warrants to purchase any shares of our common stock or any securities convertible into or redeemable or exchangeable for shares of our common stock now owned or hereafter acquired directly by such person or with respect to which such person has or hereafter acquires the power of disposition. The foregoing restriction has been expressly agreed to preclude the holder of such securities from engaging in any hedging or other transaction which is designed to or reasonably expected to lead to or result in a Disposition of securities during the lock-up period, even if such securities would be disposed of by someone other than the holder. Such prohibited hedging or other transactions would include, without limitation, any short sale (whether or not against the box) or any purchase, sale or grant of any right (including, without limitation,

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any put or call option) with respect to any securities. Notwithstanding the foregoing, if (i) during the last 17 days of the lock-up period, the Company issues an earnings release or material news or a material event relating to the Company occurs or (ii) prior to the expiration of the lock-up period, the Company announces that it will release earnings results during the 16-day period beginning on the last day of the lock-up period, the foregoing restrictions shall continue to apply until the expiration of the 18-day period beginning on the issuance of the earnings release or the occurrence of the material news or material event. These lock-up agreements will cover approximately 4,395,963 shares of our outstanding common stock and shares underlying warrants in the aggregate. These agreements will not cover shares acquired in connection with the participation in the Company s dividend reinvestment plan, shares acquired upon the exercise of stock options pursuant to the Company s stock option plan, pledges of securities in connection with their purchase upon the exercise of employee stock options following termination of employment with the Company, the sale of shares in connection with net issuances of shares to satisfy tax withholding obligations related to the vesting of shares of restricted stock or the exercise of stock options to purchase shares of the Company s common stock that were granted pursuant to the Company s equity compensation plans, or the exercise or conversion of any security into shares of our common stock so long as the shares received remain subject to the lock-up. The agreements also exclude dispositions (i) as a bona fide gift or gifts, (ii) as a distribution to partners or shareholders of such person (or in the case of a trust, to the beneficiaries thereof), (iii) to any corporation controlled by the transferor, (iv) to any trust for the direct or indirect benefit of the transferor or their immediate family, provided that such transfer does not involve a disposition for value other than for the benefit of the transferor s immediate family, and (v) charitable dispositions of securities that do not involve a disposition for value, provided that in each case (i)-(v) the recipient agrees in writing to be bound by the restrictions of the lock-up. Citigroup Global Markets Inc. may, in its sole discretion, allow any of these parties to dispose of common stock or other securities prior to the expiration of the 45 day period. There are, however, no agreements between Citigroup Global Markets Inc. and the parties that would allow them to do so as of the date of this prospectus supplement.

The underwriter does not intend to confirm sales to any account over which it exercises discretionary authority.

Until the distribution of the common stock is completed, rules of the Securities and Exchange Commission may limit the ability of the underwriter and certain selling group members to bid for and purchase the common stock. As an exception to these rules, the underwriter is permitted to engage in certain transactions that stabilize, maintain or otherwise affect the price of the common stock.

In connection with this offering, the underwriter may engage in stabilizing transactions, over-allotment transactions, syndicate covering transactions, penalty and market making bids in accordance with Regulation M under the Securities Act of 1934.

Stabilizing transactions permit bids to purchase the underlying security so long as the stabilizing bids do not exceed a specified maximum.

Over-allotment transactions involve sales by the underwriter of the shares of common stock in excess of the number of shares the underwriter is obligated to purchase, which creates a syndicate short position. The short position may be either a covered short position or a naked short position. In a covered short position, the number of shares over-allotted by the underwriters is not greater than the number of shares that they may purchase in the over allotment option. In a naked short position, the number of shares involved is greater than the number of shares in the over allotment option. The underwriters may close out any covered short position by either exercising its over allotment option and/or purchasing shares in the open market.

Syndicate covering transactions involve purchases of the shares of common stock in the open market after the distribution has been completed in order to cover syndicate short positions. In determining the source of shares to close out the short position, the underwriter will consider, among other things, the price of shares available for purchase in the open market as compared to the price at which it may purchase shares through the over allotment option. If the underwriter sells more shares than could be

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covered by the over allotment option, a naked short position, the position can only be closed out by buying shares in the open market. A naked short position is more likely to be created if the underwriters are concerned that there could be downward pressure on the price of the shares in the open market after pricing that could adversely affect investors who purchase in the offering.

Penalty bids permit representatives to reclaim a selling concession from a syndicate member when the shares of common stock originally sold by the syndicate member are purchased in a stabilizing or syndicate covering transaction to cover syndicate short positions.

In passive market making, market makers in the common stock who are underwriters or prospective underwriters may, subject to limitations, make bids for or purchases of our common stock until the time, if any, at which a stabilizing bid is made.

These stabilizing transactions, syndicate covering transactions and penalty bids may have the effect of raising or maintaining the market price of our common stock or preventing or retarding a decline in the market price of the common stock. As a result the price of our common stock may be higher than the price that might otherwise exist in the open market. These transactions may be effected on the NASDAQ Global Select Market or otherwise and, if commenced may be discontinued at any time.

The underwriter will deliver an accompanying prospectus and prospectus supplement to all purchasers of shares of common stock in the short sales. The purchases of shares of common stock in short sales are entitled to the same remedies under the federal securities laws as any other purchaser of shares of common stock covered by this prospectus supplement.

The underwriter is not obligated to engage in any of the transactions described above. If it does engage in any of these transactions, it may discontinue them at any time.

Notice to Prospective Investors in the European Economic Area

In relation to each member state of the European Economic Area that has implemented the Prospectus Directive (each, a relevant member state), with effect from and including the date on which the Prospectus Directive is implemented in that relevant member state (the relevant implementation date), an offer of shares described in this prospectus supplement may not be made to the public in that relevant member state other than:

to any legal entity which is a qualified investor as defined in the Prospectus Directive;

to fewer than 100 or, if the relevant member state has implemented the relevant provision of the 2010 PD Amending Directive, 150 natural or legal persons (other than qualified investors as defined in the Prospectus Directive), as permitted under the Prospectus Directive, subject to obtaining the prior consent of the relevant Dealer or Dealers nominated by us for any such offer; or

in any other circumstances falling within Article 3(2) of the Prospectus Directive,

provided that no such offer of shares shall require us or any underwriter to publish a prospectus pursuant to Article 3 of the Prospectus Directive.

For purposes of this provision, the expression an offer of securities to the public in any relevant member state means the communication in any form and by any means of sufficient information on the terms of the offer and the shares to be offered so as to enable an investor to decide to purchase or subscribe for the shares, as the expression may be varied in that member state by any measure implementing the Prospectus Directive in that member state, and the expression Prospectus Directive means Directive 2003/71/EC (and amendments thereto, including the 2010 PD Amending Directive, to the extent implemented in the relevant member state) and includes any relevant implementing measure in the relevant member state. The expression 2010 PD Amending Directive means Directive 2010/73/EU.

The sellers of the shares have not authorized and do not authorize the making of any offer of shares through any financial intermediary on their behalf, other than offers made by the underwriter with a view to the final

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placement of the shares as contemplated in this prospectus supplement. Accordingly, no purchaser of the shares, other than the underwriter, is authorized to make any further offer of the shares on behalf of the sellers or the underwriter.

This prospectus supplement and the accompanying prospectus are only being distributed to, and is only directed at, persons in the United Kingdom that are qualified investors within the meaning of Article 2(1)(e) of the Prospectus Directive that are also (i) investment professionals falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the Order) or (ii) high net worth entities, and other persons to whom it may lawfully be communicated, falling within Article 49(2)(a) to (d) of the Order (each such person being referred to as a relevant person). This prospectus supplement and its contents are confidential and should not be distributed, published or reproduced (in whole or in part) or disclosed by recipients to any other persons in the United Kingdom. Any person in the United Kingdom that is not a relevant person should not act or rely on this document or any of its contents.

Notice to Prospective Investors in the United Kingdom

This prospectus supplement and the accompanying prospectus are only being distributed to, and is only directed at, persons in the United Kingdom that are qualified investors within the meaning of Article 2(1)(e) of the Prospectus Directive that are also (i) investment professionals falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the Order) or (ii) high net worth entities, and other persons to whom it may lawfully be communicated, falling within Article 49(2)(a) to (d) of the Order (each such person being referred to as a relevant person). This prospectus supplement and its contents are confidential and should not be distributed, published or reproduced (in whole or in part) or disclosed by recipients to any other persons in the United Kingdom. Any person in the United Kingdom that is not a relevant person should not act or rely on this document or any of its contents.

Notice to Prospective Investors in France

Neither this prospectus supplement nor any other offering material relating to the shares described in this prospectus supplement has been submitted to the clearance procedures of the *Autorité des Marchés Financiers* or of the competent authority of another member state of the European Economic Area and notified to the *Autorité des Marchés Financiers*. The shares have not been offered or sold and will not be offered or sold, directly or indirectly, to the public in France. Neither this prospectus supplement nor any other offering material relating to the shares has been or will be:

- released, issued, distributed or caused to be released, issued or distributed to the public in France; or
- used in connection with any offer for subscription or sale of the shares to the public in France.

Such offers, sales and distributions will be made in France only:

- to qualified investors (*investisseurs qualifiés*) and/or to a restricted circle of investors (*cercle restreint d investisseurs*), in each case investing for their own account, all as defined in, and in accordance with articles L.411-2, D.411-1, D.411-2, D.734-1, D.744-1, D.754-1 and D.764-1 of the French *Code monétaire et financier*;
- to investment services providers authorized to engage in portfolio management on behalf of third parties; or
- in a transaction that, in accordance with article L.411-2-II-1°-or-2°-or 3° of the French *Code monétaire et financier* and article 211-2 of the General Regulations (*Règlement Général*) of the *Autorité des Marchés Financiers*, does not constitute a public offer (*appel public à l épargne*).

The shares may be resold directly or indirectly, only in compliance with articles L.411-1, L.411-2, L.412-1 and L.621-8 through L.621-8-3 of the French *Code monétaire et financier*.

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Notice to Prospective Investors in Hong Kong

The shares may not be offered or sold in Hong Kong by means of any document other than (i) in circumstances which do not constitute an offer to the public within the meaning of the Companies Ordinance (Cap. 32, Laws of Hong Kong), or (ii) to professional investors within the meaning of the Securities and Futures Ordinance (Cap. 571, Laws of Hong Kong) and any rules made thereunder, or (iii) in other circumstances which do not result in the document being a prospectus within the meaning of the Companies Ordinance (Cap. 32, Laws of Hong Kong) and no advertisement, invitation or document relating to the shares may be issued or may be in the possession of any person for the purpose of issue (in each case whether in Hong Kong or elsewhere), which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong (except if permitted to do so under the laws of Hong Kong) other than with respect to shares which are or are intended to be disposed of only to persons outside Hong Kong or only to professional investors within the meaning of the Securities and Futures Ordinance (Cap. 571, Laws of Hong Kong) and any rules made thereunder.

Notice to Prospective Investors in Singapore

This prospectus supplement has not been registered as a prospectus with the Monetary Authority of Singapore. Accordingly, this prospectus supplement and any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of the shares may not be circulated or distributed, nor may the shares be offered or sold, or be made the subject of an invitation for subscription or purchase, whether directly or indirectly, to persons in Singapore other than (i) to an institutional investor under Section 274 of the Securities and Futures Act, Chapter 289 of Singapore (the SFA), (ii) to a relevant person pursuant to Section 275(1), or any person pursuant to Section 275(1A), and in accordance with the conditions specified in Section 275 of the SFA or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA, in each case subject to compliance with conditions set forth in the SFA.

Where the shares are subscribed or purchased under Section 275 of the SFA by a relevant person which is:

a corporation (which is not an accredited investor (as defined in Section 4A of the SFA)) the sole business of which is to hold investments and the entire share capital of which is owned by one or more individuals, each of whom is an accredited investor; or

a trust (where the trustee is not an accredited investor) whose sole purpose is to hold investments and each beneficiary of the trust is an individual who is an accredited investor,

shares, debentures and units of shares and debentures of that corporation or the beneficiaries rights and interest (howsoever described) in that trust shall not be transferred within six months after that corporation or that trust has acquired the shares pursuant to an offer made under Section 275 of the SFA except:

to an institutional investor (for corporations, under Section 274 of the SFA) or to a relevant person defined in Section 275(2) of the SFA, or to any person pursuant to an offer that is made on terms that such shares, debentures and units of shares and debentures of that corporation or such rights and interest in that trust are acquired at a consideration of not less than S$200,000 (or its equivalent in a foreign currency) for each transaction, whether such amount is to be paid for in cash or by exchange of securities or other assets, and further for corporations, in accordance with the conditions specified in Section 275 of the SFA;

where no consideration is or will be given for the transfer; or

where the transfer is by operation of law.

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Notice to Prospective Investors in Australia

No prospectus or other disclosure document (as defined in the Corporations Act 2001 (Cth) of Australia (Corporations Act)) in relation to the common stock has been or will be lodged with the Australian Securities & Investments Commission (ASIC). This document has not been lodged with ASIC and is only directed to certain categories of exempt persons. Accordingly, if you receive this document in Australia:

(a) you confirm and warrant that you are either:

(i) a sophisticated investor under section 708(8)(a) or (b) of the Corporations Act;

(ii) a sophisticated investor under section 708(8)(c) or (d) of the Corporations Act and that you have provided an accountant s certificate to us which complies with the requirements of section 708(8)(c)(i) or (ii) of the Corporations Act and related regulations before the offer has been made;

(iii) a person associated with the company under section 708(12) of the Corporations Act; or

(iv) a professional investor within the meaning of section 708(11)(a) or (b) of the Corporations Act, and to the extent that you are unable to confirm or warrant that you are an exempt sophisticated investor, associated person or professional investor under the Corporations Act any offer made to you under this document is void and incapable of acceptance; and

(b) you warrant and agree that you will not offer any of the common stock for resale in Australia within 12 months of that common stock being issued unless any such resale offer is exempt from the requirement to issue a disclosure document under section 708 of the Corporations Act.

Our common stock is quoted on the Nasdaq Global Select Market under the trading symbol HTGC.

In the ordinary course of its businesses, the underwriter and/or its affiliates have in the past performed, and many continue to perform, investment banking, broker dealer, lending, financial advisory or other services for us for which they have received, or may receive, customary compensation. We had a securitized credit facility (the Citibank Credit Facility) with Citigroup Global Markets Realty Corp., an affiliate of the underwriter, which expired under the normal terms and was paid off during the first quarter of 2009. Citigroup Global Markets Realty Corp. has an equity participation right on the warrants that collateralized the Citibank Credit Facility. For a more detailed discussion of the warrant participation agreement, see Management s Discussion and Analysis of Financial Condition and Results of Operations Citibank Credit Facility and the discussion set forth under Note 4 to the Consolidated Financial Statements in this prospectus supplement.

The principal address of Citigroup Global Markets Inc. is Brooklyn Army Terminal, 140 58th Street, Brooklyn, NY 11220.

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LEGAL MATTERS

Certain legal matters with respect to the validity of the shares of common stock we are offering will be passed upon for us by Sutherland Asbill & Brennan LLP, Washington, D.C. Certain legal matters related to the offering will be passed upon for the underwriter by Fried, Frank, Harris, Shriver & Jacobson LLP, New York, NY.

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The financial statements as of December 31, 2010 and for the year ended December 31, 2010, included in this prospectus, and the effectiveness of internal control over financial reporting as of December 31, 2010 have been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report (which contains an adverse opinion on the effectiveness of internal control over financial reporting) appearing herein.

Certain of our audited consolidated financial statements included in this prospectus have been so included in reliance upon the report of Ernst & Young LLP, our former independent registered public accountants. Ernst & Young LLP s principal business address is 560 Mission Street, San Francisco, CA 94105.

CHANGE IN INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

On September 9, 2010, we dismissed Ernst & Young LLP as our independent registered public accounting firm. During the fiscal years ended December 31, 2008 and 2009 and through September 9, 2010, there were no disagreements between us and Ernst & Young LLP with respect to any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of Ernst & Young LLP, would have caused it to make reference to the subject matter of such disagreements in its reports on the financial statements for such years. Nor were there any reportable events as such term is described in Item 304(a)(1)(v) of Regulation S-K, promulgated under the Securities Exchange Act of 1934, as amended.

On September 9, 2010, we engaged PricewaterhouseCoopers LLP as our new independent registered public accounting firm to audit our consolidated financial statements for the fiscal year ending December 31, 2010. During the two most recent fiscal years and through September 9, 2010, the date of the engagement of PricewaterhouseCoopers, neither the Company nor any person on its behalf has consulted with PricewaterhouseCoopers with respect to either (i) the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on the Company s consolidated financial statements or (ii) any matter that was either the subject of a disagreement or a reportable event as such terms are described in Items 304(a)(1)(iv) or 304(a)(1)(v), respectively, of Regulation S-K promulgated under the Exchange Act. PricewaterhouseCoopers LLP s principal business address is 300 Madison Avenue, New York, NY 10017.

AVAILABLE INFORMATION

We have filed with the SEC a registration statement on Form N-2, together with all amendments and related exhibits, under the Securities Act, with respect to our shares of common stock offered by this prospectus supplement. The registration statement contains additional information about us and our shares of common stock being offered by this prospectus supplement.

We file with or submit to the SEC annual, quarterly and current reports, proxy statements and other information meeting the informational requirements of the Securities Exchange Act of 1934. You may inspect and copy these reports, proxy statements and other information, as well as the registration statement and related exhibits and schedules, at the Public Reference Room of the SEC at 100 F Street, N.E., Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements and other information filed electronically by us with the SEC, which are available on the SEC s website at *www.sec.gov*. Copies of these reports, proxy and information statements and other information may be obtained, after paying a duplicating fee, by electronic request at the following e-mail address: *publicinfo@sec.gov*, or by writing the SEC s Public Reference Section, 100 F Street, N.E., Washington, D.C. 20549.

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CONSOLIDATED FINANCIAL STATEMENTS

HERCULES TECHNOLOGY GROWTH CAPITAL, INC.

CONSOLIDATED STATEMENT OF ASSETS AND LIABILITIES

(unaudited)

(dollars in thousands, except per share data)

	September 30, 2011 (unaudited)	December 31, 2010
Assets		
Investments:		
Non-Control/Non-Affiliate investments (cost of $572,558 and $445,782, respectively)	$ 573,494	$ 428,782
Affiliate investments (cost of $3,236 and $2,880, respectively)		3,069
Control investments (cost of $11,611 and $31,743, respectively)	2,983	40,181
Total investments, at value (cost of $587,405 and $480,405, respectively)	576,477	472,032
Cash and cash equivalents	96,309	107,014
Interest receivable	4,667	4,520
Other assets	11,184	7,681
Total assets	$ 688,637	$ 591,247
Liabilities		
Accounts payable and accrued liabilities	$ 7,755	$ 8,716
Long-term SBA Debentures	188,750	170,000
Long-term Liabilities (Convertible Debt)	70,082	
Total liabilities	266,587	178,716
Net assets consist of:		
Common stock, par value	43	43
Capital in excess of par value	486,557	477,549
Unrealized depreciation on investments	(10,861)	(8,038)
Accumulated realized losses on investments	(47,604)	(51,033)
Distributions in excess of investment income	(6,085)	(5,990)
Total net assets	$ 422,050	$ 412,531
Total liabilities and net assets	$ 688,637	$ 591,247
Shares of common stock outstanding ($0.001 par value, 100,000,000 authorized)	43,908	43,444
Net asset value per share	$ 9.61	$ 9.50

See notes to Consolidated Financial Statements (unaudited)

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HERCULES TECHNOLOGY GROWTH CAPITAL, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS

September 30, 2011

(unaudited)

(dollars in thousands)

Portfolio Company	Industry	Type of Investment[1]	Principal Amount	Cost[2]	Value[3]
Acceleron Pharmaceuticals, Inc.	Drug Discovery	Preferred Stock Warrants		$ 69	$ 878
		Preferred Stock Warrants		35	186
		Preferred Stock Warrants		39	85
		Preferred Stock		1,341	2,473
Total Acceleron Pharmaceuticals, Inc.				1,484	3,622
Anthera Pharmaceuticals Inc.	Drug Discovery	Senior Debt Matures September 2014 Interest rate Prime + 7.3% or Floor rate of 10.55%	$ 25,000	24,269	25,019
		Common Stock Warrants		541	378
Total Anthera Pharmaceuticals Inc.		Common Stock Warrants		443	308
				25,253	25,705
Aveo Pharmaceuticals, Inc.	Drug Discovery	Senior Debt Matures June 2014 Interest rate Prime + 7.15% or Floor rate of 11.9%	$ 25,000	26,554	27,304
		Common Stock		842	2,583
Total Aveo Pharmaceuticals, Inc.				27,396	29,887
Dicerna Pharmaceuticals, Inc.	Drug Discovery	Senior Debt Matures January 2015 Interest rate Prime + 5.75% or Floor rate of 10.15%	$ 7,000	6,986	6,986
		Preferred Stock Warrants		206	90
		Preferred Stock Warrants		31	26
		Preferred Stock Warrants		28	15
		Preferred Stock Warrants		187	143
		Preferred Stock		502	439
Total Dicerna Pharmaceuticals, Inc.				7,940	7,699

EpiCept Corporation[5]	Drug Discovery	Common Stock Warrants	4	13
Total EpiCept Corporation			4	13
Horizon Therapeutics, Inc.	Drug Discovery	Common Stock Warrants	231	1
Total Horizon Therapeutics, Inc.			231	1
Inotek Pharmaceuticals Corp.	Drug Discovery	Preferred Stock	1,500	
Total Inotek Pharmaceuticals Corp.			1,500	
Merrimack Pharmaceuticals, Inc.	Drug Discovery	Preferred Stock Warrants	155	1,115
		Preferred Stock	2,000	3,825
Total Merrimack Pharmaceuticals, Inc.			2,155	4,940
Paratek Pharmaceuticals, Inc.	Drug Discovery	Preferred Stock Warrants	137	140
		Preferred Stock	1,000	1,348
Total Paratek Pharmaceuticals, Inc.			1,137	1,488

See notes to Consolidated Financial Statements (unaudited)

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HERCULES TECHNOLOGY GROWTH CAPITAL, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)

September 30, 2011

(unaudited)

(dollars in thousands)

Portfolio Company	**Industry**	**Type of Investment[1]**	**Principal Amount**	**Cost[2]**	**Value[3]**
PolyMedix, Inc.	Drug Discovery	Senior Debt Matures September 2013 Interest rate Prime + 7.1% or Floor rate of 12.35%	$ 7,611	$ 7,394	$ 7,546
		Common Stock Warrants		480	78
Total PolyMedix, Inc.				7,874	7,624
Portola Pharmaceuticals, Inc.	Drug Discovery	Preferred Stock Warrants		152	285
Total Portola Pharmaceuticals, Inc.				152	285
Total Drug Discovery (19.25%)*				75,126	81,264
Affinity Videonet, Inc.	Communications & Networking	Preferred Stock Warrants		102	149
Total Affinity Videonet, Inc.				102	149
E-band Communications, Corp.[6]	Communications & Networking	Convertible Senior Debt Matures May 2013 Interest rate Fixed 6.00%	$ 356	356	
		Preferred Stock		2,880	
Total E-Band Communications, Corp.				3,236	
IKANO Communications, Inc.	Communications & Networking	Preferred Stock Warrants		45	
		Preferred Stock Warrants		72	
Total IKANO Communications, Inc.				117	
Intelepeer, Inc.	Communications & Networking	Senior Debt Matures May 2013 Interest rate Prime + 8.12% or Floor rate of 11.37%	$ 6,524	6,509	6,640
		Senior Debt	$ 1,100	998	998

		Matures May 2012			
		Interest rate Prime + 4.25%			
		Preferred Stock Warrants		102	123
Total Intelepeer, Inc.				7,609	7,761
Neonova Holding Company	Communications & Networking	Preferred Stock Warrants		94	21
		Preferred Stock		250	197
Total Neonova Holding Company				344	218
Pac-West Telecomm, Inc.	Communications & Networking	Senior Debt			
		Matures October 2014			
		Interest rate Prime + 7.50% or			
		Floor rate of 12.00%	$ 4,369	4,164	4,164
		Preferred Stock Warrants		121	
Total Pac-West Telecomm, Inc.				4,285	4,164
PeerApp, Inc.	Communications & Networking	Senior Debt			
		Matures April 2013			
		Interest rate Prime + 7.5% or			
		Floor rate of 11.50%	$ 2,072	2,091	2,112
		Preferred Stock Warrants		61	91
Total PeerApp, Inc.(5)				2,152	2,203

See Notes to Consolidated Financial Statements (unaudited)

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HERCULES TECHNOLOGY GROWTH CAPITAL, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)

September 30, 2011

(unaudited)

(dollars in thousands)

Portfolio Company	Industry	Type of Investment(1)	Principal Amount	Cost(2)	Value(3)
Peerless Network, Inc.	Communications & Networking	Preferred Stock Warrants		$ 95	$ 187
		Preferred Stock		1,000	2,370
Total Peerless Network, Inc.				1,095	2,557
Ping Identity Corporation	Communications & Networking	Preferred Stock Warrants		52	410
Total Ping Identity Corporation				52	410
PointOne, Inc.	Communications & Networking	Senior Debt Matures April 2013 Interest rate Libor + 9.0% or Floor rate of 11.50%	$ 8,375	8,153	8,153
	Communications & Networking	Common Stock Warrants		131	194
Total PointOne, Inc.				8,284	8,347
Purcell Systems, Inc.	Communications & Networking	Preferred Stock Warrants		123	89
Total Purcell Systems, Inc.				123	89
Seven Networks, Inc.	Communications & Networking	Preferred Stock Warrants			